THE TRANSPORT FINANCE LAW REVIEW

Third Edition

Editor
Harry Theochari

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PREFACE

The Transport Finance Law Review is intended to provide the industry with a guide to transport finance today, in each of the key jurisdictions globally in which aircraft, rolling stock and ships are financed.

Traditional asset finance, in the form of bank debt, has long been the mainstay of the transport sector. It is apparent, however, that debt finance alone is no longer sufficient to meet the needs of the global aviation, rail and shipping sectors. As a result, the transport finance sector is undergoing a revolution, requiring its legal advisers to respond by providing clients with a far broader set of legal skills and market knowledge than was previously required.

The global financial crisis has had far-reaching consequences for the transport sector, not limited to the immediate impact of a worldwide economic downturn. Following the crisis, new regulation intended to prevent future crises has been introduced, notably Basel III and Basel IV, which are designed to strengthen banks' balance sheets by requiring them to hold additional capital against their loan books. The impact on an industry as capital-intensive as the transport sector is that long-term lending is now less attractive. This has led certain banks to exit the asset finance market altogether, with a number of banks taking the decision to sell all or part of their loan books to help them meet the new capital requirements.

However, it must be said that there is a marked difference in the attitude of banks and financial institutions when considering loans to the aviation and rail sectors and the shipping sector. At the time of writing, capital is readily available to much of the aviation industry, and there is competition between banks for what are considered to be the best customers. The capital markets are also open for business for the aviation sector, and there is a flow of equity investments from both hedge funds and private equity as well as large-scale investments from Asia (and China, in particular). In the rail market, where significant investment is being made globally, participants are increasingly looking outside their traditional markets in search of new opportunities. So far as the shipping industry is concerned, the amount of debt finance available to it has fallen dramatically, and alternative sources of finance, such as private equity, hedge funds, bond markets and capital markets, have also reduced greatly. This is not surprising to many as shipping gradually emerges from possibly the worst recession it has ever experienced in modern times, impacting across the entire spectrum of the industry, from dry bulk to tankers and from container ships to offshore vessels.

Asset finance in its traditional form is now available from relatively few banks, who in turn are prepared to lend to relatively few names, which are usually leaders in their relevant sectors. Despite this, the majority of capital available to the transport sector continues to take the form of bank debt. Tenors are shorter, however, and borrowing is more expensive. For a sector that requires billions of dollars to fund itself annually, a shortfall in funding is inevitable.

In response to the financial crisis, many companies operating in the transport sector reduced their debt, in preparation for more difficult trading conditions. Now, however, aviation and rail in particular face an upsurge in demand as passenger numbers rise, particularly in developing economies, and while industrial shipping remains bruised by overcapacity and lower freight volumes, demand in the cruise sector is growing, particularly in new markets.

This, coupled with the introduction of increasingly sophisticated and more costly technology, including fuel-efficient jets, high-speed rail and high-specification cruise vessels, is leading to increased funding requirements in many areas of the transport sector.

New participants see significant opportunities in transport and are entering the market using innovative new structures.

Capital markets and private equity structures now account for a substantial proportion of the transport finance market. In the shipping industry, well-known private equity players invested their own cash and continue to support the businesses into which they have invested rather than writing off these amounts, in the belief that the cyclical nature of shipping will result in some returns in the medium to long term. Other private equity investors consider that we have reached the bottom of the shipping cycle and that investments made now may yield attractive returns in the short term, In the aviation industry, leasing firms, who are frequently supported by private equity players, now account for around 40 per cent of the major aircraft manufacturers' sales. In the case of rail, privatisations are being considered in some jurisdictions and new investors are being attracted to the industry by the commitments made by governments worldwide to improve existing infrastructure and invest in new, sophisticated rail links. China's Belt and Road initiative is an example of a government-led programme that is likely to have a far-reaching impact on rail activity.

The aviation, rail and shipping industries each have their own unique characteristics and need lawyers with a deep understanding of how each of these complex industries operates. A detailed knowledge of the principles of asset finance is now also required, combined with the ability to advise on new capital markets and corporate structures. In addition, while the majority of asset financings in the transport sector tend to be governed by New York or English law, an understanding of the principles of local law in the key jurisdictions in which transport assets are registered is also of great importance.

We have sought contributions from jurisdictions that play a leading role in the financing of transport assets. Each chapter provides an overview of the transport finance industry in these jurisdictions, with an analysis of how key lenders have changed over the past five years and how the financing of assets has developed as a result. Contributors have provided an overview of the legislative framework for transport finance and financial regulation affecting lenders to the transport sector. Authors have also been asked to review any significant innovations and notable recent and pending financings and cases, and to provide assessments of how the transport sector is likely to continue to develop in their markets.

I would like to thank the contributors to this volume. Their efforts are deeply appreciated and represent a substantial contribution to the transport law library during a period of transformation for the sector.

Each contribution reflects the significance of the transport sector today, and the need for readily available funding for industries that underpin the global economy by transporting people and commodities around the world every day.

While we are now beginning to see new banks entering the asset finance market, traditional asset finance is likely to remain in short supply in the coming years, and innovation will remain at the centre of our industry. The days of one asset financed by one

bank have passed and, in response, lawyers have had to become increasingly nimble as clients require advice on developing intricate joint-venture agreements and complex capital market products. It is an incredibly exciting time to be a lawyer in this field, as our contributors demonstrate in the following chapters.

Harry Theochari
Norton Rose Fulbright
London
May 2017

Chapter 1

COMPLIANCE OF TAX LEASE FINANCINGS WITH THE EUROPEAN STATE AID REGIME

Christine Ezcutari and Yann Anselin[1]

One of the key issues for shipowners, aircraft owners or rail companies is to find the relevant financial resources to finance the acquisition of the assets used for their business operations at the cheapest price available. This has become even more problematic after the financial crisis suffered by the relevant players following the Lehman Brothers bankruptcy.

While secured lending was the most traditional way of raising finance, asset finance solutions through leasing and hire purchase agreements have been designed specifically to help businesses overcome the challenges of raising the necessary capital to purchase new assets. This provides a more targeted option than securing an overdraft or bank loan, and allows companies to spread their payments over a longer time frame to ease the cash-flow impact.

Some limited jurisdictions within the European Union offer tax benefits and tax allowances, which makes lease finance structures an even more interesting way of raising finance. In a context where the financed asset is a moveable asset, and where companies are less reluctant to register their asset or incorporate the asset-owning company in the most economically advantageous jurisdiction, studying which jurisdiction offers an advantageous tax lease-based structure is of interest to many potential borrowers.

In a typical tax lease structure, the bank will incorporate a special purpose vehicle (the Owner), which will acquire the asset to be financed. The Owner will then lease the asset to the client of the bank, the company operating the asset (the Lessee). The payment of the rentals due under the lease by the Lessee will be used by the Owner to pay all the sums due under the loan agreements it will enter into to finance the acquisition of the asset. Payment of rental under a finance lease may be distinguished from rental under an operating lease on the basis that, rather than paying exclusively for the use of the asset, the rental paid will be calculated so that, over the term of the lease, the Lessee will reimburse the Owner for its acquisition and financing costs for the asset. The specificity of the tax lease in comparison with a simple finance lease transaction is that the Owner will pass on to the Lessee, through the calculation of rentals and termination sums due under the lease by the Lessee, all or part of the benefit to the Owner of any capital allowances or any other tax benefits that it is able to claim in respect of its cost of acquiring the asset under the applicable tax laws.

Several Member States of the European Union have introduced such tax schemes in their legislation. For example, the French market has developed a tax lease structure that enables French banks to provide to their customers a cost saving of 5–10 per cent compared to a traditional loan-based financing. This type of financing does not rely on a structure provided as such by the French tax code, but is based on a combination of several features of

1 Christine Ezcutari is a partner and Yann Anselin is a senior associate at Norton Rose Fulbright LLP.

French tax law, namely: (1) tax consolidation enabling the Owner to transfer to its group any loss triggered by the Owner for the group to pay less tax; (2) depreciation of the asset enabling the Owner to benefit from an amortisation of the asset that will generate a tax-deductible loss during the first phase of the financing; (3) the advantageous tax treatment of the sale of the shares in the Owner to the Lessee, which is an indirect way for the Lessee to become at some point the beneficial owner of the asset; and (4) in shipping finance transactions, the election of the advantageous tax tonnage scheme by the Lessee once it acquires the shares in the Owner.

In Italy, the 2008 Financial Act (Law No. 244 of 24 December 2007) also introduced a tax lease scheme to encourage certain financing transactions for the building of ships that require a crew of at least six persons.

The question arises as to whether such tax lease financing schemes could constitute indirect state aid providing some European jurisdictions with an unfair advantage in comparison with others, which would be prohibited by European state aid legislation.

While the Commission has no direct authority over national tax systems, it is indeed competent to investigate whether certain fiscal regimes, including in the form of tax rulings, constitute state aid under Article 107(1) of the Treaty on the Functioning of the European Union, and for this reason should be prohibited. This may be the case when a fiscal regime favours the recipient of the tax benefit with respect to its competitors and thus distorts competition on the market.

The recent judgment of the European Court of Justice on 14 April 2016 provides a useful indication in this respect.

By way of reminder, this judgment constitutes the most recent episode of the 'Spanish Tax Lease System' (STLS) saga, which began in May 2006 when the Commission started receiving complaints from several shipyards. Those complaints essentially argued that the STLS allowed maritime shipping companies to benefit from a 20–30 per cent price reduction when purchasing ships constructed by Spanish shipyards, to the detriment of the shipyards of other Member States.

The STLS is notably used in the context of ship purchasing where income tax discounts are granted to operators that invested in an Economic Interest Grouping (EIG) for the purpose of acquiring newly built ships from a shipyard through leasing contracts with a view to later selling the ships to a shipping company; the latter benefitting in turn from a considerable price reduction for the ship purchasing. These tax discounts notably stem from the Spanish tax rules that enable an accelerated depreciation, over three to four years, of payments made under a leasing contract; and an early depreciation to be brought forward so that it starts before the asset becomes operational, that is, as soon as construction begins.

Hence, accelerated and early depreciation increases the costs of the EIG and creates losses for it, which the investors can deduct from their tax bases.

Following the opening of a state aid investigation into the STLS in June 2011 – and perhaps sensing the risk that STLS breaches state aid law – the Kingdom of Spain notified the Commission that it had introduced new legislation on early depreciation.

Before even adopting any position on the former regime, the Commission declared this amended new regime compatible with state aid rules on 20 November 2012 (the Decision).

Key to the Commission's assessment was that this new early depreciation regime did not entail advantages accruing exclusively to certain undertakings or to certain sectors of activity. As a reminder, tax measures can amount to state aid if they are selective (i.e., provided that the criteria applying to the derogatory tax burden must 'be such as to characterise the

recipient undertakings, by virtue of properties which are specific to them, as a privileged category, thus permitting such a regime to be described as favouring "certain" undertakings or the production of "certain" goods').[2]

However, the Commission found that the acquisition of assets financed through financial leasing contracts is generally accessible to companies of all sectors and sizes. In addition, leasing contracts and early depreciation can be used with respect to assets built in (originating from) Member States other than Spain. The General Court confirmed this analysis on the following grounds: the measure applied to all undertakings that are subject to income tax in Spain; any kind of asset acquired by any kind of company active in any sector of the economy can be the subject of a leasing contract; and if the measure required certain conditions, as regards the asset being custom-built and as regards the construction period and pre-financing, these are justified since they offset the fact that a lessee has to bear the financial cost of a significant part of the asset before it actually becomes operational.

This assessment was confirmed on 14 April 2016 by the European Court of Justice.

Ironically, it turns out that the General Court had confirmed in the meantime that the former STLS scheme did not constitute state aid either.

The Commission had initially concluded otherwise in July 2013, on the basis that the scheme established a selective fiscal benefit for investors. However, the General Court subsequently reversed that analysis, noting that despite the existence of an authorisation system, the tax benefits were available to any investor who decided to participate in the transactions within the STLS by purchasing shares in the EIGs set up by the banks. Moreover, the Commission's finding that the STLS favoured 'certain activities' did not concern the industrial or economic activities of the investors, who operated in all sectors of the economy.

The two judgments indicate that the compatibility of tax lease schemes in the European Union will greatly depend on whether they are selective or not in their application. By contrast, in its decision of 30 June 2004 on Belgian tax measures in favour of maritime transports, the Commission also specified that a regime that provides a specific early depreciation of ships was selective and constituted state aid.[3]

In any case, the most recent episode of the 'STLS saga', of 14 April 2016, underlines that tax optimisation is really on the radar of the Commission. As the Commission has challenged the judgment on the former STLS before the European Court of Justice, the story may not yet be at an end.

2 Judgment in *Netherlands Maritime Technology Association v. Commission*, T-140/13, ECLI:EU:T:2014:1029, paragraph 99.

3 Commission Decision of 30 June 2004 concerning a series of tax measures that Belgium is planning to implement for maritime transport, [2005] OJEU L150/1.

Chapter 2

BRAZIL

Carlos Rameh, Marcelo Rodrigues, Paulo Mattar Filho, Renata Iezzi and Nicole Cunha[1]

I INTRODUCTION

i The transport finance industry

Water transport is the main mode of transportation in Brazil. In 2016, the Brazilian ports handled nearly a billion tons of cargo.[2] This represents a decrease of 1 per cent compared with 2015 but still shows resilience by the transport sector in Brazil when such results are compared to the forecasted 3.16 per cent contraction of Brazil's GDP in the past year.[3] The water transport sector currently represents 3.49 per cent of Brazil's GPD, against 3.8 per cent in 2015. The expectation for 2017 is, however, an increase of 0.49 per cent in Brazil's GPD for this sector,[4] which could indicate the beginning of the recovery of the shipping sector in Brazil. The Brazilian fleet of seagoing and domestic navigations increased over the period by 4.4 per cent and 7.6 per cent, respectively.[5]

By the end of 2016, the Brazilian merchant fleet had 4,886 ships: 2,293 seagoing ships and 2,593 used for domestic navigation.[6] Apart from Brazilian vessels, there are currently 476 foreign-flagged ships operating in Brazil,[7] most of them in offshore oil and gas projects.

Domestic finance schemes in Brazil are mainly sourced by the Maritime Merchant Fund, which is a fund that finances the construction and acquisition of ships in Brazil. The purpose of the fund is to develop the Brazilian merchant marine fleet and foster construction in Brazilian shipyards. The fund is basically formed by tax on freights payable by shippers. It is managed by the Ministry of Transport and has Brazilian public banks – such as the national development bank, BNDES – acting as financial agents.

On 8 November 2016, the Brazilian Association of Airline Companies published research showing the impact of commercial aviation on the Brazilian economy.[8] The research shows that Brazil is the third biggest domestic air transport market sector of the world,

1 Carlos Rameh, Renata Iezzi, Nicole Cunha and Paulo Mattar Filho are partners, and Marcelo Rodrigues is a senior associate at Basch & Rameh Advogados Associados.

2 998,068,793, according to the Brazilian National Waterway Transportation Agency (ANTAQ).

3 See www.brasil.gov.br/economia-e-emprego/2016/08/mercado-melhora-previsoes-par a-o-pib-de-2016-e-de-2017.

4 See http://portal.antaq.gov.br/wp-content/uploads/2017/03/Apresenta%C3%A7%C3%A3o-do-Anu%C3 %A1rio-Estat%C3%ADstico-2016.pdf.

5 Ibid.

6 Ibid.

7 See www3.dpc.mar.mil.br/sisgevi/consultainternet/relat_ait_ajb_validos_internet_criterio_selecao.asp.

8 See www.agenciaabear.com.br/sem-categoria/abear-lanca-estudo-sobre-o-impacto-da-aviacao-na-economia-dos-estados-brasileiros/.

and that air commercial transportation contributed 313 billion reais to the Brazilian global economy in 2015, which is equivalent to 3.1 per cent of national production, reflecting tax collection of about 60 billion reais.

International finance schemes over ships and aircraft that operate in Brazil, on the other hand, will typically be sourced by the US, European and Asian (more specifically Japanese and Chinese) banking markets. In the offshore shipping sector, high-value assets are normally financed thorough syndicated loan structures and in some of them export credit agencies join the pool of lenders. Bonds and private placements involving foreign investors are also used by Brazilian large-vessel owners.

II LEGISLATIVE FRAMEWORK

There is no specific legislation governing the finance of ships operating in Brazil. Parties to international finance structures normally agree to subject the finance documentation to English or New York law. On the aviation finance side, aircraft leases in particular are specifically covered in the Brazilian Aeronautical Code (the Aeronautical Code).[9] Operating and finance leases are the main type of contracts supporting importation of commercial aircraft into Brazil. Choice-of-law clauses are generally upheld in courts, provided, among other things, that the terms of the chosen law do not violate Brazilian sovereignty, good customs or public morality.

Domestic legislation affecting international finance will typically be limited to capital control regulations and tax matters. There are no capital conversion restrictions in Brazil; however, there are regulations that require certain registrations with local banks. Brazilian law has, however, a more prominent role in default or insolvency scenarios, generally by imposing restrictions on enforcements and setting priorities among competing creditors.

To record legal ownership over Brazilian ships, Brazil maintains a vessel registry system, which is maintained by the Brazilian Maritime Tribunal. Registration is mandatory for any Brazilian ships with gross tonnage over 100 tonnes. Proprietary security rights over Brazilian ships are perfected and achieve third-party effectiveness upon registration with the ship registry, which also sets priority rules between secured creditors based on the date of registration (i.e., the first to register prevails over others).

Brazil has ratified several international conventions related to the Maritime Law, including the 1926 Maritime Liens and Mortgages Convention, incorporated by Decree 351/1935 (the 1926 Brussels Convention); the 1928 Private International Law Convention, incorporated by Decree 18.871/1929 (the Bustamante Code); and the 1982 United Nations Convention on the Law of the Sea, incorporated by Decree 1530/1995.

The Brazilian Aeronautical Registry (RAB) is the exclusive registry for aircraft and also registers contracts relating to the registered aircraft therein, such as leases and mortgages. The RAB is an owner register in the sense that ownership is obtained through registration with the RAB. Rights *in rem* over aircraft such as ownership and security interests have priority over contractual obligations.

For conventions related to aviation, Brazil has ratified the Convention on International Interests in Mobile Equipment and the Protocol to the Convention on International Interests in Mobile Equipment on Matters specific to Aircraft Equipment – the Cape Town Convention (CTC). Its implementation decree was published on 16 May 2013. According

9 Brazilian Federal Law 7,565/1986 (Articles 127–132 and 137).

to the Declarations Brazil approved with the CTC, there is a need to obtain authorising entry points (AEP Codes) from the RAB to effect valid registration on the international interests with the International Registry. Although Brazil is not signatory of the 1986 Hague Convention on Trusts, the RAB recognises the role of a security trustee or of owner trustees. In Brazil, the concept of a trust raises several issues with courts and its full recognition in some instances may be questioned. A trustee would probably be treated as an agent holding interests for third parties. This issue, however, is not entirely clear. Both owner trustees and security trustees are common in Brazil. Brazil is also a signatory of the Geneva Convention, the Warsaw Convention and the Chicago Convention.

i Domestic and international law and regulation

Mandatory domestic law and regulation will apply to any transaction, party or asset subject to the Brazilian jurisdiction.

International laws and regulations arising from treaties ratified by Brazil have to be incorporated before having legal effects domestically. International treaties incorporated in Brazil are understood as being ranked at the same level as domestic federal law.

Rights and obligations created and subject to foreign laws are generally regarded as valid in Brazil to the extent they do not offend public policy, sovereignty and good morals.

ii Specific practices

As a general rule of law, contractual provisions are overridden by legislation considered to be of mandatory application in the event of conflict. This rule will apply to both domestic and international finances when the transaction, parties or assets are subject to the Brazilian jurisdiction. In practice, however, experience shows that mandatory Brazilian laws only affect international finances more substantially in default or insolvency scenarios.

III FINANCIAL REGULATION

The Brazilian Banking Law (Law 4,595/64) created the National Financial System, which is formed by the National Monetary Council (NMC), National Council for Private Insurance and National Council for Complementary Pensions.

Banks funding the transport sector in Brazil are affected by regulations of the NMC and Brazilian Central Bank (BCB). The NMC is the main regulatory authority for the financial market, while the BCB is the supervisory authority for financial institutions.

'Resolutions' are issued by the NMC and represent the highest level of regulation within the Brazilian Financial Market. 'Circulars' and 'circular letters', on the other hand, are mandatory regulations issued by the BCB to address areas to which the law has attributed authority to the BCB.

i Regulatory capital and liquidity

Basel implementation in Brazil has primarily focused on standardised approaches to credit, market and operational risks. The BCB implemented Basel II regulations in 2007 and Basel III regulations in March 2013.

The Basel III regulations were introduced through a combination of BCB resolutions and circulars that became effective in October 2013. These regulations include definitions

of regulatory capital, capital requirements and capital buffers; components of risk-weighted assets; risk management, liquidity management, capital management and senior management compensation; disclosure of information; and preventive prudential measures.

In December 2013, the Basel Committee on Banking Supervision of the Bank for International Settlements (the BIS Committee) concluded that the capital regulations in place in Brazil were compliant with the internationally agreed minimum Basel III standards.[10]

The BIS Committee, however, also pointed out that minimum capital requirement regulations (Pillar 1) on credit risk and capital buffers were found to be only largely compliant and, although this had a limited impact on the overall assessment, indicated the need for future assessments.

In relation to capital buffers, deviations were generally found to be immaterial and the Brazilian regulations to assess market risk were considered more restrictive than the Basel III standards. Regulations on legal and regulatory framework and supervisory actions regarding the supervisory review process (Pillar 2) were the other components found to be only largely compliant by the BIS Committee, and would be kept under review.

In summary, Brazil's implementation of the Basel risk-based capital regulations has been closely aligned to international standards, where 11 out of 14 assessed components were found by the BIS Committee to be 'compliant'.[11] The components that were deemed as only largely compliant had been considered immaterial when assessing the overall compliance status.

ii Supervisory regime

The BCB is the financial institution supervisory authority in Brazil. Failure to comply with the BCB regulatory framework, and with regulations cascaded from the NMC, may result in sanctions ranging from fines to licence cancellation of local parties.

IV SECURITY AND ENFORCEMENT

Finance providers in domestic financings may require a security package including mortgage, fiduciary assignment (title-retention instrument), assignment of earnings and insurances, assignment of receivables and step-in rights under existing long-term charter contracts (typical for high-value offshore units), pledge over bank accounts, pledge over shares of single-ship-owning companies and bank guarantees.

i Financing of contracts

For ships under construction in Brazil, finance providers may require a mortgage apart from other collateral typically required in ship finances. This type of mortgage is possible in Brazil only when the construction has started, and will affect the parts of the ship as they are built. It is not possible under Brazilian law to create the mortgage over the entire ship prior to or during its construction. Brazilian mortgages cannot be created over future assets.

It is, however, much more likely for ships under construction in Brazil that financiers require a fiduciary assignment over the ship instead of a ship mortgage. The fiduciary assignment has a number of benefits in Brazil compared to a ship mortgage. This includes

10 See www.bis.org/bcbs/implementation/l2_br.pdf.

11 See www.bis.org/bcbs/publ/d299.pdf.

better protection for the security holder in the event of insolvency of the borrower, given that the ship's title is held by the security holder until the discharge of the secured obligations. In an insolvency of the borrower, the ship is not subject to priority rules among the creditors of the borrower. Another benefit of the fiduciary assignment is that the borrower, for not having ownership but only possession of the ship, has no right to dispose of or place an encumbrance on the ship in any form except for maritime liens arising from regular trade.

Finance providers may also require the assignment of the buyer's right under the shipbuilding contract and any associated guarantee or security provided to the buyer for the obligations of the shipbuilder.

In accordance with the Aeronautical Code, only registered aircraft in Brazil are subject to Brazilian mortgages. An aircraft that has never been registered in Brazil may not be subject of a Brazilian mortgage. Brazilian mortgages, after being fully perfected by registration with the RAB, will afford a first priority security interest *in rem* over an aircraft in favour of a mortgagee. Considering the recent accession and ratification of the CTC, there is a lack of precedents in judicial and administrative levels to ensure, at this point, the immediate and literal application of all terms and conditions thereof. However, we are of the view that there are legal grounds to defend that such treaty should prevail, in accordance with its terms and the declarations deposited by Brazil, in respect thereof. After registration with the International Registry, Brazilian mortgages and leases in relation to registered aircraft in Brazil should be effective to create international interests.

ii Enforcement

Generally, Brazilian courts are expected to enforce consensual security interests perfected in accordance with applicable law.

In an insolvency context, enforcements will occur insofar as higher-ranked competing creditors under the Brazilian Insolvency Law are paid first. Insolvency contexts also trigger stay periods, in which no legal action can be taken against the debtor to secure payment.

Since 2005, Brazil has a Bankruptcy and Restructuring Law (NBRL), which allows airlines to avail themselves of insolvency protections roughly similar to the US Chapter 11. There is no stay in the NBRL for aircraft leases, but the CTC has adopted a stay period of 30 days. This has not yet been tested, but in principle a lessor should be able to repossess an aircraft from an airline that is restructuring within 30 days, unless the airline is complying with its lease obligations.

In a default context, maritime liens created by operation of law also have to be considered when assessing the rank of priority of security interests deriving from the finance documentation.

Ship finance providers in a default or insolvency context will typically consider enforcing mortgagee's rights to secure the payment of the debt. Because self-help remedies are not recognised under Brazilian law, a mortgagee in such a case has to seek court intervention to enforce its rights.

A mortgagee cannot request in court to take possession of a mortgaged ship. Under Brazilian law, the mortgagee's main right is to request the court to seize and auction the mortgaged asset. The security holder of a fiduciary assignment is, however, the legal owner of the collaterised asset and can thus repossess it from a defaulting borrower. Ship arrests in Brazil are normally avoided. This has much to do with the lack of experience of Brazilian

courts in dealing with ship arrests and the considerable amount of time that the proceeding could take when the shipowner, operator or other competing creditors try to resist by making use of different types of appeals available in law.

In relation to mortgages over aircraft in case of an event of default under a Brazilian mortgage, the mortgagee may pursue foreclose proceeding pursuant to such Brazilian mortgage; however, the mortgagee would not be automatically entitled to seek repossession of an aircraft from a lessee.

Recent practice in insolvency cases has proven that controlling the movement or effectively taking possession of a collateralised ship in Brazil is often achievable more efficiently by a combination of out-of-court negotiations and other alternatives, such as taking control of the borrower through an existing share pledge.

On 18 March 2016, a new Brazilian Code of Civil Procedure (the New CCP) became effective. The New CCP revoked and replaced the previous code (the Revoked CCP). The statutory changes made through the New CCP are intended, essentially, to improve the speed and the effectiveness of civil court proceedings. The changes that are, in our view, relevant to the enforcement of security interests typically available in ship finance transactions have been included in the updated version of this chapter that is being published in the Third Edition.

One new provision of the New CCP that could be particularly relevant refers to foreclosure actions, which can now be proposed directly against the owner of the collateralised asset, and not only against the principal debtor, its assignors or successors, which was required under the Revoked CCP.

The change consolidates an understanding that was already largely accepted by Brazilian scholars and courts. According to such understanding, a beneficiary of a security interest may take action directly against the owner of the property in cases where the principal debtor and the owner are different individuals or entities.

This new provision may also be relevant if a secured property is transferred and the relevant beneficiary of the security needs to enforce its *in rem* rights against the new owner. This is particularly important in relation to Brazilian mortgages, since the principal debtor is not required by law to obtain a consent from the beneficiary of the security before transferring title to the property. Note that a contractual provision demanding such consent may be held invalid. However, Brazilian law would allow for a provision under the financing documents to establish that a transfer of title without the consent of the security holder represents an event of default.

iii Arrest and judicial sale

Brazil has not ratified the Conventions on the Arrest of Ships of 1952 and 1999. Ships can generally be arrested on the basis of the Brazilian Commercial Code and the Brazilian Civil Procedure Code. Arrest can also occur on the basis of the 1926 Brussels Convention, the Bustamante Code, the International Convention on Civil Liability for Oil Pollution Damage and the Assistance and Salvage Law (Law 7,203/84).

Under Brazilian law, there is one category of maritime claim that can be brought by way of arrest of a ship. This category is described in the Brazilian Commercial Code and provides that as long as maritime privileged credits existing against the ship continue to exist (the law actually speaks of 'privileged' claims), the arrest may be granted. Privileged obligations have *in rem* effects, and constitute a maritime lien over the ship.

The list of maritime privileged credits that gives rise to a maritime lien on the vessel includes mortgagee's rights. The entire list is found in the Brazilian Commercial Code and is amended and complemented by the 1926 Brussels Convention.

In addition to maritime liens, which is the main category that can give rise to the arrest of a vessel, there is a second type of claim that might cause the start of a judicial arrest of the vessel not as consequence of an *in rem* obligation but as a consequence of an *in personam* obligation.

By way of a right of attachment, the Brazilian Civil Procedure Code allows a party to seek conservatory detention of the vessel through an *ex parte* order seizing a vessel on the basis of (1) an existing net and certain debt; (2) the fact that an action on the merits was or will be commenced in Brazil; and (3) the fact that the shipowner against whom the action will be filed has no assets other than the vessel in the jurisdiction.

The arrest, or embargo, of a ship is a provisional remedy in Brazil, adopted to secure an underlying claim that is subject to the Brazilian jurisdiction. Generally, a claim is subject to the Brazilian jurisdiction if the defendant is domiciled in Brazil; if the obligation is performed in Brazil; or if the event giving rise to the claim has taken place in Brazil.

The arrest of a ship based on a foreign decision or arbitral award is also permitted. If the arrest order is granted as an urgent interlocutory decision, according to the New CCP, the arrest order would be recognised and accepted by Brazilian courts without examination of the merits upon ratification by the Superior Court of Justice .

The condition to ratify an urgent interlocutory decision is that:

a it must comply with formalities necessary for its enforcement under the laws of the place where it was rendered;

b it must have been given by a competent court after proper service of process on the parties or after sufficient evidence of the parties' absence, as established pursuant to applicable law;

c it must not be contrary to Brazilian sovereignty, public policy or morality;

d it must be duly apostilled pursuant to the Apostille Convention or authenticated by the competent Brazilian consulate and be accompanied by a sworn translation into the Portuguese language; and

e it must not be a decision on any matter over which the Brazilian Judiciary has exclusive jurisdiction.

If it becomes necessary to enforce in Brazil a foreign decision or arbitral award that is final and on the merits of the dispute, the party seeking the enforcement must first ratify the decision with the Superior Court of Justice to confirm that the requirements (a) to (e) above have been met, in addition to demonstrating that the decision may not be subject to appeal. Again, no examination of the merits is made. Brazil has ratified the 1958 New York Convention.

Ships can be arrested in Brazil under *in rem* or *in personam* claims. Claims *in rem* are possible when the creditor has a proprietary security interest over the ship. Claims *in personam*, on the other hand, refer to credits that the arrestor has against the shipowner and not the ship.

Under *in personam* claims, the arrestor is required to prove with a certain degree of certainty not only its credit in respect of the vessel owner, but also the risk of the frustration of its claim if the arrest is not granted. Typically, the risk of frustration is demonstrated when the vessel that is subject to the arrest proceeding is the only asset of the shipowner and no court bond is provided by the shipowner to secure the claim.

In the case of an *in rem* claim, on the other hand, it is not required that the arrestor demonstrates the risk of frustration. It should suffice in such a claim to prove the mere existence of a maritime lien. Maritime liens include a consensus property security interest, originating, for instance, from a mortgage instrument, and a non-consensus property security interest, secured to its holder through an *ex lege* security right such as seamen's wages, bunker or port duties.

A foreign-domiciled arrestor with no assets in Brazil is further required to secure the payment of judicial costs and attorneys' fees corresponding to 10–20 per cent of the claim value, except if there is an applicable international treaty where such requirement is waived. Additionally, a counter-guarantee may be requested in very exceptional cases, at the judge's discretion, to grant the arrest order. The amount of the counter-guarantee is generally set at 20 per cent or a major percentage over the amount assigned to the debt in dispute. Any guarantee must be posted either in cash, bank guarantee, insurance bond or other collateral acceptable to the court. Generally when dealing with foreign plaintiffs, courts are likely to require cash and bank guarantees.

While Brazil does not have specific legislation on wrongful arrests, a separate civil claim can be brought in tort by an arrested party against a wrongful arrestor. In such cases, the arrested party has to prove not only the damage and causation but that the wrongful arrestor acted with negligence in arresting the vessel.

The arrested party must also demonstrate that the wrongful arrestor acted in bad faith (e.g., by using false pretences or unsupported facts) when bringing the arrest proceeding. The arrested party in such a claim may seek compensation for actual damages and payment of a penalty for bad litigation ranging from 1–10 per cent of the updated claim value.

As for the arrest of a sister ship or associated arrests, Brazil does not have legislation allowing these on the basis of a maritime lien. The alternative in such cases is to enforce a right of attachment, which is an action *in personam* against the shipowner, and seize the sister ship to secure the main claim.

Judicial sale

The judicial sales of assets can follow three different proceedings in Brazil:

a Adjudication (award) – the creditor (including secured creditors) is authorised to request the award of the asset, which transfers the title to the creditor, provided that the creditor offers an amount not lower than the value indicated in the official appraisal of the vessel.

b Court-regulated private sale – the creditor can procure the sale of the asset by him or herself or through a broker registered with the court upon the judge's authorisation. The judge shall have determined all the minimum requirements (i.e., minimum price, payment method, guarantees, publicity method, etc.), following a very similar procedure to that of the public auction but by private initiative.

c Public auction – this is the most common method used for an asset sale. The proceeding requires the publication of an advisory notice at least five days before the auction date to inform possible interested purchasers. With the New CCP, it is preferred that the auction be made online, although the court may decide in a particular case that the physical auction is more adequate. The valuation of the asset is made through an official appraisal and the court has discretionary powers to set the minimum sale price. The

amount of the valuation and the minimum sale price must be included in the advisory notice of the auction. If the court does not set the minimum sale price, the minimum sale price will be no less than 50 per cent of the amount of the valuation.

In cases contemplated by law and when the assets deposited in court are subject to quick deterioration or require high custody costs, the judge can order an anticipated sale of the asset by auction. Additionally, the judicial costs involved in the legal proceeding aiming to foreclose on the vessel takes preference over all privileged credits.

If the sale is completed through the adjudication method, the procedure may be concluded in a relatively short period (around one to three months). Any of other two methods rarely takes less than six months to a year.

Governing law

Brazilian law governs arrests and judicial sales procedures of assets carried out in Brazil.

V CURRENT DEVELOPMENTS

i Recent cases

A recent case in the state court of Sao Paulo concerns the recognition and enforceability in Brazil of a Liberian mortgage over a Liberian-flagged floating production, storage and offloading unit (FPSO).

The first-instance decision, upheld in February 2016 by the Sao Paulo Court of Appeal, did not recognise a Liberian law mortgage and denied the mortgagee's rights of priority against a creditor arresting the FPSO on the basis of an *in personam* obligation (a defaulted letter of credit). The mortgagee in this particular case is a bond trustee.

The decision of not recognising the mortgage was based, among other matters, on the fact that Liberia is not a party to the 1926 Convention or to the Bustamante Code, which, according to the decision, are the only pieces of legislation allowing for the recognition of a foreign mortgage in Brazil.

In our view, the decision is incorrect and failed to apply principles of international law (e.g., comity, reciprocity and cooperation between nations) to endorse the Law of the Flag principle and recognise the Liberian mortgage in Brazil.

Moreover, in our view the court has failed to consider the practical and economic consequences of the decision. There are currently 391 ships in Brazil with flags from countries other than those that have ratified the 1926 Convention or the Bustamante Code,[12] and the decision of the Sao Paulo courts could significantly affect secured creditors of those ships.

Also, on the basis of publicly available information, the parties in dispute have apparently reached an extrajudicial settlement agreement by which the arresting creditor has assigned its claim to a company of the group of the FPSO financiers. The assignment was approved by the court in January 2017, and the claim may soon be dismissed at the request of the parties.

12 See: https://www3.dpc.mar.mil.br/sisgevi/consultainternet/relat_ait_ajb_validos_internet.asp?txtnomeemb=&txtBandeira=*&txtTipo=*&txtnrinscricao=&txtnrim%E2%80%A6.

There was some expectation that the Superior Court of Justice or the Supreme Court would eventually revoke the decision of the Sao Paulo Court of Appeal. However, with the probable settlement of the dispute by the parties, the case is now likely to terminate without any further court decisions.

While the decision of the Sao Paulo Court of Appeal does not bind other Brazilian courts, it does create legal risk in relation to ship mortgages over ships operating in Brazil that are not flagged in a Bustamante Code or 1926 Brussels Convention country. That risk should remain relevant and should be taken into consideration by credit providers, at least until there are other court precedents in favour of the recognition of foreign ship mortgages regardless of the application of the Bustamante Code or 1926 Brussels Convention to the flag country.

As well as the above case involving the recognition of a foreign mortgage, there has been a recent case concerning a mortgagee's request to arrest a ship simultaneously with the arrest of the same ship by another creditor.

In the case, both the trial court and appeals court denied the pleadings of certain creditors to join an arrest proceeding under which the arrest order had already been granted to another creditor. The case illustrates that an arrest order granted in favour of a determined creditor does not benefit a mortgagee nor any other party with interests over a certain asset.

ii Developments in policy and legislation

In terms of aviation regulation, in June 2015, the Brazilian Senate formed a commission to draft a bill to replace the Brazilian Aeronautical Code (the Code). The intention is to enact a more modern Code, as the existing Code dates back to 1986. The commission has been promoting meetings and working to present a final text of the draft in March 2016. While this was the target at the time of writing, further delays are possible.

Although the draft bill is still being debated and its approval is subject to further discussions and possible changes in the Brazilian House of Representatives and the Brazilian Senate, there are some relevant proposals that we believe are important to consider.

The draft bill, in its current state, will include an express reference to aircraft engines in the section that deals with mortgages. At present the current Code has only a broad reference to aircraft mortgages without any express reference to engines. Additionally, engines do not have separate registration in Brazil. The change to expressly include engines will essentially reaffirm existing practice in Brazil, as the Brazilian civil aviation authority, the National Civil Aviation Agency (ANAC) does accept mortgages and other agreements (e.g., leases) in relation to engines, regardless of the lack of any express reference in the Code.

Expected developments in the aviation industry for 2017 include privatisation of airports run by the Brazilian state or companies controlled by the government, and new rules for air transport contracts. As to airport privatisations, in March 2017, the Brazilian federal government scheduled an auction for concessions of the following airports: Salvador, Porto Alegre, Florianópolis and Fortaleza. Different from the procedure taken with the first five airports that were privatised, the federal government has advised that it will not request the participation of Infraero (the existing administrator controlled by the government) in the new consortiums to administrate such airports. Finally, in December 2016, ANAC issued Resolution No. 400 imposing new rules for air transport contracts between airline operators and consumers that are valid and intended to become effective on 14 March 2017. Such regulation mainly changes the rules related to the possibility of charging for luggage, ticket refunds and information to be listed in airline tickets. Such changes have caused fierce discussions among the Senate and Consumers Associations. Still, in 2016, the Senate approved Decree PDS 89/2016, which partially revokes ANAC's Resolution No. 400 in relation to luggage charges. Until now such Decree is still pending ratification by the Lower House.

Chapter 3

CAYMAN ISLANDS

Richard Munden, Nick Dunne and Edward Rhind[1]

I INTRODUCTION

i The transport finance industry in the Cayman Islands

Despite having a small domestic transport market, the Cayman Islands has a high profile in international transport finance transactions, particularly for commercial aircraft and ships. The authors would conservatively estimate that each year in excess of US$4 billion dollars of new aircraft and ship deliveries are financed using Cayman Islands structures.

The Cayman Islands is a popular jurisdiction for structuring such deals for a number of reasons including: (1) offering the political and economic stability of a British overseas territory that has been a leading financial services jurisdiction for several decades; (2) a combined common law and statute-based legal system that reflects many principles of the laws of England and Wales with case law from the English courts being persuasive (although not binding) in the courts of the Cayman Islands; (3) the Cayman Islands currently has no income tax, corporate tax or capital gains tax and no withholding tax is imposed in the Cayman Islands on any cash flows; (4) the Cayman Islands boasts a substantial and sophisticated financial and legal services sector and many professionals in the sector have extensive experience from other leading financial centres; and (5) the Cayman Islands government works closely with the private sector to implement changes to practice and legislation to promote the competitiveness of the jurisdiction in respect of both established and new products. Most financing structures involve a Cayman Islands special purpose vehicle (SPV), typically a Cayman Islands exempted limited company, and this is discussed further below.

In addition to the use of Cayman Islands financing structures for transport assets situated or registered outside the islands, the Cayman Islands is often the preferred state of registry for ships (commercial and yachts) and private aircraft; the respective registers are maintained by government agencies (the Maritime Authority of the Cayman Islands and the Civil Aviation Authority of the Cayman Islands) rather than private entities or private-public enterprises. Each registry has the reputation for being professional, responsive and flexible and providing effective oversight of compliance by registered assets and users with applicable rules and conventions. Major financial institutions and other lenders that participate in aircraft and ship finance for assets registered with these authorities benefit from regulatory oversight to support residual value and a registration system to determine priority of security interests.

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ii Recent changes

The mix of financing products that use Cayman structures changes with the fluctuations in the aviation and shipping markets and broader economic conditions. During the global financial crisis there was a significant increase in export-credit supported financing of asset deliveries. The typical structure for this type of financing uses an 'orphan' borrower as described in more detail in Section IV.i, below. As liquidity has returned to the markets the volume of export-credit transactions has significantly reduced.

On the aircraft side, economic recovery has resulted in an increase in capital market transactions including ECA-wrapped bonds, ABS and EETC deals and Cayman Islands SPVs often feature as issuers in such deals. There is a long history of Cayman Islands SPVs acting as issuers in the capital markets with the result that the insolvency considerations and other concepts of Cayman Islands law that are instrumental both to analysis by investors and by the rating agencies are widely understood.

The shipping markets continue to face several challenges, and one of the effects has been that fewer owners are able to obtain finance from traditional ship finance banks. There has been an increase in the use of Cayman Islands orphan SPVs by: (1) banks enforcing bad loans while keeping shipping assets off balance sheet; and (2) Chinese lessors as an alternative source of finance for shipowners.

II LEGISLATIVE FRAMEWORK

The Cayman Islands has its own legal system, which is closely related to that of England and Wales. Decisions of the English courts are of high persuasive authority in the courts of the Cayman Islands. Laws are implemented through the domestic legislative process and may also be enacted by the UK government through the mechanism of an Order in Council.

i Domestic and international law and regulation

Shipping

The Merchant Shipping Law (2011 Revision) of the Cayman Islands (MSL) is the principal legislation for all Cayman Islands-registered vessels and although primarily based on the corresponding law of England and Wales it has been adapted for the Cayman Islands. The MSL sets out the categories of qualified persons who may own a ship registered in the Cayman Islands and also provides for several different kinds of registration available including full registration, interim registration, provisional registration, ship-under-construction registration (which can then be converted to a full registration on delivery) and demise charter or bareboat registration. The MSL provides for the registration of mortgages over completed vessels, mortgages over vessels under construction, and the ability to record a priority notice giving an intending mortgagee priority over later registered mortgages.

The international conventions that have been extended to or otherwise been introduced by domestic law in the Cayman Islands include:

a Load Line (International Convention on Load Lines 1966, as amended by the Protocol of 1988);

b Tonnage (International Convention on Tonnage Measurement of Ships 1969);

c MARPOL (International Convention for the Prevention of Pollution from Ships 1973 and 1978 Protocol);

d SOLAS (International Convention on the Safety of Life at Sea 1974 and 1978);

e STCW (International Convention on Standards of Training, Certification and Watchkeeping for Seafarers 1978);
f COLREG (Convention on the International Regulations for Preventing Collisions at Sea 1972 as amended);
g Maritime Labour Convention 2006; and
h UNCLOS (United Nations Convention on the Law of the Sea).

Aircraft

Oversight of civil aviation throughout the Cayman Islands and of aircraft registered in the Cayman Islands is carried out by the Civil Aviation Authority of the Cayman Islands (CAACI). The CAACI operates in accordance with the Air Navigation (Overseas Territories) Order 2013 (as amended) (ANOTO), which was enacted in the United Kingdom and extended to the Cayman Islands as a British overseas territory. ANOTO, the Overseas Territories Aviation Regulations and certain other aviation-related legislation and regulations set out requirements for the registration, operation and continuing airworthiness of aircraft registered in the Cayman Islands. ANOTO is primarily concerned with air safety, aircraft registration and the implementation in the overseas territories of the United Kingdom's obligations under the Chicago Convention. ANOTO also sets out the categories of qualified persons who may hold a legal or beneficial interest by way of ownership in an aircraft registered in the Cayman Islands.

The Mortgaging of Aircraft Regulations 2015 provide for the recording of aircraft mortgages over Cayman-registered aircraft on the register of aircraft mortgages maintained by the CAACI. Priority of these mortgages is generally determined by the order in which a mortgage is registered. It is also possible to file a priority notice with the CAACI to preserve a prospective mortgagee's priority position pending the anticipated execution and registration of a mortgage.

A new development for the Cayman Islands is that the Convention on International Interests in Mobile Equipment concluded in Cape Town, South Africa on 16 November 2001 (the Convention) and the Protocol to the Convention on Matters Specific to Aircraft Equipment (the Protocol) (the Convention and the Protocol together, the Cape Town Convention) came into force in the Cayman Islands on 1 November 2015 pursuant to the International Interests in Mobile Equipment (Cape Town Convention) Law, 2015 (the CTC Law). The CTC Law sets out the declarations under the Cape Town Convention that apply with respect to the extension by the United Kingdom of the Cape Town Convention to the Cayman Islands (as a territorial unit of the United Kingdom). No declaration has been made with respect to Article 60(1) of the Convention and, as a result, the Cape Town Convention and the CTC Law do not apply to pre-existing rights or interests, which retain the priority enjoyed prior to 1 November 2015.

As part of the process of implementing the Cape Town Convention in the Cayman Islands, certain other legislative changes and updates have been made including replacement of the Mortgaging of Aircraft Regulations 1979 with the Mortgaging of Aircraft Regulations 2015, amendment of ANOTO and enactment of the Civil Aviation Authority Law (2015 Revision) and the Bills of Sale (Amendment) Law 2015.

ii Specific practices

The recent implementation of the Cape Town Convention means that there is no settled practice as to whether a mortgage over a Cayman-registered aircraft should be registered

on the register of aircraft mortgages maintained by the CAACI in addition to registering the associated international interest on the International Registry. There is also currently no reported case law in the Cayman Islands with respect to the interpretation and applicability of the Cape Town Convention.

III FINANCIAL REGULATION

The Cayman Islands Monetary Authority (CIMA) is responsible for licensing and regulating banking business in the Cayman Islands and the Banks and Trust Companies Law (2013 Revision) provides the legal framework for the operation of banks in the Cayman Islands. A bank carrying on business in the Cayman Islands and lending to the transport sector is required to comply with the Law and would be subject to CIMA oversight.

i Regulatory capital and liquidity and supervisory regime

The Banks and Trust Companies Law (2013 Revision) sets out minimum net worth thresholds for banks that vary according to the type of banking licence held. That Law stipulates that a bank incorporated in the Cayman Islands must have a capital adequacy ratio (risk asset ratio) of no less than 10 per cent or such other percentage as may be determined by the CIMA. Capital adequacy concepts including the capital structure and classification and risk-weighting of asset types are determined by the CIMA. The authority currently requires subsidiaries of foreign banks that are subject to consolidated supervision to maintain a minimum capital adequacy ratio of 12 per cent and locally incorporated banks to maintain a minimum capital adequacy ratio of 15 per cent. Banks are also required to comply with limits prescribed by the CIMA (calculated by reference to a bank's capital base) with respect to certain other matters including large exposures and credit risk concentration.

IV SECURITY AND ENFORCEMENT

i Financing of contracts

Cayman Islands structures are frequently used for the financing of pre-delivery payments for new aircraft and vessels. The typical structure is substantially the same as the orphan structure described in Section IV.i, below, save that the security package customarily includes an arrangement between the lender and the manufacturer pursuant to which the lender can purchase the asset (in lieu of the original customer) if the customer is in default.

Typical ship finance structure

A typical structure (whether the vessel is registered in the Cayman Islands or elsewhere) involves a Cayman SPV being used as the vehicle to acquire the vessel. The SPV will enter into a credit facility as borrower and the advances it receives are applied to finance its acquisition of the vessel. The SPV will then make the vessel available for charter and the charter income is used by the SPV to pay interest and repay principal under the credit facility. There are no taxes imposed in the Cayman Islands with respect to the charter income received by the SPV or on the payment by the SPV to the financing parties of the interest and principal. The lender will usually take security over the vessel (if the vessel is registered in the Cayman Islands then a statutory mortgage would usually be registered at the Cayman Islands Shipping Registry (CISR)) and over the issued share capital of the SPV itself. An assignment by the SPV to

the lender of vessel insurances, earnings, requisition compensation and its rights under any charter will also give the lender effective control of the enforcement of rights of the SPV as against relevant third parties, including, in particular, any charterer of the vessel. An orphan structure is often used and this is discussed further in the section on aircraft structures below.

Typical aircraft finance structure

Similar to a vessel finance transaction, the typical structure involves a Cayman SPV acting as borrower and owner to acquire the aircraft, receive advances from a lender and lease the aircraft to the airline or other operator. The lender will usually take security over the aircraft, over the SPV's rights under the lease and under manufacturer warranty agreements, and over the issued share capital of the SPV itself.

With respect to aircraft registered in the Cayman Islands, the registered owner of the aircraft will typically be either a Cayman Islands exempted company incorporated with limited liability or a company incorporated in another qualifying jurisdiction whose shares are held by the beneficial or ultimate owner of the aircraft. It should also be noted that the Cayman Aircraft Register is not an owner registry; a registered owner (who must fall within one of the categories of qualifying persons) may be a 'charterer by demise' (for example, a lessee under a lease). A lender will typically take security over the aircraft in the form of an aircraft mortgage (which can be registered in the Register of Aircraft Mortgages maintained by the CAACI). Further, a suite of self-help documents such as a deregistration power of attorney from the registered owner, a beneficial-owner consent from the ultimate owner of the aircraft and an Irrevocable Deregistration and Export Request Authorisation in most cases will be provided to the lender and lodged with the CAACI. There is no prescribed form of mortgage and it can be, and typically is, governed by foreign law.

For both aircraft and vessel financing, an orphan structure is often used in which the shares of the borrower SPV are held by a share trustee. From the perspective of the lender this structure may provide certain advantages including protection from the consequences of the vessel or aircraft operator becoming insolvent (neither the SPV nor the vessel or aircraft would be an asset of the insolvent party) and bankruptcy remoteness (if the lender is the only material creditor of the SPV).

Except to note that a vessel mortgage may be registered with the CISR and an aircraft mortgage may be registered with the CAACI, there is no central security register in the Cayman Islands and, accordingly, no filings are required to perfect a security interest.

ii Enforcement

The Cayman courts will recognise and enforce foreign law-governed contractual and security arrangements provided the arrangements are enforceable under the applicable foreign law. Relevant government agencies and other parties will also cooperate with the exercise of any self-help remedies available to a transaction party; for example, the cancellation of an aircraft registration pursuant to a deregistration power of attorney or a transfer of shares pursuant to a pre-signed share transfer form in respect of shares in an SPV.

With respect to Cayman Islands registered vessels, in the event it becomes necessary for a secured lender to exercise its rights under a vessel mortgage, the Merchant Shipping Law contains a statutory power of sale.

With respect to aircraft registered in the Cayman Islands, although legal proceedings relating to locally registered aircraft and aircraft mortgages are rare, the Cayman Islands courts are able to deal competently and effectively with claims that may arise. As a practical

matter, if the aircraft or other relevant property is located at an airport in the Cayman Islands, then permission would be needed from the Cayman Islands Airport Authority to enter that location and take physical possession of the aircraft or property.

iii Arrest and judicial sale

The procedure for enforcement of interests under Cayman Islands law, while governed by local rules, is similar to the procedure followed in the courts of England and Wales.

Proceedings in respect of ship arrest are brought in the Admiralty Division of the Grand Court (the Court) and allocated to a designated Admiralty judge. Once a writ has been issued, any party to the action may apply for a warrant of arrest to the Clerk of the Court on affidavit setting out the nature of the claim (or counterclaim), verifying that it has not been satisfied and identifying the vessel and its home port. The onus is on the party seeking the warrant to conduct searches to ensure that no caveat against arrest has been lodged, and there are diplomatic formalities to be complied with where the ship is a foreign ship of a state with a consulate in London, or where any treaty exists with the relevant state in respect of ship arrest.

Service of a warrant of arrest, which is valid for 12 months after the date of issue, is effected by affixing the writ for a short time to the mast or any suitable part of the superstructure, and on removal leaving a copy affixed on a sheltered, conspicuous part of the ship. Warrants are executed by the bailiff, subject to an undertaking from the relevant party to pay on demand their fees and expenses. Thereafter, the bailiff is able to apply for directions in respect of the property under arrest, as may any other person concerned.

In cases of wrongful arrest, on application by the aggrieved party the Court may not only discharge the warrant but also order the payment of damages in respect of any losses sustained by reason of the arrest.

As there is no provision in Cayman Islands law extending the jurisdiction of the Admiralty Division over matters concerning aircraft, it is unlikely that the judicial arrest procedure will be available in such cases. However, the Court has a broad and well-developed power to grant freezing injunctions applicable both within and outside the jurisdiction that is arguably more appropriate in respect of aircraft and capable of prohibiting both disposal and movement.

In terms of the process for sale, the Cayman Islands is a creditor-friendly jurisdiction that will commonly recognise and enforce contractual and security arrangements, provided those have been validly created under the applicable national law. Where the arrangements make provision for self-help remedies, those will generally be enforceable without the need for any separate court order authorising these steps, and in this regard (as discussed in Section II.i, *supra*), the Cayman Islands have enacted the provisions of the Cape Town Convention into domestic law, including Article 8 relating to the sale and seizure of charged objects.

Where court intervention is required, the process for obtaining an order for sale of charged property is relatively streamlined, involving a short application before a judge supported by an affidavit, and may be coupled with the appointment of a receiver over the property in an appropriate case. Security interests in respect of registered ship mortgages may be enforced in the same way as interests over any other personal property, subject to the ordinary duty of the chargee to obtain the best price reasonably possible. For the avoidance of doubt, foreclosure, although technically available, is rarely utilised by the Cayman Islands courts and for practical purposes security interests will ordinarily be realised by way of sale.

V CURRENT DEVELOPMENTS

i Recent cases

The recent decision of the English Court of Appeal in *PK Airfinance SARL & Anor v. Alpstream AG & Ors*[2] is likely to be highly persuasive in analogous cases before the Cayman courts. The case offers significant guidance to secured parties wishing to obtain 'ownership' of aircraft in which they hold security interests upon enforcement of those security interests. Key points covered by the case include (1) a 'sale' by a secured party to itself would be void, but a sale to a connected party (for example to a group entity) may be possible, notwithstanding that such a process might give rise to a conflict; (2) where such a conflict exists, the burden of proof will rest with the secured party to establish that the transaction was in good faith and that reasonable precautions were taken to obtain the best price at the time of the sale, and (3) where a secured party cannot demonstrate these matters, the courts will as a general rule set the transaction aside or, if inequitable to do so, order damages.

ii Developments in policy and legislation

On 8 July 2016, the Limited Liability Companies Law 2016 came into force. The Limited Liability Companies Law 2016 provides for the incorporation of a new form of Cayman Islands vehicle, the exempted limited liability company (ELLC). The law is similar to the Delaware LLC law and an ELLC is considered to be similar to a Delaware LLC, being a body corporate with separate legal personality. It is hoped that the similarity will encourage investors and lenders that are accustomed to working with Delaware LLCs to consider the ELLC as a viable alternative when structuring transactions.

iii Trends and outlook for the future

The Caymans Islands should remain a popular jurisdiction for structuring finance transactions for aircraft, vessels and other types of moveable asset wherever situated. The implementation of the Cape Town Convention in the Cayman Islands is a positive development for the jurisdiction, enabling the Cayman Islands to keep pace with other jurisdictions used for aircraft finance structures that are already contracting states to the Convention.

The Cayman Islands government supports the development of a maritime cluster in the Cayman Islands and has recently created the Cayman Maritime Services Park within the Cayman Enterprise City (a special economic zone within the Cayman Islands designed to facilitate foreign investment). The ongoing focus by the government on the maritime sector is expected to increase the profile of the Cayman Islands within the shipping industry.

2 [2015] EWCA Civ 1319 (21 December 2015).

Chapter 4

CHINA

Wang Shu, Zhu Jun and Zhang Ling[1]

I INTRODUCTION

i The transport finance industry

The transport finance industry is a fast-growing business in China, mainly because the Chinese transportation industry has experienced rapid growth and expansion in recent years during the urbanisation of the country and the modernisation of China's transport infrastructure.

Aviation

China's civil aviation market is one of the most important and rapidly growing aviation markets in the world. According to the data published by *China Aviation Daily*, during the period from January to November of 2016, the profits of China's civil aviation industry hit a historic high amount of 60.13 billion yuan. Solely in 2016, China's airlines have imported 369 commercial aircraft, and the size of the entire Chinese commercial aircraft fleet has reached 2,933 aircraft.

The aircraft finance industry in China is also growing rapidly, in line with the expansion of the Chinese commercial aircraft fleet. While the industry used to be dominated by foreign lessors and commercial banks, more and more Chinese domestic lessors and investors have started aircraft finance businesses and are expanding their businesses quickly, mostly by using Chinese tax bonded area leasing and financing structures. Owing to the fluctuation in the exchange rate of Chinese currency since 2015, some Chinese airlines have started to seek Chinese yuan funding instead of US dollar funding, to finance their acquisition of aircraft. Some large Chinese lessors have built up their offshore aircraft fleet as well, and have extended their business to the Middle East, South Asia, South America and Europe.

Shipping

China plays an important role in the world's shipping industry in terms of its shipbuilding and water transportation capacities. According to the data published by the China Association of the National Shipbuilding Industry, during the period from January to November 2016, the national shipbuilding enterprises reached 1,469 with the prime operating revenue being 697.57 billion yuan. In 2016, China's completed tonnage was 35,320,000, and the new order tonnage was 21,070,000, representing 35.6 per cent and 65.2 per cent of the global market share.

Despite the downturn of the shipping market after the financial crisis in 2008, certain Chinese lenders have continued to be active in ship financing. The leading banks that provide

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shipping finance include the Bank of China, the Export-Import Bank of China and the China Development Bank. An increasing number of financial leasing companies have also participated in the shipping finance industry through financial leases and bareboat charters.

Rail

Owing to its importance in China's economy, China's rail industry is highly controlled and influenced by the state. Before 2013, most of the Chinese rail assets were directly owned and operated by the Ministry of Railway and its local bureaus. After 2013, China established China Railway Corporation (CRC), which is one of the largest state-owned companies in China, to own and operate China's rail assets. After the establishment of CRC, the Ministry of Railway was dissolved and consolidated into the Ministry of Transportation.

Owing to CRC's dominant position in the industry, the finance of rail equipment is mainly through CRC's bank lending, bonds issuance and financial leases. The state also encourages private capital to invest in the railway sector, especially for the construction and operation of intercity railway, urban (suburban) railway, railway designed for resource development and branch railway field.[2] The public–private partnership model, which is very popular in China for attracting private capital in the infrastructure industry, has also been adopted by the rail industry.

ii Recent changes

China has boosted bank credits, cut taxes and embarked on a massive infrastructure spending programme in a wide-ranging effort to mitigate the adverse effect of the financial crisis in 2008 and the slowing-down world economy. These stimuli extend to the transport industry as well, and it is expected that, during 2016 to 2020, China will invest 15 trillion yuan in the transport sector (which includes 3.5 trillion in rail transportation, 7.8 trillion in road transportation, 0.65 trillion in civil aviation and 0.5 trillion in water transportation).

The main transport financers in the Chinese market include:

a the four big state-owned commercial banks, which are Bank of China, China Construction Bank, the Industrial and Commercial Bank of China and the Agricultural Bank of China);

b the policy banks, which include China Development Bank, and the Export-Import Bank of China;

c certain large commercial banks focusing on transport section, such as the Bank of Communications;

d the financial leasing companies and the domestic and foreign-invested leasing companies; and

e the foreign banks that specialise in transport finance sector.

The noteworthy changes in China's transport finance sector in the past five years include:

a the fast growth of the Chinese leasing industry and the rise in Chinese lessors;

2 NDRC, the Ministry of Treasury, the CBRC and other authorities, Fa Gai Ji Chu [2015] No. 1610, 'Implementing opinions on encouraging and expanding the investment of private capital in the construction of railways.'

b the reformation in China's value added tax system and, after the reformation, the PRC lessees are permitted to deduct their value added taxes paid for capital expenditures; and

c the establishment of a number of tax bonded areas and free trade zones and these areas and zones help to create Chinese tax bonded lease structures for aircraft and ship finance.

II LEGISLATIVE FRAMEWORK

In China, the sources of laws that may affect the transport finance include:

a the laws made by the National People's Congress (NPC) and its Standing Committee;

b the administrative regulations made by the State Council;

c the administrative rules made by the ministries, commissions and departments of the State Council;

d the local regulations and autonomous regulations made by the local people's congresses and their respective standing committees;

e the local administrative rules made by the local governments;

f the judicial interpretations to the relevant laws made by the Supreme People's Court of the PRC; and

g the international treaties and conventions approved by the NPC and its Standing Committee.

For the transport finance transaction that does not involve foreign parties, the legal documentation has to be governed by Chinese law. For cross-border transport finance transactions, parties are allowed to select the governing law of the documentation they prefer, and the laws of England and New York are usually preferred by the financers.

On 28 October 2008, China ratified the Cape Town Convention on International Interests in Mobile Equipment and the Aircraft Protocol. According to China's declarations, the Cape Town Convention does not apply to Hong Kong SAR and Macao SAR. To implement the Cape Town Convention, in 2009, the Civil Aviation Administration of China (CAAC) issued the Measures on Regulation of Applications for Authorisation Codes for Registrations with the International Registry and the Administrative Procedures for the De-registration of Nationality of Civil Aircraft according to an Irrevocable De-Registration and Export Request Authorisation.

i Domestic and international law and regulation

China's transport industry is regulated by different regulatory agencies, which include:

a the CAAC for civil aviation;

b the National Railway Administration of the PRC for railway transportation;

c the Water Transportation Agency under the Ministry of Transportation for domestic water transportation; and

d the Maritime Safety Administration (MSA) of the PRC for maritime transportation.

Aviation

In China, the nationality, ownership, mortgage rights, priority rights and leasehold interest and airworthiness management in respect of China-registered civil aircraft and the Chinese civil aviation industry are governed by the Civil Aviation Law of the PRC (Civil Aviation Law) and the administrative rules and orders issued by the State Council and the CAAC.

The CAAC maintains a civil aircraft nationality register (CAAC Nationality Register) and a civil aircraft rights register (CAAC Rights Register). The CAAC Nationality Register is an operator-based register and is now operated by the Airworthiness Department of CAAC. The CAAC Rights Register is now operated by the Legal Department of CAAC and can register the relevant party's rights to civil aircraft. To date, there is no separate rights register for aircraft engines.

China has designated the CAAC as an authorising entry point for registration on the International Registry. According to the CAAC's regulations, the parties have to obtain authorising entry point (AEP) codes from the CAAC to perform registrations in the International Registry against aircraft with Chinese nationality. The Legal Department of the CAAC is now responsible for granting the AEP codes.

Shipping

The branch offices of the MSA are the authorities that administer the nationality and rights registrations of vessels that fly the Chinese flag, according to the Maritime Law of the PRC, the Regulations on Vessel Registration of the PRC and the administrative rules issued by the MSA. Vessels that can fly the Chinese flag include:

a vessels that are owned by a Chinese citizen who has domicile or main place of business in China;

b vessels that are owned by an enterprising legal person established according to the laws of China and with their principle place of business in China (if such legal person is a foreign-invested company, the equity owned by the Chinese investor is no less than 50 per cent, unless otherwise permitted by the MSA);

c public vessels of the Chinese government or vessels owned by Chinese institutional legal persons; and

d vessels on bareboat charter to Chinese entities.

ii Specific practices

Compliance with China's foreign exchange regulations is essential for foreign financers' financing to a Chinese debtor in transport finance, particularly in respect of the rules on foreign debt control and provision of cross-border security for the financing. The State Administration of Foreign Exchange (SAFE) is the authority responsible for enforcement of China's foreign exchange regulations. The completion of the applicable foreign debt and cross-border security approval, filing and registrations requirements are normally conditions precedent for the disbursement of the financing.

Foreign debt regulation

For regulation purposes, the foreign debt refers to the financial indebtedness (which may be in the form of a loan, a cross-border financial lease or an issuance of bonds) of a Chinese debtor to a foreign creditor. To take on a foreign debt, the Chinese debtor needs to ensure that it has a sufficient foreign debt quota (such quota is determined according to a formula

by reference to the Chinese debtor's net assets, the applicable cross-border finance leverage ratio and China's macroeconomy adjustment factor), and must complete the filing with the National Development and Reform Commission (NDRC) or its authorised local counterpart (since 14 September 2015, the financial indebtedness of the offshore entity controlled by a Chinese enterprise is also required to be filed with NDRC). In addition, after the execution of the relevant foreign debt agreement, the Chinese debtor needs to register such agreement with the SAFE and such registration is a pre-condition of the Chinese debtor to open a bank account to receive the funds of the foreign debt and to remit funds out of China to repay the foreign debt.

Cross-border security regulation

According to the SAFE regulations, a security arrangement may constitute a cross-border security if:

a the provider of the security makes a legally binding undertaking to the creditor that it will perform the relevant payment obligation according to the security agreement; and

b such arrangement may cause cross-border payment and receipt of funds or cross-border transfer of asset ownership.

The security arrangement may take the form of a guarantee, a pledge, a mortgage and other forms of security that are permitted by applicable law.

For a cross-border security arrangement, if the provider of the security is established and registered in China, and the debtor and the creditor are established and registered in offshore jurisdictions,[3] the provider of the security is required to register such cross-border security with SAFE. There are also certain conditions for using such cross-border security structure in certain particular types of finance, including:

a if the secured debt is in the form of issued bonds, the Chinese security provider shall have, directly or indirectly, equity interest in the debtor;

b if the funds of the secured debt are used to acquire equity interest in, or are to be borrowed by, an offshore entity, the acquisition of such equity interest and the lending should comply with the outbound investment regulations of the Chinese authorities; and

c if the secured debt is a payment obligation under a derivative transaction of the debtor, the purpose of such derivative transaction should be for hedging only, and such transaction should be within the debtor's business scope and duly authorised by its shareholder or shareholders.

If the provider of the cross-border security is established and registered in an offshore jurisdiction, and the debtor and the creditor are established and registered in China,[4] the following conditions need to be satisfied:

a the Chinese debtor has to be a non-financial institution registered in China;

b the Chinese creditor has to be a financial institution registered in China;

c the secured debt has to be a yuan or foreign exchange lending (other than entrusted loans) or a legally binding lending commitment; and

d the form of the security must comply with Chinese law and the applicable foreign law.

3 Such cross-border security structure is called *neibaowaidai* in Chinese.

4 Such cross border security structure is called *waibaoneidai* in Chinese.

According to the SAFE rules, the Chinese creditor needs to report the relevant financial data secured by such security structure to SAFE, and after enforcement of the security, the Chinese debtor needs to register its obligation to indemnify the offshore security provider as a foreign debt.

III FINANCIAL REGULATION

China's financial industries are highly regulated.

The People's Bank of China (PBOC) is China's central bank, which formulates and implements China's monetary policies. The PBOC is also responsible for maintaining and supervising China's payment, clearing and settlement systems, regulating China's interbank markets and manages China's foreign exchange and gold reserves. The PBOC oversees SAFE, which is the regulator of China's foreign exchange, and normally the head of SAFE is also a vice president of the PBOC.

The China Banking Regulatory Commission (CBRC) is the regulator of China's banking industry. It supervises banks, financial leasing companies, asset management companies, trust and investment companies as well as other deposit-taking financial institutions. Certain foreign-invested leasing companies and domestic leasing companies are regulated and supervised by the Ministry of Commerce of the PRC (MOFCOM).

The China Securities Regulatory Commission is the regulator of the securities, capital and futures industries of China, and the China Insurance Regulatory Commission is empowered to regulate and supervise China's insurance market.

i Regulatory capital and liquidity

China did not implement Basel I – it moved directly to Basel II and Basel III. Since 2012, China has issued a number of regulatory guidelines and rules to set forth the roadmap and details to implement Basel III in China, including:

a the core elements of Basel III standards in the Regulations on Management of Commercial Bank's Capital promulgated in June 2012 (the Capital Regulations);

b the supplementary documents for implementation of the Capital Regulations promulgated in October and November 2012;[5] and

c the implementation policies and documents as to regulation of commercial banks' capital promulgated on 19 July 2013.[6]

The Capital Regulations, and its supplementary documents and implementation policies and documents, comply with the implementation schedule set forth by Basel Committee

5 The full names of these documents are the Supervisory Guidance on Capital Instruments Innovation for Commercial Banks and the Notice of the CBRC on Transition Arrangements for the Implementation of the Capital Rules for Commercial Banks.

6 These policies and documents include the Notice on Measurement Rules of Capital Requirements for Bank Exposures to Central Counterparties (CCPs); the Notice on Enhancing Disclosure Requirements for Composition of Capital; the Notice on Regulatory Policies for Implementing IRB of Commercial Banks; and the Notice on Policy Clarification of Capital Rules. These policies and documents provide for further clarifications and rules on exposures to central counterparties (CCPs), disclosure requirements for capital instruments, requirements for internal ratings based approach (IRB) implementation and certain technical clarifications.

on Banking Supervision for Basel III, and apply to all commercial banks incorporated in China, and certain non-bank financial institutions (including group financial companies, consumer finance companies, financial leasing companies, automobile finance companies, lending companies and rural credit cooperatives). The Capital Regulations do not apply to policy banks that do not accept deposits from the public.

In a few areas, China has adopted a stricter approach than the minimum standards prescribed by Basel, including:[7]

a The Capital Regulations not only apply to China's international banks, but also apply to all other commercial banks, including those small banks and local banks.

b There is no phase-in arrangement for the minimum capital ratio. Commercial banks should meet a minimum ratio of 5 per cent CET1, 6 per cent Tier 1 and 8 per cent total capital as of 1 January 2013. The minimum requirement for CET1 is 5 per cent rather than 4.5 per cent as required by Basel. The requirement for CET1 including the capital conservation buffer is 7.5 per cent instead of 7 per cent as required by Basel.

c The Capital Regulations generally apply a risk weight of 1,250 per cent to commercial banks' equity investments in commercial entities, with the only exception of a 400 per cent risk weight applied to 'equity investments in commercial entities passively held by the bank within the legally prescribed disposal period' and 'equity investments in commercial entities made by the bank owing to policy reasons and with the special approval of the State Council'.

d Under the Standardised Approach for credit risk, claims secured by residential property are risk-weighted at 50 per cent rather than 35 per cent, the minimum required by Basel.

ii Supervisory regime

Lending is a regulated business in China and Chinese law generally prohibits an unlicensed Chinese company from lending money to another Chinese company (cross-border loans are not subject to such prohibition). Therefore, lending between Chinese companies is usually done through a licensed Chinese bank through an 'entrusted loan'. Under an entrusted loan, the lender, the borrower and the entrusted Chinese bank will enter into an entrusted loan agreement and the lender will disburse the loan to the borrower through the entrusted bank. The lender, not the entrusted bank, shall bear all borrower's credit risks by itself.

China also has mandatory requirements on the portion of the loan provided by a Chinese bank in the whole investment amount of the financed project (the maximum lending ratio). Such maximum lending ratios vary according to the industry of the financed project. As to transport-related industries, the maximum lending ratios are 20 per cent for railway, road and urban railway transport project, and 25 per cent for airport, harbour and coastal and inland waterway projects. The State Council is empowered to change such ratios from time to time, according to the circumstances of China's economy.

A Chinese financial institution's ability to provide finance to a debtor may also be limited by the applicable regulatory requirements. For example, for a financial leasing company regulated by the CBRC, its ability to provide financial leasing finance to a lessee may be limited by:

7 The Assessment of Basel III regulations-China published by Basel Committee on Banking Supervision on 27 September 2013. The full report is available at www.bis.org/press/p130927.htm.

a the single customer finance concentration ratio: in other words, the unpaid balance of all financial leases to a single company may not exceed 30 per cent of its net capital;

b the single group customer finance concentration ratio: in other words, the unpaid balance of all financial leases to all companies within the same group may not exceed 50 per cent of its net capital;

c the single related party finance ratio: in other words, the unpaid balance of all financial leases to a single related party of the financial leasing company may not exceed 30 per cent of its net capital;

d the all related party finance ratio: in other words, the unpaid balance of all financial leases to all related parties of the financial leasing company may not exceed 50 per cent of its net capital; and

e the single shareholder finance ratio: in other words, the unpaid balance of all financial leases to a single shareholder of the financial leasing and all related parties of such shareholder may not exceed all capital contributed by such shareholder.

The lendings and financial leases from offshore companies to the Chinese debtors are subject to the foreign debt regulations discussed above, and the relevant Chinese debtor shall have sufficient foreign debt quota and complete the relevant foreign debt filing and registration procedures.

IV SECURITY AND ENFORCEMENT

The lenders usually take a mortgage[8] over the financed aircraft, vessel and rolling stock as security of the finance. Pledge over financed aircraft, vessels and rolling stock is rare as, for perfection of pledge interest, the pledged asset need to be possessed by the pledgee or a person on behalf of the pledgee. According to the Civil Aviation Law and the Maritime Law of the PRC, the mortgage over a civil aircraft is governed by the laws of the state where the aircraft is registered and the mortgage over a ship shall be governed by the law of the flag state of the ship. In practice, as to the finance of aircraft registered in China but owned by offshore entity, it is not unusual that the financer will also take a mortgage over the aircraft governed by the foreign law (which is usually the law of the state of incorporation of the offshore owner).

Under Chinese law, the financial lessor can obtain the legal title to the leased property that serves as the security to the lessee's obligations under the financial lease.

Aircraft

The following rights and security interest can be registered with the CAAC Rights Register:

a owner's title to the aircraft;

b mortgagee's mortgage right to the aircraft;

c priority right to the aircraft;[9] and

8 'Mortgage', according to Article 33 of the Security Law of the PRC, means, the obligor or a third person secures the performance of an obligation by property without handing over possession thereof and upon failure of the obligor to perform the obligation that the mortgage secures.

9 Article 19 of the Aviation Law provides that the following creditor's rights have priority over those of a mortgagee of a civil aircraft: (a) the reward for rescuing the civil aircraft (this refers to salvage awards); and (b) the necessary fees for safekeeping the civil aircraft (this refers to costs of necessary repair, maintenance and so forth).

d lessee's possessory right to the aircraft under a lease duration that is no less than six months.

According to the Civil Aviation Law, it is not mandatory to register the title of the mortgage or possessory right in a civil aircraft with the CAAC Rights Register, but without such registration the title, mortgage or possessory right have no legal effect against other *bona fide* third parties; and without registration with CAAC Rights Register, the relevant party's priority right shall terminate on the date falling three months after the occurrence of the event out of which such priority right arose.

The priority rights to a civil aircraft shall have priority over the security interest in the civil aircraft in relation to compensation concerning such civil aircraft.

After the Cape Town Convention took effect in China, the CAAC Rights Register and the International Registry have functioned in parallel. Filing with the International Registry is a must if the creditor wishes to retain its priority under the Cape Town Convention, and the registration with CAAC is necessary to preserve its priority under Chinese domestic security law.

Shipping

The following rights and security interest can be registered in the register book maintained by the MSA:

a the owner's title to a completed vessel or a vessel under construction, and, if applied by the owner, the vessel's funnel mark or house flag;
b the mortgagee's mortgage right to the vessel; and
c the bareboat charter.

According to the Regulations on Vessel Registration of the PRC and the rules issued by the MSA, it is not mandatory to register the title of or the mortgage right in a vessel with the MSA, but without such registration, the title or mortgage rights have no force against other *bona fide* third parties. It is a mandatory requirement to register the bareboat charter if the bareboat charter is related to a domestic charterer chartering a PRC-flagged vessel, a domestic charterer chartering a foreign-flagged vessel or a foreign charterer chartering a China-flagged vessel. During the period of the charter, the charterer cannot register the reletting of the vessel without the prior consent of the vessel owner. Additionally, the mortgage rights over a vessel under a registered bareboat charter can only be registered if the registered charterer's consent has been obtained.

As to international conventions on property rights and security interests, China signed the International Convention on Maritime Lease and Mortgages on 18 August 1994. However, this convention has not been ratified yet and is not effective in the Chinese jurisdiction.

Rail

China does not maintain a register of title or other rights in respect of rolling stock. The mortgage over rail stock is treated as a mortgage over moveables.

The mortgage over moveables can be registered with the local office of the State Administration of Industry and Commerce (which maintains the company registry in China) where the mortgagor is registered.

i Financing of contracts

Aircraft

In China's market, the financers to Chinese airlines include export credit agencies (ECAs), Chinese banks (including both commercial banks and policy banks), foreign commercial banks, Chinese lessors (including both CBRC-regulated financial leasing companies and the MOFCOM-regulated leasing companies) and foreign lessors. The financing may take the form of direct lending, financial leases, operating leases, ECA financings and other structured financings.

The typical security package to the financer of the aircraft may consist of:

a mortgage over the aircraft;
b assignment of insurances;
c airframe and engine warranties assignments;
d assignment of lease agreement;
e pledge over receivables in respect of the aircraft;
f guarantee from the parent company;
g escrow and pledge over the relevant bank accounts; and
h pledge over the equity of the special purpose project company.

Shipping

Chinese law permits a mortgage over a ship under construction. A Chinese shipbuilder may mortgage its ship under construction to a financial institution in China to obtain finance, and such mortgage can be registered with MSA's ship register. The shipowners are not allowed to mortgage the ship under construction yet.

Normally, the account bank of the Chinese shipbuilder can issue a pre-delivery payments refund guarantee in favour of the shipowner, and the shipowner can assign such guarantee together with its interests and rights under the shipbuilding contract to its financer as security of the pre-delivery payments finance.

The typical security to the financer of the ship may consist of:

a mortgage over the ship;
b the general pledge and assignment of insurances, ship charters, etc.; and
c pledge over receivables in respect of the ship.

Rail

Typically, the CRC will contract with the rolling stock manufacturers for purchase and finance the purchase of rolling stock through its financers.

ii Enforcement

Chinese law does not expressly accept 'self-help' remedies or equivalent concepts. However, if the debtor or mortgagor does not cooperate, the creditor may have to enforce its rights through legal actions of the court.

The mortgage agreement can provide for the circumstances in which the mortgage may be enforced and contractual rights that the mortgagee may have upon enforcement. The typical trigger events that would result in enforcement of the mortgage include the failure to pay any amount due under the financing or the occurrence and continuance of other event of default.

In addition to the mortgagee's contractual enforcement rights under the mortgage agreement, the Security Law of the PRC and the Property Law of the PRC also provide for certain statutory rights for the mortgagee to enforce the mortgage, which include the auction of the mortgaged property, the transfer of the ownership of the mortgaged property to the mortgagee with consent of the mortgagor after the enforcement to satisfy the debt, and the private sale of the mortgaged property with consent of the mortgagor. Under Chinese law, it is not lawful to set forth in the mortgage agreement that the mortgagee can foreclose the mortgaged directly upon enforcement.

iii Arrest and judicial sale

Arrest

Under Chinese law, a creditor may petition to the competent Chinese court to arrest the aircraft, ship or the rolling stock upon enforcement:

a either before the litigation, if the creditor can show to the court that the circumstances are urgent and the creditor's lawful rights and interests will suffer irreparable harm without immediate preservation of the aircraft, ship or rolling stock; or

b during the litigation process, if the creditor can show to the court that without arrest of the aircraft, ship or rolling stock it will be impossible or difficult to enforce the subsequent court judgment or order, or will cause other damages to the creditor because of the actions of the mortgagor or other reasons.

If the action is brought up against the mortgagor in a foreign court rather than a Chinese court, it would be very difficult for the Chinese court to order asset preservation against the mortgaged property in China.

The arrest of ships is not dealt with by the ordinary people's court in China, but is subject to the jurisdiction of maritime courts of the PRC (a special type of court formed to hear maritime litigation).

Judicial sale

If the debtor is not cooperative upon enforcement, the creditor may sue the debtor and petition to the court to enforce its rights. Set out below is a general description of the typical civil litigation procedures in China:

a A bill of complaint is submitted to the appropriate court, setting forth the name and address of the defendant, the claim and the facts and legal bases of the case and the evidence that will support it. The Chinese court in the location of the domicile of the defendant has jurisdiction.

b If the Chinese court finds the bill of complaint acceptable (within seven days), it will file the case and will send a copy of the bill of complaint to the defendant (within five days from such filing). For the party that files the lawsuit, a court fee will be payable, as well as the usual litigation costs.

c The defendant should file a bill of defences with the court (within 15 days).

d After the court determines the date of trial, a trial will be held and a judgment rendered (within an extendable six-month period), although appeals to higher courts are permitted.

In addition to the above, parties to a dispute may reach a settlement agreement at any time before judgment (therefore, a court-approved mediation settlement is permitted to be entered

into between a foreign lessor and a Chinese airline). If a settlement agreement is reached, the court will draw up a mediation decision. If a judgment or mediation decision requires enforcement, additional court fees as well as actual expenses for enforcement must be paid by the party seeking enforcement.

To facilitate enforcement of security interest and improve protection of the creditor, the Civil Procedure Law of the PRC (Civil Procedure Law) also provides for a fast track procedure for enforcement of security interest. According to the Section 7 of Chapter 15 of the Civil Procedure Law, provided that there is no substantive dispute, the holder of the security interest may petition to the court for auction or sale of the property subject to the security interest. In this fast track procedure, the court would review and determine whether the conditions for enforcement of the security have been satisfied. If the answer is affirmative, the court will make an enforcement order within 30 days.

As to those security documents that are submitted to the jurisdiction of foreign court, in the event that a final and conclusive judgment is obtained from the foreign court, such judgment can be recognised and enforced in China without re-examination or relitigation on the subject matter thereof, if the following conditions are met:

a the judgment is made by a foreign court with competent jurisdiction and is final and conclusive;

b the jurisdiction of the foreign court is not precluded by any law, order or treaty;

c service of process for any proceeding against the Chinese party in the jurisdiction of the competent court has been lawfully effected on the Chinese party (other than by public notice), or the Chinese party has appeared and responded on the merits of the case in the relevant proceedings without receiving service thereof;

d the court of China is satisfied that the judgment neither contradicts the basic principles of the laws of China nor violates China's state sovereignty, security and public interest; and

e judgments of the Chinese courts receive reciprocal treatment in the jurisdiction of the foreign court. As a matter of Chinese law, this means that there exists a bilateral or multilateral treaty concluded or acceded to by China and the jurisdiction of the foreign court as to the mutual recognition and enforcement of judgments. To date, there has been no bilateral or multilateral treaty between China and United Kingdom or United States in connection with recognition or enforcement of court judgment. Therefore, the judgments made by the United States or United Kingdom court cannot be enforced in China directly.

V CURRENT DEVELOPMENTS

i Recent cases

Aircraft

In China's records, there are very few precedent cases regarding repossession and enforcement against civil aircraft. The bankruptcy of Dongxing Airline after the financial crisis in 2008 and the repossession of the aircraft leased to Dongxing by GECAS has been an important case that tested the Chinese laws for a foreign operating lessor to repossess its aircraft.

Shipping

A recent case is the arrest of a dry bulk carrier named 'Futong 09'. Owing to a dispute in respect of a loan to Wuhu Futong Shipping Co, Ltd and the shipowner, Far Eastern Leasing

Co, Ltd and Pudong Branch, Bank of Shanghai Co, Ltd jointly brought an action in the Shanghai Maritime Court and reached a mediation agreement through the court. According to the mediation agreement, Futong Shipping Co, Ltd and the shipowner agreed to pay the loan, failing which Far Eastern Leasing Co, Ltd and Pudong Branch, Bank of Shanghai Co, Ltd shall be entitled to petition the court to auction Futong 09 and be paid from the proceeds of the auction. Because the Futong Shipping Co, Ltd and the shipowner failed to perform the mediation agreement, Far Eastern Leasing Co, Ltd and Pudong Branch, Bank of Shanghai Co, Ltd applied for enforcement by the court. The Shanghai Maritime Court established a special committee, and consulted the Shanghai United Assets and Equity Exchange to carry out an online auction and auctioned the dry bulk carrier.[10] The proceeds of the auction of Futong 09 were distributed to Far Eastern Leasing Co, Ltd and Pudong Branch, Bank of Shanghai Co, Ltd and the crew of the vessel and other related creditors according to Chinese law. This case is one of the recent tries made by the Chinese court to facilitate enforcement and protect the creditor.

ii Developments in policy and legislation

To boost the economy, China aims to cut its overall tax burden of the enterprises and has continued to reform its turnover tax system. One development of note is the further reformation in China's value added tax policies, particularly on deduction of value added tax on the interest paid by a Chinese debtor to the financial institutions from its overall value added tax payable, and the share of value added tax revenue between the central government and the local government, which may affect the fiscal incentives provided by the local government to attract financers in the transport finance industry.

10 Supreme People's Court. *Ten Model Cases regarding Arrest and Auction of Vessels by Maritime Courts across the Country*. Case regarding Arrest and Auction of 'Futong 09' by Shanghai Maritime Court.

Chapter 5

DENMARK

Morten L Jakobsen[1]

I INTRODUCTION

i Aviation

Denmark is a small country, but the air traffic industry in Denmark is nevertheless of quite some size. Copenhagen Airport is generally the Nordic hub for international traffic with just short of 30 million international passengers, making it by far the largest international airport in the Nordic region.

The sizeable Scandinavian Airlines System Denmark-Norway-Sweden (SAS) is historically the main Nordic airline, with its joint Danish, Swedish and Norwegian ownership, although it is meeting strong competition from Norwegian Air Shuttle, and, while other Danish-incorporated air carriers are of a number and size as would be expected for a country of Denmark's size, charter-operation airlines have found a good foothold.

Denmark covers the home-ruled territories, Greenland and the Faroe Islands. The airborne connections to these territories are indispensable parts of Denmark's infrastructure, and the air traffic within the territories – great parts of which are fairly inaccessible – is vital.

Apart from operating the main route, Copenhagen–Kangerlussuaq, Greenland's flag carrier, Air Greenland, is one of the largest helicopter operators in Europe.

The oil and wind industry in Denmark also requires helicopter support operations.

There is no specialised aviation finance community in Denmark, and by far most aircraft are financed through foreign credit providers. Danish aircraft finance deals involving Danish credit providers are generally done on a 'relationship' basis as opposed to being asset-driven deals. On the operational leasing side, the situation is the same, with no real aircraft lessor community, but with one major exception, the Danish-incorporated Nordic Aviation Capital, being the world's largest turboprop lessor.

ii Shipping

Denmark is a leading nation in the shipping industry and has a global maritime industry with established shipping activities and advanced technologies. Moreover, Denmark is among the leading nations in terms of the development of eco-friendly solutions that minimise the shipping industry's effect on the environment.

Denmark has a strong tradition within the shipping and maritime industry, and the Danish shipowning companies are among the most influential and advanced both in Denmark and within the global shipping arena. Throughout the past 150 years, globalisation

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has also been a major factor, and large shipowning companies such as ØK and Maersk have been driving factors behind the globalisation and vast internationalisation of the Danish transport and shipping industry.

Denmark offers a highly stable and favourable regulatory framework for the shipping industry, and the Danish government pursues a long-term and sustainable industrial policy, which offers long-term advantages and beneficial conditions. The regulatory framework, particularly the Danish International Register of Shipping and the Danish tonnage tax regime, is among the decisive factors that make Denmark a popular shipping nation and preferred flag state for both shipowners and charterers. The Danish tonnage tax regime was introduced in 2002, and the scope was extended to include capital gains on the sale of vessels in June 2007. Furthermore, a new Tonnage Tax Act was passed in late 2015, under which ship owners may decide to quantify their taxable income pursuant to the new rules.[2] Furthermore, Denmark has a beneficiary taxation system for sailors.[3] Thus, the offshore sector has been a growing market in Denmark for many years.

The scale of Danish shipping reached a historic high in 2016. This can be illustrated by means of numbers and statistics: Denmark is the seventh-largest shipping nation in the world; the Danish fleet carries roughly 10 per cent of all goods that are transported globally; around 4 per cent of the world merchant fleet is operated by operators domiciled in Denmark; and roughly 5 per cent of the tonnage in the world is controlled in Denmark.[4]

As regards the ship finance industry, Denmark has a long history of ship finance and there are a number of strong and well-established players in the ship finance community.

Alongside the Danish-incorporated banks that specialise in ship finance, where Danske Bank, Nordea and Danish Ship Finance are particularly notable, there is a strong presence by foreign banks that also provide finance to Danish shipping companies, the majority of those being European, but with Asian banks also well represented.

Some Danish shipowners have turned to the bond market and in recent years successfully issued bonds through the Danish, European, US and – not least – Norwegian markets.

iii Rail

For rail operations, Denmark is typical for Europe with the major passenger operator, DSB, being state-owned and with smaller, regional operators generally being owned by the municipalities and local interests. Historically, rolling stock has been and is still to a large extent owned by the operators, and self-financed.

The Danish market has, however, been undergoing a liberalisation process, and Denmark has now had the presence of private operators for quite some years, in respect of both intercity and regional traffic.

With the liberalisation of rail operations came the operational rail lessors, where the English rolling stock operating companies are still dominant, but German rolling stock lessors have also made their way into the Danish market.

2 The consolidated act of 6 August 2015 No. 945.

3 The Sailors Taxation Act of 27 May 2005 No. 386.

4 Statistics from the Annual Logbook of 2016 of the Danish Shipowners' Association and Danish Shipping Statistics of November 2016 available at the Danish Shipowners' Association website: www.shipowners.dk/en/om-os/danmarks-rederiforening/.

The operational leasing model seems to be the most popular financing model, and the lending market to Danish operators does, accordingly, not seem to be significant. No Danish financiers offer specialised rolling stock leasing or lending.

II LEGISLATIVE FRAMEWORK

Apart from generally applicable laws on banking, contracts, insolvency, etc., there are no specific laws governing the financing of aircraft, ships or rolling stock. Security rights, including mortgages, over Danish-registered aircraft and ships are, however, governed by legislation, but there is no specific legislation governing such rights over rolling stock assets.

Denmark has recently adopted the Cape Town Convention on International Interests in Mobile Equipment (the Cape Town Convention) and the Protocol thereto on Matters specific to Aircraft Equipment. There are no immediate plans by the government of Denmark to propose the adoption of the Cape Town Convention's protocol on rail equipment, and it would anyhow require that the rail community request the adoption, which it has not yet done.

For aviation finance and leasing documentation, English and New York law are probably the most common choices of governing law, except in respect of mortgages over Danish-registered aircraft, vessels and other Danish assets where Danish law is often opted for. With a substantial established Danish ship finance community, Danish-law ship finance documentation from Danish financiers to Danish shipowners is quite common, but there has also been a tendency for these deals to move towards English law. For ship finance by foreign banks or by syndicates including both Danish and foreign banks, English law seems to be the preferred choice. For rail leasing, there is probably a 50–50 split between Danish and English law, but that is closely connected to the fact that the main passenger operator, DSB, is state owned and is generally reluctant to enter into contracts governed by laws other than Danish law.

i Domestic and international law and regulation

Aircraft

Operation, maintenance, safety and security in respect of Danish-registered aircraft are governed by the Danish Air Navigation Act and various EU regulations, including European Aviation Safety Agency regulations, and the registration of aircraft and rights over same are governed by the Danish Air Navigation Act, the Danish Cape Town Act (incorporating the Cape Town Convention and the Aircraft Protocol thereto) and the Act on Rights over (Smaller) Aircraft.

Registration of aircraft with the Danish Aircraft Nationality Register, which is an owners register, brings the aircraft within the jurisdiction of Denmark, and Danish regulations as to operation, airworthiness, crew, etc. are applicable. With the adoption of the Cape Town Convention, registration of rights over aircraft (and engines) is now generally handled through the International Registry established under the Cape Town Convention and its aircraft protocol. The convention came into force in Denmark on 1 February 2016 and Denmark has ratified the convention in compliance with the Organisation for Economic Co-operation and Development qualifying declarations required to obtain the Cape Town Convention discount from export credit agencies, financing or guaranteeing the finance of

aircraft. For smaller aircraft, the Cape Town Convention does not apply and rights over such aircraft may be registered with the Danish Register of Rights over (Smaller) Aircraft, maintained by the Danish Civil Aviation Administration.

Denmark is also a party to the 1948 Geneva Convention on Recognition of Rights in Aircraft and, subject to the Cape Town Convention, is obliged to respect and uphold certain qualifying rights over aircraft, provided that they are duly registered in another Geneva Convention state. Denmark has also ratified the 1933 Rome Convention on Precautionary Arrest of Aircraft restricting the arrest of aircraft in certain circumstances, subject, however, to the Cape Town Convention.

Ships

Generally, Danish shipping is regulated by the Danish Merchant Shipping Act, and by international conventions and regulations and directives from the EU; the tonnage and seafarers' tax regimes are also important constituents to the Danish legislative regulation of shipping.

Registration of ships and security rights over ships are governed by the Danish Merchant Shipping Act. Registration of merchant ships take place either in the Danish Ships Registry or the Danish International Register of Shipping; registration with the latter bestows certain advantages on ships operating internationally.

An unusual feature in Danish ship finance is the Danish Ship Finance Institute (DSF), which is statutorily governed by the Act on the Ship Finance Institute and generally funds itself by way of bond issues on NASDAQ OMX Nordic. DSF lends directly to shipowners solely for the purpose of financing ships.

Apart from the Danish Ship Finance Institute, no special legal framework on ship finance applies in Denmark.

Denmark ratified the 1952 Arrest Convention and the 1967 Brussels Convention on Maritime Liens and Mortgages, and has implemented both in the Danish Merchant Shipping Act.

Rail

The operation of rolling stock is governed by the Danish Railway Act and various EU regulations. The establishment and certain corporate and finance aspects in respect of DSB, the state-owned rail operator, is governed by special legislation.

There are no specific regulations in respect of financing, leasing and encumbering rolling stock, neither are there any Danish registers of title to or security rights over rolling stock, but the encumbering of rolling stock is subject to general rules on security over assets.

III FINANCIAL REGULATION

i Regulatory capital and liquidity

Danish financial institutions are generally regulated by the Danish Financial Business Act. Also, the Capital Requirements Regulation (CRR) applies in Denmark. The Capital Requirements Directive (CRD IV) has been implemented into Danish law by way of the Danish Financial Business Act. The CRR regulates, *inter alia*, the calculation of capital base, risk-weighted assets, liquidity and large exposures, whereas the CRD IV concerns, *inter alia*, process matters in determining solvency requirements. The CRR and CRD implement Basel III.

ii Supervisory regime

Danish banks and other financial institutions are supervised by the Danish Financial Supervisory Authority.

Lending is not a regulated activity in Denmark and lenders need not to operate under a bank licence. If, however, the lender is also licensed as a bank (i.e., if the lender also conducts regular banking activities, such as holding money deposits), its lending activities will be governed by the capital and liquidity requirements applicable to such banks.

IV SECURITY AND ENFORCEMENT

i Security

Aircraft

International interests over Danish registered aircraft may be registered with the International Registry established under the Cape Town Convention and the Aircraft Protocol.

Registration of international interests in respect of airframes and engines (mortgage or similar) with the International Registry is necessary to obtain protection against claims from third parties, including any bankruptcy estate of the aircraft owner.

The ranking of rights against a Danish-registered aircraft (i.e., their order of priority to the aircraft and any sale proceeds) will depend on the actual circumstances giving rise to the rights. Rights will generally be ranked according to the time when the encumbrances arose or were perfected, and so the position can be stated tentatively only. However, generally, the ranking would be as follows:

a salvage charges and indispensable expenses (indispensable expenses covering extraordinary expenses for the preservation of the aircraft) pursuant to the Air Navigation Act (this encumbrance falls away if not registered with the International Registry or, as the case may be, the Registry of Rights over (Smaller) Aircraft within three months of the relevant event);

b statutory charges for public duties if set out in the enactment in relation to the subject public duty (currently, there are no such enactments in place);

c certain levies of execution based on detention rights relating to betterments and preservation of the aircraft;

d registered rights; and

e unregistered rights.

In addition to a mortgage, it is usual to assign the insurances that are taken out or will be taken out by the owner or operator of an aircraft, and certain other types of security may be normal, depending on the structure of the transaction. Such assignment should also be registered with the International Registry.

Shipping

Under Danish law, three different types of mortgage deeds can be registered over Danish registered vessels:

a an ordinary mortgage deed;

b an owner's mortgage deed; and

c a letter of indemnity.

Each of these has to be duly registered with the Danish Ship Registry or, as the case may be, the Danish International Register of Shipping, in order to obtain protection against claims from – and/or acquisitions by – third parties, including the bankruptcy estate of the owner of the vessel. A mortgage deed usually includes – besides the vessel itself – machinery, marine engines, radio equipment and other inventory acquired by the owner. If the vessel is registered as a newbuild, the mortgage also includes the materials for the building of the vessel. The provisions on claims ranking are found in the Merchant Shipping Act, which are based on the 1967 Brussels Convention on Maritime Liens and Mortgages. The relevant factor is the nature of the claims, which are divided into three categories with the following ranking: maritime liens (e.g., wages, port or canal duties, personal injury and third-party damage claims), registered rights and other claims.

In addition to a mortgage deed, it is common to assign insurances and charter earnings and certain other types of security, depending on the structure of the transaction, including pledges over earnings accounts and, in special purpose vehicle finances, share charges.

Rail

As in many other jurisdictions, Denmark does not maintain a register of title or rights in respect of rolling stock. The procedure for mortgaging rolling stock is the same as applies generally to moveables.

The owner of any rolling stock would grant the mortgage in favour of the lender and the mortgage could then be registered with the Personal Registry (a register of, *inter alia*, chattel mortgages for both corporate and natural persons). If the owner of the rolling stock is a foreign company, there may be certain practical challenges to having the mortgage registered in the Personal Registry, but it is and has proved possible.

In addition to a mortgage, it is typical to make an assignment of the insurances that are taken out or will be taken out by the owner or operator of the rolling stock, insofar that the owner or operator is not self-insured, which is generally the case for state or municipality-owned operators. Certain other types of security may be normal depending on the structure of the transaction.

ii Financing of contracts

Aviation

Danish airlines typically seek operational leasing or unsophisticated debt finance structures for the financing of their fleet, including new aircraft. In respect of new aircraft, an airline would generally either (1) contract with the manufacturer itself and put in place prior to delivery finance for sale or leaseback, and maybe also arrange for pre-delivery payment finance; or (2) have a lessor order the aircraft from the manufacturer or, as many lessors have ordered aircraft without having identified the lessee, commit to take delivery of the ordered aircraft upon its delivery from the manufacturer.

Shipping

Newbuildings contracted by a shipowner would typically be financed by traditional ship finance debt at a size equivalent to a certain percentage of the ship's contract price or market value (in recent years generally being between 60 and 80 per cent). The payment of the newbuilding contract price is typically split up in instalments, often payable on (1) contract signing, (2) steel cutting, (3) keel laying, (4) launch and (5) delivery, so the shipowner

may take out pre-delivery instalment finance, which would be against an assignment of the shipbuilding contract and such refund guarantees as may have been provided to the shipowner as security for the yard's repayment obligation in respect of instalments if the ship is not delivered (in a timely manner).

Rail

The operator would typically contract for the rolling stock with the manufacturer itself and finance through state appropriations for state-owned operators and own funds for municipality-owned operators, possibly with state support. Alternatively, either upon having contracted for the rolling stock with the manufacturer or in connection with the contracting, the operator may arrange with a lessor or financier to novate into the contract, take delivery of and lease the rolling stock to the operator.

iii Enforcement

Self-enforcement of security over vessels and rolling stock is not available under Danish law and any out-of-court sale is subject to the mortgagor's consent. Generally, a power of attorney to sell rendered by the mortgagor to the mortgagee prior to the default triggering the security enforcement may not be upheld by the Danish courts, whereas such powers rendered in connection with the triggering default would generally be upheld.

Enforcement of assets such as vessels and rolling stock would typically be commenced by way of arresting the asset. For arrests in Denmark, the arrest rules are laid down in the Danish Administration of Justice Act, and the Merchant Shipping Act for certain ship arrests. Arrests of these three types of assets generally follow the same provisions, and fall under the jurisdiction of Denmark's bailiff's courts that are located at the district courts.

Under Danish law, a vessel may be arrested in accordance with the rules set forward in the Merchant Shipping Act and the Danish Administration of Justice Act. Pursuant to the Merchant Shipping Act, a vessel can only be arrested for a maritime claim against the owner of the vessel. Section 91 of the Merchant Shipping Act lists exhaustively those types of maritime claims that allow for the arrest of the vessel as security for the claim under the Merchant Shipping Act. However, under the Danish Administration of Justice Act, a vessel can be arrested as security for any claim.

With the ratification of the Cape Town Convention, self-help remedies were introduced (e.g., in respect of the sale of an aircraft by the mortgagor). Procedures have still to be established in respect of the practical handling of the self-help remedies set out in the Cape Town Convention, but it is expected that some court assistance will be required.

iv Arrest and sale

Arrest

The general prerequisites for the bailiff's court to make an arrest are as follows:

a the creditor must have a claim for the payment of money for which there presently is no means of execution. Thus, if statute grants to the creditor of a claim an immediate right of execution (e.g., for airport and air navigation charges), arrest is only possible if the claim is due and unpaid; and

b it must be shown that the prospect of obtaining payment at a later stage will otherwise be significantly reduced.

Before the arrest of the aircraft, ship or rolling stock, the court may require the creditor to provide adequate security (as calculated by the court) for any possible damage or inconvenience to the owner of the asset that may arise from the arrest.

Arrest does not entitle the creditor to sell the asset, but it prevents the use of the asset in a way that could jeopardise the creditor's rights. It may also be possible for the owner to avoid the arrest of the asset if sufficient security is provided.

If arrest is made or has been prevented by the owner by way of providing security for the claim, the creditor will have to issue a writ against the owner within a certain period after the arrest order has been rendered (or the arrest has been prevented) to have the court confirm that the arrest was legally and validly made for a valid claim against the owner (or confirm that had the arrest not been prevented, it would have been justified).

With respect to aircraft, the Danish Arrest of Aircraft Act (implementing the 1933 Convention on Precautionary Arrest of Aircraft) limits arrest in certain circumstances; for instance, aircraft that are exclusively appropriated for state service, actually in service on a regular public transport line (together with the indispensable reserve aircraft), or appropriated for the carriage of persons and goods for reward, where the aircraft is ready to start on that carriage, are prevented from being arrested. The act does not apply to arrests of aircraft registered in a state that is not a party to the said 1933 Convention. Furthermore, the Act does not apply to aircraft objects to which the remedies in the Cape Town Convention and the Protocol apply.

Judicial sale

The rules on forced sale of moveable property, which includes aircraft, ships and rolling stock, are laid down in the Danish Administration of Justice Act Chapters 49–50. The rules set out below also apply to the forced sale of stock of spare parts mortgaged in connection with an aircraft.

A trustee that is seeking a forced sale of moveable property from a bankruptcy estate must follow the same procedure as a creditor. Prior to commencing a forced sale, the creditor must give the debtor one week's prior written notice with demand for payment of the outstanding amount.

A forced sale must be announced in the Danish Official Gazette prior to the sale and the bailiff's court will usually require that an announcement be inserted in one or two relevant newspapers; this announcement must be inserted twice. If the subject moveable property is an aircraft or a ship and is registered in a foreign registry, the sale must further be announced at the place of the registry, and information also sent to the registry. The bailiff's court informs the owner and any other known rights holders in respect of the moveable property of the auction.

The bailiff's court conducts the forced sale. If the bailiff's court finds that a better price can be obtained it can order that a second and final auction be held. Usually, a set of standard terms is used but it is recommended that individual prepared terms be worked out when it is a sale of these asset types.

iv Insolvency regulation in Denmark

Denmark is not a party to the European Insolvency Regulation, and insolvency proceedings initiated in Denmark will thus be subject only to the provisions of the Danish Insolvency Act, which incorporates two formal proceedings: winding up proceedings, and reorganisation or administration proceedings.

V CURRENT DEVELOPMENTS

i Recent cases

There are no recent cases specifically relating to finance for aircraft, ships and rolling stock.

ii Developments in policy and legislation

Since the ratification of the Cape Town Convention and the aircraft protocol thereto, there have not been developments in policy or legislation.

iii Trends and outlook

Aviation

As indicated above, operational leasing seems to be the most favoured finance model and indications are that the operational lease market will continue to grow.

SAS, the largest operator in Denmark, reflagged part of its Danish and Swedish fleets to the Cape Town Convention Member State Norway, reportedly following a request from some of its lenders. With ratification of the Protocol to the Cape Town Convention, Denmark may experience a growth in Danish-registered aircraft.

Shipping

The Danish shipping market has generally been in consolidation mode, although new, rapidly expanding players have set sail in recent years. The Danish shipping community appears to be moving out of the global financial crisis. During the crisis, Denmark experienced a great deal of activity in shipping debt trading, something that is likely to come to an end in a more consolidated market.

As a positive to come out of the crisis, there has been an increasing amount of funding from third-party players such as private equity funds, and it seems likely that private equity players will play a more important and decisive role in the future of the shipping industry, including as finance providers.

Rail

If the Rail Protocol to the Cape Town Convention is ratified, it will enhance the possibilities of attracting rolling stock finance to Denmark. Also, according to the media, there have been discussions between the Ministry of Transport and DSB, the state-owned operator, concerning certain internal restructurings, which may also create rolling stock finance possibilities.

Chapter 6

INDIA

Shardul J Thacker[1]

I INTRODUCTION

The transportation industry – aviation, shipping and rail – has been predominantly owned by government entities since India's independence in 1947. Air India and Indian Airlines, both government-owned, ruled the skies; the Shipping Corporation of India (SCI), established in 1961 and owned by the government, owns and operates around one-third of the Indian tonnage. All railway property is government owned.

i The transport finance industry

Since shipping and aviation are global industries, with cyclical ups and downs, Indian entrepreneurs, in the context of other industries, have not considered them 'safe havens' for their investments. Both are also dollar-based industries, and global banks tend to focus on large fleet-owners of aircraft and ships, which are rare in India. Indian banks are unable to commit long-term foreign currency financing for such cyclical industries, even if there is a natural hedge by earnings from freight. Besides this, the financing costs of the Indian banks are not competitive in terms of global financing, as interest rates are high.

Owing to the vast difference in the costs of domestic borrowing and external commercial borrowing (ECB), Indian companies have long since obtained finance for the acquisition of ships and aircraft from foreign banks located predominantly in Singapore, Hong Kong and Dubai. Indian banks such as SBI, ICICI and Axis Bank also provide finance through their offshore branches. The regulations governing ECB are framed by the Ministry of Finance and the Reserve Bank of India (RBI), and ECB borrowed by Indian companies to finance the cost of acquisition of ships must be in accordance with the Foreign Exchange Management Act and the guidelines, notification and circulars issued thereunder.

ii Recent changes

Traditionally, the ECB advanced by foreign lenders for acquiring ships and aircraft was secured by the creation of mortgages or charges over the underlying assets (the acquired ships or aircraft) and the assignment of insurance, and charter hire income of such underlying assets in favour of such foreign lenders. Owing to the global economic crisis and the average interest margin, which is charged at a higher rate for Indian companies than in other Asian countries, security prices in India have fallen drastically over the past few years, which in turn has resulted in domestic borrowers offering additional security over their other vessels or aircraft, cross-collateralising vessels to maintain the minimum security value. Such additional

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security has resulted in ships or aircraft financed under other loans being mortgaged to the enforcing lenders and created heavy debt-mortgage profile for the ship or aircraft owner – this has raised concerns of a single loan default triggering several cross-default provisions. Since 2012, however, the RBI has been periodically reviewing and relaxing its guidelines relating to the securities that can be offered by ECB borrowers. Indian borrowers can now offer charges over their immoveable and moveable assets, and their financial securities. They can issue corporate or personal guarantees, subject to prior permission from the authorised dealer banks and compliance with the terms and conditions laid down by the RBI. This has brought great relief to Indian borrowers and foreign lenders alike. Domestic borrowers can now offer a variety of securities to maintain the minimum security values specified under facility agreements.

In keeping with macroeconomic developments and the experience gained by the RBI in administering the ECB regime over the past 10 years, the RBI, in consultation with the Indian government, has reviewed the extant ECB framework and issued new Master Directions on External Commercial Borrowings, Trade Credit, Borrowing and Lending in Foreign Currency by Authorised Dealers and Persons other than Authorised Dealers (the Master Direction) on 1 January 2016. The overarching principles of the new Master Directions, among others, are as follows:

a a more liberal approach, with fewer restrictions on end uses, a higher all-in-cost ceiling, etc., for long-term foreign currency borrowings as the extended term makes repayments more sustainable and minimises rollover risks for the borrower;

b similarly, a more liberal approach for Indian rupee-denominated ECBs where the currency risk is borne by the lender;

c expansion of the list of overseas lenders to include long-term lenders like sovereign wealth funds, pension funds and insurance companies;

d only a small negative list of end-use requirements applicable to long-term ECBs and Indian rupee-denominated ECBs;

e alignment of the list of infrastructure entities eligible for ECB with the Harmonised List of the Government of India;

f companies in the infrastructure sector, non-banking financial companies-infrastructure finance companies, non-banking financial companies-asset finance companies, holding companies and core investment companies are now also included in the list of eligible borrowers for medium-term foreign currency borrowings; and

g several provisions have been introduced allowing start-up entities to borrow ECBs up to a ceiling of US$3 million per financial year without any end-use restrictions.

The framework for ECB as a means to attract flow of funds from abroad continues to be a major tool for calibrating the policy towards capital account management in response to an evolving macroeconomic situation.

However, under the Master Direction, shipping and airline companies are now eligible to raise ECB only for import of vessels and aircrafts respectively. The aviation industry opened up to domestic private participants in 1994, restricting them to Indian skies for five years, and requiring them to maintain a fleet of minimum of 20 aircraft, before allowing them to fly to overseas destinations. In addition to the national airline, there are now eight private airlines operating in India, with a fleet of 370 aircraft, of which 263 are run by private airlines.

Indian airlines prefer leasing aircraft to acquiring them. Since availing themselves of ECB for working capital was not possible under ECB guidelines before 2012, Indian airlines used to borrow funds from domestic lenders for working capital purposes. In view of this, the RBI relaxed the ECB guidelines in 2012, allowing ECB to be used as working capital in the civil aviation sector, and also for the refinancing of outstanding working-capital rupee loans from domestic banks, under the approval route, provided the borrower has complied with the terms and conditions stipulated in the ECB guidelines. However, under the Master Direction, airline companies are now allowed to borrow ECB for import of aircraft only, and not for any other purpose. That said, ECB loans that have already been fulfilled prior to 2 December 2015 may continue without requiring any further consent from the RBI or the authorised dealer bank.

II LEGISLATIVE FRAMEWORK

i Domestic and international law and regulation

Shipping

Flag or mortgage registration

The registration of Indian ships and mortgages are governed by:

a the Merchant Shipping Act 1958 (MSA);

b the Merchant Shipping (Registration of Indian Ships) Rules 1960, as amended in 1966, 1970, 1994 and 1997; and

c notifications issued by the Ministry of Shipping and the Directorate General of Shipping (DGS) under the MSA.

The Union Cabinet recently approved the Merchant Shipping Bill 2016. Under said Bill, Indian vessels have an obligation to register at any port as prescribed under the Bill. An Indian vessel can also be registered in a country other than India, subject to certain conditions, as may be prescribed. However, an Indian vessel must be substantially owned (having more than 50 per cent of the shares of the ownership of the vessel) by an Indian citizen or a company that has its principal place of business in India, and also by a co-operative society, in order to be registered as an Indian-flagged vessel.

An Indian-flagged vessel may be registered at any one of the five ports of registry. Foreign investment regulations were relaxed 15 years ago, enabling foreign entities to invest 100 per cent equity in an Indian shipping company, thereby operating in cabotage-regulated coastal trade. There is no parallel registration for bareboat charter structures, either for charter-in or charter-out or for vessels under construction, where mortgages in favour of lenders could be registered.

Pursuant to the cabotage policy, no foreign ship can engage in coastal trade between two Indian ports except under licence from the DGS. In 2012, the cabotage policy was relaxed at the International Container Transshipment Terminal (ICTT) Vallarpadnam, Cochin for exim[2] container cargos. This relaxation enables foreign vessels to call at the ICTT, which is only 76 nautical miles from the main east–west shipping route, allowing the discharge of

2 Export–import.

Indian cargo at Cochin rather than at neighbouring mainline transshipment ports such as Colombo or Singapore. From 2015, cabotage has been relaxed for certain special vessels for five years up to 2020.

Further, since July 2014, Indian shipping companies can now own foreign-flagged ships subject to compliance with the DGS guidelines The Indian-controlled tonnage scheme allows shipowners based in India to acquire ships abroad and also flag them in the country of their convenience – typically tax-friendly jurisdictions to help access cheap sources of funds – while achieving fiscal and cargo benefits available in India.

Admiralty

The Union Cabinet has given its approval to the proposal of Ministry of Shipping to enact Admiralty (Jurisdiction and Settlement of Maritime Claims) Bill 2016, and to repeal five archaic admiralty statutes. The Bill consolidates the existing laws relating to admiralty jurisdiction of courts, admiralty proceedings on maritime claims, arrest of vessels and related issues. It also repeals five obsolete British statutes on admiralty jurisdiction in civil matters, namely:

a the Admiralty Court Act 1840;
b the Admiralty Court Act 1861;
c the Colonial Courts of Admiralty Act 1890;
d the Colonial Courts of Admiralty (India) Act 1891; and
e the provisions of the Letters Patent 1865, applicable to the admiralty jurisdiction of the Bombay, Calcutta and Madras high courts.

This proposal seeks to fulfil a long-standing demand of the legal fraternity.

The jurisdiction with respect to maritime claims under the Bill will vest with the respective high courts, and will extend up to the territorial waters of their respective jurisdictions. The admiralty jurisdiction currently applies to the Bombay, Calcutta and Madras high courts and is further extended to Karnataka, Gujarat, Orissa, Kerala and Hyderabad.

The high courts may exercise jurisdiction over claims relating to:

a disputes regarding ownership of a vessel;
b disputes between co-owners of a vessel regarding employment or earnings of the vessel;
c mortgage; and
d environmental damage caused by a vessel.

While determining maritime claims under the specified conditions, the courts may settle any outstanding accounts between parties with regard to the vessel. They may also direct that the vessel or a share of it be sold. With regard to a sale, courts may determine the title to the proceeds of such sale. Maritime liens are given the highest priority among all claims, followed by mortgages and all other claims. In the case of maritime claims, claim for wages is given the highest priority, followed by claims with regard to loss of life or personal injury. Such claims shall continue to exist even with the change in ownership of the vessel.

Courts may exercise admiralty jurisdiction against a person with regard to maritime claims. However, the courts will not entertain complaints against a person in certain cases. These include:

a damage, loss of life or personal injury arising out of a collision between vessels that was caused in India; or

b non-compliance with the collision regulations of the Merchant Shipping Act 1958 by a person who does not reside or carry out business in India.

Further, courts will not entertain action against a person until any case against them with regard to the same incident in any court outside India has ended.

The courts may order the arrest of any vessel within their jurisdiction for providing security against a maritime claim that is the subject of a proceeding. They may do so under various reasons, such as:

a the owner of the vessel is liable for the claim;
b the claim is based on the mortgage of the vessel; and
c the claim relates to ownership of the vessel, etc.

With regard to appeals, any judgments made by a single judge of the high court can be appealed against to a division bench of the high court. Further, the Supreme Court may, on application by any party, transfer an admiralty proceeding at any stage from one high court to any other high court. The latter high court will proceed with the matter from the stage where it stood at the time of the transfer.

The high court vested with admiralty jurisdiction exercises the enforcement of maritime liens and maritime claims through the arrest of vessels and cargo on board and their judicial sale. This antiquated statutory law[3] was largely updated to match those prevailing in most maritime nations by the landmark judgment of the Supreme Court in *MV Elizabeth* in 1993, allowing sister-ship arrest, etc.

Aviation

The civil aviation sector is regulated by:

a the Aircraft Act 1934 and the Aircraft Rules 1937;
b the Airports Authority of India Act 1994;
c the Airports Economic Regulatory Authority of India Act 2008;
d the Civil Aviation Requirements, issued from time to time;
e the Convention on International Interests in Mobile Equipment 2001 and the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment 2001 (Cape Town Convention); and
f the Carriage by Air Act 1972.

The Cape Town Convention was ratified by India in 2008 to protect the interests of the lenders and lessors involved in the financing of aircraft. It provides for the repossession of aircraft or collateral in the event of financial default by the lessee of the aircraft or borrower.

ii Specific practices

For most lenders, Indian-flagged vessels have not been suitable targets owing to a host of procedural issues. For instance, lenders have to make do with only provisional mortgage

3 The admiralty jurisdiction of the high courts has been traced to the Charters of the British parliament 1774/1798, as expanded by the Letters Patent of 1823, 1862 and 1865 read with the Admiralty Court Act 1861, the Colonial Courts of Admiralty Act 1890 and the Colonial Courts of Admiralty Act 1891, which are still in force as preserved by Government of India Act 1935, and the Constitution of India.

registration as security for one or two months following loan disbursements. Further, mortgages over ships in India only secure the principal and interest, whereas the norm elsewhere is that a mortgage allows lenders to claim enforcement costs.

Additionally, while the MSA permits enforcement of a mortgage by a sole mortgagee without intervention of the court, in order to gain a clean title to the vessel, free and clear of all claims, liens and encumbrances and to avoid mortgagee's exposure to claims from other parties to also ensure cooperation of the master and crew, lenders are usually left with no choice but to enforce the mortgage through the admiralty courts.

Also, pursuant to the General Insurance Business Act 1972, Indian entities are not allowed to insure any of their property in India, including any ship or aircraft registered in India, with insurers whose principal places of business are outside India, except with prior permission of the government. This restriction is not applicable in respect of types of insurance that are not offered by Indian insurance companies – for example, protection and indemnity insurance cover. This is a hindrance to some extent, as foreign lenders prefer insurance policies to be maintained with international insurance companies.

The Indian flag, although considered expensive, is still bankable with several international lenders, having lent funds to Indian shipowners such as SCI, the Great Eastern Shipping Company Limited, Greatship (India) Limited, Great Offshore Limited, and Mercator Limited.

III FINANCIAL REGULATION

i Regulatory capital and liquidity

In accordance with the RBI guidelines, implementation of Basel III commenced on 1 April 2013, to be phased in by 31 March 2018. The RBI has fixed the minimum Tier 1 capital ratio at 7 per cent of risk-weighted assets (RWA), of which 5.5 per cent must be common equity. One of the key features of Basel III is that all non-common Tier 1 and Tier 2 instruments issued by the banks must allow such instruments to be either written off or converted into common equity by banks that have solvency issues. In India, the RBI has not published the requirements on countercyclical capital buffers (0 to 2.5 per cent of RWAs), which aims to ensure that banking sector capital requirements take account of the macrofinancial environment in which banks operate.

On 31 March 2015, the RBI made several revisions to the Basel III regulations. Pursuant to the revised guidelines that came into effect on 1 April 2015, all new restructured loans must be classified as bad loans and provided for. Banks should call in the loan and take recovery action at the earliest opportunity or sell non-performing assets to asset reconstruction companies. This is broadly similar to the situation in US bankruptcy law.

ii Supervisory regime

Under the ECB regulations, whether under the automatic route or under the approval route, Indian borrowers have to apply for and obtain loan registration numbers from the RBI. Monthly reporting of withdrawals, utilisation, repayment and other payments is required, including any revisions or modification in the ECB, such as an increase or reduction in the loan amount or revisions to the schedule of disbursements, repayments or interest payments. Thus, the RBI governs and regulates the borrowing of funds and security, and also monitors ECB until it is repaid, including enforcement of security.

Such stringent regulations have reassured foreign banks that borrowers' crucial activities are being overseen. On the other hand, restrictions on charging default interest, on mandatory repayments following a default event, and restrictions on the tenor make loans inflexible, which has put off some foreign lenders. The RBI has, however, recently permitted authorised dealer banks to allow changes or modifications in the drawdown and repayment schedules, average maturity period and changes to the all-in cost, provided the ceilings imposed by the RBI guidelines are complied with.

IV SECURITY AND ENFORCEMENT

The ECB guidelines permit Indian borrowers to grant security of their choice to foreign lenders. Primarily, ships and aircraft for the acquisition of which the ECB is borrowed are secured in favour of the lenders. No approval is required from the RBI or authorised dealer for creation of a mortgage or charge over the ships and aircraft, as well as for the assignment of insurance, charter hire income of such ships and aircraft. Security over aircraft may also be created by way of hypothecation, fixed or floating charge, lien, pledge, retention of title, conditional sale and assignment.

Pursuant to the MSA, multiple mortgages can be created over a vessel, but the sole mortgagee of a vessel can enforce its rights over the vessel without the intervention of the court whereas, in the case of multiple mortgages registered over a vessel, a mortgage can only be enforced by applying to the competent court.

i Financing of contracts

Under Indian law, a mortgage can only be created over a vessel that has been provisionally or permanently registered with the Registrar of Ships and cannot be created over a hull under construction. Hence, financing of newly built ships is secured by the assignment of the shipbuilding contract executed between the shipbuilder and the borrower (i.e., purchaser) and the refund guarantees issued by the banks of the shipbuilders in favour of the lenders until such time as the ship is constructed and delivered to the borrower and registered with the Registrar of Ships.

ii Enforcement

Shipping

A mortgage registered over an Indian vessel may be enforced in India or outside India.

In India, a vessel can be arrested and sold through the admiralty courts in India by public auction, thereby ensuring clean title to the vessel, free and clear of all claims, liens and encumbrances. Port dues, admiralty marshal's costs and maritime liens ranking in priority, however, must be paid.

Under the MSA, the sole mortgagee may also enforce a mortgage by taking possession of the vessel and selling it to a third party without the involvement of the courts. Although in law, a sole mortgagee has the right to proceed against and sell a vessel without the intervention of the court, in reality, the cooperation of the master and crew is necessary. Also, a private sale does not clear the title of the vessels of all claims and encumbrances, and the buyer of the vessel has to acquire the vessel subject to such claims and encumbrances.

A mortgage registered over an Indian vessel can also be enforced outside India, provided the loan documentation permits such enforcement. If the mortgage is enforced outside India, the foreign lender who has obtained a decree from a court in a foreign country can approach an Indian court for enforcement of the decree under the Civil Procedure Code.

If a judgment has been obtained in any reciprocating territory, the same will be recognised and enforced by the courts in India without re-examination of the issues, provided the judgment is pronounced by a competent court and is on the merits and based on principles of international law, and not opposed to natural justice, or founded on fraud or a breach of any Indian law.

Aviation

The Cape Town Convention confers remedial rights on a lender when the facility has been charged and registered as per the Convention. The chargee can take possession of the aircraft from the lessee in the event of default. Since India is a signatory to the Cape Town Convention, the Directorate General of Civil Aviation (DGCA) will cancel the registration of the aircraft, thereby permitting the chargee to take possession of it.

In the event of financial default, the lessor may unilaterally terminate the agreement and repossess the aircraft or obtain an order from the district court having jurisdiction over the place at which the aircraft is located, for its repossession. The lessors are also required to get the aircraft deregistered from the DGCA prior to repossessing the aircraft. Unless there is an explicit provision in the Cape Town Convention requiring the chargee to seek leave of the court, India has declared that a chargee will not require leave of the court. This can be construed to imply that, even in the case of a bankruptcy of an Indian lessee, such chargee will not be required to obtain leave of the court to repossess the aircraft.

The DGCA requires the consent of the lessee to deregister the aircraft. It may also receive objections to such cancellation from government departments if they are owed money by the defaulting airlines. Moreover, even after deregistration of the lessor's aircraft by the DGCA, the Airports Authority of India (AAI) may impose a lien on the aircraft for unpaid dues by way of ground rent, landing charges, etc., and has the right to detain the aircraft. Also, the aircraft are sometimes impounded by the custom authorities for non-payment of custom duties, which can be a problem in the repossession of an aircraft by lessors.

The power to detain aircraft and other assets is derived from Section 142(c)(ii) of the Customs Act 1962 and Section 87(c) of the Finance Act 1994 (the Finance Act), which allow attachment of 'any moveable or immoveable property belonging to or under the control' of a defaulter. In a matter brought by the service tax authorities, relating to the attachment of engines belonging to Natixis, the high court rejected the lien exercised by the service tax authorities. In another similar matter, International Lease Finance Corporation (ILFC) challenged the attachment order passed under Section 87(c) of the Finance Act by the service tax authorities – the engines have now been redelivered. In the *Natixis* decision, the court held that property owned by a third party cannot be attached for the dues payable by Kingfisher Airlines.

In the case of *Aer Lingus Limited v. Airport Authority of India*, the Bombay High Court held that if dues are owed by the airline operator to the Airport Authority of India, the owner of such a craft cannot be deprived of deregistering and repossessing its aircraft in circumstances where the lessee has outstanding airport parking fees. However, this case is very different from the *Kingfisher* case.

iii Arrest and judicial sale

Courts may order the arrest of any vessel within their jurisdiction for providing security against a maritime claim that is the subject of a proceeding. They may do so under various grounds, such as:

a the owner of the vessel is liable for the claim;
b the claim is based on mortgage of the vessel; and
c the claim relates to ownership of the vessel.

For admiralty actions, a ship must be in Indian territorial waters. The prerequisite for an admiralty action for enforcing *in rem* rights is that the claimant must demonstrate that the res – the ship – is in Indian waters; hence, no action can be filed in anticipation of a ship that is yet to arrive. A substantive admiralty suit must be filed, unlike in other jurisdictions where only a writ need be entered.

The suit must be filed in the admiralty division of the high court by submitting a complaint with full documentation. The high court will schedule a hearing to consider the merits of the claim for arrest. The arrest warrant is issued by the sheriff's office, and is served on the vessel or the master, ports agent and the customs authorities. A court sale is by public auction conducted by the sheriff, inviting offers through advertisements in leading shipping papers such as *Lloyd's List* or *Tradewinds*. If the borrower contests the mortgage claim or other creditors apply to intervene in the proceedings, additional hearings are scheduled and the priorities of claim determined.

With regard to appeals, any judgments made by a single judge of the high court can be appealed against to a division bench of the high court. Further, the Supreme Court may, on application by any party, transfer an admiralty proceeding at any stage from one high court to any other high court. The latter high court will proceed with the matter from the stage where it stood at the time of the transfer.

Security for costs and damages is not a condition for the arrest, but when applying for the arrest, an undertaking is required to pay such sum by way of damages as the court may award in the event of an affected party sustaining harm from the arrest.

V CURRENT DEVELOPMENTS

i Recent cases

Shipping

In 2016, the Supreme Court of India in the case of *CIT v. Trans Asian Shipping Services (P) Ltd*,[4] observed that whenever there is a question of a tonnage of ship and the said tonnage is to be determined, it has to be in accordance with the valid certificate indicating its tonnage and it is a compulsory obligation of the taxpayer to produce such a certificate. Nonetheless, the arrangement pertains only to purchase of slots, slot charter and the sharing of the break-bulk vessel. The requirement of producing a certificate does not apply when the entire ship is not chartered. Allowing the benefit of a tonnage tax scheme to the taxpayer, this Supreme Court decision may help the shipping companies to claim the benefit of a tonnage tax scheme for slot charter arrangements.

4 *CIT v. Trans Asian Shipping Services (P) Ltd* (2016) 8 SCC 604.

In 2015, in the case of *Petromarine Products Ltd v. Ocean Marine Services Co Ltd*,[5] the Supreme Court held that when a suit is filed before court having jurisdiction over vessel in question and that court passes order for arrest and sale of vessel pursuant to which sale is effected, vessel and sale proceeds become custodial legis of that court and no subsequent proceedings by any other person interested can be maintained before another court without leave of jurisdictional court (Section 3(15) of the Merchant Shipping Act 1958). Since the vessel was berthed at Madras Harbour, the Madras High Court alone had the jurisdiction to enter any claim against the subject vessel as per the aforementioned Section. The arrest of the vessel by the Madras High Court being the first arrest, the vessel and the sale proceeds are custodial legis of the said court.

In 2016, in the case of *Union of India v. Sancheti Food Products Ltd*, the Supreme Court,[6] within the short compass of facts, justified the award of compensation for damage suffered by the vessels in question. This was because of the following contradicting and conflicting stands that delayed the registration of the vessel: Part XVA of the Act that deals with the registration of 'fishing boats' was brought into the statute book in 1982 (to include seagoing shipping vessels) and was pursuant to the exercise of fresh legislation for the registration of vessels; whereas the Rules of 1960 that governed the parameters of registration were not substituted by this amendment made to the Merchant Shipping Act 1958 – the relevant statute dealing with registration of vessels.

In *MT Hartati* in 2014, the Bombay High Court, while deciding on the issue of arrest of a sister ship, also considered whether beneficial ownership existed, and held that the Court could look beyond the registered owner and 'pierce the corporate veil' only if it could be demonstrated that the ownership structure was a sham – created with the intention of defrauding creditors.

An associated ship owned by one company cannot, however, be arrested for a claim against another associated ship owned by another company, even though both companies might have common beneficial ownership, because the Indian courts generally do not pierce the corporate veil.

In the matter of *MV African Eagle* in 2013, the Bombay High Court decided that since the primary relief was for securing the foreign arbitral award, the Court had no jurisdiction to issue interim relief in support of a foreign arbitral proceeding in view of the Supreme Court decision in *Bharat Aluminium Co v. Kaiser Aluminium Technical Services Inc*.[7]

Aviation

In Delhi High Court in 2013, in the matter of *DVB Aviation Finance Asia Pte Ltd v. Directorate General of Civil Aviation*, the lessee, Kingfisher Airlines, objected to the repossession by claiming ownership rights as it was a financial lease. The court directed the DGCA to deregister the aircraft. No no-objection certificate was required from Kingfisher for deregistration of the aircraft.

In the ILFC matter, six aircraft leased to Kingfisher Airlines were directed by the Ministry of Civil Aviation to be deregistered to enable the lessor to repossess the aircraft to be flown out of India. However, the airport authorities detained the aircraft for their own

5 *Petromarine Products Ltd v. Ocean Marine Services Co Ltd* (2015) 7 SCC 229.

6 *Union of India v. Sancheti Food Products Ltd* (2016) 3 SCC (Civ) 390.

7 *Bharat Aluminium Co v. Kaiser Aluminium Technical Services Inc* (2012) 9 SCC 5520.

claim for ground rent, etc. At the behest of the IFLC, the Delhi High Court passed an order releasing the aircraft. Eventually, the Supreme Court directed the AAI to release the aircraft upon ILFC furnishing a bank guarantee for the AAI's claim.

In March 2015, in the matter of *Awas 39423 Ireland Ltd and Ors v. Directorate General of Civil Aviation and Ors*, the Delhi High Court ordered the latter to deregister six of SpiceJet's Boeing 737 planes, following the termination of lease agreements. Babcock and Brown Aircraft Management had also sought the return of six Boeing B737 aircraft and a payment of US$100 million from SpiceJet for unpaid rent and maintenance costs. The court observed that the DGCA was obliged to deregister planes on receiving a request from a leasing company in accordance with the Cape Town Convention.

ii Developments in policy and legislation

Shipping

2016 has been one of the most remarkable years for Indian shipping, as it witnessed major policy changes that aim to drastically improve the overall growth of the industry. A slew of reforms were initiated to ensure a better policy environment conducive to business. The highly ambitious 'Sagarmala' project, which was conceptualised in 2015, has finally seen the light of day. The project aims to promote port-led direct and indirect development and to provide infrastructure to transport goods along the long coastline and the inland waterways to and from ports, quickly, efficiently and cost-effectively.

The types of development project currently being undertaken at the Sagarmala initiative include:

a port-led industrialisation;
b port-based urban development;
c port-based and coastal tourism and recreational activities;
d shipbuilding, ship repair and ship recycling; and
e offshore renewable energy projects with base ports for installations.

Maritime India Summit 2016

The maiden Maritime India Summit (Mumbai, 14–16 April 2016) was organised by the Ministry of Shipping. The objective of the Summit was to create awareness of the untapped potential of the Indian maritime sector and to showcase investment opportunities. More than 140 business agreements were signed during the Summit. The value of investments in these 140 projects is around US$13 billion (approximately 830 billion rupees). The Ministry of Shipping also showcased around 240 projects that present investment opportunities in this sector in India over the next few years. The investment potential of these projects is around US$66 billion (4.34 trillion rupees).

Inland waterways

India has a vast riverine system that lies underdeveloped and is underutilised for transportation of cargo. The Indian government has realised the potential of the inland waterways and has directed the Inland Waterways Authority of India (IWAI) to make riverine transportation in India a reality. There is an enormous focus on the development of 'inland waterways', and the IWAI is going full throttle on reviving the inland waterways. The development of these waterways opens up new opportunities for business, such as:

a supplying dredgers;

b barges and cargo handling equipment;
c construction and management of terminals; and
d hydrographic services.

In July 2014, the Ministry of Shipping permitted Indian shipping companies to acquire and own foreign-flagged vessels on the condition that the tonnage flagged outside India should not exceed the tonnage owned in India. This recent development has encouraged foreign lenders to lend ECB to Indian companies wishing to acquire foreign-flagged ships, as the consequent security (mortgage) would be created in the flagship registry, often having lesser procedural issues and faster and easier enforcement mechanisms than those in India.

The RBI has also proactively taken several progressive steps to overcome the global financial crisis. In September 2014 it allowed foreign banks to offer rupee-denominated loans to domestic companies by mobilising Indian rupees through swap transactions with authorised dealer banks in India. For the purpose of executing swaps for ECBs denominated in Indian rupees, a recognised ECB lender may also set up a representative office in India. Around four dozen foreign banks from 22 countries, including Japan, China and Germany, have representative offices in India. This additional source of money should benefit the corporate sector and also bring in competition.

Recently, the Asian Development Bank approved US$631 million in loans and grants to develop the first key 800km section of a planned 2,500km East Coast Economic Corridor that will spur development on India's Eastern Coast and create seamless trade links with other parts of South and South-East Asia.

The Ministry of Shipping has also announced the preparation of framework or rules for Indian vessels to be given exim and domestic state-owned cargo support for three to five years.

Port-led developments

The Ministry of Shipping has formulated a revised Central Sector Scheme to provide financial support to major or non-major ports and state governments for the creation of infrastructure for movement of cargo or passengers by sea or national waterways. This is in line with the Ministry's port-led development programme – Sagarmala – for creating better infrastructure and to promote coastal shipping. Simultaneously, a bill was passed in March 2016 to begin work on the '101 waterways' to transport cargo through the riverine systems and reduce the carbon footprint and logistics cost.

In order to improve port-rail connectivity, the Ministry of Shipping set up the Indian Port Railway Corporation Limited (IPRCL) to link all ports to the railway network across the country. The IPRCL is currently conducting a feasibility study for implementation of seven projects connecting various ports. The projects are deemed to be implemented by relevant central ministries, state governments, ports and other agencies through public–private partnerships (PPPs). Around 20 projects were taken up for consideration across eight major ports, out of which, 11 projects total US$1.13 billion.

There has been a lot of emphasis recently on the development of coastal shipping by the government. In July 2016, the government announced the creation of 14 coastal economic zones (CEZs), to be aligned to relevant ports in the maritime states, that will house coastal

economic units for setting up manufacturing facilities. The CEZs are spatial-economic regions that could extend along 300–500km of coastline and 200–300km inland from the coastline. Each CEZ will be an agglomeration of coastal districts within a state.[8]

Although the Indian coastline is 7,517km, it has only 13 major ports administered by the government. The Union Cabinet gave 'in-principle' approval for the concept and institutional framework of the Sagarmala project in March 2015. Its prime objective is to promote port-led direct and indirect development and to provide infrastructure to transport goods along the long coastline and the inland waterways to and from ports, quickly, efficiently and cost-effectively. There are 187 minor ports, which are owned by the federal coastal state or PPPs or are private ports. These are not integrated with the major ports through coastal trade. At the major ports, tariffs are regulated, but at other ports they are market-driven. The Sagarmala project, *inter alia*, aims to enhance connectivity with the main economic centres and expand rail, inland water, coastal and road services, in order to lessen congestion on the road and railways. This would also be a more eco-friendly mode of transport, reducing greenhouse gas emissions. The current fiscal year has seen an investment of 700 billion rupees.

The Sagarmala Development Company (SDC) was incorporated on 31 August 2016, after receiving Cabinet approval on 20 July 2016, for providing equity support to residual projects under Sagarmala. The first board meeting of the SDC was held on 21 September 2016 and subscribed share capital of 0.9 billion rupees has been released to the SDC. The process of appointing a managing director and functional directors is underway.

Aviation

Since 2012, foreign airlines have been permitted to invest up to 49 per cent in domestic airline companies other than Air India after obtaining government approval. This resulted in Etihad Airways acquiring a 24 per cent stake in Jet Airways. Furthermore, there are talks about Etihad Airways raising its stake in Jet Airways up to 49 per cent. Similarly, India's newest airline Air Vistara is a result of the joint venture (i.e., Vistara) between Tata Sons Ltd and Singapore Airlines Ltd, wherein Tata Sons Ltd holds a 51 per cent stake in the said joint venture and the remainder (49 per cent) is held by Singapore Airlines in accordance with the governmental norms. In the case of non-scheduled air transport services or non-scheduled airlines, chartered airlines and cargo airlines, foreign direct investment (FDI) of up to 74 per cent is allowed[9] and investment by non-resident Indians of up to 100 per cent is allowed via the automatic route. Helicopter services and seaplane services require DGCA approval on FDI up to 100 per cent using the automatic route.

The same levels of investment are allowed with respect to ground-handling services, but this is subject to sectoral regulations and security clearances. FDI up to 100 per cent is allowed on the automatic route for maintenance and repair organisations, flight training schools and technical training institutions.

The Indian government has recently amended the Aircraft Rules to protect the interests of creditors in the aircraft leasing and lending sector in accordance with the provisions of the Cape Town Convention. Rule 30 of the Aircraft Rules has been amended by the insertion of a new Sub-rule 7, which provides for mandatory cancellation of the registration of an aircraft by the DGCA on receipt of an application from an IDERA holder prior to the expiry

8 *Maritime Gateway*, August 2016.

9 Via the automatic route, up to 49 per cent, and Foreign Investment Promotion Board (FIPB) approved, between 49 per cent and 74 per cent.

of the lease, subject to fulfilment of certain conditions mentioned therein by the IDERA holder. The Cape Town Convention Indian Aircraft Rules, reflecting the Indian Declarations, eliminates any residual arguments concerning the availability of a 'fleet-type' lien in India.

iii Trends and outlook for the future

Shipping

The Indian Shipping Registry is ranked 18th in the world in terms of tonnage, having the largest merchant shipping fleet among developed countries, with private interests having grown from 12 per cent in 1990 to the current level of 55 per cent, comprising 10.23 million tons held among 102 shipping companies. The current registered tonnage in 2016 stands at 1,63,38,00 deadweight tonnage, and the size of the Indian fleet is currently 1625 vessels.

Considering that half of the present Indian fleet is 20 years old – an average of 17.5 years – approximately 4 million tonnes is due to be replaced, and an additional 16 million new gross tonnage required in the next five years to meet demand in the growing exim trade; this opportunity is valued at US$20 billion. With the foreign flag relaxation, Indian shipping companies can now own 50 per cent of the new tonnage under foreign flags as foreign-controlled tonnage. Foreign banks should take this as some comfort in funding this new tonnage, enabling the Indian shipping companies to grow in terms of exim trade and the offshore oil and gas energy industry offering opportunities in investing in floating production, storage and offloading units, floating storage and regasification units, LNG vessels and specialist vessels for project cargo and river–sea transportation vessels, etc.

The remainder of this US$10 billion could be debt in equity funding shared between Indian corporates and Indian lenders, thereby making the shipping industry an opportunity for domestic investment.

Increasing investments and cargo traffic point towards a healthy outlook for the Indian ports sector. Providers of services such as operation and maintenance, pilotage and harbouring and marine assets such as barges and dredgers are benefiting from these investments.

The Planning Commission of India forecasts an investment of 1,806.26 million rupees (US$26.55 billion) for this industry in its 12th Five Year Plan.[10] In addition, through the Maritime Agenda 2010–2020, the Ministry of Shipping has set a target capacity of over 3,130 MMT by 2020, which would be driven by participation from the private sector. Non-major ports are expected to generate over 50 per cent of this capacity.

Aviation

FDI inflows into air transportation between April 2000 and January 2015 stood at US$562.65 million according to the Department of Industrial Policy and Promotion Board. Boeing is planning to set up an aircraft-manufacturing base in India in keeping with the 'Make in India' programme of the Indian government. The government has also decided to put management contracts out to tender for Kolkata, Chennai, Jaipur and Ahmedabad airports and request for qualification documents have already been sent out by the AAI. The government agency predicts that there could be around 500 airports, on both brownfield and greenfield sites, by 2020 with private-sector participation through PPP models with state support by way of finance, concessional land allocation and tax breaks. India's first ever greenfield airport was constructed at Andal near Durgapur in West Bengal, and became

10 www.ibef.org/industry/ports-india-shipping.aspx.

operational on 18 May 2015. However, since Air India was the sole airline functioning from the newly built Kazi Nazrul Islam Airport (Andal), it decided to withdraw its services from 17 June 2016 for operational reasons, resulting in no scheduled flights to and from the airport. After such withdrawal, Zoom Air, after receiving its DGCA licence, began its operations at Andal from 12 February 2017.

The National Civil Aviation Policy was approved by the Indian Cabinet on 15 June 2016, and covers 22 areas of the civil aviation sector. The timelines for effecting the schemes introduced under the said Policy differ, and will come into force at different times as may be notified. The new policy aims to take flying to the masses by making it affordable and convenient; establish an integrated ecosystem that will lead to significant growth of the civil aviation sector to promote tourism; increase the number of airports, employment and balanced regional growth; enhance regional connectivity through fiscal support and infrastructure development; and enhance ease of doing business through deregulation, simplified procedures and e-governance.

In October 2014, the Union Cabinet stipulated that for Indian carriers to fly abroad, they must fly on domestic routes for five years and have a fleet of 20 aircraft. With the introduction of the Civil Aviation Policy, the aforementioned requirement has now been modified, and all airlines can commence international operations provided that they deploy 20 aircraft or 20 per cent of total capacity (in term of average number of seats on all departures put together), whichever is higher for domestic operations.

Chapter 7

ITALY

Anna Masutti, Claudio Perrella and Pietro Nisi[1]

I INTRODUCTION

i The transport finance industry

According to recent official statistics from the Italian Ministry of Infrastructure and Transport (2012–2013), gross fixed investment in the Italian transport sector represented 8.3 to 9.9 per cent of the total economy between 2000 and 2013.

A globalised sector such as air transport will be influenced by the general European trend of the gradual decline of the national flag carrier (in Italy, this would be Alitalia), entailing that fewer and fewer public funds are invested and more private capital enters the sector. Moreover, traditional carriers are losing ground to foreign low-cost carriers and also face increased competition from high-speed trains on some critical national routes. This has triggered important developments in terms of industrial infrastructure and capital. However, with regard to the specific case of Alitalia, the hope is for a quick recovery and growth following the agreement with Etihad Airways. Although the budget in 2015 closed with losses of €200 million, forecasts are for losses to decrease to €44 million in 2016, and a return to profit is expected in 2017.

In addition, transnational alliances, mergers and acquisitions of air carriers are becoming increasingly frequent. These operations have a common goal: to boost operational and marketing efficiency, to improve financial results, leading to economic and industrial improvements through economies of scale, and to reduce barriers to entry. The most significant merger in the aviation sector in Italy has been between Alitalia-CAI and Etihad Airways, which received the green light from the European Commission for its merger clearance at the end of 2014. Approval was granted under EU Regulation No. 139/2004 as the new partnership complies with European regulations on competition and air law, as Etihad bought a 49 per cent stake in Alitalia, and cooperation started in early 2015.

Recently, the EU released a Draft Commission Regulation amending Regulation (EU) No. 651/2014 with the aim of revising exemption criteria for airport investment aid from prior Commission scrutiny under EU state aid rules. This Draft Regulation has the purpose to facilitate public investments in order to create jobs and growth while preserving competition. The Regulation is specifically designed for regional airports, which are defined as 'airports with average annual passenger traffic of up to three million passengers', and also for decreasing the regulatory burden and costs for public authorities and other stakeholders in the EU. It will be of a great importance for Italy, as the country is characterised mainly by regional airports.

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The criteria provided by the Regulation establish that aid does not exceed 50 per cent or 75 per cent of eligible costs of airports handling between one and three million and fewer than one million passengers per annum respectively during the two financial years (preceding the year in which aid is granted). Furthermore, there should not be any other airports located within 100 kilometres distance or 60 minutes travelling time by car, bus, train or high-speed train.

However, a lack of coherence remains. In fact, the Regulation does not include state aid for airports with annual passenger numbers above 3 million (as per the 2014 airports guidelines), and does not provide for operating aid and start-up for regional airports (as per the 2014 airports guidelines) either. Moreover, there is no reference to a notification exemption in the particular case of airports in the same catchment area and managed by a single operator. Consequently, if several airports in the same catchment area are managed by the same operator, there cannot be any distortion of competition.

The Italian aviation market is made up of a network of numerous airports, some of which are relatively small and frequently compete against each other. This entails a more dispersed system than in many other competing European countries. The result is a system that is highly polarised between Milan and Rome, and other minor airports come into play thanks to the aforementioned low-cost carriers. In 2015, the Minister for Infrastructure and Transport, to make the air navigation system more efficient, developed the National Airport Plan, which identifies airports of national interest in each of 10 areas of homogeneous traffic, and among them those airports of particular strategic importance. The 10 areas identified by the Plan have been determined according to the criterion of being within the maximum distance of a two-hour drive from an airport of particular strategic importance. The purpose of the National Airport Plan is to focus and address resources and investment towards precise targets. Another important role was played by the Italian Ministry of Infrastructure and Transport on August 2016. The Ministry presented new guidelines concerning state aid, which have the purpose of developing air routes and promoting air carriers. Such governmental intervention, which has also been commented on by the new independent Authority of Transport Regulation, aimed to ensure wider accessibility to a major number of air carriers and to incentivise public investment.

In addition, the Italian Ministry of Infrastructure and Transport guidelines and the Authority of Transport Regulation intervention may be also revised, in accordance with the Draft Commission Regulation (amending Regulation (EU) No. 651/2014) for regional airports.

Private capital has been invested in the management of several airport authorities – such as those in Rome, Milan, Naples and Venice, which have seen significant financial input from private investors in recent years – and the management of other airports is currently in the process of being privatised. Bologna airport saw tangible growth following privatisation, and was listed on the stock market in July 2015. More specifically, on 14 July 2015, the global offer of sale and subscription was equal to 14,049,476 common shares, corresponding 38.92 per cent of share capital after the global offer.

The offer was completed with a request for 39,162,516 shares with a value of €4.50 per share. At present, the share value is equal to €15.94, and for Bologna airport an investment is expected of €120 million up to 2020.

A recent case of privatisation involves Alghero airport: in December 2016, F2i Found purchased 72.5 per cent of Alghero airport shares, whereas the remaining shares are accounted for by Sardinia Region.

With respect to shipping, Italy is traditionally known for its family shipping businesses, its few listed companies and analysts, and a very traditional approach to financing. Shipping represents a major branch of Italy's maritime economy, which in turn plays a key role in the national economy: the turnover of the sector was around €40 billion.[2]

Currently, shipping is almost exclusively financed by private capital in Italy. In all, around 40 operators dominate the market; the main three of these control 50 per cent of it, while the top 10 account for more than 80 per cent of the sector.

In the past, shipping has been subject to much financial speculation, mainly with respect to financial derivatives and forecasts on future freight, and this has led to the collapse of some companies at low points in the market.

Some problems that concern this segment are the limited presence of foreign investors, high credit costs, significant business fragmentation, lack of innovation, and structural problems resulting from low competition. Italy is not a major player in international ship financing and Italian lenders tend not to specialise in the complex arena of the maritime finance industry.

Finally, regarding the railway sector, Italy's national railway company FS,[3] formerly a public agency, became a limited company in 1992. The rail market was also liberalised but Trenitalia, wholly-owned by FS, remains the major Italian rail carrier of passengers and goods. The public sector has in fact financed rail transportation in Italy with considerable investment. This explains the state's vested interest in the profitable functioning of the rail market; in the past few years, the relative percentage invested in railways – especially in high-speed trains – has increased. Nonetheless, the first private company recently entered the rail market in Italy. NTV[4] has placed its high-speed Italo trains in direct competition with Trenitalia's high-speed services, but only the most profitable routes are covered. NTV was founded in 2006 and made its way into the railway market in 2011, despite claiming that FS was obstructing its entry into the market. In 2015, NTV became completely Italian following the exit of French group SNCF. In the last Industrial Plan 2017–2026, FS Group predicted an investment of €94 billion in projects aimed at transforming FS into an international company with integrated global mobility.

Particular attention has also been given to foreign investments that currently constitute 13 per cent of the total revenue, with the objective of achieving 23 per cent in 2026. In fact, the strategic plan presents three main lines of action regarding foreign investments. The first step consists of proposing FS company as a general contractor, able to realise railways, especially in states with marked infrastructure gaps. The priority areas for this international expansion are the Middle East, India and South East Asia, South America and Africa.

The second line of action aims to make the railways services market grow abroad by exporting high-speed trains.

The last point of the Plan regards the international development of local public passenger transport, which will be realised by promoting the FS Group abroad.[5]

The main shareholders are now the private investors Diego Della Valle, Luca Cordero di Montezemolo and Gianni Punzo, who together hold 40 per cent of the company, followed by Intesa San Paolo with 24 per cent, and other private investors.

2 2.5 to 3 per cent of GDP over the past three years.

3 Ferrovie dello Stato.

4 Nuovo Trasporto Viaggiatori.

5 Piano Industriale 2017–2026.

ii Recent changes

It is clear that the various transport segments in Italy have been significantly affected by the economic crisis, but since 2009, each has responded differently. However, recent years have shown a positive trend and registered growth: the added value produced by the transport sector between 2011 and 2015 is expected to show growth of 2.6 per cent per year on average.

Recently, the industrial districts, or clusters, have represented one of the main strengths of the Italian industrial system. They are homogeneous, local productive systems, characterised by a high concentration of mainly small and medium-sized industries, highly specialised in their area of business activity. Recently there has been a significant growth of industrial clusters in many fields, bringing new opportunities and benefits to the transport sector. In particular, the Lombardy Aerospace Cluster is an excellent example of an integrated system of enterprises, universities and research centres equipped with technological expertise and scientific capabilities in the aerospace industry.

The latest figures from the Lombardy Aerospace Cluster confirm its development in recent years, with growth in sales revenue reaching record levels. In 2013 (latest data available), the Lombardy aerospace companies generated a turnover of €4.9 billion; an increase of €1.2 billion from €3.7 billion in 2009.

In the past, the global economic crisis has affected the Italian aviation industry more than in any other major European country. In this context, it is not only Alitalia-CAI that has suffered negative effects from the international crisis – minor players in the national airline sector, such as Blue Panorama, Wind Jet and Meridiana Fly, have also been affected.

Nevertheless, as a sign of recovery, on October 2016 the Italian Civil Aviation Authority (ENAC) has issued to Blue Panorama Airlines the Air Operator Certificate (AOC) and the Air Transport Licence.[6]

Over the past decade, Alitalia has had to cope with increasingly aggressive competition from low-cost carriers such as Ryanair and easyJet, whose significant gains in market share have exceeded that of Alitalia itself. According to data provided by the Irish airline, Ryanair is the most important carrier in Italy in terms of the number of passengers carried;[7] in fact, according to traffic data published recently by ENAC, on the basis of the number of passengers carried in 2014, the top two positions are occupied by Ryanair, followed by Alitalia. Ryanair has also increased its forecast for 2024 from 119 million passengers to 200 million per year.

In addition, in 2017 the Irish Airline will invest, in Italy, an estimated US$1 billion in new aircrafts, new air routes and the creation of jobs and growth.

As competition generated by low-cost carriers became increasingly aggressive, and Alitalia's recurrent losses frustrated attempts by the Italian government to recapitalise it, it became necessary in 2008 to initiate insolvency proceedings to preserve the continuity of Alitalia's transport services. Although the intervention of the Italian government aimed at ensuring the business continuity of Alitalia's services, and at forcing the new shareholders to ensure greater stability for the former flag airline, the desired effects were not actually achieved.

6 ENAC – Comunicato Stampa No. 81/2016.

7 In 2014, Ryanair carried 26.1 million passengers compared with Alitalia's 23.3 million, although, technically, another 2 million passengers carried by the Alitalia subsidiary AirOne should also be added to the latter's numbers.

Previously, even other Italian carriers faced difficulties: Meridiana Fly (which merged with Air Italy in 2012) reported a 2012 net loss of €190 million, which led the company to start negotiations with Qatar Airways. Recently, the latter has purchased 49 per cent of Meridiana's shares.

In view of the challenging economic conditions, the Italian government expanded the range of protective measures for firms in difficulty by approving the Development Decree.[8] The government considered it necessary to update the old regulatory framework for bankruptcy situations and, in particular, the recovery tools, to avoid the bankruptcy of firms in crisis and in an effort to keep them afloat.

In the past, an insolvent party had little room for negotiation with creditors. Generally speaking, the new measures aim at supporting Italian companies despite the impact of the debts shown on the balance sheet. The Development Decree provides for measures primarily aimed at reshaping the instrument of composition with creditors, and the latest reforms include, in particular, significant innovations to the process, focusing on its flexibility and the guarantee of temporary protection to debtors against actions by the creditors (the automatic stay). The reform introduces specific measures to further facilitate business continuity, which itself becomes an element characterising a specific type of composition with creditors.

The Decree also affords specific opportunities to debtors to obtain additional exceptions to the general principles of Italian law, such as the possibility of cancelling pending contracts, overcoming the traditional principle of the stability of contractual relations. The Decree also allows benefits in the form of obtaining loans for company reorganisation, as well as tax advantages.

All these measures have a single purpose, which is to try – as much as possible – to keep alive firms facing bankruptcy in all sectors including transport, so as to keep the entrepreneurial system alive.

Shipping has also been affected, although it is slowly recovering to pre-crisis levels. Nonetheless, in 2012 maritime passenger transport registered its lowest levels since 2005.

National shipping companies have been forced to present refinancing plans to the banks in 2011 and 2012 as a result of a worsening in their balance results and of their failure to meet the covenants of their previous financing agreements. Recent statistics show longer-than-average repayment times, as well as increasing insolvency rates. This has widely led to share capital increases and to renegotiation or cessation of bank financing.

Railway transport would appear to be the segment best responding in the aftermath of the economic crisis in Italy, at least as in terms of cargo, but as far as passenger transport is concerned, investment does not seem to be creating a response either way. This is somewhat surprising given that, as explained above, investment in railway has increased more than in the other transportation segments.

In February 2015, the European Investment Bank signed a €950 million loan agreement with Italy's Ministry for Economics and Finance, which will be used by FS to fund the modernisation of conventional railway lines in Italy. One of the FS Group's strategic priorities has been to launch new projects to modernise the infrastructure and technology used on the conventional network – investments made possible by recent government measures such as the 'Unblock Italy' Decree at the end of 2014 and the 2015 Stability Law. These new financial resources will speed up the launch of projects and remove obstacles to important projects already planned to help contribute to the recovery of growth and employment.

8 Decree-Law 22 June 2012, No. 83, converted into Law No. 134 of 7 August 2012.

II LEGISLATIVE FRAMEWORK

The Italian banking sector was liberalised in the 1990s. Since this reform took place, erasing any distinction between special credit and ordinary credit, aviation and shipping assets are largely financed by banks and other financial operators. Therefore, the corresponding financial regulation applies to the financing of aviation and shipping assets.

i Domestic and international law and regulation

In Italy, general EU rules on state aid applies. There are no sector-specific rules regulating direct or indirect financial support to companies of the aviation sector by the government or public agencies. Many local Italian airports are controlled by public entities and, as a result, their management and financing is subject to EU state aid rules; as previously mentioned, some are in the process of being privatised.

As for the railway sector, European Directive 91/440/EEC, on the development of the Community's railways, launched the liberalisation process of the rail segment. This first Directive was further modified by Directive 95/18/EC and Directive 95/19/EC, which shared the same goal. Subsequently, Directives 2001/12/EC, 2001/13/EC, 2001/14/EC and 2001/16/EC followed as a part of this first regulation package, and were implemented through Legislative Decrees 188/2003 and 268/2004. Directive 2012/34/EU of 21 November 2012 – which was to be transposed by mid-2015 and established a single European railway area – recast the first railway package and replaced and repealed Directives 2001/12/EC, 2001/13/EC and 2001/14/EC of 26 February 2001.

This legislation identified the Ministry of Infrastructure and Transport as the body empowered to watch over competition and network issues in the railway sector.

Regulation (EC) No. 881/2004, Directive 2004/49/EC, Directive 2004/50/EC and Directive 2004/51/EC (i.e., the second railway package) completed the liberalisation process with regard to transport of goods.

A third railway package, consisting of Directives 2007/59/EC and 2007/58/EC, as well as Regulations 2007/1370/EC, 2007/1371/EC and 2007/1372/EC, was approved, which introduced the liberalisation of the European railway market for the transport of passengers, effective January 2010.

A new independent Italian Transport Authority has also recently been established. It enjoys financial powers only in the railway sector, where it can set up financing plans, as well as monitoring the separation between the corporation that manages the infrastructure and the one that manages transport. In the airport sector, however, the Authority monitors and approves the rate systems and the level of airport charges paid by airport users for the use of facilities and services, which are exclusively provided by the airport managing body and which are related to landing, take-off, lighting and parking of aircraft, and processing of passengers and freight, in accordance with Directive 2009/12/EC.

As airport charges should be non-discriminatory, Directive 2009/12/EC established a compulsory procedure for regular consultation between airport managing bodies and airport users with the option for either party to have recourse to an independent supervisory authority whenever a decision on airport charges or the modification of the charging system is contested by airport users. For the effective application of this Directive, an independent supervisory authority should be established in every Member State.

Despite the terms of Directive 2009/12/EC, the EU Commission has received claims reporting the airports of Milan, Rome and Venice for non-compliance. In infringement procedure 2014/4187, the Commission contested the consultation procedure established to

regulate airport charges through contract agreements between airport management bodies and ENAC. In fact, although under Law Decree No. 201/2011 an independent supervisory authority has been established in Italy (i.e., the Transport Regulation Authority), the airports of Milan, Rome and Venice are not subject to its control on the matter of airport charges. At the moment, proceedings are still pending in the pre-litigation phase before the European Commission.

ii Specific practices

Public financing has played a critical role in the turnover of several Italian airports. The major Italian airports thus produce profit for the businesses that have been granted their handling, while minor airports are handled at a loss. Nonetheless, in many cases profits are the result of the presence of public finance (be it from the state, the regions or the EU).

In Italy, loan conditions have slightly improved in recent years, thanks to a general improvement in economic expectations. Moreover, the increasing number of financing sources has led Italian banks to lower the hurdles for businesses to access financing.

In the maritime sector, recent financial practice has seen experiments with new types of covenant. It is worth noting the practice of the Italian bank Carige in a recent operation for the financing of the acquisition of two ships in a judicial sale with a high leverage for the buyer and a subordinated loan, reimbursement of which was dependent on the occurrence of a series of suspensive conditions (i.e., the operation puts into practice a profit share agreement between bank and buyer). Moreover, in 2015, Italian bank UniCredit has declared its intention to invest €1 billion in the maritime sector.

The implementation of the aforementioned European legislation for the liberalisation of the railway sector implies the introduction of an institutional and regulatory framework in Italy that ensures effective competition and free access. Notwithstanding the formal implementation of this legislation, and the recent establishment of the new independent authority, the goal of liberalisation has not yet been realised in Italy. The entrance of new operators in the sector have been repeatedly hindered by the network operator, irregularities that have been condemned by the Court of Justice of the EU, and sanctioned by the Italian and EU competition authorities.

III FINANCIAL REGULATION

Italian law assigns the responsibility for safeguarding the stability of the national financial system to the Bank of Italy. The Bank of Italy performs this task both through microprudential supervision of banks, in partnership with the European Central Bank within the Single Supervisory Mechanism, of other financial intermediaries and of some markets, as well as by implementing macroprudential policies aimed at the system as a whole.

The legal basis of the Bank of Italy's authority lies in Directive No. 2013/36/EU and its implementing Law 12/05/2015, No. 72, and Regulation No. 575/2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.

More concretely, Italian Law No. 154 of 7 October 2014 was enacted to implement EU Directives into Italian legislation in this domain. Article 3 provides for the broad empowerment of the Italian government to adapt current legislation to the EU Capital Requirement Directive and Capital Requirement Regulation, among the Europe-wide legal pillars of the Single Supervisory Mechanism. This will entail substantial changes to Italian

banking and finance legislation, mainly the Banking Act of 1993 and the Finance Act of 1998. Where possible, such changes will likely be brought through the regulatory powers of the Bank of Italy, the Italian Banking Authority and Consob, the Italian Markets Authority.

Banks can now be fined up to 10 per cent of their consolidated turnover. Furthermore, if the individual author of a breach of the legislation has obtained determinable benefits, or the bank has obtained determinable benefits resulting from the breach, the fine applied will be twice the benefit obtained, even if the amount exceeds the cap described above. These are all very relevant changes in the context of the Italian financial scene, where such punitive powers had never before been attributed to any regulatory authority.

These soon-to-be-implemented changes in the Italian legal framework for banks and listed companies will be relevant and substantial, and they will require that banks, listed companies, and their directors and shareholders introduce appropriate measures. Further relevant changes to Italian banking law are expected as soon as the Single Resolution Mechanism comes into play.

i Regulatory capital and liquidity

Bank of Italy Circular No. 285 of 17 December 2013, last modified on 24 November 2015, entitled Supervisory dispositions for banks, provides for the supervisory regime that applies to Italian banks in its implementation of EU legislation and transposes the content of the Basel III Agreements.

The Bank of Italy has implemented the EU regulation on liquidity[9] by regulating in detail the procedure for liquidity risk management and all related aspects.

ii Supervisory regime

Banking supervision and regulation in Italy has always been entrusted to the central bank. After Consob was created in 1974, the division of labour with the Bank of Italy was defined by purpose of regulation, rather than by type of intermediary. The Bank is in charge of the stability-oriented prudential supervision of banks, financial companies and investment firms, while Consob is in charge of transparency and investor protection, and in this capacity it has regulatory powers over companies as issuers of securities and over banks and investment firms as providers of investment services to the public.

Since November 2014, in accordance with Regulation EU No. 1024/2013, the European Central Bank, assisted by the Bank of Italy, has been responsible for the prudential supervision of systemically significant banks, as listed by the ECB on 4 September 2014.

IV SECURITY AND ENFORCEMENT

Under Italian law, parties have a general freedom to grant security over their assets, with the following exceptions: state property, assets that constitute a patrimonial fund pursuant to Article 167 of the Italian Civil Code, and undistrainable goods pursuant to Article 514 of the Italian Code of Civil Procedure.

As regards aircraft, security may be taken by a mortgage, but only of the voluntary kind. Pursuant to Article 1027 of the Italian Navigation Code, the security document must be notarised and the mortgage registered with the National Aeronautical Register. Article 1028 of

9 Directive 2010/41/EU.

the Navigation Code allows a mortgage to be taken out on an aircraft under construction, but in this case, instead of registration with the National Aeronautical Register, the mortgage must be filed in the special constructions register.

The law governing this mortgage will generally be Italian law. Although, in theory, the deed of mortgage could be governed by law other than Italian law, all relevant security interest elements need to comply with Italian law in any case. It is therefore more typical to have a mortgage deed governed by Italian law.

Italy is a signatory to, but has not yet ratified, the Convention on International Interests in Mobile Equipment and the Protocol on Matters Specific to Aircraft Finance (the Cape Town Convention). Broadly speaking, the Convention applies to 'international interests' (which include interests under security agreements) in 'aircraft objects' that are created at a time when either the borrower is situated in a contracting state or the aircraft is registered in a contracting state. The Convention provides creditors with the following standard default remedies under security agreements:

a taking possession or control of an aircraft;
b selling or granting the lease of an aircraft;
c collecting or receiving income or profits arising from the management or use of an aircraft; and
d procuring the deregistration, export and physical transfer of an aircraft from the territory in which it is located.

These remedies are exercisable without a court order unless the contracting state in question has made a declaration under the Convention prohibiting self-help.

The Convention also provides for interim relief (provided that the borrower has agreed to it) and sets out regimes that contracting states may apply on a borrower's insolvency.

Italian law also allows security over ships to be taken by a mortgage. Pursuant to Article 565 of the Navigation Code, the security document must be notarised and the mortgage registered. A mortgage may, once again, be taken over a vessel under construction, but, as with aircraft, the mortgage must be filed in the special constructions register.

i Financing of contracts

Leasings are widespread throughout the aviation sector as a necessary instrument for the expansion of most airlines. The high cost of aircraft calls for financial instruments of this kind that allow airlines to obtain the physical availability of aircraft without the risk to their capital.

The Italian legislator has duly noted this widespread financing practice, which implies the dissociation between formal ownership and economic availability, and aims to safeguard the dynamic aspects of the possession of the aircraft. Therefore, since Regulation (EEC) 2407/1992 – part of the European Community third aviation package – came into force, Article 756 of the Navigation Code allows the registration of aircraft by anyone who enjoys ownership rights or rights of usage over it. Any right other than ownership that entails registration in the National Aeronautical Register, however, must be specified.

ii Enforcement

A secured creditor in Italy may only enforce security through a court action, converting the asset through judicial sale and using the proceeds to meet the debt, and enforcement of security over vessels and aircraft follow the same principles.

Enforcement of security governed by foreign law in Italy is possible in principle, if Italian courts have jurisdiction on the matter and are able to pass judgment applying the relevant foreign law; however, in practice, it is highly unlikely that enforcement proceedings would be brought in Italy when the security is governed by foreign law. Therefore, the interested party – the beneficiary of a security – would usually act before a competent Italian court, or seek enforcement of a foreign judgment in Italy. In any case, the only way to enforce the rights on such aircraft or vessels is to launch judicial proceedings, which culminate in a judicial sale.

Italian courts are competent when the attached aircraft or vessel is located in Italy, when the aircraft or vessel to be sold is registered or located in Italy, or when the relevant convention provides for it.

iii Arrest and judicial sale

A judicial order from the competent authority is necessary to take possession of the aircraft. As mentioned above, security cannot be enforced by taking physical possession of the aircraft, so the interested party may either act before the competent Italian court or enforce a foreign judgment in Italy.

Under Italian law,[10] the owner or beneficiary of the security can apply to the court for an injunction to return the aircraft, which can be granted *inaudita altera parte* and either be immediately enforceable or subject to a waiting period of 40 days for a possible defence from the counterparty. To obtain an order that is immediately enforceable depends to a great extent on the actual event of default claimed and the evidence that the beneficiary is able to provide to the court regarding the right to repossess.

The arrest of ships is possible in a wide variety of situations, including claims for damage done by or suffered by a vessel, and claims for goods, bunker or materials supplied to a vessel for its operation or maintenance. Action can be taken by a bank that has terminated the loan facility and wishes to draw on its mortgage, by crew members that have outstanding wages, and by insurers for claims for loss of – or damage to – goods.

Arrest may be allowed regardless of whether the Italian courts have jurisdiction on the merits of the case; the Italian court may be competent for the arrest if it is the court of the port of call, and the application is subject to the condition that the vessel is within Italian territorial waters.

Italy is a signatory to the Brussels Convention 1952. If a ship is flying the flag of a state party to the 1952 Arrest Convention, arrest in Italy can be sought only with respect to maritime claims listed under Article 1.1; if the ship is not flying the flag of a contracting state it can be arrested for the aforesaid claims as well as for any other claim for which arrest is permissible under Italian law (i.e., virtually any credit or claim against the owner of the vessel, including those not mentioned in the list of maritime claims set out in Article 1 of the Arrest Convention). Italian courts generally also apply the 1952 Arrest Convention for arrest of ships flying the flag of a non-contracting state on the basis of a rather broad application of Article 8.2 of the Convention.

Arrest proceedings for aircraft are triggered through an application to the competent court and the service of a deed to the counterparty. The deed of attachment will contain,

10 Article 633 of the Code of Civil Procedure.

inter alia, an injunction to the counterparty ordering it to refrain from any action aimed at depriving the applicant of the aircraft under dispute. It will also include an order to the captain not to allow the aircraft to take off.

Under Article 1057 of the Italian Navigation Code, aircraft cannot be seized, confiscated, attached or be the target of precautionary measures unless prior authorisation is obtained from the Italian Ministry of Infrastructure and Transport, if it is owned by the state, it is operated for the carriage of passengers or goods for profit and is either ready to take off or flying, or it is operated for scheduled services in Italy.

Generally, since mortgages in Italy are formalised in a public deed, no prior judicial authorisation is needed to attach the aircraft – a notarised mortgage is in fact an enforceable instrument that has the same effect as a court order. The beneficiary will then have to contact the bailiff, who will proceed with the formalities for the attachment of the aircraft. The competent Italian authority will then appoint a custodian.

This claim for arrest (*sequestro conservativo*), conceived as an interim measure to secure a potential enforcement of the mortgage on an aircraft following default by the party in possession of the aircraft, is, however, different from another type of arrest (*sequestro giudiziario*) that may be ordered by a judge when ownership rights are called into question within the framework of judicial proceedings.

Italian courts normally grant the arrest of ships *ex parte* (provided they are satisfied by the *prima facie* evidence of the basis of the claim) upon presentation of the application, and set a hearing for the appearance of the parties (normally within a short time).

In non-maritime arrest proceedings the judge will summarily examine the request and grant the measure if the claim brought is well grounded at first glance (*fumus boni iuris*) and the applicant proves that it may be exposed to unrecoverable damages during the course of ordinary proceedings (*periculum in mora*). The requirement of *periculum in mora* is generally not requested for maritime arrest, however, certainly, if the arrest is sought pursuant to Brussels Convention 1952, the Convention does not contemplate this.

Alternatively, the court may issue an order preventing the vessel from leaving pursuant to Article 646 of the Navigation Code. The order does not state the quantum for which the arrest is granted and is not, strictly speaking, an arrest, but has the same practical effects.

Unusually, no security is required as a preliminary condition to seeking arrest of a ship. The judge may order that the applicant tender countersecurity, but this is rather uncommon at the time of the filing of the application, and security is normally requested only if the court considers the arrest to be controversial or that the merits of the claim have not been assessed in sufficient depth.

Where the arrest is obtained and confirmed, the applicant is compelled to commence the proceeding for the merits (unless one is already pending) before the court having jurisdiction within 30 days. If an application is rejected, it is possible to file an appeal within 15 days. It is debatable whether an appeal can be pursued once a ship has left Italian waters; the ability to seek appeal should be unquestionable under Italian law, but a few decisions have held that an appeal cannot be pursued where the ship cannot actually be placed under arrest.[11]

If the claim is subject to foreign law and jurisdiction (for instance, where arrest is sought as security for a claim arising from a charterparty containing an English law and

11 Court of Gorizia, 25 May 2006, *Stx Pan Ocean Co Ltd v. Adam Swoboda*.

jurisdiction clause) the applicant must provide suitable evidence for the basis of the claim; this could be provided, for example, by means of affidavits or disclosing foreign authorities and case law proving the grounds for the claim.

The competent court for the judicial sale of the aircraft is the court of the place where the aircraft is located. The procedure for the sale of the aircraft, following a judicial order, is rather complex. First, the order is served on all the parties to the proceedings, and it is also disclosed to the public. When it comes to the sale itself, different methods may be used, depending on whether the sale takes place through a public auction – in any case, the mortgagor is not allowed to bid. The price is paid by the winning bidder in accordance with the sale terms set out by the judge.

Arrest of a vessel does not give an automatic right to initiate judicial sale proceedings; it merely provides security, and judicial sale proceedings are conditional on the claimant having an enforceable claim in accordance with the rules of the Civil Procedure Code. In practice, this means that the claimant can proceed with the sale of the vessel only once an enforceable and binding court decision on the claim itself (the merits) has been issued.

The proceeds of sale will be divided among creditors in accordance with certain rules of priority. After all costs in connection with the judicial sale proceedings have been deducted, claims secured by maritime liens or mortgages on the vessel will first be paid. Any balance thereafter will be divided among the other creditors, with the time of registering the claim being a crucial factor.

V CURRENT DEVELOPMENTS

i Recent cases

Since January 2015, Italy's national airline and flag carrier has been jointly controlled by the national carrier of the United Arab Emirates, Etihad. The agreement, entered into in August 2014, that Etihad would acquire 49 per cent of Alitalia's shares, allowed the latter to recover from a difficult financial situation. In fact, Etihad underwrote a substantial equity commitment towards Alitalia and restructured €695 million of the Italian company's debt. As this operation represented a concentration with great repercussions in the European market, competition clearance from the European Commission was required before the acquisition could be perfected. Clearance was granted on condition that some commitments were respected to safeguard free competition.

Another recent interesting case in the aviation sector is the privatisation of the Italian company SEA, which operates Milan Linate and Malpensa airports. F2i's bid to acquire a 29.75 per cent stake in the airport operators was approved by the local government in 2011.[12] At present, F2i controls 44.3 per cent of SEA, while 55.65 per cent remains in public-sector hands and, following a recent acquisition, F2i Found also controls 72.5 per cent of Sogeaal.

As previously mentioned, Bologna Airport saw strong growth in 2015 and in July of that year was listed on the Italian stock market; the entry of private investment means that this airport will only become more competitive. It raised about €63.2 million at IPO, with a market capitalisation of about €162.4 million.

12 F2i is an Italian asset management company, controlled by several private banks, and specialising in investments in the infrastructure sector.

In 2015, Finmeccanica and Hitachi announced the closing of transactions covering the acquisition by Hitachi of AnsaldoBreda's business and Finmeccanica's 40 per cent stake in Ansaldo STS. The purchase price under the Ansaldo STS share purchase agreement was €9.65 per Ansaldo STS share. In 2016, Ansaldo has been the subject of a takeover bid by Hitachi, with a view to purchasing the shares remaining on the market and those shared among different investors.

Finally, the first Italian, privately owned, railway company, NTV, is now wholly Italian, as it is now controlled by private Italian shareholders, the Italian bank Intesa San Paolo and other private investors (see Section I.i, *supra*).

ii Developments in policy and legislation

From a general perspective, the 2015 Stability Decree provided several financing programmes, especially for small to medium-sized enterprises, with the goal of boosting the national economy.

In January 2014, the Italian Ministry of Infrastructure and Transport launched a new national airports plan to rationalise and reorganise the Italian airport system. One of its main objectives is to set out the infrastructure priorities into which investment should be concentrated, but there have been problems with the identification of nationally important and strategic airports.

Furthermore, following the 2014 European guidelines, on August 2016 the Ministry provided new guidelines concerning state aid that also aim at facilitating and incentivising public investments for regional airports.

iii Trends and outlook for the future

In the aviation sector, it seems likely that the current trend in the rise of low-cost carriers will continue, eventually leading to the consolidation of a limited number of large networks of carriers and a limited number of large low-cost carriers. This evolution will certainly affect the market structure, along with competitive fair play. Carriers that do not take part in strategic alliances may well collapse or be subject to acquisition or merger.

Moreover, in 2015 the Italian Ministry of Economy has planned to partially privatise ENAV,[13] the national air navigation service provider. ENAV is still wholly-owned by the aforesaid Ministry, which will nonetheless launch a public bid for a maximum of 49 per cent of ENAV's capital, since it wants to retain at least 51 per cent of the company.

As for the maritime sector, southern Italy is facing a challenge regarding the EU funding programme for 2014 to 2020 and the chance to bridge the gaps appearing between the Italian shipping industry and those of other Mediterranean countries. European policy has recently greatly stimulated the short-sea-shipping sector, where Italy excels thanks to the competitive advantage of its geographical position as a more sustainable substitute for road transport. The Italian ship financing system still poses many challenges, however, notwithstanding its cautiousness compared with other international banks. Better-structured

13 Ente Nazionale di Assistenza al Volo. ENAV is responsible for the provision of air traffic control services, flight information services, aeronautical information services, and issuing weather forecasts for airports and the airspace.

technical competence, greater diversification of financial products and services, and wider diffusion of innovative financing techniques other than leasing are required. In this regard, corporate bonds and private equity are two options that seem worth exploring.

Finally, along the same line as ENAV, Italy's Minister of Economy and Finance has announced that the government is planning a partial privatisation of the Italian state railways in a bid to reduce public debt and improve the competitiveness of the railway in the high-speed rail and regional public transport markets. The government intends to proceed with the sale of a 40 per cent stake in FS, describing the decision as an opportunity to improve a company that has been an engine in the modernisation process in Italy. A task force will now discuss the terms and conditions of the privatisation process, which, because of its complexity, should be completed within the next two years.

Chapter 8

JAPAN

Norio Nakamura and Taichi Hironaka[1]

I INTRODUCTION

i The transport finance industry

Aviation is one of the few growing fields for financiers given the recent opening up of the market to low-cost carriers. The demand for air transportation is expanding, with an expected annual growth rate of around 5 per cent.[2] Japanese financiers (including banks, leasing companies and trading companies) have ambitiously started to participate in aviation finance or investment focusing on the profits brought by the aeroplanes themselves rather than the credit capabilities of the airlines. For example, in Japan, the Development Bank of Japan (DBJ), a government financial institution, set up a team dealing specifically with aircraft finance in 2011, and arranged syndicated loans in 2013 with BNP Paribas Tokyo involving 14 financiers, including five regional banks.[3] In terms of tax reduction, investment in a scheme of silent partnership or voluntary partnership is also attractive to general investors.

There has been fierce competition in the shipbuilding field in south-east Asia, especially in Japan, China and Korea,[4] there being many ship types,[5] sizes[6] and numbers, a situation quite different to that of aircraft, where the majority are manufactured by Boeing and Airbus. Since the financial crisis triggered by the bankruptcy of Lehman Brothers, order numbers for new vessels have improved following the inflow of surplus funds to combat the strength of the Japanese yen, and the increase in demand for liquefied natural gas (LNG) carriers.

In the rail business, the Ministry of Land, Infrastructure, Transport and Tourism (MLIT) is planning to set up joint venture companies (special purpose vehicles, or SPVs) for the lease of new types of vehicle to local governments, with the SPVs being invested in by local governments, the Japan Railway Construction, Transport and Technology Agency (JRTT),[7] and a variety of other financial resources. It is also investigating another scheme in which the JRTT directly finances local transport business without the need for an SPV.[8]

In the general area of transport finance, financial institutions have had to be careful in examining finance upon requirement of the Basel Capital Accords. Liquidation of credit

1 Norio Nakamura and Taichi Hironaka are partners at Yoshida & Partners.

2 Kazuki Sugiura, *Kinyu Houmu Jijo*, 10 October 2013, pp. 25–26.

3 Miyazaki, Oita, Miyazaki-Taiyo, Kagoshima and Higo; *DBJ News*, 30 June 2014.

4 For example, CSSC, Daewoo, Hyundai, Imabari, Samsung and SCIC.

5 For example, bulk carriers, container ships, oil tankers, chemical tankers or reefer ships.

6 For example, Handysize, Panamax or Capesize.

7 An independent Japanese administrative institution.

8 *Nikkei News*, 21 September 2014.

receivable, such as securitisation of aviation finance or loan participation in ship finance, has gradually increased. Basel III, which deals with liquidity coverage ratios and net stable funding ratios (NSFRs), may also have a certain influence on the field of transport finance.

ii Recent changes

Aviation

As a result of amendments to the tax regime in fiscal year 2005, any benefits gained from leveraged leases in aviation were removed and the operating lease has become the most frequently used structure for aviation finance; one version of this entails a silent partnership scheme and the other is the direct ownership scheme. The JOLCO[9] is now the most used vehicle in Japan, in which the total amount of the lease charge is set at less than the purchase price of the aircraft and the lessor bears the risk of shortfall in the residual value at the maturity date, but may benefit from depreciation under the tax laws.[10] As yet, no services have been arranged through the Enhanced Equipment Trust Certificate by Japanese finance institutions.

In recent times, financiers and trading companies have started to enter the leasing business for aircraft engines looking for higher rates of earning, setting up joint ventures[11] as well as financing aircraft.

Shipping

The financial condition of domestic shipowners has improved in recent trading resulting from the weakness of the Japanese yen against foreign currencies, and so the attention of financiers has focused on ships as objects of money supply.

Under Annex VI of MARPOL, vessels operating in emission control areas may only burn bunker oil with a maximum 0.1 per cent sulphur content from 1 January 2015, and so demand for LNG as a fuel is being seen in these waters. The Japanese government and shipping industry are trying to put LNG-fuelled vessels into practical use, which will also lead to more demand for LNG tankers and LNG-bunkering vessels. In 2014 Nippon Yusen Kaisha placed an order with Hanjin Heavy Industries and Construction for the world's first LNG-bunkering vessel. It is likely that finance for LNG vessels or projects will become progressively more attractive.

9 Japanese operating lease with call option.

10 Hidehiko Suzuki and Keisuke Imon, 'Theory and Practice of Aviation Finance', *Kinyu Houmu Jijo*, No. 1994–1996.

11 For example, Mitsui & Co participated in GE9X engine development with Willis Lease Finance in 2011; Sumitomo Corporation set up a joint venture with MTU Aero Engines in 2013; Mitsubishi UFJ Lease & Finance purchased all the shares of Engine Lease Finance in 2014; and NTT Finance collaborated with the DBJ in 2015.

II LEGISLATIVE FRAMEWORK

i Domestic and international law and regulation

Aviation

Aviation law broadly covers the relevant issues on safety of aircraft and air navigation and also proper and rational management of the transport business by air.[12]

Ownership of aircraft can be perfected upon registration in Japan,[13] but aircraft owned by (1) non-Japanese nationals; (2) foreign governments or authorities; (3) legal entities incorporated under foreign law; or (4) corporations of which the representative director or more than one-third of the executive officers are those stipulated in (1) to (3) above, and those under foreign state flags, may not be registered.[14] A party that intends to participate in the air transportation business must also have permission from the MLIT.[15]

The 2006 Cape Town Convention on International Interests in Mobile Equipment has not been ratified in respect of mortgages or liens on aircraft, so the domestic Aviation Mortgage Law is applicable.

Shipping

There are statutory requirements for owners of Japanese-flagged vessels, which limits ownership to (1) the Japanese government or public authorities; (2) Japanese nationals; or (3) legal entities incorporated under Japanese law of which the representative director and two-thirds of the executive officers must be Japanese nationals. There are, however, no particular regulations applicable to owners of foreign-flagged vessels, who are always subject to the law governing the registration of the vessels.

Registration of ownership or mortgages on Japanese vessels takes place according to the Ship Act,[16] the Ship Registration Rules or the relevant regulations. In terms of maritime liens and ship mortgages, which concern financiers, Japan has ratified neither the International Convention for the Unification of Certain Rules relating to Maritime Liens and Mortgages in 1967 nor the International Convention on Maritime Liens and Mortgages in 1993. Enforcement of liens and mortgages on ships is dealt with under the Civil or the Commercial Codes. Chapter 3 of Commercial Code (maritime law) broadly covers commercial transactions or issues concerning shipping, maritime and admiralty.

Rail

According to the Railway Business Act,[17] parties who enter into railway business must have permission from the Minister of Land, Infrastructure, Transport and Tourism. Before 1999, railway business was licensed by the government taking into consideration supply and demand, but competition was subsequently introduced into the field.

The Railway Mortgage Act makes provision for mortgages secured on complete railway facilities, incorporated as 'foundations'.

12 Section 4 of the Aviation Act.

13 Section 3-3 of the Aviation Act.

14 Section 4 of the Aviation Act.

15 Section 100 of the Railway Business Act.

16 Senpaku Hou (in Japanese), which regulates qualification, registration and national certification for Japanese vessels.

17 Section 3 of the Railway Business Act.

ii Specific practices

Aviation

Aircraft to be operated by domestic airlines are in fact limited to those registered in Japan who have perfected ownership, but to register aircraft in Japan, owners are required to be Japanese nationals or corporation (see Section II.i, *supra*), and reservation of ownership to foreign financiers or their affiliates (SPVs), regardless of whether incorporated in Japan, is not possible. In such a situation, the aircraft may be sold to the affiliate of a Japanese company and then sold back to the affiliate of the foreign financiers holding ownership at the Japanese affiliate.

Shipping

Japanese maritime law was originally intended to cover Japanese-flagged vessels owned by Japanese owners, and there have been many disputes on the issues of whether mortgages on foreign-flagged vessels are recognised, or whether liens on foreign vessels are created for credit or claims brought under contract governed by foreign law. This is a matter of international conflict law as no clear answer has yet been supported by Japanese statute law.

Rail

In Japan, in the established system, the JRTT gives direct finance to each railway operator upon obtaining funds from a variety of financial resources.[18] Railway operators will obviously prefer to undertake railway construction or provide service in a stable investment environment so that the balance of the account is exceeded in the long term. Railway facilities are leased or assigned to railway operators by the JRTT, which retains ownership. Finance for train construction is usually obtained by debt finance, vehicle trust, lease or leveraged lease.

III FINANCIAL REGULATION

i Regulatory capital and liquidity

According to the Banking Act, the prime minister may set the levels for the capital adequacy of financial institutions; under this Act, the minimum capital adequacy ratios were set at 8 per cent for financial institutions subject to international standards and at 4 per cent for financial institution subject to domestic standards by the Notification of the Financial Services Agency of 27 March 2006, in accordance with Basel I and II.

The Financial Services Agency published the revised notification following Basel III (1) of the international standards for financial institutions on 30 March 2012, effective from 31 March 2013; and (2) of the domestic standards for financial institutions on 8 March 2013, effective from 31 March 2014.

The liquidity coverage ratio (LCR) under Basel III was implemented on 31 March 2015 with a required level of at least 60 per cent; it will be fully phased in by 1 January 2019, by which time the required level will reach 100 per cent. The NSFR, which requires financial institutions' medium to long-term funding to be covered by their medium

18 The JRTT obtains certain funds from commercial banks, such as by way of syndicated loan schemes. According to recent information from JRTT, it obtained finance by way of syndicated loan, for example, in February 2015, ¥28.5 billion for one year arranged by Mituis Sumitomo Bank and, in March 2015, ¥27 billion for four years arranged by Aozora Bank.

to long-term financial resources, will be introduced on 1 January 2018. Financial institutions are required to increase the stock volume of high-quality liquid assets to improve their LCRs and should pay attention to any low returns on assets or the increasing cost of liability.[19]

In the meantime, the Deposit Insurance Act, which secures funds of depositors in the event of a bank's failure under the management of the Deposit Insurance Corporation, was revised on 12 June 2013.

ii Supervisory regime

Under Article 27 of the Foreign Exchange and Foreign Trade Act, foreign investors are required to notify the Minister of Finance and the competent minister in advance should they make inward direct investment in any business that may result in (1) national security being impaired, public order being disturbed or public safety being compromised; or (2) obvious significant adverse effects on the management of the Japanese economy. As it is a matter of significant public interest, the railway transportation business falls within the scope of the above regulation.

IV SECURITY AND ENFORCEMENT

i Financing of contracts

Ships

In most cases newly built ocean-going vessels are registered in Panama or other tax-haven countries and owned by SPVs established in these countries. The finance schemes for such vessels depend on the laws of the countries in which they are to be registered, as the enforceability and effect of the security might be governed by such laws. There are two major schemes that are used to finance these vessels: loan schemes and lease schemes. Under a loan scheme, the vessel is owned by an SPV established and controlled by the shipowner, and the following agreements are prepared:

a the loan agreement between the financier and the SPV (guaranteed by the shipowner);
b a mortgage agreement;
c a charter hire assignment; and
d an insurance assignment.

Under a lease scheme, the vessel is owned by an SPV established and controlled by the financier, and the following agreements are prepared:

a a bareboat charter party between the SPV and the shipowner (or its subsidiary);
b a charter hire assignment from the shipowner (or its subsidiary) to the SPV; and
c an insurance assignment.

New domestic vessels should be registered in Japan because foreign vessels are prohibited from engaging in domestic transportation under Japanese law.[20] They may be financed by loan schemes, each of which needs a loan agreement and a mortgage agreement. For the

19 For Basel III, Yasuhiro Nakayama, 'Response to Basel III Liquidity Control', Mizuho Information and Research Institute Report in March 2013; Yoji Hamada, 'Risk Management affected by Basel III Liquidity Control', Kinzai Institute for Financial Affairs Inc, 2014.

20 Section 3 of the Ship Act.

new building of domestic cargo vessels and passenger vessels, another option is to apply to the Joint Ownership Shipbuilding Scheme, a low interest-rate finance scheme offered by the JRTT. Under the project, the JRTT pays up to 70 or 80 per cent of the building costs with corresponding co-ownership on the vessel and then receives repayment (as a lease payment towards the co-ownership of the JRTT) from the shipowner. When paid off, the shipowner owns 100 per cent of the vessel. This project needs the following agreements:

a a shipbuilding contract; and

b a co-ownership and lease agreement between the JRTT and the shipowner.

Rolling stock

Railway construction is characterised as public infrastructure development, even if it is operated by a private railway company. Railways are constructed by the JRTT and sold to each railway company on an instalment basis, and there is a railway mortgage system in place to secure such loans. Under this system, the railway, rolling stock and any other facilities necessary for railway operations are treated as a monolithic property known as a 'railway foundation' to prevent railway facilities being sold off in pieces by public sale.

In most cases rolling stock is self-financed, but is sometimes bought using a lease scheme; for example, the new Keisei Skyliners – the airport express trains between Narita International Airport and northern Tokyo – were financed by a lease scheme.[21]

Aircraft

Loan schemes and lease schemes are available to finance aircraft. Under a loan scheme, the airline owns the aircraft, and the financiers hold the mortgage on the craft; this type of scheme needs a loan agreement and a mortgage agreement. Under a lease scheme, the financiers set up an SPV, and the SPV owns the aircraft and leases it to the airlines in accordance with a lease agreement between the SPV and the airline.

Since aircraft operated by Japanese airlines should be registered in Japan,[22] a special arrangement is necessary when such aircraft are financed by foreign financiers under a lease scheme – this is called a 'sale and conditional sale structure'. In this scheme, the foreign financier sets up an SPV in a foreign country (the foreign SPV) and a Japanese partner sets up another SPV in Japan (the domestic SPV). The foreign SPV buys the aircraft from the manufacturer and sells it to the domestic SPV, buys it back without the ownership of the aircraft, and then the foreign SPV leases it to the Japanese airline. The foreign SPV holds the mortgage on the aircraft and a pledge on the shares of the domestic SPV.[23] This scheme needs a lease agreement, an aircraft sales agreement, a conditional sales agreement, a participation agreement, a mortgage agreement and a share pledge agreement.

ii Enforcement

Ships

Ship mortgages may be registered in Japan but may not be enforced against third parties unless they are registered under Japanese law. Maritime liens on vessels arise with respect to

21 See Nissay Leasing Co Ltd, www.nissay-lease.co.jp/service/index.html.

22 Section 5 of the Civil Aeronautics Act.

23 Hidehiko Suzuki and Keisuke Imon, 'Theory and Practice of Aircraft Finance (v2)', 1995, *Kinyu Houmu Jijo*, 64, 65–6 (2014).

claims for pilotage, towage, bunker expenses, crew wages and salvage,[24] and also claims in connection with marine casualties such as collisions or oil pollution,[25] and these have priority over the ship mortgage.[26] Under the Bankruptcy Act, loan claims under a ship's mortgage are treated as a right of separate satisfaction, and claimants may enforce their rights during bankruptcy proceedings. Under the Corporate Reorganisation Act, they are treated as secured reorganisation claims. Claimants may not enforce their rights outside proceedings, and will be paid in accordance with the reorganisation plan, in the amount reflecting their priority and claim.

A finance lease (full-payout lease) claim is also treated as a secured reorganisation claim in corporate reorganisation proceedings since it is similar to a loan agreement; thus, the financier will be paid in accordance with the reorganisation plan in the same way as the mortgagee. The operating lease is treated as a pending contract and the trustee has the option of continuing or terminating the lease, but the lessor may not terminate the lease even should there be a clause giving the lessor that right in the event of the lessee's application for such proceedings. Such clauses are considered invalid in the context of corporate reorganisation proceedings as they undermine the purpose of the Act.[27]

Rolling stock

The Railway Mortgage Act provides the railway mortgage system. Under this system railway mortgages should be placed on the railway foundation, which is the collateral railway facility, and may be registered.[28] In bankruptcy proceedings and corporate reorganisation proceedings, a railway foundation is treated as a single mortgaged item.

A lease on rolling stock is treated in the same way as that of a ship in corporate reorganisation proceedings.

Aircraft

The Aircraft Mortgage Act and Civil Execution Act and Rules[29] provide the aircraft mortgage system. Under this system, aircraft mortgages may not be asserted against third parties unless they are registered.[30] Formal mortgage registration, however, is not usually applied because of the high charges incurred in the process, so only provisional registration is used. Provisional registration reserves the priority order as a security right of the mortgage subject to the condition that the provisional registration is transformed into a formal one.

A lease on an aircraft is treated in the same way as that on a ship in corporate reorganisation proceedings.

24 Section 842 of the Commercial Code.

25 Section 95 of the Act on Limitation of Liability of Shipowners.

26 Section 849 of the Commercial Code.

27 If the termination were allowed, almost all pending contracts would be terminated, and purported corporate reorganisations would probably fail.

28 Section 2 of the Railway Mortgage Act.

29 Section 84 of the Civil Execution Act.

30 Section 5 of the Aircraft Mortgage Act.

iii Arrest and judicial sale

Ships

Even if a vessel and mortgage are registered in a foreign country, the mortgagee may apply for arrest and judicial sale of the vessel by submitting documentation proving the existence of the mortgage on the vessel[31] to the court, as long as it is in Japan. Usually, the mortgagee will obtain a court order to obtain the certificate of the vessel's nationality and any other documents necessary for its sailing before its arrival at a Japanese port; upon arrival an enforcement officer then confiscates the foregoing documents from the vessel so that it cannot sail from the port.[32] Within five days of the documents being apprehended, the mortgagee must formally apply for commencement of the judicial sale of the vessel to the court that has jurisdiction where the vessel arrested.[33] The court may decide to commence the judicial sale proceeding and appoint a trustee to manage the vessel until completion of the sale.[34] By this stage, the mortgagee will have had to pay anticipated costs and expenses for the proceedings in advance, an amount that will be returned out of the proceeds of the sale. For example, a mortgagee paid about ¥13 million in a case of judicial sale under a ship mortgage before the Hakodate District Court.[35] It usually takes about six months from the commencement of the judicial sale to distribution of dividends.

In such proceedings, other security holders such as other mortgagees and maritime lien holders may also demand distributions from the proceeds of the judicial sale. In the same way, in a judicial sale concerning a maritime lien, mortgagees may also demand distribution. Under Japanese law, a variety of claims may be secured by maritime liens, and all maritime liens have priority over the mortgages;[36] thus, the existence of maritime liens and the priority order between mortgages and maritime liens are often disputed.

With respect to the governing law in terms of maritime liens, there are conflicting precedents:

a Applying only Japanese law as the forum law.[37]

b Applying both the flag law and the governing law of the claim to be secured by the maritime lien.[38] The maritime lien would be admitted only if it exists both under the flag law and the governing law for the claim.

c Applying both the law of the vessel's place when the maritime lien arises and the governing law for the claim.[39] The maritime lien will be admitted only if it exists under both the law of the vessel's location when the maritime lien arises and the governing law for the claim.

As to the priority order, there are also conflicting precedents:

31 It is usually a certificate of registered matters.

32 Sections 115(1), 189 of the Civil Enforcement Act.

33 Id., Sections 115(4), 189.

34 Id., Sections 116, 189.

35 Yasumori Takase, 'Introduction of the judicial sale case based on the mortgage before the Hakodate District Court, 1941', *Kinyu Houmu Jijo* 116 (2012).

36 Sections 842, 849, 704(2), 849 of the Commercial Code; Section 95 of the Act on Limitation of Liability of Shipowners; Section 19(1) of the Carriage of Goods by Sea Act.

37 Tokyo District Court, Decision 15 December 1992.

38 Takamatsu High Court, Decision 18 July 2008.

39 Mito District Court, Decision 20 March 2014.

a Applying only Japanese law as the forum law.[40] Maritime liens have priority over ship mortgages.

b Applying only the flag law.[41] The court applies Panamanian law, and admits the priority of ship mortgages over some maritime liens.

Since Japanese law might apply to the existence of maritime liens and the priority order between mortgages and maritime liens, Japan may not prove to be an attractive forum for arresting vessels for the mortgagee financiers.

Rolling stock

The mortgage on a railway foundation is enforceable by auction or compulsory administration, at the mortgagee's choice.[42] If the mortgagee selects auction proceedings, the railway foundation will be sold to a winning bidder as a single property. In 1934, the mortgage on the railway foundation owned by Musashino Railway Company was enforced by way of compulsory administration.[43] There have been no further reported cases of enforcement of railway mortgages since then.

Aircraft

Section 84 of the Civil Execution Act provides *mutatis mutandis* for application of the provisions for ship arrest proceedings to aircraft arrest proceedings. Therefore, aircraft arrest proceedings are very similar to ship arrest proceedings.

V CURRENT DEVELOPMENTS

In Japan, an amendment to the Commercial Code in relation to transportation law and maritime law has been discussed in the Legislative Council of the Ministry of Justice; the outline of the draft amendment was issued in February 2016. Although a change to the priority order between ship mortgages and maritime liens had been included in the tentative proposal in March 2015, this has been withdrawn in the outline. Therefore, the priority order will not change, and thus maritime liens will take priority over ship mortgages as is currently the case in the Code. The draft amendment was submitted to the Diet and will be enacted in 2017.

40 Takase, 'Introduction of the judicial sale case based on the mortgage before the Hakodate District Court', 120.

41 Hiroshima High Court, Decision 9 March 1987.

42 Section 40 of the Railway Mortgage Act.

43 Takatoshi Tamekuni and Yoshio Hanzawa, 'A Historical Study on Relationship between the Management of the Tobu Railways and the Area along its Railway Lines before the World War II', 16 *Study on Civil Engineering History* 547, 555.

Chapter 9

MALTA

Tonio Fenech and Christian Farrugia[1]

I INTRODUCTION

i The transport finance industry

Malta's strategic location at the centre of the Mediterranean Sea has always placed the international transportation industry as an area of particular focus for economic development, and the island has a long-standing tradition as a hub of maritime activity between Europe, North Africa and the Middle East.

The development of a strong maritime infrastructure started from the time of the Knights of Malta in the 16–18th centuries, and continued in the years of British dominance over the islands from the beginning of the 19th century. As a result, the maritime infrastructure in Malta is consolidated and diversified, with major transhipment, shipbuilding and ship-repair facilities, within famously safe natural harbours. Furthermore, the knowledge infrastructure available in the maritime field has developed over the centuries, and is widely respected in the artisanal, technical, professional and other fields.

The fact that Malta is a premier jurisdiction for asset finance is immediately evident when one considers the success of its ship and aircraft registers. After independence was gained in 1964, Malta considered it vital to have a voice in international maritime affairs that matched its strategic position, rather than its population size, and it soon became clear that this was best achieved by gaining the confidence of financiers to ensure that a large ship registry could be built. It is widely accepted that the main impetus behind the ship registry's continuing growth has been proactive legislative and regulatory action, starting with a comprehensive package introduced in the late 1980s. This started a trend, evidencing the priority given to the sector, which continues unabated.[2]

In the aviation field, Malta has sought to match its maritime success by carefully designing and implementing a legislative and infrastructural development policy over the past 15 years or so. This has led to the development of further aviation-driven infrastructure,

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2 As at the end of April 2016, the registered gross tonnage in the Malta ship registry was 68.46 million gross tons. With over 900 ships having a gross tonnage of over 12 million tons registered during 2015 alone, Malta is the leading ship registry in Europe and the sixth largest in the world.

successfully attracting major international investment in aircraft maintenance and related sectors.[3] The aviation register has also been successful,[4] particularly after Malta ratified the Cape Town Convention and related protocol in 2010.[5]

Most aircraft and ships registered or operating in Malta are financed through foreign credit providers rather than local banks or credit institutions. There is, however, a strong presence of service providers specialising in asset finance.

II LEGISLATIVE FRAMEWORK

i Domestic and international law and regulation

Shipping

A number of legislative instruments come into play in relation to the financing of vessels. The general rules on contract law, contained in Chapter 16 of the Laws of Malta (the Civil Code), may apply to various forms of finance documents, such as loan or leasing agreements, where Maltese law is the governing law. Moreover, the Civil Code contains relevant provisions on certain types of security often required by financiers, including pledges, irrevocable powers of attorney and security by title transfer. The Civil Code also contains specific provisions on ranking of creditors, causes of preference and inter-creditor agreements.

The laws relating to companies, specifically Chapter 386 of the Laws of Malta (the Companies Act), and subsidiary legislation enacted under the Chapter 234 of the Laws of Malta (the Merchant Shipping Act),[6] will also be relevant in some respects, in view of the fact that the entities that will be directly responsible towards financiers for repayment generally take the form of limited liability companies that own the vessels. The creation, maintenance, dissolution, winding-up and insolvency of such companies is regulated by the Companies Act, and the aforementioned subsidiary legislation.

The registration and operation of vessels, as well as the creation and registration of mortgages, privileges, hypothecs and liens over vessels, is governed by the Merchant Shipping Act, which widely adopts Anglo-Saxon notions in this regard. The Merchant Shipping Directorate at Transport Malta, commonly referred to as the Malta ship registry, is responsible for the registration of vessels under the Malta flag and the provision of all aspects of the ongoing administration of Malta-flagged vessels, including the registration of mortgages over vessels. Registration of a mortgage under the Merchant Shipping Act provides a high degree of security to financiers willing to fund the purchase of ships and yachts. The nature and effects of Maltese mortgages are further discussed in later sections of this chapter.

Chapter 12 of the Laws of Malta (the Code of Organisation and Civil Procedure) is also highly relevant in the ship-finance context, in that it lays down specific remedies available to creditors and the various methods of enforcement, including arrest of ships, judicial sales by

3 Lufthansa Technik established major facilities in Malta in 2003, followed by SR Techniks in 2010, among others.

4 As at the beginning of March 2017 , the Maltese Aviation Registry totals 241 aircraft (61 of which were registered in 2015 alone) and close to 30 Air Operator Certificate holders.

5 The Convention on International Interests in Mobile Equipment was adopted in Cape Town, South Africa on 16 November 2001, and came into force on 1 March 2006. Following ratification, the Convention entered into force in Malta on 1 February 2011.

6 Subsidiary Legislation 234.42 – Merchant Shipping (Shipping Organisations – Private Companies) Regulations.

auction and court-approved private sales. Jurisdiction of the Maltese courts and the claims in respect of which a creditor may proceed by means of an action *in rem* are also identified in the Code.

In addition to the above, domestic private international law rules – also found in the Code of Organisation and Civil Procedure, as well as Regulation (EU) No. 1215/2015, which recently substituted the Brussels I Regulation – are also directly applicable and may be relevant to creditors depending on the multitude of factors that determine applicable laws and jurisdiction in relation to any particular matter.

Aviation

The Civil Code, Companies Act and Code of Organisation and Civil Procedure, as well as private international law rules, are also relevant in connection with aircraft, any aircraft-financing arrangement insofar as they govern general contract law, certain forms of security, limited liability companies, arrest and other enforcement procedures, including choice of law and jurisdictional issues.

Aircraft registration and various forms of security, including mortgages and other security interests over aircraft, are governed by Chapter 503 of the Laws of Malta (the Aircraft Registration Act), which, in 2010, revamped Maltese laws relating to aviation, effectively consolidating the laws on registration and security over aircraft into a single legislative instrument. The Aircraft Registration Act also implements the Convention on International Interests in Mobile Equipment, 2001 (the Cape Town Convention) and its Protocol, ratified by Malta in 2010 and amended further in November 2016.

The Aircraft Registration Act formally recognises modern ownership structures such as fractional ownership and ownership through trust structures besides facilitating aircraft leasing, while working hand in hand with relevant amendments to the Civil Code to create a comprehensive security regime.

III FINANCIAL REGULATION

i Regulatory capital and liquidity

The principal legislative instrument regulating the banking industry in Malta is the Banking Act,[7] which is concerned with the licensing of banks, while further catering for their ongoing regulation and supervision. The Capital Requirements Directive of the European Union (Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms) and Regulation No. 575/2013 on prudential requirements for credit institutions and investment firms are implemented into Maltese law by way of the same Banking Act, which is supplemented by a set of 14 Banking Rules issued by the Malta Financial Services Authority (MFSA) for this purpose. The MFSA is the regulator of the banking industry in Malta and is responsible for the vast majority of financial-services activities undertaken in Malta.

As a general rule, the Banking Act stipulates that all credit institutions must have effective measures in place to assess and maintain internal capital levels necessary to cover the nature of risks to which they are or may be exposed. The Banking Rules issued by the MFSA serve to specifically regulate the bank capital adequacy regime applicable to credit

7 Chapter 371 of the Laws of Malta.

institutions and make reference to the capital requirements criteria that must be fulfilled by these institutions. These criteria are often represented by means of the capital requirements ratio, which expresses the credit institution's own funds as a proportion of risk-weighted assets and off-balance sheet items, as well as perceived risk-weighted assets in respect of operational and market risk. In accordance with Regulation No. 575/2013 as implemented by the Banking Rules here referred to, the minimum level of the capital requirements ratio is 8 per cent, subject to the power afforded to the MFSA to increase this minimum level as a licence condition. Without prejudice to the minimum level of capital requirements ratio, it is pertinent to mention that the Banking Act further provides that no organisation shall be granted a licence to act as a credit institution unless it has initial capital amounting to at least €5 million, or an equivalent amount in another currency.

In addition to the above, local credit institutions must also ensure that they adhere to two relatively new liquidity standards, introduced by Regulation No. 575/201 to safeguard against a situation where a bank or similar institution is facing a shortage of liquid funds. Local banks, in fact, must now also ensure compliance with:

a the Liquidity Coverage Ratio – essentially banks must hold an amount of high-quality liquid assets capable of covering a 30-day stress period; and

b the Net Stable Funding Ratio – banks must ensure that long-term loans are funded from equivalent to long-term financing sources.

The credit institutions' adherence to the above-mentioned ratios should ensure that in the event of another financial downturn banks will be better equipped to absorb certain losses.

Financial leasing activities are licensed under and regulated pursuant to the Financial Institutions Act,[8] although recent amendments thereto have made it clear that such activity involving ships or aircraft shall not require such a licence, where the lessor is owned and controlled or exclusively funded by persons or entities as described in Annex II of the MiFID II Directive.[9]

ii Supervisory regime

Banks and other credit institutions in Malta are regulated and overseen by the MFSA. The Central Bank of Malta must also supervise the conduct and activities of the local banks as it is responsible for ensuring the financial stability of the same.

IV SECURITY AND ENFORCEMENT

i Ships

The Merchant Shipping Act provides for three forms of security that may be created, by agreement or operation of law, over a vessel. A vessel may secure an obligation by means of (1) a mortgage; (2) a general hypothec over all debtor's assets, including the vessel; or (3) a special privilege arising in terms of law.

A crucial feature of the rules on ships as security for debts is that ships constitute a particular class of moveables whereby they form separate and distinct assets within the estate of their owners for the security of actions and claims to which the vessel is subject. In

8 Chapter 376 of the Laws of Malta.

9 Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014.

the event of bankruptcy of the owner of a ship, all actions and claims to which the ship may be subject shall have preference, on the said ship, over all other debts of the estate. In effect this would mean that if, for instance, a ship owner has a number of creditors, each having various forms of security over various assets, a creditor having a mortgage over the ship, would rank before all other creditors in respect of the ship, notwithstanding that the same creditor will rank after other creditors in respect of other assets.

Other than these three main forms, the Civil Code, Companies Act and other subsidiary legislation, provide the framework for other forms of security commonly required by banks or other entities financing the acquisition or operation of ships, including, *inter alia*, assignments of rights and other receivables, pledges of shares, suretyship, and irrevocable powers of attorney.

The most common, and certainly one of the strongest forms of security available to lenders under Maltese law, is the registered mortgage. A number of characteristics of the Maltese law mortgage make this form a security particularly attractive to lenders. Among these, the most salient are the following:

a a registered mortgage is not affected by bankruptcy of the mortgagor or shipowner and the mortgage shall therefore have preference on the said vessel, over all other debts, claims or interests of any other creditor of the bankrupt;

b a mortgage constitutes an executive title, meaning that the specific means of enforcement (such as warrants of arrest, seizure, etc.) are available to creditors, without the necessity of obtaining judicial confirmation of their claim by means of a judgment ordering payment; and

c the Merchant Shipping Act gives mortgagees extensive and easily enforceable rights in the event of a default of the debtor.

The procedure for registering a mortgage is straightforward. The mortgage is drawn up on the statutory form and delivered to the Ship Registrar, who will make the appropriate entry, indicating the exact time of registration, in the register kept for the purpose.

ii Aircraft

Legislation governing security over aircraft largely follows that applicable in respect of ships. The Aircraft Registration Act was in fact modelled on the basis of the Merchant Shipping Act. There are, however, certain differences, resulting mainly from the implementation of the Cape Town Convention and related Protocol on aircraft.[10]

As is the case with ships, the legal framework allows for various forms of security to be granted in favour of creditors, including, among others, mortgages, privileges, hypothecs, share pledges, assignment of rights, sureties and irrevocable powers of attorney. The two main forms of security over aircraft are the registered Maltese mortgage and the international interest under Cape Town Convention.

The registered mortgage over aircraft shares many of the features applicable to mortgages over ships. The aircraft is a separate asset within the estate of the owner, and is unaffected by bankruptcy of the owner. Furthermore it constitutes an executive title and affords the mortgagee various rights enabling expeditious enforcement.

10 The Cape Town Convention is implemented through Articles 45 et seq. of the Aircraft Registration Act.

The registration procedure is also similar to that for registration over vessels with the mortgage being recorded on a statutory form and delivered for registration in the National Aircraft Register.

iii Financing of contracts

Ships

A mortgage may also be registered over a vessel under construction. Banks and other institutions financing newbuildings, however, must be aware that Maltese law favours the shipbuilder by imposing a possessory lien in the shipbuilder's favour over the vessel. This entitles the shipbuilder to retain possession of the ship until all debts due to the shipbuilder have been paid. A debt secured by a mortgage will rank after the debt secured by the statutory lien in favour of the shipbuilder.

Aircraft

A possessory lien is also granted *ex lege* to aircraft manufacturers.

iv Enforcement

Ships

Creditors seeking to enforce their rights will generally institute court proceedings by sworn application. Once judgment is given in favour of the creditor, the latter may use any of the warrants available at law, including, *inter alia*, a warrant of arrest, seizure, or a garnishee order, to recover the relevant amount due from the assets of the judgment debtor. A creditor having a registered mortgage, however, will be in a significantly more advantageous position than other creditors having other forms of security against the debtor. This is because a registered mortgage gives the creditor extensive and easily enforceable rights to recover amounts due, including self-help remedies, namely the right to take possession of and sell the ship. Furthermore, a registered mortgagee may obtain an executive warrant of arrest of the vessel, and subsequent judicial sale by auction, without the necessity of first obtaining judicial confirmation of the claim, in view of the fact that the mortgage is considered an executive title. Where a mortgage is not for an amount that is set, liquid and due, the mortgagee can easily ensure executive title status by means of an affidavit specifying the sum due at the time of enforcement, served on the mortgagor. Another remedy available to the registered mortgagee, is the court-approved private sale, in terms of Article 358 et seq. of the Code of Organisation and Civil Procedure. The creditor will here, having identified a prospective buyer, seek court approval of the sale for a determined price, thereby avoiding the slightly more complex judicial sale-by-auction procedure.

The Merchant Shipping Act also contains provisions regarding ranking of creditors. A debt secured by a mortgage ranks in preference to all other claims other than the following specified privileged claims: tonnage dues; wages and expenses for assistance, recovery of salvage and for pilotage; wages of watchmen and related expenses; rent of warehouses; expenses for preservation of the ship; wages due to master, officers and members of the vessel's complement; damages due to seamen for death or personal injury; moneys due to creditors for labour, work, repairs prior to the departure of the ship on her most recent voyage; ship agency fees due for the ship after her most recent entry into port; and debts due to the ship repairer or shipbuilder for building or repairs. The registered mortgagee will rank prior to all other claims.

The significant advantages enjoyed by a registered mortgagee over other creditors was one of the factors that led to the introduction of the mortgage as a legal concept in Maltese law for ships and aircraft more than 40 years ago, in the early 1970s. The resultant asset finance regime has in turn been a major factor underlying the success of the Maltese ship registry. Judicial practice has followed in kind as the Maltese courts have generally distinguished themselves in generally dealing with claims involving vessels as a form of security rather expeditiously, recognising that delay in such matters is often highly prejudicial to the parties involved.

Aircraft

The holder of a registered mortgage over an aircraft is afforded self-help remedies under the Aircraft Registration Act that are similar to those available to a ship mortgagee. In addition, the Aircraft Registration Act lists two particular remedies that in the past were not clearly considered available to holders of mortgages over vessels: (1) the right to lease the aircraft to generate income; and (2) the right to receive any payment of the price, lease payments and any other income that may be generated from the management of the aircraft. There is also express mention of the fact that the said rights may be exercised without the requirement of seeking leave of the court,[11] as well as an additional right to obtain the support of the court should the mortgagee find any hindrance in the exercise of its self-help remedies. Further recent legislative amendment provides for application of funds received by a mortgagee after enforcement, as well as for circumstances where vesting of any mortgaged aircraft in the mortgagee (or controlled entity) in or towards the satisfaction of secured obligations, after due notice, is possible.

Mortgagees may also enforce their rights by obtaining an executive warrant of arrest, leading to a judicial sale by auction of the aircraft, or by seeking a court-approved private sale, the latter two procedures being regulated under the provisions of the Code of Organisation and Civil Procedure.

Furthermore, as Malta is a party to, and has fully implemented the Cape Town Convention and its Aircraft Protocol, creditors secured by an international interest registered with the International Registry, may exercise all the remedies available under the Convention in satisfaction of their claim.

As in the case of ships, the Aircraft Registration Act also provides for the ranking of creditors depending on the type of claim. A claim secured by a registered mortgagee or by a charge in the International Registry ranks before all other claims except claims for judicial costs incurred in the enforcement of an executive title, as well as the following privileged claims: sums due to the Director General in respect of the aircraft; crew wages; debts due to the holder of a possessory lien for the repair or preservation of the aircraft; expenses incurred for repair or preservation of the aircraft; wages and expenses for salvage; and debts secured by possessory liens.

11 The courts have confirmed that this is also the case in respect of holders of mortgages over ships, notwithstanding the lack of any express affirmation in the law – *Norddeutsche Landesbank Girozentrale v. Chemstar Shipping Limited*, Appell Civili Numru. 810/2011/1, 25 May 2012.

v Arrest and judicial sale

Ships

Ship arrests are governed by the Code of Organisation and Civil Procedure. The said Code lays down the procedure, conditions and rules relating to the issuing of a warrant of arrest of a sea vessel.

The Code distinguishes between a precautionary and an executive warrant of arrest. The former may be issued by any person, without the necessity of a prior judgment or other executive title, to secure a debt or a claim, whether *in personam* or *in rem*, that could be frustrated by the departure of the ship. The precautionary warrant is issued and carried into effect on the responsibility of the person at whose request the warrant is issued. The claimant may therefore be liable for payment of damages and penalties where a warrant is sued out maliciously. Once a precautionary warrant is issued, the applicant has 20 days within which to bring the action in respect of the right stated in the warrant.

An executive warrant of arrest, on the other hand, can be issued out where the claimant already has an executive title, such as a judgment in its favour, or a registered mortgage. On demand for issue of an executive warrant, the court may, in its discretion, order the sale of the vessel, or fix a time limit within which the debtor must pay the amount due. On expiry of the time limit, the court is bound to order the sale if the debtor has not yet paid.

It is very relevant, in this respect, to highlight the fact that registered mortgages under Maltese law are considered to be an executive title, as explained above. This is highly beneficial to creditors seeking to enforce a mortgage, as it enables them to sue out an executive warrant of arrest, leading to the judicial or private sale of the vessel, without first going through the whole process of obtaining a judgment confirming that the debt is due and ordering the debtor to pay. A creditor having a mortgage registered in its favour will only be required to serve the debtor with an intimation to effect payment by means of a judicial act, following which the creditor may proceed to obtain a warrant of arrest to proceed with the sale of the vessel in settlement of the debt. Naturally, creditors must not issue out a warrant without valid grounds for doing so, as nullity of the warrant will expose them to an action for damages by the debtor.

The procedure for obtaining an executive warrant of arrest provides for the filing an application to the court containing the demand for the warrant to be issued. Once the court has ordered the warrant to be carried into effect, the court executing officer may then proceed to exercise all such powers as are necessary to arrest the vessel. No opposition to the execution of any warrant is possible until the execution has been effected. The debtor is notified of the warrant and may bring an action for revocation of the warrant, if there is any reason valid at law for doing so.

It is possible, in certain cases, to arrest a sister ship under Maltese law. The Code of Organisation and Civil Procedure lists the claims *in rem* that may be brought against a vessel. It goes on to specify that in respect of a number of these claims, an action *in rem* may be brought against any vessel where the person who would be liable on the claim for an action in personam, is, at the time the action is brought, the owner or beneficial owner of the relevant vessel. Therefore, where there is a right to bring an action *in rem* against a sister ship, the creditor of the claim may obtain a warrant of arrest over that ship, as security or in execution of that right.

The procedure for judicial sale of ships is the ordinary procedure applicable to judicial sale of moveables in general. The judicial sale takes place by auction conducted by a public auctioneer. An appraisement may be demanded by the debtor or creditor. Should

an appraisement be made, no offer of less than 60 per cent of the appraised value may be accepted. A purchaser would be required to deposit the price in court within seven days of the date of final adjudication. Any creditor having a judgment in his or her favour or other executive title may bid *animo compensandi*, that is, in set-off of the debt owing to him or her. In such cases, the purchaser *animo compensandi* will not be required to deposit the price in court, unless the price exceeds the amount of the debt, in which case the purchaser would deposit only the surplus.

Aircraft

Aircraft arrests are also governed by the Code of Organisation and Civil Procedure. The same rules regarding precautionary and executive warrants apply in respect of aircraft. This list of possible claims *in rem* against aircraft, however, are more limited that those that may be brought against a vessel. Nevertheless, a claim in respect of a mortgage or international interest is included in the list.

It should, however, be noted that the situation regarding arrest of aircraft differs from that of arrest of ships in that it is only possible to institute proceedings *in rem* against the aircraft in connection with which the claim arose, and not against other aircraft of which the person who would be liable on a claim *in personam* is the owner or beneficial owner. The procedure for judicial sale of an aircraft is practically identical to the same procedure applicable in respect of vessels and moveables in general.

V CURRENT DEVELOPMENTS

i Recent cases

Two recent significant cases in the field of asset finance, are the following.

In the aviation context, a recent case wherein the court applied and interpreted the provisions regarding the precautionary warrant of arrest of aircraft is the *Medilink International Air Ambulance Limited* case.[12] The court here once again removed doubt as to the nature of alternative security that would allow for release of the relevant aircraft to be put up by a party against whom the warrant of arrest is issued. The party requesting the revocation of the warrant had claimed that the alleged debtor had sufficient assets in the form of shares in a Maltese company that were shown to have a certain market value that would clearly cover the original demand that had led to the arrest. The court refused to accept this as sufficient security, highlighting that the relevant alternative security must be firm, clear and capable of being realised by the judgment creditor. The court also confirmed that security in the form of a bank guarantee would also be acceptable.

The *MV Kay* case is of particular interest, as it arguably affords creditors additional remedy possibilities.[13] The plaintiff (creditor) had a first-ranking mortgage registered in St Vincent and the Grenadines, which the court considered equivalent to a mortgage under Maltese law as it satisfied the requisite conditions for recognition, and, therefore, also constituted an executive title. The plaintiff, therefore, arrested the vessel, and the

12 *Medilink International Air Ambulance Limited v. L-Arjuplan* 9H-MCM MSN-0028, decided by the First Hall, Civil Court on 5 October 2015, Reference No. 291/2015.

13 *Pacific Seaways Shipbuilding Inc. v. il-Bastiment mv Kay*, decided by the First Hall, Civil Court on 18 February 2016, Reference No. 35/2016.

court exercised its discretion to allow the plaintiff a short period to repay the debt. In the meantime, the plaintiff filed an application for court-approved private sale of the vessel, rather than following through with the procedure that would have resulted in judicial sale by auction. The unusual feature in this case, however, was that the creditor sought to have the court approve its own acquisition of the vessel by way of set-off for amounts it had claimed, rather than a private sale to a third-party buyer. The court considered that the law imposed no restriction on who can be the purchaser in a court-approved sale, and therefore upheld the claimant's request. This judgment therefore allows mortgagees to proceed with acquiring the relevant vessel themselves, without going through the entire (more complex and costly) procedure of bidding *animo compensandi* in a judicial sale by auction, thereby acquiring title to the vessel concerned free from all privileges and encumbrances.

The approach adopted in cases such as the above highlights a judicial attitude that consistently favours clear certainty in the field of ship and aircraft finance, ensuring that principles enunciated in recognising security interests in mobile assets are developed consistently and predictably. This is yet another aspect of the Maltese asset-finance panorama that will continue to underscore the island's progressive development as a centre of expertise and excellence in the asset-finance field.

ii Developments in policy and legislation

Act LII of 2016, which was enacted on 29 November 2016, amends various pieces of legislation, mainly in order to better provide for the financing of aircraft engines (including the specific extension of *in rem* jurisdiction thereon and the possibility of arrest thereof). The amendments also provide for simplified insolvency procedures for aircraft companies,[14] thus further alleviating the position of preferred creditors.[15] In both aviation and maritime law, the legal regime continues to develop mainly through court interpretation and application of existing rules and regulations.

iii Trends and outlook for the future

A notable trend that has subsisted over the years, in both the aviation and maritime sectors, is the tendency towards an approach that favours creditors. This can be seen in legislation protecting and strengthening the position of creditors, as well as the stance adopted by the courts in enforcing creditors' rights, as explained in previous sections of this chapter. Meanwhile, the ship and aircraft registries remain attractive to numerous ship and aircraft owners for various reasons, as evidenced by the statistics regarding registry growth provided in the introductory section.

In light of this, there is a positive outlook for both aviation and maritime industries, with further growth expected in both registries, and continued refinement of the legal regime governing vessel and aircraft financing, through legislative and court action.

14 Defined as companies whose centre of main interests is in Malta or is registered in Malta and the sole asset of which is an aircraft or aircraft engines and other related assets.

15 This term refers to the holders of a mortgage, an international interest or a security interest, or trustees or agents for such persons.

Chapter 10

PORTUGAL

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I INTRODUCTION

i The transport finance industry

Shipping

Portugal is historically a country of maritime adventurers, shipowners and shipbuilders. Portugal's geography, which includes the archipelagos of Madeira and the Azores and a long Atlantic coast, calls for port activity and places Portugal as an entry point for the transport of goods into Europe.

Notwithstanding this, the shipping industry in Portugal has been struggling in recent decades. Currently, the number of newly built ships is relatively low and shipyard activity is mainly focused on repairs and maintenance. In addition, a significant number of shipowners active in Portugal correspond to international carriers and not to nationally run companies.

In this context, Portugal is taking the opportunity to regain its importance as a player in the shipping sector through the International Shipping Register of Madeira (MAR). MAR is a second shipping register operating under the Portuguese flag, open to non-residents and allowing registration of both commercial vessels and yachts. MAR was created in the late 1980s within the International Business Centre of Madeira (IBCM), which consists of a set of incentives, mainly of a tax nature, approved by the European Commission and currently in its fourth version. MAR offers attractive conditions for shipowners and crew members, while ensuring high levels of security. MAR is proving to be very successful in attracting foreign investment and is now one of the largest shipping registers in Europe.[2] At the end of 2016, MAR had 491 vessels, which represents an increase of 92 vessels in relation to the previous year.

As a consequence of the above, and drawing on our experience, domestic financing for the construction and acquisition of vessels currently maintains a residual importance, while the relevance of Portugal as a flag-state is increasing. In fact, in recent years there have been several significant financings for the construction or transfer of ships, at an international level, connected with Portugal through MAR. The registration of vessels in MAR calls for the application of the Portuguese jurisdiction, mainly as concerns security packages.

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2 Refer to Decree-Law 96/89, of 28 March (DL 96/89), which enacts the legal framework of MAR, and to the information available on the official IBCM website: www.ibc-madeira.com/en/welcome.html.

Aviation

The main Portuguese airports are located in Lisbon, Porto, Faro, Funchal (Madeira) and Ponta Delgada (the Azores). During 2016, an overall increase of activity in all the main airports was verified. The force behind this increase is international air passenger transport, in which low-cost airlines – specifically easyJet and Ryanair – are playing a significant role. According to the information available for the last quarter of 2016, the most important airlines at the main airports are TAP, Ryanair and easyJet. In Ponta Delgada, the presence of SATA Air Açores and SATA Internacional is also very significant.[3] Monarch Airlines Ltd has appeared as an important new player, particularly in the airports of Faro and Funchal.

At the end of 2015, there were 1,211 aircraft registered in Portugal, which represents a decrease of seven aircraft in relation to 2014. The total number of aircraft includes 602 intended for private transportation and 67 for regular and non-regular transportation. There were also 26 companies licensed for air transportation and 15 for executive aviation.[4] In our experience, numerous aircraft are operated in our jurisdiction under lease or financial lease agreements.

Rail

The railway network in Portugal is currently managed by Infraestruturas de Portugal, SA, a public company that resulted from the merger of Rede Ferroviária Nacional – REFER, EPE (REFER) and EP – Estradas de Portugal, SA, enacted by means of Decree-Law 91/2015, of 29 May (DL 91/2015).

According to the REFER annual management report for 2014,[5] the relevant operators in Portugal were CP and Fertagus (for passengers) and CP Carga and Takargo (for cargo). CP was the main operator.

ii Recent changes

The main changes to the transport industry in Portugal over the past five years consist of political responses to the global financial crisis, implemented through legislative or regulatory measures. The government's Strategic Plans for Transportation for the terms of 2011–2015 and 2014–2020 were useful instruments for understanding the changes in the transport sector.

The measures put into practice over recent years provided for public investment in the port sector and railway sector, while simultaneously promoting the privatisations of both a national shipyard (Estaleiros de Viana) and the management body of the main Portuguese airports (ANA). Transportes Aéreos Portugueses, SA (TAP), the national airline, has also been partially privatised.[6]

3 Quarterly Statistics Report concerning 2016, available at www.anac.pt/vPT/Generico/PublicacoesINAC/BoletinsEstatisticosTrimestrais/Paginas/BoletinsEstatisticosTrimestrais.aspx.

4 Civil Aviation Annual Report for 2015, available at www.inac.pt/SiteCollectionDocuments/Publicacoes/anuarios/AAC_2015_V2.pdf.

5 Available at www.infraestruturasdeportugal.pt/sites/default/files/files/files/rc_rf_2014_pt.pdf (see page 31).

6 Concerning the privatisation of TAP, two significant issues arose. On the one hand, in 2015 a stake representing 61 per cent of TAP was sold to Atlantic Gateway SGPS, SA (Atlantic Gateway). Upon the change of Portuguese government following the elections of 4 October 2016, an agreement was reached between Atlantic Gateway and the Portuguese State, on 19 May 2016, for the partial repurchase of shares by the latter, in order to maintain control over 50 per cent of TAP. On the other hand, the Portuguese Civil Aviation Authority (ANAC), in a decision dated 19 February 2016, raised the issue of the non-conformity

Furthermore, the 2020 Operational Programme for the Sea (*Programa Operacional MAR 2020*) was approved by the European Commission on 30 November 2015. The programme has been implemented in different instruments approved throughout 2016. Among other things, the programme sets out measures to support investment in fishing ports[7] and energy efficiency in fishing vessels.[8]

On a different matter, in the judgment of the Court of Justice (First Chamber) of 11 September 2014 (Case C-277/13), Portugal was censured in connection with competition restrictions at Lisbon, Porto and Faro airports concerning ground-handling activity (baggage handling, ramp handling and freight and mail handling).

In spite of this, Parliament Resolution No. 78/2016, approved on 31 March 2016, provides some guidelines that show that the liberalisation process of the ground handling services in Portugal may be put on hold.

In summary, some of the main changes to the transport industry in Portugal over the past years concern the increase of private investment in traditionally publicly held companies and the international pressure to allow competition. Therefore, such changes are, to some degree, subject to political changes in Portugal.

Finally, it should be noted that in 2017 certain measures in transport-related industries – such as the Single Port Invoice[9] – have already come to light. Others – such as legislative efforts to accommodate road transportation of passengers by means of electronic platforms – are currently under discussion.[10]

II LEGISLATIVE FRAMEWORK

The financing of aviation, rail and shipping assets is not subject to specific regulations in Portugal. In general terms, the common legislation applicable to civil and commercial matters applies.

Notwithstanding this, there are certain specificities particular to the financing of transport assets when security interests are created. Mortgages are the most common guarantee granted in Portugal to secure the financing of transport assets and may be subject to specific rules, depending on the financed asset and its registration rules.

Finally, it should be noted that the legal framework applicable to transport matters in Portugal is highly fragmented. There are numerous outdated provisions and conventions, which sometimes overlap with European Union instruments or conflict with common practices. Even though this general note does not apply to MAR's specific regime nor does it currently deter transport finance in Portugal, this factor should be taken into consideration by operators in the Portuguese transport sector.

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of the corporate control and financing of Atlantic Gateway with Regulation (EC) No. 1008/2008 of the European Parliament and of the Council of 24 September 2008, which requires that Member States or nationals of Member States own more than 50 per cent of the undertaking and effectively control the aviation company. This issue has subsequently been overcome, as illustrated in a new decision from ANAC dated 23 December 2016. Refer to ANAC's press releases in this regard: www.anac.pt/vPT/Generico/Noticias/noticias2016/Paginas/ComunicadodeImprensa012016.aspx and www.anac.pt/vPT/Generico/Noticias/noticias2016/Paginas/ComunicadodeImprensa042016.aspx.

7 Refer to Order 57/2016 of 28 March, as amended.

8 Refer to Order 61/2016 of 30 March.

9 The Single Port Invoice was enacted by Decree-Law 6/2017 of 6 January and Order 14/2017 of 10 January.

10 Refer to Law Proposal 50/XIII.

i Domestic and international law and regulation

Commercial ships in Portugal are subject to a dual registration system (the administrative register and the commercial register), while recreational craft are subject to a single register.

Thus, mortgages over commercial ships in Portugal must be registered with the Commercial Registry Office, under the terms of Decree-Law No. 4264, of 14 November 1959. Mortgages over recreational craft must be registered with the captaincies, under the terms of Articles 19 and 77 of the General Regulation of Captaincies and Regulation of Recreational Navigation, established by Decree-Law No. 124/2004 of 25 May.

Also, pursuant to Article 589 of the Portuguese Commercial Code (the Commercial Code), mortgages over vessels may guarantee up to five years of interest, while the ordinary regime set out in Article 693 of the Portuguese Civil Code (the Civil Code) only allows for a maximum of three years.

Finally, DL 96/89 sets out some specific rules applicable to mortgages registered in MAR. In fact, and among other specificities, MAR's regime allows the parties to choose the law applicable to the mortgage. This option may be particularly interesting taking into consideration, for example, that a mortgage under Portuguese law may not allow for self-help remedies.

If the parties fail to choose the applicable law, Portuguese law will apply nevertheless. In that scenario, however, the right to release a mortgage set out by Article 721(b) of the Civil Code will not apply. Such a right would allow the acquirer of the mortgaged asset to cancel the mortgage by paying the mortgagee an amount equal to the price paid for the mortgaged asset. Pursuant to the MAR regime, release under those circumstances can only occur if the acquirer undertakes to pay the mortgagee for all rights under the mortgage agreement.

Concerning aviation, the registration of aircraft in Portugal must be submitted to the ANAC, further to Decree 20062, of 13 July 1931 (the Air Navigation Regulation). ANAC is also competent to register mortgages.

Finally, it should be noted that Portugal did not sign the Cape Town Convention on International Interests in Mobile Equipment.

ii Specific practices

Under Portuguese law, rights *in rem* usually are constituted or transferred by means of the applicable agreement. However, mortgages require registration and will only be deemed incorporated upon registration, which should be carefully provided for within a financing.

The possibility of choosing the law applicable to the mortgage registered in MAR should be carefully evaluated, taking potential discrepancies between applicable jurisdiction and applicable law specifically into consideration, as well as accounting for any enforcement issues that could arise.

Finally, and given the fragmented legal framework applicable to the Portuguese transport industry, it is advisable to liaise beforehand with the competent authorities for the registration of the financed asset concerning any aspect of the transaction that may give rise to registry or regulatory issues.

III FINANCIAL REGULATION

In Portugal, only credit institutions have permission to grant credit as a professional activity. The legal definition of a credit institution is provided by Decree-Law No. 298/92, of 31 December (DL 298/92). DL 298/92 enacts the General Credit Institution and Finance

Companies Regime, which regulates the activities of banks and other financial institutions. According to DL 298/92, credit institutions are defined as entities whose activity consists of receiving deposits from the public – or other kinds of repayable funds – and granting credit on their own account. Only entities expressly recognised as credit institutions are authorised to carry out financing activities. Obviously, banks, as the main credit institutions, assume a central role in the field of financing activities.

Portugal is part of the single supervisory mechanism, with the banking system supervised by the Bank of Portugal in partnership with the European Central Bank. Created to ensure the safety and soundness of the European banking system, the single supervisory mechanism comprises the European Central Bank and the competent national authorities of each Member State of the euro area (of which the Bank of Portugal is part). The European Central Bank directly supervises the main credit institutions, while the Bank of Portugal is responsible for the supervision of the remaining institutions. Notwithstanding this, the European Central Bank has the power to replace the Bank of Portugal at any time and directly supervise the other institutions.

i Regulatory capital and liquidity

The need to ensure the safety and soundness of the national (and European) banking system after the 2007 international financial crisis, and the adoption of the Basel III Agreements – which were implemented in the European Union through Directive No. 2013/36/EU and Regulation No. 575/2013 – resulted in the implementation of a set of important measures intended to ensure the solvency and liquidity of banks and to reinforce the powers of the supervisory authorities.

Consequently, among other aspects, Portuguese banks are now obliged to ensure that their own funds are never below the minimum amount of share capital legally required. Additionally, current Portuguese legislation compels banks to have a minimum share capital of €17.5 million.

ii Supervisory regime

The supervisory system for Portuguese banks is based on two fundamental components: prudential supervision and 'supervision of conduct'.

Prudential supervision has the main objective of ensuring credit institutions' financial stability and the security of the funds that are entrusted to them. Therefore, supervisory institutions have power to authorise the incorporation of credit institutions, monitor their activity, enforce compliance with the applicable regulations, issue rules and recommendations, sanction potential infractions and take extraordinary measures to correct irregularities.

On the other hand, supervision of conduct compels credit institutions to respect certain standards of conduct in their relations with clients. This second component of this supervisory regime entitles supervisory institutions to establish rules to assure the transparency of the information provided by credit institutions to their clients, as well as the fairness of products and financial services transactions – either between credit institutions or between credit institutions and their clients – in addition to regulatory and supervisory powers. The legal framework also grants clients the right to file complaints with the Bank of Portugal.

Finally, it is important to stress the existence of a central credit register. The central credit register is a central database, managed by the Bank of Portugal, that contains detailed

information regarding the loans granted by credit institutions to their clients.[11] All credit institutions are obliged to communicate this information, so that the Bank of Portugal, on a monthly basis, may determine the amount of credit granted to each client. Through this mechanism, credit institutions are able to evaluate the risks of granting credit to a specific client with a higher degree of accuracy.

IV SECURITY AND ENFORCEMENT

Portuguese law provides a specific framework on security interests over vessels:

a Article 578 of the Commercial Code sets out a list of 15 credits that enjoy a priority-ranking privilege; and

b Article 25 of Decree-Law 201/98, of 10 July (DL 201/98) and Article 14 of Decree-Law 203/98, of 10 July establish that the vessel's constructor and the maritime rescuer are granted the right to retain the vessel as security for the payment of the credits arising from its construction and the maritime salvage.

The mortgagee is granted a priority-ranking privilege, which prevails (even in the event of the mortgagor's insolvency) over (1) the priority-ranking privileges provided for by the Civil Code and any other statutes (Article 574 of the Commercial Code); and (2) rights of retention subsequently constituted (Article 750 of the Civil Code). Court expenses and monetary consideration for the maritime salvage are ranked as having priority over the mortgagee's credits (Article 578(1)(2) of the Commercial Code).

Portuguese law does not grant specific priority-ranking privileges to entities that finance the acquisition of aviation or rail assets. As such, the lender's position – if a security interest is constituted over the aircraft or the rolling stock – results from the general framework set out in the Civil Code.

In fact, Portuguese law only provides the Portuguese state, the Autonomous Region of the Azores and the airports managing body with a priority-ranking privilege over the aircraft as security for the payment of (1) fees due for the operation of airline companies in Portuguese airports; and (2) administrative fines imposed for infringement of the framework governing non-scheduled transport services (Article 46 of Decree-Law 254/2012, of 28 November, Article 30 of Regional Legislative Decree 35/2002/A, of 21 November, and Article 38 of Decree-Law 19/82, of 28 January).

According to general rules, the mortgagee's credits shall be ranked as having priority over (1) the credits secured by a priority-ranking privilege that has been subsequently constituted; and (2) the credits held by entities that enjoy a right to retain the aircraft (Articles 686, 750 and 758 of the Civil Code).

Finally, note that Portugal is not a party to any convention regarding securities over aviation, rail and shipping assets (such as the Convention for the Unification of Certain Rules relating to Maritime Liens and Mortgages, adopted in Brussels on 10 April 1926, and the Convention relating to Maritime Liens and Mortgages, adopted in Geneva on 6 May 1993).

11 Only balances for liabilities with a value of at least €50 need to be communicated.

i Financing of contracts

Financing of new assets usually follows a traditional pattern of asset finance: credit against a security interest over the asset.

Aircraft are usually acquired under a financial lease agreement. Generally, the parties enter into a sale and leaseback arrangement: the airline operator negotiates the construction and acquisition of the asset, purchases it and oversees the import procedure; then, registers the aircraft and sells it to the financial lessor. Subsequently, the operator is granted the use of the asset under a financial lease agreement (the term of which may not exceed 30 years). In many cases, the financing is granted by several financial lessors (acting as a consortium), as a means to mitigate the economic risk of the transaction.[12]

ii Enforcement

A secured creditor may enforce security by means of an enforcement procedure filed against the debtor (principal action or interim measure). The merits may be decided in accordance with the laws of another jurisdiction if private international law leads to the exclusion of Portuguese law (e.g., in the event that the parties have validly chosen the law of another jurisdiction to govern the financing or the security relationship).

It is generally stated that the mortgagee may take possession over the secured asset without filing a claim if the parties have entered into an agreement whereby the mortgagee undertakes – after the breach of the contract – (1) to request an updated valuation of the asset (in accordance with a procedure defined by the parties); and (2) to repay the amount corresponding to the difference between the asset's value and the amount of the debt. In fact, it is said that the rules prohibiting self-enforcement only apply if the procedure is not agreed with the mortgagor and may not be controlled by this entity (otherwise, their rights are not jeopardised).

iii Arrest and judicial sale

Shipping

The arrest of a vessel is governed by the Convention for the Unification of Certain Rules relating to the Arrest of Sea-going Ships, adopted in Brussels on 10 May 1952 (the Brussels Convention), whenever:

a the claimant holds a maritime claim pursuant to Article 1 of the Brussels Convention (namely a credit secured by a mortgage); and

b the vessel is present in Portugal and flying the flag of a contracting state.[13]

The nationality or the address of the owner of the vessel or its domicile is, thus, irrelevant.

The Brussels Convention can only be applied when at least one of two elements (the flag of the vessel or the domicile of the applicant for the arrest) does not have a connection with the Portuguese jurisdiction (Article 8(4)).

12 See Conceiçao Soares Fatela, 'A Locação Financeira de Aeronaves', *Cadernos de Direito Privado*, No. 49, January/March 2015.

13 The protective order may be as well accepted if the vessel flies the flag of a non-contracting state: in this case, the vessel may be arrested to secure a maritime claim pursuant to Article 1 of the Brussels Convention, or any other claim that legitimates the arrest according to the *lex fori* (Article 8(2)(3) of the Brussels Convention).

The Brussels Convention regulates: (1) the arrest of the ship to which the credit refers (offending ship), when the debtor is the owner or the charterer or whenever a third party is debtor of a maritime credit related to that ship; and (2) the arrest of another ship (sister ship) belonging to the person who, on the date of the constitution of the credit, is the owner or the charterer of the ship to which the credit refers, or debtor of a maritime credit, unless the injunction seeks coercive compliance regarding the credits indicated in Article 1(1)(o)(p) or (q) of the Brussels Convention.

For a vessel to be arrested under this international instrument, a mere claim of the right of maritime credit suffices; it is not necessary for the claimant to present evidence for the procedure, nor to allege and prove the risk of the loss of the guarantee represented by the asset (*periculum in mora*) (Articles 3 and 5 of the Brussels Convention).

If the case does not fall within the scope of the Brussels Convention, the Portuguese Civil Procedural Code (CPC) will be applicable. In this circumstance:

a the claimant must allege and present evidence of the relevant facts, including the credit entitlement and the grounds for granting the interim measure (*fumus boni iuris*), the risk of losing the security and the admissibility of attaching the vessel (Articles 365(1), 368(1), 391(1), 392(1) and 394 of the CPC);

b if the legal requirements are met, the arrest is declared by the court without hearing the defendant (Article 393(1) of the CPC); and

c the vessel may be arrested even if it is undertaking a journey (Article 9(1) of DL 201/98).

The Brussels Convention and the CPC set out similar provisions:

a the claimant may request the arrest even if it does not enjoy any security interest (mortgage) over the vessel;

b other ships owned by the debtor may be arrested, even if they have not been given as security; and

c the claimant may be liable for all damages arising out of the arrest in the event that the measure is deemed unjustified (this liability shall be governed by the Portuguese internal rules).

The judicial sale of ships takes place in the principal action (which has to be filed prior to or after requesting the arrest), and is carried out – after the asset having been seized – by an enforcement agent, in accordance with the rules set out in the CPC. The vessel may continue to operate until the sale (Articles 769 and 770 of the CPC). If the debtor is insolvent, the sale of the asset is governed by the Insolvency Code.

Aviation

Article 21 of Decree-Law 149/95, of 24 June, entitles the financial lessor to make a request to the court for the immediate apprehension and restitution of the leased asset in the event of termination of the financial lease agreement (due, among other grounds, to an event of default attributable to the financial lessee).

The granting of the interim measure depends on:

a the termination of the agreement having been declared by the financial lessor, by serving a written notice to the counterparty;

b the registration of the agreement having been cancelled; and

c the court considering proved – *prima facie* – the defaulting event, the non-delivery of the asset and the termination of the agreement.

Once the apprehension is ordered, the financial lessor is entitled to grant a third party the use of the asset, namely by entering into a sale and purchase, lease or financial lease agreement.

If the aircraft is owned by the airline company, an enforcement procedure has to be filed to collect the debt (through judicial sale).

V CURRENT DEVELOPMENTS

i Developments in policy and legislation

The main development in transport finance over the past several years was enacted by Decree-Law 8/2009, of 7 January, which amended the Commercial Code to include the credits guaranteed by mortgages or pledges over the vessel in the third position of the ranking of privileges over the vessel.

This measure was followed, in 2011, by Portugal's withdrawal from the Convention for the Unification of Certain Rules relating to Maritime Liens and Mortgages, adopted in Brussels on 10 April 1926.

In fact, up until those legislative measures were introduced, mortgages would be ranked in a less favourable way (from the credit institutions' perspective), which was presumably preventing registrations in Portugal (and in MAR). These changes were a turning point for creditors, which to some extent contributed to the growth of MAR.

ii Trends and outlook for the future

Portugal is regaining its importance in the shipping sector, and specifically in the asset finance industry through MAR. In fact, the second registry in Portugal has undergone a steady and sustainable increase over the past years and is drawing the attention of shipowners and finance parties alike. Currently,[14] MAR has 491 vessels (40 commercial yachts, 73 recreational craft and 378 commercial vessels), with a gross tonnage of 12,076,294. At the end of the previous year of 2015, a total of 399 vessels were registered, with a gross tonnage of 7,925,042. The average age of the ships dropped from 11.9 years in 2015 to 11.8 in 2016. In our experience, lenders from jurisdictions as varied as Spain and Japan are relying on Madeiran mortgages to secure financing.

The growth of MAR calls for a timely response by related public entities, specifically concerning the certification of crew members. Therefore, modernisation and legislative changes are being requested from the Portuguese government in this regard.

While MAR is in development, the ordinary shipping register and the overall shipping sector in Portugal still require extensive updates. For example, on 30 April 2009, the Council of Ministers approved a proposal for a commercial navigation law that never came to fruition. Furthermore, a proposal for a new aeronautical navigation regulation was under public discussion up until 31 January 2009, and subsequently was never approved.

On 3 March 2016, the Portuguese Council of Ministers decided on several matters concerning the Portuguese strategy for the sea. Further to such meeting, Resolution of the Council of Ministers No. 11/2016 created a working group under the Ministry of Sea, which shall propose a course of action to promote sea transportation and the development of national commercial vessels, namely by means of amending the current vessel registration system. The proposals of this group are not yet public.

14 Official newsletter 2017-01 of CINM, encompassing data concerning 2016.

A broad, planned reform of the legal framework applicable to the maritime and transport sector in Portugal is long overdue. In this scenario, the refocusing of legislative efforts in the transport sector is very welcome.

Chapter 11

RUSSIA

Alexander Mednikov[1]

I INTRODUCTION

i The transport finance industry

The financial sector is an important part of Russia's economy and includes national and international players (through Russian subsidiaries). The biggest banks, such as Sberbank and VTB, have the Russian state as their principal shareholder, but there are also a substantial number of purely privately owned institutions, such as Alfa-Bank, Otkrytiye and others. In addition to the banks, other types of institutions, including finance leasing companies and financial companies, are entitled to lend money under various arrangements. Following the Ukrainian crisis, substantive Western sanctions have been applied against the Russian financial sector, and a number of institutions have been directly affected.

As far as the transport finance industry in particular is concerned, a number of principal points should be noted. First, the current federal legislation allows almost unrestricted access to the international financial market for Russian lenders – in other words, any Russian commercial enterprise is permitted to borrow abroad in foreign currency. Second (and particularly important for shipping and aviation asset financing, and less so for rail assets), in many cases, lenders prefer to have the financed assets registered outside of Russia, because of the belief that this provides them with a more transparent and flexible means of enforcement of security measures. Indeed, in the 1990s, when the market reforms had just begun, Russian legislation did not provide the borrowers with sufficient protection in this respect; however, things have changed quite substantially since then. Third, the current terms of financing offered by Russian lenders are, in many cases, less attractive than those that are available on the international markets. Because of this, Russian borrowers acquire from foreign lenders in a large number of transport finance transactions. This is particularly true for the ship finance sector, but less so for aviation and rail asset financing, where Russian lenders have a bigger share of the market.

ii Recent changes

Over the past few years, Russia's legislation regulating many aspects of asset financing, in particular legislation on pledge and mortgage, has been considerably modernised in many respects. This is not directly connected with the Ukranian crisis, but rather with the Russian government's goal of increasing Moscow's attractiveness as a financial centre of international

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importance. In particular, it is now possible to enforce a Russian law mortgage without a corresponding court judgment, as well as enter into mortgage management agreements between mortgagees, pledge rights over a bank account, etc.

II LEGISLATIVE FRAMEWORK

The list of legislative acts that apply to transport finance is quite substantial and includes the Civil Code of Russia, the Merchant Shipping Code, the Air Code, and Federal laws 'on banks and banking activities', 'on hypothecation (mortgage)', 'on financial lease' and 'on registration of rights to aircraft and transactions with them'. Various aspects of (or relating to) financial transactions are also regulated by sub-legislative acts issued by various federal bodies of the executive branch (e.g., the Government of the Russian Federation and the Ministry of Transport) and by the financial regulator (the Central Bank).

i Domestic and international law and regulation

In accordance with the Constitution of the Russian Federation, generally accepted principles and provisions of international law and international agreements to which Russia is a party form an integral part of Russia's legal system. If there is conflict between provisions of national legislation and of an international agreement to which Russia is a party, provisions of the latter shall have priority. At the same time, the Civil Code of Russia recognises the right of the parties to choose law applicable to their contracts. Only in relatively few cases does the law explicitly state that certain contracts shall be governed by the Russian law – usually when the contract or its object is closely related to Russia. In cases when Russian law is not mandatorily applicable and the parties have chosen to apply foreign law, but the contract is closely related to Russia and not to any other country, applicability of foreign law chosen by the parties will be recognised by Russian courts, unless this would come into the conflict with imperative provisions of Russian law. In such cases, such imperative provisions will apply in spite of the choice of foreign law.

ii Specific practices

In most transport financing transactions, the parties will be relatively free to choose the law applicable to their contractual relations – this applies to the principal contract and to the associated contracts and instruments, in particular to the security instruments. In the majority of cases, choice of law will be determined by the lender: if the lender is a Russian institution, it will be most likely to insist on Russian law to govern the relations in question; if the lender is a foreign or international institution, the applicable law will most probably be the law of domicile of the lender or the law of the third country, which is 'neutral' to both parties, most often English law.

However, in most instances of transactions where the principal loan or credit agreement is governed by foreign law, provisions of Russian law will inevitably come into play in more than one instance. Most obviously, this will be the case when collateral is located in or registered in Russia. It should be noted that ships and aircraft are treated by Russian law as immoveable property, and Russian law shall apply to the contracts in respect of immoveable property that is registered in Russia. Russian law will also regulate the procedure of enforcement of the mortgage or other measures against collateral that is physically located on the Russian territory at the time of enforcement, even if it is registered abroad. It is also

necessary for foreign lenders to understand the impact of provisions of Russian law on such issues as insolvency, currency control, taxation of interest, enforcement of claims, customs issues, compliance requirements relating to the relevant transport operations, etc.

III FINANCIAL REGULATION

As outlined above, Russian financial legislation is fairly liberal with regard to providing Russian borrowers with access to foreign or international financial markets. Therefore, Russian financial regulations apply to Russian lenders (including the subsidiary banks of foreign financial institutions) irrespective of the nationality of the borrowers, but when foreign lenders provide loans to Russian borrowers, provided they do so directly (i.e., cross-border loans), they are subject to their national financial regulations.

i Regulatory capital and liquidity

As a member of the Basel Committee on Banking Supervision, Russia undertook to implement Basel III standards in accordance with the schedule adopted by the Committee; in other words, until 2018 inclusive.

ii Supervisory regime

In Russia, banking activities are subject to licensing, with licences being granted by the Central Bank of Russia. Banking institutions licensed in Russia are subject to supervision and control from the Central Bank of Russia, which in the recent past has also taken over supervisory functions in respect of other financial institutions – particularly exchanges and entities involved in the securities market.

IV SECURITY AND ENFORCEMENT

i Financing of contracts

There are two widespread mechanisms of financing new-build means of transport in Russia: through bank loans or through finance leasing.

In the first case, upon reaching the agreement and signing the appropriate instruments, the bank advances the amount of the loan either to the borrower directly or to the seller or builder of the respective means of transport as payment of the purchase price. Normally, the bank would fund only part of the purchase price with the remainder, on average 20–40 per cent, being pre-financed by the borrower itself. In most cases, the repayment of the loan and interest is secured by the mortgage or pledge of the respective means of transport, with loss and damage insurance placed in favour of the lender (jointly with the borrower), and with special arrangements in respect of the cash flow attributed to the item, channelled through a special account in the lender bank. In most cases, mortgage of the means of transport must be registered in the same registry where the title thereto is already registered; for ships, it is also possible to register them (and mortgages over them) in the registry of vessels under construction. The borrower becomes the owner of the respective item and starts to repay the loan.

In the second case, it is normally the finance leasing company that becomes the owner of the ship, aircraft or rolling stock. Its purchase price is paid over time by the lessor (normally the item's long-term lessee or operator). When the lease payments are completed, the title to the item of lease passes to the lessee.

ii Enforcement

Russian legislation with regard to pledge enforcement has undergone substantial change over the past few years. Principal new trends have been the increase of protection of mortgagees' rights and simplification of enforcement. Initially, enforcement of mortgages was only possible on the basis of a court judgment. However, it has recently become possible to enforce a mortgage out of court – by public sale, by private sale or by appropriation of the object of mortgage by the lender. The legislation is yet to be tested by practice, but the availability of this option shows substantial progress.

Rights of the mortgagees are highly ranked: for example, in bankruptcy, the registered mortgagee, although obliged to surrender mortgaged property to the receivers, is also entitled to receive up to 70 per cent of the proceeds of the sale (80 per cent if the creditor is a bank that lent money for the purchase or construction of the respective property). Claims from the side of the mortgagees of the ship are outweighed only by the claims secured by the maritime liens, by the shipbuilder's lien and claims for costs of wreck removal.

iii Arrest and judicial sale

Russia is a party to the 1952 International Convention Relating to the Arrest of Sea-Going Ships and to the 2001 Cape Town Convention on International Interests in Mobile Equipment. Specific provisions concerning ship arrest on the basis of maritime claims are also contained in the Merchant Shipping Code of Russia (with the wording of respective provisions being based on the 1999 International Convention on the Arrest of Ships rather than the 1952 International Convention for the Unification of Certain Rules Relating to the Arrest Of Seagoing Ships). Arrest of a ship or aircraft (or of any other property of the debtor or defendant) can also be applied for as a security measure or as a preliminary security measure within the frames of judicial procedure. In such case it will be governed by the Code of Civil Procedure and Code of Arbitration Procedure (the latter regulates procedures in Russia's commercial courts, which are traditionally known as 'arbitration courts').

The primary purpose and focus of arrest on the basis of a maritime claim is to obtain security – sale *pendente lite* is not possible under Russian law. Ship arrest may be imposed by the ruling of a competent court or, in some cases of arbitration, on the basis of an application of a creditor. The court must consider such application within the next day, and if the arrest is granted the vessel will be forbidden to leave port or its other location by the bailiffs or the harbour master. The applicant should be prepared to provide guarantee against damages caused by wrongful arrest on its own initiative or upon the order of the court. The vessel may be released from arrest only if the owner or debtor provides a guarantee in a suitable format. Normally, the vessel may be arrested if it is owned or bareboat-chartered by the debtor under a maritime claim. A sister ship (a vessel owned by the debtor but not connected with the claim) may also be arrested. However, the 1952 Convention also provides for the possibility to arrest the vessel when the party responsible under the claim was merely the time-charterer of the ship.

OW Bunker

The recent collapse of OW Bunker, a major ship fuel supplier, raised a wave of claims and threats to arrest ships from the unpaid physical suppliers of fuel against the shipowners in many countries, including Russia. In some instances, shipowners that took delivery of the fuel have been time-charterers rather than owners or bareboat-charterers of the vessels in question, so the possibility of invoking the relevant provisions of the 1952 Convention was widely considered.

Procedure for judicial sales of ships or aircraft

Ships or aircraft may be sold on the basis of the court judgment ordering such sale. On the basis of the judgment, the court will issue an execution order, pursuant to which the bailiffs shall impose an executional arrest and appoint a specialised organisation to make the arrangements for the sale. Notification of the sale shall be published and the court will also send notices of the intended sale to the registered owners and mortgagees. As a rule, the sale will be effected by way of public auction. If the sale is not successful, the creditor that initiated the sale may be entitled to take the title to the vessel, in which case 10 per cent will be deducted from the initial sale price of the vessel (25 per cent if sales repeatedly fail) and this will be set-off against claims to the owner. Proceeds of the sale shall first be used to cover the costs of the sale and related procedures, then the interest accrued and then the principal amount of the debt

All procedural issues related to enforcement shall be governed by Russian law.

V CURRENT DEVELOPMENTS

i Developments in policy and legislation

Russian civil legislation, particularly legislation on mortgage and pledge, as well as on loans and credit, is expected to develop further, which could lead to Russia becoming a more attractive jurisdiction for lenders. Russia's banking regulations are intended to gradually simplify foreign investors' access to the country's financial sector. However, the sanctions imposed against Russia in connection with the crisis in Ukraine are unlikely to be removed very soon, and this obviously has a negative impact on the economy's growth.

Chapter 12

SPAIN

Tomás Fernández-Quirós and Carlos López-Quiroga[1]

I INTRODUCTION

i The transport finance industry

It is important to consider that the climate for transport asset financing in Spain does not significantly diverge from that of the general financing context. The legacy of the crisis has been excessive indebtedness, scarce credit, numerous restructurings, exceptionally strict conditions on the lending side and substantial concern and focus on insolvency legislation, among other repercussions. Today, the Spanish economy seems to be recovering, showing an increased appetite from investors, increased competition, debtors seeking to refinance, the return of corporate financing and a need to offer more tailor-made solutions to each borrower.

In this context, market standard clauses on loan transactions are being revisited: mandatory prepayments, undertakings, ratios, majorities and waivers, assignment clauses, a review of the role of agency, intercreditor agreements, etc. Also of note is the increasing regulatory pressure (Basel III, etc.) and the concentration of the domestic financial sector (including the restructuring of the savings banks sector).

Shipping

Spain's ship finance industry is largely driven by shipbuilding, a sector that has been considerably affected by the global credit crunch, resulting in fewer and more complex transactions. We have seen Spanish banks financing (traditionally foreign) shipowners building in Spanish yards, and increasingly resorting to export credit tools.

Spanish banks' traditional approach to ship finance is based on a combination of project and corporate finance. Lenders typically seek out a stable long-term charter to back the financing, but invariably scrutinise the shipowner's balance sheet.

Another angle has been the granting of pre-delivery financing to Spanish yards to assist them in completing the construction of vessels, or in the issuance of refund guarantees, sometimes simply against the issuance by the shipowner's bank of a guarantee for the payment of shipbuilding milestones.

In view of this scenario, we cannot disregard the fact that the Spanish ship finance market is (and has been) shaped by the Spanish tax lease framework. The EU challenge

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negatively impacted domestic ship finance between 2011 and early 2015. The recuperation of the Spanish economy and approval at both domestic and EU levels of a new tax lease framework are currently revitalising the market.

Aviation

According to recent official statistics from Aena, SA (the Spanish airports manager), the aviation industry recovered in 2016, with over 22.8 million more passengers travelling compared with the preceding year. The economic crisis combined with the development of the high-speed train line for passengers between Madrid and Barcelona (one of the most profitable air links in the world) had caused the sector to suffer one of its worst periods in years. Nevertheless, long-haul routes are currently growing more quickly in terms of passenger numbers and seats offered. Vueling, Ryanair, easyJet, Air Europa and Iberia lead the Spanish market. Within International Consolidated Airlines Group, Iberia (the former Spanish flag carrier) has undertaken an important readjustment in its lines and the airports it operates.

Turning to financing tools, as in the international market, the domestic market is driven by tax financial structures, particularly operating leases. Banco Santander, CaixaBank, Banco Sabadell and Banco Popular are the usual actors financing those transactions.

Rail

Spain is undertaking a comprehensive modernisation of the railway system, including the construction of a new high-speed network. Having been frozen during the worst years of the crisis, infrastructure works seem to be reactivated. The new regulatory framework and attempts to liberalise the passenger transport sector have bolstered the train finance market since 2013. Although the passenger market continues to be largely controlled by Renfe Operadora, several operators have attempted to enter the market, such as Acciona, Comsa, Alsa, Ferrovial and Continental. Although the international passengers transport was opened to the market in 2010, the national transport is still under Renfe's monopoly.

Significantly for the finance market, Renfe was divided into four companies, one being Renfe Alquiler de Material Ferroviario, in an attempt to emulate the United Kingdom's rolling stock operating companies (ROSCOs).

Given the limited domestic economic activity during the crisis, the trend by Spanish manufacturers (notably CAF and Talgo) has been to export rolling stock abroad with export finance support. The lack of funds from regional authorities has either halted or significantly slowed investments in light rail and subways, one of the drivers for many years. In that respect, there have been several more complex operating lease structures with Metro de Madrid for providing subway units in which finance leases are also used.

ii Recent changes

Shipping

Spain's ship finance industry will unquestionably benefit from the approval of the new tax lease framework based on the European Commission's decision of 20 November 2012. The entry into force of the Spanish Maritime Navigation Act 24/2014 reforms the Spanish Maritime Act, which was previously codified in the Commercial Code of 1885 and the Ship Mortgage Act of 1893.

Aviation

Two significant recent events are notable in the aviation sector. The first was the attempt to privatise Aena, SA, which was subsequently delayed. The second is Spain's ratification of the Cape Town Convention and its Aircraft Protocol, entered into force on 1 March 2016, which will attract investment to a sector suffering from lower prices and increased operating taxes.

Rail

The entry into force of the Spanish Rail Sector Act 38/2015 unified the Spanish Railway Act. In particular, it transposed Directive 2012/34/EU of the European Parliament and of the Council of 21 November 2012 establishing a single European railway area. On 14 December 2016, the last pillar of the Fourth Railway Package, which is introduced by Regulation 2016/2338 and Directive 2016/2370, was published. These proposals intend to open the market for domestic passenger transport services by rail in 2019, and to implement competitive tendering procedures, as general rule, to award public service contracts from 2023.

II LEGISLATIVE FRAMEWORK

i Domestic and international law and regulation

There are several notable provisions to take into account when financing the construction or acquisition of transport equipment. First, in the absence of an agreement or a specific act, the manufacture of transport equipment is regulated by the Spanish Civil Code, while the acquisition of transport equipment is regulated by the Commercial Code and, subsidiarily, by Spain's Civil Code.

Apart from this general rule, the following provisions specifically regulating each type of transport equipment should be considered when financing such equipment.

Shipping

The Maritime Navigation Act regulates the main aspects of shipbuilding contracts and sale and purchase agreements. Although the provisions are not mandatory, the shipbuilder cannot be exonerated from liability in the event of wilful misconduct or gross negligence.

Spain has a dual registration system for ships, vessels and naval artefacts. The Registry of Ships and Shipping Companies is the administrative registry for registering vessels that fly the Spanish flag. Vessels flying the Spanish flag are bound by Spanish tax, employment, documentation and safety regulations.

The Chattel Registry is a private registry that contains information in its ships section regarding the ownership and encumbrance of ships, vessels and naval artefacts to provide legal certainty in related matters. Third parties have standing to challenge information registered in the Chattel Registry.

All ships, vessels and naval artefacts, including those under construction, may be subject to a ship mortgage pursuant to the provisions of the Maritime Navigation Act and the International Convention on Maritime Liens and Mortgages signed in Geneva on 6 May 1993. The ship mortgage must be registered with the Chattel Registry to be valid and enforceable.

Aviation

Spain has not passed any law specifically regulating the construction, acquisition or financing of aircraft.

After the amendments introduced by Royal Decree 384/2015 of 22 May, aircraft operated by Spanish operators must be registered with the Aircraft Matriculation Registry and the Chattel Registry. Registration of an aircraft with the Civil Aircraft Registry confers Spanish nationality as well as the applicable tax and safety provisions, while the Chattel Registry records ownership and encumbrances affecting the aircraft.

Apart from the above, Spain has ratified the Convention on International Interests in Mobile Equipment and the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment, signed in Cape Town on 16 November 2001.

The result is that Spain has a triple registration system, with aircraft also being potentially registered with the International Registry set up by the Cape Town Protocol to Aircraft Equipment. International interests created pursuant to the Cape Town Protocol are fully enforceable in Spain.

Among its declarations to the Cape Town Protocol to Aircraft Equipment, Spain designated the Chattel Registry as the entry point to the International Registry.

That Spanish entry point has been set up as an authorising entry point (i.e., the Chattel Registry only authorises the transfer of mandatory information to the International Registry for the registration of an international interest by issuing a code). After obtaining that code, the parties are entitled to register, and therefore claim, an international interest in the International Registry by providing the required information electronically.

Furthermore, the creditor secured by an international interest is not entitled to take self-remedy actions unless it holds an Irrevocable De-Registration and Export Request Authorisation (IDERA). According to the Spanish Declaration to the Cape Town Protocol to Aircraft Equipment, the holder of an IDERA is authorised to request deregistration and export of an aircraft without obtaining judicial authorisation.

Although the Chattel Mortgages and Non-dispossessory Pledges Act of 16 December 1954 regulates chattel mortgages over an aircraft, in practice they will no longer be used in Spain in the near future as international interests take priority over any national interest created after 1 March 2016.

Act 18/2014 of 15 October establishes the main rules governing the management and legal status of unmanned aerial vehicles (UAVs). Under Act 18/2014, UAVs qualify as aircraft.

Rail

Spain has not enacted any law that specifically regulates the financing, construction or acquisition of rolling stock. As with shipping transport equipment, rolling stock must be registered with the Special Railway Registry, an administrative registry. Registration of rolling stock with the Chattel Registry is optional.

Regarding interests, chattel mortgages can be created over private wagons and over public and private locomotives, as established by the Chattel Mortgages and Non-dispossessory Pledges Act.

Spain is not expected to ratify the Luxembourg Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Railway Rolling Stock signed on 23 February 2007.

III FINANCIAL REGULATION

i Regulatory capital and liquidity

The provisions of Basel III were implemented into the legal framework of the European Union, mainly by means of (1) Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (CRD IV); and (2) Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012 (CRR).

CRD IV has been implemented into Spanish law by (1) Law 10/2014 of 26 June, on the organisation, supervision and solvency of credit institutions; (2) Royal Decree 84/2015 of 13 February, implementing Law 10/2014 of 26 June, on the organisation, supervision and solvency of credit institutions; and (3) Circular 2/2016 of 26 February, of the Bank of Spain, to credit institutions, on supervision and solvency, completing the adaptation of Spanish domestic law to Directive 2013/36/EU and Regulation (EU) No. 575/2013.

The above legal framework imposes on credit institutions requirements in the following areas: (1) own funds and capital buffers, (2) measurement and management of risks, (3) large exposures, (4) liquidity and (5) leverage, among others.

In November 2016, the European Commission published a proposal of amendment to both CRD IV and CRR. The key elements of the proposal relate to the leverage ratio, the net stable funding ratio, the total loss-absorbing capacity, Basel's work on capital requirements of institutions that trade in securities and derivatives and other amendments intended to make existing rules more proportionate in order to ensure their compliance by small and non-complex entities.

ii Supervisory regime

Since the establishment of the Single Supervisory Mechanism in 2014, the supervision of credit entities in Spain is shared between the European Central Bank (ECB) and the Bank of Spain in the terms set out under Council Regulation (EU) No. 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (the SSM Regulation). According to the SSM Regulation, the ECB has exclusive competence to carry out certain tasks for prudential supervisory purposes. For instance, it is responsible for granting and withdrawing authorisations for the establishment of credit institutions in the eurozone, assessing notifications for the acquisition and disposal of qualifying holdings, performing stress tests, carrying out supervision on a consolidated basis and ensuring banks' compliance with EU prudential requirements, such as own-funds requirements, liquidity, leverage or corporate governance.

However, for the sake of efficiency, supervisory tasks and responsibilities are allocated to the ECB and the Bank of Spain depending on the bank's significance in accordance with the SSM Regulation and Regulation (EU) No. 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and

with national designated authorities. The conditions for a bank to qualify as significant are established in the SSM Regulation and a list of these is published by the ECB and the Bank of Spain.

IV SECURITY AND ENFORCEMENT

Access to financing in the maritime, aircraft and railway sectors is a key factor for success in the current commercial context. The indebtedness that companies operating in those sectors must assume for the construction, financing and acquisition of vessels, aircraft and rolling stock depends on the companies' capacity to provide sufficient and adequate security to the financing entities. The security package is therefore essential in asset finance. In Spain, a mortgage over the financed asset is normally granted as security to the lenders and has an important economic function and an essential role in new building projects. The entry into force of the Maritime Navigation Act, representing a significant modernisation of Spain's former maritime law, establishes the legal framework governing ship mortgages. Mortgages over aircraft and rolling stock are also subject to specific regulations. Moreover, as previously mentioned, Spain is a party to various international conventions applicable to these types of guarantees, including the International Convention on Maritime Liens and Mortgages (1993) and the Cape Town Convention on international interests in mobile equipment.

i Financing of contracts

Shipping

The ship mortgage is the basic security normally granted within the scope of shipbuilding projects, but not the exclusive form, as ancillary security such as refund guarantees and pledges are also commonly used. The legal framework governing ship mortgages is primarily contained in Articles 126–144 of the Maritime Navigation Act, substituting for Spain's previous framework on these types of security, and in the International Convention on Maritime Liens and Mortgages (1993).

There are two requirements under the Maritime Navigation Act for a ship mortgage to be validly created as a right *in rem* with effects against third parties: (1) it must be documented in writing in either a private or public document; and (2) it must be registered within the Chattel Registry. To create and register the mortgage over a vessel under construction, a third of the budgeted amount of the total hull value must have been invested and the ownership of the vessel registered with the Chattel Registry. The parties to the ship mortgage are the mortgagee (normally a bank financing the construction of the vessel) and the mortgagor (which can be the debtor under the financing contracts or another party, as the mortgage can be granted as security of third-party obligations).

In respect of the asset, the mortgage extends to both the vessel's component parts and fittings, but not accessories. The mortgage also covers licences linked to the vessel (such as fishing licences), compensation arising from insurance and from material damage to the vessel owing to collision or other accidents. In respect of the secured obligations, unless otherwise agreed, a mortgage granted as security of a credit that accrues interest will not exceed (to the detriment of a third party) the interest of the previous two years elapsed and the matured part of the current annual dues, in addition to the principal.

If a definitive change of the vessel's flag is intended, it may not be carried out unless all mortgages, charges and encumbrances have been cancelled or the written consent of

the beneficiaries of the mortgages, charges or encumbrances has been granted. Temporary changes of flag will not affect the law applicable to the mortgage, which shall continue to be the law applicable under the flag flown by the vessel at the time the mortgage was granted.

Aviation

Aircraft finance can also be secured by granting a mortgage over the asset. The legal framework applicable to this kind of mortgage is primarily established in the Air Navigation Act and in the Chattel Mortgages and Non-dispossessory Pledges Act. The mortgage must be registered with the Chattel Registry for its valid creation and the security must also be registered with the Aircraft Matriculation Registry. To be able to create and register the mortgage over an aircraft during its construction, a third of its budgeted amount must have been invested in the same. The aircraft must be identified in the mortgage deed by including, among other details, the following information: (1) registration number given to the aircraft by the Aircraft Matriculation Registry; (2) stage of construction (if the aircraft remains under construction); (3) domicile of the aircraft; and (4) insurance policies covering the aircraft. The mortgage extends to the airframe, engines, radio and navigation devices and accessories. The mortgage can also extend to spare parts, provided they are listed in the mortgage deed.

Spain adhered to the Cape Town Convention in 2013, although it was not until 15 December 2015 that Spain adhered to the Aircraft Protocol, which entered into force in Spain on 1 March 2016. The Cape Town Convention contains the general framework applicable not only to securities over airframes, engines and helicopters, but also to other mobile equipment such as railway rolling stock and space assets (specific protocols are established for each type of mobile equipment). The Aircraft Protocol completes the Convention with specific terms and provisions regarding international interests in mobile equipment on matters specific to aircraft equipment. Thus, security can also be granted in the form of international interest over airframes, engines and helicopters, in accordance with the requirements under Article 7 of the Convention. The Convention also created an International Registry (Article 16) for the registration of, among others, international interests, prospective international interests, assignments and prospective assignments of international interests and acquisitions of international interests.

Rail

If a wagon or locomotive is privately owned, a chattel mortgage can be granted as security in accordance with Article 12.2 of the Chattel Mortgages and Non-dispossessory Pledges Act. Chattel mortgages cannot be granted over wagons owned by the state. However, a pledge without displacement or 'non-possessory pledge' over wagons, or a chattel mortgage over locomotives, may be granted instead.

ii Enforcement

Article 140 of the Maritime Navigation Act lists specific events that will entitle the mortgagee to enforce its right against the vessel with a subsequent judicial sale of the same (see Section IV. iii, *infra*). Those events are: (1) expiry of the term agreed to return the principal or interest; (2) the debtor's declaration of insolvency; (3) deterioration of the mortgaged vessel rendering it definitively unseaworthy; (4) the existence of two or more vessels mortgaged to fulfil the same obligation and there arises a loss or deterioration that renders either of them definitively unseaworthy; and (5) the occurrence of any of the agreed termination events.

Upon the occurrence of any of the above events, the mortgagee has various alternatives available to enforce the mortgage, basically consisting in: (1) ordinary declarative proceedings; (2) general rules for enforcement proceedings; (3) special enforcement proceedings on mortgaged assets; and (4) non-judicial enforcement proceedings before a notary public. The action to enforce a ship mortgage has a limitation period of three years, which runs from the date when any of the above events occurs.

The enforcement of a mortgage over aircraft or rolling stock is not subject to specific regulations under Spanish law. Thus, the general rules for enforcement foreseen under the Civil Procedure Act apply.

If the mortgagee initiates the special enforcement proceeding on mortgaged assets (Articles 681–698 of the Civil Procedure Act), the claim for the due amounts secured with the mortgage can be exercised directly against the mortgaged asset itself. There are various formal requirements that must be fulfilled to initiate the proceedings, which essentially consist of the following: (1) the price of the mortgaged asset must be indicated in the mortgage deed so that it can be used as a reservation price in the auction of the asset; and (2) the debtor's domicile must be indicated in the mortgage deed (for notification and communication purposes).

iii Arrest and judicial sale

Shipping

Conservatory arrest of both domestic and foreign vessels is governed by the International Convention on the Arrest of Ships made in Geneva on 12 March 1999, Articles 470–479 of the Maritime Navigation Act and by the Spanish Civil Procedure Act. The provisional court measure causes the detention and immobilisation of the vessel. The court with subject matter jurisdiction to hear the main claim on the merits or the court with territorial jurisdiction corresponding to the port or place where the vessel is located (or expected to arrive) will order the vessel's arrest. The arrest cannot be applied to ensure the enforcement of a previous judgment or arbitration award: arrest is a provisional ancillary measure for the main claim.

The arrest is conditional on the fulfilment of the following requirements: (1) alleging the existence of a maritime claim and its cause; (2) the vessel to be arrested is eligible for arrest under Article 3 of the Convention; and (3) the claimant must provide a security to cover any loss that may be incurred by the defendant as a result of the arrest, and for which the claimant may be found liable. Pursuant to Article 472.2 of the Maritime Navigation Act, the amount of the security shall be at least 15 per cent of the amount of the maritime credit alleged.

Once the arrest has been ordered, the court will notify the harbour master of the port where the vessel is located (or expected to arrive) and will take the necessary measures to arrest and prohibit the vessel's departure. The arrest must also be notified to the vessel's master or shipping agent.

The judicial sale of a vessel is governed by the International Convention on Maritime Liens and Mortgages, made in Geneva on 6 May 1993 (the 1993 Geneva Convention), Articles 480–486 of the Maritime Navigation Act and, for matters not expressly addressed by those laws, by the Civil Procedure Act. Prior to the forced sale of the vessel, the court must give notification of the sale of the vessel at least 30 days prior to the date on which the forced sale is intended. The notification must be directed to: (1) the registrar of the Chattel Registry and, if relevant, to the authority in charge of the registration of the vessel under a temporary change of flag; (2) the owner of the vessel; and (3) the mortgagees and holders of other encumbrances, including those established in Article 4 of the 1993 Geneva Convention (provided that the court has received notification of the corresponding credits).

The court's notification must state the date and place the forced sale is to be carried out or, if it cannot be stated with certainty, the approximate date and place. The proceeds from the forced sale must first be used to pay the procedural costs and expenses arising from the arrest, or the enforcement and subsequent sale of the vessel (e.g., expenses arising from the upkeep of the vessel and the crew as well as wages, other sums and costs referred to in Article 4, Paragraph 1(a) of the 1993 Geneva Convention, incurred from the time of arrest or seizure). The remaining amount will then be distributed according to the terms and provisions of the 1993 Geneva Convention.

Aviation

Aircraft are also subject to arrest, which is governed by the Civil Procedure Act. However, there are specific particularities under Spanish law and international conventions ratified by Spain that render the cautionary measure of arrest unattractive in practice. Article 132 of the Air Navigation Act establishes that the arrest of aircraft owned by air traffic companies may not interrupt the public service in which they are operating. The same rule is established under the Convention for the Unification of Certain Rules Relating to the Precautionary Arrest of Aircraft, adopted in Rome on 29 May 1933.

V CURRENT DEVELOPMENTS

i Recent cases

One of the most important recent cases affecting the transport sector is the General Court of the European Union having given recognition to the Spanish tax lease system (STLS) for the financing of assets, particularly affecting the financing of vessels. In the judgment handed down on 17 December 2015, the General Court annulled Commission Decision No. 2014/200/EU, which had held that the STLS constituted illegal state aid.

The STLS is based on the tax depreciation of leased assets. The STLS's general contractual structure was as follows: a builder (the Builder) and a leasing entity (the Lease Co) would enter into a shipbuilding contract for the construction of a vessel, as negotiated in commercial terms between a shipowner (the Shipowner) and the Builder. The Lease Co and an economic interest group (EIG) would enter into a finance lease agreement with a purchase option. In turn, the EIG and the Shipowner would enter into a bareboat charter agreement permitting the use of the vessel by the latter after delivery. At a later stage, the Shipowner would buy the vessel from the EIG and become its owner.

The Commission declared the existence of a selective economic advantage, and therefore state aid, to the benefit of the EIG and its investors. In its judgment, the General Court found that, given the fiscal transparency of EIGs, the tax advantage could only benefit the EIG's members (i.e., the investors). With respect to the investors, the alleged selectivity was based on the grounds that it only benefited entities that performed certain types of activity and that the tax depreciation required prior authorisation from the Spanish tax authorities. The General Court considered that when a tax advantage is established under identical conditions to the benefit of any entity that performs a specific type of activity and when no restriction is imposed on participating in those kinds of entities, the tax advantage is general (and, therefore, not selective) for all investors. Furthermore, the authorisation process only examined the characteristics of the financed assets, not the characteristics of the investors, such that any private person, without discrimination, could perform the type of

activity providing the tax advantage. Therefore, the General Court held that the STLS did not provide a selective economic advantage, and consequently state aid, to the EIG or its investors.

Moreover, the General Court considered that the Commission Decision contained serious defects in its rationale when stating that the measures under the STLS were prone to distort competition and affect trade among Member States.

Although the Commission has appealed the judgment before the EU Court of Justice, the General Court's judgment is an endorsement of the STLS, which may have a significant positive impact on the Spanish naval industry.

In the aviation sector, 49 per cent of the shares of Spanish airport operator Aena have been listed on the Madrid, Barcelona, Bilbao and Valencia stock exchanges. Aena is the world's leading airport operator in terms of passenger volume (serving 195.9 million passengers in Spain in 2014). The initial public offering of the shares took place on 11 February 2015; the Spanish government raised approximately €4.3 billion and continues to hold 51 per cent of the shares in Aena.

In 2016, Renfe put in an order for 15 trains, plus their first 30 years of maintenance, for a maximum of €786 million. This was the biggest order in Spanish railway history.

ii Developments in policy and legislation

The main legislative development in the aviation sector was the entry into force in Spain of the Aircraft Protocol to the Cape Town Convention on 1 March 2016. Furthermore, the Directorate General for Registry and Notary Offices of the Ministry of Justice issued a resolution on 29 February 2016 with the aim of approving specific forms to facilitate access to the International Registry by means of the Spanish entry point, the Chattel Registry. Spain has also submitted declarations to the Convention, which entered into force on 1 June 2016. These declarations are made pursuant to Article 39 (rights having priority without registration), Article 40 (registrable non-consensual rights or interests) and Article 53 (determination of courts).

On the other hand, Act 38/2015 on the Railway Sector replaces the 2003 law and aims to unify Spanish railway legislation, further homogenising it with the European framework. The new legislation contains measures that seek to increase the sustainability of rail infrastructure and transparency in the finances of its administrators.

iii Trends and outlook for the future

Although Spain's geographic location favours the aviation sector, the sector's financing market is stagnant. Its geographically competitive location would be further boosted by offering airlines access to efficient asset-based financing, as well as more efficient security for leases. The entry into force of the Cape Town Convention could be an important instrument for resolving the situation. Currently, Spain faces the challenge of performing all the necessary internal amendments to ensure that the entry into force of the Cape Town Convention, and specifically the IDERA enforcement, is implemented in the most effective manner. In any event, Spanish intervening agents (e.g., public bodies, registrars) are taking significant steps for the correct implementation of the Cape Town Convention. These developments may have a significant positive impact on Spain's aviation financing sector.

Turning to the maritime sector, Spanish ports are receiving an increasing number of traffic containers, consolidating their leading position by traffic volume within Europe. With regard to the shipping financing industry, although the EU Commission approved a new tax

lease framework, the industry suffered following Commission Decision No. 2014/200/EU declaring that the STLS constituted illegal state aid. The new Spanish tax lease framework was subsequently upheld by the judgment of the EU General Court on 9 December 2014 dismissing the claim raised by the Netherlands Maritime Technology Association. These circumstances, together with the judgment of the General Court of 17 December 2015 should provide more confidence to all intervening parties and provide an optimistic view of the future.

In the railway sector, Act 38/2015 has continued the liberalisation process of the market for transport services by rail. Nevertheless, the complete opening of the sector to competition may not arrive until the European Union establishes it, which is not expected until 2019 at the earliest.

Chapter 13

SWITZERLAND

Olivier Bazin and Jennifer Pelosi[1]

I INTRODUCTION

i The transport finance industry

The total costs for transport in Switzerland by rail and air are surveyed every five years. In 2010 they amounted to 93.5 billion francs,[2] out of which 72.8 billion francs was accounted for by passenger transport and 20.7 billion francs by the transport of goods. These figures include the cost of accidents and the cost of transport-related damage to the environment and health, in addition to the cost of transportation assets and of transport infrastructure. This chapter only addresses the financing of transportation assets.

The Swiss lending market, which is largely dominated by banking institutions, has remained stable for the past few years despite the financial crisis, and has brought the necessary financial support to the transport industry.

The transportation of goods ensures the supply of commodities to trading companies and of consumption goods to the Swiss population. It also allows commodities trading to take place on a worldwide scale. For those reasons, in addition to the support provided by the banking industry, the Swiss federal government also supports freight transport companies by offering them investments, contributions and compensation – particularly to encourage the transfer of 'transalpine' freight from road to rail and to develop rail freight traffic.[3]

Aviation

In 2010, the cost of aviation transport amounted to 6.4 billion francs. The majority of this amount (i.e., 5.2 billion francs) was generated by passenger flights and charters. On the other hand, the cost of transport of goods by air amounted to 0.7 billion francs, and the cost of general aviation, including general smaller aircraft, amounted to 0.5 billion francs.

The most important category of aviation costs – aviation transport assets – was 4.1 billion francs.

Aviation transport users (passengers, freight forwarders, etc.) incurred a significant part of the aviation costs – 5.3 billion francs, representing 83 per cent of the total cost. 0.9 billion francs were deferred to the community, representing 14 per cent of the cost. The balance of 0.2 billion francs was borne by airlines and airports, which offset the deficit suffered in relation to aviation with profits made from ancillary activities.

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2 The next statistics publication is scheduled for 2018.

3 Financement des transports www.bav.admin.ch.

Shipping

The Swiss merchant marine fleet is composed of 49 ships with a total capacity of 1.7 million tons (deadweight tonnage), which corresponds to 0.001 per cent of global tonnage. The Swiss fleet operates worldwide, as needed.

Shipowners finance the building and purchase of their fleet essentially by means of bank loans with preferential interest rates. These loans are granted on the basis of a guarantee facility provided by the Swiss Confederation. In exchange for this guarantee facility, shipowners have agreed to provide the Swiss Confederation with the use of their fleet to secure national economic supply of essential goods and services in the case of serious shortages that the private sector itself is unable to counteract.

Railway

In Switzerland, the largest transport volumes are undertaken by rail and motorised transportation. In 2013, the total cost of rail transport amounted to 10.3 billion francs out of which 4.8 billion francs represented the cost of rail transport assets. The cost of passenger rail transportation amounted to 8.4 billion francs, 6.8 billion francs of which was financed by private transportation companies and 1.1 billion francs of which was financed by the Swiss authorities.

The total cost with respect to rail transportation of goods amounted to 1.9 billion francs, out of which 0.8 billion francs were spent on rail transportation assets. 1.4 billion francs out of the total cost related to rail transportation of goods were financed by private transportation companies, and 0.2 billion francs were financed by the Swiss authorities.[4]

ii Recent changes

The most significant change in the Swiss transport finance sector relates to the shipping industry.

The size of the Swiss fleet has increased considerably over the past few years, owing to the fact that shipowners have been able to obtain bank loans more easily, with preferential interest rates on the basis of the guarantee facility granted by the Swiss Confederation.

Until 2012, the guarantee facility was capped at 600 million francs. It was then increased to 1.1 billion francs and extended until June 2017. The guarantee facility has not been utilised until recently but, for the first time, the Swiss Confederation might be requested to assist a shipowner in financial difficulty.

Owing to the fall in commodity and freight prices, the international and Swiss shipping industry is facing a worse storm today than it did following the global financial crisis, and the Swiss market has not been spared despite the celebration of the Swiss flag's 75th anniversary in spring 2016.

Owing to the risks associated with the shipping industry, the Swiss government has announced that it will not extend the guarantee facility any further in favour of the Swiss fleet after June 2017. The direct consequence of this decision would be for banks to pull back on loans and to stop granting preferential interest rates, which may lead to the disappearance of the Swiss fleet in the long term.

4 OFS 2016 – Statistique des coûts et financement des transports.

II LEGISLATIVE FRAMEWORK

i Domestic and international law and regulation

The principal domestic legislation applicable to aviation, ship and railway finance is the Swiss Code of Obligations (SCO), Swiss Civil Code (SCC) and the Federal Act on International Private Law. The specific domestic and international legislation applicable to these different areas are outlined below.

Aviation

Relevant domestic law related to aviation finance also includes the Federal Aviation Act, the Ordinance on Aviation, the Federal Act on Aircraft Records Register and its implementing Regulations.

On the international side, Switzerland is a party to the Rome Convention 1933 and the Geneva Convention 1948.

Switzerland has signed, but not yet ratified, the Cape Town Convention 2001 and the Aircraft Protocol. It has also joined the Multilateral Agreement on Commercial Rights of Non-Scheduled Air Services in Europe 1956.

Finally, the majority of the European aviation legislation applies in Switzerland on the basis of the Agreement between the European Community and Switzerland on Air Transport 1999.

Shipping

In addition to the SCO and SCC, the domestic law in relation to ship finance includes the Federal Act on Vessel Records Register, the Federal Act on Maritime Navigation under the Swiss Flag and the Ordinance on Maritime Navigation.

The Federal Act on the National Economic Supply, the Ordinance on the Constitution Reserves and the Ordinance on the Guarantee Facility to Finance Swiss Vessels in High Seas are also applicable.

The international legislation includes the International Conventions for the Unification of Certain Rules related to Privileges and Maritime Mortgages 1954, the Convention in relation with the Registration of Interior Navigation Vessels 1965 and for the Unification of certain Rules related to the Conservatory Attachment of Sea Vessels 1952.

ii Specific practices

Aircraft, vessels and rolling stock are all moveable properties pursuant to Article 655 SCC. Unless otherwise prescribed by the law, moveable property cannot be subject to a mortgage (which represents the most common form of security granted over immoveable property).

However, according to Swiss law, aircraft and vessels can – unlike rolling stock – be subject to a mortgage on the basis of the Federal Act on Aircraft Records Register and the Federal Act on Vessel Records Register.

The legal effect of this is that taking a security interest over an aircraft or a vessel in the context of secured lending is equivalent to taking security interest over an immoveable property, namely, in the form of a transfer for security purposes of a 'mortgage note' charging the relevant immoveable property.

However, with respect to the railway industry, Swiss law does not presently provide for the possibility to create a mortgage over rolling stock. Pursuant to Swiss law, the security interest over tangible moveable property would take the form of a pledge and would require

that possession of the pledged asset be transferred to the secured lenders, taking a security interest over operational moveable assets. If the assets represent operational moveable assets, such as rolling stock, such security interest is not obviously compatible with the operational requirements of the security provider. For those reasons, this form of security is rarely adopted in Switzerland and is not applied – although it is available to rolling stock – despite its tangible moveable characteristics.

For the reasons given above, other types of credit support are adopted in the case of rolling stock, such as pledges over funds and title retention agreements, as well as sale and leaseback arrangements.

III FINANCIAL REGULATION

i Regulatory capital and liquidity

The financial markets not only form part of the economy, they also represent its most heavily regulated sector. Regulation aims to protect creditors, investors and insured individuals, to maintain the stability of the system and to ensure the smooth functioning of the financial markets.

Owing to the increasing cross-border integration of financial markets, Swiss regulations have been considerably impacted by international standards. In light of these changes, Switzerland has recently revised its financial market regulation to promote its financial centre and its competitiveness.

Although the recent changes have not had a major impact on the Swiss corporate lending market, the capital and liquidity requirements applied to Swiss banking institutions have changed. A limit has been placed on the overall volume of available credit and collateral requirements in relation to lending transactions, including within the transport industry, have increased.

The Basel Committee on Banking Supervision (BCBS) aims to enhance the security and reliability of the international banking system. The Committee is made up of representatives of the central banks and banking supervisory authorities of 27 countries. Switzerland is represented on the Committee by the Swiss Financial Market Supervisory Authority (FINMA) and the Swiss National Bank.

Drawing on the lessons of the global financial crisis, the BCBS (which aims to enhance the security and reliability of the international banking system) published a reform package in 2010 known as Basel III to reinforce capital and liquidity requirements.

In Switzerland, the Basel III standards are being implemented by adapting the Capital Adequacy Ordinance and the relevant FINMA Circulars. The new provisions entered into force in 2013, and should be fully implemented by the end of 2018.

Swiss financial institutions are required to comply with the Basel III standards when providing finance to the transport industry.

ii Supervisory regime

Switzerland is governed by a continental legal system. FINMA has adopted a principle-based approach that is reflected in the Swiss capital rules. First, the rules remain less specific than the Basel standards in several areas and second, while a substantial part of Swiss Basel rules are established in primary legislation, a large part are also contained in secondary legislation and the remainder in tertiary legislation. In light of the above, FINMA has the discretion and flexibility to specify the technical requirements.

FINMA's supervision of banks and financial institutions has traditionally been characterised by a two-tier system: substantial reliance on external auditors who perform a formal supervisory function and are, thereby, part of the supervisory system, in addition to the supervisory role of FINMA. To a certain extent, the auditors act as an extension of FINMA. The auditors are requested to examine the annual financial statements with an independent valuation of assets and liabilities and review whether the banks comply with their articles of association and their organisational rules, as well as with applicable Swiss law, the FINMA Circulars and any applicable self-regulatory provisions.

FINMA also assesses on an annual basis the 'long-form reports' prepared by external auditors, which provide a comprehensive overview of the business activities and the internal organisation of the relevant financial institution.

The Swiss supervisory regime ensures that financial institutions comply with regulatory requirements while providing financing support to the Swiss transport sector. In the same way, it will ensure that the general corporate lending market in Switzerland complies with those same regulatory requirements.

IV SECURITY AND ENFORCEMENT

i Financing of contracts

Aircraft

An aircraft is an example of moveable property pursuant to Article 655(2) SCC *a contrario*. Except where otherwise provided by the law, moveable property may be pledged only by the transfer of possession of the pledged moveable property to the pledgee.[5] Article 885(3) SCC provides, however, that the transfer of possession is not established as long as the pledgor retains exclusive possession of the moveable property.

To remedy this issue, the Federal Act on Aircraft Records Register provides that an aircraft, although moveable property, can be subject to a mortgage unless otherwise provided by the law. In practice, the financing of aircraft in Switzerland is generally done by way of a financial lease, which is usually structured as a sale and lease back or with a pre-delivery financing under assignment of the purchase agreement to the financing institution or by way of a bank loan together with an aircraft mortgage.

A security package will be required by the financing institution in a typical transaction. Depending on the circumstances, such security package may include:

a a personal or corporate guarantee;
b security assignments;
c a multipartite agreement;
d a pledge of managed assets; or
e a charge over shares in the company that owns the aircraft or has the latter on lease.

An aircraft mortgage can secure an obligation (present, future or contingent) even if the secured amount is undetermined or floating provided that the aircraft is registered with the Swiss Aircraft Records Register (SARR). The registration of an aircraft mortgage is necessary for the creation and perfection of the mortgage. In this respect, the registration of the mortgage can be requested simultaneously with the registration of the aircraft.

5 Article 884(1) of the Swiss Civil Code (RS 210).

In order to register a mortgage with the SARR, the owner of the aircraft is required to submit the mortgage agreement together with the relevant Federal Office of Civil Aviation form.

The mortgage is then attributed a fixed rank for a maximum secured amount. If several mortgages are registered with the SARR, the priority order depends on the ranking. Aircraft subject to a registered mortgage cannot, however, be subject to any retention right or pledge. Therefore, under Swiss law, other mortgages or charges cannot conflict with registered mortgages.

The mortgage covers the aircraft itself and its integral parts and accessories. It can also cover various aircraft belonging to the same owner or to jointly liable debtors in relation to the same debt.

Obligations secured by an aircraft mortgage are not subject to statutory limitations.

In addition to a contractual mortgage, the mortgagee is also entitled to an accessory legal mortgage over claims that the aircraft owner may have against third parties in relation to any loss or damage to the aircraft. It covers any specific reserve of assets (including cash) that the owner may have set up in anticipation of such events. Such legal mortgages take priority over all contractual mortgages registered on or before the date on which the legal mortgage have been announced for registration with the SARR.

Unlike aircraft mortgages, aircraft leases cannot be registered with the SARR. Swiss law does not provide for a specific form of security over aircraft leases. An assignment of the rights and claims under an aircraft lease may, however, be provided to a creditor as security in case of an event of default. Such assignment, which must be in writing, is possible even without the consent of the debtor, unless the assignment is prohibited by the terms of the lease.

The rights and claims under an aircraft lease may also be pledged in favour of a creditor. However, this is unusual in practice.

Airframes and aircraft engines may also be subject to legal or contractual mortgages as well as retention rights, pledges or reservation of title, depending whether they are registered with the SARR or with the Swiss Aircraft Register only.

Vessels

Similar to aircraft, a vessel represents a chattel pursuant to Article 655(2) SCC *a contrario*, which may be pledged only by the transfer of possession of the pledged chattel to the pledgee.[6] As indicated above, the transfer of possession is not established if the pledgor retains exclusive possession of the chattel.

To remedy this issue in relation to vessels, the Federal Act on Vessel Records Register provides that a mortgage may be created over a vessel to secure an obligation, which may be either present, future or contingent, provided that the secured amount is determined and indicated in Swiss francs. Should the secured amount not be determined, the parties shall indicate a fixed sum as the maximum secured amount.

The vessel must be expressly designated when the mortgage is created. However, it does not need to be owned by the debtor.

The mortgage covers the vessel itself and its integral parts and accessories. It can also cover various vessels belonging to the same owner or to jointly liable debtors in relation to the

6 *Ibidem*.

same debt. In all other cases, where a mortgage is created over several vessels, each of them shall be mortgaged up to a determined portion of the debt as the guaranty allotment is done proportionally to the value of the vessels unless provided otherwise.

Similar to an aircraft mortgage, a vessel mortgage can only exist if it has been registered with the Swiss Vessel Records Register (SVRR). A written mortgage agreement must be submitted to the SVRR to register the security.

Obligations secured by a vessel mortgage are not subject to statutory limitations.

As is the case with aircraft, vessels subject to a registered mortgage cannot be subject to any retention right or pledge.

Finally, legal mortgages and privileges (i.e., legal mortgages that are not registered with the SVRR) can also be created over a vessel in certain circumstances and by specific individuals pursuant to Articles 51 and 53 *bis* of the Federal Act on Vessel Records Register provided that they are also registered with the SVRR.

Rolling stock

In practice, the financing of rolling stock intended to remain in Switzerland is generally done by way of a lease of 10 to 25 years, structured as a sale and lease back with a fixed interest rate. The lease agreement is usually based on the value of the rolling stock and beneficiary company. Security can be required in certain circumstances, however, this is usually not the case as the bank or financial institution has title to the asset. If the rolling stock does not remain in Switzerland, the financing will not be done by way of a lease but by means of loans generally unsecured. In certain situations, banks will require security.

Rolling stock is subject to the law on ordinary moveable property pursuant to Articles 655 SCC.

The taking of security over moveable property requires that the secured party obtains physical possession and control of the relevant assets. Thus, Swiss law does not recognise the concept of floating charges or floating liens.

For practical purposes, the taking of security over rolling stock – serving in other jurisdictions as a collateral – is not practical under Swiss law. The requirement of physical possession and control over rolling stock is viewed as too burdensome and costly.

In light of the above, other types of credit support are adopted, most commonly pledges over funds and title retention agreements as well as sale and leaseback arrangements.

A fiduciary assignment of receivables or other claims that transfers title in the assigned claims (including interest, and certain ancillary security and other rights) to the assignee can also be envisaged. If the debtor defaults, the creditor can assert the claim against the third party to recover the debt. When a bank is acting as a lender, all of the debtor's claims (including existing and future ones) are usually assigned to the bank. As future receivables arising before a potential bankruptcy of the assignor may be assigned, this instrument is commonly used in practice.

A reservation of title could also be considered as it enables the seller of rolling stock to retain title over it until all amounts due by the purchaser have been paid. To be valid where the purchaser is carrying out business in Switzerland, the reservation of title agreement must be registered with a specific public registry held by the Debt Collection Office (the Office)[7] located at the place of residence or the principal place of business of the purchaser.

7 Office des poursuites.

ii Enforcement and arrest

Aircraft

The mortgage agreement generally provides for the circumstances in which a mortgagee can foreclose the mortgage. Enforcement can usually be required by the mortgagee when the secured obligations have become due and payable, and are unpaid.

The enforcement of a mortgage over an aircraft located in Switzerland is governed by Swiss debt enforcement law,[8] regardless of the nationality of the aircraft.

A mortgagee is not entitled to take possession of the mortgaged aircraft on the simple basis that the debtor did not reimburse its debt. The mortgage must first be enforced through a forced execution proceeding under the compulsory control of the Office located at the domicile of the owner of the aircraft in respect of Swiss aircraft, and in respect of foreign aircraft at the place where the aircraft is located.

The mortgagee will start by filing a forced execution proceeding request with the competent Office. A payment order will then be served by the office to the debtor. The latter will have one month to comply with the payment order. At the same time that the payment order is served, the aircraft's administration is taken over by the Office to ensure that the aircraft is not taken away from the proceedings. An opposition may be made to the payment order by the debtor, in which case the mortgagee will have to set aside the opposition before proceeding with the enforcement process. Once the opposition is set aside, only then can the mortgagee require the sale of the aircraft through a public auction, unless a private sale has been agreed among the parties involved. The public auction or private sale – depending on what has been agreed – takes place three months after the mortgagee's request to sell.

If the mortgaged aircraft is likely to be removed from the Swiss jurisdiction and thereby will likely escape the enforcement proceedings, the mortgagee is entitled to request the competent Swiss court to arrest the aircraft as a precautionary measure. The arrest must however be done in compliance with the Rome Convention for the Unification of Certain Rules Relating to the Precautionary Arrest of Aircraft 1933.

The risk that a mortgaged aircraft is moved outside the Swiss territory is theoretical on the basis that the Office takes over the administration of the aircraft as soon as a payment order is served on the debtor.

Vessels

Usually, a mortgage agreement will provide that enforcement may be required by the mortgagee when the secured obligations have become due and payable, and remain unpaid.

The enforcing of a mortgage over a vessel is similar, if not identical in procedure, to the enforcement of an aircraft mortgage. A mortgage over a vessel will be assimilated to an immoveable asset mortgage within the forced execution proceeding.

The proceedings will be controlled and directed by the Office located where the vessel is registered in Switzerland. The latter will also be in charge of the arrest, the administration and the sale of the vessel.

A vessel will only be arrested if the value of any available chattels and immoveable property is not sufficient to cover the amount of the debt, or if the arrest is requested by the creditor and debtor. If several vessels can be arrested, the ones which are not navigating will be arrested first and the ones navigating abroad last.

8 Swiss Debt Collection and Bankruptcy Act (RS 281.1).

The Office is entitled to take into its custody an arrested vessel as a precautionary measure if there is a risk that the latter is removed from the Swiss jurisdiction thereby escaping the enforcement proceedings. This is unless the creditors renounce such a measure in writing.

The sale of the vessel may be requested by the mortgagee one month before, but at the latest one year after, the vessel has been arrested. When a vessel is sold through public auction, the amount of the mortgaged debts (including interest arrears secured by the mortgage) shall be repaid from the proceeds of sale, even if the principal is not overdue.

In the case of wreck removal by the authorities in the interest of the general public, the cost of the removal will also be paid using the proceeds of sale.

Rolling stock

The enforcement conditions of security are determined by law as well as by the relevant provisions of the relevant security or sale-leaseback contracts. The secured party must have a secured and matched claim to be entitled to enforce the security. As with aircraft and vessels, the security agreements simply refer to an event of default according to the credit agreement governing the secured loan. When a secured debt becomes due and has not yet been paid, the security for the loan automatically becomes enforceable.

Private enforcement measures become available in accordance with the security agreement. Enforcement is otherwise governed by the Swiss Debt Collection and Bankruptcy Act.

V CURRENT DEVELOPMENTS

The most significant developments in the Swiss transport finance sector in 2016 relate to the shipping industry.

Although the Swiss lending market remains stable today, shipping banks have shown less appetite and have been pulling back on loans in 2016 against the background of rising market turbulence and regulatory pressure.

Moreover, the decision taken by the Swiss federal government not to extend any further the guarantee facility in favour of the Swiss fleet, will likely create additional challenges as until today this represented a fundamental form of credit support for banks engaged in lending to Swiss shipowners.

Chapter 14

UNITED KINGDOM

Kenneth Gray, Richard Howley and Tom Johnson[1]

I INTRODUCTION

i Aviation

England is one of the major jurisdictions concerned with the financing of aircraft on account of the position of the City of London as the major international financial centre, the pre-eminence of English law as the governing law for international contracts and the importance of the aviation industry within the United Kingdom.

The aviation industry in the United Kingdom can be divided into manufacturing, operating and financing, each of these underpinned by English law and English lawyers.

The United Kingdom is the second-largest exporter of aerospace equipment in the world, both from domestic manufacturers, such as Rolls-Royce and British Aerospace and from foreign corporations working though United Kingdom plants, including Airbus and Boeing.

New aircraft require financing running into the hundreds of billions of dollars annually. A very large proportion of this will be provided by banks and financial institutions lending from their offices in the City of London.

Finally, with British Airways and easyJet, the United Kingdom is home to two of the largest carriers in Europe, both having substantial financing needs.

Commercial bank lending for aircraft fell dramatically after 2008, but aircraft deliveries continued to increase, even during the recession. Funding is now largely split evenly between own funds, the capital markets and commercial banks.

Brexit may have a huge impact on the aviation industry in the United Kingdom, though the effect on the finance aspects of the industry will be limited.

ii Shipping

Ships carry something like 90 per cent of the world's trade. This includes dry bulk cargoes (such as grain, coal, iron ore and other raw materials), liquid bulk cargoes (such as liquefied gas, crude oil, refined oil products and chemicals), foods (often in refrigerated ships) and finished products (in ships such as car carriers and container ships). Ships and other vessels also participate extensively in offshore oil and gas exploration, development and production and provide platforms for leisure activity (the cruise business) and for transportation of passengers, and private and commercial vehicles.

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1 Kenneth Gray is a consultant, and Richard Howley and Tom Johnson are partners at Norton Rose Fulbright.

London is the world's leading centre for the provision of shipping services such as broking, insurance, finance, legal and arbitration, ship management and technical advice.

Despite the decline in the United Kingdom-registered merchant fleet relative to some other leading maritime nations during the post-war period, the United Kingdom also remains a significant base for ownership and control of ships, particularly through the growth in United Kingdom-based tonnage credited to the United Kingdom tonnage tax scheme. British overseas territories such as Bermuda and Crown dependencies such as the Isle of Man also have substantial fleets of merchant ships registered with them.

Shipping is predominantly financed by a combination of shareholder funding (private or public) and bank or (for new ships) export credit agency-backed lending secured by mortgages over ships and related rights, with a significant – albeit often cyclical – contribution of funding from debt capital markets, principally within the United States and Norway.

London is one of the leading centres for financing the global shipping industry and hosts shipping teams from domestic banks in the United Kingdom and, very significantly, foreign banks (such as the United States, Far Eastern, Continental European and Scandinavian banks). These banks arrange and extend secured lending and ancillary financial services and also provide structuring and advisory services for other financing products (such as leasing, public and private equity, debt capital markets and derivatives).

iii Rail

The rail sections of this chapter consider the financing of passenger rolling stock in the United Kingdom. This activity may be viewed with interest internationally in terms of contributing to an understanding of how a privatised railway might be financed and the opportunities this presents. In the United Kingdom, passenger rolling stock tends to be owned by specialist owning companies and not by train operators. There are three principal rolling stock owners,[2] which each own a substantial portion of the passenger rolling stock on the system, although in recent years the market has attracted attention from alternative financiers. ROSCOs will typically buy rolling stock from the manufacturer in a tripartite arrangement with the initial operator of the rolling stock. The purchase is funded by equity or debt, under corporate facilities or sometimes a specific facility. The rolling stock is then leased to successive operators of the rolling stock under franchises.

The ROSCOs' source of funding has changed since privatisation. Bank debt has always played a part, particularly when the ROSCOs were all owned by banks. Over the past few years, however, there has been a significant shift in the equity interest with investment in ROSCOs coming from private equity, pension funds and foreign strategic investors. The attractions include a long-term steady return on investment coupled with attractive forecasts of rail growth and opportunities to extend the life of existing rolling stock.

II LEGISLATIVE FRAMEWORK

Other than the recent implementation of the Cape Town Convention into law, there is no specific legislation governing the financing of aircraft, ships or rolling stock.

2 Eversholt Rail (UK) Limited, Angel Trains Limited and Porterbrook Leasing Company Limited – known by the acronym ROSCOs.

The United Kingdom ratified the Cape Town Convention on International Interests in Mobile Equipment and the Protocol thereto on Matters specific to Aircraft Equipment (together, the Cape Town Convention) with effect from 1 November 2015 (see below). The government of the United Kingdom is also considering the ratification of the Protocol on Railway Equipment, but no timetable has been set for this.

English common law is an internationally accepted choice of law for financing aircraft, ships and, to a lesser extent, rolling stock, whether the financing is arranged out of London or other industry or financial centres. English-qualified lawyers serving the transportation and asset-financing community are located in London and across the globe.

However, laws of countries where assets are registered or other related assets and rights are located will also be relevant in most financings and the insolvency regimes applicable to transportation companies based in other countries will also be relevant.

i Domestic and international law and regulation

Aircraft

The leasing and mortgaging of aircraft is subject to standard common law principles. In addition, institutions benefiting from a mortgage over an aircraft registered with the Civil Aviation Authority of the United Kingdom (CAA) may protect their priority thereunder by registering it on the Register of Aircraft Mortgages maintained by the CAA in accordance with the Mortgaging of Aircraft Order 1972.

The government legislated for the Cape Town Convention pursuant to the International Interests in Aircraft Equipment (Cape Town Convention) Regulations 2015 (the Cape Town Regulations), which came into force in November 2015. The Cape Town Convention is intended to:

a facilitate the acquisition of financing of aircraft by providing for the creation of a *sui generis* 'international interest' in aircraft;

b provide for a range of default and insolvency-based remedies to be available to creditors under international interests; and

c provide for an international registry in which international interests may be registered, so guaranteeing their priority,

The relationship between the Cape Town Regulations, the Mortgaging of Aircraft Order, 1972 and other English domestic law is a complex one and depends on a number of factors, including timing, the location of the parties, the situs of the aircraft at any given time and the state of registration of the aircraft. Different principles may apply to airframes and to engines.

The ratification of the Cape Town Convention and the passage of the Cape Town Regulations has had a significant impact on the finance documents relating to aircraft registered in the United Kingdom. Although the Cape Town Convention is heavily influenced by common law doctrine on the creation of security over and leasing of assets, there are certain variations from English law that will need to be reflected in the financing documentation.[3]

One particular benefit of the ratification of the Cape Town Convention is that creditors wishing to obtain security over an aircraft under English law may be able to do so, to the extent that the Cape Town Convention applies, by obtaining an international interest under the terms of the Cape Town Convention rather than by means of an English-law mortgage.

3 A full discussion of the effects of the Cape Town Convention can be found at www.awg.aero.

The common law *lex situs* requirement (that a mortgage over an aircraft must be created in accordance with the laws of the jurisdiction where the aircraft is situated at the time of its creation) will not apply to international interests created under the Cape Town Convention.

The Cape Town Convention is a 'mixed agreement'; that is to say, parts of it (such as those provisions relating to insolvency) are within EU competence while other parts (such as those relating to the establishment of the International Registry) are within the competence of Member States. Accordingly, it has been ratified by both the EU and the United Kingdom. A complex question is whether any further steps need to be taken by the United Kingdom to ensure that its ratification is complete following Brexit.

Ships

Ships benefit from a system of registration established under the laws of maritime countries that, *inter alia*, provide mechanisms for recording legal ownership, mortgages over ships and priority between different mortgages.

When lying in port or in a country's territorial waters, ships are subject to arrest and possible sale as security for contractual and other claims relating to them or other ships under common ownership or, in some countries, control (as well as ship mortgage claims). The types of maritime claim that can be protected and enforced in this way and the priority they will have among themselves and against registered ship mortgages will usually depend on the local law where the ship is located.

Rail

There are special rules relating to the process following a railway company going into administration, but in general, rolling stock is subject to the general laws relating to moveable possessions. There is no rolling stock title register nor any mortgage register. Rolling stock is not specifically mortgageable and if security were to be taken over rolling stock (whether called a mortgage or a charge), it would be in the form of a fixed charge.

Domestically, there has been concern that ROSCOs are making excessive profits from their rolling stock leases. The most recent major competition authority investigation found these concerns to be unfounded and recommended only small changes to ROSCO practices, rather than the need for specific regulation.

The operational side of the railway industry in the United Kingdom is generally covered by Directives of the European Union, of which there have been three (with a fourth in the process of being agreed) dealing specifically with the structure and operation of railways in the European Union. The United Kingdom generally complies with these Directives, but they do not have any direct impact on the financing of the rolling stock.

III FINANCIAL REGULATION

i Regulatory capital and liquidity

Regulation No. 573/2013 of the European Union on prudential requirements for credit institutions and investment firms (the Capital Requirements Regulation or CRR) came into force on 1 January 2014 and implements the provisions of Basel III. Its provisions will become applicable progressively over a period ending in 2019. The CRR is intended to ensure that losses incurred by banks on their trading and lending books do not require bailouts by taxpayers and that depositors' rights are safeguarded. The CRR does this in a number of ways, of which the following specifically affect the financing of transportation assets.

First, the CRR requires banks to hold a minimum amount of regulatory capital (see below) against their risk-weighted assets. For security over a tangible asset to be eligible to reduce the risk-weighting of a corresponding loan, a number of conditions need to be met, including those concerning the availability of data on the market value of the asset and the liquidity of the resale markets. In practice, this means that aircraft are more likely to be eligible as collateral than other tangible assets.

Second, the CRR increases the quantity and quality of regulatory capital that a bank is required to hold against its risk-weighted assets (including its loan book). Common equity is substantially prioritised over other types of regulatory capital, such as subordinated loans and capital markets instruments. The amount of common equity required to be held varies according to the size of the bank and the prevailing economic conditions in its jurisdiction, but will increase by a factor of between 350 per cent and 650 per cent over the pre-CRR requirements. The increase in the amount of common equity that a bank is obliged to account for against a particular loan will have an inevitable effect on the pricing of that loan.

Third, in addition to the new risk-weighted ratios, a new leveraged ratio will be introduced that does not take account of the risk weighting of any particular asset. The level of the new ratio is yet to be set but a consequence is that certain transactions (particularly those involving export credits or that otherwise benefited from a low risk weighting) will need to be reviewed by banks in that they will have greater consequences on their balance sheet treatment than is currently the case.

Fourth, two new liquidity ratios will be introduced:

a the liquidity coverage ratio, which provides (in essence) that banks must hold enough high-quality assets to meet their obligations over 90 days in a stress situation; and

b the net stable funding ratio, which provides that banks should fund long-term loans (by which is meant a loan with a maturity in excess of one year) from equivalent long-term sources, making short-term corporate loans more attractive than longer-term loans into the transport sector.

The cumulative effect of these provisions has been to dampen banks' appetite for long-term debt, even when attractively secured. There have been several instances of banks deleveraging.[4] That said, bank lending into the transport sector has recently been on the increase so it may turn out that the fears as to the impact of the CRR have been exaggerated.

Because the CRR is implemented pursuant to an international accord, Basel III, we would anticipate it to continue having effect in the United Kingdom immediately following Brexit.

ii Supervisory regime

Banks in the United Kingdom are supervised by the Financial Conduct Authority and the Prudential Regulation Authority. The CRR is the principal legislation affecting banks' ability to lend into the transport sector.

4 Selling their asset finance portfolios in an attempt to free up their regulatory capital.

IV SECURITY AND ENFORCEMENT

i Security

Aircraft

Lenders require a first priority mortgage (or equivalent security) over an aircraft that is enforceable in every relevant jurisdiction. Problems arise, however, where different jurisdictions have different rules as to how security over a particular aircraft should be created. For example, under English law, before the Cape Town Convention was implemented, the validity of proprietary rights over aircraft had to be determined in accordance with the *lex situs* – the laws of the jurisdiction where the aircraft is situated at the relevant time. That is still the case except to the extent that rights are created under the Cape Town Convention. However, under French law, the laws of the state of registration would be determinative of the issue.

It is common practice in some situations for an English law mortgage to be executed over an aircraft while it is in English airspace and, possibly, a mortgage governed by the laws of the state of registration of the aircraft (often referred to as local law mortgages) when it is physically situated there.

Local law mortgages are often problematic because:

a there may be no legal framework for their creation (for example, in Belgium);

b there may be prohibitive stamp duty payable on their registration (for example, in Spain);

c there may be restrictions on the identity of the creditor to whom they may be given (for example, in Colombia); or

d their enforcement before the local courts may present practical problems in terms of timing and judicial risk.

It is for these reasons that an English law mortgage is often required instead of, or in addition to, a local law mortgage. Lenders, however, need to consider in which jurisdictions such an English law mortgage over a foreign-registered aircraft would be recognised.

Security over aircraft may now also be created under English law by creating an international interest under the Cape Town Convention to the extent that it applies. It will apply if either the debtor is situated in a contracting state or, to a limited extent, if the aircraft is registered in one.

If an individual aircraft is owned by a special purpose company, it is common for the lenders to take security over the shares in that company.

Shipping

The main security will generally be a ship mortgage (governed by the laws of the ship's state of registry), supplemented by security over the ship's earnings and insurances, any compensation that may be due if the ship is ever confiscated by its state of registry (e.g., in time of war) and, sometimes, a significant charter of the ship.

It is also common for lenders to take security over bank accounts into which a ship's earnings are to be paid or reserved.

When financing a ship that is still under construction (and therefore cannot yet be registered and mortgaged by its intended owner), lenders will take security over the buyer's rights under the shipbuilding contract and any related guarantees or security provided to the buyer for the shipbuilder's obligations.

Lenders may also take security over the shares of a single-purpose, single ship-owning company.

Rail

There being no specific legislation concerning the legal nature of rolling stock or protecting its title or for the creation of security over rolling stock, rolling stock falls to be dealt with in the same way as any other moveable property.

A corporate owner may create a charge over the rolling stock in favour of a lender and that charge should be registered on the Companies House charges register of the chargor.

There being no statutory protections, it was common in the early days of privatisation for notices to be fixed to rolling stock to ensure nobody could claim not to have notice of the ownership, as that lack of notice could defeat the claims of the true owner. However, such is the level of clear identification of each rolling stock vehicle and of the tracking of the daily movements of each vehicle, that the risk of loss of vehicles in this way is minimal.

ii Financing of contracts

Aviation

Airlines wishing to finance new aircraft will normally issue a Request for Proposals seeking offers from financial institutions to finance the relevant aircraft. There are a number of common structures that are often established for financing purposes, including:

a a finance lease, in which the aircraft is owned by an orphan trust and leased to the airline;

b export credit financing, in which the export credit agency of the state where the aircraft is manufactured provides support for its financing;

c purchase and leasebacks, in which, following delivery of the aircraft by the manufacturer to the airline, the latter immediately on-sells it to an operating lessor and takes it back on operating lease; and

d capital markets-based structures, such as the Enhanced Equipment Trust Certificate.

Increasingly, operating lessors buy aircraft directly from manufacturers for immediate use in their leasing business.

Shipping

For ships under construction, typically, the buyer will pay between 20 and 50 per cent of the contract price from equity or debt by stage payments. The builder funds the construction and is paid the balance on delivery, which may be funded by export credit agency-supported debt (perhaps at a fixed rate).

Rail

Typically, rolling stock is procured at the behest of a franchised operator who needs more rolling stock. The contract for manufacture is normally tripartite, with the ROSCO taking title and paying the stage payments. The ROSCO will fund the purchase from equity or from general corporate, or specific debt, facilities, and will negotiate the payments required to service that debt as part of the lease discussions with the operator. Although the operator

might be required to undertake a proper competitive tender procurement exercise for the rolling stock, the financing will normally be arranged privately by the operator approaching one or more ROSCOs.

On occasion, rolling stock is financed directly by an operator group, but this carries risks for the financier, which are reduced significantly if the ROSCO is the borrower. It is unlikely that an operator will hold the necessary franchise for the operation of the rolling stock for its full useful life, giving rise to risks with regard to the repayment of the debt.

The owner of rolling stock is normally required to enter into an agreement with the franchising authority (currently the Department for Transport), ensuring the continued availability of the rolling stock for the franchised railway system and restricting rights of disposal.

iii Enforcement

The general English law approach to the enforcement of security over assets is one of self-help, relying on the contractual terms of the security without the need to enlist the aid of the court. Other laws, however, may not allow lenders the full range of self-help remedies and may require judicial authorisation and, possibly, the enforcement of security through a court-supervised public auction. There are certain specific concerns for aircraft, ships and rail equipment.

All of these enforcement methods may be restrained if the owner of the asset is subject to insolvency procedures that restrain creditors from enforcing security (such as administration in the United Kingdom and Chapter XI proceedings in the United States).

Aviation

Countries ratifying the Cape Town Convention are encouraged (but not required) to adopt self-help remedies for creditors in respect of aircraft equipment and also to adopt Chapter XI-style insolvency proceedings for airlines under their jurisdiction under 'Alternative A' procedures. Under these procedures, defaulting airlines will be required to remedy a default within a specified waiting period or, if not, hand the aircraft back to the creditor. The United Kingdom has adopted Alternative A, replacing the administration framework currently in place (which requires the creditor to obtain court consent before repossessing the aircraft).

Creditors seeking to repossess aircraft also need to be aware of possible third-party creditors of the airline who may be able to claim liens, or detention rights, over the aircraft at law. Who these creditors consist of is a matter for the laws of the jurisdiction where the aircraft is situated at the relevant time. Common categories include repairmen, airports and air navigation authorities and unpaid salaries and taxes.

Shipping

The most common method of enforcement is to seek the arrest of the ship while in port and request that the local court sell the ship, usually by some form of auction process. The court will then distribute the net proceeds (after expenses) to the mortgagees and others with maritime claims against the ship. This method is favoured because such a sale is generally recognised in maritime countries as freeing the ship from existing encumbrances and debts.

If a ship is not sold through a court in this way then existing liabilities could potentially be left in place and, as a result, a potential buyer is likely to require warranties and indemnities from a creditworthy person against the existence and consequences of such liabilities (which a lender will probably be unwilling to give).

If self-help remedies are available under the laws of the ship's state of registry, other options may be to sell the ship as mortgagee or to take possession of it. Selling a ship privately as mortgagee will, however, only clear the ship's title of registered mortgages and not other types of maritime claim. Obtaining possession raises practical difficulties but, having achieved it, exposes the lender to the risk of claims arising from accidents or pollution incidents involving the ship during its possession, as well as responsibility for bearing the costs of insuring, maintaining and conserving the ship. Procedures and practices for arrest and sale of ships vary from country to country and some are considered more favourable to a speedy and efficient process than others.

Rail

When taking security over rolling stock used within the franchised railway system, the security holder is required to agree with the franchising authority that the rights to enforce the security are subject to rights of the franchising authority to take on the leasing of the rolling stock. To date, no enforcement action has been taken against rolling stock for borrower default.

There are special rules relating to the administration of a railway company, intended to ensure that the rolling stock owned or operated by that company remains active in the franchised railway system.

iv Arrest and sale

All relevant issues relating to the arrest and sale of aircraft, ships and rolling stock are dealt with in Section IV.iii, *supra*.

V CURRENT DEVELOPMENTS

i Recent cases

While there have been few cases relating specifically to the financing of ships or rolling stock, the English courts have been confronted by a plethora of cases in the aviation sector. These cases include:

a the *Blue Sky* case[5] relating to the *lex situs* rule for the creation of proprietary interests in aircraft;

b the *Alpstream* case[6] on the duties of mortgagees of aircraft;

c the *Pindell* case[7] on remedies for failure to redeliver aircraft in the right condition;

d the *Paramount* case[8] on the applicability of the doctrine of relief from forfeiture to aircraft leases;

e the *ACG v. Olympic* case[9] on the risk of latent defects in aircraft at delivery; and

f the *Global Knafaim* case[10] on the detention rights of the CAA and Eurocontrol.

5 *Blue Sky One Limited & Ors v. Mahan Air & Anor* [2010] EWHC 631 (Comm).

6 *Alpstream AG and Others v. (No. 1) PK Airfinance SARL (PK), and (2) GE Capital Aviation Services Limited (GECAS)* [2013].

7 *Pindell Limited and BBAM Aircraft Holdings 98 (Labuan) Limted v. AirAsia Berhad* [2010] EWCH 2516.

8 *Celestial Trading 71 Limited v. Paramount Airways Private Limited* [2010] EWHC 185 (Comm).

9 *ACG Acquisition XX LLC v. Olympic Airlines (in special liquidation)* [2012] EHWC 1070 (Comm).

10 *Global Knafaim Leasing Ltd & Anor v. The Civil Aviation Authority & Ors*, Court of Appeal – Administrative Court [2010] EWHC 1348 (Admin).

It is an empirical fact that the aircraft finance and leasing sector is becomingly increasingly litigious.

ii Developments in policy and legislation

Aviation

The main legal development in the aviation sector in the United Kingdom has been the ratification of the Cape Town Convention, which has already been discussed.

Export credit finance for aircraft has been largely put on hold as a consequence of political problems at Eximbank and European export credit agencies.

The aviation industry is one for which Brexit poses particular challenges. The European ownership of British airlines (and British ownership of other European airlines) may no longer be viable. The access of British airlines to foreign markets – for example to North America via the open skies agreement or within Europe by virtue of European skies – is also at risk. British airlines may no longer be able to benefit from 'horizontal agreements': aircraft services agreements between third-party countries and another EU state, which have been extended to the United Kingdom. The basis for the United Kingdom's continued participation in the European Air Safety Agency will need to be established. A host of regulations (for example, relating to compensation or wet leasing) will also need to be reconsidered. At the moment there is a lack of clarity as to how these problems will be resolved over the next few years.

Shipping

Changes in regulation can affect a shipping company and its financiers by requiring additional capital expenditure to modify a ship to comply with new requirements or by restricting the economic usefulness or life of the ship (perhaps where modification is not economically or technically feasible), thus reducing its profitability and value.

Much shipping legislation in the United Kingdom derives from conventions and regulations issued by the International Maritime Organisation. However, the European Union also provides some additional regulation and legislation relating to the shipping industry. While the United Kingdom has voted to leave the European Union, the terms of its exit have not, at the time of writing, been agreed, and so it is conceivable that there may be some changes to domestic shipping legislation as a result of Brexit, but it is doubtful whether these would be significant or wide-ranging.

Rail

Railway policy is politically charged and constantly changing. There are renewed threats of renationalisation against a background of continued discussion about fundamental aspects of the industry, such as:

a the adequacy of the performance of the infrastructure (whether Network Rail should be broken into regional entities to create a more competitive environment; whether operators should be able to take over the infrastructure management);

b the appropriate approach to franchising (how long franchises should last for); or

c whether foreign state operators should be allowed to take on franchises and extract the profits (the German, Dutch and French state railways all operate franchises).

There are also discussions about whether to restructure the regulation of franchising, taking the role of reletting franchises out of government hands. Despite all these issues, the only

scenario potentially relevant to the financing of the rolling stock would be renationalisation, in which case rolling stock owners might expect to be paid out at an appropriate market value.

iii Trends and outlook

Aviation

The main manufacturers are forecasting a significant increase in the number of aircraft operated globally over the next 10 to 20 years. Much of the new fleet will be destined for operation in the Asia-Pacific region or Latin America, with the number of aircraft being operated in Europe remaining relatively stable.

As the financial crisis becomes more distant and banks find alternative sources of liquidity for their debt offerings, there has been a return of the commercial banks to the aircraft finance market.

As bank margins have increased, more airlines have been turning to the capital markets to finance aircraft. In particular, there has been more appetite for the Enhanced Equipment Trust Certificate, with airlines such as Air Canada, Emirates, Turkish Airlines, Norwegian and British Airways accessing the market.

Finally, the percentage of aircraft operated by airlines under operating leases continues to grow. There is a significant number of new entrants into the operating lease sector, often backed by private equity, and they too have their financing needs.

Shipping

Resumption in trade growth should gradually ease the imbalance between supply and demand for ships. Shifts in oil prices affect demand for assets involved in offshore oil and gas and changes in trading patterns or regulatory changes may affect demand, positively or negatively, for certain other categories of ship.

As with other types of economic activity, there will be some shift of emphasis in global ship-owning towards the Far East (for example, as Chinese shipping companies continue to grow their fleets) and other emerging markets, which international shipping banks and English-qualified shipping finance lawyers will be well placed to serve.

The impact on the shipping industry of the United Kingdom's decision to leave the European Union remains to be seen. If trade to and from the United Kingdom is significantly affected by Brexit, then this could have implications for shipping. However, given the global nature of the industry, the Brexit vote may have little impact and may offer new opportunities to some sectors.

There will, however, always need to be ships, and finance for them. While it is likely that banks and export credit agencies will also continue to have the major role in ship financing, there is likely to be a growing role for debt and equity capital markets and other specialised forms of finance.

Rail

Two of the three ROSCOs (Porterbrook and Eversholt) have in recent years been sold to new investors, and the level of interest in those sales suggests that those new investors find the ROSCOs' market position and the nature of the rolling stock market in general to be attractive; also, potential investors are not put off by the concerns referred to above regarding competition authority investigations into the level of profit made by the ROSCOs. In

addition, a number of financiers other than the three ROSCOs have been involved in rolling stock financing transactions in recent years, and project financing structures have been seen in relation to major orders for rolling stock for intercity trains and Crossrail, and might be proposed for the new HS2 train order.

Passenger numbers continue to grow, but fare increases are unpopular. New rail infrastructure is being built (Crossrail, Thameslink and possibly HS2, HS3, Crossrail 2 and Crossrail 3) signifying a long-term belief in rail. On the freight side there is investment in getting more freight onto trains and away from the roads; there are many keen investors. The trends look positive as infrastructure investments (in track, stations and signalling) improve, leading to greater efficiency and increased traffic, but as a business activity, a lot depends on whether the railway system remains in private hands.

Chapter 15

UNITED STATES

Brad L Berman[1]

I INTRODUCTION

The United States – and specifically New York – is a global financial centre and leading jurisdiction for vessel-financing transactions. Home to many large financial institutions and public exchanges, shipping companies have long sought financing in the United States. Furthermore, many international shipping companies, as well as major legal, financial and other service providers to such companies, are located in the United States. In addition, admiralty law is subject to US federal jurisdiction establishing consistent court precedent providing security for business practice.

Historically, the shipping industry's principal source of capital has been the domestic and international ship finance bank market; however, financing for the shipping industry has been affected by the recent global economic downturn and it has proven much more difficult to secure. The US vessel finance market has adapted to this changing landscape and has expanded sources of capital to include public capital market equity and debt offerings and, most recently, the infusion of private equity (PE) investments. In the latter case, PE investors have learned the intricacies of the shipping markets and invested in a multitude of different projects.

In addition, the past surge in US crude production created strong demand for US-flagged Jones Act tankers and record charter rates for such owners. Future oil prices will dictate the direction of this trend. Domestically there are several US-flagged new-build vessels that are currently on order or have recently entered service. This secures jobs in the United States and ensures the longevity of the US shipbuilding industry.

II LEGISLATIVE FRAMEWORK

i Domestic and international law and regulation

The financing of US-flagged vessels is regulated by national, state and local laws as applied through various administrative agencies. National legislation includes the Ship Mortgage Act, the Merchant Marine Act, the Maritime Security Act, the Oil Pollution Act (OPA), the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) and

1 Brad L Berman is a partner at Norton Rose Fulbright US LLP. The author would also like to thank colleagues Julie Pateman Ward, Utsav Mather, Kathleen Scott and Kassandra Savicki for their assistance in preparing this chapter.

the Coast Guard Authorization Acts. Administrative agencies include the United States Coast Guard (USCG), its sub-agency, the National Vessel Documentation Center (NVDC) and the Maritime Administration (MARAD).

Vessel documentation requirements

Section 27 of the Merchant Marine Act, also known as the Jones Act, provides for the registration and documentation of vessels under the US flag. The NVDC is authorised to document any vessel of at least five net tons not documented under the laws of a foreign country and wholly-owned by an 'eligible owner'. An eligible owner, also known as a 'documentation citizen', must satisfy certain management-level criteria. For example, in the case of a corporation, the chief financial officer (by whatever title) and chairman of the board of directors must be US citizens. All directors, except a minority of the quorum, must be US citizens.

A US-flagged vessel is eligible to receive one of three 'endorsements' – registry, fisheries and coastwise – each of which permits the vessel to engage in certain types of commercial activity. As part of its due diligence prior to financing the purchase of a US-flagged vessel, a financier should examine the relevant vessel's trade endorsement and confirm that the vessel is authorised to conduct the contemplated commercial activity. A registry endorsement entitles a vessel to engage in trade between a US port and a foreign port, and between two foreign ports. A coastwise (cabotage) endorsement entitles a vessel to engage in trade between two points in the United States to which the coastwise laws apply, either directly or via a foreign port. To be eligible for a coastwise endorsement, a vessel must be built in the United States and owned, operated and manned by US citizens. A corporation is only deemed a US citizen for coastwise trade purposes if at least 75 per cent of its equity interests are held by US citizens.

Debt financing

Since the 1996 amendments to the Ship Mortgage Act (eliminating the requirement of the 'Westhampton Trust'), there are no restrictions on the citizenship of mortgagees holding a mortgage on a US-flagged vessel. If a mortgage covers the entirety of a documented vessel, it will be characterised as a preferred ship mortgage, valid against the grantor, mortgagor or assignor, the heir or devisee of any such party, or any other party having actual notice of the mortgage. To be valid against third parties, it must be perfected by filing with the NVDC. This requires that the mortgage identify the vessel, state the name and address of each party, state the amount of the direct or contingent obligations, the interest of the grantor, the interest mortgaged and be signed and notarised. A foreign mortgage is deemed preferred in the United States if it was executed under the laws of a foreign country and has been registered at a foreign central office.

Lease financing

An entity that meets the documentation citizen requirements in relation to a registry endorsement is permitted to own a vessel with a coastwise endorsement if (1) the entity is primarily engaged in leasing or other financing transactions; (2) the vessel is under demise charter for at least three years in duration to an entity qualified to engage in coastwise trade; and (3) the owner is independent from and not affiliated with any charterer or any person that has the right to direct vessel movement or its use. This 'foreign lessor exemption' was designed to permit passive foreign leasing companies to finance under a lease structure US

vessels with a coastwise trade endorsement. In the event of a default, while lessors cannot operate a coastwise vessel directly, they may sell the vessel to a US citizen or a non-US citizen with MARAD approval or appoint a new lessee to charter the vessel (under a new lease or a lease assumption). A foreign lessor will be exempt from the strict environmental liability provisions of OPA 90 and CERLCA if they hold an 'indicia of ownership' primarily to protect a security interest, and do not exercise decision-making control over the vessel.

In the *Lykes Bros Steamship* case,[2] a bankruptcy court held that a vessel lease-financing transaction was a mere 'financing transaction' and not a 'true lease'. The court recharacterised the transaction and held that the demise charterer was the true owner, rendering the lessor an unsecured creditor. To protect against this risk of recharacterisation, lessors can require the demise charterer to execute and file a preferred ship mortgage (usually for the full value of the vessel) in favour of an affiliate of the lessor. Typically, the foreign lessor then purchases the vessel back from the demise charterer for a nominal sum before chartering back the vessel. This legal framework ensures that if the transaction is recharacterised as a loan, the preferred ship mortgage in favour of the bank's affiliate, which predates the transaction, operates to provide the bank with some degree of security over intervening creditors.

III FINANCIAL REGULATION

i Regulatory capital and liquidity

Banking organisations in the United States are subject to complex risk-based regulatory capital rules. Some banking organisations may use internal risk management models approved by the relevant regulator; others must use standardised rules set out in the regulations. Generally speaking, the more risk associated with a particular loan, the more capital that must be reserved against it on a bank's books. The risk associated with shipping has put capital constraints on ship lenders.

The United States has adopted the Basel III risk-based capital requirement regime, which is being phased in by 1 January 2019. Each federal bank regulatory agency has promulgated the requisite risk-based capital requirements.[3] For example, under the standardised regulatory capital regulations, ordinarily, corporate loans are assigned a 100 per cent risk weight, which can be adjusted upwards by the applicable supervisory authority. In accordance with the applicable regulations, collateralisation of a loan may then mitigate the risk weight of a particular asset. Notwithstanding, the delivery of standard ship security (mortgage, assignments of earning and insurances, etc.), loans to finance ships are considered high-risk and impose significant capital reserve requirements on banks lending to this sector.

In addition to the risk-based capital requirements, banking organisations also need to comply with a leverage requirement, which is a ratio of its Tier 1 capital (e.g., common equity) to an aggregate of certain assets (e.g., on-balance sheet assets such as loans). Banking organisations also will be subject to certain short and long-term liquidity requirements. Requirements may vary depending upon the amount and nature of the banking organisation's assets and activities.

2 *In Re Lykes Bros Steamship Co Inc*, 216 BR 856 (MD Fla 1996).

3 See 12 CFR Parts 3, 217 and 324.

ii Supervisory regime

In the United States, there are several bank regulators. Bank holding companies are regulated by the Board of Governors of the Federal Reserve System (Federal Reserve Board). Banks can be chartered by either a US state regulator, such as the New York Department of Financial Services (a state-chartered banking organisation), or the United States Department of the Treasury (a national bank or federal savings association). Federal deposit insurance is provided by the Federal Deposit Insurance Corporation (FDIC). State-chartered banking organisations also have a federal overlay of banking regulation and supervision, by either the Federal Reserve Board or the FDIC, depending upon whether the state-chartered banking organisation is a member bank of the Federal Reserve System. The applicable federal and state banking laws, including the capital regulations, are the primary banking legislation and regulation affecting the banks' ability to lend into the transport sector, but their applicability may be limited by more specific US transport-financing laws and regulations discussed elsewhere in this chapter.

IV SECURITY AND ENFORCEMENT

i Security documents

Lenders typically require a package of security documents, enforceable against the shipowner, or the ship itself, in the jurisdictions into which the ship calls. These include preferred ship mortgages, assignments of a vessel's earnings, insurances, charters and requisition compensation, share pledges by owner holding companies, undertakings by vessel managers, guarantees and assignments of deposit accounts.

Under US law, the most common form of US vessel security is the 'preferred ship mortgage' under the Commercial Instruments and Maritime Liens Act (CIMLA). To gain preferred status, a mortgage must meet several requirements, including being made in favour of a mortgagee that is either a United States state, the United States government, a federally insured depository institution, a citizen of the United States, a person qualifying as a citizen of the United States under Section 50501 of Title 46 of the United States Code, or a person otherwise approved by the Secretary of Transportation. A preferred ship mortgage is perfected by filing the mortgage with the central registry at the NVDC.

ii Enforcement, arrest and judicial sale

The primary mechanism for enforcement of a preferred ship mortgage on either a US or foreign-flagged ship in the United States is an *in rem* action under a federal court's admiralty jurisdiction. Such an action may be brought in any US District where the vessel is physically present. The court may appoint a receiver to operate the mortgaged vessel in global trade so the vessel may continue to earn revenue while maintaining *in rem* jurisdiction over the vessel, or, if the court finds that the lender's mortgage is valid and in default, the court may order that the vessel be arrested by the US Marshals Service and sold in a judicial sale. The US marshal for that judicial district will then serve the warrant and related documents to the vessel and effectuate the arrest. If the owner is unable to post a bond or other security for the mortgage claim, the vessel will remain in the custody of the court pending an interlocutory sale thereof. When a vessel is sold by order of a district court in an *in rem* action, all claims against the vessel are terminated and subsequently attach to the proceeds of the sale.

Ranking of liens

Judicial sale does not guarantee the lender full repayment. The proceeds from a judicial sale are used to satisfy maritime liens in order of relative priority; for example, competing maritime liens are ranked according to class and top-ranked claims are paid out first, while among maritime liens of equal class, later liens have priority according to the 'inverse order' rule).

Preferred ship mortgages rank highly as maritime liens, taking priority over all claims (except the costs of administering the sale) that are not 'preferred maritime liens', consisting of seaman's liens, salvage and general average liens, tort liens, and any other maritime liens arising before a preferred mortgage was filed. As between two mortgages, each is prioritised according to the 'first-in-time' filing rule, subject to the application of the 'voyage rule', which provides that two claims of the same class arising during the same voyage are paid *pro rata*. The date a mortgage is filed is the relevant date for the ranking analysis, not the date the funds are actually advanced, provided the mortgage covers the subsequently advanced debt. If a mortgage is amended to provide for an advancement of new funds not covered by the original agreement, then the new funds are treated as being covered by a separate, newly created mortgage.

A lender is not bound by the remedies afforded it by operation of US federal law. A lender can exercise private and extrajudicial remedies – such as taking possession of the vessel – if such remedies are permitted under the contract (mortgage or loan agreement) and under the laws of the state where the vessel is located. CIMLA expressly allows lenders to 'enforce [a] preferred mortgage lien or a claim for the outstanding indebtedness secured by the mortgaged vessel […] by exercising any other remedy (including an extrajudicial remedy) against a documented vessel [or] a foreign vessel […] for the amount of the outstanding indebtedness or any deficiency in full payment of that indebtedness', but only if the remedy is allowed under the law of the state where the vessel is docked. For example, in the *Dietrich v. Key Bank* case,[4] the court held that a bank could repossess a vessel that was docked at a Florida harbour since the bank specifically contracted for such a self-help remedy and the right of repossession existed under Florida state law.

Repossession by a non-citizen

Complications can arise when a vessel with a coastwise endorsement is repossessed or purchased at a judicial sale by a non-citizen mortgagee. Such a right of purchase by a mortgagee is specifically provided for in 46 USC, Section 31,329, notwithstanding the strict regulation of the citizenship of entities that own and operate coastwise-qualified vessels under the Jones Act. If a coastwise-qualified vessel is repossessed or purchased by a non-US citizen mortgagee, the vessel may only be held temporarily for resale subject to emergency sale restrictions. It may not be 'operated, or caused to be operated, in commerce'.[5] The vessel will also not permanently lose its coastwise trading privilege, which it would if it were sold to a non-citizen.

4 *Dietrich v. Key Bank NA*, 72 F.3d 1509 (11th Cir 1996).

5 46 CFR § 221.19.

V CURRENT DEVELOPMENTS

i Recent cases

The definition of which structures constitute 'vessels', thus capable of being the subject of preferred ship mortgages, was recently revised by the Supreme Court in the decision *Lozman v. City of Riviera Beach, Florida*.[6] In that case, the Court considered whether a house-boat, permanently moored and without a propulsion mechanism, constituted a vessel subject to federal maritime law. The Court referenced the Rules Construction Act, which defines a vessel for purposes of the US maritime statutes as including 'every description of watercraft or other artificial contrivance used, or capable of being used, as a means of transportation on water'. The Court further articulated that a floating structure is not a vessel 'unless a reasonable observer, looking to the [structure]'s characteristics and activities, would consider it designed to a practical degree for carrying people or things over water'. This has come to be known as the 'reasonable observer' test for determining vessel status. Under this test, 'not every floating structure is a "vessel"', and the mere ability to relocate a structure over water does not automatically render it a vessel. Moreover, the subjective intent of the structure's owner is irrelevant – only the 'physical attributes and behaviour of the structure', which are 'objective manifestations' of the structure's 'purpose', affect vessel status. The decision has cast doubt over established principles of the United States Circuit Courts of Appeals, and created confusion regarding which vessels can be subject to preferred ship mortgages. The decision also creates the potential situation that, despite a structure's USCG status as a documented vessel, it may not constitute a vessel under the general maritime law as applied by federal courts.

The challenge of a public company satisfying coastwise citizenship requirements was highlighted in the USCG's recent investigation into the citizenship of Trico Marine Services Inc. In that case,[7] a non-citizen shareholder of Trico alleged that, through its two vessel-owning subsidiaries, Trico had breached the 75 per cent US citizenship requirement of its vessels' coastwise endorsements. Trico contended that it was impossible to verify whether public shareholders were of US citizenship as certain shareholders are entitled to prohibit the disclosure of their identity under SEC regulations including the Exchange Act. In the alternative, Trico relied upon shareholder declarations obtained through the Depository Trust Company programme, which showed that no more than 25 per cent of shareholders were non-citizens. In making its decision, the Coast Guard dismissed both of Trico's defences as inadequate to establish compliance with the 75 per cent threshold. It held that if a publicly traded corporation sought the 'privilege of engaging in the coastwise trade', it must 'structure itself and its equity securities in such a way […] by which it can satisfy its obligations under the Jones Act'. The Coast Guard fined Trico approximately US$6 million and recommended that the NVDC invalidate each vessel's certificate of documentation. The decision arguably left publicly traded corporations with little guidance as to how to structure their operations to ensure compliance with coastwise requirements.

6 *Lozman v. City of Riviera Beach, Florida*, 133 S Ct 735 (2013).

7 Memorandum from Timothy V Skuby, Acting Dir, Nat'l Vessel Documentation Ctr, US Coast Guard, to Kevin Cook, RADM, US Coast Guard, US Coast Guard 1, 20–21 (12 January 2011), www.uscg.mil/hq/cg5/nvdc/report/Trico.pdf.

ii Developments in policy and legislation

The shipping industry is frequently subject to changing legislation that affects the profitability of vessels and the value of vessel security. For example, new environmental regulations and vessel security measures require shipowners to make additional capital expenditures to ensure compliance. It is important to note that these regulations are imposed by local, state and national authorities, and can be inconsistent.

While there has recently been proposed legislation in the US Congress to repeal the restrictions on coastwise endorsements and to open the Jones Act trade market to foreign-flagged vessels, the proposal was defeated because of strong opposition from US shipyards, maritime unions and national defence interests.

There have also been recent efforts to further bolster the US shipbuilding industry through legislation. In late 2015, Congress was considering legislation that would require all US-produced LNG to be exported on US-built-and-flagged vessels. However, the proposal failed to gain significant momentum because a report[8] by the Government Accountability Office indicated that the time and expense associated with building a Jones Act-qualified LNG fleet may undermine the competitive advantage of US LNG exports.

iii Trends and outlook for the future

New York will continue to be a key jurisdiction in vessel-financing transactions. While traditional sources of financing have constricted in the United States and elsewhere, the US market has adapted and responded to meet the financing demands of shipping companies. With the increase investment in shipping by US private equity investors, US-based lending through US lenders and US branches of foreign lenders has also increased. These newly created US-based companies backed by US private equity interest will continue to require US law transactions.

8 GAO-16-104: Implications of Using US Liquefied-Natural-Gas Carriers for Exports, www.gao.gov/assets/680/673976.pdf.

Appendix 1

ABOUT THE AUTHORS

JOÃO ANACORETA CORREIA

Uría Menéndez – Proença de Carvalho

João Anacoreta Correia became a partner at Uría Menéndez – Proença de Carvalho in 2004 and is currently managing partner of the Porto office. He jointly heads the litigation and corporate law practice areas, and also specialises in M&A, capital markets, securitisation and insurance.

He is recognised by the leading international legal directories and has been named by *Chambers Europe* as one of the best lawyers for general business law in Portugal (Tier 1), and Lawyer of the Year 2016 in corporate law (Porto) by the publication *Best Lawyers* in Portugal. He is also recommended by Best Lawyers in Portugal as a leading lawyer in arbitration and mediation, telecommunications law and transportation law.

In describing João, *The Legal 500* notes that 'his leadership of the team of lawyers of the Porto office is highly admired by the market', emphasising his close relationship with the cultural and economic market in Galicia and northern Spain.

YANN ANSELIN

Norton Rose Fulbright LLP

Yann Anselin is a senior associate in the antitrust, competition and regulatory department of Norton Rose Fulbright LLP in Paris.

Yann specialises in competition and European law. His practice focuses on cartel and abuse-of-dominant-position cases before national and EU authorities, and he deals with merger notifications both at national and European levels.

Before joining Norton Rose Fulbright LLP in October 2009, Yann worked for the European Commission's Directorate-General for Competition (2004–2005), for a Brussels public affairs consulting firm (2006), and for the law firm Dentons (formerly Salans LLP).

Yann holds a master's degree in competition and European law from Saarland University in Germany (2004) and a master's degree in international law and business from Panthéon-Sorbonne University (2002).

Yann was admitted to the Paris Bar in 2007.

OLIVIER BAZIN

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Olivier Bazin is a partner of HFW's Geneva office. He is a finance lawyer with more than 15 years' experience in trade, commodities and emerging markets. He has gained extensive transactional experience in corporate finance and structured trade finance, advising both financiers and borrowers. He is particularly skilled in cross-border finance transactions; structuring and negotiating transactions in the transport, agri, oil and gas, metals and mining sectors; and advising on debt restructuring and work-out situations. Olivier also has experience in secured lending in the logistics and rail sectors. He spent 10 years with a leading London finance law firm, including four years in their Moscow office, before joining BNP Paribas (Suisse) SA in Geneva, as in-house counsel. At BNPP he was a senior English Counsel in the corporate and investment banking division, and latterly head of legal – Eastern Europe. Olivier is qualified in England and Wales, and speaks various languages including French, Russian and Spanish.

BRAD L BERMAN

Norton Rose Fulbright US LLP

Brad Berman is a partner in the New York office of Norton Rose Fulbright US LLP. He has over 30 years' experience in international structured finance and corporate law. He regularly advises owners, operators, investors and lenders on corporate ownership structure, financing arrangements and vessel registration. In addition, he has also advised issuers and underwriters on domestic and international corporate and securities matters, including initial public offerings, leveraged buyouts, international private placements, and private equity investments.

NICOLE CUNHA

Basch & Rameh Advogados Associados

Nicole is a Brazilian lawyer based in Rio de Janeiro. She has worked in the areas of business, corporate and finance laws with a particular focus on aviation finance transactions. She obtained her Bachelor of Laws degree at the Candido Mendes University in Rio de Janeiro. She has a postgraduate in business law with a focus on tax laws from the Fundação Getúlio Vargas (FGV/RJ,) and obtained her Master of Laws degree (LLM), achieving overall distinction, at the Queen Mary University of London.

MARIA JOÃO DIAS

Uría Menéndez – Proença de Carvalho

Maria João Dias is an associate in the M&A practice area of Uría Menéndez – Proença de Carvalho's Porto office. Maria João joined the firm in 2008. For the last quarter of 2015 and first of 2016 she was on secondment to the maritime and transport team of the Madrid office.

Maria João specialises in commercial and corporate law and has a wealth of experience in M&A at a national and international level. She has worked on numerous private equity deals, especially in the health sector. Maria João has also provided assistance in several due diligence processes and negotiations within acquisition and joint-venture transactions.

Maria João also specialises in financing within the maritime sector and matters relating to the International Shipping Register of Madeira.

NICK DUNNE

Walkers

Nick Dunne joined the Walkers Cayman Islands office in 2008. He is senior counsel in the firm's commercial litigation and dispute resolution group. He deals with a wide range of local, international and cross-border commercial disputes and arbitrations, with a particular expertise in asset recovery. He is described in the 2015 edition of *Who's Who Legal* as a 'regular on the asset-recovery scene' and frequently appears in cases before both the Grand Court and the Cayman Islands Court of Appeal, with experience of appeals to the Judicial Committee of the Privy Council.

He is also a member of the regulatory group, with significant practical experience of local licensing and approvals for financial services, aviation and technology operations.

Nick was called to the Bar by Middle Temple in 2001 and was a barrister in private practice until he relocated to the Cayman Islands.

CHRISTINE EZCUTARI

Norton Rose Fulbright LLP

Christine Ezcutari heads the Paris shipping practice of Norton Rose Fulbright.

She joined the Paris practice in 1997, having qualified as both a solicitor of the Supreme Court of England and Wales and an *avocat à la cour*. She became a partner in 2006.

Christine regularly acts on behalf of large European financial institutions and lessors. She has experience in structured financings, in the form of complex multi-jurisdictional financing, tax structures and export credit financings. She has advised banks and shipowners on many ship and export credit financings, as well as on general commercial matters. Christine has acquired a particular expertise in the field of export credit financing.

She is recommended in many legal directories including *Chambers* and *The Legal 500* and has been recognised as one of the world's leading women in business law by the Legal Media Group's *Expert Guides* (2012), and as 'lawyer of the year' in transportation in France by Best Lawyers (2014/2015).

Christine is a member of the Association Française de Droit Maritime and author of the France section of Marine Money's Official Guide to Ship & Yacht Registries. She is also a board member of WISTA France.

In 2015, Christine was named a Knight of the National Order of Merit by the French Ministry of Ecology, Sustainable Development and Energy for her career achievements.

CHRISTIAN FARRUGIA

Fenech Farrugia Fiott Legal

Dr Christian Farrugia is one of the founding and co-managing partners of Fenech Farrugia Fiott Legal, a Malta-based business and tax law firm with offices in Valletta and Swatar. With a postgraduate degree in maritime and insurance law conferred upon him by the University of London following his graduation as a Doctor of Laws in Malta in 1987, he counts commercial and corporate law, shipping and financial services within his main areas of specialisation. Dr Farrugia is also a founder director of ARQ Fiduciaries Ltd, an MFSA-licensed fiduciary

and trustee, as well as a non-executive chairman director of Advent Insurance PCC Limited and MFC Merchant Bank Limited.

Dr Farrugia is a member of the Chamber of Advocates and the Malta Chamber of Commerce and Industry, and he lectures in shipping law at the University of Malta.

TONIO FENECH

Fenech Farrugia Fiott Legal

Dr Fenech's career has been marked, on the one hand, by the development of a wide legal practice as a transactional lawyer and, on the other, by taking a leadership role with a number of professional services providers he has served, developing platforms for integrated multidisciplinary professional services offerings.

Dr Fenech's professional experience and expertise as a Malta-based lawyer span a number of areas of law, but he has concentrated particularly in the fields of maritime and aviation law, corporate commercial law, various aspects of financial services law and the developing field of the law of fiduciary obligations, including the law of trusts and foundations.

Dr Fenech is a founding partner at Fenech Farrugia Fiott Legal, a full-service law firm based in Malta. He is also a founding director at the ARQ Group of companies, a multidisciplinary corporate, trust and related services provider also based in Malta. He is also active in academic fora, and has been teaching undergraduate and postgraduate students in the University of Malta Faculty of Laws for over 20 years, running courses on asset finance, insurance law and trusts and fiduciary structures.

TOMÁS FERNÁNDEZ-QUIRÓS

Uría Menéndez

Tomás Fernández-Quirós has been a partner in the Madrid office of Uría Menéndez since 2002. From 2002 to 2011 he was based in the firm's office in Barcelona.

Tomás specialises in maritime and transport law, and in international litigation and arbitration. He advises Spanish and foreign companies in the maritime and port sector, and financial entities in projects relating to the development, operation and financing of ports and port terminals. He also has extensive expertise in the yacht sector.

He is regarded as a leading lawyer in Spain for maritime business law by *Who's Who Legal* (2010 to 2017) and *Chambers Europe* (2012 to 2017).

RICARDO GASPAR DIAS

Uría Menéndez – Proença de Carvalho

Ricardo Gaspar Dias is a junior associate in the M&A practice area of Uría Menéndez – Proença de Carvalho's Porto office, which he joined in 2014.

His professional practice is mainly focused on civil and corporate law, with an emphasis on litigation and advising on all aspects of dispute management. He has experience in matters relating to ship financing and intervenes frequently in ship-arrest proceedings.

Ricardo regularly provides assistance in the drafting of civil and commercial contracts and in M&A processes (mainly in due diligence processes for the acquisition of companies, businesses and real estate assets), advising both national and international clients.

KENNETH GRAY

Norton Rose Fulbright

Kenneth Gray is a consultant in our London banking department and has over 30 years' experience of advising on banking and security law in London and Paris. He joined Norton Rose Fulbright in 1986, founded the Paris office in 1990 and became a partner in 1993. He has been a consultant to the practice since 2006.

During his career, Mr Gray has focused primarily on aircraft and other asset finance. Many of the transactions on which he has worked have been selected as 'deal of the year' by trade periodicals. Since becoming a consultant at the practice, Mr Gray's activities have focused on advising clients on strategic issues such as the implementation of the Basel Accords and the Capital Requirements Regulation, the ratification of the Cape Town Convention by the United Kingdom and the consequences of Brexit.

In parallel to his consultancy, Mr Gray has developed a successful career training banks and other companies on diverse issues such as aviation finance, asset finance, structured finance and loan and lease documentation.

Mr Gray is a member of the Legal Advisory Panel to the Aviation Working Group and the head of the UK National Contact Group for the Cape Town Convention.

TAICHI HIRONAKA

Yoshida & Partners

Since joining Yoshida & Partners in 2002, Taichi Hironaka has handled a number of maritime cases, involving collision, grounding, engine trouble, charter party disputes and cargo defences. In light of his knowledge, understanding and keen interest in technical issues, he has also dealt with many disputes involving engineering matters relating to engine and hull structure. He is also well versed in IP matters (especially patents and trademarks) and architectural disputes. He became a partner in 2017.

Mr Hironaka graduated from Kyoto University in 2001 with a Bachelor of Engineering degree, majoring in architecture. He was called to the Bar in 2002, and, in 2013, received his LLM from the University of Southern California Gould School of Law.

RICHARD HOWLEY

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Richard Howley is a banking lawyer based in London who is experienced in international ship finance, with a particular focus on financing LNG carriers. He has a broad range of experience in bilateral and syndicated debt facilities and structured financings, including the project and lease financing of LNG carriers and the project financing of semi-submersible drilling rigs, FPSOs and other floating production units, and the negotiation of shipbuilding and other transport contracts, particularly in connection with shipowners tendering for LNG projects. Mr Howley has been involved with the financing of both second-hand and new-build vessels, acting for shipowners, banks and lessors worldwide. He has also acted for international banks and finance lessors in relation to the debt financing and lease restructuring of semi-submersible drilling rigs, drillships and FPSOs.

RENATA IEZZI

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Renata is a Brazilian lawyer based in São Paulo. She concentrates on commercial and civil law litigation involving foreign entities and international trading agreements, aircraft financing and leasing, civil liability in air transportation and shipping, damages of varied types, judicial recuperation and bankruptcy. Her overall professional experience also includes consulting for foreign entities investing in Brazil, and contracts in general. She obtained her Bachelor of Laws degree (LLB) at the University of São Paulo, Brazil (LLB, 1993). Renata has been a member of the Brazilian Association for General Aviation (ABAG) since 2013.

MORTEN L JAKOBSEN

Gorrissen Federspiel

Morten L Jakobsen is a partner at Gorrissen Federspiel, and heads the firm's aviation department and also works in shipping and transportation and finance. Since 1997, he has specialised in aviation and in aircraft, ship and rail financing, and advises airlines and other aircraft operators, lessors, banks, shipping companies, rail operators and other players within the transportation sector with respect to, *inter alia*, leasing, wet-leasing, charters, purchase and sale, maintenance, incidents and accidents, regulatory matters, registration, arrest and repossession, traffic rights, insurance, code-sharing, airline start-ups and transportation sector-related M&A, procurement, restructurings, insolvencies and insolvency work-outs.

Mr Jakobsen is on the management committee of the European Air Law Association and holds office as secretary of the association and co-arranges conferences and seminars in Europe focusing on legal issues relevant to the aviation industry, including heading the biennial Copenhagen Air Finance Legal Seminar. He is also a co-lecturer on aircraft finance at Leiden University's International Institute of Air and Space Law, speaks on aviation-related conferences and seminars, both national and international, and has contributed to a number of publications in his field of work.

TOM JOHNSON

Norton Rose Fulbright

Tom Johnson is a banking lawyer based in London. He specialises in rail-financing transactions and has extensive experience advising on a wide variety of rail-related matters, both in the United Kingdom and internationally. He is also global head of the rail group.

Mr Johnson is described in *Chambers UK* 2014 as 'one of the most respected practitioners in the field of rail finance'.

He joined the London practice in 2004 having previously worked in the Tokyo office of another leading international legal practice for a number of years.

CARLOS LÓPEZ-QUIROGA

Uría Menéndez

Carlos López-Quiroga has been a partner in the Madrid office of Uría Menéndez since 2002.

He specialises in maritime and transport law, asset finance transactions in the transport sector, and M&A. He advises on all kinds of complex structures for the acquisition, leasing, construction, insurance and securitisation of assets.

Carlos has been recommended for shipping finance by *Chambers Europe* (2008–2017) and *Best Lawyers in Spain* (2013–2017).

ANNA MASUTTI

LS Lexjus Sinacta

Professor Anna Masutti is head of the department of aviation and aerospace at LS Lexjus Sinacta. Her experience includes the drafting of contracts for the aviation sector, in particular purchase, sale, leasing (wet or dry lease) aircraft and helicopters and related financial transactions and warranty. Her practice focuses on advising and representing business enterprises and public institutions, and she regularly advises on a wide variety of regulatory matters concerning aerospace industries, airlines and airports and assists clients on aviation litigation before both Italian and international courts.

She is professor of air law and European transport law at the University of Bologna; she is also visiting professor at the European University Institute (EUI) in Florence.

She is currently very active in the implementation of the Single European Sky and SESAR programmes. She frequently contributes to projects on the SES and is a partner of the following: System-Wide Information Management Supported by Innovative Technologies (SWIM-SUIT) with SELEX Sistemi Integrati, a Finmeccanica Company; Assessing Liability Issues of Automated Systems (ALIAS) with Eurocontrol and SESAR JU; and the Unmanned Aerial Systems in European Airspace (ULTRA) project promoted by Indra Sistemas SA.

Professor Masutti is on the board of the European Air Law Association (EALA), is a board member of the Italian Business Aviation Association (IBAA) and is a member of the executive committee of the Centre for Aeronautical Military Studies (CESMA). In addition, she is editor of *The Aviation and Space Journal*, and the Italian representative in the International Panel of 'Air and Space Law'. She is also a member of the aviation committee of the International Bar Association (IBA).

PAULO MATTAR FILHO

Basch & Rameh Advogados Associados

Paulo is a Brazilian lawyer based in São Paulo. He obtained his Bachelor of Laws degree (LLB) and his business law specialisation at the Pontifical Catholic University of São Paulo (PUC/SP). He obtained his Master of Laws degree (LLM) at the University of Chicago Law School. Paulo concentrates on commercial and corporate matters, M&A, joint ventures and foreign investments in Brazil, as well as transactions in the oil and gas industry, including financing transactions (asset finance) of oil platforms, drilling rigs and vessels. Paulo is a founding member and director of the Applied Corporate Law Institute (IDSA) and has published a number of articles.

ALEXANDER MEDNIKOV

Jurinflot International Law Office

Alexander Mednikov is a managing partner of Jurinflot. Having graduated with honours from the law faculty of the Russian People's Friendship University (Moscow) in 1998, he joined the firm full-time in 1999, being admitted to the Bar in 2002 and becoming a partner in 2003. Alexander advises clients primarily in issues of ship finance, international trade and M&A.

RICHARD MUNDEN

Walkers

Richard Munden is based in Walkers' Cayman Islands office, where he is a partner in the firm's global finance and corporate group. He advises on a broad range of finance and corporate matters and specialises in aircraft, shipping and other asset finance, acting for lenders, leasing companies, manufacturers, export credit agencies and operators. Richard also advises on financing for hedge funds, private equity funds and venture capital funds and advises with respect to downstream acquisitions and other transactions. His corporate practice covers share acquisitions and sales, equity issues and joint venture and shareholder arrangements across a wide range of industry sectors.

Prior to joining Walkers, Richard was general counsel and part of the early stage management team of Vueling Airlines in Barcelona. After the IPO of the airline, he was appointed head of fleet. While in-house, Richard worked on a range of commercial projects and was heavily involved in the aircraft finance and leasing market, leading his airline's fleet acquisition programme and manufacturer negotiations.

Before his in-house role, Richard was part of the finance group at Freshfields Bruckhaus Deringer in London and Madrid. He specialised in cross-border asset finance, bilateral and syndicated lending and project finance for clients including banks, airlines, leasing companies and other large corporates.

NORIO NAKAMURA

Yoshida & Partners

Since joining Yoshida & Partners in 1995, Norio Nakamura has dealt with all aspects of maritime law, including charter parties, ship finance, ship sale, shipbuilding, collision, salvage, cargo recovery or defence, marine insurance, personal injury, ship arrest, bankruptcy and marine pollution. He was made a partner in 2002.

Mr Nakamura gained his LLB in 1986 from Keio University, and was called to the Bar in 1992. From 2000 to 2001 he undertook practical training in the United Kingdom and the United States.

PIETRO NISI

LS Lexjus Sinacta

Pietro concentrates his practice on advising and representing companies in contentious and non-contentious business matters, with particular regard to international contracts, insurance, logistics and transport. He assists, among others, major traders, marine insurers, carriers and freight forwarders in Italy and Europe. He also advises in connection with dealings with the market supervisory authority in respect of regulatory matters, compliance and authorisation procedures, and procedures before the Italian antitrust authority, the AGCM.

JENNIFER PELOSI

Holman Fenwick Willan Switzerland LLP

Jennifer Pelosi is an associate in HFW's Geneva office. Her practice focuses on all aspects of commercial law (including international projects and transactions), international trade, commodities and arbitration. Before joining HFW, Jennifer worked in the dispute resolution department of a leading Swiss law firm and, therefore, also deals with matters related to Swiss commercial litigation, insolvency law, recovery as well as compliance. Jennifer qualified as a lawyer in Switzerland.

CLAUDIO PERRELLA

LS Lexjus Sinacta

Claudio's main areas of practice are commodities, marine cargo and goods in transit claims (charterparties, bills of lading, CMR and multimodal transports, GAFTA, FOSFA and Incograin contracts) and related insurance disputes in both court and arbitration proceedings. He specialises in international trade, agency and distribution contracts, corporate and commercial law, and commercial litigation.

Fluent in English and French, he assists some of the major traders, marine insurers, carriers and freight forwarders in Italy and Europe, and has represented clients in court proceedings and arbitrations in several jurisdictions. He is an accomplished and well-known lecturer, both nationally and internationally, on the legal aspects of shipping and trading. Author of the handbooks *Liquidazione del Danno e Gestione della Rivalsa Nell'assicurazione delle Merci Trasportate; La Vendita Internazionale di Soft Commodities alle Condizioni GAFTA, FOSFA ed INCOGRAIN Guida per il Trader Italiano*; *Cargo Recovery Actions in Italy* and *Arrest of Ships in Italy*, he is regular contributor (with papers on shipping, insurance and international sales) to *Il Diritto Marittimo*, *Maritime Risk*, *Gaftaworld*, *International Law Office*, *Mondaq*, *Arrestnews*, *Forwarderlaw.com* and *ICC Italia Newsletter*.

Claudio has promoted and is the founder of Meditlegal (www.meditlegal.com), an association of independent law firms based in the countries of the Mediterranean, Middle East and the Gulf, which provides a reliable legal network for business people and investors.

CARLOS RAMEH

Basch & Rameh Advogados Associados

Carlos is a Brazilian lawyer currently based in London. He obtained a law degree at the Pontifical Catholic University of São Paulo Law School, Brazil (LLB, 1986), and a Master of Laws at Georgetown University Law Center, Washington, DC (LLM, 1989), with a specialisation in international trade and finance. Carlos qualified as a lawyer in Brazil in 1987, and as a lawyer in New York, in the United States, in 1989. He specialises in ship finance.

EDWARD RHIND

Walkers

Edward Rhind joined the Walkers Cayman Islands office in 2016, where he is an associate in the firm's corporate and finance group. He acts on a range of finance and commercial matters for clients including banks, shipowners, airlines, leasing companies, operators and

funds, and specialises in asset and structured finance. Edward has particular experience with ship finance, and offshore vessel and equipment finance, as well as yacht finance, sale and purchase, shipbuilding contracts and restructurings. Having been based in Asia, Europe and the Caribbean, Edward has experience of a wide range of transactions.

Prior to joining Walkers, Edward worked in the ship finance team of Stephenson Harwood LLP in Singapore and London.

MARCELO RODRIGUES

Basch & Rameh Advogados Associados

Marcelo is a Brazilian lawyer based in Rio de Janeiro. He specialises in ship finance, maritime law and a wide variety of corporate and commercial matters. He is particularly experienced in advising clients with interests in the oil and gas industry. Marcelo is a member of the Brazilian Association of Maritime Law. He read law at Fluminense Federal University in Niteroi, Brazil, and he holds a master's degree (LLM) from the London School of Economics and Political Science. In 2014, Marcelo was temporarily assigned to work for an English law firm specialising in shipping finance.

EDUARDO SOUTO DE MOURA

Uría Menéndez – Proença de Carvalho

Eduardo Souto de Moura is a trainee lawyer in Uría Menéndez – Proença de Carvalho's Porto office. He joined the firm in September 2015, as a member of the M&A practice area. Eduardo has experience in ship registration proceedings, mainly in the International Shipping Register of Madeira.

SHARDUL J THACKER

Mulla & Mulla & Craigie Blunt & Caroe

Shardul Thacker has extensive experience in infrastructure projects in terms of oil and gas, ports, PPP projects, offshore construction and logistics. He contributes actively to structuring and negotiations in such projects. He currently acts for a multinational in India's first FSRU project.

Mr Thacker also has extensive experience of ship finance practice, having completed 350 ship finance deals over the past 10 years, including the acquisition of LNG carriers flying foreign flags and chartered by Indian companies. He advises on obtaining statutory long-term licences for chartering LNG carriers, and advises rig owners on Oil and Natural Gas Corporation Limited tender documents, requests for qualifications and requests for proposals.

He was ranked third in the 'Top 10 lawyers' by *Lloyd's List* for 2014, and has been rated as a leader in the fields of banking and finance, and shipping by *Chambers Asia-Pacific* since 2011. He is also the India correspondent for *Lloyd's Maritime and Commercial Law Quarterly* and vice president of the Indian Maritime Law Association, affiliated to the CMI.

HARRY THEOCHARI

Norton Rose Fulbright

Harry Theochari is a shipping and asset finance lawyer based in London, where he is the firm's global head of transport. He is experienced in international shipping finance and has wide experience of syndicated facilities, OECD and export credit-based financings, structured financings, private equity and capital market transactions.

Mr Theochari is highly regarded in international shipping finance and has been involved in some of the most innovative ship finance structures of recent years, for both new-building and second-hand vessels, oil rigs, platforms and other floating structures all over the world.

He has been named by *Lloyd's List* as the most influential shipping lawyer in the world and by *Tanker Shipping and Trade* as one of the most influential people in the tanker industry. Mr Theochari is cited by *Chambers Global* (2017) as a leading individual for asset finance and for shipping finance, where he is described as 'an institution in ship finance'.

WANG SHU

Han Kun Law Offices

A partner at Han Kun Law Offices, Wang Shu started her legal profession in 2000 and is now the head of Han Kun's banking and finance team. Her practice areas include general banking, asset finance, project finance, aviation and shipping finance. She is listed in the top tier for both banking and finance and aviation finance in China by *Chambers Asia-Pacific* and *Global*, *IFLR1000*, *Asia Law* and *Legal 500*.

ZHANG LING

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Zhang Ling is an associate of the banking and finance team of Han Kun Law Offices.

ZHU JUN

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Zhu Jun is a partner of the banking and finance team of Han Kun Law Offices. His practice areas include asset finance, project finance, cross-border and domestic lending transactions, establishment of financial institutions and regulation compliance, and other banking and finance transactions.

Appendix 2

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