

Cape Town Convention and Aircraft Protocol - Outline

SUMMARY

Framework

International interest

Connecting factors

Assignments of associated rights

Priority Registration

Standardised remedies

Insolvency regime

This note outlines the key features of the Convention and Aircraft Protocol¹. These are complex texts and a detailed analysis of their application to individual transactions needs to be undertaken in every case. This note does not purport to cover all issues that may arise or have relevance in any transaction.

The Convention is an international treaty which came into force on 1 April 2004. It aims to support cross-border leasing and financing of high value equipment. It is drafted as a general document, supplemented by three equipment specific protocols². The Aircraft Protocol is by far the most advanced and came into force on 1 March 2006³ in respect of those countries that have ratified or acceded to it (the "Contracting States")⁴.

The Convention provides a system to create, perfect and enforce security rights over relevant assets. Although the Convention provides a uniform set of rules, parties have a certain degree of flexibility in terms of how and whether certain rules should apply in their transactions (subject to minimum Convention requirements). Similarly, Contracting States may choose to "opt in" or "opt out" of certain Convention provisions, by way of declarations.

This means that while the Convention rules need to be broadly understood if the Convention applies (or may apply) to a transaction, the application and effect of the Convention will vary on a case-by-case basis, depending on the specific declarations made by the relevant Contracting State(s) and the parties' negotiations and final agreement. It should also be remembered that in many areas covered by the Convention, local laws are still relevant and should not be disregarded even if the Convention applies. Indeed, the Convention defers to national laws in various aspects, for example, in procedural issues. Where a State has "opted out" or varied a Convention rule, domestic law will still apply.

Framework

The three key elements introduced by the Convention are:

- (i) the creation of an "international interest" recognised by all Contracting States;
- (ii) a system for perfection and priority of such interests by electronic registration; and
- (iii) a standardised set of rights and remedies on a debtor default.

Sphere of Application

The Convention will apply if the following requirements are met:

- (i) there is an "*aircraft object*" as defined in the Convention - airframes, engines⁵ and helicopters of a minimum size or power, (broadly speaking, this covers most

If you would like to know more about the subjects covered in this publication or our services, please contact:

[Clive Carpenter](#) +44 (0)20 7006 2006

[Marisa Chan](#) +44 (0)20 7006 4135

[William Glaister](#) +44 (0)20 7006 4775

[Antony Single](#) +44 (0)20 7006 2736

[Geoffrey White](#) +44 (0)20 7006 2012

To email one of the above, please use firstname.lastname@cliffordchance.com

Clifford Chance LLP, 10 Upper Bank Street,
London, E14 5JJ, UK
www.cliffordchance.com

¹ The Convention on International Interests in Mobile Equipment 2001 and the Protocol thereto on Matters specific to Aircraft Equipment 2001.

² The other two equipment classes to which the Convention applies are railway rolling stock and space assets. The Convention has no effect in respect of such assets until the relevant protocol comes into force (neither protocol is effective at this time).

³ Please see our Client Briefing dated December 2005 in relation to the effective date of the Aircraft Protocol and steps for parties to consider in transactions going forward. For the purposes of the remainder of this note, references to the Convention should be read as references to the Convention as it applies to aircraft objects AND to the Aircraft Protocol, unless stated otherwise.

⁴ The Contracting States to date are Afghanistan, Angola, Colombia, Ethiopia, Ireland, Kenya, Malaysia, Mongolia, Nigeria, Oman, Pakistan, Panama, Senegal, South Africa and the United States of America

⁵ Note the Convention encourages spare engines financing by following the doctrine of "title tracking" so interests in an engine are preserved, notwithstanding attachment to or removal from a particular airframe

commercial passenger aircraft);

- (ii) there is an agreement creating an "*international interest*" in an aircraft object - a security agreement, a conditional sale agreement (and other title reservation agreements) or a lease agreement⁶. The Aircraft Protocol also extends certain Convention rules to contracts of sale in respect of an aircraft object (e.g. registration and priority rules but not default remedies), however, the interest of an outright buyer does not itself constitute an international interest; and
- (iii) one of two "*connecting factors*" apply, either the debtor is situated in a Contracting State when the agreement is concluded, or the agreement relates to an aircraft object (but not engines) which is registered in a Contracting State.

An international interest in an aircraft object extends to insurance and other loss related proceeds, but not to sale proceeds or income generated by the object.

The Convention refers to the "creditor" to whom obligations are owed under the relevant agreement (the chargee, conditional seller or lessor) and the "debtor" who owes obligations (the chargor, conditional buyer or lessee), or, in the case of a contract of sale, the creditor is the buyer and the debtor is the seller.

Assignments of associated rights

The Convention also applies to assignments of "*associated rights*" that transfer the related international interest. Associated rights are rights to payment or other performance by a debtor under an agreement that are secured by or associated with the aircraft object. For example, rights to repayment of a loan secured by a mortgage over the aircraft or rights to lease rentals and performance under a lease of the aircraft are associated rights.

An assignment of associated rights automatically transfers the related international interest and the assignor's priority position and other interests. Parties can agree *not* to transfer the related international interest under the assignment, in which case the Convention treats such assignment as only an assignment of receivables and hence excluded from its rules.

Registration System

The International Registry is based in Ireland and operates an electronic notice-filing system. International interests may (and should) be registered as well as various other interests set out in the Convention, including assignments, sales and certain non-consensual rights which arise by operation of law (e.g. liens)⁷.

Registration establishes priority from the date of filing, preserves effectiveness upon insolvency and serves as notice. Broadly speaking, a registered interest will take priority over subsequent registered and any unregistered interests (regardless of actual prior knowledge of the registered creditor). The system allows advance filing of *prospective interests* in which case priority runs from the date of the prospective filing and no additional registration is required when the actual interest arises (provided there is no change in the filing details)⁸.

The Convention sets out the order of priority of interests, although parties may vary this order by entering into a subordination agreement and registering it.

Remedies

The Convention lists certain remedies on a debtor default, although transaction parties can contract out of these and Contracting States may make declarations varying them. Remedies include termination, repossession, power of sale/power to lease, power to collect/receive income, de-registration and export (in most cases these remedies require debtor consent). The Convention also provides for interim relief measures, including custody of the aircraft object and preservation of its value.

The Convention defines a default as an event which substantially deprives the creditor of what it is entitled to expect under the relevant agreement, although parties can agree their own events of default. There is a requirement to act in a commercially reasonable manner when exercising any Convention remedy.

⁶ An "international interest" is a creature of the Convention and if the above conditions are met, then such interest will arise, outside of any national laws, although the Convention defers to national law on questions such as characterisation of agreements and capacity and authorisation. Note that characterisation of transactions differs between jurisdictions - for example, certain countries including the United States of America often apply a "functional" approach that may lead to finance leases or conditional sales being treated as security devices.

⁷ The Convention does not change the current system of nationality of aircraft nor does it remove the requirement to comply with each country's local registration requirements (although registration of an international interest under the Convention overrides any national registrations/interests in any Contracting State, subject to any specific declarations by the state.

⁸ Note a lease with a purchase option is considered a prospective sale and is registrable by the lessee as a buyer/creditor.

A particular point to note is that the Convention provides for a "foreclosure" mechanism on a debtor default for chargees, subject to agreement by the debtor and other interested parties or by order of the court, i.e. ownership of the aircraft object will vest in the chargee in satisfaction of some or all secured obligations.

Debtor Insolvency

The Convention offers two alternative insolvency regimes, but crucially, both are "opt in" provisions (without further amendment) for Contracting States. Under the "hard regime", the debtor or administrator must give the creditor possession of the aircraft object or cure all defaults and agree to future performance within a specified period. A court cannot prevent or delay the creditor exercising its remedies after such time. The "soft regime" allows the debtor or administrator to choose whether to allow repossession or to cure all defaults and agree to future performance within a specified period. A court may then intervene and authorise possession after such period on terms it considers appropriate⁹.

This Client briefing does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

If you do not wish to receive further information from Clifford Chance about events or legal developments which we believe may be of interest to you, please either send an email to nomorecontact@cliffordchance.com or by post at Clifford Chance LLP, 10 Upper Bank Street, Canary Wharf, London E14 5JJ.

www.cliffordchance.com

Clifford Chance LLP is a limited liability partnership registered in England and Wales under number OC323571.

Registered office: 10 Upper Bank Street, London, E14 5JJ

We use the word 'partner' to refer to a member of Clifford Chance LLP, or an employee or consultant with equivalent standing and qualifications.

⁹ Clearly, the special insolvency rules could give significant comfort to financiers in jurisdictions where insolvency proceedings are known to be lengthy and complex, not to mention costly and uncertain. However, as domestic insolvency rules will continue to apply unless a Contracting State adopts either regime, the benefit of the Convention rules depends on the Contracting States' "buy-in" to the system.