

The Desirability of Registering a New International Interest When Extending the Term of a Lease

March 12, 2021

Introduction

This Aviation Advisory considers the desirability of registering a new international interest at the International Registry corresponding to the extension of the term of a lease of an aircraft, airframe or engine, as to which an international interest has already been registered.

The Commentary¹ and Practitioner's Guide² recommend registering an extension as a new international interest. The Consolidated Text³, however, does not expressly require it. The Commentary and Practitioner's Guide are advisory commentary only and might not necessarily be followed by a court that is considering the priority of creditors' interests in or outside of an airline bankruptcy.⁴

The Commentary's rationale for registering an extension — protecting creditors of a debtor from having their residual interest in the debtor's secured assets impaired — is at odds with the Consolidated Text for three reasons. First, the Consolidated Text does not require that the original registration publicly state the amount of the obligation of the debtor for which the creditor claims a priority interest over other creditors in the specified property. Second, such a registration, if made, would merely repeat the original registration that remains on the public record. Third, the Commentary's rationale does not apply when the debtor is a lessee, because the lessee does not own the asset to begin with.

A decision to follow the recommendation of the Commentary and Practitioner's Guide to register an extension as a new international interest should be considered on a case-by-case basis for two reasons. First, registering an extension may inadvertently subordinate the initial lease registration to interests that are perfected between the first and second registrations. If the lease is a leveraged lease, this consequence may also violate the credit or security agreement by which the aircraft is financed. Second, registering the extension as a new international interest could have adverse tax consequences. The leasing of the aircraft should be continuous through the base term and any extension. Taking a position that there is a "new lease" means there could be a deemed redelivery to the lessor and a new delivery to the lessee, which may be taxable events in some jurisdictions.

¹ Commentary to the Convention and Protocol by Professor Roy Goode (4th Edition 2019).

² The Practitioner's Guide to the Cape Town Convention and The Aircraft Protocol (<http://awg.aero/wp-content/uploads/2020/12/Practitioners-Guide-December-2020.pdf>).

³ The Consolidated Text of the Cape Town Convention and Aircraft Protocol (http://164.100.60.133/int_conv/Chap_XXIV.pdf).

⁴ The Commentary recites that it is designed only to be an authoritative guide to the Convention and Aircraft Protocol, but "is in no way binding on national courts..." Introduction, paragraph 7.

Discussion

The Consolidated Text defines an “international interest” as follows:

“An international interest ... is an interest in airframes, aircraft engines or helicopters: (a) granted by the charger under a security agreement; (b) vested in a person who is the conditional seller under a title reservation agreement; or (c) vested in a person who is the lessor under a leasing agreement...” Consolidated Text, Article 2.

The Consolidated Text further defines a “leasing agreement” as:

“[A]n agreement by which one person (the lessor) grants a right to possession or control of an aircraft object (with or without an option to purchase) to another person (the lessee) in return for a rental or other payment [.]” Consolidated Text, Article 1.

The Consolidated Text goes on to state that an interest will be constituted as an “international interest” where: “[T]he agreement creating or providing for the interest: (a) is in writing; (b) relates to an aircraft object of which the charger, conditional seller or lessor has power to dispose; (c) enables the aircraft object to be identified; and (d) in the case of a security agreement, enables the secured obligations to be determined, but without the need to state a sum or maximum sum secured.” Consolidated Text, Article 10.

The Commentary discusses when an amendment to an existing international interest creates a new international interest. Paragraph 2.56 of the Commentary states that an amendment to an agreement that creates an international interest “may, without necessarily affecting the existing registration, give rise to a new international interest which will not be protected by initial registration but requires to be separately registered.” One example given in the Commentary of an amendment that gives rise to a new international interest is an amendment to change the airframe or engine, or to change the lessor or lessee. This is consistent with the Consolidated Text because the new item of equipment or new party does not already appear in the existing registration. Another example given is adding to the amount secured by the aircraft object in a grant of security interest.⁵

With respect to lease extensions, the Commentary provides:

“The extension or renewal of a lease creates a new registrable interest in favour of the lessor, and this is so even if the lease itself gives the lessee an option to extend or renew the lease, for the option may never be exercised and unless and until it is exercised the lessor has no existing international interest as regards the extension or renewal period. However, where the extension or renewal is provided for in the lease itself the lessor can register it as a prospective international interest from the outset, with no need to reregister when the extension or renewal takes effect, and if the lease provides for successive renewal periods, a single registration of a prospective international interest will cover all renewals.” Commentary paragraph 2.56, p. 45.

Lastly, the Commentary further provides, “The factor common to all the above amendments [i.e., those that require filing a new international interest] is that the original international interest is in some way enlarged, replaced or supplemented by a new interest or a new type of interest, to the potential detriment of intervening creditors [of the debtor or lessee] whose interests will be thereby eroded. So it is important to effect registration of the new or varied international interest in order to preserve its priority. However, the original registration remains effective to the extent that the international interest to which it relates still subsists.” *Id.*

This rationale may be considered questionable for several reasons. The Commentary assumes the amendment creates a new interest, but it does not explain why that is. Furthermore, it is not clear how the amendment may be detrimental to an intervening creditor. Any amendment that changes any obligations of the grantor potentially affects the interests of other creditors of the grantor because it may affect whether the grantor can also perform

⁵ This is an intriguing example because the Convention expressly states that the amount secured is not included in the registration at all.

its obligations to the other creditor. This is true for all interests. The Convention deliberately provides for a simple notice filing. It does not allow the registrant to specify whether the international interest is a security interest, a lease or something else. It does not allow for the recording of the amount secured. It does not allow for the recording of the base term of the lease. The inference in the Commentary's rationale that the creditor somehow becomes automatically unperfected to the extent of a change in the underlying obligations is plainly at odds with the Consolidated Text itself, which does not require the creditor to record the amount of such obligations or term in the first place.

In the case of an international interest that is a true lease, the "debtor" is the lessee and the "creditor" is the lessor. The lessee does not own the aircraft. Someone deciding whether to extend credit to the lessee cannot rely on the value of the aircraft to repay the lessee's obligations to it. As such, there are no hypothetical creditors of the true lessee who may have a residual interest in the aircraft that ought to be protected. Commentary paragraph 2.56(4) implies that any amendment to increase the rent on a true lease will not require a new registration. So if an amendment that doubles the rent on a one-year lease does not require a new registration, why would an amendment that doubles the term of the lease but keeps the rent constant require registration? The potential rights of third-party creditors may be affected in each instance. Registration of an international interest remains effective until discharged (unless there is an expiration date specified in the registration). Therefore anyone searching the registry after the lease is entered into will see there is an international interest and be prompted to make further inquiries of the lessee. A registration of another international interest (prospectively or when the renewal begins) corresponding to a renewal will precisely duplicate the existing registration, other than as to filing date, and not provide the searcher any more information than it could already have obtained.

The Practitioner's Guide concludes that the Commentary requires that lease extensions be registered,⁶ adding a provision that is not in the Consolidated Text. The Consolidated Text itself does not provide that a lease extension is a new international interest.⁷

Furthermore, if the extension of a lease is treated as a new international interest, it logically also means that one must go on to record a transfer of right to discharge and an assignment of that interest in favor of a security assignee at the International Registry. This creates two additional issues.

First, registering a second international interest changes the registration date for (1) the lease; (2) the transfer of right to discharge; and (3) the assignment to the security trustee from the date the original lease interest was filed to the date the lease-extension interest was filed. This change is undesirable, because the International Registry follows the first-in-time filing rule. If a court someday decides the extension did not have to be filed, because it added nothing new to the existing filing, the court could still decide that the lessor's new filing impaired the priority of the lease registration and security assignment registration. Creditors who filed at the International Registry between the first and second filings would take priority over both the lessor and the secured lender. In addition to impairing the lessor's interest in the lease directly, this would be a violation of the typical covenant in a credit agreement not to impair the first priority of the security trustee's security interest in the collateral package.

Second, because the lease typically gives the lessee quiet enjoyment, the lessee normally insists when the lease commences that the lease be recorded at the International Registry before the international interest corresponding to the aircraft security agreement is filed. If the extension is filed, then in order to preserve that priority, the lessee may insist that the security trustee file at the International Registry a subordination (under Article 33(2) of the Consolidated Text) of its mortgage to the lease extension. A secured party may be reluctant to do so.

⁶ Practice Note, p. 33.

⁷ See the provisions of the Consolidated Text included above.

Conclusion

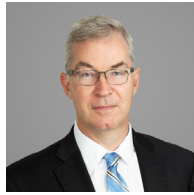
The Practitioner's Guide and Commentary in essence provide that the registration of a new international interest for an extension of a lease term is routine. However, the utility of such a registration is not apparent, because the registration will just duplicate an existing registration in what is a notice-filing system. It also may not simply be a harmless extra step, because it may affect the priority of a security interest in the lease and have other adverse effects. For the reason discussed herein, whether to register a lease extension should be carefully considered in each case.

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3/10/21