

# THE NATIONAL LAW REVIEW

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## Choice of Law After England's Blue Sky One Case

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England's *Blue Sky One* case presents perplexing problems for bankers, aircraft operating lessors, airlines and their lawyers.<sup>[1]</sup> This note discusses the fallout from *Blue Sky One*, and explains how parties can address these problems in their affected aircraft financing deals.

### **The Problem**

Following the *Blue Sky One* case, there is an issue as to whether an English law mortgage creates a valid security interest in an aircraft in certain situations. A valid security interest is created under English law without additional requirements only when an aircraft is located in England at the time of closing or where the location of an aircraft is unknown.<sup>[2]</sup>

In all other situations there are now complicated legal and practical risks to address before parties can be comfortable that an English law mortgage is effective. In summary, the requirements are as follows:

- If an aircraft is outside England at closing, an English mortgage must be valid under the law of the jurisdiction where the aircraft is located in order to be effective.
- If an aircraft is over international waters at closing, best practice is to ensure the mortgage is valid under the law of the jurisdiction where the aircraft is registered to ensure the mortgage is effective.<sup>[3]</sup>

These new requirements have cost, risk and timing implications for transactions using an English law mortgage. A best case scenario resolution addressing the new requirements is that local counsel in the jurisdiction where an aircraft is located or registered will be able to give a clean opinion confirming that the English law mortgage is valid under local law. At worst, local counsel will give an opinion containing assumptions or exclusions that push the risk of a mortgage being invalid back to the parties, or will not be able to give an opinion at all – potentially because the English law mortgage will not, in fact, be effective under local law (as was the case in *Blue Sky One*).

Whichever scenario applies, *Blue Sky One* means that using English law will now result in higher legal costs and potential timing and closing risk. Consequently, lenders, lessors and airlines should question their counsel carefully to understand new risks that may exist, even where a local law opinion has been provided.

### **The Solutions**

The issues with *Blue Sky One* can be side-stepped by having an aircraft mortgage governed by laws other than English law. New York law is an alternative to consider, with a developed body of case law, and courts and a legislature that openly induce commercial contracts to designate New York law.

A choice of New York law in a commercial case will receive nearly absolute respect in New York



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courts. Section 5-1401 of New York's General Obligations Law provides that:

"The parties to any contract, agreement or undertaking...covering in the aggregate not less than two hundred and fifty thousand dollars... may agree that the law of this state shall govern their rights and duties in whole or in part, whether or not such contract, agreement or undertaking bears a reasonable relation to this state."

The general rule in **Section 5-1401** leaves little scope for the type of uncertainty created by *Blue Sky One*. If an aircraft is worth more than \$250,000, a mortgage under New York law will validly create a security interest in it regardless of aircraft location.<sup>[4]</sup>

A second solution is to rely solely on a mortgage governed by the law of the jurisdiction where the aircraft is located or registered at closing.<sup>[5]</sup> This will be less desirable if local rules on enforcement are not as familiar or as effective as the laws of a "moneycenter" jurisdiction like New York. Taking only a local mortgage may also necessitate local counsel and local courts becoming more involved in the enforcement process, potentially reducing certainty and increasing enforcement risk for lenders.

It is worth noting that, if the debtor is located in a country that has adopted the **Cape Town Convention**, then the parties arguably have a broader choice for the mortgage's governing law. The Cape Town Convention provides that, so long as the relevant contracting state has made the election under Article XXX(1), the transaction parties are free to choose the governing law of their agreements.<sup>[6]</sup> In this case, a New York law mortgage still would be a sensible choice, as this would give the parties the choice of law protections afforded by both The Cape Town Convention and New York law.

## Conclusion

Following *Blue Sky One*, lenders taking English law mortgages over aircraft that are not located in England at closing must take additional steps to ensure that they have an effective security interest including confirming that the English law mortgage is valid under the law of the jurisdiction of the location of the aircraft or considering a New York law governed mortgage.

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<sup>[1]</sup> *Blue Sky One Limited & O'rs v. Mahan Air & Ano'r* [2010] EWHC 631 (Comm). Here it was held that the validity of an English law mortgage of an aircraft is to be determined by the *lex situs*, the law of the place where the aircraft is situated, at closing. The facts of this case amply demonstrate the importance of the holding. The debtor granted an English law mortgage over several aircraft. One of the aircraft was located in The Netherlands at the time the mortgage was granted. The court found that the mortgage was not effective under Dutch law and consequently the lender was not entitled to enforce its claim against the aircraft.

<sup>[2]</sup> This may never be the case in the age of smart phones and free flight tracking apps.

<sup>[3]</sup> Following *Blue Sky One* it is not clear whether English law or the law of the jurisdiction of registration applies, so best practice is to confirm that the mortgage is valid under the law of the jurisdiction of registration.

<sup>[4]</sup> New York is not alone in addressing the potential problem by statute. New York's chief domestic jurisdictional competitor, Delaware, introduced Delaware UCC Article 9-111 which provides expressly on-point "If a security agreement is governed by the Laws of the State of Delaware, then those Laws shall govern, among other things... [t]he creation, attachment, validity and enforcement of the security interest."

<sup>[5]</sup> The law of the country of registration is applicable only if the aircraft's location cannot be determined, most likely because the aircraft is over international waters.

<sup>[6]</sup> See Article VIII of the Protocol. In fact, in certain English law transactions the parties currently are using Irish law mortgages, although it is unclear why Irish law would be preferable to New York law.

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