



The Cape Town Treaty: Perfecting Interests in Aircraft Under the New Law

Aircraft lessors will need to promptly change their closing procedures to meet the new rules. Otherwise, their aircraft interests may not be perfected.

Prior to March 1, 2006, in order to perfect an interest in a U.S.-registered aircraft, a lender or lessor only needed to file documents with the Federal Aviation Administration. Today, that requirement has changed because of the new Cape Town Treaty (formally, the Convention on International Interests in Mobile Equipment and the related Protocol on Matters Specific to Aircraft Equipment). Although the familiar FAA filing requirements remain in place, the Cape Town Treaty requires an additional step—registering the interest with the International Registry of Mobile Assets created by the Treaty. Compliance is essential, because failure to register under the Cape Town Treaty will result in the aircraft interest being unperfected and potential loss of priority in the secured equipment—even with respect to a later creditor who has actual knowledge of the unregistered interest.

In short, a U.S.-registered aircraft must be registered at

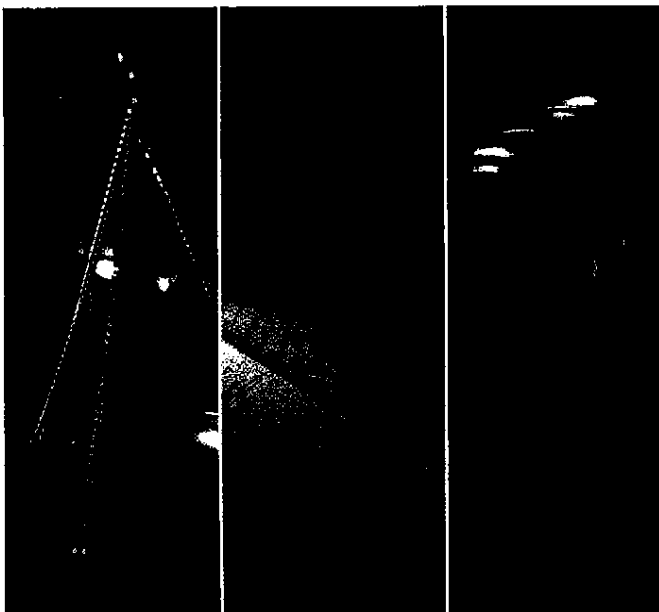
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the FAA, and the interests in the aircraft must be filed at the FAA *and* registered under the Treaty.

What is the Treaty?

On March 1, 2006, the Cape Town Treaty became effective in the U.S. and eight other countries that, as of June 1, 2006, have ratified it. It applies when the obligor in the transaction is situated in a country that has ratified the Treaty. The stated intent of the Treaty is, generally, to expand the sources and lower the costs of aircraft financing by establishing a central, international registry for the creation, enforcement, perfection and priority of interests in “aircraft objects” (defined in the Treaty as airframes, aircraft engines, and helicopters). Although the Treaty creates a new registration system, it does not dismantle the pre-Treaty filing and registration system in the U.S.

The Cape Town Treaty creates an electronic (internet) registry that is accessible 24 hours a day, seven days a week and 365 days a year. The registry is “located” in Ireland (but really located in cyberspace, so where it is located for administrative purposes has little practical effect). Only interests are registered (for example, “security interest in airframe X in favor of lender Y”); the mortgage or lease itself is not filed.



To What Interests Does it Apply?

Aircraft Objects—The Cape Town Treaty applies only to defined aircraft objects. The aircraft objects that are subject to the Treaty are:

1. airframes that are certified to carry at least eight persons (including crew) or in excess of 2750 kg (6063 lbs) of cargo,
2. helicopters that are certified to carry at least five persons (including crew) or in excess of 450 kg (992 lbs) of cargo, and
3. jet engines that have at least 1750 pounds of thrust or turbine/piston engines that have at least 550 rated takeoff shaft horsepower.

The Treaty applies to interests in all such objects that meet these specifications, regardless of whether the aircraft is used for business, commercial or personal purposes. Propellers, aircraft/engine parts, and floating inventories of spare engines are not included in this list, and are not covered under the Treaty. Security interests in such equipment should be perfected against U.S. debtors in the same manner as before the Treaty. In addition, interests in airframes and engines that do not meet the foregoing size and power specification fall outside the jurisdiction of the Treaty and should continue to be perfected by other means.

Registrable Interests—Basically, the Cape Town Treaty provides a registration system for security interests and leases. One kind of interest that must be perfected under the Treaty is referred to as an “international interest.” An international interest is the security interest under a security agreement or a title reservation agreement (conditional sales), or a lessor’s interest under a lease. Also registrable are assignments, bills of sale (which the Treaty calls “contracts of sale”), subordination agreements, subrogation agreements, prospective assignments, prospective sales, and prospective leases, and amendments, discharges (terminations and releases), and extensions of those interests.

Prospective Interests—Parties may “pre-register” under the Treaty, by registering “prospective” interests. Registering a prospective interest allows a party to gain a priority position that (upon perfection) will relate back to the date of the registration. As long as the prospective interest filing sufficiently describes the final transaction, no second registration will be required upon closing of the transaction. If the transaction for which a prospective interest is perfected does not close, no actual interest is created and the filed prospective interest has no effect. Regardless, the parties to such a failed transaction should register a discharge of the prospective interest, because the interest will remain on the Registry until it is discharged.

The intent of the Treaty is to expand the sources and lower the costs of aircraft financing by establishing a central, international registry for the creation, enforcement, perfection and priority of interests in “aircraft objects.”

Domestic Transactions—Even though the Treaty uses the misleading phrase “international interests”, it applies equally to purely domestic transactions such as transactions involving: (1) U.S. parties only, (2) aircraft registered in the U.S., and (3) aircraft that never leave U.S. airspace.

Retroactivity—The Cape Town Treaty does not require or permit registrations of interests that existed in FAA-registered aircraft before March 1, 2006. So there is no need (or ability) to make “precautionary” filings of old deals. Of course, the parties will need to determine whether a modification to an existing deal creates a new interest (for example, a renewal of an existing lease).

Priority of Interests

Before the Cape Town Treaty, the general priority rule for interests in U.S.-registered aircraft was as follows: The first to file its interest at the FAA had priority over all other interests, unless the filing party had actual notice of a pre-existing interest in the same aircraft object. The Treaty creates a new priority scheme: Whoever registers its interest with the Registry first has priority over all other interests, even if the registering party has actual knowledge of a prior (but unregistered) interest in the same property. As such, under the Treaty, a lessor who files transaction documents with the FAA but fails to register its interest with the Registry is at risk of losing its priority to a subsequent creditor who registers its interest with the Registry.

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Searching the Registry

Any person may search the Registry for interests registered against aircraft by obtaining a "priority search certificate" against the particular airframe, engine, or helicopter involved. A priority search certificate is a certificate issued by the registrar of the Registry that either lists in chronological order all registered information relating to the object being searched, or states that there is no information in the Registry relating to the object. The priority search certificate does not indicate if interests on file are international interests or prospective interests.

Generally, it is advisable to do a search at the beginning of a transaction, immediately prior to closing, and immediately after the registrations of the parties' interests have been completed. For aircraft delivered before March 1, 2006, parties also will need to search the FAA registry (or, if applicable, other countries' registries) to confirm the non-existence of pre-Treaty filings.

Registering an Interest

The process for perfecting an interest with the Registry is entirely electronic, done by computer from the transacting parties' own computers. The registration process is a fairly simple task, and it normally will be accomplished on each party's behalf by a specialized law firm or other professional. However, each transaction party who is registering an interest—i.e., both the lessor and the lessee, or both the secured party and the debtor—must itself be pre-registered with the Registry as a "transacting user entity." So,

each lessor or lender—and its lessee or borrower—who will be using the Registry for the first time, should be warned of the time-consuming and somewhat difficult task of becoming registered with the Registry. Accordingly, transaction parties may need to allow several days' lead time to register with the Registry prior to a scheduled closing of a transaction.

Including registration of the transacting parties, the following summarizes the steps necessary to perfect an interest under the Treaty in a U.S. transaction:

1. Register with the Registry.

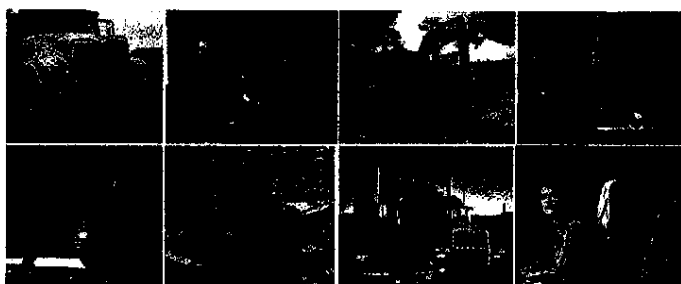
Before an interest can be registered with the Registry, each of the transaction parties (each known as a "transacting user entity" or TUE) must register with the Registry. Such registration is accomplished by downloading certain software through the Registry's website at www.internationalregistry.aero. During the registration process, the Registry "fingerprints" the hard-drive of one specific computer as the TUE's official computer. The process can take some time—a few days, including Registry approval time—and assistance of an IT staff member often is an essential part of the process for the TUE.

When signing up with registry, each TUE must pay a setup fee. The fee can be paid for just one year of registration (\$200) or in advance for five years (\$500).

Once registered, a TUE may choose to appoint a "professional user entity" or PUE (such as a law firm, title company, or other service provider) to assist it on an aircraft-by-aircraft basis with registering interests on the Registry. For efficiency and convenience, one such service provider might be appointed as the PUE for all parties (just as special FAA counsel has traditionally served as "counsel for the transaction" for FAA purposes in many closings).

Before appointing a PUE, however, the TUE itself must be registered.

If a TUE has created a special purpose entity for a specific transaction, there is no need to obtain separate approval for such entity. The TUE may electronically approve the entity for purposes of registering with the Registry under the same identity as the TUE (i.e., the existing entity can register for the special-purpose entity using the same



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"fingerprinted" computer).

2. Select an Administrator. Each TUE, and each PUE as well, must select an "Administrator" who will be the contact person for the Registry and the person at the TUE (or PUE) who approves all other users on behalf of the applicable entity. The Administrator is also the person who can effect registrations on the Registry.

The Registry's website contains additional information on the process of registering with the Registry and provides links to download: (a) the Procedures for the International Registry, (b) the Regulations for the International Registry, and (c) the International Registry User Manual. These materials provide further detail on the process of registering, as well as detailed instructions on how to register, search, and perform other tasks with the Registry.

3. File with the FAA. After the TUE has registered and selected an Administrator, it is ready to file its interest with the Registry. The FAA has been designated as the U.S. "entry point" for transmitting information to the Registry. As such, before registering against a FAA-registered aircraft under the Treaty, the parties must file an application for aircraft registration at the FAA and must file the transaction documents (such as a security agreement or lease) with the FAA. In addition, parties must file with the FAA AC Form 8050-135. AC Form 8050-135 is a simple form that requires only the name of one of the parties to the transaction, a description of the collateral (make, model, manufacturer's serial number, and U.S. registration number, if applicable), the type of interest being filed, and the name of the submitter. After receiving Form 8050-135, the FAA provides the filing party with a unique authorization code for use when filing the interest with the Registry.

If the interest being filed is a prospective interest, no transaction documents are required to be filed with the AC Form 8050-135. In order to retain the priority date created with the prospective filing, the parties must file the underlying transaction documents with the FAA within 60 days thereafter.

4. Register with the International Registry. After receiving the authorization code from the FAA, it is time to register the interest(s) with the Registry. The electronic registration is simple and accomplished by entering the necessary information, such as the parties' names and the pertinent airframe/engine information (manufacturer's name, the model designation, and the manufacturer's serial number).

5. Consent of Other Party. The Registry then will send an e-mail message to the other (non-registering) transaction party seeking its consent to the proposed registration. (For example, if the lessor electronically initiates the registration of the interest, the lessee must electronically consent, and vice versa.) If a single PUE is acting for both parties, this process is virtually automatic. When the other party consents to the filing, the international interest becomes of permanent record and perfection is complete. If the non-filing party does not consent within 36 hours, then no interest is created or perfected and the interest will not be registered unless the process is repeated with the Registry. Therefore, if the parties are not using the same PUE, a lessor or lender will need to decide whether it is willing to release funds or to deliver the asset before the registration process (including the consent) has been completed.

When to Register

The Cape Town Treaty gives financing sources filing against U.S. debtors two options for when to register: (1) file transaction documents at FAA and subsequently register with the Registry, or (2) make a prospective registration with the Registry before the anticipated transaction closes, and follow-up such Registry filing with the filing of appropriate documents with the FAA (but incur the expense of the proposed registration, and the discharge thereof, if no closing occurs). As mentioned, priority relates back to the date of the prospective registration with the Registry.

Aircraft lessors and lenders must be sure to follow the new procedures and rules established by the Cape Town Treaty. Because the Treaty is a new law and because the system contains some complexities, many early questions regarding how the Treaty operates remain unanswered. Lessors and lenders must also be sure to keep up with changes to the registration system, clarification of rules and procedures, and other decisions relating to the new law as the Treaty is tested over time. To that end, it is suggested that aircraft lessors and lenders seek the advice of legal counsel with respect to transactions involving interests in aircraft. **ELT**

ELT thanks Todd Pollack, Troutman Sanders LLP, for this month's column.