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Square Pegs in a Round Hole - The Effects of the 2006 Cape Town Treaty Implementation and Its Impact on Fractional Jet Ownership

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THE INCREASINGLY GLOBAL economy has led to a variety of attempts to smooth financial transactions across international borders. One recent attempt has centered on aircraft transactions. However, while the initial goal was to improve international transactions, questions remain as to its effect on the domestic aviation industry within the United States.

The Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment, more commonly known as the Cape Town Treaty ("Cape Town" or "Treaty"), officially entered into force in the United States on March 1, 2006. Adopted on November 16, 2001, the Treaty began at a diplomatic conference held in Cape Town, South Africa. Technically, the Treaty consists of two parts: "(1) the Convention itself, which is drafted in general terms to deal with commercial transactions involving mobile equipment, and (2)
the Protocol, which is specific to aircraft transactions."³ The Treaty creates a new international registry where notices of rights in aircraft and aircraft engines can be recorded to establish the priority of competing financial interests.⁴

One such economic burden not yet accounted for is the impact of the Cape Town Treaty on corporate aircraft domestic, especially fractional ownership programs. As their name indicates, these programs allow parties to purchase only a portion of an aircraft.⁵ Fractional ownership programs are "multi-year programs covering a pool of aircraft, most of which are owned by more than one party and all of which are placed in a dry lease exchange pool and available to any program participant."⁶ However, the Treaty was initially crafted with large commercial aircraft and single whole aircraft transactions in mind.⁷ The original impetus for the Cape Town Treaty was a 1996 request by the Boeing Company to the International Air Transport Association (IATA) to "seek assistance in 'breaking the logjam' in Unidroit with a specific request that IATA propose a means of moving forward with respect to aircraft equipment only," leaving other forms of transportation to be addressed later.⁸ Unfortunately, "later" has not yet come. As a result, the burgeoning interest in fractional ownership aircraft, especially in the United States, is somewhat at odds with the structure currently found in the Treaty. Similarly, the registration requirements of the Treaty are more burdensome for all aircraft, meaning that the

⁶ Id. at 324. Gleimer notes in footnote 9 that a "dry lease" means the "lease of an aircraft where the crew is provided by the lessee." Id. at 324, n.9. See also Philip E. Crowther, Taxation of Fractional Programs: "Flying Over Uncharted Waters," 67 J. AIR L. & COM. 241, 241 (2002) (discussing the tax implications of fractional ownership programs).
⁸ Id.
domestic aviation industry is experiencing a struggle with implementation as well. In fact, it is possible that since the registration system under the Treaty is structured toward big manufacturers and lenders, the complications for individual aircraft sellers and dealers will ultimately prove to be too burdensome, merely creating extra levels of bureaucracy that parties will choose to circumvent. Several have already chosen to do just that.

This Comment will explore both the impact of the recent implementation of Cape Town on the American aircraft industry in general, as well as the specific impact on fractional ownership aircraft and the response of the industry. Part I will review the history and intent leading up to the Treaty and provide a practitioner's guide to navigating the new system. Part II will address the fractional ownership industry. It will explore how other areas of law have adapted to and dealt with the fractional ownership programs as a way to better understand how Cape Town might eventually interact with fractional programs. Part III will examine the Treaty's domestic impact since implementation, as well as any benefits or growing pains realized to date. It will also look at the current application of Cape Town to the fractional ownership industry. Finally, Part IV will offer recommendations of possible adjustments that could be made to the Treaty to ease the transition into full implementation.

I. UNDERSTANDING THE CAPE TOWN TREATY

In order to understand the Cape Town Treaty, it is necessary to first look at events leading up to the Treaty. The Treaty was the fruit of more than thirteen years of labor. Beginning in the late 1980s, the Canadian government recommended that Unidroit explore possible ways of standardizing the laws for security interests, specifically for mobile equipment. Unidroit initially part of the League of Nations, Unidroit was re-established in 1940. Its function is "to study needs and methods for modernising, harmonising and co-coordinating private and, in particular, commercial law as between States and groups of States." Over

9 Id. at 4.

10 Int'l Inst. for the Unification of Private Law (Unidroit), About Unidroit, http://www.unidroit.org/english/presentation/main.htm (last visited Sept. 28, 2007). Unidroit is the French acronym for the International Institute for the Unification of Private Law, which is an independent intergovernmental organization headquartered in Rome. Id. Initially part of the League of Nations, Unidroit was re-established in 1940. Id. Its function is "to study needs and methods for modernising, harmonising and co-coordinating private and, in particular, commercial law as between States and groups of States." Id.

time, the effort grew to involve the combined efforts of multiple parties including Unidroit, the Aviation Working Group, the International Air Transport Association and the International Civil Aviation Organization. Co-chaired by Airbus and Boeing, the Aviation Working Group membership includes major figures such as Bombardier, Citibank, GE Capital Aviation, JP Morgan, and Morgan Stanley. The International Air Transport Association is a global trade organization with more than 240 member airlines, representing 94 percent of the international air traffic. These groups represented interests of primarily large commercial carriers, as evidenced by their member lists of large aircraft carriers and financing groups. The primary focus of the group was to "produce new treaty law governing security interests in cross border transactions concerning high-value mobile assets" specific to the aviation industry.

A. THE BIRTH OF THE CAPE TOWN TREATY

In a nutshell, the desire for coordination and uniformity within the aviation industry was financially driven. Specific financial challenges accompany the sale or lease of expensive equipment (such as airplanes and airplane parts) that can easily move between countries. A key challenge "concerns the risk and uncertainty in the securing of loans for the purchase [sic] such equipment." Usually, potential creditors secure these loans by getting an interest in the equipment as collateral. However, because this aviation equipment is highly mobile by its very nature, often moving across national boundaries, the protection of that creditor's interest by a foreign jurisdiction is po-

12 Clark, supra note 7, at 4 n.8. The Aviation Working Group is a "not-for-profit trade association representing aerospace manufacturers, air transport leasing companies, and major financial institutions supporting the aviation industry." Id.
13 Id.
14 Clark, supra note 7, at 4.
15 Id. at 4, n.8.
16 Id. at 4, n.8.
17 Clark, supra note 7, at 4.
19 Id.
20 Id.
tentially limited.\textsuperscript{21} For example, the foreign jurisdiction may favor local interests over those of the creditor.\textsuperscript{22} This is because outside North America, many jurisdictions favor the law of \textit{lex situs}.\textsuperscript{23} So, when mobile equipment "acquire[s] a new situs, the question arises as to whether the security interest created in the first country has any effect in the second."\textsuperscript{24} Because of this uncertainty, the cost skyrockets for "aircraft financing in many countries, which is reflected in the interest rate the financier charges the debtor, or whether financing is available at all."\textsuperscript{25} According to one international law scholar, "the disparity of national laws is contrary to the requirements of modern economy and inimical to the development of international relations; a uniform law is superior to a system of conflicts of law."\textsuperscript{26} While this is an extreme view, there was a pervasive feeling at the conference, in an era of increasingly global aviation transactions, that standardization was more and more appealing.

These concerns highlighted the negotiations that took place between the parties leading up to the 2001 conference held in South Africa. The goal was to "establish an international legal regime for the creation, perfection, and priority of security, title-retention, and leasing interests in such equipment."\textsuperscript{27} At the end of the convention, twenty-two countries, including the United States, signed the Treaty.\textsuperscript{28} Since 2001, of the signatory

\textsuperscript{21} \textit{Id.}
\textsuperscript{22} \textit{Id.} Similar concerns surround the leasing of equipment.
\textsuperscript{23} Gopalan, \textit{supra} note 11, at 61.
\textsuperscript{24} \textit{Id.}
\textsuperscript{25} Karan Bhatia, Assistant Sec'y for Aviation and Int'l Affairs, Address before the Subcommittee on Aviation, Committee on Transportation and Infrastructure, U.S. House of Representatives (Apr. 29, 2004) \textit{available at} http://testimony.ost.dot.gov/test/pasttest/04test/Bhatia1.htm.
\textsuperscript{26} Gopalan, \textit{supra} note 11, at 80 (quoting Marc Ansel, \textit{From the Unification of Law to its Harmonization}, 51 Tul. L. Rev. 108 (1976)).
\textsuperscript{27} Murphy, \textit{supra} note 18, at 852. The convention officially concerns "three types of equipment: aircraft equipment, railway rolling stock, and outer space assets." \textit{Id.} at 852-53. The aircraft protocol (including airframes, aircraft engines, and helicopters above a certain size) went into effect at the same time as Cape Town. \textit{Id.} at 853. The other two protocols have yet to become active, while officials continue to negotiate their terms. \textit{Id.}
countries, fifteen (Angola, Afghanistan, Kenya, Mongolia, South Africa, Ethiopia, Ireland, Malaysia, Nigeria, Oman, Pakistan, Senegal, Columbia, Panama, and the United States) have ratified the Treaty. 29 Drafters anticipated that the Convention would have a positive impact on the global economy, benefiting both well-developed and under-developed economies. For example, supporters note that "countries with inadequate legal regimes struggle to raise capital from overseas lenders who may be anxious regarding protection of their security interests . . . Accordingly, an improvement in the legal system may increase lender activity." 30 But what has been the effect in the United States?

B. INCORPORATION INTO THE UNITED STATE'S EXISTING SYSTEM

Prior to ratification, the United States “amended many U.S. laws to comply with the Treaty (e.g., Federal Aviation Regulations, Title 49 of the United States Code, and the Uniform Commercial Code).” 31 The Cape Town Treaty Implementation Act was adopted by Congress in June of 2004, was signed into law in August 2004, 32 and finally entered into force in March 2006. The delay of full implementation can be explained, in part, because “technical amendments to legislation regulating the Federal Aviation Authority were necessary for that authority to implement its functions under the Convention and protocol.” 33 For example, the United States now allows the registration of “slightly less powerful engines with the FAA’s Civil Aircraft Registry (FAA Registry), as well as for notices of prospective interest in aircraft or aircraft engines, which are eligible for recording under the Cape Town Convention.” 34 The Federal Aviation Administration (FAA) authorization also changed to being optional for aircraft engines. 35

30 Gopalan, supra note 11, at 66.
32 Murphy, supra note 18, at 854.
33 Id.
35 Id. The rationale given was that “engines do not have any country’s nationality.” Id.
Significantly, one question remained as to how the Treaty would affect liens or interests that were perfected before March 2006. The United States deliberately chose not to affect these interests, but rather adopted the Treaty so that perfected interests would be grandfathered in under the Treaty, fully intact. However, one commentator notes that some lenders may prefer to register a lien under the Treaty. This means that parties who have interests perfected prior to March 2006, but who want to take advantage of the Treaty, now have to register as a new international interest, as opposed to registering under their original interest. To comply, parties should “enter into new documents . . . probably in the form of a second priority lien or an amended and restated agreement, and register that interest at the [International Registry].”

According to Unidroit's official “Overview of the Convention,” the Convention and supporting Protocols were created with five basic objectives in mind:

- To create an international interest, recognized by all Contracting States;
- To offer the creditor a “range of basic default remedies”; additionally, if evidence of default is found, to offer the creditor a process for fast “interim relief” while awaiting final resolution of the claim;
- To create an ‘electronic international register’ for international interests (the international registry should give notice to all parties and give the registrant first-in-time priority);
- To meet the specific needs of the particular industry segment contained in each of the Protocols; and
- To encourage creditors to extend credit, improve credit ratings and lower risk and costs for all parties of the transaction.

Professor Goode also points out that the Convention provides for protection of five different categories of interest: (1) interna-

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36 Polk, supra note 3, at 7.
37 Id.
38 Id.
39 Id.
41 Goode, supra note 28, at 4.
tional interests, (2) prospective international interests, (3) na-
tional interests, "(4) [n]on-consensual rights or interests arising
under national law and given priority without registration . . .
[and] (5) [r]egisterable non-consensual rights or interests aris-
ing under national law."  

Financially speaking, the Treaty "adopts the United States as-
set-based financing concepts reflected in the Uniform Commer-
cial Code (UCC) as the international standard in this area."  
The Treaty expands this system into countries of the world
whose existing systems of commercial law have historically been
problematic in aircraft transactions due to their inherent credit
challenges.  

More specifically, the Treaty "establishes an 'inter-
national interest' which is a secured credit or leasing interest
with defined rights in a piece of equipment. . . . consist[ing]
primarily of 1) the ability to repossess or sell or lease the equip-
ment in case of default; and 2) the holding of a transparent fi-
nance priority in the equipment."  

C. THE INTERNATIONAL REGISTRY

The establishment of the International Registry (Registry) is
at the heart of the Treaty and its goals. For the United States,
the Registry means that since the March 2006 activation, an ex-
tra step has been added in the searching and filing require-
ments that attend perfecting ownership and lien interests.  
The FAA operates a Civil Aviation Registry (the FAA Mike
Monroney Aeronautical Center) in Oklahoma City. It is a well-
established system that is responsible "for developing, maintain-
ing, and operating national programs for the registration of
United States civil aircraft and certification of airmen."  
The Civil Aviation Registry is "a comprehensive registry that func-
tions not only as the entity that establishes the nationality of a
U.S. aircraft. . .[but] it also operates a system for the recording
and full documentation of certain security interests in U.S. civil
aircraft, engines and spare parts."  

42 Id. at 6.  
43 Halloway, supra note 34, at 421.  
44 Id.  
45 Murphy, supra note 18, at 853.  
46 Polk, supra note 3, at 4.  
47 Fed. Aviation Admin., Flight Standards Service–Civil Aviation Registry,
http://www.faa.gov/about/office_org/headquarters_offices/avs/offices/afs/afs
700/ (last visited Sept. 28, 2007).  
48 Bhatia, supra note 25.
FAA is the official “entry point” into the International Registry. In other words, once an owner registers through the usual FAA registry, the FAA provides an International Registry code so the new owner can then file his interest with the Cape Town International Registry. As part of the ratification, the United States mandated that the “FAA Registry must authorize filings with the International Registry [for] U.S. registered aircraft, aircraft engines, and notices of prospective interest in aircraft that have received a U.S. identification number.” The International Registry is “a 24-hour a day, 7 days a week, 365 days a year, first-to-file electronic registry established to implement the Convention regime... For the purposes of this provision (and certain other provisions) of the Convention, the term ‘registration’ includes ‘an amendment, extension or discharge of a registration.’”

The “first-to-file” aspect is a significant differentiating factor of the Treaty. Essentially, once a creditor files an international interest with the Registry so that it becomes searchable, his interest has priority over all other interests, superseding both subsequent registries and all interests that remain unregistered. This changes the historical United States priority rule that states “the first to file a security interest at the FAA Registry has priority over all other liens against the aircraft or engine unless the filing party has ‘actual notice’ of another claim or right in the aircraft or engine.” This change puts the onus directly on the purchaser/owner/lessor to register or risk losing its interest, regardless of actual notice. The creation of the International Registry involved lengthy negotiations, largely because the airlines, heavily supported by the Aviation Working Group, lobbied for a system that would be “simple, efficient and inexpensive.” However, the extent to which the Registry is proving to fulfill these goals for United States interests (especially fractional interests) remains to be seen.

49 Murphy, supra note 18, at 853.
50 Polk, supra note 3, at 6.
51 Halloway, supra note 34, at 422.
52 Clark, supra note 7, at 9 (quoting Cape Town Convention, supra note 2, art. 16, para. 3).
53 Murphy, supra note 18, at 853.
54 Polk, supra note 3, at 6.
55 Id.
56 Clark, supra note 7, at 9.
The scope of the Treaty is also key to understanding the magnitude of its impact on American aviation. The Treaty restricted itself to equipment that had high value and consisted of an international interest, complete with the formalities that accompany such an interest.\(^{57}\) Additionally, while the debtor must be in a contracting country when the agreement is final, the creditor's location is irrelevant.\(^{58}\) The Cape Town Treaty applies to "aircraft objects" which cover the following items: (1) airplanes that are "type-certified to transport at least eight persons (including crew)" or goods of more than 2,750 kilograms, (2) helicopters type certified to "transport at least five persons (including crew)" or goods of more than 450 kilograms, (3) or aircraft engines of at least 550 horsepower or the equivalent of 1,750 pounds of thrust, "if at the time of the underlying transaction the aircraft is registered in a Contracting State or if the debtor is situated in a Contracting State."\(^{59}\) Under these rules, aircraft and engines require separate filings. A twin-engine aircraft, therefore, requires three separate registrations. While much of the Treaty is aimed at large single-craft transactions, the scope, regulations and requirements of the Treaty are less than ideal for smaller craft, especially fractional ownership transactions.

II. UNDERSTANDING FRACTIONAL OWNERSHIP PROGRAMS

Fractional ownership programs, which began in the late 1980s (ironically around the same time that talks leading to the Treaty began), have grown significantly since Executive Jet Aviation launched its NetJets initiative as the first fractional ownership program.\(^{60}\) As a fractional owner, an individual or company buys an interest (generally one-eighth or more) and co-owns the aircraft with other fractional owners.\(^{61}\) Because scheduling conflicts are sure to arise between multiple owners of one craft, the

\(^{57}\) Gopalan, *supra* note 11, at 70. Gopalan argues that an international interest could mean either "(1) an interest granted under a security agreement; (2) an interest vested in a conditional seller under a title reservation agreement; or (3) an interest vested in a lessor under a leasing agreement." *Id.*

\(^{58}\) *Id.*

\(^{59}\) Reigel, *supra* note 31.


\(^{61}\) *Id.*
fractional owners "enter into a type of interchange agreement pursuant to which the owners agree to make their aircraft available to the other participants in the program."62 The end result is comparable to timeshare programs used by resorts.63

A. HISTORY AND STRUCTURE OF FRACTIONAL OWNERSHIP PROGRAMS

Historically, corporate aviation branched out of commercial aviation and quickly increased in popularity. The FAA recognized this rapidly growing field and adopted a new subpart in Part 9164 of their regulations in 1972 that "afforded aircraft owners the potential to recoup a portion of their investment by spreading the cost of the aircraft, [thus] business aircraft became available to entities that did not need full time use of aircraft."65 As far as the FAA was concerned, cost sharing was allowed as long as the aircraft did not engage in common carriage.66 As corporate aviation continued to expand, more growing pains began to show. Sharing a plane or chartering a jet did not always provide the ready access that companies desired.67 Many wanted the immediate accessibility of wholly owning their own aircraft, but they did not use the plane enough to justify the

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62 Id. See also Crowther, supra note 6, at 251 (noting that economically, "the primary advantage of a fractional program is that aircraft utilization can be increased significantly. Once a flight is completed, the aircraft does not have to be flown deadhead back to the home base. Instead, the aircraft is simply flown to where the next customer is located").


64 Kristen A. Bell, Comment, Where Do They Fit? Fractional Ownership Programs Wedged into Current Air Law Decisions and Guidelines, 69 J. AIR L. & COM. 427, 431 (2004) (discussing recent cases and their effect on developing law relating to fractional ownership programs). Bell notes that Part 91 provisions relate to private owners while Part 135 provisions cover "common carriers." Id. Part 135 contains additional restrictions regulating airport use, flight crews and the aircraft itself. Id.

65 Eileen M. Gleimer, When Less Can Be More: Fractional Ownership of Aircraft – The Wings of the Future, 64 J. AIR L. & COM. 979, 982–83 (1999) (discussing the expanding industry of fractional ownership programs). The new Part 91 subpart rules imposed additional requirements for large and multi-engine turbine-powered aircraft "to ensure a higher level of safety, and at the same time, eliminated many of the administrative, financial and organizational requirements imposed on commercial operators that were purely economic in nature." Id. at 983.

66 Id.

67 Id. at 984.
expense of buying an entire plane. Executive Jet Aviation addressed the needs of these parties in 1986 with the debut of NetJets and offered fractional "interests in a fleet of eight Cessna Citation II aircraft." Within ten years, NetJets had grown to a fleet of almost 100 aircraft and 700 owners, and other players were entering the lucrative fractional ownership industry.

Fractional programs involve responsibilities for both the fractional owner and the managing company. The following describes a typical NetJets transaction, although this interaction is typical of most fractional programs. A fractional owner generally must sign multiple contracts to finalize his interest, as well as to fully understand and agree to the responsibilities that accompany participation in the program. For example, in order to join the program, the owner obviously must agree to share his fraction of available flight times with other fractional owners so that each owner can fly when he or she chooses. Additionally, fractional owners enter into a number of agreements including a Purchasing Agreement, an Owners Agreement, a Master Interchange Agreement, and a Management Agreement.

Each of these agreements plays an important role in the fractional ownership program. The Purchase Agreement provides

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68 Id.

69 Id. See also Anthony Bianco, What's Better Than a Private Plane? A Semiprivate Plane, Bus. Wk., July 21, 1997, at 57 (highlighting the successful NetJets enterprise, the reporter notes that it "is broadening the market for private jets by selling them at a fraction of the prices offered by manufacturers . . . . But the real beauty of NetJets is that fractional owners don't have to wait their turn or put up with group travel.").

70 Gleimer, supra note 65, at 985. Early competitors included FlexJets (launched by Business JetSolutions, a company jointly owned by Bombardier, Inc. and AMR Combs Inc., American Airlines' charter affiliate) and a fractional program offered through Travel Air, a subsidiary of Raytheon Aircraft Company. Id.

71 Bell, supra note 64, at 429.

72 Id.

73 Id. See also Executive Jet Aviation, Inc. v. United States, 125 F.3d 1463, 1465–66 (Fed. Cir. 1997) (describing the contractual process accompanying NetJet's fractional ownership program as part of its decision regarding the application of tax laws to the program).

74 Bell, supra note 64, at 429. Owners also must agree "to be severally liable for the costs of operating the aircraft and the owners sign a 'lease' that allows each owner to use another's aircraft on an as-needed basis." Id.
the sale's terms and conditions.\textsuperscript{75} This includes the "purchase price, closing date, delivery conditions, and representations and warranties."\textsuperscript{76} The Purchase Agreement should "specify that the customer is acquiring a specific percentage or fraction of the ownership interests in the aircraft, and that the customer will hold its interest as a tenant-in-common with all other persons possessing ownership interests in the aircraft."\textsuperscript{77} The Agreement differs from most other aircraft purchase contracts in that it "will likely include provisions to require and facilitate the repurchase of the aircraft ownership interest by the fractional program at some later date, as well as substantial restrictions on the customer's right to sell or otherwise transfer the ownership interest to any party other than the fractional program."\textsuperscript{78} Fractional owners should carefully review the Purchase Agreement because provisions can include "caps on the repurchase price, 'remarketing' fees, and the methods and assumptions used to determine the fair market values of program aircraft."\textsuperscript{79} However some fractional ownership programs offer customer protections against excessive risk by outlining a minimum price the program will pay for a repurchased interest.\textsuperscript{80}

The Management Agreement is arguably the most comprehensive of the agreements.\textsuperscript{81} As opposed to the Purchase Agreement, the Management Agreement details the party's ownership interest, the usage rights of the aircraft, and all flight services charges.\textsuperscript{82} In addition, it covers issues ranging from monthly fees charged, to geographical coverage permitted, to catering services provided.\textsuperscript{83} The Ownership Agreement is an agreement

\textsuperscript{75} Troy A. Rolf, \textit{The Coming of Age of Fractional Aircraft Ownership Programs}, 15 \textit{Air \& Space Law} 11, 11 (2001) (examining the "traditional" model for fractional ownership programs).

\textsuperscript{76} Id.

\textsuperscript{77} Id.

\textsuperscript{78} Id.

\textsuperscript{79} Id. at 12.

\textsuperscript{80} Id. In most instances under this protection, the "customer will qualify for the protection only when trading in its ownership interest for an equal or greater percentage interest in a newer aircraft of equal or greater value." Id.

\textsuperscript{81} Id.

\textsuperscript{82} Id.

\textsuperscript{83} Id. Other issues included in the agreement may include: general management and administration of the aircraft and aircraft records; the fractional program's obligations to inspect and maintain the aircraft and to furnish trained and qualified pilots for all flights; ... ferrying and miscellaneous charges; minimum charges for use of program aircraft; upgrade-downgrade rights; ... excise
among the various fractional owners of the aircraft themselves and outlines the costs and responsibilities shared among the parties. Finally, the Interchange Agreement between all of the fractional program’s customers “serves as a lease, pursuant to which each owner of a fractional interest in an aircraft agrees to lease its interest in the aircraft, from time to time and on an as needed basis, to each other owner of a fractional interest in an aircraft managed by the fractional program.”

As part of a fractional program such as NetJets, fractional owners also “contract for the services of a common management company that administers the interchange and provides the support necessary to facilitate the operation of the aircraft by an owner.” Under the Management Agreement, the management company agrees to certain responsibilities for a monthly program manager fee. These include exterior and interior maintenance, payment of fuel and flight crews, storage, provision of liability insurance, and compliance with FAA record and flight log requirements.

B. FAA’s Classification of Fractional Ownership Programs

Because fractional ownership programs inhabit the gray area between private owners of whole aircraft and commercial carriers, these programs have presented a challenge as to where they fit in the corpus of aviation law since their inception. As mentioned above, fractional ownership programs have historically been categorized under Part 91 of the FAA’s Federal Aviation Regulations (FAR). Under the FAR, aircraft are generally classified as either: (1) private aircraft, (2) charter aircraft or (3) Federal Aviation Regulations (FAR). Under the FAR, aircraft are generally classified as either: (1) private aircraft, (2) charter aircraft or (3)

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84 Id. at 14. The fractional ownership program itself is generally not a party to the Agreement, although they usually provide the form of the Agreement. Id.
85 Id.
86 Gleimer, supra note 65, at 984.
87 Bell, supra note 64, at 430.
88 Id. The management company also synchronizes flight schedules per the Interchange Agreement and may be responsible for federal taxes. Id.
89 Id.
90 Gleimer, supra note 65, at 984.
airline aircraft. As a general matter, "[p]rivate aircraft are typically operated under Part 91 of the [FARs], charter aircraft are typically operated under Part 135, and airline aircraft are typically operated under Part 121." This caused some controversy for the air taxi operators operating under Part 135 who believed that "fractional ownership programs have an unfair economic advantage due to their ability to operate under Part 91."

Due to such arguments and following the growth and expansion of the industry, the FAA reexamined that classification in 1996. They focused primarily on the question of "operational control" and whether that control lay with the fractional owner or with the management company. The FAA's Fractional Ownership Aviation Rulemaking Committee (The Committee) determined that fractional owners "share more of their regulatory characteristics with the owners of non-commercially operated aircraft than with passengers using on-demand operators."

Following that review, the Committee determined that a new Subpart (k) should be added under Part 91 to "define and govern fractional ownership operations." By locating the program under Part 91, the FAA made "commercial purpose" of the aircraft the distinguishing factor between Part 91 and Part 135, while still recognizing the differences between whole and fractional owners by locating it under Subpart (k). Under Subpart (k), clearly articulated roles are laid out for the fractional owner and the program manager. Additionally, it provides "for the joint and several responsibility of the owner and program man-

91 Crowther, supra note 6, at 244.
92 Id. Crowther notes that an aircraft owner would "generally prefer to operate under Part 91, since there are fewer requirements and limitations regarding the operation of the aircraft. However, a Part 91 operator also cannot transport others for compensation or hire." Id.
93 Gleimer, supra note 5, at 329.
94 Id.
95 Id. at 330. If the operational control had been found to fall to the program manager, the fractional ownership programs would have been governed under Part 135 (the same part regulating air taxi operators). Id.
96 Bell, supra note 64, at 433 (quoting Regulation of Fractional Aircraft Ownership Programs and On-Demand Operations, 66 Fed. Reg. 37,520, 37,522 (Jul. 19, 2001)).
97 Rolf, supra note 75, at 15.
98 Bell, supra note 64, at 433. As a result of Subpart (k), fractional ownership "arrangements such as time-sharing, interchange, and joint ownership arrangements" are allowed to stay "under the less stringent guidelines of Part 91." Id.
99 Id. at 434.
ager for the safe operation of the flight and for compliance with the FARs." 100

C. APPLICATION OF GENERAL AVIATION LAWS TO FRACTIONAL
OWNERSHIP PROGRAMS

The Cape Town Treaty is not the first time that the law and fractional ownership programs had to find a way to coexist despite incompatible traits. Because fractional ownership programs are relatively new and relatively distinctive (as compared to more conventional aviation systems), other bodies of law have had to adapt to the fractionals’ singular needs. Reviewing how other laws have adapted gives some insight into ways that Cape Town can adapt to the needs of fractional ownership programs.

1. Tax Law Adaptations

While the Subpart (k) classification helped define fractional ownership programs, other areas of law continued to have challenging relationships with such programs. 101 One such area concerned the tax laws. 102 Payment of taxes turned on a distinction between commercial and non-commercial flights after the 1970 enactment of the Airport and Airway Revenue Act. 103 While commercial flights had to pay an air transportation tax, non-commercial flights were only subjected to fuel taxes. 104 The Internal Revenue Code “defines ‘noncommercial aviation’ as ‘any use of an aircraft, other than the use in a business of transporting persons or property for compensation or hire by air.’” 105

When determining whether “the use of an aircraft should be considered a taxable transportation service, the IRS relies on the

100 Id. at 434–35.
101 Id. at 430. See also Krohn, supra note 63, at 1182–1224 (evaluating the impact of securities laws on fractional aircraft ownership).
102 Crowther, supra note 6, at 243. The federal transportation tax is part of the Internal Revenue Code of 1986, and is codified in I.R.C. §§ 4261 et seq. (West 2002 & Supp. 2007). For a complete discussion of the full tax implications, see generally Crowther, supra note 6 (discussing the complications that fractional ownership programs cause in tax law classification and application).
104 Bell, supra note 64, at 435. See also Executive Jet Aviation, Inc. v. United States, 125 F.3d 1463, 1464–65 (Fed. Cir. 1997).
105 Bell, supra note 64, at 435. See also Executive Jet Aviation, 125 F.3d at 1465.
‘possession, command and control’ test.” However, commentators note that in recent rulings, the IRS has adopted the FAA “concept of ‘operational control’ for determining who has ‘possession, command and control’ of the aircraft.” In 1992, the IRS issued a Technical Advice Memoranda regarding a fractional ownership program and “concluded that the fractional owners had relinquished ‘possession, command and control’ of the program aircraft to the management company (‘the taxpayer’).” However, in that determination, the IRS admitted that the owners were the title owners to the aircraft. The IRS holding of relinquishment was “clearly in conflict with the FAA’s latest decision to assume operational control of the aircraft in the fractional owner.”

Following the IRS ruling, Executive Jet Aviation wanted the courts to decide the matter. Unfortunately for Executive Jet Aviation however, the courts agreed with the IRS “determination that the private owners have relinquished ‘possession, control and command’ and therefore held that the management company is subject to the federal [Airport and Airway Revenue Act] tax for commercial flights.” As part of an excise tax claim for a refund, Executive Jet Aviation filed a claim on behalf of one of their fractional owners, Texaco Air Services, Inc. (Texaco Air). Executive Jet Aviation and the IRS differed as to whether Executive Jet should pay only IRS fuel taxes as a non-commercial carrier, or should pay the air transportation tax as a commercial carrier. The Court of Appeals considered

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106 Crowther, supra note 6, at 253. See also Leary v. United States, 81 U. S. 607, 610 (1871) (first referring to the “command, possession, and control” test).

107 Crowther, supra note 6, at 254. Crowther also noted the IRS recently adopted the FAA terminology and held that a “‘wet lease’ (aircraft and flight crew) is taxable transportation, while [holding] a ‘dry lease’ (aircraft only) [to be] a nontaxable rental.” Id.


109 Crowther, supra note 6, at 264. See also Bell, supra note 64, at 436.

110 Crowther, supra note 6, at 264.

111 Bell, supra note 64, at 436.

112 Executive Jet Aviation is the sister company of Executive Aviation International, infra note 172.

113 Bell, supra note 64, at 436.

114 Executive Jet Aviation, Inc. v. United States, 125 F.3d 1463, 1466–67 (Fed. Cir. 1997). Texaco Air owned an undivided one-half interest in a Cessna aircraft. See also Crowther, supra note 6, at 267; Bell, supra note 64, at 436.


117 Bell, supra note 64, at 436. See also Executive Jet Aviation, 125 F.3d at 1467.
and rejected Executive Jet Aviation’s argument that it was only an aircraft manager, instead ruling in favor of the IRS, and held that “as far as the NetJets program was concerned, Executive Jet Aviation was in the ‘business of transporting persons or property for hire by air.’” 118 Consequently, the transportation tax was properly imposed.” Relying on the “substance over form” doctrine, the court found “negligible differences between the NetJets aircraft interchange program and the operation of a commercial air charter business.” 119 Consequently, the “net effect [of the case is] that interest owners are required to pay more tax than other Part 91 operators, but less tax than charter customers.” 120

Although the IRS is not compelled to follow FAA principles, Executive Jet Aviation appears to be the first case where both the IRS and the courts could have provided a clear test around the term “operational control” but, unfortunately, the decision provided only a vague standard. 121 Aviation and tax law scholar, Philip Crowther, points out a significant difference in the tests used by the IRS and the Federal Circuit. 122 He notes that, although they came to the same conclusion, the IRS test examined whether the “person providing the pilots has ‘possession, command and control of the aircraft’” while the court’s test looked at whether that person “is using the aircraft ‘in a business of transporting persons or property for compensation or hire by air.’” 123 Such a discrepancy only causes further confusion in the body of law around fractional ownership programs. This confusion is also seen in both income and state tax laws.

When a business involves the use of an aircraft, the IRS generally allows a deduction for the ownership and aircraft usage costs “associated with the ownership and use of the aircraft.” 124 Generally, the “person entitled to tax depreciation is referred to

118 Executive Jet Aviation, 125 F.3d at 1468–69. See also Crowther, supra note 6, at 268.
119 Executive Jet Aviation, 125 F.3d at 1469. See also Crowther, supra note 6, at 269; Bell, supra note 64, at 437.
120 Crowther, supra note 6, at 278.
121 Id. at 277–78.
122 Id. at 278.
123 Id. (quoting Executive Jet Aviation, 125 F.3d at 1465). See also Bell, supra note 64, at 437.
124 Crowther, supra note 6, at 279. Crowther also notes the tax laws “allow deduction of depreciation and other expenses related to the production of income.” Id. at 279 n.143. See also I.R.C. § 162 (West 2002 & Supp. 2007).
as the ‘tax owner’ of the property” because this person is usually the one “who suffers an economic loss by reason of the depreciation and erosion in the value of the property.”

In the *Executive Jet Aviation* decision, while the court held the program manager must pay federal excise taxes, the court “said nothing which would indicate that the interest owner should not be considered the tax owner.” Instead, income tax laws “have treated ‘joint owner[s] of property as the tax owner of their share of the property,’ and there is no indication in case law or administrative discussion that this practice will, or should, change.”

Crowther believes that “as long as the interest owner has the risk of loss of value on the resale of the aircraft, the tax owner should be considered the tax owner of the aircraft and should be entitled to claim the depreciation deduction on the aircraft.” However, because of the differences between excise and income taxes, fractional owners have to navigate a system of inconsistency. For example, on one hand, “the IRS and courts have held that, although the owners technically own the aircraft, the program manager is in control of the aircraft’s use, and thus subject to federal excise taxes.” At the same time, current income tax laws allow “fractional owners to deduct depreciation of the aircraft from their income tax filings.”

One commentator notes that if program managers are “unable to elicit funds paid for the excise tax from the fractional owners, an unfair result may occur as the program manager pays taxes for the aircraft’s use but is unable to deduct any depreciation resulting from that use on its annual payment of federal income tax.”

State tax is a final area of the application of tax laws to fractional ownership programs that has received some attention. Aircraft transactions involve several state taxes including state income tax, sales and use tax, as well as property and registration tax. For example, in 2003, the Missouri Supreme Court

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125 Crowther, *supra* note 6, at 280.
126 Id. at 284.
127 Bell, *supra* note 64, at 437. See also Crowther, *supra* note 6, at 282–83.
128 Crowther, *supra* note 6, at 285.
129 Bell, *supra* note 64, at 437–38.
130 Id. at 438.
131 Id.
132 Id.
133 Crowther, *supra* note 6, at 287. The sales and use taxes are both one-time taxes, with both generally percentages of the purchase price. *Id.* The property tax is “an annual tax on property located in the State” and the registration tax is
answered the question of whether state use taxes were expected from fractional owners on their fractional interests in an aircraft. The court ultimately held that “the fractional interest in the aircraft was tangible personal property, and therefore, the fractional owner was subject to the use tax under Missouri law.” In making its determination, the court looked at the “sale of property” defined in the purchase agreement, the FAA’s decision that the owner (not the management company) was in “operational control,” and that a “reasonable nexus” existed between Missouri and the property. But again, the law is unsettled because other states have reached opposite conclusions. For example, “in Texas, the Office of the Comptroller sent out a declaration that the program manager is ‘responsible for any tax on the purchase of the airplane.’” In a similar ruling, the New York Commissioner of Taxation and Finance ruled that “a fractional program is a non-taxable transportation service” because the aircraft was not “really sold” to a fractional owner in a fractional program. Unfortunately, different decisions revolving around the same issue of “operational control” have resulted only in complicating precedent even further for fractional ownership programs. Further, only some states have reached the issue of state taxes for fractional ownership programs. Due to unsettled questions, one commentator notes the danger that “a lack of uniformity on this issue may lead to forum-shopping by fractional ownership programs looking for a state tax that is economically beneficial to their operational goals.”

an “annual tax on the use of an aircraft in the State” which is “generally imposed ‘in lieu of’ the property tax.” Id.

134 Bell, supra note 64, at 438. See also Fall Creek Const. Co. v. Dir. of Revenue, 109 S.W.3d 165, 167 (Mo. 2003).

135 Bell, supra note 64, at 438; see also Fall Creek, 109 S.W.3d at 167.

136 Bell, supra note 64, at 438.

137 Id. at 439. Bell also notes that the Comptroller’s office determined “although the participant provides some direction to the pilots, possession of the aircraft remains with the seller.” Id. at 439 n.64. In other words, “the participant is contracting for a nontaxable air charter service, and a taxable sale or rental of an aircraft to a participant does not occur.” Id.

138 Bell, supra note 64, at 439. See also Crowther, supra note 6, at 308–09. However, Bell points out that the New York situation differed slightly from the NetJets program in that while the Gap program manager performed the same duties, he was not the initial seller of the aircraft. Bell, supra note 64, at 439 n.65.

139 Id.

140 Id.

141 Id. at 439–40.
2. Securities Law Adaptations

Beyond tax laws, other areas of law have struggled to accommodate fractional ownership programs. For example, questions have been raised as to the correct application of United States securities laws to fractional ownership programs, specifically the Securities Act of 1933 (1933 Act) and the Securities Exchange Act of 1934 (1934 Act). While securities laws are intended to provide protection for people's investments in certain enterprises, violations of the securities laws can result in civil and criminal liability, as well as personal liability. Liability under the securities laws will only apply to an interest in a fractional ownership if the interest comprises a security. The answer to that issue "lies in whether fractional ownership programs are considered security investments under the Howey test created for implementation" of the 1933 Act and the 1934 Act. The Howey Test requires the fulfillment of three elements to subject a company to securities regulation: (1) a monetary investment; (2) a common enterprise; and (3) an "expectation of profits derived solely from the effort of others." All of the elements of the Howey test are "met through the practice of fractional ownership programs except the requirement that there be an expectation of profits." This third prong is "generally not met when an investor's sole expectation is to receive the output or use of the asset that is the subject of the investment." Using this approach when faced with fractional own-

142 Krohn, supra note 63, at 1181.
144 Krohn, supra note 63, at 1182-83.
145 Id. at 1192; see also Koch v. Hankins, 928 F.2d 1471, 1475 (9th Cir. 1991).
146 Bell, supra note 64, at 447. See also Krohn, supra note 63, at 1192-93. Krohn notes that the U.S. Supreme Court articulated the Howey test as "[A]n investment contract for purposes of the [1933 Act] means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise." Id. (quoting SEC v. W.J. Howey Co., 328 U.S. 293, 298 (1946)).
147 Bell, supra note 64, at 447. See also Howey, 328 U.S. at 298; Krohn, supra note 63, at 1192-93.
148 Bell, supra note 64, at 447. See also Krohn, supra note 63, at 1199-1203.
149 Krohn, supra note 63, at 1201. Krohn distinguishes the third prong of the Howey test by noting that "when a purchaser is motivated by a desire to use or
ership programs, courts must decide "who is in control of the aircraft and whether this entity is in the ‘business’ of providing transportation."\textsuperscript{150} The program will likely not be classified as an investment under the securities laws if individual owners use their fractional interest in the aircraft for personal travel.\textsuperscript{151} However, if (similar to the Executive Jet Aviation decision)\textsuperscript{152} courts find that the program is "in the business of transporting individuals for hire," then such programs may qualify under the securities laws.\textsuperscript{153} Because the law is so unsettled, programs need to be carefully structured and promoted.\textsuperscript{154} In the meantime, one commentator recommends: (1) agreements should ban interest transfers;\textsuperscript{155} (2) individuals owners should not sell or transfer “for compensation or hire their right to use program aircraft;”\textsuperscript{156} (3) every effort should be made to avoid being perceived as a "commercial enterprise;”\textsuperscript{157} and (4) marketing materials should stress “‘use’ aspects rather than any ‘profit’ aspects”\textsuperscript{158} of the fractional ownership program.

3. Employment Law Adaptations

Other areas of law that have struggled to incorporate fractional ownership programs include employment and tort law.

consume the item purchased . . . the securities laws do not apply.” Id. at 1200. (citing United Housing Found., Inc. v. Forman, 421 U.S. 837, 852 (1975)).

\textsuperscript{150} Bell, supra note 64, at 447.
\textsuperscript{151} Id. See also Krohn, supra note 63, at 1210.
\textsuperscript{152} Executive Jet Aviation, Inc. v. United States, 125 F.3d 1463, 1465 (Fed. Cir. 1997).
\textsuperscript{153} Bell, supra note 64, at 447. See also Krohn, supra note 63, at 1210–12. Krohn argues that:

certain program structural and promotional characteristics, when considered in the aggregate, could rise to a level that causes the predominate attraction of the program to be financial returns, rather than the use of the aircraft . . . [T]he program interests could be deemed to be securities . . . because the interest in the aircraft is subject to an agreement under which the manager is to provide services to the participant related to the aircraft . . . [and because] the participants must hold the aircraft available for use by others, must use an exclusive management agreement agent, and are materially restricted in their occupancy of the aircraft. In addition, there are a number of promotional characteristics that contribute to an expectation of profits.

\textsuperscript{154} Bell, supra note 64, at 447–48.
\textsuperscript{155} Krohn, supra note 63, at 1225.
\textsuperscript{156} Id. at 1225–26.
\textsuperscript{157} Id. at 1226.
\textsuperscript{158} Id. at 1227.
Difficulties and confusion often arise because of the "common carrier" classification. For example, under employment law, issues such as "union membership, overtime pay, and flight crew work regulations are all affected" by the unsettled nature of the laws surrounding fractional ownership programs. For instance, the National Mediation Board (the Board) approved union representation for Executive Jet Aviation employees in 1971. However, this approval meant that the Board found Executive Jet Aviation to have "common carrier" status. Again, differing approaches by various agencies clouds the waters of classification of fractional ownership programs.

Another area of employment law affected is the application of the overtime provisions of the Fair Labor Standards Act (FLSA). Because they are classified as "common carriers," most commercial air carriers are exempt from these overtime provisions under the Railway Labor Act (RLA). The FLSA exemption was granted to help "keep transportation moving" and lessen the likelihood of strikes. Because of this exemption, employees of commercial air carriers often belong to unions to guard against unfair labor practices. However, if employees do not have notice of such an exemption, they cannot make an informed decision of whether or not to unionize and may unwittingly leave themselves exposed. In other words, until the "common carrier" status of a fractional ownership program is settled, thus establishing its place within the FLSA provisions, fractional program employees may not know how to proceed.

159 Bell, supra note 64, at 440.
160 Id. The National Mediation Board is the federal agency "responsible for administering the Railway Labor Act ['RLA']". Through its certification process, common carriers can apply for union representation through the Board. If approved, the Board then oversees collective bargaining agreements among common carriers to verify compliance with the RLA." Id.
161 Id.
164 45 U.S.C.A. § 181; Bell, supra note 64, at 444 (citing Verrett v. The Sabre Group, 70 F. Supp. 1277, 1281 (N.D. Okla. 1999)). In 1934, Congress expanded the Railway Act to include companies that perform "transportation-related services." Bell, supra note 64, at 444.
165 Id. at 441.
166 Id.
167 Id.
The Fifth Circuit answered whether or not Executive Jet International, creator of NetJets, was a “common carrier” under the FLSA in Thibodeaux v. Executive Jet International.168 Because Executive Jet International was a non-union fractional ownership management company, when flight-attendants wanted compensation for overtime worked on NetJets, they filed suit under a FLSA claim.169 The Fifth Circuit reversed the lower court “analysis, which focused on the FAA regulations and recent proposal to keep fractional ownership programs under Part 91 of the regulations.”170 Instead, the Fifth Circuit used a test which assessed “whether the carrier has held itself out to the public or to a definable segment of the public as being willing to transport for hire, indiscriminately.”171 When applied to the NetJets program, the Fifth Circuit held that Executive Jet International was a “common carrier” as a matter of law because the court found that Executive Jet International “defined itself through its own marketing efforts as being willing to carry any member of that segment of the public which it serves.”172 The Thibodeaux holding left the flight attendants without recourse for their overtime worked.173 When considering other employment law implications, it is also important to note that crew work schedules are further restricted under Subpart (k) of the FAA’s Part 91 regula-

168 Id. See also Thibodeaux v. Executive Jet Int’l, 328 F.3d 742, 746 (5th Cir. 2003). For a complete discussion of the Thibodeaux decision and its impact on fractional jet ownership, see Kristen Bell, Note, Thibodeaux v. Executive Jet International: Determining Whether Fair Labor Standards Exemptions for Overtime Compensation Apply to Fractional Ownership Programs, 69 J. Air L. & COM. 605, 605 (2004) (discussing the court’s use of an “ill-suited standard” for “common carrier” classifications and the impact on the fractional ownership program industry).

169 Bell, supra note 64, at 441. See also Thibodeaux, 328 F.3d at 744–45. Although Executive Jet International handled Part 91 and Part 135 flights, the flight attendants that brought suit in this case spent 100 percent of their time on Part 91 flights. Id.

170 Bell, supra note 64, at 441.

171 Id. at 442. See also Woolsey v. Nat’l Transp. Safety Bd., 993 F.2d 516, 518 (5th Cir. 1993). Bell notes that when asked to determine if a pilot was subject to Part 135 regulations in Woolsey, the Fifth Circuit “looked to the nature of his business, Premier Touring, Inc., which contracted with musicians to provide flight transportation.” Bell, supra note 64, at 442. This approach created the test used again in Thibodeaux. Id. at 441.

172 Bell, supra note 64, at 442. Bell notes that the Thibodeaux court “also gave significant weight to the [Board’s] determination that [Executive Jet Aviation], [Executive Jet International’s] sister company, was a ‘common carrier’ under the Railway Act.” Id. at 442 n.83. See also Thibodeaux, 328 F.3d at 753.

173 Bell, supra note 64, at 442.
The flight crew of a fractional ownership aircraft must operate under stricter flight, duty, and rest requirements than those of other Part 91 aircraft.

The classification of fractional ownership programs continues to be vaguely defined. This lack of clarity only serves to further confuse an already gray area of business. Given this already hazy area of the law, it is still unclear how fractional ownership programs will interact with the requirements of the Cape Town Treaty.

III. CAPE TOWN’S EFFECTS SINCE IMPLEMENTATION

What has been the effect of the Cape Town Treaty in the United States since March 1, 2006? Although it is too early to tell in many respects, one way to see the effects is to consider what benefits were anticipated by the Treaty’s drafters and early supporters. In a speech delivered in June 2003, the United States Department of Transportation Under Secretary of Transportation Policy described the anticipated benefits as follows:

"[O]nce fully implemented, [it] will . . . facilitate the modernization of airline fleets around the world. The economic benefits will be truly global. Less-developed countries and their airlines will be able to modernize their fleets through easier access to aircraft at reduced financing costs. The world’s skies will be safer and cleaner as newer aircraft replace those currently in use. And for countries that manufacture aircraft there will be increased exports as the number of aircraft orders increases."

It is much too early to gauge the success of this list of advantages. Many are long-term in scope and much depends on the phrase “once fully implemented.” Unidroit’s website lists legal and economic advantages as the primary global benefits of Cape Town.

Of these, Unidroit claims that the “Convention and its
protocols will greatly improve predictability as to the enforceability of security, title reservation and leasing rights.”\textsuperscript{178} Unidroit also argues it “should reduce risks for creditors and consequently borrowing costs for debtors and facilitate the extension of credit for the acquisition of high-value mobile equipment, particularly in developing countries.”\textsuperscript{179}

While hopeful, these predicted benefits are long-term and global in effect. What about predicted effects for the United States’ domestic aviation market? One proponent of the Treaty predicted Cape Town would bring “significant economic benefits to a variety of U.S. constituencies,” in part because in “countries that manufacture aircraft there likely will be increased exports as the number of aircraft orders increases.”\textsuperscript{180} Increased exports also could mean more jobs for exporter countries such as the United States.”\textsuperscript{181} Along those lines, in a 2004 speech, the FAA administrator agreed that “reduced costs should encourage increased exports and export-related economic growth – not just by major manufacturers, but also by smaller companies that make the parts and provide related aviation services.”\textsuperscript{182} The administrator also noted anticipated benefits to domestic financial institutions which finance aircraft in other countries because of the Treaty’s creditor protections.\textsuperscript{183}

Along with the benefits come a few growing pains as the Treaty continues to affect systems already in place in the United States. Within a month of implementation, one Connecticut attorney noted that the International Registry was “far from trouble-free” and had “caused confusion, delay and consternation for buyers and sellers of aircraft.”\textsuperscript{184} He cited problems such as “delays of days and weeks in completing transactions, many caused by a misunderstanding of how the security features

\textsuperscript{178} Id.
\textsuperscript{179} Id.
\textsuperscript{180} Bhatia, supra note 25.
\textsuperscript{181} Id.
\textsuperscript{183} Id.
of the system work, and others caused by start-up woes in assigning user identities at the Registry itself."\(^{185}\) In other cases, e-mail providers with "strong Internet firewalls were unable to download the digital certificates needed to authenticate their transactions."\(^{186}\) Still others "tried to register only to find that their particular make and model of aircraft was not yet listed."\(^{187}\) However, once they were registered, "most users of the international registry report that subsequent transactions have gone smoothly."\(^{188}\)

The Registry did have some initial hiccups, due in large part because of the large volume of transactions that suddenly came from the United States. In fact, an "estimated 90% of the registry's transactions in the first three months [since March 1, 2006 have come] from the U.S."\(^{189}\) Niall Greene, managing director of Aviareto Ltd. of Dublin (operators of the Registry), acknowledged that some users were "annoyed by the registration process" when the electronic International Registry initially debuted on March 1, 2006.\(^{190}\) He also admitted the volume was "considerably in excess of what had been anticipated," but that process improvements have since sped up the process.\(^{191}\)

The Registry does involve the burden of additional fees and time. For example, as noted earlier, the registration process now involves two steps. A party must register with the FAA, which then provides an International Registry code which must be registered separately. In other words, now, in order to perfect the interest, that second code must be registered on the International Registry's site. This requires a consensual action in which all the parties, certainly both the grantor and grantee, must participate.\(^{192}\) As such, both must set up accounts with the Registry and, depending on the volume at the Registry, the en-

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185 Id.
187 Id.
188 Id.
189 Id.
190 Id.
191 Id.
192 Louis M. Meiners, Jr., *Cape Town Treaty Impacts Sales and Financing*, AvBuyer, http://www.avbuyer.com/Articles/Article.asp?Id=345 (last visited Sept. 28, 2007) (noting that each party must register as a "transacting user entity" and could include as many parties as the seller, buyer, new lender, old lender, lessee, sublessee, and guarantor).
tire process could take several days. As a result, parties must figure a delay into the process that did not exist before. As for the increased fees, while nominal compared to the cost of an aircraft, they also add costs that did not exist before. First, each party to an aircraft transaction must register with either a one-time $200 fee or $500 fee, good for five years. Additionally, the Registry “charges registration and search fees for a subject aircraft ranging from $35.00 to $100.00. This does not include the increased attorney and title fees a party will incur to comply with the Treaty’s requirements.”

Other questions remain unanswered regarding the Treaty’s impact on the United States’ aviation market. For example, the new priority system implemented by the Registry changes actual notice to first-in-time. With fifty different jurisdictions within the United States, a judge may or may not recognize the international interest in an actual notice situation. The varying decisions could become very complicated and lead to lack of certainty for aircraft purchasers. Also unknown is how global this Treaty will actually be. So far, the United States is the only major economic power that has fully implemented the Treaty. Proponents claim other signatories will be ratifying soon, but multiple layers of international politics are in the way. For example, if the European Union countries came in as block entity, they would first have to make each of their own systems compatible. Until additional countries with significant economic power join, it is impossible to know what impact they will have. But the more countries that join, the more effective the Treaty will be.

Finally, the Registry’s relationship with fractional ownership programs is in limbo. Currently, it offers no way to register so that a joint or fractional ownership interest can be accurately reflected. Yet, the officials who drafted the Treaty clearly had an interest in smaller corporate aircraft, given their inclusion of aircraft seating eight people. The United States corporate aircraft industry is especially attractive because it can provide such a large volume of transactions for the International Registry.

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193 Id.
194 Reigel, supra note 31.
195 Id.
196 Meiners, supra note 192.
197 Kent S. Jackson, Cape Town, Aviareto and You; A Word of Caution: If You Have an Aircraft Deal in the Works, Start Looking into the New Additional Requirements Sooner Rather Than Later Because Your Deal Will Be Affected, BUS. & COM. AVIATION, May 1, 2006, at 98; see also Searles, supra note 186, at 106.
For example, NetJets averages a volume of 115 transactions per month.\textsuperscript{198} However, while the Registry is likely to continue to include smaller aircraft in order to benefit from the volume it generates, it is currently not seeing much benefit from the fractional ownership programs because most are not even participating. For example, NetJets currently prohibits fractional owners from registering their interests until the Registry provides a way to accurately reflect partial interests.\textsuperscript{199} Under the Registry's existing system, each registered interest looks like a 100 percent ownership interest which certainly clouds the title for a fractional interest owner.\textsuperscript{200}

The lack of certainty, in turn, makes both subsequent purchasers and subsequent lenders uncomfortable. This makes it difficult, if not impossible, to sell other shares while banks balk at the title.\textsuperscript{201} In a few instances, NetJets has allowed international registration if extensive paperwork accompanies the transaction, clearly indicating a "subordination of the international interest." \textsuperscript{202} In reality, the paperwork does not so much reflect a true "subordination" as it orders the rights of the parties.\textsuperscript{203} For example, if a buyer owns a one-eighth interest and is allowed to register on the International Registry, all his paperwork must show that he gives the program manager a superior right to the remaining seven-eighths. NetJets notes that officials are claiming that the Registry will modify its electronic system to accommodate fractional interests by April of this year.\textsuperscript{204} If this happens, NetJets plans to offer Cape Town registration for every fractional owner.\textsuperscript{205} In the meantime, the current rule of thumb is that major fractional ownership programs do not participate in the Cape Town International Registry, and fractional ownership is only reflected in the FAA registry.

\section*{IV. RECOMMENDATIONS FOR MOVING FORWARD}

Every change comes with a period of adjustment. Following that trite, but true, statement is the truism that every system can

\textsuperscript{198} Telephone interview with Amanda Applegate, Vice President of Contract Administration, NetJets, Inc., in Columbus, Ohio (Jan. 29, 2007).
\textsuperscript{199} Id.
\textsuperscript{200} Id.
\textsuperscript{201} Id.
\textsuperscript{202} Id.
\textsuperscript{203} Id.
\textsuperscript{204} Id.
\textsuperscript{205} Id.
be improved upon. The Cape Town Treaty is no exception. One of the most repeated complaints concerning the Treaty has been the delays it has caused, especially with aircraft bought and sold with the intention of domestic use only. Since the Treaty was aimed primarily at large international aircraft transactions, it is significant that smaller domestic transactions have been adversely affected.

One commentator notes that the Treaty “contained an election for each adopting country to exempt internal transactions” but that the United States chose not to do so.\textsuperscript{206} Possibly, Congress might choose to make such an exemption in the future. In fact, a 2006 article quoted Oklahoma Senator James Inhofe, as saying he is considering introducing legislation to “exempt aircraft weighing 100,000 pounds or less or with thirty seats or less from the burdens of the implementing act.”\textsuperscript{207} But is this a feasible solution that everyone will accept?

Given the volume and revenue generated by the smaller corporate aircraft, that solution is likely to meet with stiff opposition. However, the legislature could come up with some sort of compromise. One such compromise might involve the corporate aircraft industry (fractional ownership programs as well as general corporate craft) agreeing to participate, but as a block constituent. In other words, the legislature could come up with a certain size requirement, such as the one suggested by Senator Inhofe above. Sellers of qualifying aircraft, as well as fractional ownership programs, could elect to collectively participate in the Cape Town Treaty, but in a subcategory. Regular FAA registration would still be observed. But instead of immediately filing another Cape Town registration, participants in this new subcategory would maintain a file of these newly registered owners in their own records. On a monthly or bimonthly basis, the participants would then file a bulk registration with the International Registry on behalf of their clients, as part of the cost and service of the airplane transaction. For fractional ownership programs, this could be included in the Management Agreement and left up to the program manager to implement for a fee. Ideally the extra steps of Cape Town would become invisible to the clients and delays would cease.

In order for this subcategory to be viable, several aspects would have to be amended for this special subcategory. First,

\textsuperscript{206} Meiners, \textit{supra} note 192.
\textsuperscript{207} Jackson, \textit{supra} note 197, at 98.
the cost of the altered system would have to be paid by someone. To justify the time and effort of maintaining a subcategory, participating programs would need to pay a yearly fee. This fee would then likely be passed on to the customers, along with the original filing fees. Unfortunately this plan adds costs to the system. However, in all likelihood, the fees would only be several hundred dollars at most. In the context of a multimillion dollar purchase of an aircraft, an increase of even several hundred dollars is not very consequential. Parties would hopefully view this as a cost of efficiency and be willing to pay. Another aspect of the International Registry that would have to be amended for the new subcategory is the bilateral aspect of the registration. Instead of having both parties register at the same time, the International Registry would need to allow subcategory members to register interests on behalf of their clients, possibly with the aid of electronically-scanned signed agreements. Finally, the priority rules of the International Registry must change for this type of subcategory solution. With a month (or longer) between registrations, the priority rule could not be first-in-time for subcategory participants. Rather, the subcategory could adopt the FAA priority rules that favor actual notice. Ideally, the subcategory would allow United States registrants to rely first on FAA filings for priority, however this would be a more difficult concession for the Cape Town Treaty, given the priority rules for all other aircraft.

Another possible recommendation for improving Cape Town implementation for domestic aircraft would require making the FAA registration more than an entry point. In other words, the legislature could decide to let the aircraft industry, already familiar and comfortable with the FAA registration process, continue to only file a registration with the FAA. The FAA registration could then be linked to the International Registry so that the filings could occur simultaneously. Fees could still be paid to each, but also simultaneously, through one portal. This would completely erase the added delays caused by the additional requirements imposed by the International Registry. While the priority rules would still be at odds, they could simply co-exist as they already do.

Additionally, specific modifications for fractional ownership aircraft could only help the Cape Town implementation, given the fact that most fractional programs do not currently participate at all. As one NetJets executive notes, fractional ownership programs are “not new to designing systems” within existing sys-
tems. 208 The first improvement the internet site needs is the addition of an option to correctly reflect an owner's fractional interest. This improvement alone would likely encourage most, if not all, fractional ownership programs to begin participation. A simple drop-down menu with the ability to reflect specific percentages would suffice. However, to further encourage fractional ownership program participation, Cape Town needs to provide fractional owners with more incentives. Right now, the Treaty is so focused on large international transactions that there is little incentive for domestic participation, much less for fractional ownership programs. In addition, the legislature could opt to financially support the domestic small aircraft industry's compliance with the Treaty. The federal government could sponsor a special program for small aircraft owners who meet specified size requirements and either (1) only finance and use their aircraft domestically or (2) participate in joint or fractional ownership programs. As part of this program, in order to provide similar financing incentives and benefits to the ones enjoyed by international transactions of larger aircraft, the federal government could subsidize loans for purchasers of smaller, domestic craft who comply with Cape Town.

The Cape Town Treaty is a part of the United States aviation landscape. The entire aviation industry is adjusting to the new requirements and the process is improving daily. Additionally, the industry is cognizant of the challenges faced by the smaller, corporate aircraft owners. As a result, they are looking for solutions to ease the adoption of Cape Town. As parties to aircraft transactions become more knowledgeable about the new requirements, the process will only improve. Although improvements are still needed for the domestic market, the Cape Town Treaty does offer global benefits. In order to support the goals of global efficiency and international market stability, the federal government should provide incentives to put the domestic and corporate aviation market on more equal footing with the larger aircraft carriers. Once that happens, the Treaty's benefits will truly be realized, both internationally and domestically.

208 Interview with Amanda Applegate, supra note 198.