

CAPE TOWN CONVENTION – THE FUTURE OF AIRCRAFT FINANCE AND THE BENEFITS TO BERMUDA

by Clive Langley

With the worldwide growth of aircraft financing and leasing the need for greater certainty and predictability given the cross border nature of transactions is becoming increasingly important. The various methods utilised to finance aircraft objects require, for their effectiveness, a set of legal rights and remedies to be in place which allow parties to quickly and effectively enforce under a contract.

The Cape Town Convention on International Interests in Mobile Equipment (**the Cape Town Convention**) and the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment (the **Protocol**) (the Cape Town Convention and the Protocol together the **Convention**), which came into effect on 1 March 2006, has as its main objective, the facilitation of aircraft finance by standardising transactions involving moveable property with respect to 'aircraft objects' (airframes, aircraft engines and helicopters) by the creation of an electronic international registry of 'international interests' which are recognised by those states that have implemented the Convention (**Contracting State**) and to provide various default remedies to a creditor (including in the context of insolvency) should the need arise.

To date the Convention has not been extended to Bermuda as it can only directly apply through implementation by the United Kingdom. However, it is expected that the United Kingdom will ratify the Convention later this year and a group of Bermuda specialists from the public and private sector, including Appleby, is currently working towards the implementation of the Convention and the enactment of domestic legislation in order to give effect to the relevant provisions of the Convention.

This article considers some aspects of the Convention and how the extension to Bermuda will benefit the future of its aircraft finance industry.

WHAT IS AN INTERNATIONAL INTEREST?

An 'international interest' is essentially an interest in uniquely identifiable aircraft objects:

- granted by a chargor under a security agreement;
- vested in a person who is the conditional seller under a title reservation agreement;
- vested in a person who is the lessor under a leasing agreement
- granted by a seller under a sale agreement; or
- held by an assignee.

An international interest in an object also extends to proceeds of that object.

FORMAL REQUIREMENTS

In order to be constituted as an international interest under the Convention, the agreement creating or providing for the interest must:

- be in writing;
- relate to an object of which the chargor, conditional seller or lessor has power to dispose;
- enable the object to be identified in conformity with the Convention; and
- 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.

DEFAULT REMEDIES

The rules regarding remedies under the Convention are based on common law self-help remedies (i.e. remedies that do not require a court order in order to enforce), however, a Contracting State that has a legal system based on civil law which enforces remedies by court order has the option to make a declaration to the effect that the remedy may only be exercised by leave of the court.

The default remedies provided by the Convention to a chargee are as follows:

- to take possession or control of any object charged to it;
- to sell or grant a lease of any such object;
- to collect or receive any income or profits arising from the management or use of any such object.

In addition to the above remedies the following are additional remedies (subject to various pre-conditions being satisfied):

- to effect the de-registration of an aircraft object; and
- to effect the export and physical transfer of the aircraft object out of the territory in which it is located.

It should be noted that in order to exercise these remedies the debtor must agree. The creditor must exercise any remedy provided under the Convention in a “commercially reasonable manner” which means that it must be exercised in accordance with the relevant provisions of the security agreement (except where such provisions are manifestly unreasonable).

INTERIM RELIEF

If a creditor provides evidence of default by the debtor, the creditor may, pending a final determination of its claim (and subject to the debtor agreeing to such relief), obtain a “court speedy relief” in the form of one of the following orders:

- preservation of the object and its value;
- possession, control or custody of the object;
- immobilisation of the object; and/or
- lease or management of the object and income therefrom.

The court can, however, “impose such terms as it considers necessary to protect interested persons” (such as the debtor).

IDERAS

The Convention allows for Irrevocable de-registration and export request authorisations (abbrev. IDERA) to be recorded on the International Register. As the name suggests, an IDERA allows the creditor (provided the debtor has agreed) to de-register the aircraft object in order to export the aircraft object to another territory.

ADVANTAGES OF REGISTRATION FOR AIRCRAFT FINANCIERS

- i. gives notice of the interest to third parties;
- ii. speed, certainty and reduction of costs in respect of the repossession of aircraft and aircraft engines on an insolvency or default where the assets in question are located in a country whose legal system may cause enforcement or other issues that may make repossession difficult or impossible under local laws;
- iii. the ability to protect a party’s title and security in aircraft and engines through the ‘International Registry’ which is available 24 hours a day, seven days a week;
- iv. the availability of a register which creates priority upon registration of a security interest under the Convention whereby registered interests take priority over unregistered interests, earlier registrations take priority over later registrations, and parties are able to vary the priority of a security interest through the registration of subordination arrangements at the International Registry; and

- v. ensures the effectiveness of an international interest in the event of insolvency proceedings against the debtor whereby the proprietary interest is recognised and the creditor will have a claim against the object for any outstanding obligations.

LIKELY ADVANTAGES FOR AIRLINES

The Convention will reduce some of the risk associated with aircraft finance and leasing transactions and potentially broaden credit options available to borrowers and reduce interest rates. It will also potentially give rise to longer term financing structures given on favourable terms.

The implementation of the Convention by the United Kingdom and extension to Bermuda will allow creditors and secured parties dealing with Bermuda based borrowers to take advantage of all the rights, benefits and remedies granted to creditors under the Convention giving them increased certainty with respect to security interests.

The extension of the Convention to Bermuda will strengthen further its position as one of the top offshore leaders in the global aircraft finance and leasing industry.

KEY CONTACTS

For more information on the Convention and how the extension to Bermuda will benefit the future of its aircraft finance industry, please contact a member of the Bermuda aviation team.



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