

INTERNATIONAL AIRCRAFT REGISTRATION TREATY TAKES OFF

Protocol designed to assist creditors, reduce financing costs

By RICH ROCHLIN

There's a relatively inexpensive, expedient and well-settled process for taking and perfecting a lien on so-called "traditional" collateral such as inventory and equipment. It involves, in most instances, filing a UCC-1 with the Secretary of the State in the state of debtor's location. In contrast, the process of taking a security interest in and perfecting a lien on an aircraft or helicopter requires multiple filings, additional time, increased costs and a careful analysis of state and federal law, as well as, perhaps, the law of the jurisdiction where the aircraft or helicopter is to be located and operated.

As of March 1, 2006, this process changed and a new step was added when the United States and various other countries became bound to the Aircraft Protocol to the Cape Town Convention. The goal of the treaty was to establish an international and centralized filing system for registration of "international interests" in aircraft and to create more certainty for creditors enforcing post-default rights. The hope was that the uniformity of the treaty's provisions (i.e., each ratifying country would agree to be bound by the same rules) would assure lenders/lessors assurances that the remedies contained in their contracts with borrowers/lessees could actually have some bite in countries that had ratified the treaty. In so doing, collaborators posited, the costs of financing aircraft would decrease and the frequency of financings would increase.

The treaty's goal to create a centralized filing system was realized with the establishment of the International Registry of Mobile Assets, a notice-based registry accessible and searchable at any time by anyone with Web access. The registry, operated out of Dublin, Ireland by Aviareto, is a joint venture between the Irish government and SITA, a Swiss information technology provider. The registry is supervised by the International Civil Aviation Organization (ICAO). Unlike the process of filing documents with the U.S. Federal Aviation Administration, parties need not file documents with the notice-based registry. Accordingly, registrations are made against (and inquires are made of) criteria such as serial number, model and manufacturer. Additionally, the registry, unlike the FAA, which maintains fairly traditional business hours, allows parties to register interests and conduct searches at any time via the Internet, without the logistical hassle of coordinating the time zone differences of contracting parties.

Applicable Transaction

The treaty applies to the following aircraft objects:

- Aircraft certified to transport at least eight persons (including crew) or cargo in excess of 6,050 pounds
- Helicopters certified to transport at least five persons (including crew) or cargo in excess of 992 pounds



- Engines rated with at least 1,750 pounds of thrust or turbine/piston engines that have at least 550 rated takeoff shaft horsepower.

The treaty applies to these aircraft objects regardless of whether such objects are used for commercial or personal purposes. Engine parts and floating inventories of spare engines are not covered and should continue to be perfected against in the same manner they were prior to the treaty being adopted.

The treaty contemplates registration of "international interests." The main components of "international interests" include a lessor's interest in a lease, a security interest under a security agreement and title reservation agreements. Other concepts capable of registration include subordination agreements, contracts of sale and assignments of international interests. Would-be registrants should not be fooled by the use of the slightly misleading term "international interests" and should instead focus on what it encompasses before electing not to register an interest in a purely U.S.-based transaction. The treaty is clear that it can and does apply to purely US-centric transactions (assuming the aircraft objects in play are covered by the treaty).

Priority

Like the Uniform Commercial Code, the registry and treaty adhere to a "first-to-file" convention in determining priority of security interests. Thus, if an object is eligible for registration and it is not registered, the lessor/creditor will not have priority over the liens of other creditors that may register at a later date (but prior to the unregistered interest) – the equivalent result of failing to file a UCC-1 financing statement against a debtor. The treaty even adopts a harsher rule by not punishing a new creditor who registers an interest with the knowledge that an unregistered interest exists. It should be noted that the consensus among practitioners is that "interests" perfected prior to the effectiveness of the Treaty remain intact and no additional filings are needed.

Remedies

If an aircraft is located in a country that has adopted the treaty, the rights of lessors/creditors will be much more favorable to them and could provide for the following remedies:

- seek court orders to enforce agreements
- sale or lease of the aircraft
- replevin
- de-registration of the aircraft
- receive or collect income arising from the aircraft

Conclusion

This article sets forth a basic framework for understanding the practical effects of the treaty and the registry. As one could imagine, there are many other significant implications for the treaty and the registry, particularly those that relate to the intersection of how existing U.S. law treats secured party remedies and how the treaty deals with these issues. While a full examination of all the issues one must consider in these types of transactions cannot be adequately covered in this space, practitioners (at a minimum) should carefully examine the deal documents to ensure that their clients are availing themselves of the benefits that the treaty provides. Parties should also consider the impact of having the aircraft reside in a country that has yet to adopt the treaty.



The point is that practitioners must carefully examine the details of a transaction and, if applicable, advise their clients of the necessity of registering the "international interest" created by their particular transaction with the Registry. As was the case prior to March 1, 2006, parties must continue to make the requisite filings with the FAA in the traditional manner (the filing with the FAA is a prerequisite to registering with the Registry). The consequences of failing to file with the registry can be catastrophic: an unregistered security interest unperfected and can result in a loss of priority, even to a new creditor who has actual knowledge of the unregistered interest.

To minimize this risk, lawyers that represent lessors and lenders in "aviation-finance" transactions should engage FAA counsel to assist with the filing of certain transaction documents (e.g., the security agreement or lease agreement) with the FAA, to effectuate the registration with the Registry and to help navigate the issues arising from the intersection of the Treaty and the law of another relevant jurisdiction (including the U.S.). ■



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CORPORATE BOARDS SEEK OUTSIDE LEGAL HELP

Independent counsel help directors in conflict-of-interest situations

should an individual director seek his or her own individual independent counsel?

Board committees, whether standing or special in nature, often require separate and independent counsel. SOX explicitly requires that all public companies authorize their audit committees to engage independent counsel and various stock exchanges have established similar requirements for compensation committees.

In our experience, many public companies provide their board's audit, compensa-

tion and D&O insurance issues, and crisis situations such as financial restatements. Consequently, independent directors of public companies stand a better chance than ever of finding themselves asked to serve on a "special committee" of the board. In many transactions involving a potential conflict of interest, such as a proposed management buyout, corporate governance standards and current law generally suggest that a board create a special committee of independent directors who are free of any financial or other interest in the transaction and that such a special committee engages independent counsel.

Each special committee will have been formed because of a unique set of facts; but whatever the committee's situation, its actions will be the subject of after-the-fact examination, usually in a litigation setting. This means that special committee members should pay particular attention to process, especially in connection with their selection of advisors. It is important for special committees to select independent legal counsel that will be in an unfettered position to assist the committee in its role as an independent negotiator on behalf of the public shareholders. When reviewing the qualifications of potential counsel, the committee will need to carefully evaluate such counsel's independence, including past and current relationships with the company

Examples of conflict-of-interest situations include management buyouts, parent-subsidiary mergers, and internal or governmental investigations.

tion, nominating and corporate governance committees with the authority to retain independent counsel on a standing basis -- not only in a crisis situation.

Avoiding Conflicts

Even before the recent corporate governance reforms, boards have engaged independent counsel to avoid actual or perceived conflicts of interest. Many conflict-of-inter-

est transactions are regulated through the rules provided in each state's corporate statute. The common feature of such statutes is the required review by the company's disinterested and independent directors of the conflict transaction with the assistance of independent counsel.

In 2006, the SEC amended its disclosure rules for related-party transactions to include a discussion of the company's "policies and procedures for the review, approval or ratification" of related-party transactions. It is, therefore, more important than ever that public companies' boards re-examine their procedures for dealing with related-party transactions and other conflict situations.

By **STEVEN E. GROSS**
and **ARLENE ELGART MIRSKY**

This past July marked the sixth anniversary of the Sarbanes-Oxley Act (SOX), which brought about considerable changes in corporate governance and regulation and ushered in the era of the (mostly) independent board.

Looking back, we have seen an increasingly hostile attitude toward public companies develop, motivated in part by ongoing news of corporate scandals. As a consequence of these scandals, SOX, new Securities and Exchange Commission rules, stock exchange listing requirements and evolving expectations of directors under state laws, anxiety continues to grow in corporate boardrooms. In response, boards, board committees and directors of public companies have been seeking legal advice more frequently and on a recurring basis from independent counsel, in addition to seeking legal advice from in-house or regular outside corporate counsel. This trend raises a number of interesting questions. What are some of the specific situations in which there is general agreement on the need for independent counsel? When



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and its management, to determine if any relationships could cast doubt on such counsel's ability to adequately represent the special committee and shareholders.

Internal Investigations

A special subset of conflicts of interest are those situations in which a public company's board is required to conduct an internal investigation to deal with suspected or alleged wrongdoing. The independent investigation may be controlled by the board or by one of the board's committees. The board or board

shareholders demand that the company take action against directors, officers or others for alleged wrongdoing that has harmed the company. If and when the company refuses to take such action, the shareholders may bring an action against the alleged wrongdoers and join the company as a defendant.

Generally, the company has a number of potential responses: it can allow the plaintiff to proceed with the litigation on its behalf while at the same time attempting to protect its personnel from discovery excesses; it can decide to try to obtain a stay of the litigation

in order to conduct its own investigation, creating a special litigation committee for that purpose, and, if that investigation concludes that the suit is without merit, the company can then move for dismissal of

the derivative suit; or it can commence settlement discussions with the plaintiffs, generally under the supervision of the board's independent directors or a special committee. Each of these options raises conflict issues requiring a board's full attention. In making their decisions, the disinterested and independent directors on the board or who comprise the special litigation committee will rely heavily on their advisors, most importantly the special litigation committee's counsel. Moreover, courts are much more likely to find a special litigation committee independent and follow their recommendations if the committee has retained separate and independent counsel who has not represented the individual defendants or the

company in the past.

When a company faces lawsuits or governmental investigations, individual directors also must consider whether their interests and those of the company are best served by their retaining separate counsel. If a director is not named personally as a defendant, it may be appropriate for the counsel representing the company to represent its board members as well. However, a lawsuit naming a director as a defendant implicates his or her own personal interests, which may differ in many respects from those of the company and the company's officers. In such a case, or in any case where the interests of the director and the company are potentially adverse, a director should seriously consider retaining separate counsel.

Audit Committee

For example, when counsel engaged by the audit committee conducting an internal investigation brings a board member in for questioning, that director needs to be cognizant of the fact that the counsel represents the audit committee, not the individual director. What the board member says to that counsel may not be privileged. When that counsel later communicates with the government, he or she will act in the company's best interest, which may not be in the best interest of the individual director.

If the matter includes an investigation in which the SEC or another regulator is involved, directors again need to determine whether they need to engage their own counsel. This is particularly true today due to the trend towards "deputization" -- witnesses in internal investigations may be charged criminally with obstruction of justice and making



false statements during interviews conducted by private lawyers because they knew that the lawyers' interview notes would be turned over to the government. Moreover, directors may need their own counsel to protect their personal interests against the prospect of future litigation and to be fully advised regarding their individual issues as well.

The corporate governance changes that have come about in recent years continue to change the board's role from solely steering strategy and advising management to monitoring and enforcing corporate compliance, performing due diligence and conducting investigations. In their new and expanded roles, directors are being called upon increasingly to exercise independent review and judgment of management activities. A natural outgrowth of these activities is the increased use of independent counsel for the board, board committees and for individual directors of public companies. ■

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committee in turn engages independent counsel without a prior relationship to the company or to the individuals being investigated. This structure helps to provide public shareholders with the assurance that corporate decisions will be made based on unbiased sets of facts and independent legal analysis of the actions at issue. In addition, regulators and enforcement officials, by and large, will recognize an investigation carried out by independent legal counsel as a more credible process, often leading to better outcomes for the company.

Another situation which may confront a public company's board that will require the assistance of separate and independent counsel is the commencement of shareholder derivative litigation. In a typical case, unhappy

Lawyers Kept Lines Moving

■ From POOR WOMAN on PAGE 3

down in his car. "It was fun and everything worked very smoothly," said Orr, who said it's unclear whether the battalion of lawyers was necessary, or whether everything went well because, in part, of their presence.

One polling place forgot to provide the second page of the ballot, which was filled with candidates for local elections.

Orr befriended a John McCain poll observer and the two helped anyone with questions about the ballot, regardless of party affiliation. "I was inspired by the whole process," said Orr. "It helped to restore my optimism in the democratic process. I would do it again in a heartbeat."

Four lawyers from Bingham McCutchen's Hartford office also volunteered to help out at the polls, working with the non-partisan group Election Protection in Tampa, Fla. Other than long lines when the polls first opened on Election Day, they encountered no major problems.

Attorney Katherine Dobson said that

one woman was bounced around between five or six polling places, with officials at each one telling her she was in the wrong place. Eventually, she found Dobson, who was able to place a call to Election Protection's command center, which was finally able to determine where the woman was supposed to vote. "She was, after six hours, finally able to cast her ballot," Dobson said.

Another hitch, explained Bingham's Anthony Goodman, was that one polling place forgot to provide the second page of the ballot, which was filled with candidates for local elections. Once that situation was straightened out, the lines moved faster.

Goodman thinks the presence of poll observers helped keep Election Day fair. "I think the idea that people are watching can act as a preventative measure."

Gerety said New Englanders could not fathom having to wait upwards of five hours just to vote. On Election Day itself, he was sent to Homestead, Fla, a poor area devastated by Hurricane Andrew in 1992. The lines were about four-and-a-half hours long.

"It's appalling to me," said Gerety, noting that there were too few voting booths and too many items on the ballot. He said the problems are most prevalent in areas with large minority populations. "It just doesn't make much sense and people here think its normal." ■

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To bring into harmony or proportion

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