

Aircraft Financing Under Scheme of the Cape Town Convention

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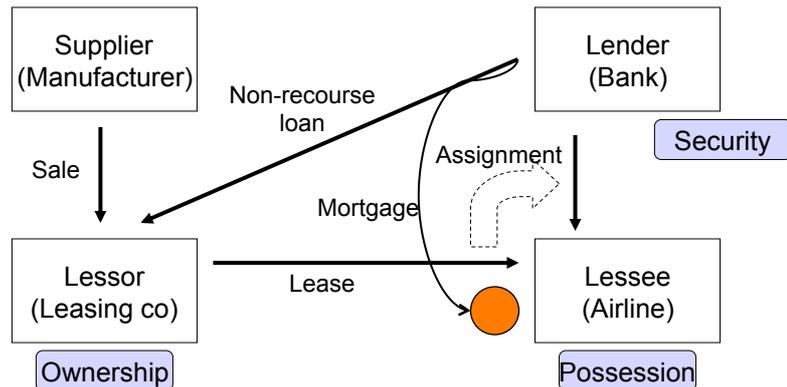
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Leveraged Lease

* Based mainly on Roy Goode, *Commercial Law* (2010) p. 779.



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Geneva Convention 1948

Data

- Name: Convention on the International Recognition of Rights in Aircraft
- Drafting agency: ICAO
- Adoption: 1948
- Parties: 89

Objective: Construction of international recognition framework of rights concerning aircraft

Kinds of right to be recognized (Art. 1(1))

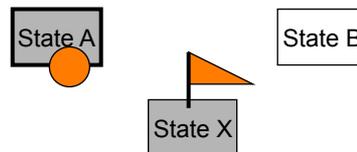
- Rights of property in aircraft
- Rights to acquire aircraft by purchase coupled with possession of the aircraft
- Rights to possession of aircraft under leases of six months or more
- Mortgages, hypothèques and similar rights in aircraft

Requirements of recognition (Art.1(1))

Such rights

- have been constituted in accordance with the law of the contracting state in which the aircraft was registered as to nationality, and
- are recorded in a public record of that state.

Sphere of application (Art.11(1)): In each contracting state, the Convention is applied to all aircraft registered as to nationality in another contracting state.



- Grey box represents a contracting state, and
- White box represents a non contracting state.
- Black box represents that the country is governed by the Convention.

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Problem of the Geneva Convention 1 - Limit of Conflict of Laws Resolution

(1) Research costs on foreign law

In a normal situation that aircraft has the nationality of country where airline is located, that costs inevitably occur.

(2) Mosaic of governing laws

The Convention doesn't prescribe for assignment of secured obligation and treatment in the case of insolvency.

→ It must expand research into other than the law of aircraft's nationality.

(3) Blank zone of application

- In the country of aircraft's nationality ($\hat{=}$ airline located country), the Convention doesn't apply.

→ Any care is not paid to the recovery of aircraft in that country.

↓

- In practice, in order to cope with the country risk of the country, export credit guarantee or aircraft repossession insurance have been used.

→ Airlines located in developing countries must bear the high risk premiums. It has prevented efficient transactions.

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Problem of the Geneva Convention 2 - Inefficient Domestic Registration System

(1) Registration system of chattel mortgage in past Peru

- Registrar's staffs had authority to review applications of registration and to permit third parties to browse the data of registry.

→ It interfered with smooth registration and browse.

- As to browse, even a person who received a permission was not free to browse all data.

→ Understanding priority exactly was difficult.

- Possible corruptions

(2) Registration system of aircraft in Japan

As registration fee is 3/1000 of secured loan, the majority of aircraft mortgage effectively constituted are not registered.

↓

Registration systems are often useless.

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Cape Town Convention and Aircraft Protocol

Data

- Name
 - Convention on International Interests in Mobile Equipment
 - Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment
- Drafting agency: UNIDROIT
- Adoption: 2001
- Parties: Convention 60; Protocol 54

Objective

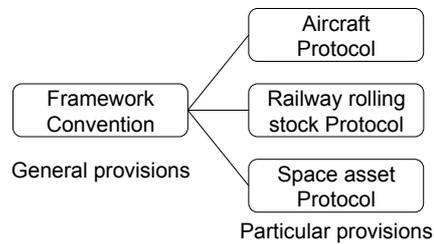
- Facilitating asset-based financing and leasing of high-value mobile equipment in an efficient manner
- The Convention establishes an international legal regimen of security interests in relation to transactions involving that equipment.

Target

- Equipment: (a) aircraft (airframe, engine, and helicopter), (b) railway rolling stock, and (c) space asset
- Transaction: (a) secured loans, (b) title reservation, and (c) lease

Structure

- Dual instruments structure (see below)
- System of Declarations



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Intl Interest and Intl Registry

International Interest

- = Original right representing collateral interest for creditor (chargee, conditional seller, lessor)
- Formal requirements of the constitution → Art.7
- Perfection → Registration in the International Registry (Art.29)



Photo: Sato

International Registry

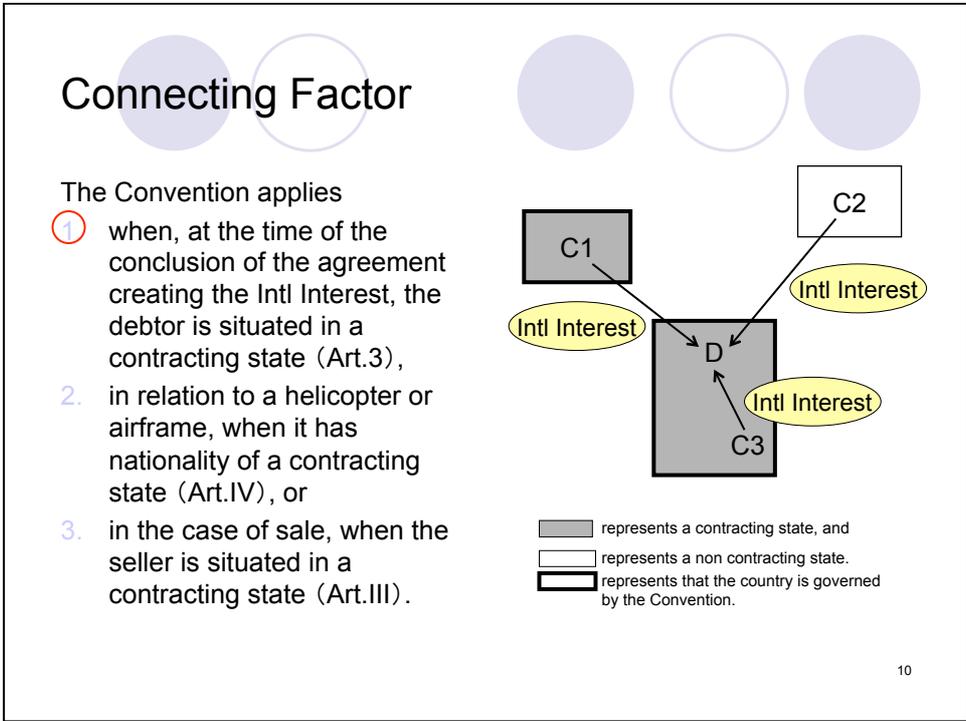
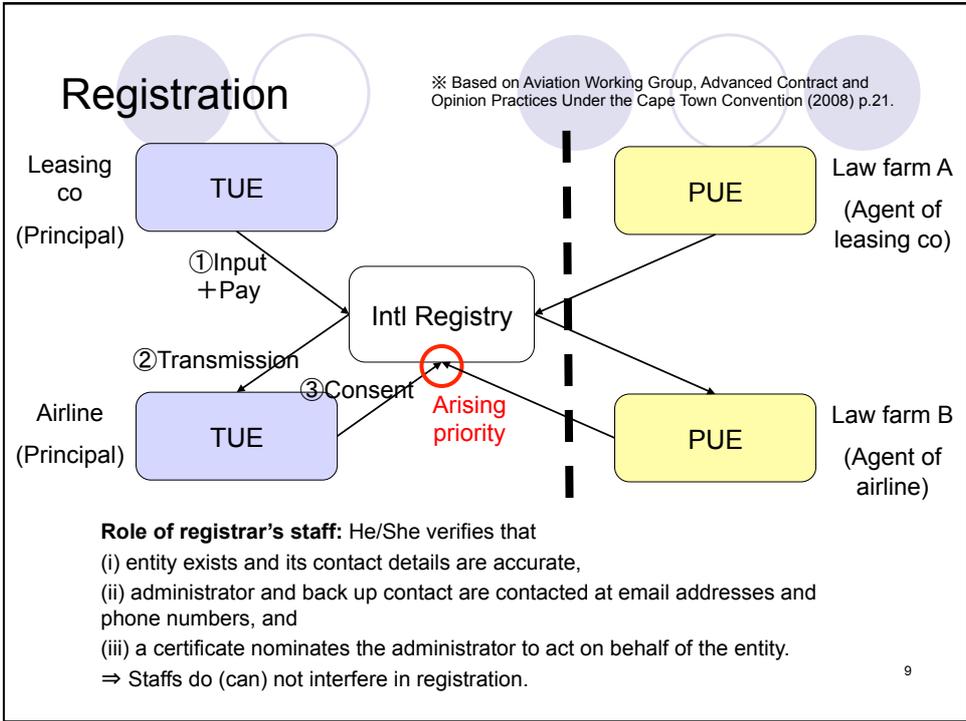
Data

- Name: International Registry of Mobile Assets
- Operating body: Aviareto (joint venture company of the Irish Government and SITA)
- Location: Dublin

Feature

- The system is fully electronic.
- The data base is made up asset by asset. Access for registration is strictly controlled. Search service is available to everyone through online-issued "Priority Search Certificate" (\$35).

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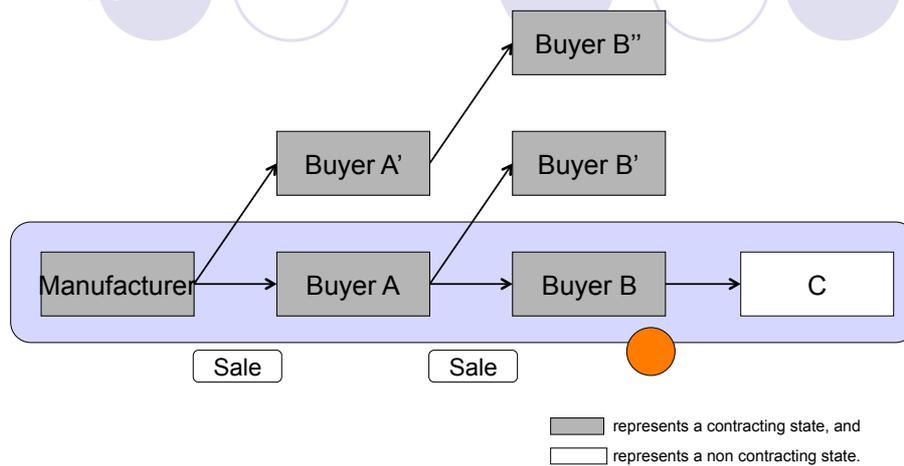
Interests Registrable in the Intl Registry

Art.16(1), III

1. Intl interests and prospective Intl Interests
2. Registrable non-consensual rights and interests
- ③. Assignments and prospective assignments of Intl Interests
4. Subordinations of interests
5. Acquisitions of Intl Interests by legal or contractual subrogations under the applicable law
6. Notices of national interests
- ⑦. Sale and prospective sale

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Sale



⇒Activation of the used aircraft market

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Assignment of Intl Interests

Requirements of effect to the debtor

- ① written notice, ② identification of obligations, and ③ written consent by debtor (Art.33 and Art.XV)

Requirements of effect to the third party

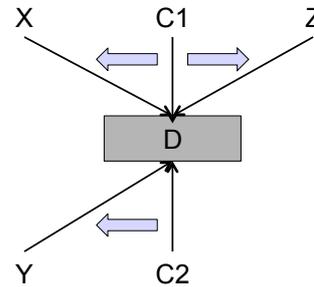
- (a) Assignments of two sets of obligations related to different Intl Interests
- (b) Successive assignments of the same set of obligations arising in relation to a single Intl Interest

(a) Priority problem between X and Y

Art.31(1): Assignee succeeds the rights of assignor.
 Ex.) If C1 registers his "Intl Interest" earlier than C2,
 → X has priority to Y.

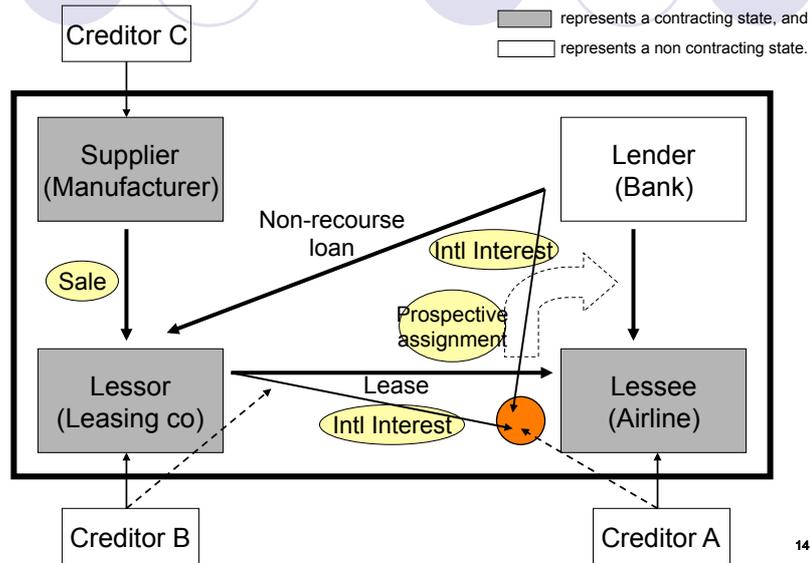
(b) Priority problem between X and Z

Art.35: In order of registration
 Ex.) If X registers her "assignment" earlier than Z,
 → X has priority to Z.



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Protection of the Whole Transaction



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Jurisdiction: Choice of Forum (Art.42)

Par.1: Subject to Articles 43 and 44, the courts of a Contracting State chosen by the parties to a transaction have jurisdiction in respect of any claim brought under this Convention, whether or not the chosen forum has a connection with the parties or the transaction. Such jurisdiction shall be exclusive unless otherwise agreed between the parties.

Par.2: Any such agreement shall be in writing or otherwise concluded in accordance with the formal requirements of the law of the chosen forum.

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Jurisdiction on the Relief Pending Final Determination (Art.43)

Relief pending final determination

- If a creditor adduces evidence of default, he obtains from courts speedy relief in the form of orders as the creditor requests, pending final determination of its claim and to the extent that the debtor has so agreed (Art.13(1)).
- Courts may impose some terms only in the two events (Art.13(2)).
 - (a) The creditor fails to perform its obligations to the debtor under the Convention.
 - (b) The creditor fails to establish its claim on the final determination.
- However, even these safeguards for the debtor may be eliminated if agreed in writing (Art.X(5)).

Jurisdiction on the relief

- Court where object located (Art.43(1))
 - (a) preservation of the object and its value
 - (b) possession, control or custody of the object
 - (c) immobilisation of the object
- Court where debtor situated (Art.43(2), X(3))
 - (d) lease, or management of the object and the income therefrom
 - (e) sale and application of proceeds therefrom
- Court chosen by the parties and court where the object is registered as to nationality (Art.43(1)(2), XXI)
 - (a) to (e)

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Jurisdiction to Make Orders Against the Registrar (Art.44)

Par.1: The court of the place in which the registrar has its center of administration (Irish court) has exclusive jurisdiction to award damages or make orders against the registrar.

Par.2, 3: Ex.) When a deregistration event of the Intl Interest (such as satisfaction for the secured obligation) occurs and a debtor requests a creditor to procure discharge of the registration, the creditor fails to respond to that request.

- (i) When the creditor has ceased to exist or cannot be found,
Irish court has exclusive jurisdiction, on the application of the debtor, to make an order directed to the registrar requiring to discharge the registration.
- (ii) In other cases,
Irish court may direct the registrar to take such steps as will give effect to an order of a court having jurisdiction under the Convention.

Irish court takes the guardian role of the data of the Intl Registry.

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Discount and Compliance

For the details, see Zasu and Sato, "Providing Credibility around the World: Effective Devices of the Cape Town Convention," 33(3) *European Journal of Law and Economics* 577 (2012).

Overview

- From July 2007, the 'Cape Town Convention Discount' is operated on the basis of the OECD's Sector Understanding on Export Credits for Civil Aircraft (ASU). The discount may reduce the risk premium of export credits by up to 10%.
- A set of options on default remedy is specified in ASU. A contracting state is required to choose and implement that set in order for its own airlines to enjoy the Discount.

Ex. of the specified option

- (1) Extra-judicial exercise of remedies
 - (2) Hard rules on debtor's insolvency
 - (3) Deadlines on the Relief Pending Final Determination
- Relief (a)-(c): within 10 days from petition
Relief (d),(e): within 30 days from petition

Feature

- Contracting states eligible for the Discount are placed on a list (20 states). The list is disclosed on the OECD's website.
- When an eligible state breaches the Convention, the OECD countries are obliged to notify the OECD secretariat. In response, the secretariat deletes that state from the list. Then, airlines located in the state can no longer enjoy the Discount.

Effect

- Growth in the number of contracting states
- Convergence of option selection among states
- Share of Information on breach among the export credit agencies and effective sanction to the breaching state
→ ensuring compliance

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Conclusion

- Legal stability that the Geneva Convention 1948 provides is costly and fragile. The Cape Town Convention 2001 shapes an ultra-national legal regimen of security interests for aircraft.
- The International Registry achieves economies of scale. In addition, its System fused with technology succeeds in excluding country risk from registration and search service. Moreover, as a result of solving priority problems including assignment of Intl Interest or sale, the system makes it possible to protect the whole transaction structure even in international context.
- Jurisdiction provisions are applied to accomplish both dispute resolution in a credible court and rapid enforcement of Intl Interest. In addition, they grant inviolability to the International Registry.
- Involving a sanction mechanism in the discount system may deter developing countries from breaching the Convention



In order not only to establish cooperative relations among states, but also to secure the commitment of non-interference in transaction from states, multilateral treaty is applied.