Flynn O’Driscoll Legal Update

THE CAPE TOWN CONVENTION – AN OVERVIEW

Background

The Cape Town Convention is designed to create an international framework for the formation, registration (through an International Registry), protection and enforcement of certain international interests in airframes, aircraft engines and helicopters.

Advantages to aircraft financiers

For an aircraft financier, the merits of the Cape Town Convention and its Aircraft Equipment Protocol (together Cape Town) are that it aims to:

- protect the parties’ title and security interests in aircraft and engines by:
  - providing for the registration of international interests at a single, web-based International Registry that is always open
  - subjecting those interests to a simple priority regime whose main principles are:
    1. registered interests take priority over unregistered interests;
    2. earlier registrations take priority over later registrations; and
    3. the parties can vary priorities by registering subordination arrangements at the International Registry.

- bring speed, certainty and cost savings to the process of repossessing (and otherwise realising value from) aircraft and engines on an insolvency or other default, particularly where these assets are in a country whose legal system would otherwise give cause for concern in such matters.

Advantages to airlines

The intention of Cape Town is that the benefits for financiers will result in reduced finance costs to airlines.

This is already proving to be the case for airlines in ratifying states that want to add Boeing aircraft to their fleets as US Eximbank
offer a discount on its exposure fee on
financings into Cape Town states.

In which states does Cape Town apply?

Cape Town came into force on 1 March 2006,
Ireland was the first EU state to ratify, the
International Registry itself is based in Dublin.

As of 16th January 2014, the following sixty
countries and regional economic
organisations have ratified or acceded to the
Convention:

Afghanistan, Albania, Angola, Bahrain,
Bangladesh, Belarus, Brazil, Cameroon,
Canada, Cape Verde, China, Colombia, Congo, Costa
Rica, Cuba, Ethiopia, European Community,
Fiji, Gabon, India, Indonesia, Ireland, Jordan,
Kazakhstan, Kenya, Kuwait (effective 1st
February 2014), Latvia, Luxembourg,
Madagascar, Malawi (effective 1st May 2014)
Malaysia, Malta, Mexico, Mongolia,
Mozambique, Myanmar, New Zealand,
Nigeria, Norway, Oman, Pakistan, Panama,
Russian Federation, Rwanda, Saudi Arabia,
Senegal, Seychelles, Singapore, South Africa,
Spain, Syrian Arab Republic, The Kingdom of
the Netherlands, Tajikistan, Togo, Turkey,
Ukraine, United Republic of Tanzania, United
States of America, United Arab Emirates,
Zimbabwe.

Ireland

In late 2013 the Irish government announced
plans to adopt an enhanced aviation
insolvency regime which will result in more
certainty to leasing companies and airlines in
the event of insolvency by creating a clear
timetable for both the creditor and the airline
during which they can negotiate the return or
retention of the aircraft.

The changes will enable Ireland to have a
regime equivalent to Alternative A in Protocol
Article XI of the Cape Town Convention on
International Interests in Mobile Equipment
(the “Convention”) and the Protocol to the
Convention on Matters Specific to Aircraft
Equipment and will also facilitate the issuance
of Enhanced Equipment Trust Certificates
(“EETC’s”) in Ireland.

The Convention offers contracting states
three options on insolvency, namely:

- To adopt, by declaration, Alternative A
  of Article XI of the Protocol (‘Alternative
  A’), or
- To adopt, by declaration, Alternative B
  of that Article (‘Alternative B’), or
- To retain national insolvency law, by
  making no declaration.

If a contracting state adopts Alternative A or
B, the chosen alternative will then override
otherwise applicable insolvency law.

Alternative A requires the insolvency
administrator or insolvent debtor, by the end
of a ‘waiting period’ specified in the
contracting state’s declaration, either:

a) to give possession of the aircraft to the
   creditor, or
b) (b) to cure all defaults and to agree to
   perform all future obligations under
   the relevant agreement (the lease,
The ‘waiting period’ is decided at a national level with the majority of countries, including Ireland, choosing a 60 day waiting period. Thus Alternative A provides both the creditor and the airline with a clear timetable during which they can negotiate the return or retention of the aircraft.

**Russia**


Cape Town has applied in Russia with effect from September 1, 2011.

The Russian Federation ratified Cape Town by the Federal Law dated December 23, 2010 No. 361-FZ with declarations in relation to:

- the priority of certain claims in insolvency proceedings over registered international interests;
- the possibility of arrest or detention of aircraft objects for unpaid services rendered in relation thereto;
- the jurisdiction of state arbitration courts to resolve disputes relating to Cape Town;
- the possibility of out-of-court exercise of remedies that require no application to court under Cape Town; and
- the application of Alternative A of Article XI of the Protocol in all types of bankruptcy proceedings with a waiting period of 60 calendar days.

Accession by the Russian Federation to Cape Town represents a significant leap forward towards its recognition of international standards in aircraft financing and may give international aircraft financing institutions more confidence in participating in aircraft financing and leasing transactions with Russian operators.

**To what transactions does it apply?**

Cape Town will apply to the type of document listed below when, on execution of the document in question, the ‘debtor’ is situated in a state in which Cape Town is in force. A debtor could be:

- a lessee under an aircraft lease;
- a mortgagor under an aircraft mortgage;
- an assignor under a security assignment of a lease or other document originally creating an international interest;
- a buyer under a conditional sale or hire purchase agreement; or
- a seller under an aircraft purchase agreement or engine contract.

It also applies when the parties have agreed the aircraft or helicopter in question (but not engines which are detached from an aircraft or helicopter) will be registered in one of those states.
A party is ‘situated’ for these purposes in a state where, it is incorporated, has its place of business, registered office or centre of administration in the state. The state(s) in which the other parties to the documents listed above are situated has no effect on whether Cape Town applies.

The approach to pre-Cape Town transactions

A fundamental rule of Cape Town is that it does not affect pre-existing rights and interests or their priorities, in other words, the Cape Town regime does not apply retrospectively. Accordingly, for the most part, there is little to do if Cape Town comes into force in a jurisdiction where the lessee or borrower or buyer etc, under a pre-Cape Town transaction, is situated.

Ratifying states can depart from this fundamental rule when or after ratifying by declaring that the priority of rights arising under pre-existing transactions will be subject to the Cape Town regime, however, to date no state has done so.

There are two other situations in which Cape Town could affect an existing financing. These are where the transaction documents:

- contain a Cape Town further assurance clause or
- are amended, or novated or supplemented in ways that create interests to which Cape Town applies.

Further assurance clause

It has been common for several years to provide in documents that the parties will enter into new agreements and take other actions, if Cape Town comes into force in states relevant to the transaction, so as to provide the financiers with rights under Cape Town.

If financiers invoke these clauses, then any international interests those new documents create will need to be registered at the International Registry to protect the priority of the international interests they create.

Financiers may decide, however, that they would rather rely on the protection given by Cape Town’s priority rules not applying retrospectively, than invoke their further assurance clause.

Amending, novating or supplementing existing transaction documents

If Cape Town has come into force in a state where your lessee, mortgagor or other debtor is located or in a state you have agreed the aircraft will be registered, and, for whatever reason, your transaction documents are amended, novated or supplemented in ways that create international interests, then those interests should be registered under Cape Town.

There are many permutations as to what changes to transaction documents will or will not create an international interest under Cape Town to be worth summarising here. It is best to analyse, and take legal advice, on individual cases as they arise.
Should you have any queries arising out of the foregoing please contact either of the undersigned who will be happy to assist.

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