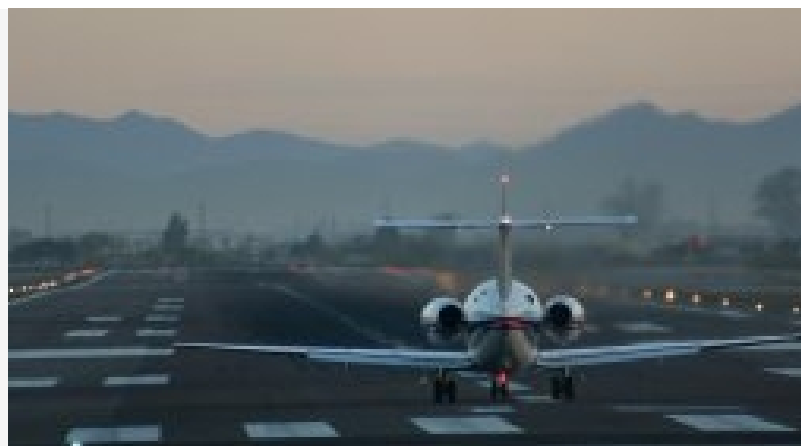


FULL METAL JACKET: CHANGE OF TRUSTEE IN UTAH AIRCRAFT OWNING COMMON LAW TRUST TRIGGERS A METAL TRANSFER

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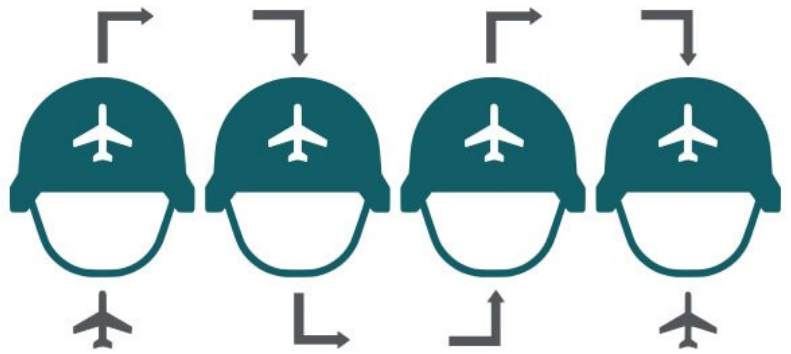


Does resignation by a trustee and the appointment of a successor trigger the need to transfer title of the aircraft held in the trust to the appointed successor (i.e. is a “metal transfer” required)? Following the recent notification by Wells Fargo Trust Company, N.A. (“WFTC”) to many of its leasing company customers that, for business reasons, it intends to resign as owner trustee from all or substantially all of its aircraft owner trusts, many leasing companies looking to assess the consequences of this event have asked this question of their legal advisors. This same inquiry was made, with input from various firms, during the development stage of the Global Aircraft Trading System (“GATS”), and has informed how the GATS documentation has been drafted.

Except where expressly stated otherwise, this article considers only those trusts governed by the laws of the State of Utah and established pursuant to the Utah Uniform Trust Code[1] (the “Trust Code”) and common law trust principles applicable in the State of Utah[2] (referred to in this article as “common law trusts”). It does not consider, or apply to, Utah business trusts formed pursuant to the Utah Business Trust Registration Act[3].

This article arrives at the conclusion that, given the nature of a common law trust, a metal transfer is required but, more importantly, that such transfer might not in all cases be effected *automatically* upon appointment of the new trustee (without any further act). Given the value of the assets at stake, leasing companies should exercise caution and consider additional steps that may need to be taken, including, in particular, the execution of a bill of sale.

To provide more clarity and provide a fuller response to the inquiry, this article also takes a look at some of the other commercial, practical and related legal issues that leasing companies may wish to consider when formulating a strategy for transitioning its affected aircraft with a new trustee, including considering the opportunities made available by GATS.



WHAT IS A COMMON LAW TRUST, AND WHY IS IT NOT A SEPARATE LEGAL ENTITY?

A trust may be defined as a fiduciary relationship in which one person (the trustee) holds property (the ‘trust estate’, as it is usually defined) subject to an equitable obligation to keep or use that interest for the benefit of another (the beneficiary)[1].

In common law trusts typically used in aircraft finance and leasing transactions, the trust estate comprises, principally: (a) the aircraft equipment, usually being the only tangible asset(s) in the trust, and (b) a bundle of intangible assets, including, perhaps most importantly, the right to receive rent under any lease agreement entered into by the trustee, as lessor, relating to that aircraft equipment.

In contrast to other legal structures, such as a limited liability company, a common law trust is not a separate legal entity but, rather, a legal relationship among two or more parties describing a means of property ownership subject to certain terms. This is because legal ownership of the trust estate of a common law trust is held by and in the name of the trustee[2], as trustee, and not by the trust itself, notwithstanding that the trustee may exercise its powers ‘in the name of’ the trust[3] (which may be useful, or even required, for public filings and recordations). It is, therefore, the trustee who is the party against whom third parties, such as a lessee or mortgagee, must enforce their rights and interests in or to the property forming part of the trust estate, rather than the trust itself. That is not to preclude the possibility of a direct agreement between a third party and the beneficiary, but to highlight the facts that it is the

trustee, and not the trust, who is the legal owner of the trust estate and the correct party from whom property interests in the trust estate itself are acquired.

The beneficiary[1] holds the ‘beneficial interest’ in the trust and, subject to the terms of the trust instrument, has the right to enjoy all of the benefits of the trust property, principally the proceeds of any income (e.g. rent) or capital (e.g. proceeds of sale of any aircraft equipment). In this sense, the beneficiary is often described as the beneficial or economic owner of the trust property[2], but cannot, without joining the trustee into any contract, agreement or other instrument, directly dispose of any legal interest in the aircraft equipment or other property forming part of the trust estate. The beneficiary is sometimes described or defined as the ‘owner participant’, ‘trustor’ or, more traditionally, ‘*cestui que trust*’ [3].

Upon resignation or removal of the existing trustee, how does title to the aircraft equipment (and other trust property) transfer to the new trustee?

If the trustee^[4] resigns or is removed and a new trustee is appointed, for the trust to continue to operate correctly, the legal title to the trust estate needs to pass to the new trustee as the new legal owner of the trust estate. In other words, there must be a 'metal transfer' of the aircraft equipment by the existing trustee in favor of the new trustee.

However, the more important inquiry is whether the transfer is 'automatic' (that is to say, occurring upon the new trustee's appointment without any further act) or must the transfer to the new trustee be effected by one or more additional instruments (such as a bill of sale or, in the case of the rights under a lease agreement, a novation or assignment agreement)?

On whether the transfer of the trust estate is automatic, the prevailing general view, as a matter of U.S. trust law jurisprudence, is that the new trustee will succeed to the title of the trust estate on its appointment without any further act^[5]. There is no reason to doubt this general rule for 'ordinary' chattels that are, perhaps, more commonly the subject of a trust outside the aircraft finance and leasing context; however, there is a legitimate question of whether this general rule continues to hold true for all classes of asset, especially those, such as aircraft, which are situated or registered in a foreign jurisdiction, the transfer of which may require certain formalities to be observed for the transfer to be valid. There is case law from other states and from U.S. federal courts which acknowledges that, for the same reason, automatic transfer may not be effective for foreign realty^[6], the effective transfer of which is typically subject to an array of formalities.

The Trust Code also provides that '*a trustee who has resigned or been removed shall proceed expeditiously to deliver the trust property within the trustee's possession to the ... successor trustee*' ^{[[1]]}. In other words, there seems to be an acknowledgment that further action may, in some cases, need to be taken to give effect to the passing of legal title in the trust estate to the new trustee. Thus, in the context of a common law trust whose trust property principally comprises commercial aircraft, it would appear to be the case that Utah law operates to transfer automatically to the appointed new trustee as much of the property forming part of the trust estate to the extent it is *legally possible* to do so as a matter of applicable law and, depending on the requirements of other applicable laws, further steps may need to be taken to ensure the transfer is valid and effective.

Consequently, leasing companies should exercise caution on this issue, and may wish to ensure: (a) that the existing trustee executes a bill of sale in favour of the new trustee in respect of any aircraft equipment held in the trust, (b) compliance with any applicable formalities under the law of the state of registration or other applicable jurisdictions required to give legal effect to the transfer, and (c) that the transfer is otherwise handled with the same level of diligence as would be applied to an internal transfer of legal title to another entity within the leasing company's organisation.

Needless to say, the consequences of relying solely on the appointment instrument, if this is subsequently determined to be ineffective to transfer legal title to aircraft equipment held in the trust to the new trustee, would be disastrous, and must be weighed against the relatively small cost and inconvenience of taking additional precautionary steps.

OTHER LEGAL, COMMERCIAL AND PRACTICAL CONSIDERATIONS FAVOURING A SEPARATE INSTRUMENT

There are other legal, commercial and practical considerations which, in the context of commercial aircraft finance and leasing, favour the contemporaneous execution of one or more instruments in favour of the new trustee. These are discussed below.

Future marketability of aircraft equipment

Future purchasers of the aircraft equipment, whether acquiring legal title to it or the beneficial interest in the common law trust holding it, will usually want to see as part of their due diligence evidence of an uninterrupted chain of title from the manufacturer to the current legal owner (i.e. the new trustee). Such evidence typically takes the form of the seller providing originals or copies of 'back to birth' bills of sale. A future purchaser's due diligence would, if there is no standalone bill of sale from the existing trustee in favor of the new trustee, reveal a missing link, and may not accept (whether rightfully or wrongfully) the instrument appointing the new trustee as being sufficient. Future purchasers, particularly those unfamiliar with common law trusts, will judge the absence of a standalone bill of sale as a risk, and this may adversely affect the marketability and sale price of the aircraft equipment.

Dealings with governmental authorities

Future filings made with governmental authorities around the world, such as registration of an aircraft held in the trust, may require evidence of legal ownership by the current legal owner (i.e. the new trustee). A standalone bill of sale, as the conventional means of evidencing legal ownership, will make the task much easier than reliance on an instrument appointing the new trustee, particularly in relation to filings made with governmental authorities in those foreign countries who either do not recognise trusts or whose knowledge of trust law and practice is very limited.

Third parties and agreements to which the existing trustee is a party

Many agreements to which the existing trustee is a party will contain provisions restricting it from (or imposing conditions upon it) assigning its rights and transferring its obligations under that agreement. Any transfer of all of the trust estate to the new trustee would operate as an assignment of all of the rights of the existing trustee under each such agreement. As to the transfer of the existing trustee's corresponding obligations^[1], while the instrument appointing the new trustee could contain express provisions whereby the new trustee assumes all of those obligations, third parties, such as lessees and financiers, will likely require a separate instrument documenting the transfer, such as a novation or assignment agreement, to make sure both the rights and obligations under each such agreement are cleanly transferred to the new trustee under the applicable governing law (and not the governing law of the instrument of appointment, which is likely to be Utah law). Furthermore, financiers will be particularly concerned that any mortgage over the aircraft equipment and other security documents entered into by the existing trustee (such as a collateral assignment over its rights under a lease) are re-executed by the new trustee.

APPOINTMENT OF A NEW TRUSTEE UNDER GATS

One important innovation of the GATS standard form documents is that a trustee of a GATS trust will not be allowed to resign without cause[2]. This is in contrast to the rights of trustees today who are typically entitled to resign without any restriction or limitation, provided that the agreed prior written notice is given to the beneficiary. The new language in the GATS documentation should therefore provide some comfort to those leasing companies intending to participate in GATS that the risk of a resignation by the trustee of a GATS trust (and the costly and burdensome exercise accompanying any such resignation) will be an even more unlikely occurrence in the future.

As to the resignation (or removal) of the existing trustee and the appointment of a new trustee within the GATS documentary architecture, one other area of improvement is that, while it should only occur infrequently, such an event is specifically contemplated by and mapped out in the GATS form of 'Transfer Instrument (Successor Trustee Transaction) (US-UT)'[3]. This instrument removes any ambiguity as to whether a metal transfer does or does not occur automatically on the appointment of the new trustee by including express operative language providing for the assignment and transfer to the new trustee of all of the existing trustee's right, title and interest in and to the trust estate[4], as well as all of its rights and obligations under the trust instrument[5]. Moreover, the further assurance clause of the GATS transfer instrument is expressly permissive of other standalone instruments[1], expressly contemplating the need for a bill of sale and one or more novation or assignment agreement, which may be executed by the parties to ensure that the metal transfer can be evidenced in the manner desired by the beneficiary and any other third parties requesting such other instruments from the beneficiary.

CONCLUSION

It is estimated that WFTC currently acts as owner trustee for approximately 4,000 aircraft owning trusts. Therefore, its resignation and the various steps necessary for or accompanying the appointment of a successor will affect many leasing companies and will consume many resources, both in terms of cost and time. This remains true whether or not the transfer of the trust estate to its successor is 'automatic'.

It would appear that, under Utah law, a metal transfer would need to occur upon a change of trustee but, more importantly, the appointment of the new trustee might not in all cases effect such transfer *automatically* (i.e. without any further act).

Perhaps more importantly, there are various commercial and practical reasons why leasing companies will require a bill of sale regardless of the position as a strict matter of law, and it should not be overlooked that lessees and financiers will likely require a novation or assignment agreement to ensure that obligations backed by the assets in the trust estate are properly and cleanly assumed by the new trustee. Furthermore, financiers will require any aircraft mortgages and other security given by WFTC in their favour to be re-executed.

One final remark is that leasing companies may see the appointment of a new trustee as an opportunity to adopt the GATS form documents so that they are 'GATS ready' and can efficiently migrate their owner trusts onto the GATS electronic platform once it is launched early next year.

One thing is clear: leasing companies will be shopping around for a new trustee for their owner trusts.

Disclaimer: The author is admitted to practice in the State of New York, the State of California and England and Wales (solicitor), but is not admitted to practice in the State of Utah. This article does not constitute legal or business advice of the author, Watson Farley & Williams LLP or any other person.

[1] Utah Code Ann. § 75-7-101, *et seq.*

[2] Pursuant to § 75-7-106 of the Trust Code, the applicability of the common law and principles of equity on trusts is preserved, except to the extent modified by the Trust Code.

[3] Utah Code Ann. § 16-15-101, *et seq.*

[4] Bogert's The Law of Trusts and Trustees, § 1; Restatement (Second) of Trusts, § 2 (1959); Restatement (Third) of Trusts, § 2 (2003).

[5] Bogert's The Law of Trusts and Trustees, § 1; Restatement (Second) of Trusts, § 2, comment i (1959); Restatement (Third) of Trusts, § 3 comment c (2003).

[6] Utah Code Ann. § 75-7-814(3) which, when read in conjunction with § 75-7-106 and in the absence of anything in the Trust Code ascribing rights to a common law trust to sue or be sued in its own name (c.f. a Utah business trust established pursuant to the Utah Business Trust Registration Act), does not disturb the principle that the trustee holds legal title to the trust property.

[7] In a typical common law trust used for aircraft finance and leasing purposes, there is usually a sole beneficiary.

[8] Whether the beneficiary's rights to the trust property exist merely as a personal right against the trustee to perform its duties under the terms of the trust (i.e. rights *in personam*) or rise to the level of proprietary rights in the trust property enforceable against third parties (i.e. rights *in rem*) has been the subject of legal debate in U.S. trust law jurisprudence over the years; see further the discussion in Bogert's The Law of Trusts and Trustees, § 183. To avoid any doubt, the GATS form of trust instrument (and transfer instrument) characterizes each separately, referring both to the beneficiary's 'Beneficial Interest' in the trust estate, and the beneficiary's 'Rights' under the trust instrument.

[9] The term 'beneficiary' is nowadays the preferred term used by U.S. federal and state courts and legislators.

[10] In a typical common law trust used for aircraft finance and leasing purposes, there is usually a sole trustee.

[11] See Bogert's The Law of Trusts and Trustees, § 532; Restatement (Second) of Trusts, § 110 (1959).

[12] See, e.g. *West v. Fitz*, 109 Ill. 425, 1884 WL 9808 (1884); and *Corbett v. Nutt*, 77 U.S. 464, 19 L. Ed. 976, 1870 WL 12784 (1870).

[13] See Utah Code Ann. § 75-7-707(2). The word 'possession' would appear to refer to all tangible trust property (i.e. trust property constituting 'choses in possession') rather than property in the trustee's actual or constructive possession.

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[14] Contractual obligations of the trustee are not ‘property’ and therefore do not form part of the trust estate. However, pursuant to Utah Code Ann. § 75-7-1010, a trustee is not personally liable on a contract to which it is a party in its capacity as trustee, if the contract makes clear that it is entering into the contract in such capacity. Accordingly, obligations incurred or assumed by the trustee acting in such capacity must be satisfied out of the proceeds of the trust estate, and the other parties to the contract cannot reach into the proceeds of the trustee’s personal assets to satisfy any claim.

[15] See section 11.1(a) of the GATS Trust Instrument Master Terms (US), available for download at <http://awg.aero/projects/gats/>; GATS trustees will be permitted to resign only (a) during an off-lease period, (b) if required to do so by applicable law, (c) if the beneficiary has materially breached the terms of the trust instrument, (d) unresponsiveness by the beneficiary, and (e) with the consent of the beneficiary.

[16] Available for download at <http://awg.aero/projects/gats/>.

[17] See section 3.1 of the GATS form of ‘Transfer Instrument (Successor Trustee Transaction) (US-UT)’.

[18] See section 3.2 of the GATS form of ‘Transfer Instrument (Successor Trustee Transaction) (US-UT)’.

[19] See section 4.1 of the GATS form of ‘Transfer Instrument (Successor Trustee Transaction) (US-UT)’.

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