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CAPE TOWN CONVENTION CHANGES RULES OF AIRCRAFT PURCHASE AND FINANCE

On March 1, 2006, the Aircraft Protocol to the Cape Town Convention on International Interests in Mobile Equipment came into force, radically changing aircraft purchase and finance in "Contracting States" (*i.e.*, signatory countries), including the United States. The Aircraft Protocol is intended to stimulate purchase of aircraft in emerging-market countries by reducing the risks, and therefore the costs, associated with financing such transactions. The Aircraft Protocol tries to minimize risks by centralizing information, standardizing procedure, and exporting key features of American and Canadian aviation law. While it remains to be seen whether these changes will have the intended effects, there is no doubt that the changes have created a complicated regulatory regime that is fraught with pitfalls for the uninformed.

A key feature of the Aircraft Protocol is the creation of a new priority system for ownership and security interests that trumps, but does not replace, national priority rules. For transactions occurring on or after March 1, 2006, priority of ownership and security interests is determined by the order in which parties register with the Cape Town International Registry ("CTIR"). The CTIR, located in Dublin, Ireland, is operated by a joint venture between the Irish government and a Swiss-based aviation information technology firm, with oversight by the International Civil Aviation Organization of the United Nations. Simply put, for transactions governed by the Aircraft Protocol, full compliance with all applicable national perfection rules may not be enough to protect an interest. International registration is critical. Furthermore, the CTIR "first to file" system might surprise those accustomed to exceptions for "actual notice," as under the traditional U.S. priority rule.

The Aircraft Protocol applies to a transaction where three requirements are met: (i) the aircraft/engine meets certain size/power requirements, (ii) an

"International Interest" is created, and (iii) the aircraft is registered in, or the debtor is "situated in," a Contracting State at the time of conclusion of the agreement creating the interest. Unfortunately, these requirements create a host of problems and are very difficult to deal with in practice.

Aircraft meet the minimum size requirements when they are certificated to transport at least eight persons (including crew) or goods in excess of 2,750 kilograms. Helicopters meet the minimum size requirements when they are certificated to transport at least five persons (including crew) or goods in excess of 450 kilograms. Engines meet the minimum power requirements when they are rated to at least 550 horsepower or the equivalent. These minimum requirements have been heavily criticized because they sweep in the majority of aircraft used in business aviation; this appears to be greatly overinclusive, given the aim of the Aircraft Protocol to stimulate purchase of large, commercial aircraft by airlines and commercial operators. Furthermore, because engines and aircraft are treated as separate "aircraft objects," it is possible that the engines will be covered by the Aircraft Protocol, but not the aircraft, or vice versa.

International Interests include security interests, leasehold interests, conditional sales agreements, ownership interests evidenced by bill of sale (but not the ownership interests standing alone), and some nonconsensual liens, as well as amendments, assignments, and subordinations related to International Interests. The breadth of International Interests under the Aircraft Protocol is enormous, which means that the importance of CTIR registration extends far beyond traditional secured creditors. In practice, determining whether an interest is an International Interest can be challenging, especially since Contracting States may have different standards for what constitutes an International Interest. For example, Contracting States can elect to treat interests registered in a national registry as "National Interests" excluded from the Aircraft Protocol, even though those interests would otherwise be International Interests. The U.S. has not taken this approach, but other Contracting States can. Therefore, evaluation of International Interests requires a country-by-country analysis for all Contracting States relevant to the transaction.

The final requirement for coverage under the Aircraft Protocol is for the aircraft to be registered in a Contracting State or the debtor to be "situated in" a Contracting State at the conclusion of the agreement, creating the International Interest in the aircraft object. The term "debtor" is defined broadly in this context, including, for example, a seller in a traditional sale, a borrower under a security agreement, and a lessee under a lease. A debtor is "situated in" a Contracting State if it is formed or incorporated, or has its principal place of business, in a Contracting State.

Another aspect of the Aircraft Protocol that might surprise parties to aircraft transactions is the ability to register prospective International Interests. This allows parties to perfect their rights before a transaction closes, in sharp contrast with traditional Federal Aviation Administration ("FAA") procedures. The perfection is effective as of the time the interest is registered with the CTIR, provided that the transaction closes. A potential problem arises when the interest remains in the CTIR database but the transaction never closes. This problem is exacerbated by the fact that the CTIR does not take filings of complete documents, instead accepting what are essentially references to the relevant documents. It is not possible to tell whether or not the interest is valid, so a party in need of this information will have to take the additional step of verifying the validity of the interest by contacting the third party directly.

In the U.S., the entry point to the CTIR is through the FAA. It is important to note that filing with the CTIR does not replace FAA registration requirements—airframes still must be registered, and encumbrances on airframes and engines filed, with the FAA as usual. To access the CTIR, a party must fill out an AC Form 8050-135 and submit it to the FAA. In return, the party will receive a unique 17-character authorization code that allows the party to access and transmit information to the CTIR. Unfortunately, even a small mistake in the timing of the paperwork can result in the interest owner forever losing the ability to access the CTIR.

An AC Form 8050-135 absolutely must be presented at the same time as any documents filed under Subpart C of Part

49 of the Federal Aviation Regulations (*i.e.*, Aircraft Ownership and Encumbrances Against Aircraft). The FAA has taken the rather draconian position that if an AC Form 8050-135 is submitted a few days, or even a few minutes, after submission of the documents, the FAA will never issue the submitting party a unique authorization code for that transaction. This means that the party can never register its interest in the CTIR and will effectively lose priority to any subsequent party that registers an interest in the CTIR. There will surely be many future attempts to circumvent this harsh result, but for now the only sure way to safeguard an interest through CTIR registration is to get it right the first time.

Once an interest owner has the unique authorization code, that owner gains access to the CTIR as a transaction user entity ("TUE"). The TUE can then, at its option, designate a professional user entity ("PUE"), such as a law firm or other professional firm, that can also access the CTIR. Each user entity must register an administrator, who is the individual authorized to deal with the International Registry on behalf of the entity. Note that TUEs and PUEs must keep the CTIR updated if this individual should change—it is the individual, not the entity, that interfaces with the CTIR.

This *Commentary* is only a general introduction to the Aircraft Protocol to the Cape Town Convention on International Interests in Mobile Equipment; as such, it has had to omit many nuances of the system for the sake of clarity and brevity. Furthermore, while the CTIR registration system is one of the most sweeping changes brought about by the Aircraft Protocol, the Aircraft Protocol has wide implications beyond the scope of this *Commentary*. The Aircraft Protocol departs from Geneva Convention deregistration procedures, creates new remedies for creditors, preempts the Transportation Code, and has generated a host of novel legal questions about its application. Ultimately, parties to aircraft transactions must understand that the Aircraft Protocol has dramatically changed aircraft purchase and finance, and the time to ask questions is now, before their rights are inadvertently compromised.

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