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Lease Registrations, Subordination and Lessee Protections under the Cape Town Convention.

By Jessi Saba



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L A T A M



PRONUNCIATION:

'che-l&m, is Latin for airspace or sky. The Romans began questioning the rights they had in the space above the land they owned and how high above them those rights would extend. They decided on, Ad coelum et ad inferos, meaning that their property rights would extend as high up as the heavens and all the way down to hell.

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The Cape Town Convention and the Aircraft Protocol created a global system to determine priority between competing interests in aircraft. One of the Convention's most important innovations is the International Registry, which allows parties to register interests in aircraft equipment. In general terms, the system follows a simple rule: priority is determined by the order of registration.

Although the framework is designed to provide clarity and predictability, questions sometimes arise in more complex financing structures. One issue that occasionally appears in refinancing transactions is whether a lease registration can be subordinated to a lender's financing interest, and whether doing so affects the lessee's right to quiet possession and use of the aircraft under the Convention.

The discussion involves the interaction between Article 29 of the Convention¹, which governs priority between interests, and Article XVI of the Aircraft Protocol² which protects a debtor's quiet possession and use of the aircraft.

The Convention's Priority Framework

Under Article 29 of the Cape Town Convention, priority between competing interests in an aircraft object is generally determined by the time of registration in the International Registry. A registered interest has priority over interests registered later and over interests that are not registered.

In aircraft leasing transactions, the lessor typically registers an international interest arising from the lease. While this registration reflects the lessor's rights under the lease, it also plays an important role in protecting the lessee's position within the Convention's priority framework.

Article 29(4) addresses the position of a lessee. In simple terms, it provides that a lessee takes its interest in the aircraft subject to interests registered before the lease registration, but free from interests that were not registered at that time.

The Official Commentary³ explains that this rule allows parties to rely on the International Registry to determine which interests exist and how they rank in priority. The timing of registrations therefore becomes critical in determining whether another creditor's interest may affect the lessee.

"A registered interest has priority over interests registered later and over interests that are not registered."

The Aircraft Protocol adds an additional layer of protection. Article XVI provides that, as long as the debtor is not in default, the debtor is entitled to quiet possession and use of the aircraft against certain creditors. In practical terms, this means that a creditor whose interest is subordinate under the Convention's priority rules cannot interfere with the lessee's use of the aircraft.

Why Subordination Issues Arise

In many aircraft financing structures, the lessor grants security over the aircraft and the lease to a lender. The lender then registers its financing interest in the International Registry.

1. <https://www.unidroit.org/instruments/security-interests/cape-town-convention/>

2.- <https://www.unidroit.org/instruments/security-interests/aircraft-protocol/>

3.- R. Goode, *Official Commentary on the Convention on International Interests in Mobile Equipment and the Protocol thereto on Matters Specific to Aircraft Equipment* (4th ed.) para. 3.98.

If the lease interest was registered first, the Convention's priority rules may show the lease-related interest ahead of the lender's interest. While lenders typically rely on contractual assignments and security arrangements to protect their position, some lenders prefer to ensure that their financing interest ranks ahead of the lessor's rights in the registry.

To address this, lenders may request that the lessor subordinate its registered lease interest to the lender's financing interest. The Convention allows parties to modify priority arrangements by agreement, and such agreements may be registered in the International Registry as a subordination.

The question that sometimes arises is whether subordinating the lease registration changes the protections that the Convention provides to the lessee.

Subordination as a Creditor Priority Arrangement

One interpretation is that a subordination agreement affects only the priority relationship between the creditors involved, usually the lessor and the lender.

Under this view, the subordination simply changes the ranking of those creditors in relation to each other. The lessee is not a party to the subordination agreement and therefore its rights should not be affected by it.

The Official Commentary⁴ explains that the Convention's priority rules can be modified by agreement between creditors and that a registered subordination changes priority between the parties to that agreement and their successors. The debtor does not need to consent to the arrangement and continues performing its contractual obligations.

From this perspective, the lessee's right to quiet possession under Article XVI of the Aircraft Protocol remains intact. The subordination is viewed as a technical adjustment within the creditor hierarchy rather than a change to the lessee's treaty protections.

Subordination May Affect Convention Protections:

Another interpretation focuses more closely on the relationship between priority and the lessee's quiet possession rights.

Article XVI protects the debtor's quiet possession against a creditor whose interest is subordinate to the debtor's position under the Convention's priority rules.

"The Convention allows parties to modify priority arrangements by agreement, and such agreements may be registered in the International Registry as a subordination."

If a lease registration is subordinated to a financing interest, the lender's interest may become senior in the International Registry. In that case, the lender may no longer be considered a creditor whose interest is subject to the lessee's rights under Article 29(4).

Some practitioners therefore argue that subordinating the lease registration may remove the condition that triggers the Convention's quiet possession protection against that creditor. In that scenario, the lessee's protection would rely primarily on contractual arrangements, such as quiet enjoyment undertakings contained in financing documents.

4.- R. Goode, *Official Commentary on the Convention on International Interests in Mobile Equipment and the Protocol thereto on Matters Specific to Aircraft Equipment* (4th ed.) para. 4.191.

While these contractual protections can provide comfort to the lessee, they are not identical to the protection provided directly by the Convention.

Practical Considerations

In practice, aircraft financing transactions often balance the interests of lenders and lessees. Lenders may seek certainty that their security interests are protected in the event of enforcement, while lessees may prefer to preserve the priority structure that supports their protections under the Convention.

As a result, many transactions address the issue through a combination of registry filings and contractual undertakings designed to ensure that lenders' security interests are protected while the lessee's operation of the aircraft remains uninterrupted.

Conclusion

Although different interpretations exist regarding the effect of subordinating a lease registration, the Convention itself clearly supports the view that such arrangements operate primarily at the level of creditor priority. As noted in the Official Commentary, the Convention allows creditors to vary priority by agreement, and a registered subordination changes the ranking of interests between those creditors and their successors, without requiring the debtor's consent.

At the same time, aircraft finance transactions rarely rely solely on the theoretical operation of the Convention. Financing structures commonly and sufficiently include additional protections for the lessee, such as quiet enjoyment undertakings from lenders, security assignments of the lease, and non-disturbance provisions, all of which reinforce the lessee's ability to continue operating the aircraft without interference.

As a result, even where a subordination of the lease registration is contemplated, the practical framework of the transaction typically ensures that the lessee's operational rights remain protected. In that sense, the Convention's priority regime and the existing contractual protections built into modern aircraft financing structures operate together, providing both lenders and lessees with the certainty required for these transactions to function effectively.

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Jessi is a partner and head of the transactional group. She has over 14 years of experience advising a wide range of lessor and financial institutions in structured financing and leasing matters, organizing complex cross-border asset-finance structures in Mexico and Latin America. Jessi has negotiated transactional documents for commercial and executive aircraft and aircraft equipment assuring the enforceability or Sierra LATAM clients' rights and remedies.

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