



## **Mortgage of Aircraft**

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

### 1. Form of Mortgage:

(i) Is it possible to create a mortgage over an aircraft in the State of Registration?

Yes. Chattel mortgages are governed by the Law of Chattel Mortgages Without the Taking of Possession (Ley de Hipotecas Mobiliarias y Prenda Sin Desplazamiento de la Posesión) of 1973 (hereinafter the "Chattel Mortgage Law"). This law stipulates the basic requirements of a chattel mortgage as well as the judicial procedure for the execution of a chattel mortgage. The law also stipulates that a prerequisite to being able to register a chattel mortgage is to first obtain the authorization of the corresponding agency of the Venezuelan government to constitute the mortgage, which in the case of chattel mortgages on aircraft is the Ministry of Infrastructure. A basic requirement of the law is that a chattel mortgage may not be constituted if the vendor of the aircraft could sell it under the law of conditional sales, that is the Law of Sales with Reserve of Title (Ley de Ventas con Reserva de Dominio). Accordingly, normally if an aircraft is being sold directly by the manufacturer or by a private owner then such a sales transaction could not require the buyer to also constitute a chattel mortgage. Rather the chattel mortgage would usually arise in the case of a loan to the buyer who then purchases the aircraft and is in the position of a financial debtor to the lender.

(ii) Are there any special provisions which must be included (or which it is advisable to include) in the mortgage? Or must a mortgage be in a statutory form?

The Chattel Mortgage Law requires that a mortgage include at least the following elements:

- a) Complete identification of the parties.
- b) Amount of the credit being guaranteed, which must be expressed in the national currency (the bolivar), although it may also be expressed in a foreign currency, the provisions regarding interest or other charges, the term, the place and form of payment, and any amount to cover the execution of the mortgage.
- c) Precise description of the goods covered by the mortgage, including any elements that would help to identify them.
- d) Evidence of ownership of the chattel being mortgaged and a declaration by the mortgagor that the good is not already subject to any form of mortgage or pledge.
- e) The obligation of the mortgagor to insure the good, if so required, or a specification

of any existing insurance thereon.

f) Specification of the domicile of the mortgagor for the purpose of judicial notices.

g) Specifically in the case of aircraft, the mortgage must indicate the tail number and any other registration data established by the civil aviation registry.

h) The make, serial number, manufacturer, date of manufacture and other information useful for the precise identification of the aircraft.

i) Specification of all existing insurance.

j) If the mortgage is to cover spare parts, etc., not presently incorporated on the aircraft, these must be specifically inventoried and identified. Provided that the mortgage document includes at least the minimum statutory requirements it may be drafted in any form or order. Likewise, the mortgage document may include various additional conditions that are typical of aircraft mortgages, such as regarding maintenance, restrictions on use or location, and so forth.

(iii) Can the mortgage secure a US dollar loan and interest or must it be converted to a local currency?

The mortgage may secure a US dollar loan and interest thereon. However, in accordance with the Chattel Mortgage Law, as well as the Law of the Central Bank of Venezuela (Art. 95), all debt instruments to be enforced in Venezuela and that are to be registered with official entities must express the amount of the obligation in bolivars. Moreover, under Venezuelan law all financial obligations payable by a Venezuelan debtor may be paid in the local currency, but if the debt is denominated in a foreign currency, the debtor is required to pay the amount in local currency equivalent to the foreign indebtedness at the prevailing rate of exchange. Further, by contractual convention the debtor can be obligated to effect payment in a foreign currency at a place outside of the country.

(iv) Must the mortgage state the amount secured, or can it be an "all monies owing" mortgage?

The mortgage must be for the specific amount of the loan, plus any contractual interest, that is conventional interest as well as any penalty interest for late payment, and so forth. In addition, the mortgage may include an additional amount for execution or collection costs, such as attorney's fees, court costs, and so forth, which is usually set at 30% above the amount of the then outstanding financial debt. However, the mortgage must be specific to the loan transaction and it may not also cover any other monies that the debtor may come to owe to the creditor.

(v) May the mortgage cover interest indemnity payments? The mortgage may cover all forms of interest payments contemplated in the loan agreement.

(vi) Are there any special rules or formalities relating to the signing of the mortgage (notarized, legalized, apostilled)?

The mortgage must be signed as a "public document" meaning that it must at least be signed before a notary public. Normally the mortgage document would be signed in Venezuela before a notary, although it could be signed outside of the country. In this case the mortgage should likewise be notarized and then the document would either have to be apostilled by the corresponding authority in that jurisdiction or it would have

to be legalized before the corresponding Venezuelan consulate with jurisdiction over the place of the signing. It may be noted that the mortgage may be a stand-alone document issued only by the mortgagor or it may be incorporated into the loan document, in which case it would be signed by both the lender/mortgagee and the borrower/mortgagor. These formalities are prerequisites to being able to register the mortgage.

(vii) Does it matter whether there are any parts which are subject to the mortgage and which are not installed on the aircraft on either the date of execution or the date of registration of the mortgage?

The mortgage document must be specific as to the chattels, including rotatory or consumable parts, covered by the mortgage. However, the mortgage may refer to parts that have been, or will be, changed over the course of the loan agreement. In addition, unless expressly excluded by the mortgage document, the mortgage will cover all components and accessories of the aircraft, whether or not incorporated on the aircraft.

(viii) May the mortgage be in the English language?

As the mortgage must be registered in Venezuela in order to be deemed a valid mortgage and as it must be enforced under Venezuelan law, the mortgage document must be in Spanish. Of course, the parties may have a translation thereof.

(ix) May the mortgage be governed by English law?

No. The mortgage must be governed by Venezuelan law. Specifically, it must be governed by the Chattel Mortgage Law.

(x) Is any jurisdiction more helpful when it comes to enforcement or for any other reason?

No. In order for a chattel mortgage on a Venezuelan registered aircraft to be deemed valid and enforceable as such it must be governed by Venezuelan law.

## 2. Registration:

(i) Please advise where the mortgage should be registered (e.g. aviation authority and other registers) and the effect of such registration, i.e. is it conclusive with respect to third parties?

As all civilian aircraft operated in Venezuela must be authorized by and registered with Civil Aviation Authority of the Ministry of Infrastructure located in Caracas, the Subalternate Registry of the Third Registry Circuit of the Federal District (the city of Caracas) has been designated by the Ministry of Internal Affairs and Justice (which is responsible for civil registry offices) as the sole registry for the registration of mortgages on aircraft and components. Accordingly, the mortgage must first be registered in this civil registry and then in the Civil Aviation Authority of the Ministry of Infrastructure. Once so registered the mortgage is deemed to be valid and conclusive with respect to any third parties.

(ii) What documents will be required for registration?

As for registering the mortgage with the civil registry, it is necessary to file an original or certified copy of the mortgage document and the authorization issued by the Ministry of Infrastructure authorizing the constitution of the mortgage. It is also necessary to provide an original receipt evidencing payment of the registration fee, which is equivalent to 0.25% of the amount of the mortgage. In the case of filing with the Civil Aviation Authority, it is necessary to present a certified copy of the mortgage as registered with the civil registry along with the other documentation required for the registration of aircraft, that is the authorization to operate the aircraft, the inspection report thereon, and evidence of registration with or solvency with the public aeronautical authorities (radio, airports, and so forth).

(iii) Are originals or certified copies required and should translations or summaries be prepared? Will any of these documents need to be certified, notarized, consularized or will faxed copies suffice?

Originals or certified copies will be required in all cases. As these documents must be in Spanish, no translations are required for the public authorities. Likewise, as only originals or certified copies will be accepted, no summaries need be prepared. For this same reason, all documents filed must comply with the formalities of notarization or legalization, and faxed copies will not suffice.

(iv) Will the mortgagee's interest be noted on the registry and what is the effect of such notation?

The mortgagee's interest will be noted on the registry. The effect thereof is to provide prima facie evidence of the mortgage in favor of the mortgagee, as stipulated in the mortgage document.

(v) Will the mortgagee's interest be recognized prior to effective registration?

No. The mortgage is only deemed to be perfected upon registration. Prior to completing the registration process the mortgage document only serves to evidence the financial and other obligations stipulated therein, but the document is not deemed to be valid as a mortgage.

(vi) What fees are required in connection with the registration?

In order to register a chattel mortgage it is necessary to pay a registration fee equivalent to 0.25% of the amount of the mortgage, that is the entire estimated amount of the mortgage including loan principal, interest and the collection percentage.

(vii) How long will registration take and can the registration of the transfer of ownership and of the mortgage take place simultaneously?

The process of registering a mortgage is relatively lengthy and complex. It is first necessary to obtain the authorization of the respective governmental agency to constitute the mortgage. This requires filing a petition to this effect along with a copy of

the proposed mortgage document, as well as possibly other supporting documentation, such as authorization on the part of the aircraft purchaser to operate the aircraft in the country. This process usually takes about two months to accomplish. Then the mortgage can only be filed for registration once the aircraft is in the country and located at its principal base. Thereafter the filing of the mortgage can proceed, which process can usually be accomplished in about one week. In order for the mortgagor to be able to register the mortgage under Venezuelan law the chattel must be owned by the mortgagor. However, the contract may stipulate that in the event that the mortgage is not registered for whatever reason the loan is terminated and is immediately due and payable.

(viii) Can the borrower execute a mortgage prior to acquiring title to the aircraft, but after signing the purchase agreement?

As the mortgagor must have title to the chattel in order to grant the mortgage, it is not possible for the borrower to execute the mortgage prior to acquiring title. The borrower cannot grant a valid mortgage to a chattel it does not own and the mortgage is not deemed to be valid as such until it has been formally registered.

(ix) Is the time or date of registration of the mortgage decisive in relation to priority and is there any procedure for lodging a priority notice of intention to file the mortgage?

The time or date of registration is decisive in relation to the priority of a mortgage; in the event of two mortgages granted on the same chattel the first mortgage to be registered will have priority independently of other legal considerations in relation to the transaction. Indeed, the second mortgage would be deemed to be invalid as in order to grant a valid mortgage there must be no prior encumbrance over the chattel. In Venezuela there is no procedure contemplated in the law for lodging a priority notice of intention to file a mortgage. (x) Would the mortgaging of the aircraft be liable to stamp duty, notarial fee, sales tax, VAT, import duty or any other tax? The registration of the mortgage with the civil registry is subject to a fee equivalent to 0.25% of the gross amount of the mortgage. The notarization of the mortgage document is subject to a notarial fee, which is based on the length of the document and the time in which it is required to be notarized, that is there is an increased fee if the document is required in less than the normal processing period. Otherwise, the mortgage itself is not subject to any form of stamp tax, sales tax, VAT, import duties, and so forth, although of course the importation of the aircraft would be subject to at least the VAT and import duties (which typically are exempted for a period of time depending on the nature of the importing party). Also, the interest or other charges on the financial loan would be subject to income tax in Venezuela.

(xi) Are any governmental consents required for the mortgage of the aircraft by mortgagor to lender?

Authorization to constitute the mortgage must be granted by the Ministry of Infrastructure in the case of aircraft and other chattels falling within its jurisdiction. In the case of domestic bank and insurance company lenders no prior governmental authorization is required with respect to the mortgage. Accordingly, one option is for a foreign lender to enter into a back-to-back loan/mortgage transaction with a domestic bank that appears as the lender of record.

(xii) Are there any categories of creditors (e.g. airport charges or air navigation charges) whose interest in the aircraft would rank ahead of the mortgagee?

Yes. Under Venezuelan law in a situation of bankruptcy of the debtor certain creditors would have priority over secured lenders. However, under the Chattel Mortgage Law these include only the expenses of the administrator or liquidator in bankruptcy in the interest of the mass of creditors, and the debts specified in clauses 3 and 4 of Art. 63 of the Civil Aviation Law, which are compensation for damages as established in the law, and expenses incurred in relation to rescue and salvage, and for any final flight.

(xiii) Does the registration require renewal? If yes, what is the cost of renewal and effect of failure to renew?

With respect to the original loan/mortgage agreement, no renewal is required as long as the parties remain within its terms. On the other hand, if the loan is extended or restructured, then the mortgage will have to be renewed. Indeed, rather than a mere renewal the new loan/mortgage will be treated as a new transaction, for which reason the procedure would be the same as in the case of the original mortgage. Accordingly, the cost for renewing the registration of the mortgage will be the same as for the original mortgage, that is the application of the fee of 0.25% on the then gross amount of the new mortgage. The effect of any failure to register the renewed or modified mortgage would be to invalidate the mortgage as such meaning that the document would only have the effect of an unsecured evidence of a financial obligation.

(xiv) Are there any other steps necessary to perfect lender's security interest in the aircraft registry?

Provided that all of the registration procedures at the civil registry and at the Civil Aviation Registry are complied with no other steps are required.

### 3. Matters affecting the Mortgagee:

(i) Is the mortgagee liable for debts, or liabilities incurred by the borrower, or for insuring or maintaining the aircraft or for any criminal sanctions or liabilities arising out of the use or operation of the aircraft?

The mortgagee is merely a lender and holder of a surety. Unless the loan or the mortgage document provides otherwise, normally the mortgagee would not be liable for any debts or other liabilities of the borrower, and nor would the mortgagee be responsible for providing insurance or maintenance. In the case of insurance, the parties may provide that the mortgagee will be responsible for contracting insurance; also, the Chattel Mortgage Law expressly provides that the mortgagee may maintain insurance policies in the event that the mortgagor fails to do so, at the expense of the mortgagor. Likewise, the mortgagee would normally not be liable for any criminal sanctions or other forms of liability arising out of the use or operation of the aircraft, absent an allegation of fraud or other direct act of commission on the part of the mortgagee.

(ii) Is the mortgagee deemed to be doing business in the State of Registration by virtue of having entered into the mortgage/loan agreement?

Provided that the mortgagee has no other business activities in Venezuela, it would not be deemed to be doing business in the country merely by virtue of having extended a loan and holding a mortgage. Notwithstanding, the mortgagee will be subject to Venezuelan income tax on any interest and other financing charges earned based on the loan or any other aspect of the transaction.

(iii) Is the mortgagee required to be licensed to do business in the State of Registration?

The mortgagee is not required to be licensed in Venezuela in order to enter into the loan and to be the beneficiary of the mortgage. However, the mortgage (and so indirectly the mortgagee) must be previously authorized by the Ministry of Infrastructure.

#### 4. Enforcement:

(i) If the borrower defaults please advise the steps, cost and ease of the mortgagee repossessing the aircraft and deregistering it and exporting it. Can this be done without the need for judicial proceedings? Is the permission of any party (including any official body) required? Would it generally assist if the mortgage was signed in the presence of a notary public or as a notarial deed?

First of all, under Venezuelan law a mortgagee only has a security interest in the value of the chattel; the mortgagee does not have a property right in it. Accordingly, in the event of default the mortgagee is entitled to execute the mortgage, which requires a judicial proceeding and which will lead to the judicial sale of the chattel, the proceeds of which will be used to cancel or amortize (depending on the amount received from the judicial auction) the debt. The only way that the mortgagee could recover the aircraft in such a judicial auction would be if it were to participate as a bidder and then purchase the aircraft from the debtor in exchange for the forgiveness of an equivalent amount of the debt. The Chattel Mortgage Law provides for a short or executory court procedure for the execution of a mortgage, which procedure in theory is characterized by merely having to prove the indebtedness and the default, but without the debtor being able to plead justifications for nonpayment. In practice, however, such judicial proceedings can become more complicated as the courts have tended to admit procedural arguments or maneuvers on the part of defendants. Hence, while the procedure for the execution of a mortgage should be shorter and more efficient than a normal lawsuit (generally not exceeding a period of three to six months, depending on the functioning of the court system), in practice if the execution is controversial it can take considerably longer. The cost of the proceeding is mainly for attorney's fees and the fees of one or more expert appraisers, as the court costs generally are minimal. Aside from the courts, the only official entity that could become involved in the execution of the mortgage and the subsequent judicial auction would be the office of the attorney general in the event of the application of the "public use doctrine". In the proceeding for the execution of a mortgage the trial court must advise the office of the attorney general, which could determine that the aircraft, if providing commercial service to the public, should remain in service under the concept of the public use doctrine. However, even in the unlikely event of the application of this doctrine the owner or lender would be entitled to be compensated and saved harmless, at least in theory, and it would be the responsibility of the court to attempt to find a solution to the impasse so that the situation of preventing the sale of the aircraft, and thus the recovery on the part of the creditor, would not

perpetuate beyond a reasonable time. The question as to notarization is not relevant as the mortgage document will have had to be notarized.

(ii) Will export duty be payable following the repossession or other termination of the mortgage?

In order for the export of the aircraft to be an issue it would have had to be purchased by the creditor or by another party wishing to export the aircraft. There is no export duty that is generally applied on the export of goods from Venezuela, although other tax questions could arise.

(iii) Can the mortgagee deregister without the borrower's consent?

The mortgagee would only be in a position to seek deregistration if it had purchased the aircraft from the borrower. However, under this circumstance the court would order the deregistration of the aircraft. Otherwise, the mortgagee would have no right or ability to deregister the aircraft without the consent of the borrower.

(iv) If the consent of the borrower is required to deregister the aircraft would an irrevocable power of attorney given by the borrower to the mortgagee at commencement of the mortgage be upheld in the jurisdiction of the State of Registration? Does the jurisdiction of the State of Registration accept the concept of an irrevocable power or attorney?

If not, could the power of attorney be governed by English law and would that be enforceable in the State of Registration? Under Venezuelan law a power of attorney coupled with an interest is legally deemed to be irrevocable. As a practical matter, however, the grantor could at least delay the use of such a power of attorney by challenging the matter in the courts, although in principle the power of attorney would be upheld provided that the beneficiary were to prevail. Under these circumstances a foreign-law power of attorney would not assist the beneficiary thereof and could complicate the enforcement of the rights of the beneficiary.

(v) Alternatively, would a signed and undated deregistration certificate be effective? No, for the same reasons stated in 4.

(iv), above.

(vi) Can the borrower deregister or lease the aircraft without the mortgagee's consent notwithstanding any contrary provision of the mortgage?

In principle, no. In addition to the contractual prohibition to do so, the Chattel Mortgage Law expressly prohibits the mortgagor from encumbering or conveying the chattel covered by the mortgage under penalty of termination of the loan by operation of law. In addition, the Chattel Mortgage Law imposes criminal sanctions on the mortgagor for so acting. Moreover, the civil aviation authority should be aware of the terms of the mortgage and disallow any such attempt on the part of the borrower. In order for the borrower to undertake such a violation it would have to do so without the knowledge of the authorities and the effect thereof should be voidable under most applicable legal systems.

(vii) Would the courts of the State of Registration uphold a Kansas or English choice of law clause in the mortgage?

No. The mortgage, in order to be enforceable in Venezuela, must be in accordance with, and governed by, Venezuelan law.

(viii) Would the courts of the State of Registration recognize a final judgment of a Kansas or English court?

Not with respect to the enforcement of the mortgage. In principle, and excepting certain contracts with central government entities, Venezuela does accept foreign law and jurisdiction with respect to general contractual matters, including with respect to foreign loans. However, in the case of chattel mortgages these must be governed by the special Venezuelan law covering this matter in order to be enforceable as such.

(ix) Would the courts of the State of Registration award, recognize or enforce a judgment expressed in a foreign currency?

See 1.(iii), above.

(x) Is a clause granting an indemnity on foreign exchange losses enforceable?

Yes. As a general proposition this type of provision may be freely stipulated by the parties.

(xi) Have any laws approximating those of Chapter 11 of the United States of America or Administration in the United Kingdom affecting the ability of the mortgagee to repossess the aircraft upon a default of the borrower caused by insolvency or otherwise been enacted in your jurisdiction?

Venezuela has norms on voluntary and involuntary bankruptcy and insolvency, which could affect the ability of the mortgagee to execute the mortgage. However, again, this is not usually a question of repossession but rather of being able to have a court proceed to a judicial auction of the mortgaged chattel, with the sales proceeds being credited against the debt of the borrower. Under a situation of bankruptcy or insolvency in Venezuela the mortgagee would not lose the benefit of its security interest over the chattel, but the intervention of the bankruptcy court could delay the execution of the mortgage in the interest of not harming other creditors.

(xii) If the answer to (xi) is yes, in what circumstances can a liquidator or administrator set aside the mortgage or impose the rights of any other creditors in priority to it or prevent or delay the ability of the mortgagee to repossess the aircraft on the termination of the mortgage?

In the case of a properly constituted and registered mortgage the liquidator or administrator in bankruptcy cannot set aside the mortgage. Any priority creditors to those of the mortgagee are referred to in 4.(xi), above. However, the liquidator or administrator could delay the enforcement of the mortgage so as to safeguard the rights of other creditors. This would be particularly likely in the event that the aircraft were

being used for commercial purposes and the borrower was permitted to continue to operate pending resolution of the situation of bankruptcy. Note, though, that the question is not one of repossession under the mortgage but rather of the judicial sale of the aircraft in order to collect a recovery amount to be applied to the debt. Likewise, there could be no repossession of the aircraft upon the termination of the mortgage as in Venezuela a legal condition of being able to mortgage a chattel is ownership by the mortgagor; accordingly, the only way in which the ex-mortgagee could regain ownership and possession of the aircraft would be to enter into a purchase transaction with the ex-mortgagor, whether in the course of a judicial auction under an execution proceeding or thereafter. In practice what sometimes occurs is for the mortgagee to acquire the aircraft in exchange for the forgiveness of part of the debt, usually as part of the judicial auction process.

(xiii) Must a court order be obtained for the sale or may sale be made by private treaty or public auction?

Under the Venezuelan Chattel Mortgage Law the sale must be ordered by a court and it will be a judicial auction of the chattel.

(xiv) What duties does the mortgagee owe to the borrower with respect to any sale and what are the liabilities of the mortgagee upon enforcement of the mortgage?

Under the Venezuelan system there are essentially no duties or liabilities owed by the mortgagee as all matters related to the execution of the mortgage and the judicial auction of the chattel are handled by the court. It is conceivable that if the mortgagee seeks to execute the mortgage the court could find that the mortgagor was not in default and, therefore, rule against the mortgagee, in which case the mortgagee could be liable in damages to the mortgagor, but this would be a rare situation indeed. (xv) Should the mortgagee obtain exchange control or other governmental consents to export sale proceeds of the aircraft if the aircraft is sold by the courts? At the present time Venezuela does not have in effect any form of exchange control regulations. Accordingly, a mortgagee could freely remit abroad any sales proceeds or other judicial award. However, it may be noted that since 1983 Venezuela did have in effect restrictions on the remittance of monies abroad during two periods that covered a total of eight years.

(xvi) Should the mortgagee apply in advance for an export license to re-export the aircraft upon the termination of the mortgage either due to expiry or to default?

There would be no question of the re-exportation of the aircraft in the context of a Venezuelan mortgage. The borrower would have to be the owner of the aircraft in order to have granted the mortgage and the mortgagee would have no right to possession of the aircraft, except via a subsequent purchase from the borrower.

(xvii) Is the State of Registration a party to the 1948 Geneva Convention on the International Recognition of Rights in Aircraft or to the 1933 Rome Convention on the Unification of Certain rules relating to the Precautionary Arrest of Aircraft?

Venezuela is not a party to either of these conventions.

## 5. Other

(i) Please advise of any other matter that a prudent lender should be aware of in this transaction. As a general proposition, a mortgage is a reasonably secure juridical instrument by which to obtain a security interest and to safeguard the interests of the lender, except to the extent that the borrower may not be in sound financial condition and, thus, risk entering into bankruptcy. Accordingly, the prudent lender will first undertake a thorough credit check of the borrower and continue to monitor the financial state of the borrower. In addition, the prudent lender will build into the loan transaction certain safeguards through which, for example, it may call the loan, increase the security guarantees, and so forth. The one principal difficulty with the mortgage is that at the time of a judicial auction it may not be possible to sell the chattel for the then fair market value thereof. Bearing this in mind, a prudent lender would be well advised to require a substantial initial payment and then to set the value of the mortgaged chattel as high as possible so as to protect against this eventuality. In principle, the value of the mortgage must guard a relationship to the actual value of the chattel, but the law permits considerable flexibility in this appreciation.