

# The Law of Aircraft Leasing in the People's Republic of China : Achievements and Challenges

Yu, Dan\*

## Contents

- I. Introduction
- II. Brief history of the legislation
- III. New trends for aircraft leasing and challenges to the laws
- IV. Contract aspects for aircraft leasing
- V. Property aspects of aircraft leasing
- VI. Remedy aspects of aircraft leasing
- VII. Conclusions

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\* Professor at International Shipping Law School, East China University of Political Science and Law.

## I . Introduction

With the sustained high growth of civil aviation transportation volume for many years in China, Chinese airlines have kept a huge and increasing market demands for aircraft. According to a market forecast just released by Boeing, in the next 20 years China will introduce another 6330 aircraft that totally cost \$9500 billion. Since leasing is one of the main channels of aircraft introduction, China has always been rated as a market with strategic and commercial importance for aircraft leasing enterprises worldwide.

In the meantime, the market of aircraft leasing in China has endured some changes in recent years. Chinese government began to attach much importance to the development of aircraft leasing industry, and policies friendly to leasing industry were issued<sup>1)</sup> and center for promoting aircraft leasing was set up<sup>2)</sup>. As a result of that, more and more domestic enterprises had joined the group of aircraft lessors. Some new structures for aircraft leasing, bonded area leasing for example, had emerged on the market.

Leasing is one of financial innovations that was born in the 1950s, the United States. As for China, it was a totally new thing when aircraft leasing was first introduced in 1980, and it is not surprising that there were no rules fully regulating this kind of transaction at that time. Great legal risks were assumed by transacting parties, especially the lessors. To facilitate the transactions for Chinese airlines to introduce aircraft, which is of great importance of national civil aviation industry, legislators of China then embarked on a way for rule-making. On one hand, domestic laws and regulations have been promulgated

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1) Opinions for promoting the development of aircraft leasing business, issued by General Office of State Council, PRC, Nov. 2013.

2) For example, International Shipping and Finance Development Promotion Center was set up in Tianjin Dongjiang Free Trade Port Zone. With the promotion of the center, 534 aircrafts and 11 aircraft engines have been leased by lessors inside this zone. See Tianjin Pilot Free Trade Zone Air Finance Investment Handbook, p7.

or updated. As a result of that, basic rules for aircraft leasing can be found in domestic laws and the parties involved could turn to judicial remedy when there is a need. On the other hand, China has also entered into some international convention systems which designed for facilitating international aircraft finance, and this aspect has provided great merits since almost all aircraft leasing transactions would involve cross-border elements.

## II . Brief history of the legislation

In 1980, one of the Chinese airlines introduced a B747-SP aircraft by the means of “Investment Tax Credit Leveraged Lease” from Hanover Leasing Company of the U.S., which was the first successful transaction of aircraft leasing with Chinese enterprise involved. After that, more and more Chinese airlines chose the device of leasing to finance their aircraft acquisition, and leasing then became the most major method of aircraft acquisition for civil aviation industry. According to a statistic made by the CAAC, almost 65% of aircraft operated by Chinese airlines have been acquired through leasing by now. <sup>3)</sup>

Although the practice of leasing emerged in the 1980s, the law was not ready for it until the mid-1990s. In 1996, the Civil Aviation Law of PRC, the only national law on civil aviation adopted by the Standing Committee of National People's Congress, entered into force. Under Chapter III of the Civil Aviation Law, Section 4 provides rules promulgated for “lease of civil aircraft”. It defines aircraft lease contract in law, which including financial lease and other lease, for the first time, and the rules in Chapter III cover both aspects of contract and real rights.

The promulgation of the Civil Aviation Law may be regarded as a cornerstone of the construction of legal regime for aircraft leasing in China. In the meantime,

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3) Guo Lijun, “Legal affairs’ importance in aircraft leasing industry”, speech given in the 4<sup>th</sup> China Air Finance Development Summit, 23th Sept, 2015.

other legislative improvements on civil law also enriched the law of aircraft leasing from different aspects. For instance, the Guarantee Law of PRC, which entered into force in 1995, stipulates that transport means such as ship and aircraft may be mortgaged. It also stipulates that aircraft mortgage should be registered, and the registration would make the effect of act against a third party. Since the transactions of aircraft leasing always involve mortgage of the leased aircraft, this stipulation in the Guarantee Law is essential for leasing activities. Another improvement is on the aspect of Contract Law. The Contract Law of PRC, which entered into force in 1999, defines the financial lease as an independent contract parallel with the lease contract.

Although the Civil Aviation Law has already defined the financial lease, the Contract Law further provides more detailed rules on contracting aspects.<sup>4)</sup>In 2007, the Property Law of PRC that had been brewing up for many years was finally brought into practice, which confirms and further enriches the law of property rights on civil aircraft that had been in use for more than 10 years. On the basis of recognizing the principle of “*numerus clausus*”, it clearly states that the varieties of real rights include *ownership, usufructuary right, secured property right and possession*.

It points out that the registration of the right serves as the precondition for priority to any *bona fide* third party. Besides, the Enterprise Bankruptcy Law of PRC, another law that entered into force in the same year, provides rules of bankruptcy for enterprises that are set up according the PRC law. It stipulates rights and obligations for parties involving in bankruptcy and other related proceedings. Since airline is covered by enterprises defined in the Enterprise Bankruptcy Law, lessors could seek remedy according to this law.

Another aspect that must be mentioned is the participation of China of the two important international conventions. Since the practice of aviation finance is always with international elements, participation into international legal system

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4) See Chapter 14, the Contract Law of PRC.

may greatly facilitate related transaction. In April 2000, China gained accession to the Convention on International Recognition of Rights in Aircraft (Geneva Convention of 1948), marking the establishment of a mutual recognition mechanism of aircraft rights among China and other contracting parties to the convention. Although China has not gained access in this system until 2000, the Civil Aviation Law of China has been deeply affected by this convention. As we will discuss in part V below, Chapter III of the Civil Aviation Law has incorporated the content of this convention in many aspects.

In 2009, China officially gained accession to the Convention of International Interest in Mobile Equipment, as well as its Aircraft Equipment Protocol (hereinafter referred to as the Cape Town System). Despite some reservations,<sup>5)</sup> China actively integrated into this “ambitious and imaginative”<sup>6)</sup> legal regime for facilitating the international financial transactions for aircraft equipment, thus fundamentally enhanced the legal environment for leasing aircraft into China.

### III. New trends for aircraft leasing and challenges to the laws

For many years, the aircraft leasing market of China had been monopolized by foreign enterprises. However, this situation has changed gradually in recent years since Chinese government began to attach great importance to the

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5) According to Article 54(2) of the Cape Town Convention, China declared that all remedies provided by the CIME which are not expressed to require application to the court may be exercised only with leave of the court of PRC. According to Article 50 of the Cape Town Convention, China declared that Convention and Protocol cannot cover internal transactions in PRC. See Decision of the Standing Committee of the National People's Congress on Ratifying the Convention on International Interests in Mobile Equipment and the Protocol thereto on Matters Specific to Aircraft Equipment.

6) Roy Goode, *Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment: Official Commentary* (revised edition), UNIDROIT, 2010, back cover.

development of local leasing industry. From the year of 2005, bans on market access had been lifted gradually for financial leasing industry.<sup>7)</sup> Both foreign-invested companies and financial institutions are allowed to set up financial leasing companies. Then in the year of 2013, “Opinions of the State Council Concerning Accelerating the Development of the Aircraft Leasing Sector” was issued,<sup>8)</sup> which provided both strategic plan and boosting measures for the development of local aircraft leasing sector.

According to the opinions, Chinese government would adjust measures on custom, tax, foreign currency, etc. to facilitate aircraft leasing transaction, and foster a friendly policy environment for accumulation of aircraft leasing enterprises.<sup>9)</sup> Besides the regulations and policies specifically designed for leasing industry, another measure that greatly benefits aircraft leasing business is the strategy on Pilot Free Trade Zone. From 2013 to 2014, China successively established Pilot Free Trade Zone in Shanghai, Tianjin, Guangdong and Fujian. Inside the areas of pilot free trade zone, institutional innovations including market access, financial regulation, and foreign exchange are launched. Moreover, these four pilot free trade zones are also covered by bonded areas which already exist.

Since aircraft leasing is in essence a kind of financial transaction that needs low tax rate and low cost finance, the establishment of pilot free trade zones have also greatly boosted local aviation leasing industry. With all the positive initiatives, more and more leasing enterprises have involved in aircraft leasing

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7) **Measures for the Administration of Foreign-capital Lease Industry** (Order of Ministry of Commerce, No. 5, 005), which stipulates that foreign investor may invest leasing industry in the forms of Chinese-foreign equity joint venture, Chinese-foreign contractual joint venture and solely foreign-capital enterprise. **Measures for Administration of Financial Lease Company** (Order of CBRC, No.1, 2007), which stipulates that commercial banks, leasing company and enterprise which main business is equipment manufacture and suitable for leasing, may invest in financial leasing company.

8) State Council of PRC, Document [2013] 108.

9) Specific measures to boost local aircraft industry were promulgated in the meantime. For example, “the Notes about the Relevant Taxation Policy concerning the Import of Aircraft by Leasing Enterprises”, jointly issued by the Ministry of Finance; General Administration of Customs and State Administration of Taxation to alleviate the tax of aircraft leasing.

business on domestic market, and they also have brought up new models for aircraft leasing.<sup>10)</sup>

## 1. Bonded Area Leasing

The consideration of tax is an essential aspect in any leasing transaction. Especially for the aircraft leasing sector, whose single transaction amount might easily exceeds \$100 million, even a discount of 1% on tax rate amounts to benefits of millions of US dollars.

For a single aircraft transaction, the lessor who has residence in mainland China should pay custom duty (5%), import VAT (17%) for the importing of aircraft and stamp duty (0.1%) for the leasing contract. Besides this, income tax (25%) on the company itself and VAT (17%) on the value-added activity should also be paid. Compared with some other countries and areas, such as Ireland and Cayman Islands, this burden of tax is heavier and less attractive to leasing enterprises. On aspect of tax, the Chinese leasing companies are much unfavorable than their competitors, which may be one of main reasons that the aircraft leasing market has been monopolized by foreign enterprises for many years.

However, the emergence of Bonded Area inside the territory of China has changed the unfavorable situation in respect of taxation. The Bonded Area is a special area set up by the Chinese Customs, or one entity under the approval, supervision and management of the Customs. The feature of the Bonded Area is “inside the territory while outside the customs”, which means that the overseas commodities are still treated as they were outside China after they entered into the prescribed bonded area, but are levied no tariff; the domestic commodities

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<sup>10)</sup> According to a statistics made by **Ascend**, Chinese lessors' market share was only 9.1% in 2007, while the share rose to 37.8% in the year 2013. See Sun Yuting, Yuan Dong, “China's civil aviation leasing market up will rise to billions of dollars in 2025, talent bottleneck to be broken”, National Business Daily, 2014-10-28, 06.

that entered into the Bonded Area could be entitled to tax reimbursement for export, as if they have left Chinese custom areas. Under the model of Bonded Area Leasing, the lessors take residence inside the Bonded Area and get aircraft from overseas through purchasing or leasing; the lessees (airlines) that situated outside the Bonded Area but inside the territory of China lease aircraft, and pay for tariff and import VAT by the time of rental paying. Since rental is paid periodically in the whole lease terms, the tax is also paid periodically. While, there is no need to pay tax to the Customs if the lessees are foreign companies situated outside China, in which case the aircraft would be transported directly to destination other than mainland of China.

The tax preferences of Bonded Area Leasing are obvious. According to the existing tax rate, a lessor who in transaction for an aircraft valued at \$100 million should be charged a tax over the amount of \$20 million. However, by means of Bonded Area Leasing, the lessor has no obligation to pay custom related tax, and the total amount of financing at the time of “pre-delivery” and “delivery” would be decreased accordingly. For the part of Bonded Area lessee, who is the ultimate tax undertaker, the time to pay is deferred significantly, which would set aside more space for cost-saving. Besides the above mentioned benefits, the Bonded Area lessor may also enjoy preferential rate on import VAT. According to a document recently issued by the Chinese government, leasing companies who import aircraft and lease it to domestic airlines, on the conditions of aircraft weight is not less than 25 tons, are entitled to enjoy preferential import VAT rate at 5%.<sup>11)</sup>

For the purpose of risk isolation, the lessor of FTZ leasing is mainly a SPV(Special Purpose Vehicle) or a subsidiary of comprehensive leasing enterprise. While the restriction on subsidiary company of financial leasing company has just been removed,<sup>12)</sup>the single-aircraft SPV has taken overwhelmingly dominance in

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11) See “the Notes about the Relevant Taxation Policy concerning the Import of Aircraft by Leasing Enterprises”, jointly issued by the Ministry of Finance, General Administration of Customs and State Administration of Taxation, No.16, 2014.



the market. Until August, 2015, there are almost 500 single-aircraft SPV that have been set up in Tianjin Dongjiang Pilot Free Trade Port Zone.<sup>13)</sup>With the huge transaction amount and promising prospect for aircraft demand of Chinese airlines, Bonded Area Leasing has already been regarded as one of most prevailing models for aircraft leasing that parallels to the French tax leasing and leveraged leasing worldwide.

## 2. New challenges to the current legal regime

New models also present new challenges to current legal regime of aircraft leasing.

First of all, the structures have become more and more complicated and the domestic law has not been ready for this. The transaction of aircraft leasing never means that there is only one deal between lessor and lessee. It is a series of contracts that respectively realize the purpose of sale, debt, mortgage, pledge, and sub-lease, etc. Before the booming of domestic aircraft leasing industry of China, almost all aircraft leasing transactions were with foreign-related element, and only one party involved (airline lessee) resided in the territory of China. Another party, i.e., the lessor, was always foreign companies, and since the related transaction environment in China was not as attractive as that of other places, they completed other transactions indispensable for leasing outside China.

As China is only the home country of lessee, the requirement for domestic law is quite simple, for it only has to deal with two aspects of the leasing transaction. On the one hand, since leasing contract would be implemented in China, the domestic law of China should provide rules for the contract of leasing, and then make sure that the parties involved can get remedies when facing default. On

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12) Notice of the General Office of the China Banking Regulatory Commission (CBRC) on Issuing the Interim Provisions on the Administration of the Specialized Subsidiary Companies of Financial Leasing Companies, No. 198,2014, CBRC.

13) See Tianjin Pilot Free Trade Zone Air Finance Investment Handbook, p7.

the other hand, the real right rules of China should include clear priority rules to assure lessor's property interests on the leased aircraft. After years of construction, the domestic law of China could cover the two aspects aforementioned. However, the domestic law of China has not been ready for other aspects of leasing related transactions. For example, the civil and commercial laws have not provided enough rules for some common device, such as the account pledge and asset securitization, which is indispensable for providing security for lessor's financial activities.

Secondly, some leasing transactions are no more embodied by the form of foreign related contracts, and only domestic law applies. According to the current laws of China, only parties to the "foreign related contract" may be entitled to choose foreign law as the applicable law of contract,<sup>14)</sup> and only parties to the "foreign related contract" may choose to settle dispute by arbitration outside of China.<sup>15)</sup> Although the laws fail to give a clear-cut of identification standards for the "foreign related contract", there is a general assumption in legal practice that two conditions must be satisfied.

One condition is that the contract should contain at least one foreign related factor as follows: (a) one of the contractual parties is situated outside mainland China; (b) *fait juridique* that causes the establishment is outside China; (c) alteration and termination of the contract take place outside China; and (d) the object of the contract situated outside of China. Another condition is that the contract must involve conflict of different legislative jurisdictions and thus it is necessary to make choice between laws from different countries.<sup>16)</sup> For the most prevailing model of aircraft leasing, the Bonded Area Leasing, lessors still reside in the territory of China and are within the jurisdiction of China, thus some leasing transactions of aircraft are no more fit for the criteria of "foreign related

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14) Article 126, Contract Law of PRC.

15) Article 128, Contract Law of PRC.

16) LV Yanfeng, theoretical difference and historical development of law application for international contracts, Journal of the Party School of CPC Changchun Municipal Committee, 1999, 1.

elements” that are qualified for choosing foreign law as their applicable law. In this case, the domestic law of China would apply.

When China entered into the Cape Town Convention, it made a declaration of exclusion on “internal transaction”.<sup>17)</sup> That means the lessors and secured creditors in “internal transaction” cannot turn to Cape Town remedies, and only remedies stipulated under domestic law may be used. As will be discussed in Part VI of this paper, compared with the Cape Town remedies, the domestic remedies are a little more disadvantageous to creditors. For them, the exclusion of the Cape Town remedies to internal transaction results in an uncompetitive situation.

#### IV. Contract aspects for aircraft leasing

According to the Civil Aviation Law, the contract for aircraft leasing can be divided into two kinds. One is financial lease, which refers to the purchase by the lessor of the aircraft in kind or from the supplier designated by lessee, and the lease of this aircraft from the lessor to the lessee for use with payment of rentals at regular intervals.<sup>18)</sup> The other is lease contract, which refers to all other lease contract that cannot be characterized as financial leasing contract. The characterization is quite simple and clear, since only the “form” but not the “substance” of transaction would be considered in court. A leasing would not be re-characterized as “security” if the transaction satisfies the form of “financial lease” or “lease”. Financial lease should consist of three parties: the lessor, the

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17) According to Article one of Cape Town Convention, “internal transaction” is a security agreement, title reservation agreement or leasing agreement in respect of which (a) the center of main interests of all parties is situated and the equipment is located in the same contracting state at the time of conclusion of the contract and (b) the interest created by the transaction has been registered in a national registry in the declaring state.

18) Article 27, the Civil Aviation Law of PRC.

vendor and the lessee, and the lessor should purchase the aircraft from the designated vendor and then lease it to the lessee.

At the early stage of Chinese airlines introducing aircraft by leasing, almost all the transactions used the contract of financial lease. Since the main purpose of Chinese airlines at that time was to finance their aircraft introduction, financial lease may well satisfy the demand. However, along with the development for aviation finance, both of the airline and lessor tend to realize more functions by the form of leasing.

Sometimes, airline turns to rely on lessor's professional knowledge to choose the aircraft and vendor. Sometimes, the lessor himself is not the owner of the leased aircraft. More flexible and complicated structures have emerged on the market and some of them can not satisfy the legal definition of "financial lease". As a result of that, some transactions may be excluded by the application of the rules of financial lease. That is very disadvantageous for "lessor", since in most other transactions, its property right on aircraft cannot be fully recognized; or the lessor, as the owner of the aircraft, may be asked to assume the responsibility for warranty of defect and operational liability risk, which runs counter to the original intention of financial leasing transaction.

The aforementioned problems not only exist in the area of aviation finance, they also exist in other field of equipment leasing. Since the rights and obligations of financial lessor are greatly different from those of other creditors, the characterization issue is always on hot debate. To solve this problem, the "Interpretation of the Supreme People's Court on Several Issues Concerning the Application of Law in the Trial of Cases Involving Financial Leasing Contract" was issued in 2013.

Pursuant to Article 1 of this Interpretation, the people's court should identify whether the financial leasing legal relationship is formed on the basis of the property of the subject matter, value, and the constitution of rental, as well as the contract rights and duties of the relevant parties, as the Article 237 suggests.

This Interpretation releases an unprecedented trend for contract characterization, which provides that some substance matter should also be considered. Although this is only one article stipulated by the judicial interpretation, it should be regarded as a huge achievement, as it is the first step for the courts to give up absolute formalism on characterization for leasing contract.

## V. Property aspects of aircraft leasing

*Numerus clauses* is the core principle of the Chinese property law. According to this old principle, both variety and content of the property rights should be stipulated by law. Aircraft, as a kind of special personal property recognized by the civil law of China, should be regulated by this principle undoubtedly. Real rights stipulated by the Property Law include *ownership*, *usufructuary right*, *secured property right* and *possession*. Theoretically, all these kinds of real rights can be applied to aircraft. However, we can only find limited kinds of real rights in the Civil Aviation Law of China. In Chapter III, which is named Civil Aircraft Right, the ownership of aircraft, acquisition of aircraft by purchase, possession of aircraft by lease contract for a term of more than six months, aircraft on mortgage and preemptive right over aircraft are listed.

The varieties and contents of aircraft rights in the Civil Aviation Law mainly originate from that of the Geneva Conventions of 1948. Instead of a comprehensive international convention on the standardization of the aircraft real rights, the Geneva Conventions is simply a periodic achievement in removing the obstacles existing in the international recognition of aircraft rights in the middle of last century. Therefore, the content of the “civil aircraft rights” in the Civil Aviation Law that draws upon the Geneva Conventions is destined to be incomplete, which fails to represent all the varieties of “aircraft real rights” under the Chinese legal framework.

Likewise, problems related to the limited varieties of aircraft rights are still found in the system of registration of civil aircraft rights, which is established on the basis of the Civil Aviation Law. The right allowed for registration is only limited to the five aircraft rights specified in the Civil Aviation Law. Among which, the registration of ownership is only open to the civil aircraft with Chinese nationality, and there is no requirement on nationality for the registration of other rights. As to the registration of aircraft leasing, there is one point to mention. The aircraft lessor can only register his real rights (ownership or possession) to the aircraft, but in practice the aircraft that is leased to others could only be publicized through the registration by the lessee for “possession of aircraft”. Therefore, if the lessee does not register its possession right, the leasing transaction would not be publicized in this registration system.

The register stipulated by the Civil Aviation Law is the Civil Aircraft Rights Register under auspices of the Civil Aviation Administration of China (CAAC). Since the registry of the CAAC is also the designated access point for International Registration under the Cape Town Convention, and the CAAC is responsible for nationality registration of civil aircraft, it is convenient for the CAAC to exercise both administration and service functions. Besides the register of CAAC, there are another two registers set up recently for lessors to publicize their financial transactions. The lessor for financial lease may register the lease transaction in the CCRC Movable Financing Register<sup>19)</sup> that is managed by the People’s Bank of China, and financial lessors may also turn to Financial Leasing Enterprises Information System<sup>20)</sup> under the auspices of the Ministry of Commerce of China. Registration in any of the above three registers is not a compulsive obligation for lessor, however, registration can produce the legal effect of priority against any third parties.

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19) Set up by the People’s Bank of PRC in 2007.

20) Set up by Ministry of Commerce, PRC on Dec. 2014.

Since priority is of great importance for any creditors to claim their property rights, lessors would not hesitate to register their rights to get priority. As mentioned above, there are three registers exercised by different authorities in China for lessor to register. The CAAC register can only be accessed by civil aircraft right holder, while the other two are open to any financial lessors as related to movables. More channels for publicizing may mean much security to lessors. But on the other hand, it also burdens lessors repeatedly on registration affairs.

## **VI. Remedy aspects of aircraft leasing**

Theoretically, leasing poses more credit risk on the lessor's side in lease term, as the lessor's and lessee's obligations are carried out in different time. The lessor finishes its main task when delivery of the aircraft is made to the lessee, which also means the lease commence. However, the lessee's obligation, the rental paying, will be carried out periodically in the whole lease term. Credit risks from lessee are under risk especially in the following two situations: default and bankruptcy (or related bankruptcy proceedings). Therefore, default remedies and bankruptcy remedies are most focused aspects in the law by the involved parties.

### **1. Default remedies**

Should the lessee be in default, the lessor is entitled to repossess the aircraft, this is a common article in current aircraft leasing contract. Although repossession may be realized both by self-help and judicial proceedings, self-help remedies for repossession are forbidden by the Civil Procedure Law of China. If the lessee declined to return the aircraft according to the lease contract, the lessor could only turn to the people's court for repossession. The judicial

proceedings for repossession usually take more than a year to get the final judgment, and sometimes actions to enforce the judgment also take months. There are two relief procedures pending final determination under the Civil Procedure Law of China, which are the Property Preservation and Advance Enforcement. Although they both can be enforced before getting final judgment, these two relief procedures usually cannot be applied successfully by the aircraft leasing company, which is always regarded as a deep pocket party.<sup>21)</sup>

After the Cape Town Convention came into force in China, the Cape Town creditors have been entitled to get default remedies under this system. Since the Cape Town system is a pro-creditor legal regime, standard for lessor protection is higher than that of domestic law of China. As to default remedies, the Cape Town lessor has more choices than the lessor in domestic transaction.

First, the Cape Town lessors can directly terminate the contract and take possession or control of any aircraft to which the contract related. However, according to the declarations made by China before gaining accession to this convention, the creditors cannot exercise the aforementioned remedies; instead, it can be exercised only with the leave of the court. By then, there are no further rules or interpretations issued by the legislative, judicial and administrative institutions to explain what “the leave of court” is.

If it still necessitates the judicial proceedings for judgment from the court, the advantages and effectiveness of the default remedies under the Cape Town system will be greatly reduced. Then, “the Cape Town creditors” can seek the relief pending final judgment through the courts. The people’s court of China should make decision and enforce the decision within 10 working days for the creditor’s request, for the preservation, possession, control and custody and the immobilization of the aircraft object.

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21) Property Preservation, mainly targeting at the cases that become impossible or difficult to enforce a judgment because of the acts taken by one of the parties or for other reasons, may be exercised through seizure, detain, freeze, or other methods as prescribed by law. The precondition for Advance Enforcement is that the relationship of rights and obligations between the parties are definite, and the refusal of advance enforcement would seriously affect the life or business operation of the petitioners.



Meanwhile, the people's court of China should also make decision and enforce it within 30 working days for creditor's applications related to leasing and management of aircraft and the earnings produced. Compared with the measures in the domestic laws in China, the relief pending final judgment under the Cape Town system is much friendly to the lessors with its low threshold of launching and rich remedy varieties.

## 2. Insolvency remedies

In insolvency proceedings of lessee, what concerns the lessor most is whether he is able to take the aircraft back timely and smoothly. The Enterprise Bankruptcy Law of PRC, which was enforced in 2007, stipulates that the lessor's demand of getting the aircraft back can be fulfilled. First of all, the lessor's real rights to the leased aircraft are effective against any third party. Both bankruptcy administrator and other creditor of the lessee fall into the group of "third party". Therefore, the aircraft possessed by lessee will not be classified into the bankruptcy estates that destined to distribution.

Second, if the contract has not been fully performed when bankruptcy proceeding begins and does not stipulate that the contract will be terminated automatically at bankruptcy, the bankruptcy administrator shall decide to rescind or continue to perform a lease contract. The bankruptcy administrator should make the decision of continuing performing or terminating the contract, and notify the lessor within two months after the beginning of the bankruptcy proceedings. If he decides to terminate the contract, the leased aircraft should be immediately returned to the lessor.

If the contract will be continued, duplicate protection should be offered to the aircraft lessee according to the Bankruptcy Law: for one thing, the leasing contract debts that produced after the beginning of bankruptcy would be turned into Community Liabilities so as to obtain the priority of being clear off by lessee's assets at any time; for another, full guarantee should be provided for

further performance of the contract as the lessor requests.

Once the lessee is declared bankrupt, the legal basis for lessee to possess the aircraft does not exist anymore, and the administrator should return the aircraft to the lessor immediately.

When gained accession to the Cape Town Convention, China opted to apply the Alternative A in Article XI of the Protocol Thereto on Matters Specific to Aircraft Equipment, declaring that the debtor or the bankruptcy administrator should return the aircraft within the 60-day waiting period under the circumstances of failing to perform the contract. The Alternative A of the Cape Town System is formulated from the perspective of creditors in aviation financing, which poses a high standard protection for aircraft lessors and other creditors. Compared with Alternative A, the National Bankruptcy Law of China is still lagged behind in the perspective of aircraft lessor. First of all, the waiting period of returning the aircraft has been specified quite clear in Alternative A.

In the Bankruptcy Law of China, there is no clear deadline provided for the returning of properties possessed by the debtor. Then, Alternative A has specified that no obligations of the debtor under the agreement may be modified without the consent of the creditor. As a result, if it is agreed that the aircraft leasing contract terminates automatically upon bankruptcy, the bankruptcy administrator should immediately terminate the contract.

However, the regulation of such kind is found absent in the Bankruptcy Law of China. Actually in judicial practice of China, it is disputable whether the clause of automatically terminating upon bankruptcy should be enforced in bankruptcy proceedings.

Finally, according to Alternative A, the insolvency administrator or the debtor should cure all defaults other than a default constituted by the opening of insolvency proceedings and has agreed to perform all future obligations under the agreement, which serves as the precondition of the further performance of leasing contract. However, there is no requirement to make remedies for the nonperformance under.

## VII. Conclusions

Fleets of Chinese airlines have been rapidly expanded through the means of easing, thus sustaining the fast growth of the civil aviation transport volume. It is no exaggeration to say that aircraft leasing activity is one of the key factors boosting the development of civil aviation transport industry in the past, now and future. To back up the development of aircraft leasing activities, China has striven to improve the relevant legal protection standard. Currently, China has established the relatively comprehensive legal system in respect of “contract characterization”, “real rights registration” and “default and bankruptcy remedies” that is vital to the interests of the lessors, and proactively integrated into the relevant international convention system. It is worth noticing that Chinese government has attached great importance to development of leasing business, and fostering sound legal environment is fallen into one of the government's working plans.

Meantime, there are still many problems existing in current legal regime for aircraft leasing in China. The stipulations of contract and right registration are too simple to cover the leasing practices which become more and more complicated. Compared with that of the Cape Town system, remedies for creditors (lessors) in internal transaction are poor.

To keep pace with the fast development of local aircraft leasing industry, this paper suggests that the national law should be improved as follows: (a) providing more detailed contract rules for leasing; (b) expanding varieties of aircraft rights and permitting all the rights registered in Civil Aircraft Register; and (c) withdrawing the declaration of the Cape Town Convention that excludes internal transactions.

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## 초 록

리스는 중국 항공사들이 해외 제조업체들로부터 항공기를 도입해올 때 사용하는 한 가지 방법이며 중국 항공사들은 리스를 30년 넘게 사용해왔다. 항공기 리스는 본질적으로 금전적 거래의 성격을 지니고 있으며 임대인(리스회사)은 임대된 항공기의 소유권을 양도하는 방식을 통해 임차인에게 재원을 제공한다. 30년 전 중국이 리스 방식을 통해 항공기를 들여오기 시작했을 때, 중국 국내 법은 이러한 리스 활동들을 규제하기에 매우 불충분했다.

그러므로, 당시에 항공기 리스 법에 대한 제정이 촉발되었으며 일부 수확들이 존재했다. 현재는 계약, 물권, 채무불이행, 파산 구제책 등의 측면들과 관련된 항공기 활동들을 조정하는 규제들이 존재한다. 그러나 시스템이 개선되기 위해서는 탐구의 과정들을 거쳐야 하듯이, 중국의 항공기 리스 법 역시 아직 많은 도전들에 직면하고 있다.

특히 국내 리스 산업의 부상과 밝은 전망으로 인해 항공기리스의 새로운 거래 구조와 모형들이 떠올랐으며, 이는 현재의 법적 체계에 대한 도전으로 작용하고 있다. 항공기 리스와 관련된 중국 법 제도의 주요 내용과 역사에 대한 소개를 기반으로, 본 논문은 계약, 물권, 구제책들과 관련된 현 중국 법안들의 성과와 도전들에 대한 분석을 제공한다.

**주제어** : 항공기 리스, 재정, 법적 제도, 보세구역 리스

## Abstract

### The Law of Aircraft Leasing in the People's Republic of China: Achievements and Challenges

Yu, Dan

Leasing is one of the main methods for Chinese airlines to introduce aircraft from overseas manufactures, and this method has been used for more than 30 years by Chinese airlines. Aircraft leasing in essence is a kind of financial transaction, through which lessors provide finance to lessees by means of the delivery of possession of the leased aircraft. At the time when China started to introduce aircraft through leasing some 30 years ago, the Chinese domestic laws were very insufficient to regulate these activities.

Therefore, a construction process for the law of aircraft leasing was triggered then, and some fruit has been gained. By far, there are rules to adjust the aircraft activities in the aspects of contract, real right, default and bankruptcy remedies. However, as the improvement of any system must undergo a process of exploration, the law of aircraft leasing in China is still faced up with many challenges.

Especially with the emergence and prosperous of domestic leasing industry, new transaction structures and models of aircraft leasing have emerged, which leaves new challenges to current legal system. On the basis of introducing the history and main contents of Chinese legal regime of aircraft leasing, this paper offers an analysis of achievements and challenges on present Chinese laws in the aspects of contract, real right and remedies.

**Key words** : aircraft leasing; financial; legal regime; bonded area leasing