This article discusses how the Cape Town Convention and its Aircraft Protocol are a significant part of an international trend towards enforcing creditors’ rights and remedies in secured and leasing transactions, including in insolvency.
Part II: Debt enforcement in times of uncertainty

Where the combined Cape Town Convention on International Interests in Mobile Equipment\(^1\) and Protocol thereto on Matters Specific to Aircraft Equipment\(^2\) (hereinafter referred to as the “Cape Town Convention” or the “Convention”) is applicable, it mainly impacts the legal framework in two ways. First, it provides a system for registering all interests in aircraft equipment that were created by leasing and asset-based financing transactions, sale transactions and other interests in such aircraft equipment. The order in which interests are registered establishes the ranking of creditors and their rights against the aircraft object. Second, the Convention provides several remedies, including repossession of aircraft equipment after default under mortgages, title reservation agreements or leases; special country-optional provisions for repossession when the debtor is in an insolvency proceeding; remedies outside of court; and deregistration and export of aircraft. The Convention includes basic principles that protect the debtor and creditor from uncertainty about the process and outcomes. For many countries, adopting the Convention, and thus incorporating its remedies into domestic law for applicable transactions, has been groundbreaking.

This article summarises what the Convention is, when it applies and how the remedies work and are adopted by each country making recommended elections at ratification.

**What is the Cape Town Convention?**

The Cape Town Convention, signed in November 2001 in Cape Town, South Africa, was developed under the auspices of the International Institute for the Unification of Private Law (UNIDROIT) and the International Civil Aviation Organisation (ICAO) and was aimed at three kinds of high-value mobile equipment assets: aviation, rail and space objects. Whereas the Convention sets out international standards for registration of international interests, priority of registration and remedies available to the holders of such interest, it also provides that asset-specific regulations and remedies available to the holders of such interest in a particular type of asset should be regulated by an independent protocol.
The Convention’s overall objective is to contribute to the efficient financing of transportation equipment, which in turn leads to the development of cost-effective modes of transport using modern technologies.

This article solely concerns the Convention as modified by the Aircraft Protocol, which became effective in March 2006. With the strong support of the aviation industry, 29 countries plus the European Commission have ratified the Aircraft Protocol as of writing. The Convention’s overall objective is to contribute to the efficient financing of transportation equipment, which in turn leads to the development of cost-effective modes of transport using modern technologies. The huge outlays involved in the financing of objects of these kinds make it essential for the creditor (the financier, seller or lessor) to have confidence that if the debtor defaults, the relevant legal regime will respect the creditor’s contractual and proprietary rights and provide efficient and effective means to enforce those rights. Traditional conflict of laws rules apply lex rei sitae (law of the state where the asset is located at a given time) as the law governing certain property rights. Such a principle is unsuited to items of mobile equipment, which are constantly moving from one country to another. Dependence on national laws is disadvantageous because they vary widely. Some jurisdictions are highly supportive of security interests, while others are more hostile or restrictive. This uncertainty may discourage potential financiers from extending credit or may lead to substantially increased credit costs. Hence the need for an international set of substantive rules governing security, title retention and leasing interests in such equipment which will provide creditors with the necessary safeguards to make financing more available and on better terms.

The Convention lays down rules on four main topics:

- international recognition of the interests of creditors under security agreements, conditional sale agreements and leasing agreements with respect to high-value, uniquely identifiable mobile equipment
- default remedies of the holders of such interests, that can be expeditiously exercised
- perfection regimes by registration, thereby enabling third parties to discover the existence of security interests
- recognition and priority of those interests, both within and outside the debtor's bankruptcy.

When do the Convention and Protocol apply?

The goal of the Convention is to apply as widely as possible to situations involving mobile equipment. The Convention and Protocol apply to an “international interest” with respect to or to a “sale” of a relevant aircraft object. An international interest is constituted (if it meets the minimal formalities) when a debtor under a security agreement; a buyer under a title reservation agreement; or a lessee under a lease agreement is situated in a contracting state at the time the agreement or contract creating or providing for the interest is concluded. The location of the “creditor” is irrelevant. Although the Convention only applies to international situations, this criterion is considered satisfied by the mere mobile character of the equipment and a connecting factor to one of the contracting states by virtue of aircraft registration or the location of a debtor or lessee in a contracting state, and not on its actual use. Hence the Convention and the Aircraft Protocol can potentially apply to all transactions involving the financing of aircraft, regardless of the nationality of the parties and the use of the aircraft. For example, if an aircraft were registered in Ireland, the Convention could be applicable to a Ukrainian leasing company financing the purchase of that aircraft for a Ukrainian airline serving the domestic market only.

How do the remedies work if the Convention and the Protocol apply?

The approach taken by the Cape Town Convention is to provide a basic set of remedies under the Convention and Protocol and to provide a more advanced set of remedies that contracting states opt in or out of by declaration at the time of ratification or thereafter. This optionality reflects the trend towards developing new and better remedies and the need for certainty, but also reflects the fact that such a trend is still developing. Hence, contracting states need some latitude in initially considering whether to adopt the Convention.
Part II: Debt enforcement in times of uncertainty

All remedies included in the Convention work within certain general principles that apply without regard to declarations or elections.

General principles of all remedies

All remedies included in the Convention work within certain general principles that apply without regard to declarations or elections, and which are intended either to clarify potential gaps or conflicts that may arise with the existing law in a contracting state, or to protect the debtor.

First, any remedy provided by the Convention is to be exercised in conformity with the procedure prescribed by the applicable domestic law of the jurisdiction where the remedy is to be exercised.7

Second, party autonomy is one of the key tenets of the Convention and asset-based financing and leasing, so any additional remedies agreed by the parties and permitted by the applicable law, can also be exercised to the extent they are not inconsistent with the mandatory provisions of Article 15 of the Convention and the mandatory provision of Article IV(3) of the Protocol.8

Third, any remedy provided by the Convention must be exercised by the creditor or lessor in a commercially reasonable manner.9 A remedy is deemed to be exercised in a “commercially reasonable” manner where it is exercised in conformity with the provisions of the parties’ agreement except where such provision is “manifestly unreasonable”.10

Fourth, the general principle of a chosen forum is a key to enforcement of the rights recognised by the Convention. The courts chosen by the parties in the relevant agreement creating the international interest will have exclusive jurisdiction (unless expressly non-exclusive) over claims brought under the Convention11 except for any additional jurisdiction which is available for advance relief. There will also be jurisdiction in the courts of a contracting state where the aircraft object is situated at the time when the remedy is exercised or where the aircraft object is registered with the Civil Aviation Authority of such contracting state, and in certain circumstances in the courts of a jurisdiction where the debtor is situated.12

Lastly, the Convention provides for the priority ranking of competing interests and makes the registration of interests at the International Registry critical to parties’ protection of their interests in any kind of dispute or enforcement. All international interests must be registered on the International Registry in order to be effective against any third party in a contracting state.13 Article 30 provides that a registered interest is effective if it was registered before the commencement of insolvency proceedings.

Basic remedies

Basic remedies, which become available to all transactions subject to the Convention, are slightly different when they arise under lease agreements and title reservation agreements, or under security agreements (mortgages).

Article 10 of the Convention provides that in the event of a default under the lease agreement or title reservation agreement, the lessor or title holder may terminate the lease agreement or title reservation agreement with respect to any aircraft object to which such agreement relates or apply for a court order to authorise or direct such termination.14 Article 10 also provides that the lessor or title holder may take possession or control of any aircraft object to which such agreement relates, or apply for a court order to authorise or direct such possession or control.15

When security agreements have been entered into (in the form of a mortgage, for instance), article 8 provides that, to the extent agreed by the parties, the creditor can in an event of default take possession or control of any object charged to it and sell or grant a lease of any object on reasonable notice to applicable interested persons.16 Article 8 of the Convention provides that all sums collected or received by the creditor as a result of the exercise of the remedies mentioned shall be applied towards discharge of the amount of the secured obligations. The creditor is obliged to distribute any remaining surplus among holders of subsequently ranking interests which have been registered or of which the creditor has been given notice, in order of priority. If there is still a surplus available to the creditor after such distributions, then such surplus must be paid to the debtor.
The truly revolutionary aspects of the Convention, as far as remedies are concerned, are found in the elective remedies that contracting states can choose to opt into.

Contracting state elective remedies

Described above are the basic remedies that every contracting state automatically adopts when ratifying the Cape Town Convention. However, as mentioned above, the Convention also offers a number of remedies in the form of key declarations that a contracting state can make. These declarations critically enhance the economic benefits of the Convention, as Professor Vadim Linetsky of Northwestern University has conclusively demonstrated in a recently published study, which modelled the economic benefits of a contracting state electing the Convention’s insolvency “Alternative A” declaration, including the benefits of the “Cape Town discount” described under the “Insolvency” section below.18

The first elective remedy concerns the important mandatory declaration, if made under the Convention by a contracting state, that any remedy available to the creditor under any provision of the Convention, unless such remedy requires application to the court, may be exercised by the creditor without leave of the court.19 This, if adopted, would be quite a departure for many jurisdictions in central and eastern Europe, which have tended (but not consistently) to maintain the role of the courts on enforcement of security rights.

However, the most critical declaration or remedy is the insolvency remedy.

Insolvency. The Convention does not require contracting states to make an insolvency declaration. This in practice will mean that the contracting state retains its national insolvency law. If it chooses, however, a contracting state may elect between “Alternative A” and “Alternative B”, which deal with remedies in the event of insolvency of the debtor.20 Alternative A is the recommended option and indeed the option included in the “qualifying declarations” set out in the new Aircraft Sector Understanding (ASU) to the Organisation for Economic Co-operation and Development (OECD) Arrangement on Officially Supported Export Credits, a strict condition to the receipt of the “Cape Town discount” on the export credit exposure premium under the ASU.21

Alternative A. Of the 23 contracting states that have made an election, 22 have chosen Alternative A. It is the preferred option because it requires the debtor to give possession of the aircraft object to the creditor under the security agreement, title reservation agreement or lease no later than:

- the end of the waiting period specified by the contracting state that is the primary insolvency jurisdiction and that has adopted Alternative A or
- the date on which the creditor would be entitled to possession if the Convention and Aircraft Protocol did not apply.

Furthermore, the remedies of de-registration and export of the aircraft (see below) are made available on an expedited basis by the aircraft registry authority of a contracting state if it chooses Alternative A.

Alternative B. Alternative B has been elected by only one country, Mexico, and is considered much less useful than Alternative A because it does not provide the same level of certainty in insolvency. Alternative B provides that the obligation of the insolvent debtor is to give notice that it will either cure the applicable defaults or give the creditor the opportunity to take possession of the aircraft object in
Where a country makes the declaration under the Aircraft Protocol that Article XIII shall apply, it commits to introduce an irrevocable de-registration and export authorisation.

Alternative A is not an isolated proposition of how legal regimes should treat secured creditors in the event of insolvency, but rather part of the development of legal thought on insolvency as described in a recent article by Jeffrey Wool and Andrew Littlejohns. The article examines how insolvency law has begun to reflect contextual considerations and policies and is not simply a one-size-fits-all entitlement of a debtor in bankruptcy to hold all parties in limbo. According to this approach, the analysis of appropriate insolvency law “requires an assessment of economic considerations, in light of the practical realities of aircraft financing and airline insolvency proceedings, and balanced against other interests, assessed in concrete terms.”

Taken in this light, the Cape Town Convention is the logical development of insolvency provisions in relation to asset-based financing and leasing and to airlines as borrowers and lessees. The explicit inclusion of Alternative A in the OECD ASU confirms this.

**Other elective remedies**

Cooperation of foreign courts in carrying out Alternatives A and B. If elected, Article XII provides that the courts of the contracting state where the aircraft is located will cooperate to the maximum extent possible with foreign courts and insolvency administrators in carrying out the provisions of Article XI Alternatives A or B.

Use of IDERA in aircraft registry of contracting states. Where a country makes the declaration under the Aircraft Protocol that Article XIII shall apply, it commits to introduce an irrevocable de-registration and export authorisation ("IDERA"). An IDERA is a specific instrument defined by the Convention (which also includes a sample form) which may be obtained by the creditor from the debtor. The creditor will then submit it at the closing of the financing to the relevant aircraft registry where the airframe or helicopter (but not an engine) is registered. The IDERA will be used, in case of default, to de-register and export the aircraft. Certain protections are built into this provision. Any second-ranking creditor may not exercise this remedy without the prior written consent of the holder of any registered interest ranking in priority to that of the second-ranking creditor. Like any other remedy, it must be exercised in a commercially reasonable manner. Lastly, the exercise of the authorisation must be taken in accordance with the applicable safety laws and regulations of the jurisdiction where the aircraft object is registered.

**Speedy court relief pending final determination.**

The provisions for “speedy court relief pending final determination” require that a contracting state declares such provisions to be applicable in its jurisdiction and set up time periods after which a court would grant the relief to the creditor. Article 13 of the Convention (as modified slightly by Article X of the Aircraft Protocol), unless a contracting state opts out of it, provides for what is called “speedy court relief”, which allows the creditor, including a lessor or a title holder, to obtain the following court orders before judgment “to the extent that the debtor has at any time so agreed”, which means that the relevant agreement should cover the following remedies:

- preservation of the object and its value
- possession, control or custody of the object
- immobilisation of the object
- lease or, except where covered by subparagraphs (a) to (c), management of the object and the income therefrom
- sale and application of proceeds

Article 13 does not limit the availability of other forms of advance relief at law.
The Cape Town Convention is rightly seen as reflecting trends in international secured transactions and leasing law and as providing a significant example of and agent for accelerated development in the field of enforcement remedies, including in insolvency.

Mandatory election. Article 54(2) requires that every contracting state makes an election declaring whether it will require that any remedies under the Convention or Protocol must be taken only with the leave of court. This election was described earlier in this article and would permit non-judicial remedies by creditors under the Convention.

Contractual choice of law. Lastly, Article XXX(1) permits a contracting state to opt into the provisions for the parties to choose the law applicable to their contractual rights and obligations under Article VIII of the protocol.

Conclusion

The Cape Town Convention is rightly seen as reflecting trends in international secured transactions and leasing law and as providing a significant example of and agent for accelerated development in the field of enforcement remedies, including in insolvency. It builds on the EBRD Model Law on Secured Transactions and other work undertaken by UNIDROIT, UNCITRAL, and the Hague Conference on Private International Law, but it pushes law reform to a new, very promising dimension.

The Cape Town Convention directly addresses insolvency, the core risk in commercial transactions, and creates an international electronic registry to objectively determine priorities, a highly efficient and innovative feature. The Convention will be the starting point for all bold initiatives in this field, or at least will be a reference point when only incremental change in the law is possible.

Resources

The Official Commentary on the Cape Town Convention by Roy Goode is a critical companion for the Cape Town practitioner because it explains and analyses all provisions of the Convention and Aircraft Protocol and was authorised by the original diplomatic conference. Purchase details are available on the UNIDROIT web site: www.unidroit.org, and on the web site of the Aviation Working Group (AWG): www.awg.aero.

The AWG web site is an excellent source of material and resources on the Cape Town Convention and links to other web sites, including the International Registry where the Cape Town Convention “international interests” and all other interests thereunder are registered online to be effective against third parties in any contracting state. The web site also provides information about Cape Town seminars being held around the world under its sponsorship to help the legal and aircraft finance industries understand and work with the treaty. The AWG Legal Advisory Panel has published two booklets regarding application of the Convention to transactions. These booklets are available for purchase as described on the AWG web site.
Notes and authors


3 One exception is in those countries that ratified the Geneva Convention on the International Recognition of Rights in Aircraft, where the law of the country of aircraft registry at the time of the formation of the applicable security or lease agreement would apply to the rights against third parties. The Cape Town Convention supersedes the Geneva Convention except to the extent of rights or interests not covered or affected by the Cape Town Convention. Protocol art. XXIV.

4 Aircraft objects include airframes capable of carrying eight persons, including flight crew, or larger; helicopters capable of carrying five persons, including flight crew, or larger; and similar cargo aircraft and helicopter and aircraft engines of specified size if the connecting factors of the Convention exist, see Protocol art. I; R. Goode (rev. ed. 2008), Official Commentary on the Convention on International Interests in Mobile Equipment and Protocol Thereto on Matters Specific to Aircraft Equipment, para. 5.3.

5 Conv. art. 2(2), art. 3(1). Such an entity is “situated” in a contracting state when it is incorporated, formed in, or has its registered office, centre of administration or principal place of business in such contracting state. The Convention also applies when an airframe or helicopter is registered in a contracting state at the time of conclusion of such agreement.

6 However, it would be possible for contracting states to declare that the Convention would not apply in relation to a purely domestic transaction. Conv. Art. 50; Protocol Art. XIV(2).

7 Conv. art. 14.

8 Conv. art. 12.

9 Protocol art. IX(3).

10 Id.

11 Conv. art. 42.

12 Conv. art. 43; Protocol art. XXI.

13 Article 29 of the Convention provides that, unless varied by the parties in a registered subordination, a registered interest has priority over any other interest subsequently registered and over an un-registered interest regardless of whether or not the first-mentioned registered interest was acquired or registered with actual knowledge of any other interest that has not been registered. The Convention recognises the priority of the interests and rights pre-existing the effective date of the Convention under applicable law, unless a contracting state has elected to require pre-existing interests to be registered. No contracting state has made such an election.

14 Conv. art. 10(a).

15 Protocol art. IX(3).

16 If a contracting state declaration supports it, the creditor could also collect or receive any income or profits from the management or use of any such object. See Conv. art. 8(1).

17 Conv. art. 9(1)-(2).


19 Conv. art. 54(1).

20 Protocol art. XI.

21 See www.oecd.org.


23 Id. at 2.

24 Another key example is the Directive 2002/47/EC of 6 June 2002 on Financial Collateral (amended in 2009), which aims to assist integration, cost efficiency and stability of the financial markets and the financial system in the European Community by permitting enforcement of financial collateral against institutions regardless of otherwise applicable insolvency laws.

25 Protocol art. IX(2).

26 Protocol art. IX(3).

27 Protocol art. XIII (3).

28 Conv. art. 55.

29 Conv. art. 13(1)(a).

30 Conv. art. 13(1)(b).

31 Conv. art. 13(1)(c).

32 Conv. art. 13(1)(d).

33 Protocol art. X(3).

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