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# Aviation Finance & Leasing 2021

Philippines

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# PHILIPPINES

## Law and Practice

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## 1. AIRCRAFT AND ENGINE PURCHASE AND SALE

### 1.1 Sales Agreements

#### 1.1.1 Taxes/Duties Payable upon Execution of the Sales Agreement

The situs of sale of movable property for purposes of taxation is the place where the sale is consummated. When an aircraft or an engine is within Philippine territory at the time of the consummation of an aircraft or engine sale agreement, income derived from the agreement will be deemed income derived from Philippine sources, subject to income tax. Conversely, if an aircraft owned or produced by a non-resident foreign person is sold outside Philippine territory, the transaction would not be taxable in the Philippines.

The execution of an aircraft or engine sale agreement will likewise entail the payment of documentary stamp tax. The tax will be payable as a consequence of an original or copy of the aircraft or engine sale agreement which enters the Philippines physically or electronically. The tax shall be levied, collected and paid for, “wherever the document is made, signed, issued, accepted, or transferred when the obligation or right arises from Philippine sources or the property is situated in the Philippines, and at the same time such act is done or transaction had” (Section 173, National Internal Revenue Code).

#### 1.1.2 Enforceability against Domestic Parties

In order to ensure its enforceability against a domestic party, it is advisable for a sale agreement to be written in or translated into English, signed, notarised and, if executed outside Philippine territory, apostilled or consularised, depending on the country of execution.

A notarised document has in its favour the presumption of regularity, and can be contradicted

only by clear and convincing evidence (*Manuel vs Sarmiento*, G.R. No 173857, 21 March 2012).

### 1.2 Transfer of Ownership

#### 1.2.1 Transferring Title

In a contract of sale, transfer of title occurs when the sale is perfected and consummated. A contract of sale is perfected at the point at which there is a meeting of minds on the object of the contract and the price. Consummation takes place upon delivery of the object of the contract (BIR Ruling No DA-512-04, 30 September 2004). Unless otherwise stipulated, the transfer of title to an aircraft extends to include the engines and all installed parts such as auxiliary power units (APUs).

Philippine-registered aircraft are generally owned by and leased to corporations, which by law are vested with a legal personality that is separate and distinct from those of their stockholders. The sale of shares of stock comprising a controlling interest in a corporation is not recognised as a sale of its aircraft and or engines or transfer of legal title over them. However, from a practical point of view, the acquisition of an ownership interest in an entity that owns an aircraft or engines may effectively result in a change in beneficial interest over those aircraft or engines.

#### 1.2.2 Sales Governed by English or New York Law

The transfer of title to an aircraft or engine physically delivered in the Philippines will be recognised if the covering bill of sale is governed by English or New York law.

The choice of foreign law will be upheld as a valid choice of law in any action in the Philippines, subject to that foreign law being pleaded and proven in the action. In the event of failure to prove the foreign law, it will be presumed that

the foreign law is the same as the laws of the Philippines on the matter.

Furthermore, the choice of foreign law must not violate Philippine law, morals, good customs, public order or public policy.

### **1.2.3 Enforceability against Domestic Parties**

A bill of sale written in English need not be translated into Filipino. If the bill of sale is in a foreign language other than English, an accompanying English translation of that bill of sale should be executed for it to be enforceable against a domestic party.

For the purpose of registration, the bill of sale should be notarised and if executed outside Philippine territory, apostilled or consularised, depending on the country of execution.

### **1.2.4 Registration, Filing and/or Consent from Government Entities**

A bill of sale should be registered with the Civil Aviation Authority of the Philippines (CAAP) in order for it to be valid and effective in rem from the date of its registration. However, if unregistered, the bill of sale shall remain valid and effective against the parties, their successors-in-interest and assignees and any such persons having actual notice thereof (Section 49, Civil Aviation Act of 2008).

For the purpose of registration, the bill of sale should be notarised and, if executed outside Philippine territory, apostilled or consularised, depending on the country of execution.

The bill of sale must be supported by a Director's or Corporate Secretary's Certificate attesting to the board resolution authorising the parties to enter into the transaction and identifying the signatories thereto.

Upon submission of all the requirements, the bill of sale will be registered and a Certificate of Registration will be issued by the CAAP within 45 to 60 business days, under existing pandemic constraints.

There are no other government applications or consents required as a prerequisite to the execution and delivery of a bill of sale.

### **1.2.5 Taxes/Duties Payable upon Execution of a Bill of Sale**

For taxation purposes, the situs of sale of movable property is the place where the sale is consummated. When an aircraft or engine is within Philippine territory at the time of consummation of the bill of sale, income derived from such an agreement will be deemed income from Philippine sources subject to income tax. Conversely, if an aircraft owned or produced by a non-resident foreign person is sold outside Philippine territory, the transaction would not be taxable in the Philippines.

The execution of a bill of sale will entail payment of documentary stamp tax "wherever the document is made, signed, issued, accepted, or transferred when the obligation or right arises from Philippine sources or the property is situated in the Philippines" (Section 173, NIRC).

## **2. AIRCRAFT AND ENGINE LEASING**

### **2.1 Overview**

#### **2.1.1 Non-permissible Leases**

Engine leases are generally recognised and permissible in the Philippine aviation industry. Spare-parts leases are not common, but not prohibited. Operating leases, wet leases and finance leases are permissible, legally recog-

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nised and commonly transacted and registered in the CAAP.

## 2.1.2 Application of Foreign Laws

A lease involving either a domestic party or an asset situated in the Philippines can be governed by foreign law.

However, the choice of foreign law must not violate Philippine law, morals, good customs, public order or public policy.

## 2.1.3 Restrictions Concerning Payments in US Dollars

There are no material restrictions imposed on domestic lessees making rent payments to foreign lessors in US currency.

The purchase and outward remittance of foreign exchange for payments to be made under a lease are neither trade-related, nor usually foreign-loan trade, nor foreign investment-related. Hence, prior *Bangko Sentral Ng Pilipinas* (Central Bank of the Philippines) (BSP) approval is not needed for the purchase of foreign exchange to be remitted pursuant to an aircraft lease. All that is needed for the purpose, if the lessee is to source its foreign exchange from the Philippine banking system, is the latter's written application supported by documents relating to the underlying lease rental payments, to be submitted to an authorised agent bank.

If a lessee intends to source its foreign currency-denominated lease rental payments from its own foreign currency deposits maintained with Philippine banks, not even the aforementioned application is necessary.

## 2.1.4 Exchange Controls

There are no exchange controls that could prevent rent payments under a lease or any repatriation of realisation proceeds therefrom.

## 2.1.5 Taxes/Duties Payable for the Physical Execution of a Lease

The execution of a contract of lease in the Philippines will entail the payment of documentary stamp tax for each year of the term of the contract. Documentary stamp tax will be payable as a consequence of an original or copy of a lease being brought into the Philippines physically or electronically (Section 173 of the National Internal Revenue Code (NIRC)).

## 2.1.6 Licensing/Qualification of Lessors

The lessor need not be licensed nor otherwise registered to do business in the Philippines to enter into an aircraft and/or engine lease transaction with a domestic lessee.

## 2.2 Lease Terms

### 2.2.1 Mandatory Terms for Leases Governed by English or New York Law

Lease agreements expressed to be governed by English law and New York law are customarily thorough and usually contain terms and conditions which do not violate Philippine law, public order or public policy. Ancillary documents such as aircraft or engine mortgages commonly executed as collateral in finance leases registered in the CAAP are required to contain affidavits of good faith, which are executed under oath to attest to the fact that the mortgage was constituted for the purpose of securing the obligations specified in the provisions thereof and for no other purpose, and that those obligations are just and valid and are not entered into for the purpose of fraud (Chattel Mortgage Law, Act No 3135).

### 2.2.2 Tax and Withholding Gross-Up Provisions

Gross-up and other withholding provisions obliging a payor to pay an additional amount to a payee to ensure that the payee receives and retains that same amount that it would have

received had no tax and other payments been withheld, are customary and are valid, binding and enforceable in aircraft leases constituted in the Philippines.

### **2.2.3 Parts Installed or Replaced After a Lease's Execution**

A lease agreement may provide for its effectivity upon parts that are installed or replaced on an aircraft or engine after its execution, and such a provision would not violate Philippine law, public order or public policy. The accession of subsequently installed or replaced aircraft or engine parts is customarily stipulated by the parties in lease agreements and, once registered in the CAAP, any such agreements become valid and effective in rem.

### **2.2.4 Risk of Title Annexation**

A security interest over aircraft generally includes or covers the engines installed thereon inasmuch as it is presumed that the installed engines are owned by the same owner of the airframe. The removal of an engine or installation of an engine on another aircraft will generally not result in a change in ownership of the engine or the discharge of a security interest therein. For specificity and avoidance of doubt, parties may apply to the CAAP for the issuance of engine certificates of registration which will clearly state their ownership, as well as the serial number, other salient technical specifications of the engine, and security interests constituted thereon.

### **2.2.5 Recognition of the Concepts of Trust/Trustee**

The concept of a trust and the role of an owner-trustee under a lease is widely recognised in aircraft lease and financing transactions in the Philippines. In such transactions, the owner-trustee declares that it is a party not in its name but in its capacity as owner-trustee. The identity of the beneficial owner can validly and effectively remain confidential in these circumstances.

## **2.3 Lease Registration**

### **2.3.1 Notation of Owner's/Lessor's Interests on Aircraft Register**

The interests of the owner (legal or beneficial) or a lessor of an aircraft may be registered with the CAAP.

Registration of the owner's or lessor's title or interest to a registered aircraft constitutes binding notice in rem as to the existence of such interests and shall be valid against all persons from the date of its registration with the CAAP.

### **2.3.2 Registration if the Owner Is Different from the Operator**

The CAAP is an operator registry which issues aircraft certificates of registration in the name of the operator of the aircraft, whether or not the latter is also the owner of the aircraft. Accordingly, aircraft certificates of registration cannot be registered in the name of an owner who is not the operator of the aircraft.

### **2.3.3 Aircraft/Engine-Specific Registers**

Since the Civil Aviation Authority Act came into effect on 19 March 2008, the CAAP has been the sole and exclusive registry for aircraft and aircraft engines, as well as liens and security interests constituted on those properties.

### **2.3.4 Registration of Leases with the Domestic Aircraft Registry**

Transaction documents that are registered in the CAAP are valid and effective in rem. Even if not registered in the CAAP, such duly executed transaction documents will nonetheless be valid and effective between the parties, their successors-in-interest and assignees and persons having actual notice thereof. Hence, a lease (and a lessor's interest therein) may be registered or filed in the CAAP.

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Aircraft and/or engine leases must be approved by the Civil Aeronautics Board (CAB), which is the government agency that regulates the economic and commercial aspects of the Philippine aviation industry. These leases will be allowed registration in the CAAP only after they have been approved by the CAB.

A transaction document such as a lease can only be registered if it appears in a public document, ie, one that is duly notarised, and if executed abroad, that has been apostilled or consularised, depending on the country of execution.

Upon submission of complete requirements, and provided that the CAAP has determined that the aircraft is airworthy, a Certificate of Registration (CoR) will be issued by the CAAP within 45 business days under existing COVID-19 constraints, which may contain annotations of transaction documents evidencing security interests thereon, such as a lease or mortgage. This applies to all registration periods in general, including leases. Pending the release of a CoR, the lease shall be binding against the contracting parties, their heirs, assignees, executors, administrators, devisees, successors-in-interest, and any person having actual notice thereof.

The lease must be supported by Director's or Corporate Secretary's Certificates attesting to the board resolution authorising the parties to enter into the lease transaction and identifying the signatories thereto.

Powers of attorney are likewise customarily executed, notarised and, if executed abroad, apostilled or consularised or authenticated, depending on the country of execution.

There are no other government applications or consents required as a prerequisite to the execution and delivery of an aircraft and/or engine lease.

## 2.3.5 Requirements for a Lease to Be Valid and Registrable

For the purpose of registration with the CAAP, the lease must be in writing and should be acknowledged before a notary public. If the lease is executed outside the Philippines, it should be apostilled or consularised, depending on the country of execution.

The lease must be supported by Director's or Corporate Secretary's Certificate attesting to the board resolution authorising the parties to enter into the lease transaction and identifying the signatories thereto.

The lease need not be translated into Filipino if it is written in the English language. If the lease is in a foreign language other than English, an accompanying English translation will be required.

## 2.3.6 Taxes/Duties Payable for Registering a Lease

Registering a lease with the CAAP will not entail payment of any taxes or duties. Annotation fees are payable for lease registration.

## 2.3.7 Registration of Aircraft in Alternative Countries

Two of the most popular alternative countries in which aircraft habitually based in the Philippines are typically registered are the Republic of Ireland and the Cayman Islands.

## 2.3.8 Requirements for Documents Concerning Registration

For original registration in the CAAP, a deregistration fax or an email will have to be issued by the former registry in the case of aircraft previously registered abroad. For these, and for new aircraft, an original application for the issuance of the certificate of registration must be made in writing, signed and sworn to by the registrant.

Transaction documents such as bills of sale, leases or mortgages can only be registered if they appear in their original form, duly notarised and, if executed abroad, apostilled or consularised, depending on the country of execution.

The transaction documents must be supported by original Director's or Corporate Secretary's Certificates attesting to the board resolution authorising the parties to enter into the transaction and identifying the signatories thereto.

Original powers of attorney are likewise customarily executed, notarised, and, if executed abroad, apostilled or consularised, depending on the country of execution. While not registered with the CAAP, these are filed with its office.

Similarly, deregistration powers of attorney (DPOAs) may only be registered with the CAAP in their original form, duly notarised, apostilled or consularised.

The foregoing documents need not be translated to Filipino if they are in the English language. If any of those documents is in a foreign language other than English, an accompanying English translation would be required.

## **2.4 Lessor's Liabilities**

### **2.4.1 Tax Requirements for a Foreign Lessor**

A foreign corporation, whether engaged or not in trade or business in the Philippines is taxable only on income derived from sources within the Philippines. Rentals, charters and other fees derived by a non-resident lessor of aircraft, machineries and other equipment from a lessee in the Philippines shall be subject to a withholding tax of 7.5% of gross rentals or fees.

### **2.4.2 Effects of Leasing on the Residence of a Foreign Lessor**

A foreign lessor will not be deemed to be a resident, domiciled in, carrying on or doing business in the Philippines by virtue of an isolated aircraft lease transaction or its enforcement thereof.

A foreign lessor will be subject to withholding tax on any income derived from a lessee in the Philippines at the rate of 7.5% of gross rentals or fees.

### **2.4.3 Engine Maintenance and Operations**

By agreement of the parties, any liabilities in respect of aircraft or engine maintenance and operations may be imposed on a foreign lessor under a lease. However, such agreements are not customary because liability and expenses for aircraft and engine maintenance and operations are typically imposed upon the lessee as operator.

### **2.4.4 Damage or Loss Caused by an Asset**

A foreign aircraft- or engine-owner, lessor or financier cannot be held liable in relation to any claim arising out of the use and operation of the aircraft by the lessee. The concepts of strict liability and vicarious liability have no application to aircraft, vessels, motor vehicles, equipment or other leased property.

### **2.4.5 Attachment by Creditors**

Creditors of a Philippine lessee have no legal right or basis to obtain a writ of attachment against a leased aircraft. An attachment may only be levied upon property owned by and registered in the name of the lessee against whom the attachment is issued.

### **2.4.6 Priority of Third Parties' Rights**

The following liens will take priority over a lessor's rights under an aircraft or engine lease, whether or not it is registered with the CAAP:



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- the tax liens imposed by the National Internal Revenue Code of the Philippines and the Tariff and Customs Code for failure to pay Philippine taxes and/or customs duties;
- the statutory lien imposed by the Director General of the CAAP under Section 73 of the Civil Aviation Act of 2008 (Republic Act 9497) for non-payment of charges and other fees and failure to pay administrative fines arising from violation of rules and regulations of the CAAP;
- the lien imposed by the Manila International Airport Authority (MIAA) for failure to pay dues, charges and fees or concessions for any service provided by the MIAA; and
- the possessory liens under Article 2241 of the Civil Code of the Philippines for the unpaid price of movable sold, credits for the making, repair, safekeeping or preservation of personal property such as aircraft.

## 2.5 Insurance and Reinsurance

### 2.5.1 Requirement to Engage Domestic Insurance Companies

Under Section 192 of the Insurance Code of 2013, no person, partnership or association of persons shall transact any business of insurance in the Philippines except as an agent of a corporation, partnership or association authorised to do so by the Insurance Commissioner. It is customary in aircraft leases that insurance policies and coverage are obtained by local lessees/operators from duly licensed domestic insurance companies.

A foreign insurance company may be allowed to provide insurance, provided that it files with the Insurance Commission a written power of attorney designating a person who must be a resident of the Philippines as its general agent. The general agent shall be the foreign company's attorney-in-fact, on whom any notice provided by law or by any insurance policy, proof of loss,

summons and other legal processes may be served in all actions or other legal proceedings against that company and consenting that service upon that general agent shall be admitted and held as valid as if served upon the foreign company at its home office (Section 196, *ibid.*).

### 2.5.2 Mandatory Insurance Coverage Requirements

Section 8.2.1.8 of the 2011 Philippine Civil Aviation Regulations requires any person operating civil aircraft in general aviation operations to obtain aircraft insurance coverage. In applying for a certificate of registration of aircraft with the CAAP, a certified true copy of the aircraft's certificate of insurance must be attached to the application form. Furthermore, under Section 8.2.1.9 of the same regulations, no person may operate an aircraft unless it has a valid insurance guarantee covering the aircraft hull, each passenger, freight and third-party liability coverage.

### 2.5.3 Placement of Insurances outside of Jurisdiction

Reinsurances may be placed outside Philippine jurisdiction up to 100% coverage if the foreign insurance company is represented in the Philippines by a resident agent registered with the Insurance Commission (Section 23, Insurance Code).

### 2.5.4 Enforceability of "Cut-Through" Clauses

Cut-through provisions in reinsurance agreements (which are understood to be those which allow a party not in privity with the reinsurer to have rights against the latter in a reinsurance agreement) are not prohibited under Philippine law.

### 2.5.5 Assignment of Insurance/Reinsurance

Under Title 6 of the Insurance Code (2013), no insurance company other than life, whether foreign or domestic, shall retain any risk on any one subject of insurance in an amount exceed-

ing 20% of its net worth. Hence, assignments of insurance and reinsurance are permitted, but only to insurance companies or brokers registered with the Insurance Commissioner (Section 221).

## **2.6 Lease Enforcement**

### **2.6.1 Restrictions on Lessors' Abilities**

The lessor's ability to terminate a lease will be governed by the terms and conditions incorporated in the lease agreement.

A lessor's ability to re-export the aircraft is also governed by the terms and conditions in the lease agreement, which may be supplemented by a DPOA in favour of the owner/lessor or security agent. The aircraft need not be physically located in the Philippines at the time of the termination of the lease or consummation of the sale transaction. An owner/lessor may sell the leased aircraft, even during the effectivity of the lease by way of its novation.

### **2.6.2 Lessor Taking Possession of the Aircraft**

If the lease grants the lessor or its assignee the authority to repossess the aircraft without the need for judicial proceedings, and the lessee would be willing to relinquish possession of the aircraft voluntarily, the lessor or its assignee may do so without needing a court order. In a hostile scenario, in which the lessee refused to relinquish possession, a court order would be necessary in order to recover possession.

### **2.6.3 Specific Courts for Aviation Disputes**

Most regional trial courts in Metro Manila and other highly urbanised cities in the Philippines have specially created commercial courts which are assigned to hear and decide cases exclusively involving commercial and corporate disputes, including corporation law, aviation and maritime, financial rehabilitation and insolvency and various other similar actions.

Presiding judges assigned to these courts have undergone rigorous specialised training and are experienced in deciding enforcement actions in such cases.

### **2.6.4 Summary Judgment or Other Relief**

A lessor may obtain a summary judgment by filing a motion at any time after an answer has been served by the defendant and that answer shows that, except as to the amount of damages, there is no genuine issue as to any material fact and that the lessor is entitled to a judgment as a matter of law. The motion for summary judgment must be accompanied by supporting affidavits, depositions or admissions upon all or any part favourable to the lessor's causes of action (Rule 35, 1997 Rules of Civil Procedure).

If warranted, a lessor may likewise avail of the pertinent provisional remedies of writs of preliminary injunction (Rule 58), and replevin (Rule 60).

The lessor must also give a bond, executed to the defendant in double the value of the property as stated in its affidavit, for the return of the property to the adverse party if that return be adjudged, and for the payment to the adverse party of such a sum as he or she may recover from the lessor in the action.

The process of obtaining the court orders in connection with the lessor's availment of a summary judgment, or provisional remedies of injunction or replevin under adversarial circumstances could take between 60 to 90 calendar days.

### **2.6.5 Domestic Courts' Approach to Foreign Laws and Judgments**

The choice of foreign law to govern an aircraft lease, or the submission to a foreign jurisdiction, waiver of immunity by the parties to that lease, may be agreed upon by the parties and would be upheld as valid stipulations in any action in the courts of the Philippines.

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The choice of foreign law must be pleaded and proven in any such action, otherwise, it will be presumed that the foreign law is the same as the laws of the Philippines on the matter.

Furthermore, the choice of foreign law must not violate Philippine law, morals, good customs, public order or public policy.

## 2.6.6 Domestic Courts' Recognition of Foreign Judgments/Awards

Philippine courts will recognise and enforce a final judgment of a foreign court without re-examination of the facts from which it prescinds. In order to be recognised and enforced, the foreign judgment must have been rendered by a foreign tribunal of competent jurisdiction with notice to the parties involved; it must not have been obtained through collusion, fraud or clear mistake of fact or of law in rendering the foreign judgment, it must have become final and executory, and must not be contrary to the public policy or the good morals of the Philippines.

Recognition and enforcement of a foreign arbitral award in the Philippines is governed by the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention) and the Special Rules of Court on Alternative Dispute Resolution promulgated by the Supreme Court of the Philippines on 1 September 2009 (A.M. No 07-11-08-SC) (the Rules). In resolving a petition for recognition and enforcement of a foreign arbitral award, the court will not disturb the arbitral tribunal's determination of facts and/or interpretation of law.

## 2.6.7 Judgments in Foreign Currencies

A lessor under an aircraft lease may obtain a judgment award payable in foreign currency stipulated in the transaction document.

## 2.6.8 Limitations on Lessors' Actions Following Termination

In order to be valid and effective under Philippine law, the lessor's ability to recover default interest (or the compounding thereof), or to charge additional rent following termination of the lease for default, should be expressly agreed upon by the parties under the lease.

## 2.6.9 Lessor's Requirement to Pay Taxes/Fees

A lessor under an aircraft lease will not be required to pay taxes in connection with a suit for recovery of unpaid rent and/or possession of aircraft and/or engines.

However, legal fees and court filing fees may be assessed in connection with the enforcement of the contract of lease.

## 2.6.10 Mandatory Notice Periods

The lessor of an aircraft operated domestically, or one that is leased by a domestic operator, will be obliged to comply with the mandatory notice periods regarding termination of an aircraft lease, as agreed upon and stipulated in its lease agreement with the lessee. Other than any such periods by agreement of the parties, no other mandatory notices are imposed under Philippine law or regulations.

## 2.6.11 Lessees' Entitlement to Claim Immunity

Sovereign immunity may be claimed by agencies or instrumentalities of the Philippine Government. However, any such immunity is generally deemed waived when the State enters into a commercial agreement such as a lease.

Privately owned commercial operators or carriers are not entitled to claim sovereign immunity. Their acts, contracts or other transactions constitute private and commercial matters.

### 2.6.12 Enforcement of Foreign Arbitral Decisions

The recognition and enforcement of a foreign arbitral award in the Philippines is recognised and governed by the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention) and the Special Rules of Court on Alternative Dispute Resolution promulgated by the Supreme Court of the Philippines on 1 September 2009 (A.M. No 07-11-08-SC) (the Rules). In resolving a petition for recognition and enforcement of a foreign arbitral award, the court will not disturb the arbitral tribunal's determination of facts and/or interpretation of law.

### 2.6.13 Other Relevant Issues

The nation's flag carrier Philippine Airlines, Inc (PAL) is in the final stages of preparation for initiating Chapter 11 proceedings before the US Bankruptcy Court situated in the Southern District of New York. This action has long been speculated and will be closely observed, not only by the local business community but also by foreign lessors, banks and other institutions which maintain a financial interest in the Philippine aviation industry. It will set a precedent in terms of one of the country's oldest, most prestigious and ubiquitous business and social institutions resorting to bankruptcy protection in a foreign court and under foreign law, rather than before Philippine courts, under the Financial Rehabilitation and Insolvency Act (FRIA) and its related laws and regulations.

Aircraft lessors should be aware of these forthcoming proceedings in the US bankruptcy courts, and cross-border implementation of orders, rulings and judgments proceeding therefrom.

## 2.7 Lease Assignment/Novation

### 2.7.1 Recognition of the Concepts of Contractual Assignment and Novation

Philippine law recognises the concepts of contractual assignment and novation and, in fact, such transactions are customary in aircraft leasing and finance transactions registered in the CAAP.

### 2.7.2 Assignment/Novation of Leases under Foreign Laws

A New York or English law-governed assignment and assumption agreement or novation agreement (or deed) will be upheld and recognised in any action in the courts of the Philippines.

As a substantive requirement, New York or English law governing the assignment and assumption agreement or novation agreement (or deed) must be pleaded and proven in any such action. In accordance with the doctrine of processual presumption, in the event of failure to prove the foreign law, it will be presumed that the foreign law is the same as the laws of the Philippines on the matter.

Furthermore, the choice of New York or English law must not violate Philippine law, morals, good customs, public order or public policy.

The written consent of the lessee in transactions involving the transfer of the lessor's rights under an aircraft lease and/or novation agreement (or deed) would be necessary in the event of the CAAP registration of the underlying transaction documents, because, under existing CAAP rules, only the local operator/carrier is authorised to make representations in that office in matters concerning registration of aircraft, engines or security interests thereon.

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### 2.7.3 Enforceability of Lease Assignments/ Novations

In order to ensure its enforceability against a domestic party, it is advisable for an aircraft and/or engine lease assignment and assumption/novation to be written in English, signed, notarised and, if executed outside Philippine territory, apostilled or consularised depending on the country of execution.

If the aircraft and/or engine lease assignment and assumption/novation is in a foreign language other than English, an accompanying English translation would be required.

The transaction document must be registered in the CAAP in order to be valid and effective in rem (Section 49 of the Civil Aviation Act of 2008).

### 2.7.4 Filing/Registration of Lease Assignments/Novations

Transaction documents that are registered in the CAAP are valid and effective in rem. Even if not registered in the CAAP, any such duly executed transaction documents will nonetheless be valid and effective between the parties, their successors-in-interest and assignees and persons having actual notice thereof.

There are no consents required for registration of transaction documents in the CAAP.

An aircraft and/or engine lease assignment and assumption/novation can only be registered if it appears in a public document, ie, duly notarised, and if executed abroad, apostilled or consularised, depending on the country of execution.

Customarily, registration for transaction documents in the CAAP takes 30 to 45 business days from the submission of the completed documents.

The aircraft and/or engine lease assignment and assumption/novation must be supported by a Director's or Corporate Secretary's Certificates attesting to the board resolution authorising the parties to enter into the transaction and identifying the signatories thereto.

There are no other government applications or consents required as a prerequisite to the execution and delivery of an aircraft and/or engine lease assignment and assumption/novation in relation to aircraft registered in the CAAP.

### 2.7.5 Taxes/Duties Payable on Assignment/ Novation

The execution of an assignment and assumption/novation agreement will entail the payment of documentary stamp tax at the same rate as that imposed on the original instrument (Section 198 of the NIRC).

Documentary stamp tax shall be payable as a consequence of an original or copy of assignment and assumption/novation agreement to the Philippines. Under the NIRC, the corresponding documentary stamp tax shall be levied, collected and paid for and in respect of the transaction so made or accomplished, "wherever the document is made, signed, issued, accepted, or transferred when the obligation or right arises from Philippine sources or the property is situated in the Philippines, and at the same time such act is done or transaction had. (Section 173)."

### 2.7.6 Recognition of Transfer of Ownership Interests

Philippine-registered aircraft are generally owned by and leased to corporations, which by law are vested with legal personalities separate and distinct from those of their stockholders. The sale of shares of stock comprising a controlling interest in a corporation is not recognised as a sale of its aircraft and or engines or transfer of legal title over them. However, from a practical point

of view, the acquisition of an ownership interest in an entity that owns an aircraft or engines may effectively result in a change in beneficial interest or control over that aircraft or those engines. Such a transfer for beneficial interest in the registered owner is generally allowed and recognised as valid and effective.

As regards the transfer of the beneficial interest in the trust owning an aircraft, the Philippines will recognise the transfer as valid and binding between the parties provided that the terms and conditions governing the transfer are not contrary to Philippine law, morals, customs or public policy.

## **2.8 Aircraft Deregistration and Export**

### **2.8.1 Deregistering Aircraft in this Jurisdiction**

As a general rule, deregistration may be applied for by the lessee. The lessee, however, may delegate that power through an irrevocable DPOA executed in favour of a third party. Thus, the owner/lessor or a security trustee, on the basis of a DPOA executed in their favour by the lessee, may apply for deregistration of aircraft and/or engines.

Deregistration may be accomplished by an application to the CAAP on behalf of the owner/lessor or security trustee authorised under a DPOA.

### **2.8.2 Lessee's/Operator's Consent**

An aircraft owner/lessor or mortgagee may apply for the deregistration of the aircraft without the lessee's consent if a DPOA is executed in their favour by the lessee. Consent of the lessee is, as a matter of law, custom and practice, manifested by the execution of the DPOA in favour of the owner/lessor, which is binding and enforceable in the Philippines.

### **2.8.3 Required Documentation**

The owner/lessor or mortgagee would have to present the certificate of registration, the lease, and the DPOA and any other transaction documents supportive of the right to take possession and deregister the aircraft. These documents are customarily registered in or issued by the CAAP.

### **2.8.4 Duration of Deregistration Process**

The process of the deregistration and exportation of aircraft will typically take any time between seven to 21 calendar days, more or less, if possession will be voluntarily relinquished by a lessee/operator. Otherwise, a hostile scenario requiring the procurement of a court order for recovery of possession in conjunction with the deregistration and export of the aircraft may take between 30 to 60 calendar days, more or less.

### **2.8.5 Aviation Authority's Assurances**

The CAAP does not provide advance assurances to an aircraft owner, mortgagee or lessor as to the prompt deregistration of an aircraft.

### **2.8.6 Costs, Fees and Taxes Relating to Deregistration**

Costs would be minimal if deregistration were accomplished with the consent and participation of the lessee/operator.

In a hostile scenario, there will be additional costs in the form of legal fees, court filing fees and, in the case of recovery of possession requiring the issuance by the court of a writ of replevin, a replevin bond equivalent to twice the value of the aircraft.

### **2.8.7 Deregistration Power of Attorney**

A DPOA will be recognised by the courts and the appropriate government agencies of the Philippines.

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The DPOA should be acknowledged before a notary public. These are generally executed only by the lessee/operator, and therefore notarisation alone will suffice for purposes of CAAP registration.

The DPOA need not be translated to Filipino if it is in the English language. If the document is in a foreign language other than English, an accompanying English translation will be required.

## **2.8.8 Documents Required to Enforce Deregistration Power of Attorney**

In order to enforce the DPOA, it will suffice that a letter request be presented to the CAAP, setting out in detail the facts giving rise to and in support of the deregistration of aircraft. Transaction documents such as the lease agreement, and other supporting documents such as the relevant powers of attorney, are usually on file with the CAAP, but certified true copies thereof may be attached to the letter request for ease of reference.

## **2.8.9 Choice of Laws Governing Deregistration Power of Attorney**

A DPOA does not have to be governed by the laws of the Philippines and may be governed by foreign law.

The choice of foreign law to govern the DPOA will be upheld as a valid choice of law in any action in the Philippines, subject to that foreign law being pleaded and proven in that action. In the event of failure to prove the foreign law, it will be presumed that the foreign law is the same as the laws of the Philippines on the matter.

Furthermore, the choice of foreign law must not violate Philippine law, morals, good customs, public order or public policy.

## **2.8.10 Revocation of a Deregistration Power of Attorney**

A power of attorney can be made irrevocable if it is coupled with the interest of the owner/lessor or its attorney-in-fact in and to the aircraft. The grantor would not be legally justified in revoking such a power of attorney, or stopping the deregistration of the aircraft. A power of attorney coupled with an interest becomes irrevocable, because a bilateral contract depends on it and because the agency becomes part of another obligation or agreement. It is not solely the rights of the principal but also those of the agent and third persons which are affected. Hence, Philippine law provides that, in such cases, the agency cannot be revoked at the sole will of the grantor (Republic of the Philippines et al, versus the Hon Victorino Evangelista, et al, G.R. No 156015, 11 August 2005).

## **2.8.11 Owner's/Lessor's Consent**

As a purely legal matter, an aircraft owner/lessor or mortgagee may apply for the deregistration of aircraft without the lessee's consent if a DPOA is executed in their favour by the lessee/operator.

Consent of the lessee is, as a matter of law, custom and practice, manifested by the execution of the DPOA in favour of the owner/lessor or mortgagee, as the case may be, simultaneously upon execution of the lease agreement.

As a practical matter, under existing CAAP rules it is only the lessee/operator that may deal with that authority in matters of registration of an aircraft or engines. Consent of the lessee/operator is therefore indispensable to the expeditious and timely deregistration of aircraft from the CAAP.

The aircraft would have to be in the Philippines at the time of deregistration and/or export to enable the CAAP to ensure that all annotations on the aircraft's Certificate of Registration representing security interests or liens on the aircraft

are discharged. The CAAP will also have to conduct an inspection to ensure the aircraft's airworthiness upon export, and to send the deregistration email to the next registration authority. The aircraft will have to be located in the Philippines to enable the Bureau of Customs to issue the pertinent export permit.

#### **2.8.12 Aircraft Export Permits/Licences**

Upon the application being found in good order, the CAAP will issue an Export Certificate of Airworthiness. The Bureau of Customs will issue the Exit Permit.

With the assistance of the lessee/operator, it is estimated that an Export Certificate of Airworthiness and an Exit Permit may be obtained within a period of 15 to 20 business days.

It will not be possible to obtain an Export Certificate of Airworthiness and/or an Exit Permit in advance of their use or implementation.

#### **2.8.13 Costs, Fees and Taxes Concerning Export of Aircraft**

There are no taxes or customs duties payable upon the exportation of an aircraft from the Philippines, unless a hostile scenario arises, requiring a court order as a prelude to recovery of possession, deregistration and export of an aircraft from the Philippines.

#### **2.8.14 Practical Issues Related to Deregistration of Aircraft**

In all situations involving the deregistration of an aircraft from the Philippines, particularly in the furtherance of exportation thereof, the co-operation and assistance of the lessee/operator is indispensable to a timely, expeditious and economical process. Without such co-operation and assistance, any potential dispute shall be best resolved by reaching a commercial solution rather than a purely legal one.

## **2.9 Insolvency Proceedings**

### **2.9.1 Overview of Relevant Laws and Statutory Regimes Governing Restructurings, Reorganisations, Insolvencies and Liquidations**

The law governing proceedings for the rehabilitation of financially distressed debtors and/or liquidation of insolvent debtors in the Philippines is Republic Act No 10142, known as the Financial Rehabilitation and Insolvency Act of 2010 (FRIA), which took effect on 18 July 2010.

Under the FRIA, a debtor is considered insolvent if it is unable to pay its liabilities as they fall due in the ordinary course of business or has liabilities that are greater than its assets.

### **2.9.2 Overview of Relevant Types of Voluntary and Involuntary Restructurings, Reorganisations, Insolvencies and Receivership**

Voluntary and involuntary proceedings may occur in rehabilitation and insolvency or liquidation proceedings.

A voluntary rehabilitation proceeding is initiated by the insolvent debtor by filing a verified petition for rehabilitation with the court. The insolvent debtor is obliged to establish its insolvency and the viability of its rehabilitation.

Voluntary rehabilitation proceedings may be in the form of a pre-negotiated rehabilitation or by way of an out-of-court or informal restructuring agreement or rehabilitation plan.

Pre-negotiated rehabilitation proceedings may be initiated by the insolvent debtor itself or jointly with any of its creditors, by filing a verified petition with the court for the approval of a pre-negotiated Rehabilitation Plan. The Rehabilitation Plan must be endorsed or approved by creditors holding at least two thirds of the total



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liabilities of the debtor, including secured creditors holding more than 50% of the total secured claims of the debtor and unsecured creditors holding more than 50% of the total unsecured claims of the debtor.

In order to avail of an out-of-court or informal restructuring/workout agreement or Rehabilitation Plan:

- the debtor must agree to the out-of-court or informal restructuring/workout agreement or Rehabilitation Plan;
- it must be approved by creditors representing at least 67% of the secured obligations of the debtor;
- it must be approved by creditors representing at least 75% of the unsecured obligations of the debtor; and
- it must be approved by creditors holding at least 85% of the total liabilities, both secured and unsecured, of the debtor.

An involuntary rehabilitation proceeding may be initiated against the debtor by any creditor or group of creditors with a claim of at least PHP1 million or at least 25% of the subscribed capital stock or partners' contributions, whichever is higher.

Voluntary liquidation may be initiated by an insolvent debtor by filing a petition for liquidation with the court. The petition shall be verified and shall establish the insolvency of the debtor.

An involuntary liquidation proceeding may be initiated by the filing of a petition for liquidation by three or more creditors, the aggregate of whose claims is at least either PHP1 million or at least 25% of the subscribed capital stock or partner's contributions of the debtor, whichever is higher.

### 2.9.3 Co-ordination, Recognition or Relief in Connection with Overseas Proceedings

The Model Law on Cross-Border Insolvency of the United Nations Centre for International Trade and Development is adopted as part of the FRIA.

Cross-border insolvency proceedings may be initiated by the representative of the foreign entity that is the subject of the foreign proceeding by filing a petition before the court in connection with an insolvency or rehabilitation proceeding taking place in a foreign jurisdiction. Upon filing of the petition, the court will set it for hearing. As provision of relief, the court may issue orders:

- suspending any action to enforce claims against the entity or otherwise seize or foreclose on property of the foreign entity located in the Philippines;
- requiring the surrender of property of the foreign entity to the foreign representative; or
- providing other necessary relief.

The FRIA contains no provision that restricts the parties from adopting any co-ordination principles such as the American Law Institute and International Insolvency Institute Guidelines Applicable to Court-to-Court Communications in Cross-Border Cases 2001, and the INSOL International (International Association of Restructuring, Insolvency and Bankruptcy Professionals) Global Principles for Multi-Creditor Workouts 2000.

### 2.9.4 Effect of Lessee's Insolvency on a Deregistration Power of Attorney

Upon the occurrence of bankruptcy or insolvency of the lessee, the DPOA would still be valid and effective because a leased aircraft does not form part of the estate of the insolvent debtor.

The DPOA will cease to be effective upon the exportation of the aircraft from the Philippines, or

the date of expiry of the DPOA itself, if any such date is expressed in the document.

### 2.9.5 Other Effects of a Lessee's Insolvency

Philippine law on insolvency will not interfere with or obstruct contractual provisions in a lease agreement. However, upon the issuance of the Liquidation Order, all contracts of the insolvent debtor shall be deemed terminated and/or breached, unless the liquidator declares otherwise and the contracting party agrees. This will apply to lease agreements involving aircraft and/or engines.

In the event that the lessee becomes insolvent, the lessor/owner will be entitled, freely and unconditionally, to recover leased aircraft, because these do not form part of the assets or estate of the insolvent lessee.

The following third parties' rights constituting liens affecting an aircraft or an engine, whether or not registered in the CAAP, may be imposed by the liquidator/administrator in priority to the rights of the lessor:

- the tax liens imposed by the National Internal Revenue Code of the Philippines and the Tariff and Customs Code for failure to pay Philippine taxes and/or customs duties;
- the statutory lien imposed by the Director General of the CAAP under Section 73 of the Civil Aviation Act of 2008 for non-payment of charges and other fees and failure to pay administrative fines arising from violation of the rules and regulations of the CAAP;
- the lien imposed by the Manila International Airport Authority (MIAA) for failure to pay dues, charges and fees or concessions for any service provided by the MIAA; and
- the possessory liens under Article 2241 of the Civil Code of the Philippines for the unpaid price of movables sold, and credits for the

making, repair, safekeeping or preservation of personal property such as an aircraft.

### 2.9.6 Risks for a Lender if a Borrower, Guarantor or Security Provider Becomes Insolvent

The main risk for lenders in the event of their borrowers undergoing corporate rehabilitation would be a pro rata assumption of loss, along with other creditors, in order for the rehabilitation court to ensure the long-term financial recovery, viability and profitability of the distressed debtor. In contrast, the main risk for lenders in the event of insolvency of debtors would be the latter's dissolution, the liquidation and pro-rate distribution of the value of their assets and the extinguishment of their corporate existence.

### 2.9.7 Imposition of Moratoria in Connection with Insolvency Proceedings

In insolvency or liquidation proceedings, the liquidation court will issue a Liquidation Order which (i) will preclude the commencement of any separate action for the collection of an unsecured claim, (ii) directs actions already pending to be transferred to the Liquidator for him or her to accept and settle or contest, and (iii) will preclude foreclosure proceedings for a period of 180 days.

### 2.9.8 Liquidation of Domestic Lessees

A domestic lessee may be placed under administration or receivership under any of the following modes of rehabilitation proceedings.

#### A Voluntary Rehabilitation Proceeding

A voluntary rehabilitation proceeding is initiated by the insolvent debtor by filing a verified petition for rehabilitation with the court. The insolvent debtor is obliged to establish its insolvency and the viability of its rehabilitation.

Voluntary rehabilitation proceedings may be in the form of a pre-negotiated rehabilitation or by

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way of an out-of-court or informal restructuring agreement or rehabilitation plan.

Pre-negotiated rehabilitation proceedings may be initiated by the insolvent debtor itself or jointly with any of its creditors, by filing a verified petition with the court for the approval of a pre-negotiated Rehabilitation Plan. The Rehabilitation Plan must be endorsed or approved by creditors holding at least two thirds of the total liabilities of the debtor, including secured creditors holding more than 50% of the total secured claims of the debtor and unsecured creditors holding more than 50% of the total unsecured claims of the debtor.

In order to avail of an out-of-court or informal restructuring/workout agreement or Rehabilitation Plan:

- the debtor must agree to the out-of-court or informal restructuring/workout agreement or Rehabilitation Plan;
- it must be approved by creditors representing at least 67% of the secured obligations of the debtor;
- it must be approved by creditors representing at least 75% of the unsecured obligations of the debtor; and
- it must be approved by creditors holding at least 85% of the total liabilities, secured and unsecured, of the debtor.

### **An Involuntary Rehabilitation Proceeding**

An involuntary rehabilitation proceeding may be initiated against the debtor by any creditor or group of creditors with a claim of at least PHP1 million or at least 25% of the subscribed capital stock or partners' contributions, whichever is higher.

A domestic lessee may be liquidated either voluntarily or involuntarily under the following modes or proceedings:

- voluntary liquidation may be initiated by an insolvent debtor by filing a petition for liquidation with the court. The petition shall be verified and shall establish the insolvency of the debtor;
- an involuntary liquidation proceeding may be initiated by the filing of a petition for liquidation by three or more creditors, the aggregate of whose claims is at least either PHP1 million or at least 25% of the subscribed capital stock or partner's contributions of the debtor, whichever is higher.

### **2.9.9 Ipso Facto Defaults**

Ipso facto default clauses are fairly common in lease agreements entered into by local lessee/operators, but rarely have these been resorted to as sole or exclusive grounds for recovery of possession of aircraft during a lessee insolvency proceeding, where a lessee has most likely also defaulted in payment of lease rentals or has breached cross-default provisions in lease agreements.

### **2.9.10 Impact of Domestic Lessees' Winding-Up**

If a domestic lessee is wound up by a court or administration proceeding, the aircraft should be returned to the lessor, unless the parties agree otherwise. The lessee may be declared in default in the payment of lease rentals and will be deemed as an unsecured creditor in the proceedings for liquidation of the insolvent lessee. Most lease agreements allow forfeiture of security deposits to be applied against unpaid rent, and such a provision will be upheld as part of the parties' freedom of contract and not violative of Philippine law, public order or public policy. Maintenance reserves, whether classified as reserves or supplemental rent, are held by the lessor for the purpose of ensuring that aircraft are maintained in airworthy condition, particularly in the event of their return. Hence, maintenance reserves should belong to the lessor in

the event of the dissolution and winding up of a domestic lessee/operator.

## **2.10 Cape Town Convention and Others**

### **2.10.1 Conventions in Force**

The Philippines is not a Contracting State under the Convention or the Protocol concluded in Cape Town on 16 November 2001.

### **2.10.2 Declarations Made Concerning Conventions**

The Philippines has not made any declarations under the Convention or the Protocol, not being a party thereto.

### **2.10.3 Application of Article XIII of the Protocol on Matters Specific to Aircraft Equipment**

The Philippines is not a Contracting State under the Convention or the Protocol concluded in Cape Town on 16 November 2001. In lieu of an Irrevocable Deregistration and Export Request Authorisation (IDERA), lease agreements entered into with domestic lessee/operators are supplemented by DPOAs, which are generally couched in the same language and intended for the same purpose as an IDERA.

### **2.10.4 Enforcement of Conventions**

The Philippines is not a Contracting State under the Convention or the Protocol concluded in Cape Town on 16 November 2001.

### **2.10.5 Other Conventions**

The Philippines is a signatory and has ratified the 1948 Geneva Convention on the International Recognition of Rights in Aircraft. It is not a party to the 1933 Rome Convention on the Unification of Certain Rules relating to the Precautionary Arrest of Aircraft.

## **3. AIRCRAFT DEBT FINANCE**

### **3.1 Structuring**

#### **3.1.1 Restrictions on Lending and Borrowing**

A finance lease involving local operators may involve (i) the creation of a special-purpose vehicle (SPV) or orphan trust created by banks and other lenders to hold title to, and lease aircraft to, a domestic carrier/operator, or (ii) a contract directly with a foreign aircraft lessor. In both cases, parties are generally free to enter into contracts involving commercial terms and conditions that do not violate Philippine law, public order or public policy. These contracts may contain stipulations and covenants which govern borrowers' use of loan proceeds. In most cases, borrowers are the owners/lessors, which are essentially foreign registry orphans trusts and SPVs, and loan agreements are governed by foreign law with a venue of suit in foreign courts.

#### **3.1.2 Effect of Exchange Controls or Government Consents**

Section 2 of the *Bangko Sentral ng Pilipinas* (BSP) Circular No 1389, as amended, provides that Authorised Agent Banks (AABs) may sell foreign exchange to residents upon the latter's written application for any non-trade purpose, without the need of prior BSP approval. However, foreign exchange for payment of domestic obligations that are foreign loan- or foreign investment-related may be sold by AABs to residents upon showing that BSP approval and/or registration has been obtained for the loan or investment. AABs selling foreign exchange for remittance abroad shall ensure that taxes, when required, have been paid and that the remittance is net of any such taxes.

If the borrower or obligor sources its foreign currency-denominated payments from its own foreign currency deposits maintained with Phil-

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Philippine banks, no application or approval will be necessary.

### 3.1.3 Granting of Security to Foreign Lenders

Philippine law allows debtors to provide security to foreign lenders in the form of personal property, guarantees and special contracts such as mortgages, pledges, letters of credit and security assignments.

### 3.1.4 Downstream, Upstream and Cross-Stream Guarantees

Downstream, upstream or cross-stream guarantees in favour of lenders are widely recognised and are of customary usage in Philippine business and commercial transactions. In the local aviation industry, CAAP registration of guarantees and other collateral and security interests ensure that these become valid and effective in rem.

### 3.1.5 Lenders' Share in Security over Domestic SPVs

It is advisable for a lender to take share security over a domestic SPV that owns the financed aircraft, because collateral such as a security interest over shares of stock constitutes a lien that creates a preference in favour of a lender as a secured creditor. Such rights and preferred status are protected by Philippine law in terms of enforcement of security interests in bankruptcy or insolvency.

### 3.1.6 Negative Pledges

A negative pledge is recognised in the Philippines.

### 3.1.7 Intercreditor Arrangements

There are no material restrictions or requirements imposed on inter-creditor arrangements.

### 3.1.8 Syndicated Loans

The concept of agency and the role of an agent such as the facility agent under a syndicated loan are widely recognised in the Philippines.

### 3.1.9 Debt Subordination

It is usual for creditors to execute subordination agreements or inter-creditor agreements wherein they agree to give priority to one debt over another in respect of securing repayment from a borrower.

### 3.1.10 Transfer/Assignment of Debts under Foreign Laws

The transfer or assignment of all or part of an outstanding debt under an English or New York law-governed loan is permissible and widely recognised in the Philippines.

### 3.1.11 Usury/Interest Limitation Laws

The usury law in the Philippines was suspended by Central Bank Circular No 905, effective 1 January 1983. With its suspension, the parties to loan agreements are given much latitude in binding themselves under interest rates, provided these are not proven to be oppressive and unconscionable.

## 3.2 Security

### 3.2.1 Typical Forms of Security and Recourse

A typical form of security in an aviation finance transaction is a chattel mortgage over a Philippine-registered aircraft. Any such mortgage or security interest should be registered with the CAAP in order to be valid against all persons aside from the person by whom the mortgage is executed.

Under Philippine law, the contracting parties can stipulate in their contract that, in the case of default or non-payment of the mortgage debt, the creditor may sell at a private sale and without previous advertisement or notice, the prop-

erty mortgaged for the purpose of applying the proceeds thereof to the payment of the debt. Furthermore, it is customary for the mortgage to provide for extrajudicial foreclosure in the event of default or non-payment. For this purpose only, the mortgagee who is usually appointed attorney-in-fact for the mortgagor may take possession of the aircraft without judicial intervention. The aircraft would then be sold at a public auction by the Sheriff or by any other public officer after the usual formalities of the posting of the notice of sale. If the mortgage is foreclosed extra-judicially, the mortgagee may, after 30 days from the time of default, cause the aircraft to be sold at a public auction upon ten days' notice to the mortgagor.

### 3.2.2 Types of Security Not Available

International treaties to which the Philippines has conformed, such as the Geneva Convention on International Recognition of Rights in Aircraft are recognised and accepted as part of the law of the land. Hence, security interests recognised under the aforesaid treaty can be constituted upon aircraft and/or engines, while those which are prohibited or not recognised under the treaty are not recognised under Philippine law.

### 3.2.3 Trust/Trustee Concepts

The concept of a trust and the role of a security trustee are recognised in the Philippines.

### 3.2.4 Assignment of Rights to an Aircraft by a Borrower to a Security Trustee

A borrower may assign to a security trustee its rights to an aircraft under an aircraft lease, including in relation to insurance. An aircraft mortgage may be entered into by and between a borrower and its creditor(s), or directly with the latter's agent, such as a security trustee.

### 3.2.5 Assignment of Rights and Benefits without Attendant Obligations

Certain fundamental obligations of the lessor cannot be assigned or avoided, such as the obligation to deliver the aircraft in an airworthy condition, or to maintain the lessee in peaceful and adequate enjoyment of the lease for the duration of the contract (Article 1654, Civil Code). Certain representations and warranties in an aircraft lease may not be avoided by either existing or new lessors, even if agreed upon in lease contracts, if the waiver or renunciation of rights under such clauses, terms and conditions would be unenforceable, unconscionable or violative of Philippine law, public order or public policy.

### 3.2.6 Choice of Foreign Law

A security assignment or a guarantee does not have to be governed by the laws of the Philippines and may be governed by foreign law, such as English or New York law.

However, the choice of foreign law must not violate Philippine law, morals, good customs, public order or public policy.

### 3.2.7 Formalities/Mandatory Terms to Create and Perfect Security Assignments

A security assignment is consummated upon execution and will be perfected and deemed valid and effective in rem upon filing and registration in the CAAP. If unregistered, the security assignment will nevertheless be binding between the parties, their successors in interest and assignees and persons with actual notice thereof.

A security assignment can only be registered if it appears in a public document, ie, it must be duly notarised, and if executed abroad, apostilled or consularised, depending on the country of execution.

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A security assignment must be supported by Director's or Corporate Secretary's Certificates attesting to the board resolution authorising the parties to enter into the transaction and identifying the signatories thereto.

The security assignment need not be translated into Filipino if it is written in the English language. If the security assignment is in a foreign language other than English, an accompanying English translation will be required.

### 3.2.8 Domestic Law Security Instruments

There is no other domestic law security instrument that must be taken by a financier in addition to a security assignment governed by English or New York law.

The Philippines is not a Contracting State under the Cape Town Convention.

### 3.2.9 Domestic Registration of Security Assignments Governed by Foreign Laws

A security assignment governed by English law or New York law or domestic law may be registered in the CAAP.

### 3.2.10 Transfer of Security Interests over Aircraft/Engines

The transfer of security interests over an aircraft and/or engines will be recognised and deemed valid and effective in rem once registered in the CAAP.

### 3.2.11 Effect of Changes in the Identity of Secured Parties

Under Philippine law, the change in the identity of secured parties may be brought about either by conventional (contractual) subrogation (Article 1301, Civil Code) or by assignment of credit (Title VI, Book IV, Civil Code). In conventional subrogation, the debtor's consent is necessary; in assignment of credit, it is not required.

Accordingly, if the identity of the secured parties under a security assignment changes after its execution by way of conventional subrogation, the security interests will not be jeopardised if the consent of each of the original creditor, the new creditor, the original debtor, and the new debtor, as the case may be, are obtained in writing and preferably in a public instrument.

If the change in creditors is brought about by an assignment of credit where the consent of the debtor is not required, the security interest will similarly not be jeopardised.

### 3.2.12 "Parallel Debt" Structures

Provisions in transaction documents which may create parallel debt arrangements intended for the benefit of security trustees will be upheld in finance lease agreements entered into by domestic carriers/lessees as vital components of the structure for project financing.

### 3.2.13 Effect of Security Assignments on Residence of Secured Parties

A secured party under an isolated transaction such as a security assignment consummated in the Philippines will not be deemed to be a resident, domiciled in, carrying on or doing business in the Philippines as a result of its being a party to, or its enforcement of, its security assignment.

However, any income derived by the secured party will be considered to have been derived in the Philippines and will be subject to the payment of Philippine income tax.

### 3.2.14 Perfection of Domestic Law Mortgages

A domestic law mortgage over aircraft or engines will be perfected upon due execution and registration in the CAAP.

### 3.2.15 Differences between Security over Aircraft and Spare Engines

There is no difference between the form of security (or perfection) between aircraft and engines, which are essentially chattel mortgages over movable property.

### 3.2.16 Form and Perfection of Security over Bank Accounts

A pledge is a typical form of security that may be constituted over a bank account (such as a lease-receivables account), and this variety of special contracts has been further enhanced under the Personal Property Security Act (RA No 11057), which was enacted into law on 17 August 2018. The law provides for the creation, perfection, determination of priority and enforcement of security interests in personal property. The law, however, does not apply to aircraft, which are governed by the Civil Aviation Authority Act of 2008. Nevertheless, a security interest may be created over a bank account in aircraft finance and operating lease transactions.

## 3.3 Liens

### 3.3.1 Third-Party Liens

A third party can take or register a lien over an aircraft or engines. Certain third parties' rights will constitute liens affecting aircraft or engine, whether or not registered in the CAAP, such as:

- the tax liens imposed by the National Internal Revenue Code of the Philippines and the Tariff and Customs Code for failure to pay Philippine taxes and/or customs duties;
- the statutory lien imposed by the Director General of the CAAP under Section 73 of the Civil Aviation Authority Act of 2008 (Republic Act 9497) for non-payment of charges and other fees and failure to pay administrative fines arising from violation of rules and regulations of the CAAP;

- the lien imposed by the Manila International Airport Authority (MIAA) for failure to pay dues, charges and fees or concessions for any service provided by the MIAA; and
- the possessory liens under Article 2241 of the Civil Code of the Philippines for the unpaid price of movables sold, credits for the making, repair, safekeeping or preservation of personal property such as an aircraft.

In the case of repairer's cost and similar liens, the cited Civil Code provision is fairly comprehensive to include the pre-agreed contract price for the repair, safekeeping or preservation of the aircraft, as opposed to the actual cost thereof.

The language of the pertinent provisions of the Civil Aviation Authority Act of 2008 (Republic Act 9497) is comprehensive enough to include the imposition of a fleet lien by the Director General of the CAAP, who is given the power to impose a lien on personal and real properties, "and other assets of persons, corporations, partnerships, and such other entities that shall be in default, or fail to perform their obligations, or fail to pay the fines and other penalties imposed for violations of the law, rules and regulations of the Authority" (Sections 73 and 74, *supra*).

Properties and assets levied upon may be sold and the proceeds thereof shall be applied to the satisfaction of the obligation after due notice and hearing.

### 3.3.2 Timeframe to Discharge a Lien or Mortgage

Under prevailing COVID-19 quarantines and reduced staffing patterns, security interests registered in the CAAP may be discharged and cancelled within a period of 90 calendar days from complete submission of the appropriate document(s) to the CAAP.



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### 3.3.3 Register of Mortgages and Charges

The CAAP is the sole aircraft registry in which conveyances affecting title to or interest (including leases, mortgages, assignments and other security interests) over Philippine-registered aircraft and engines are recorded.

### 3.3.4 Statutory Rights of Detention or Non-consensual Preferential Liens

Statutory rights of detention or non-consensual preferential liens may arise over an aircraft for non-payment of Philippine taxes, customs duties, airport authority charges, CAAP administrative fines and fees.

The language of the pertinent provisions of the Civil Aviation Authority Act of 2008 (Republic Act 9497) is comprehensive enough to include the imposition of a lien on a fleet-wide basis, by the Director General of the CAAP. The Director General is given the power to impose a lien on personal and real properties, “and other assets of persons, corporations, partnerships, and such other entities that shall be in default, or fail to perform their obligations, or fail to pay the fines and other penalties imposed for violations of the law, rules and regulations of the Authority” (Sections 73 and 74).

### 3.3.5 Verification of an Aircraft’s Freedom from Encumbrances

A potential purchaser of an aircraft may search the CAAP registry, the sole aircraft registry in which transactions affecting title to or interest over Philippine-registered aircraft are recorded, to verify that an aircraft is free of encumbrances.

## 3.4 Enforcement

### 3.4.1 Differences between Enforcing Security Assignments, Loans and Guarantees

There are no relevant differences in enforcing a security assignment as opposed to enforcing a loan or a guarantee.

A recovery on a loan, guaranty or security assignment may be achieved by filing suit in court under a jurisdiction and governing law agreed upon by the parties in the pertinent transaction documents. Such actions would be in the nature of recovery of a sum of money in the case of an unsecured loan, or obtaining a writ of replevin from a court preparatory to extrajudicial foreclosure of chattel mortgage in the case of an aircraft mortgage. In the case of a guarantee, the alternative causes of action would be for specific performance and/or recovery of a sum of money. The causes of action will be essentially the same for recovery against a security assignment, except that the latter case will involve more parties, such as lenders or finance parties, possibly represented by a security trustee, the lessor/borrower/assignor and the lessee, depending on the structure and documentation of the transactions.

### 3.4.2 Security Trustees’ Enforcement of their Rights

If the security assignment provides that the lessor may validly grant to a security trustee certain rights under an aircraft lease agreement, and the lessor has contractually agreed that the security trustee may enforce those rights on the basis of a notice and acknowledgment executed by the lessor and the lessee, under Philippine law such a notice and acknowledgment would be valid and effective against both the lessor and the domestic lessee/operator. Such an agreement will not violate Philippine law, morals, good customs, public order or public policy and would therefore be protected under the parties’ freedom of contract.

### 3.4.3 Application of Foreign Laws

The choice of foreign law to govern a finance or security document, and the submission to a foreign jurisdiction and venue, may be agreed upon by the parties, and such an agreement would be

upheld as valid and effective in any action in the courts of the Philippines.

However, the choice of foreign law must not violate Philippine law, morals, good customs, public order or public policy.

#### **3.4.4 Recognition and Enforcement of Foreign Judgments and Arbitral Awards**

Philippine courts will recognise and enforce a final judgment of a foreign court without re-examination of the facts from which it prescinds. In order to be recognised and enforced, the foreign judgment must have been rendered by a foreign tribunal of competent jurisdiction with notice to the parties involved; it must not have been obtained through collusion, fraud or clear mistake of fact or of law in rendering the foreign judgment, it must have become final and executory, and it must not be contrary to the public policy or the good morals of the Philippines.

Recognition and enforcement of a foreign arbitral award in the Philippines is governed by the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention) and the Special Rules of Court on Alternative Dispute Resolution promulgated by the Supreme Court of the Philippines on 1 September 2009 (A.M. No 07-11-08-SC) (Rules). In resolving a petition for recognition and enforcement of a foreign arbitral award, the court will not disturb the arbitral tribunal's determination of facts and/or interpretation of law.

#### **3.4.5 Secured Parties' Right to Take Possession of Aircraft**

If the security agreement grants the secured party the authority to repossess the aircraft without the need for judicial proceedings, and the lessee would be willing to relinquish possession of the aircraft voluntarily, the secured party may do so without the need for a court order. In a hostile scenario, in which the lessee refuses to

relinquish possession, a court order would be necessary in order to recover possession.

Self-help remedies in the protection of property rights are recognised under Philippine law only to a limited extent, eg, theft, robbery, vandalism or destruction, and an act constituting an abuse of right may be subject to criminal prosecution for Grave Coercion, a felony. Hence, a court order is indispensable to the lawful recovery of possession of movable property from a hostile or unwilling lessee, mortgagor or person in possession.

#### **3.4.6 Domestic Courts Competent to Decide on Enforcement Actions**

Most regional trial courts in the Philippines have specially created commercial courts which are assigned exclusively to hear and decide cases involving commercial and corporate disputes, including aviation and maritime, financial rehabilitation and insolvency and various other similar actions.

Presiding Judges assigned to these courts have undergone rigorous specialised training and are experienced in deciding enforcement actions in such cases.

#### **3.4.7 Summary Judgments or Other Relief**

A secured party may obtain a summary judgment by filing a motion at any time after an answer has been served by the defendant and that answer shows that, except as to the amount of damages, there is no genuine issue as to any material fact and that the secured party is entitled to a judgment as a matter of law. The motion for summary judgment must be accompanied by supporting affidavits, depositions or admissions upon all or any part favourable to the lessor's causes of action (Rule 35 of the 1997 Rules of Civil Procedure).

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If warranted, a secured party may likewise avail of the pertinent provisional remedies of (i) preliminary attachment (Rule 57), (ii) preliminary injunction (Rule 58), and (iii) replevin (Rule 60). The latter provisional remedy will require the posting of a bond executed to the adverse party in double the value of the property in dispute.

#### **3.4.8 Judgments in Foreign Currencies**

A secured party under a security agreement/aircraft mortgage may obtain a judgment award payable in foreign currency stipulated in the parties' transaction documents.

#### **3.4.9 Taxes/Fees Payable**

A secured party will not be required to pay taxes in connection with the enforcement of a security agreement or aircraft mortgage.

However, court filing fees and sheriff's fees may be assessed in connection with the enforcement and/or foreclosure of an aircraft mortgage.

#### **3.4.10 Other Relevant Issues**

The nation's flag carrier Philippine Airlines, Inc (PAL), is in the final stages of preparation for initiating Chapter 11 proceedings before the US Bankruptcy Court situated in the Southern District of New York. This action has long been

speculated and will be closely observed, not only by the local business community but also by foreign lessors, banks and other institutions which maintain a financial interest in the Philippine aviation industry. It will set a precedent in terms of one of the country's oldest, most prestigious and ubiquitous business and social institutions resorting to bankruptcy protection in a foreign court and under foreign law, rather than before Philippine courts, under the FRIA and its related laws and regulations.

## **4. OTHER ISSUES OF NOTE**

### **4.1 Issues Relevant to Domestic Purchase, Sale, Lease or Debt Finance of Aircraft**

The impending PAL Chapter 11 proceedings before the US District Court of New York will involve material issues and a material court judgment which will be relevant to the purchase, sale, or debt finance of aircraft registered in the Philippines or involving a domestic party.

### **4.2 Current Legislative Proposals**

There are no current proposals before the legislature relating to the foregoing items.

**Agcaoili & Associates** was established in 1974 by lawyers Antonio V. Agcaoili and Alfonso V. Agcaoili. It is primarily engaged in the comprehensive practice of law, specialising in, among others, aviation, banking and finance, corporations, civil, insurance, intellectual property, immigration, labour, property and taxation laws, as well as in litigation and alternative dispute resolution. The firm provides services to a wide range of clients, several of which are leading

banks and financial institutions, both local and foreign, corporations engaged in the business of aircraft leasing and financing, advertising, chemicals, manufacturing, pharmaceuticals, real estate property development, hotel and condominium development, educational plans, garments and the like. The firm also acts as correspondent counsel for various law firms in the United States, Europe and Asia.

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**Jose Luis V. Agcaoili** was designated as managing partner in April 2001, and exercises general supervision over all areas of corporate practice and dispute resolution, also

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# PHILIPPINES LAW AND PRACTICE

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