

# Client Bulletin

April 2006

## New International Treaty Affecting Leasing Of Aircraft And Engines Now In Effect

The Cape Town Convention<sup>1</sup>, which will have a profound effect on future financing and leasing of aircraft and aircraft engines, came into effect on March 1, 2006, for the nine countries which ratified the Convention and the Aviation Protocol: Ethiopia, Ireland, Malaysia, Nigeria, Oman, Pakistan, Panama, Senegal and the United States.

The European Community is actively pursuing ratification. It is probable that the nations of the European Community will become Contracting States in late 2006 or early 2007. Several other nations are presently in the ratification process and likely to become Contracting States later this year.

The following is a brief summary of the salient provisions of the Convention:

### When does the Convention apply?

The Cape Town Convention will apply to the sale, financing and leasing of an aircraft to an operator if either the aircraft is registered in a Contracting State or the purchaser or lessee of the aircraft is located in a Contracting State. With respect to engines, the Convention applies to the transaction only if the purchaser or the lessee of the engine is located in a Contracting State.

If the home country of the airline is not a Contracting State, the Convention may still apply under certain financial structures, and lenders almost certainly will try to create a structure in which the Convention will apply. Prospective purchasers of aircraft (with the consent of the seller) can also protect themselves

from a sale of the aircraft to another by registering with the International Registry which is located in Ireland.

### Major Features of the Convention

The major features which manufacturers and airlines should be aware of are:

- In addition to customary aircraft liens, aircraft and engine leases are treated as security interests and these security interests are called “international interests”;
- An operator’s interest in aircraft leased to another (an international interest) can be protected by registration in the International Registry in Ireland which will protect that interest from third party claims;
- Aircraft engines are covered and interests in engines can be registered in the Registry; in engine interchanges, the Convention will ultimately mandate a “title tracking” system;
- Leases and security interests (e.g. mortgages on personal property) can be registered with priorities based upon time of filing in the International Registry; and
- The international interest in an aircraft, if registered, under most circumstances will have priority over a bankruptcy trustee’s and other creditors’ interests.

If certain “declarations” are made at the time of ratification, lenders also will receive a number of specific protections (such as repossession and deregistration), should the debtor default and go into bankruptcy. The Convention also offers “quiet enjoyment” protection against a lender’s repossession to a lessee airline which has registered its interest, in the event its lessor goes into bankruptcy.

**Transactions Prior to March 1, 2006**

For the Convention to govern, a new “international interest” must be created after March 1, 2006 by the “refinancing” or an amendment to the transaction documents. Transactions closed prior to March 1, 2006 are not affected by the Cape Town Convention. Whatever protections obtained in prior transactions are secure. However, since 2001, aircraft lenders anticipated the likelihood that the Cape Town Convention would soon come into force, and in many transactions after 2001, lenders inserted in transaction documents the right to ask the Debtor (the airline) for “further assurances.” If the Convention can be made to apply to a past transaction (by creating a new international interest in the refinancing documents where the Debtor (airline) is located, or the aircraft is registered, in a Contracting State), the lender will probably want to refinance or amend the documents. For its part, an airline as lessor or a leasing company, to obtain the protections of the Convention, may want to redo any leases and register them in the International Registry.

We are at an early stage of Convention applicability, as only a few countries have ratified. However, the United States is one of the ratifying countries and is an important player in the equipment manufacturing and financing market. Moreover, over the next few years, the Convention is likely to be ratified by many more nations. Accordingly, aircraft and engine manufacturers need to be aware of the Convention and its looming importance. U.S. domestic financed sales or leases of aircraft or engines will certainly be governed by the Convention after March 2006 and filings with the International Registry through the FAA portal will be necessary to protect any lender or any manufacturer-financed interest.



If you have any questions or would like further information, please contact:

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<sup>1</sup> The Convention was developed under the auspices of UNIDROIT in Rome which formed a Drafting Committee composed of representatives from several countries. The United States Department of State appointed Thomas J. Whalen, a senior partner at Condon & Forsyth LLP, as one of two U.S. representatives to the Study Group/Drafting Committee. Mr. Whalen served from 1991 to 1998, when the final draft of the Convention was completed. The Convention was opened for signature at Cape Town, South Africa in November 2001.