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The Perils and Pitfalls of Aviation Security Agreements

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In the classic Faustian Bargain, an individual deals his soul to the devil in return for some earthly pursuit. A contract, written by Satan himself, is presented for signature with little, if any review by the signer. Giving what some might call a profoundly personal guarantee, the protagonist discovers too late that he has given up too much. When the devil calls in the note, our hero's options, if any, are poor.

Aircraft security agreements present a close parallel. From the smallest charter operator to the largest freight or scheduled passenger carrier, the desire to add aircraft to a fleet almost always means asking some lender to part with millions of dollars. This they are happy to do, so long as the borrower signs a series of long documents full of legalese in six point font. Only later does the borrower learn that the devil truly resides among the details.

It is a basic rule of contract construction that each and every line of an agreement means something. When we execute reams of paper without an in depth understanding of what the words really mean, we create our own legal risk.

In one case currently pending in the Fulton County Superior Court, the borrower, a small LLC, asked for a 90 day moratorium before it would be required to make any payments

to the lender. At the closing, the lender read the following new language in Section 3.1.1 to the borrower's attorney, who had been encouraged by the lender that his attendance at the closing was not necessary and was thus present only over a speaker phone:

The payment of all Obligations will be deferred until the 90th day following the date the lender makes any advances to the borrower.

The lender conveniently neglected to read over the phone the new language that it had added right after the moratorium language, to wit:

3.1.2 Notwithstanding section 3.1.1. above, Lender shall be entitled, at its sole and exclusive discretion, to require payment of all Obligations . . . on demand, or on the first day of each month . . .

The law presumes that, absent evidence of undue duress or lack of mental capacity, we freely enter into whatever agreements we sign. The Courts will not protect you from yourself and they will not shield you from the effect of the promises you made when you signed on the bottom line.

Standard Airline Security Agreements drafted by lenders contain the following elements:

1. Grant of Security Interest

First and foremost, the document will most surely set forth in detail the nature and extent of the lender's claim to your aircraft.

2. Home Airport:

Reassigning an aircraft from one base of operations to another will usually constitute a breach of the agreement.

3. Representations, Warranties and Covenants of Debtor

This is where the borrower confirms that every financial statement provided to the lender have been prepared in accordance with generally accepted accounting principles, and that the borrower is otherwise fiscally sound.

4. Further Assurances

This is where the borrower promises to execute, authenticate any document or record necessary to perfect the lender's interest.

5. Use, Operation, Maintenance Storage and Registration

This will bind your mx and ops to the FARs, and require that you maintain the aircraft in an airworthy condition It will also require that the aircraft maintain the same utility and quality as at the time of closing.

6. Indemnification and Insurance

This protects the lender from liability arising out your operation of the aircraft. If they get sued, you will be liable for the cost of their defense and any damages. The debtor also acknowledges that it alone assumes the risk of loss.

7. Debtor's possession

Even the clauses with neutral sounding titles, typically benefit the Lender over the Debtor.

Until default, Debtor may possess the Aircraft and use it in any lawful manner not inconsistent with this Agreement. Debtor shall at all times keep the Aircraft and any proceeds therefrom separate and distinct from the property of the Debtor and shall keep accurate and complete records of the Aircraft and all proceeds. Secured Party may examine and inspect the Aircraft, wherever located, at any reasonable time, on land and in flight.

8. Default

There are two basic categories of “Events of Default”. The first category is essentially a menu of specific events after which the Lender can call in the note without prior notice or an opportunity to cure. Failing to pay is usually at the top of this list, as is the debtor’s insolvency, the loss of an engine and other specific grounds. The second category of default applies to non-specific contract violations and typically provides for some notice and opportunity to cure before the debtor can go to court.

9. Remedies of Secured Party

These clauses typically allow the Secured Party to call in the note after an Event of Default, and take immediate possession of the aircraft.

10. Principals and Waivers

This clause is designed to make all co-signers joint defendants jointly liable for the total amount of the debt and all of the lender’s costs, including its attorneys fees.

11. Reports

The Debtor will be required to notify the Lender of certain events, such as a change of name or location. Such changes cannot take effect unless approved by the lender. In addition, the lender is entitled to additional financial statements from the debtor during the life of the lender.

12. Choice of law

The Lender will usually invoke the law to govern the contract that it believes is most advantageous to it and that they are most familiar with. We recently handled a case for a Georgia operator concerning an aircraft security agreement and an aircraft lease agreement.

One document was governed by New York law; the other by the law of Connecticut. the case was litigated, however, in the Chancery Court of the State of Delaware.

13. Choice of forum (typically one way)

The Debtor may only be able to sue the lender in a single distant state, but the Lender can institute litigation in anywhere. Lenders will typically choose the forum that they believe favors them the most.

14. Waiver of right to jury trial

This is usually spelled out in capital letters.

15. Injunction without bond

One of the requirements of injunctive relief is that the party who seeks the injunction must post a bond that can compensate the defendant if it later turns out that the injunction was imprudently granted. Most lenders will attempt to include language in the contract that relieves them of this requirement..

Aircraft security agreements for small to midsize companies have a further requirement. That is, they are conditioned on the execution of personal guarantees by the principals of the debtor's company.

Aircraft security agreements are not always composed of take-it-or-leave-it boiler plate language. You can and should negotiate for the elements that will protect you and your company.

Review of these agreements prior to execution by an attorney who is competent in both aviation law and security agreements will require a few hours of legal time. Litigation without such review, however, can cost hundred of hours of attorney time and place you and your company at substantial risk