

Creditors' rights against third parties under the Cape Town Convention

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On November 16, 2001, 20 States signed the Cape Town Convention on International Interests in Mobile Equipment at a Diplomatic Conference hosted by the South African Government. It is hoped that the Convention will enter into force for applicable countries by the beginning of 2005.

The Convention together with the Protocol on Matters Specific to Aircraft Equipment (the "Protocol"), (collectively the "Convention") was designed to facilitate asset-based finance and leasing of aircraft, engines and helicopters.

It creates the concept of an "international interest" in aircraft objects and associated rights as defined by the Convention in countries that are signatories to it and provides, among other things, for the registration and priority of those rights in an international registry.

This article is a general overview of the Convention solely as it relates to the rights created and recorded under it that can be effective against third parties or against the debtor in a bankruptcy.

This article does not address rights between the parties, such as remedies upon default, or the many other useful and important aspects of the Convention and the Protocol. All references in this article are to the official Consolidated Text ("CT") of the Convention and the Protocol, which were designed to be read and interpreted together as a single document.¹

Article 1 of the CT includes certain defined lower-case terms, some of which are used in this article. It is recommended to legal practitioners that the Consolidated Text, the Official Commentary referred to in footnote no. 1, the AWG Matrix of Declarations by Contracting States maintained by the Aviation Working Group on the AWG website listed in footnote no. 1, the papers prepared under the auspices of the AWG Legal Advisory Panel according to the AWG website listed in footnote no. 1, and the regulations to be issued for the international registry, be consulted for a more thorough understanding of the Convention.

What constitutes an international interest under the Convention?

The "international interest" is a creature of the Convention. An "international interest" in aircraft objects is an interest, constituted under Article 10 of the CT, in airframes, engines or helicopters: (a) granted by the debtor under a security agreement; (b) vested in a person who is the conditional seller under a title reservation agreement; or (c) vested in a person who is the lessor under a leasing agreement. (CT Art. 2)

It should be noted that under the Convention, a security

agreement cannot also be a lease or title reservation agreement, but a lease or a title reservation agreement can also be a security agreement. Ultimately, the applicable law determines whether an international interest falls within the category of a security agreement, a title reservation agreement, or a leasing agreement (CT Art. 2(3)).

Under the Convention, all that is needed to constitute an international interest is an agreement that conforms to the requirements of Article 10 of the CT as follows: the agreement creating or providing for the international interest must: (a) be in writing; (b) relate to an aircraft object of which the charger, conditional seller or lessor has the power to dispose; (c) enable the aircraft object to be identified; and (d) in the case of a security agreement, enable the secured obligations to be determined, but without the need to state a sum or maximum sum secured.

Could different courts come up with different determinations as to the category in which an international interest falls? Yes. However, because the Convention provides for a neutral place to register an international interest, such registration does not result in the redesignation of local law as to what is a security agreement, title reservation agreement, or lease.

What types of assets and other rights are the subject of an international interest under the Convention? The Convention does not use the term "collateral." Instead, the assets and rights that function as the basis for the creation of an international interest are "aircraft objects," "associated rights," "proceeds" and "sales."

"Aircraft objects" includes the following: (a) airframes that would carry at least eight persons or goods in excess of 2750 kilograms; (b) engines having at least 1750 lbs. of thrust if jet propulsion and at least 550 rated take-off shaft horsepower if turbine-powered or piston powered; and (c) helicopters.

"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." Associated rights may be assigned, which assignment, whether by way of security or otherwise, confers on the assignee associated rights with or without a transfer of the related international interest.

Nevertheless, an assignment of associated rights must be effective to transfer the related international interest; otherwise the Convention does not apply (CT Art. 45(3)). In contrast, "an assignment of an international interest created or

provided for by a security agreement is not valid unless some or all related associated rights are also assigned” (CT Art. 45(2)).

“Proceeds” means money or non-money proceeds of an aircraft object arising from the total or partial loss or physical destruction of the aircraft object or its total or partial confiscation, condemnation or requisition (CT Art. 1(jj)). “Proceeds” does not refer to proceeds of sale or disposition after sale.

A “sale” means a transfer of ownership of an aircraft object pursuant to a contract of sale. CT Article 6 lists further CT provisions, including registration, priorities and effects on insolvency, which apply “as if references to an agreement creating or providing for an international interest were references to a contract of sale and as if references to an international interest were references to a sale.”

This means that under the Convention one would register a sale when transfer of title to an aircraft object has occurred. As described later in this article, a prospective sale could also be registered.

How do we register an international interest? The Convention provides for the creation of an international registry (the “Registry”) for registration, including, where appropriate, an amendment, extension or discharge of a registration (CT Art. 26).

The first Registrar, when appointed, should operate for a period of five years from the date of entry into force of the Convention and Protocol. Afterwards, the Registrar will be appointed or reappointed at regular five-year intervals by the

Supervisory Authority.

In addition, Contracting States are to designate at any time an entity or entities in its territory as entry points through which to transmit electronically to the Registry information required for registration.

A Contracting State may also specify the requirements to be satisfied in order to transmit such information to the Registry, including, for example, the type of interest or right, the parties, a description of the document or right, or other requirements of the entry point, the Supervisory Authority or the Registrar.

Who can register, when is registration complete and who can search the registry? Either party to an international interest, a prospective international interest or an assignment or prospective assignment of an international interest may register with the consent in writing of the other party (CT Art. 33(1)). Prospective interests, assignments and sales are explained in the next set of questions. A holder of a non-consensual right or interest may also register.

With regard to a party to an international interest, a prospective international interest or an assignment or prospective assignment, consent may be given electronically and in advance (CT Art. 33(1)(a)). It is important to note, however, that the Registrar is under no duty to inquire whether consent to registration has in fact been given or is valid (CT Art. 31(2)).

Registration is complete upon entry of the “required information” into the Registry database so as to be searchable. A registration is searchable when the Registry has assigned to it

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a file number and the registration information is stored in durable form and accessible at the Registry by manufacturer, serial number and model designation. The regulations to be issued for the Registry will provide more details.

The Registry will be searched by electronic means. Upon receiving a request for a search, the Registrar will issue a search certificate by electronic means with respect to any aircraft object.

The certificate will state all registered information relating to the aircraft object or that there is no information in the Registry. The certificate will also indicate that the creditor named in the registration information has acquired or intends to acquire an international interest in the object but not whether what is registered is an international interest or a prospective international interest.

On the Registry, there will be no “prospective” distinction shown.

When can we register and what is the duration of registration? One can register an international interest, a prospective international interest, an assignment of an international interest, a prospective assignment of an international interest, a sale or a prospective sale at any time.

Each “prospective” interest is defined as: (1) intended to be made in the future; (2) upon the occurrence of a stated event; and (3) whether or not the occurrence of the event is certain.

When a prospective international interest becomes an international interest, the international interest is considered registered from the time of the registration of the prospective interest provided the information is still current and sufficient for registration. (CT Art 32(4)).

Registration of an international interest remains effective until discharged or until expiry of the period specified in the registration. Registration of a sale remains effective indefinitely, but a registration of a prospective sale may be discharged or expire. (CT Art 34(2)).

What are the effects of registration of an international interest against third parties? Under the Convention, registration of an international interest gives priority over any other interest subsequently registered and over an unregistered interest even if the registered international interest was acquired or registered with actual knowledge of an unregistered interest, all with the exceptions set forth in the next sets of questions. (CT Art 42).

Such ranking of priority does not differ with respect to aircraft objects, assignments of associated rights (where one assignment is unregistered), proceeds and sales.

The Convention does not affect, however, rights in accessions, other than aircraft engines, where those rights are held prior to installation if those rights continue to exist after the installation.

The Convention also does not prevent the creation of rights in accessions, other than aircraft engines, that have previously been installed on an aircraft object where those rights are created under the applicable law.

Where more than one assignment of associated rights have been registered, prior-in-time registration wins only “to the extent that the associated rights are related to an aircraft object” (CT Art. 49(1), (2)). Otherwise, applicable law governs the priority of the competing assignments (CT Art. 49(3)).

In the context of registered sales, a buyer of an aircraft object acquires subject to any interest registered at the time of acquisition. However, a buyer acquires its interest in the air-

craft object free from a subsequently registered interest and from an unregistered interest, even if the buyer has actual knowledge of the unregistered interest (CT Art 42(3), (4)).

Can you subordinate interests? Holders of competing interests or rights may subordinate those rights or interests by agreement. Nevertheless, an agreement to subordinate does not bind an assignee of that subordinated interest unless at the time of the assignment a subordination has been registered relating to that agreement. (CT Art 42(b)).

What about priorities as to non-consensual interests? A Contracting State may declare at any time those categories of non-consensual rights or interests (other than registrable non-consensual rights or interests under CT Article 53) which under that State’s law shall have priority over a registered international interest.

A non-consensual right or interest has priority over an international interest only if a declaration of the Contracting State deposited prior to the registration of the international interest covers the non-consensual interest.

Nevertheless, a Contracting State may, at the time of ratification, acceptance, approval of, or accession to the Protocol, declare that a non-consensual right or interest included in a declaration under CT Article 52(1)(a) shall have priority over an international interest registered prior to the date of ratification, acceptance, approval or accession.

Insolvency. The provisions for remedies on insolvency under CT Article 23 apply only where a Contracting State has made a declaration under CT Article 71(3) that it will apply either the entirety of Alternative A or the entirety of Alternative B of CT Article 23.

The Contracting State must also specify the types of insolvency proceedings to which it will apply either Alternative A or Alternative B, as the case may be.

Alternative A of CT Article 23 requires that the insolvency administrator or debtor, as applicable, give possession of the aircraft object to the creditor no later than the earlier of the end of a “waiting period,” as specified in a declaration of the Contracting State that is the primary insolvency jurisdiction, and the date on which the creditor would be entitled to possession of the aircraft object if CT Article 23 did not apply.

The primary insolvency jurisdiction means the Contracting State in which the centre of the debtor’s main interests is situated. Unless and until the creditor is given the opportunity to take possession during this time period, the insolvency administrator or the debtor must preserve the aircraft object and maintain it and its value in accordance with the agreement.

Moreover, the creditor is entitled to apply for any other forms of interim relief available under the applicable law (i.e. the domestic rules of the law applicable by virtue of the rules of private international law of the forum State (CT Art. 5(3))).

The insolvency administrator or the debtor may retain possession of the aircraft object where the insolvency administrator or the debtor has cured all defaults (other than a default constituted by the opening of insolvency proceedings) and has agreed to perform all future obligations under the agreement.

Nevertheless, the insolvency administrator or the debtor must fulfil these requirements no later than the earlier of the end of the waiting period and the date on which the creditor would be entitled to possession if CT Article 23 did not apply. Remedies permitted by the Convention may not be prevented or delayed after this time period.

Finally, no rights or interests, except for non-consensual rights or interests, have priority in insolvency proceedings over registered interests.

Alternative B of CT Article 23 requires that the insolvency administrator or debtor give notice to the creditor within a time specified in a declaration by the Contracting State whether it will cure all defaults other than a default constituted by the opening of insolvency proceedings.

The insolvency administrator or the debtor must also give notice as to whether it will agree to perform all future obligations under the agreement or give the creditor opportunity to take possession of the aircraft object pursuant to applicable law.

If the insolvency administrator or debtor does not give notice, the court may permit the creditor to take possession of the aircraft object upon such terms as the court may order.

Effects of insolvency on registered international interests. In insol-

veny proceedings against the debtor, an international interest is effective if prior to the commencement of the insolvency proceedings that interest was registered in conformity with the Convention (CT Art. 43 (1)). This rule applies to assignments of associated rights (CT Arts. 48 (2) and 50) and to sales (CT Art. 6). With regard to priority, the Convention makes no change to applicable law in insolvency proceedings.

Note:

¹ The Convention is available to be downloaded for personal use only from www.unidroit.org; see R. Goode, *Official Commentary: Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment*, UNIDROIT (2002); see also, the Aviation Working Group website at www.awg.aero for background and current information.

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