

# Fundamental Mechanics of the Cape Town Convention

Growth Frontiers Korea 2017

VedderPrice

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# Past, Present and Future of Aviation Industry and Financing

- Phase 1: Statism
  - State ownership/control/guarantee
  - High degree of regulation
  - Low probability of default
- Phase 2: Transition
  - Advanced contracting practices
  - Complex structures and reliance on favorable choice of law/forum
  - Eroding Phase 1 features

# Past, Present and Future of Aviation Industry and Financing

- Phase 3: Privatism
  - Private ownership/control (less State guarantee)
  - Less regulation
  - Increased probability of default

# What Law Applies With Respect to Rights in Aircraft?

- Traditional rule was to apply the lex situs principle governing property rights
  - The law of the place where the property is situated governs rights against such property

# What Law Applies With Respect to Rights in Aircraft?

- How to determine priority amongst competing liens arising in different jurisdictions?
  - General conflicts of law rules of a jurisdiction
    - Would Country B recognize a lien properly established and perfected in Country A?
    - Questions of recognition and priority
    - As a general matter, this can be unpredictable

# What Law Applies With Respect to Rights in Aircraft?

- Problematic with mobile equipment
- Differing national principles created uncertainty and increased financing costs
- Need for treaty to prevail over inconsistent national law



**The Answer?**  
*Cape Town Convention*

# Underlying Economic Principles of CTC

- Importance of prompt recourse to the value of the underlying assets in asset-based leasing and finance
  - National legal rules inconsistent with prompt recourse impose costs
  - If you can create an efficient, predictable and transparent registration and enforcement mechanism, you will greatly reduce funding costs
  - Reduction in risk and therefore cost by establishing international legal framework

# Underlying Economic Principles of CTC

- Benchmark for Cape Town: asset-based financing principles
  - Transparent priority principle: clarity on the ranking of competing interests
  - Prompt enforcement principle: ability to promptly enforce rights against assets, generating proceeds and revenues
  - Bankruptcy law enforcement principle: ability to enforce in the context of bankruptcy

# Objectives of The Cape Town Convention

- Facilitate acquisition and financing of mobile equipment by providing for the creation of an “international interest” which will be recognized by all Contracting States
  - Mobile equipment creates challenges in the context of widely differing national laws
- Provide basic default remedies and insolvency-related remedies to creditors and, where there is evidence of default, access to interim protective relief
  - Interim relief can be more permanent in nature

# Objectives of The Cape Town Convention

- Establish an electronic 24/7 international registry for international interests, giving notice to third parties and preserving priority as against:
  - Later registrations
  - Unregistered interests
  - Debtor's insolvency administrator

# Cape Town Convention - Contracting States



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# Structure of Convention and Protocol

- Cape Town Convention – establishing baseline system for creating, enforcing and registering interests held by certain parties in high value mobile equipment - Final text for Convention agreed in 2001
  - Protocols
    - Aircraft Protocol - 2001 (Entry Into Force - March 1, 2006)
    - Rail Protocol - 2007 (completed but no entry into force)
    - Space Assets Protocol - 2012 (completed but no entry into force)
    - Agricultural, Mining and Construction Equipment Protocol - in initial stages

# Structure of Convention and Protocol

- Leaves to each protocol the equipment-specific provisions
- Avoids duplication of provisions which would result if individual treaties were created
- Uniform interpretations across equipment types
- Convention does not come into effect in relation to a particular type of equipment until a protocol for that equipment enters into force

# Structure of Convention and Protocol

- Aircraft Protocol – provides the means for adapting the base convention to each particular class of equipment; for example:
  - De-registration and export remedies
  - Geneva Convention superseded
    - Note: primacy of the Protocol

# Structure of Convention and Protocol

- Declarations – Contracting States have some autonomy to customize application of the Convention to it
  - There are over 20 declarations that could be made in connection with ratification for a particular Contracting State
    - “Opt-in” - Those provisions that only apply if a declaration is made
    - “Opt-out” - Those provisions that apply unless a declaration is made
    - “Mandatory” - Contracting State must make this declaration
    - Certain declarations will materially reduce risk - Without such declarations and proper implementation, major risks are NOT reduced

# Structure of Convention and Protocol

- Central to Cape Town is party autonomy
  - Parties are free to derogate from most of the provisions of the treaty

# Core Principle of CTC

- Create greater certainty that creditors will be able to realize on their collateral
  - Insolvency (Art XI of Protocol)
  - Self help
  - Relief pending final determination
  - IDERA
  - Choice of law



# Relationship with National Law

- Convention and Protocol must prevail over inconsistent national law
  - Need for clear supremacy clause in legislation (where legislation is needed)
- Still need national law in a number of areas including:
  - Damages
  - Specific performance
  - Characterization
  - Binding nature of agreements
  - Procedural law
  - Aviation safety laws and regulations

# What Equipment is Covered?

## ■ “Aircraft Objects”

- All airframes type certificated to transport
  - at least 8 persons (including crew)
  - or goods in excess of 2750 kilograms
- All aircraft engines of at least 550 horsepower or the equivalent (1750 pounds of thrust for jet engines)

# What Equipment is Covered?

- All helicopters type certificated to transport
  - at least 5 persons (including crew)
  - or goods in excess of 450 kilograms
    - Peculiar treatment of helicopter engines which might otherwise qualify as eligible equipment
- Propellers are treated as part of aircraft
- Spare parts are not covered

# Types of Interests

- Transactions that fall within the Convention – “International Interests” (*Sui generis* interests created solely for purposes of the Convention)
  - Security interest granted under a security agreement
  - Interest vested in a person who is a conditional seller under a title reservation agreement
  - Interest vested in a lessor under a leasing agreement

# Types of Interests

- International Interests, cont.
  - For aircraft objects, certain of the provisions applying to international interests (primarily priority rules) are extended to include a “contract of sale”
    - Actual title transfer document (not just mere agreement to sell in the future)
    - Registry could show a complete chain of registration relating to the transfer of title
    - These interests are NOT intended to be discharged

# Types of Interests

- So look at the CT definitions:
  - “**Contract of Sale**” means a contract for the sale of an object by a seller to a buyer which is not also a leasing agreement, security agreement or title reservation agreement
  - “**Leasing Agreement**” means an agreement by which one person (the lessor) grants a right of possession or control of an object (with or without an option to purchase) to another person (the lessee) in return for a rental or other payment

# Types of Interests

- So look at the CT definitions:
  - “**Security Agreement**” means an agreement by which a chargor grants or agrees to grant to chargee an interest (including an ownership interest) in or over an object to secure the performance of any existing or future obligation of the chargor or a third person
  - “**Title Reservation Agreement**” means an agreement for the sale of an object on terms that ownership does not pass until fulfillment of the condition or conditions stated in the agreement

# Requirements for an International Interest

- An international interest is constituted where the agreement creating or providing for the interest:
  - Is in writing
  - Relates to an aircraft object of which the chargor, conditional seller or lessor has “power to dispose”
    - “Power” to dispose is broader than “right” to dispose
  - Enables the aircraft object to be identified
    - Manufacturer, Manufacturer’s serial number and model designation
  - In the case of a security agreement, enables the secured obligations to be determined, but without the need to state a sum or maximum amount secured

# Types of Interests

## ■ Prospective International Interests

- An interest that is intended to be created or provided for in an object as an international interest in the future, upon the occurrence of a stated event (which may include the debtor's acquisition of an interest in the object) whether or not the event is certain
  - Need to be negotiating with respect to uniquely identified equipment with a view towards creation of II
  - Primary purpose of the PII is to allow a creditor to establish the priority of (not just perfect) its interest in an aircraft object prior to the closing of the transaction
  - A PII may be registered but it does not become effective until it constitutes an international interest
  - II is treated as registered from the time of registration of PII

# Types of Interests

- Non-consensual rights arising under National law and given priority without registration (Article 39)
  - Examples – Air navigation charges or claims for unpaid taxes or for wages due
  - Contracting state needs to make specific declaration

# Types of Interests

- Registrable non-consensual rights or interests arising under national law (Article 40)
  - Enables Contracting State to extend the application of Convention to non-consensual rights – such as mechanics liens
  - Contracting State needs to make specific declaration

# Types of Interests

- Other interests which are registrable
  - Subordination Agreements
  - Acquisition of international interests by legal or contractual subrogation under applicable law

# Assignments

- Assignment of associated rights transfers the related international interest
  - Associated Rights means all rights to payment or other performance by a debtor under an agreement which are secured by or associated with the aircraft object
  - Must be in writing
  - Associated rights must be identified
  - With respect to assignment by way of security, must enable obligations secured to be identified

# Assignments

- Debtor is bound but only if
  - Debtor has been given notice
  - Notice identifies the associated rights
  - Debtor has consented (consent may be given in advance and need not identify the assignee)

# When does Cape Town apply?

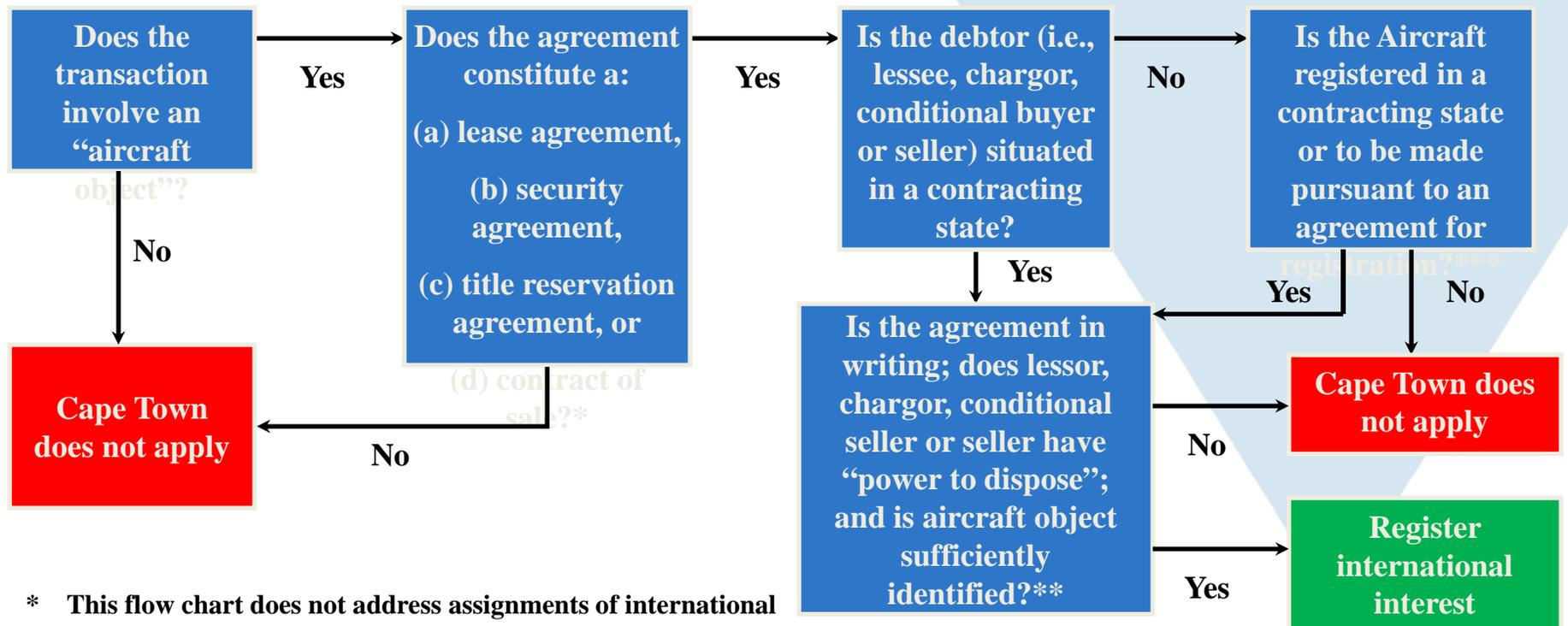
- Cape Town applies to your transaction if –
  - At the “time of the conclusion of the agreement creating or providing for the international interest” the Debtor is situated in a Contracting State
    - What is time of “conclusion”?
    - Situated includes any of the following:
      - Jurisdiction of incorporation or formation
      - Place where it has its registered office or statutory seat
      - Center of administration
      - Principal place of business
      - NOT necessarily where the documents are signed or the aircraft is registered

# When does Cape Town apply?

- Who is the **debtor**?
  - For a security agreement, it's the chargor or grantor
  - For a title reservation agreement, it's the conditional buyer
  - For a lease, it's the lessee
  - For a sale, it's the seller
- Who is the **creditor**?

# When does Cape Town apply?

- For airframes and helicopters, Cape Town also applies to your transaction if –
  - At the time of conclusion of the agreement, the Aircraft is registered in a Contracting State
    - For this purpose, includes situations where aircraft is registered subsequently pursuant to an “agreement for registration”
      - Relates back to time of conclusion of agreement



\* This flow chart does not address assignments of international interests or associated rights

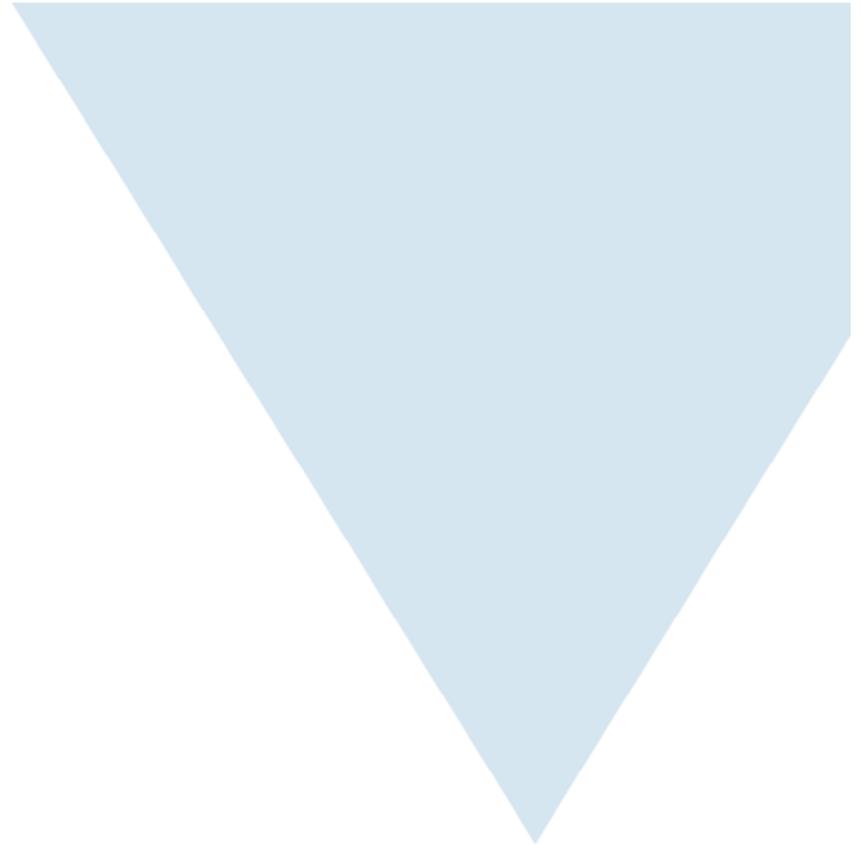
\*\* For Security Agreement, also must be able to determine secured obligations

\*\*\* Applies only to airframe

## Cape Town Application

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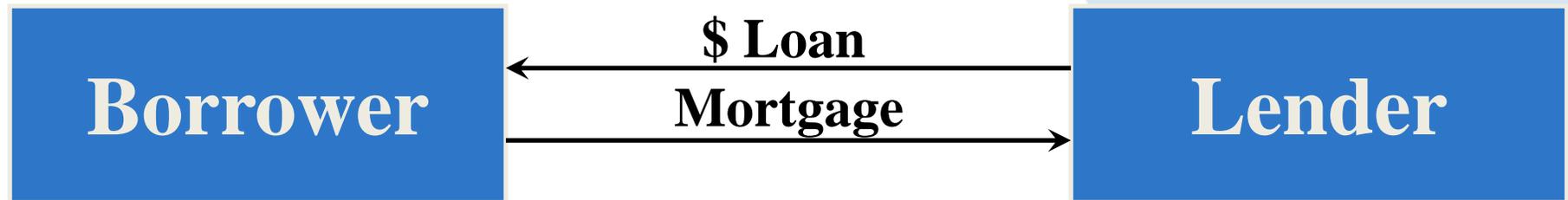
# Cape Town Application



# Aircraft Sale



# Mortgage Financing

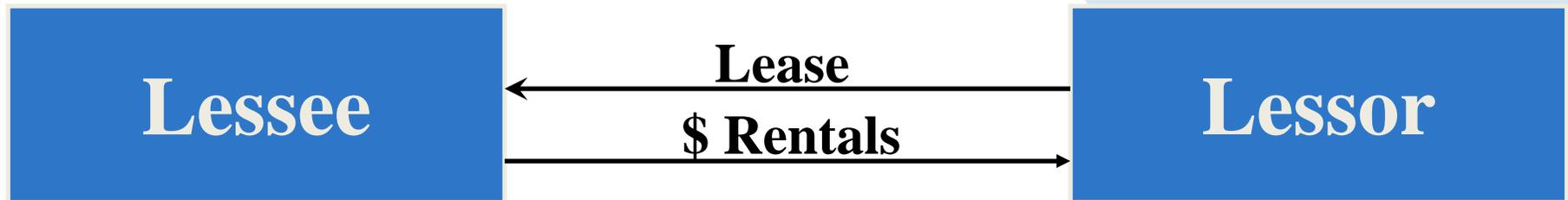


# Finance Lease Financing

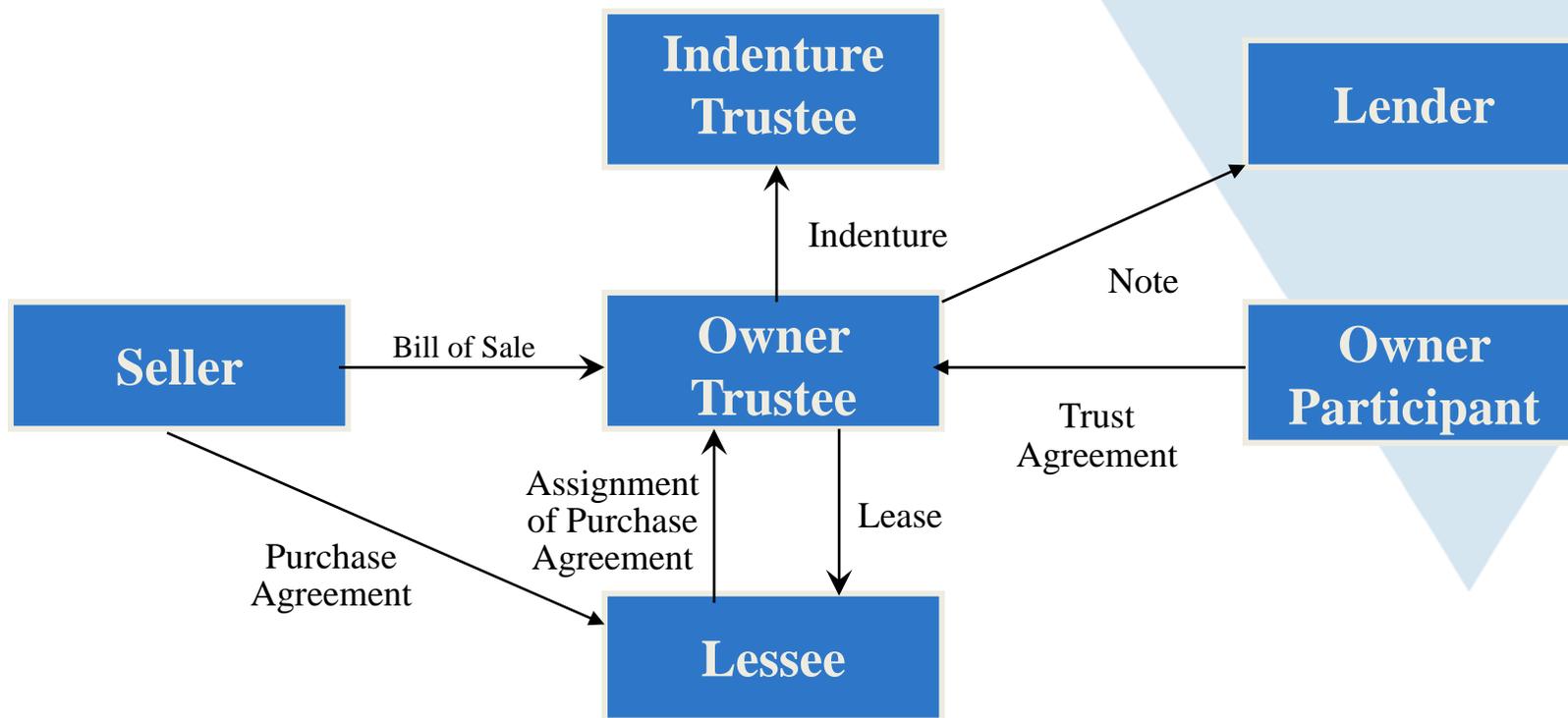


\*Title transfers to Lessee at end of Lease Term

# Operating Lease



# Leveraged Lease



# Priority Rules

- “First to File”: a registered interest has priority over all other subsequently registered interests and over unregistered interests
- Any priority given by the Cape Town Convention to an interest in an aircraft object extends to the “proceeds” of such object

# Characterization Matters!

- How do you deal with characterization issues?
  - Convention first, then applicable law
- Whether an interest falls within the Convention at all is determined by the Convention itself
  - Example: A consignment of goods
    - Outside the scope of the Convention even if under applicable law, it were to be characterized as a secured transaction or lease

# Characterization Matters!

- Article 2(4) of the CTC:
  - The applicable law determines whether an interest to which paragraph 2 applies falls within sub-paragraph (a), (b), (c) of that paragraph.
    - Once it is determined that an interest does fall within one of the three categories specified, its characterization for the purposes of subsequent provisions of the CTC is determined by applicable law

# Characterization Matters!

- Consider Remedies under the CTC:
  - Example: Seller in Paris agrees to sell an aircraft to Buyer in New York under a Title Reservation Agreement
    - New York Court = Security Agreement
    - French Court = Title Reservation Agreement
    - Remedies:
      - New York Court = Articles 8 and 9 of CTC
      - French Court = Article 10 of CTC

# Substantive Provisions of the CTC

- Most provisions in CTC are optional – that is, parties may agree otherwise
  - Certain of the provisions of the CTC are mandatory
- Choice of Law
  - If Contracting State has made applicable declaration, the parties to an agreement may agree on the law to govern their contractual rights and obligations
  - Allows choice of law determination to be made without concern of traditional choice of law limitations in the forum state

# Substantive Provisions of the CTC

## ■ Choice of Forum

- The courts of a Contracting State chosen by the parties to a transaction have jurisdiction in respect of any claim brought under the CTC
- Agreement must be in writing and otherwise concluded in accordance with the formal requirements of the law of the chosen forum

## ■ Waiver of Sovereign Immunity

- A waiver relating to enforcement of rights and interests relating an aircraft object is binding
  - Waiver must be in writing and contain a description of the aircraft object

# Substantive Provisions of the CTC

## ■ Remedies of Chargee

- Chargee may, to the extent chargor has so agreed, and subject to applicable declaration by Contracting State, exercise any of the following remedies by extra-judicial means:
  - Take possession or control of aircraft object
  - Sell or grant a lease
  - Collect or receive income or profits
- Chargee may also apply for court order in respect of the above
- 10 days prior notice is deemed reasonable advance notice of a sale or lease

# Substantive Provisions of the CTC

- Remedies of Conditional Seller or Lessor
  - Subject to applicable declaration by Contracting State, a conditional seller or lessor may exercise any of the following remedies by extra-judicial means:
    - Take possession or control of aircraft object
    - Terminate the agreement

# Substantive Provisions of the CTC

## ■ Remedies of all Creditors

- Procure the de-registration and export of the aircraft
  - Creditor shall not exercise this right without the prior consent of the holder of any registered interest ranking in priority to that of such creditor
  - Must give “reasonable prior notice” to debtor and other interested persons
  - Aviation authority must act no later than 5 working days after the creditor notifies such authority
- Any other remedy permitted by applicable law to the extent not inconsistent with CTC

# IDERA

## ■ De-registration and Export Authorization

- Only applies where Contracting State has made a declaration
- Provides that person so authorized shall be the SOLE person entitled to procure deregistration and export of the aircraft
- The authorization (in the form attached to the CTC) must be recorded at the national aircraft registry
- Cannot be revoked by debtor without the consent in writing of the authorized party
- Registry is required to co-operate with the authorized party in the exercise of remedies

# Substantive Provisions of the CTC

- Subject to declaration of Contracting State, courts in such state to provide “speedy” relief pending final determination on the merits
  - Preservation of aircraft object and its value
  - Possession, control or custody
  - Immobilization
  - Lease or management of aircraft object and income
  - Sale and application of proceeds
  - Declaration will set out number of working days which defines “speedy” (can be 10-30 days)
  - Court may require notice be given to all interested persons

# Substantive Provisions of the CTC

- Remedies on Insolvency
  - Applies where a Contracting State that is the primary insolvency jurisdiction of the debtor makes a declaration
  - Two options

# Substantive Provisions of the CTC

- Alternative A – Unless all defaults have been cured and agreement to perform, debtor must give possession of the aircraft object to the creditor no later than the earlier of (I) the end of the waiting period and (II) the date on which the creditor would be entitled to possession if the CTC did not apply
  - Does this remind you of §1110 of the U.S. Bankruptcy Code?
    - Prior to obtaining possession the insolvency administrator must “preserve the aircraft object and maintain it and its value in accordance with the agreement”
    - Does not affect right to reject

# Substantive Provisions of the CTC

- Alternative B – Insolvency administrator shall, upon request of a creditor, give notice to creditors as to whether it will either (I) cure all defaults and agree to perform all future obligations, or (II) give creditor opportunity to take possession
  - Upon failure of administrator to perform above, court may permit the creditor to take possession of the aircraft object upon such terms as the court may order
  - Option A has been selected in most instances
  - Contracting States which have made a declaration agree to assist foreign courts and foreign insolvency administrators in carrying out the foregoing

# International Registry

- Aviareto awarded contract to build and operate International Registry
  - Located in Dublin
- Duties include providing technical assistance and authorize companies/individuals to create entries in the Registry
- Does NOT provide advice or opinions

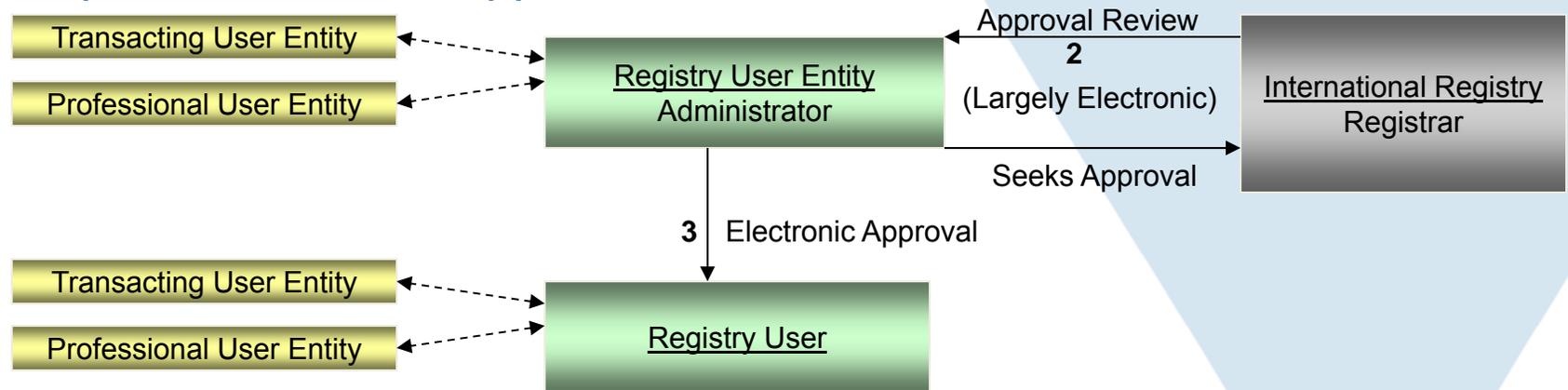
# International Registry

- System designed to protect searching, not registering, parties
- E-consents
- No further registration of prospective interests
- Infinite duration
- Criteria: name/make/MSN (generic)
- Discharge of a registration must be done by or with the written consent of the party in whose favor the registration was made
- 'Notice' filings only – not filing of complete documents

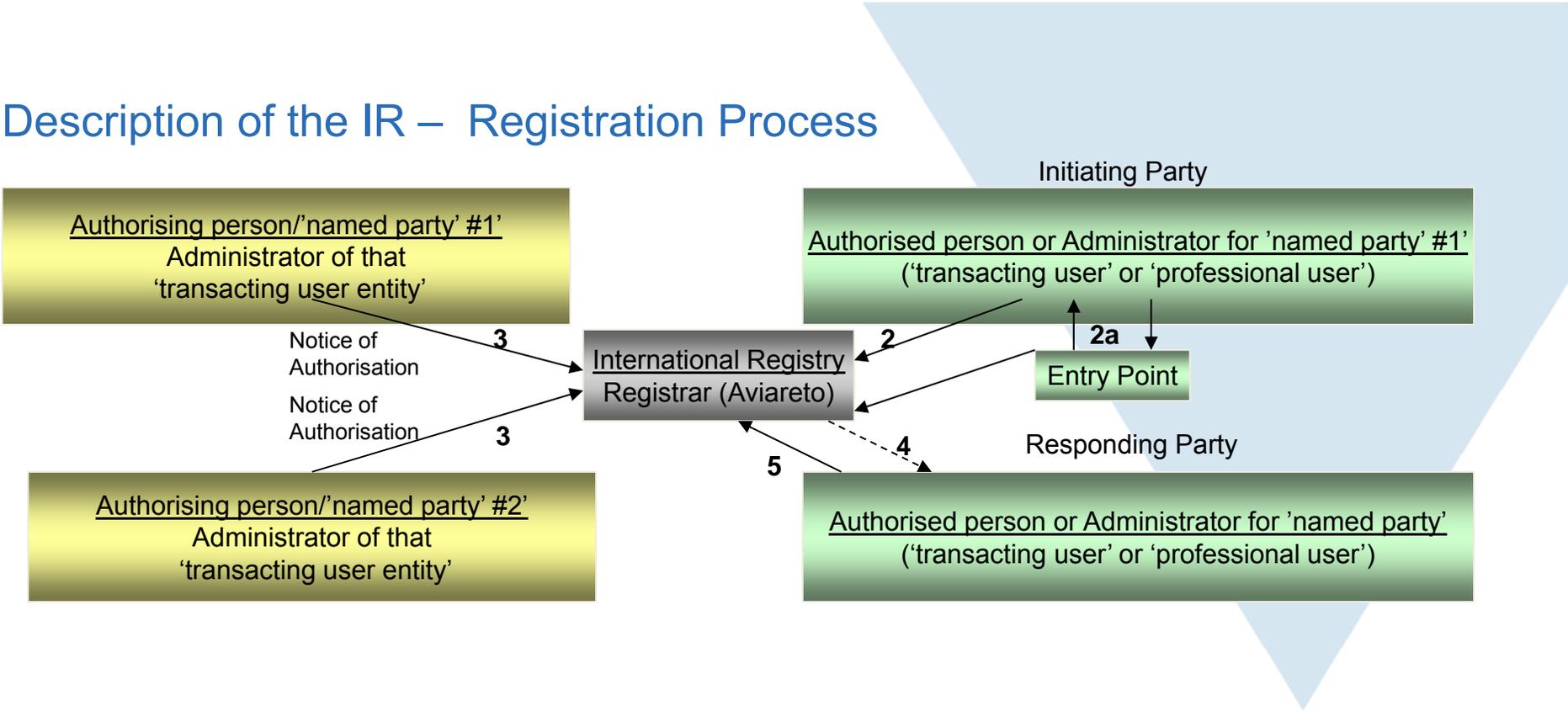
# IR in Practice - schematic description of the IR

- Approval process
- Registration process

## Description of the IR – Approval Process



# Description of the IR – Registration Process



# Designated Entry Points

- A Contracting State may at any time designate an entity as the entry point through which there shall be transmitted to the International Registry information required for registration
  - Two types of entry points
    - Authorizing entry point - authorizes the transmission of information required for registration
    - Direct entry point - transmits information directly to the International Registry
  - Mandatory for airframes, only optional for engines

**Priority Search Certificate**  
 Issued by  
**The International Registry for International Interests  
 In Mobile Equipment (Aircraft Equipment)**

This certificate was created on 26 Jan 2007 at 04:04:32 GMT

Certificate Number: 144184  
 Requested by: **Robert James v/d. Douglas Foster Peeples Hough & Jones**  
 Registry of Priority Search Certificate: **DPTM**

Search Criteria

Manufacturer: **BOEING**  
 Model designation: **737-700**  
 Manufacturer's serial number: **10244**

Search Results

| Deadline     | Details of Interest  |                        |
|--------------|--|------------------------|
|              | <u>Registration</u>  |                        |
| 26JAN2007    | Type:  | Contract of Sale       |
| 02:11:43 GMT | File number:   | 65683                  |
|              | Seller:  |                        |
|              | Wells Fargo Bank, Northwest, National Association, as Trustee                                      |                        |
|              | Buyer:   |                        |
|              | Wells Fargo Bank, Northwest, National Association, as Owner Trustee                                |                        |
|              | Contract details: <a href="mailto:michael.loggan@wellsfargo.com">michael.loggan@wellsfargo.com</a> |                        |
|              | Contract details: <a href="mailto:michael.loggan@wellsfargo.com">michael.loggan@wellsfargo.com</a> |                        |
|              | <u>Registration</u>  |                        |
| 26JAN2007    | Type:  | International Interest |
| 00:25:59 GMT | File number:   | 63659                  |
|              | Debtor:  |                        |
|              | Wells Fargo Bank, Northwest, National Association, as Owner Trustee                                |                        |
|              | Contract details: <a href="mailto:michael.loggan@wellsfargo.com">michael.loggan@wellsfargo.com</a> |                        |
|              | Contract details: <a href="mailto:debra.wight@usbank.com">debra.wight@usbank.com</a>               |                        |
|              | Contract details: <a href="mailto:debra.wight@usbank.com">debra.wight@usbank.com</a>               |                        |

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