

BENEFITS OF CAPE TOWN TO SPREAD BEYOND THE UK TO OVERSEAS TERRITORIES

by Timothy Counsell and Tiffany Boys

Anyone involved in the sale, purchase, finance or leasing of an interest in an aircraft or aircraft engines, particularly in the course of cross border transactions, should make themselves aware of the impact and potential benefits the Cape Town Convention can offer to financiers and borrowers alike.

The Cape Town Convention on International Interests in Mobile Equipment (**CTC**) and the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment (the Protocol, and together with the CTC, the Convention) came into force on 1 March, 2006. The Convention facilitates aircraft finance transactions by providing a regularized electronic international registry of "international interests" over moveable property (the International Registry), such International Registry being recognized in all Contracting States (being countries which have implemented the Convention). Following registration on the International Registry, if and as required, the Convention provides a framework for dispute management as well as remedies and relief available to creditors.

The UK government has announced, in its Response to its 2010 Call for Evidence, that it is committed to ratifying the Convention. Thereafter, the proposed extension by the UK to overseas territories such as Bermuda, means that the Convention may come into force in Bermuda as early as late 2015. There are a number of steps to be taken before the Convention can be implemented as part of Bermuda law and representatives from both the public and private sector in Bermuda involved with aircraft registration and finance have been working towards the anticipated implementation in order to ensure the alignment of relevant domestic law with the Convention.

This article will discuss the impact the ratification of the Convention will have both domestically and on borrowers and financiers in transactions involving a Bermuda component (company or aircraft or both).

BENEFITS FOR FINANCIERS

The important impact that the Convention has on aircraft finance transactions is that it changes the manner in which interests in aircraft and aircraft engines are documented, recorded and enforced. These changes provide financiers with the following advantages:

- Registration of an international interest in relation to an aircraft object (i.e. aircraft, airframe and aircraft engines) on the International Registry is available electronically, 24 hours a day, seven days a week, allowing financiers and other interested parties the opportunity to record their interests at any time from anywhere. Parties involved in cross border transactions will recognize the benefit of having an efficient and accessible registration process. They will also appreciate that the availability of the International Registry provides greater transparency, allowing any registered interests to be publicly searched, identifying any competing interests in relation to the asset.
- The International Registry is a priority register, meaning that upon registration of an international interest such registered interest takes priority over subsequent registrations in respect of the same security and against any unregistered interests. These simple and clear "first to file" priority rules can only be varied by registration of subordination arrangements on the International Registry.
- The International Registry allows for international interests over airframes to be registered separately from interests over aircraft engines. In the aviation industry, this is beneficial given the inevitable changes which result in any long term aircraft operations.
- In addition to international interests, the International Registry records IDERAs or irrevocable de-registration and export request authorizations. On provision by the borrower, the IDERA provides the creditor essential tools in any enforcement situation.
- Creditors can benefit from clear enforcement rights, which are based on common law self-help remedies (i.e. remedies which do not require a court order to enforce). These include taking possession or control of the secured asset, selling or granting a lease over the asset and/or collecting or receiving any income or profits resulting from the management or use of the asset.
- Registration of an international interest provides certainty and a reduction in costs in the event of repossession of an aircraft or aircraft engine on an insolvency or default where the secured asset is located in a country whose laws otherwise make repossession difficult or impossible.

BENEFITS FOR BORROWERS

Borrowers looking to register an aircraft in Bermuda will benefit from the uniformity to which international interests are documented and recorded. The certainty experienced by creditors will reduce the complexity of cross border transactions utilized by both borrowers and airlines, potentially reducing overall costs associated with the registration of an aircraft.

The major benefit borrowers will reap is a discount in interest costs made available in countries which have the Convention in operation or are Contracting States, being the so-called 'Cape Town Discount'. Airlines from these countries may be eligible for a discount of up to 10% on the premium of export finance provided by ECAs.

LEX SITUS RULES AND THE CONVENTION

Prior to the Convention, there were important considerations surrounding how to effect a valid Bermuda law mortgage. The lex situs rules established by the Blue Sky decision¹ confirmed that the validity of the mortgage is based on the lex situs of the aircraft, being the law of the physical location of the aircraft at the time of entry into the mortgage. As a result of the Blue Sky decision, steps are often taken to appropriately position an aircraft when a mortgage is entered into, adding to the operational and economic costs of the transaction.

The Convention does not expressly address common law issues determined under the proper law of the mortgage instrument and as such, there has been some uncertainty as to whether the lex situs rules would now be irrelevant. The UK's response to this issue has been to include a provision in the draft International Interests in Aircraft Equipment (Cape Town Convention) Regulations 2015 (the Regulations), which will serve to expressly override lex situs considerations when a mortgage is entered into, to which the Convention applies. Article 6(3) provides "the international interest has effect where the conditions of the Cape Town Convention and the Aircraft Protocol are satisfied (with no requirement to determine whether a proprietary right has been validly created or transferred pursuant to the common law lex situs rule)." Should the Regulations come into force in the UK with the above provision, and provided that the Convention applies, this will dispel uncertainty under English law and avoid the requirement for aircraft to enter English airspace at the time of entry into an English law mortgage.

Similar provisions are under consideration in Bermuda and it is likely that domestic legislation adopted by Bermuda in connection with the Convention will include a provision having the same effect as noted above.

IMPACT ON BERMUDA FOLLOWING RATIFICATION

The ratification of the Convention in Bermuda, as with most jurisdictions, will have a resultant impact on domestic law and, in particular, as it relates to the creation of security in relation to aircraft objects and registration of security over aircraft objects. That said, the mechanism by which an aircraft is registered on the Bermuda register of aircraft will likely be unaffected. Registration of a mortgage at the Bermuda Department of Civil Aviation will remain open and available and will continue to provide the primary means by which a secured party registers their interest over an aircraft where the Convention does not apply.

Implementation of the Convention will simplify aircraft finance transactions and reduce risks associated with cross border transactions in the sense that a more uniform result is to be expected on enforcement actions. Creditors contracting with Bermuda incorporated borrowers will be afforded rights and remedies under the Convention, providing such creditor with increased certainty and comfort which in turn, may result in a potential reduction in transaction costs. Moreover, financiers will appreciate that registration on the International Registry can occur notwithstanding any time zone differences.

In brief, ratification of the Convention in Bermuda will be welcomed by financiers, ECAs, borrowers, and airlines, all of whom can benefit from a harmonized legal framework provided under the Convention. Following the ratification of the Convention in Bermuda, Bermuda will enhance its existing position as a leading off-shore aircraft registration and aircraft finance jurisdiction providing an ideal jurisdiction for financiers and borrowers alike.

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