

CAPE TOWN CONVENTION ON INTERNATIONAL INTERESTS IN AIRCRAFT TO ENTER INTO EFFECT

After awaiting ratification by the requisite eight countries, the Convention on International Interests in Mobile Equipment and the related Aircraft Equipment Protocol (commonly known as the "Cape Town Convention") will enter into effect on March 1, 2006, following the recent accession of Malaysia. The convention will significantly alter the rules governing asset-based financings of aircraft objects by establishing a new international framework for the creation of security interests and the effects thereof. The convention seeks to remedy the problem of cross-border enforceability of interests in aircraft by ensuring that such interests are recognized and enforced by all contracting states regardless of the place of registration. In addition to Malaysia, the current signatories of the Aircraft Equipment Protocol are Ethiopia, Ireland, Nigeria, Oman, Pakistan, Panama, and the United States. An additional twenty-four countries have signed the convention, whose accession to the Aircraft Equipment Protocol may therefore be anticipated, including Canada, China, France, Germany, Italy, and the United Kingdom.

The convention establishes the concept of an "international interest" in airframes, aircraft engines, and helicopters that are registered in a nationality register of a contracting state (except engines) or granted by a person situated in a contracting state at the time of the conclusion of the relevant agreement. International interests will not be limited to security interests, but will include leases, conditional sale agreements and, with respect to certain provisions, contracts of sale. Contracting states have the option to declare that the convention will not apply to purely internal transactions. The United States, however, has not made such a declaration, with the result that Cape Town will apply to virtually all transactions involving aircraft objects registered in the United States. In the United States, the convention will not govern rights or interests which were created prior to its effective date, although it is conceivable that a change to an existing transaction after the effective date of the convention would constitute the creation of an international interest.

For the registration of international interests, including "prospective international interests", the convention provides for an international registry which will initially be located in Ireland and which will be accessible electronically 24 hours a day. Interests in aircraft registered in the United States will continue to be filed in the current fashion with the Federal Aviation Administration (FAA), which will serve as "entry point" for the international registration. After obtaining the required authorization code from the FAA, the parties will be able to effect the registration of an international interest by computer.

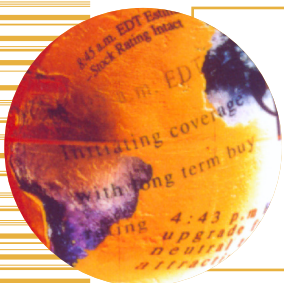
The priority of interests under the convention is governed by a straightforward first-to-file rule, subject to the ability of contracting states to declare whether unregistered non-consensual rights and interests (such as tax liens) will have priority over registered international interests. The United States has made such a declaration, thereby preserving the priority of existing and future non-consensual rights and interests.

In the event of a default, the convention provides for basic remedies, including repossession, sale, deregistration, and export of the aircraft, as well as for interim relief. Perhaps the most significant change in this area requires the FAA to honor a request to de-register an aircraft and permit its export and physical transfer from the United States under a recorded irrevocable de-registration and export request authorization issued by the debtor.

The convention also entails potential implications for insolvency proceedings. Contracting states may choose from two alternative provisions to apply upon the occurrence of an "insolvency-related event." The first alternative provides that the debtor must return the aircraft to the creditor within a given waiting period, during which the debtor is required to preserve its value. If, during the waiting period, the debtor cures the default and agrees to perform all future obligations, it may retain possession of the aircraft. The second alternative retains the same conceptual framework, but provides for greater discretion for courts to fashion appropriate remedies in insolvency cases. The United States did not choose to apply either alternative, with the result that U.S. bankruptcy law (including Section 1110) will be largely unaffected by Cape Town.

The standardization of rules for aircraft transactions provided by the convention is likely to produce substantial long-term benefits for industry participants. As the effective date of the convention draws near, awareness of its provisions and practical implications will be critical. To that end, please feel free to discuss any aspect of this Client Alert with your regular Milbank contacts or with any of the partners in our Global Transportation Finance Group, whose names and contact information are listed on www.milbank.com.

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