

NEW RUSSIAN LAW ON STATE REGISTRATION OF RIGHTS TO AIRCRAFT AND TRANSACTIONS THEREWITH

October 1, 2009

To Our Clients and Friends:

On September 14, 2009, Russian Federal Law No. 31-FZ On State Registration of Rights to Aircraft and Transactions Therewith (the “Law”) came into force.

The Law is aimed at increasing reliability of mortgages and leasing transactions, as well as facilitating, among other things, the implementation of the Cape Town Convention, which has not yet been signed by the Russian Federation.¹

To date, no governmental agency responsible for state registration of aircraft has been appointed. According to unofficial sources, the Federal Agency for Air Transport (Rosaviation) will perform these functions. A draft resolution of the Government establishing the powers and authority of Rosaviation in this area, however, is still pending approval and is being reviewed by the Ministry of Transport of the Russian Federation.

An analysis of the Law raises the following concerns and considerations:

- it is unclear whether lease agreements, agreements for use free of charge and financial lease agreements are required to be registered;
- a procedure for registering rights to new aircraft produced in Russia is not established;
- a procedure for the termination of rights in an aircraft is not established;
- the existence of separate registers for aircraft registration and for registering rights in aircraft and transactions involving aircraft could lead to discrepancies;

¹ *This has been facilitated by simplifying procedures for foreclosure on and the sale of pledged immovable property, and the establishment of a detailed procedure for foreclosure on pledged immovable property without recourse to a court of law; these amendments were introduced by Federal Law No. 306-FZ on Amendments to Certain Legislative Acts of the Russian Federation to Improve the Procedure for Foreclosure on Pledged Property, dated December 30, 2008. If the Cape Town Convention is ratified by the Russian Federation, however, amendments may be required to ensure compliance of the Law with the Convention.*

- it is unclear whether title to and transfers of permanently or temporarily replaced engines or APU must be registered;
- it is unclear whether a “holder of rights” refers only to holders of ownership rights or to holders of any registered right. If a holder of only ownership rights is deemed to be a holder of rights, it will limit the rights of pledgees to register mortgages and to obtain information on title documents as compared to the rights of pledgees under Federal Law No. 122-FZ on State Registration of Rights to Immovable Property and Transactions Therewith, dated July 21, 1997 (the “Law on Registration of Rights to Immovable Property”);
- it is unclear whether Russian law is the only law that may be chosen to apply to transactions involving Russian-registered aircraft; and
- it is unclear whether the Law applies to transactions involving foreign-registered aircraft operated in the Russian Federation.

On the whole, the Law raises many questions that can only be answered by court interpretation or official clarifications.

BACKGROUND TO THE LAW

The Russian Civil Code and the Air Code classify aircraft that must be registered as immovable property. The right of ownership and other rights *in rem* to such aircraft (and restrictions on these rights), their creation, transfer and termination, as well as transactions involving such rights are subject to state registration. Prior to the adoption of the Law, the only other federal law governing registration of rights to immovable property did not apply to aircraft.

Under current law, aircraft must be registered for operational purposes in the State Register of Civil Aircraft of the Russian Federation (the “Register of Civil Aircraft”)² in accordance with the Rules for State Registration of Civil Aircraft of the Russian Federation (approved by Order of the Ministry of Transport of the Russian Federation No. 85 dated July 2, 2007). However, such registration was not a registration of ownership rights to an aircraft and transactions involving an aircraft. In fact, the actual registration certificate issued by the

² *In addition to the Register of Civil Aircraft, there are separate registers for ultra-light civil aircraft and state aircraft.*

Register of Civil Aircraft states that it is not a document certifying ownership rights to an aircraft. In the majority of cases the courts have upheld this position.

Hence, notwithstanding the Civil Code and Air Code requirements, rights to aircraft and transactions involving aircraft were not registered. There was thus no effective mechanism in place to allow the state to keep track of civil law transactions relating to aircraft. One reason for this is the lack of a general database (register) on rights to aircraft (transfers, encumbrances, etc.). The absence of a functioning ownership registry led to greater risks when entering into transactions involving Russian-registered aircraft and a reluctance to finance aircraft registered in the Russian Federation.

RIGHTS AND TRANSACTIONS SUBJECT TO STATE REGISTRATION

The Law requires registration of rights to aircraft and transactions therewith as prescribed in the Civil Code. Under the Civil Code, the following are subject to registration:

- ownership rights;
- other rights *in rem* and, in particular, the right of economic management and the right of operational administration; and
- encumbrances on the right of ownership and other rights *in rem* (mortgages, trusts, leases,³ rights to use free of charge,⁴ seizure, claims in respect of an aircraft, etc.).

The Civil Code requires registration of the transfer of aircraft ownership rights under a contract of sale, to a trust and under financing lease,⁵ as well as in certain other circumstances.

³ *The Law classifies leases as an encumbrance, which implies that an agreement for the lease of an aircraft requires state registration. However, pursuant to the Civil Code, a lease agreement for a transport vehicle- whether with a crew or without a crew- is not subject to the rules on state registration, even though as a general rule a lease agreement for immovable property must be registered. Thus, in the absence of clarifications, it is currently difficult to conclude whether an aircraft lease agreement must be registered. There is no state registration requirement in relation to charters for marine vessels, which have a similar legal status to that of aircraft.*

⁴ *An agreement for use free of charge is similar in legal nature to a lease agreement. So, the question of the need for state registration of an agreement for use free of charge must be treated in the same way as the question of state registration of a lease agreement.*

State registration is the sole proof of the existence of any registered right to the aircraft, and this right may only be challenged in a court of law. Rights to aircraft that require state registration arise upon registration of the respective rights, unless otherwise required by law. Agreements relating to aircraft that require state registration become effective from the date of state registration, unless otherwise required by law. State registration of rights is evidenced by a certificate of the state registration, while registration of transactions is evidenced by a special registration stamp on the respective transaction document. Failure to comply with the requirement for state registration of transactions involving aircraft in cases provided by law will lead to such transactions becoming invalid.⁶

PROCEDURE FOR STATE REGISTRATION

Unified State Register Of Rights To Aircraft

Under the Law, rights to aircraft and transactions involving aircraft are subject to state registration in the Unified State Register of Rights to Aircraft and Transactions Therewith (the “Register of Rights”). The Register of Rights will be maintained, and the state registration itself will be carried out, by an executive body authorized to do so by the Government of the Russian Federation.⁷

The Register of Rights must contain information on existing and extinguished rights to aircraft, details of such aircraft and details of the holders of rights. The Register of Rights will also include files containing title documents to the aircraft (*i.e.*, the relevant legal agreements and other documents providing a legal basis for state registration).

We note that the Register of Rights must include the airframe number, the engine numbers and the auxiliary power unit number of the aircraft. The Law does not specify whether this equipment may be registered separately from the aircraft nor whether such entry of the airframe, engine and auxiliary power unit numbers in the Register of Rights serves as state registration of the right of ownership. Moreover, it is not clear whether the Register of

⁵ *There is some ambiguity regarding the registration of aircraft financing lease agreements (as there is for aircraft lease agreements in general) because it is not clear which rule should apply - the general rule on the registration of lease agreements for immovable property or the special rule exempting registration of lease agreements for transport vehicles. A conservative approach would be to apply the general rule implying state registration of financing lease agreements in relation to aircraft.*

⁶ *This applies, in particular, to mortgages.*

⁷ *As stated above, as of the date of this Client Update, no such body has been appointed.*

Rights needs to be amended to reflect a permanent or temporary replacement of such equipment or a transfer of the right of ownership. If it does, it would substantially complicate airline operations because in practice such equipment is replaced fairly frequently.

The details contained in the Register of Rights (with the exception of the content of title documents) are a matter of public record and must be made available within five business days in writing⁸ to any applicant. Extracts from the Register of Rights must include a description of the aircraft, the registered rights thereto, as well as any restrictions (encumbrances) on such rights and details of any claims in respect of such aircraft in question existing or pending in court as of the date of issue of the extract.

The content of title documents⁹ may only be made available to the persons specified in the Law. These include the holders of the rights themselves,¹⁰ other persons acting on a power of attorney from the holder of the rights, governmental bodies specified in the Law, courts and legal successors. The holder of rights to the aircraft is entitled to request the details of persons who have received information on the aircraft to which he has rights.

It is anticipated that there will be separate registers in Russia to record both the registration of aircraft as well as the registration of rights to aircraft and transactions involving aircraft. Having separate registers could prove inconvenient, especially if such registers are maintained by different governmental bodies, because any transaction involving an aircraft will require state registration in each register. Furthermore, there may be discrepancies in the information contained in the registers.

Persons Authorized To File Documents For State Registration

An application for registration of rights to aircraft and transactions involving aircraft must

⁸ *The five-day period seems too long. For instance, if a transaction for the acquisition and financing of an aircraft is being undertaken, the parties will need to be able to verify that there are no encumbrances on the aircraft on the closing date of the transaction, not five business days after the closing. The aviation registers of other countries (e.g., the UK) generally provide all information on an aircraft and any encumbrances thereon immediately, often online.*

⁹ *Title documents include agreements and other documents reflecting the content of transactions involving aircraft.*

¹⁰ *The Law does not make it clear whether this means only the holder of a proprietary right or the holder of any registered right, such as a pledgee.*

be provided by the holder of rights, the parties to the agreement¹¹ or a person authorized thereby to file such application, or on the request of a court bailiff. If the rights to an aircraft arise pursuant to a notarized transaction or other notarial action, then the notary may file the application for state registration of rights to the aircraft. In the event that a party breaches its contractual undertaking to register, registration may be carried-out pursuant to a court ruling grant upon application by the other party to the agreement.

State registration of any restrictions (encumbrances) on rights to an aircraft in the form of third-party rights may be undertaken either by the holder of rights¹² or by the parties that have acquired rights. In the latter case, the holder of rights is notified of the registered restriction (encumbrance) on such rights by the state registration authority for rights to aircraft.

Unlike the Law on Registration of Rights to Immovable Property, the Law does not set forth a procedure for the registration of rights to a newly manufactured aircraft produced in Russia. It is thus unclear what documents would be required to register such aircraft. In addition, the Law is silent as to who would be the original holder of the right of ownership of the new aircraft — the manufacturer or the first buyer.

The Law does not define a procedure for state registration of the termination of the right of ownership to an aircraft or release of encumbrances. This omission could complicate a subsequent financing and any subsequent transfer of the aircraft to a foreign register.

Documents Required For State Registration

The principal documents required to be submitted for registration of the existence, creation, transfer, termination and restriction (encumbrance) of rights to aircraft and transactions involving aircraft are as follows:

- acts of governmental or municipal authorities;

¹¹ *It is implicit in the Law that the application must be filed by all of the parties to an agreement. Thus, if a “holder of rights” refers only to the owner of the aircraft, then a pledgee will have fewer rights under the Law than a pledgee under the Law on Registration of Rights to Immovable Property. A pledgee under the new Law, for instance, may not on its own file documents for the registration of a mortgage on an aircraft by providing the necessary substantiating documents. At the same time, there is no prohibition in the Law on one party to an agreement representing all other parties under a power of attorney.*

¹² *As in the cases described above, it is not clear whether this means only the holder of a proprietary right or the holder of any registered right.*

- documents reflecting the substance of transactions involving aircraft;
- acts (certificates) of the privatization of aircraft;
- certificates of inheritance;
- court judgments that have entered into force;
- other transfer documents executed in accordance with the law of the place where the transfer occurred; and
- other documents that attest to the existence, creation, transfer, termination and restriction (encumbrance) of rights to aircraft under Russian law.

The Law does not allow for additional documents to be requested from the applicant if the documents submitted comply with the requirements established by the Law, including formal requirements such as notarization.¹³ A detailed list of documents required for state registration of rights to aircraft and transactions therewith is to be approved by the Government of the Russian Federation.¹⁴

Registration documents must meet the requirements established by law and must be in Russian or be accompanied by a notarized translation into Russian.¹⁵ The documents filed must be undamaged originals (except acts of governmental or municipal authorities and court judgments) and may not contain any deletions, insertions, crossings-out or other corrections.

¹³ For example, notarization is required for spousal consent to the disposition of joint immovable property and a pledgor's consent is needed to the out-of-court sale of immovable property under mortgage.

¹⁴ As of the date of this Client Update, no such list has been prepared.

¹⁵ The Law does not expressly mention foreign documents of title. However, the requirement to provide translations of filed documents into Russian is an indirect reference to such documents.

Period For State Registration And Related Issues

State registration of rights to aircraft should be completed no later than one month¹⁶ from the date of filing the application together with all necessary documents.

It is worth noting that as part of the state registration process, the registering authority performs a substantive legal review of the documents, including verifying the legality of the transaction and confirming that there is no conflict between the rights set out in the application and previously registered rights. It is unclear how the registering authority will verify the legality of transactions governed by foreign law.

Conducting an official legal review after registration documents are filed could increase the risks for financiers and lessors since the loan would generally have been extended and the aircraft delivered to the lessee by that time. If registration is refused, it may be difficult to recover disbursed funds and/or a delivered aircraft. In addition, it is possible that during the one-month period permitted for registration, a third-party right or claim may be registered which would have a priority.

Suspension, Refusal And Termination Of The Application Process

The registration process may be suspended by the registrar (i) for up to one month if it has doubts that there are grounds for state registration of rights,¹⁷ that the documents filed are genuine or the information contained therein is true (although the registrar must take necessary steps to obtain additional information and to confirm that the documents are genuine and the information contained therein is true) or (ii) for up to three months, pursuant to a reasoned application of a right holder, other parties of a transaction or certain other persons specified in the Law. The registration process may also be suspended pursuant to a court ruling or judgment.

During this period, applicants may submit additional proof that they do in fact have grounds for state registration of rights to aircraft, that documents filed for the state registration of rights to aircraft are genuine, or that information contained therein is true. If obstacles impeding state registration of rights to aircraft are not removed during this period, the

¹⁶ For aviation transactions this one-month period for registration seems too long. In Bermuda, for example, an encumbrance is registered on the day that the documents are filed with the registering authority.

¹⁷ This provision raises further questions since state registration should be accomplished on the basis of the documents listed in section C.

registrar must refuse (i) to register the aircraft rights and (ii) to make an appropriate entry in its register of documents.

The Law provides for an exhaustive list of grounds for refusing to register aircraft rights, including where the registration is sought by an inappropriate person or the documentation pursuant to which the registration is sought does not comply with the requirements in respect of its form or substance,¹⁸ or where there is a conflict between the rights set forth in the application and previously registered rights. A pending court dispute in respect of rights to an aircraft does not constitute grounds for refusing to register aircraft rights.

Until an entry is made in the Register of Rights, the registration process may be terminated pursuant to a request by the holder of rights, the parties to the agreement or persons authorized thereby. This requirement leads to the risk of a seller or pledgor impeding registration of the transfer of rights.

AIRCRAFT REGISTERED OUTSIDE THE RUSSIAN FEDERATION

The Law provides for registration of rights to and transactions in respect of civil aircraft that are subject to state registration pursuant to the Air Code, as well as in respect of state aircraft used for commercial purposes. According to the Air Code, the following aircraft must be registered:

- civil aircraft, with the exception of ultra-light civil aircraft, which are subject to registration in the Register of Civil Aircraft *or in the state register of civil aircraft of a foreign state, provided that there is a treaty on continued airworthiness between the Russian Federation and the country of registration;*
- ultra-light civil aircraft, which are subject to registration in the manner prescribed by the competent civil aviation authority; and
- state aircraft, which are subject to registration in the manner prescribed by the competent defense agency upon agreement of the competent authorities that have state aviation units.

¹⁸ For example, a failure to submit notarized documents where necessary may constitute a failure to comply with the requirements in respect of the form. A sham or feigned transaction, i.e. a transaction that serves no business purpose or is made for the purpose of covering up another transaction, may constitute a failure to comply with the requirements in respect of the substance.

Therefore, based on a formal reading of the Law and the Air Code, the scope of the Law appears to cover not only aircraft registered in the Russian Federation, but also aircraft registered in foreign countries that have a treaty on maintenance of airworthiness standards with the Russian Federation. However, there are several arguments for why the law does not apply to foreign-registered aircraft. First, the application of the Law to the aircraft rights registered outside the Russian Federation is prohibited by the conflict of law rules set out in the Civil Code, pursuant to which the right of ownership and other rights *in rem* to aircraft subject to state registration are governed by the law of the country in which the aircraft is registered. This conflict of law rule is intended to provide the holder of ownership rights certainty of its legal position when such aircraft physically leaves the state of registration. Second, the legislative intent stated in the explanatory note to the draft Law is that foreign-registered aircraft should be excluded from the sphere of application of the Law. Finally, the Law as drafted does not permit registration of a transaction involving an aircraft unless the underlying rights are also registered in Russia. For this reason alone, transactions involving a foreign-registered aircraft may not be recorded in the Register of Rights.

APPLICABLE LAW

In respect of the choice of law applicable to transactions for Russian-registered aircraft, either of the following two approaches may be taken:

1. As there is no requirement in the Law or specific conflict of law rule that would establish what law governs, the parties may choose any law.¹⁹ In the absence of choice of law by the parties, the applicable law will be determined pursuant to the Civil Code to be the law of the country with which such transactions are most closely connected. Therefore, Russian law will apply only if the parties have chosen Russian law or in the absence of choice of law by the parties, if the contract is most closely connected with the Russian Federation.
2. The Civil Code's requirement that all agreements for immovable property located in the Russian Federation are to be governed by Russian law could be interpreted broadly to include aircraft, because registered property may be deemed to be located in its place of registration. Therefore, any transactions involving Russian-registered aircraft must be governed only by Russian law.

¹⁹ *This applies only to transactions with a foreign element.*

Until courts address this question or official clarifications are provided, it will not be possible to give a clear answer to the question of whether the parties may choose foreign law to govern transactions with aircraft registered in the Russian Federation.

TRANSITIONAL PROVISIONS

The Law will apply to legal relations established after its effective date, September 14, 2009, and to such relations established before its effective date to the extent that any rights and obligations arise thereafter. In particular, the Law will apply to any transfer of right of ownership or creation of encumbrance occurring after September 14, 2009, even if the respective agreement was made before such date.

Rights to aircraft acquired before the effective date of the Law and transactions involving such rights consummated before such date will remain valid without registration. Right holders have the option to register their rights under Russian law at their discretion. We note, however, that the transfer of rights to aircraft and restrictions (encumbrances) of such rights or aircraft transactions will only be registered if the underlying rights have also been registered in the Register of Rights. Therefore, it may be appropriate to make arrangements to register aircraft rights obtained prior to the effective date of the Law.

We would be happy to answer any questions you may have on these or any other aviation law issues.

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