
The Cape Town Convention in the UK: Effective 1 November 2015

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Following accession to the Cape Town Convention¹ by the UK on 27 July 2015, the International Interests in Aircraft Equipment (Cape Town Convention) Regulations 2015 (the “Regulations”) will enter into force on 1 November 2015.

The ratification of the Cape Town Convention by the UK also extends to the Cayman Islands, Gibraltar and Guernsey. Work is also in progress to extend the application of the Cape Town Convention to Bermuda. As these are popular jurisdictions for aircraft owning special purpose vehicles, an increasing number of new transactions will benefit from the Cape Town Convention.

This article considers some of the key practical consequences of the UK’s ratification of the Cape Town Convention for airlines, financiers, investors, lessors and rating agencies.

Alternative A

The UK has amended its existing insolvency laws by adopting Alternative A of Article XI of the Protocol. Where an International Interest is correctly registered, the adoption of Alternative A will oblige an airline either to (i) to return the asset to the creditor within 60 days (the “waiting period”) or (ii) cure the relevant breach of contract and agree to perform all future obligations under the relevant agreement within the waiting period in order to retain the asset. The adoption of Alternative A provides similar protections to investors, financiers and lessors as compared with Section 1110 of the U.S. Bankruptcy Code as they may be assured that, at the very least, in an event of default scenario, the asset can be recovered within a fixed period. This additional protection for investors, financiers and lessors may in turn give operators access to financing on more favourable terms and at better rates and may also allow transactions involving UK airlines to benefit from improved ratings when looking to alternative sources, such as the capital markets, to raise finance.

 ¹ The Convention on International Interests in Mobile Equipment (the “Convention”) and the Protocol thereto on matters specific to Aircraft Equipment (the “Protocol”) signed at Cape Town on 16 November 2001 (the Convention and the Protocol together, the “Cape Town Convention”). Capitalised terms which are not otherwise defined in this article shall have the meaning given to them in the Cape Town Convention.

Alternative A also forms one of the conditions required to comply with the OECD Aircraft Sector Understanding discount criteria which allows an airline in a Contracting State to obtain a discount of up to 10% on the premium charged on export credit support. However, it is likely that this benefit will only materialise for most UK airlines if the so-called “home country rule”² is not applied.

Non-Consensual Rights

Certain non-consensual rights and interests which currently have priority over secured rights and interests under English law (such as statutory detention rights for unpaid airport charges, air navigation charges or charges relating to the EU Emissions Trading Scheme and possessory liens for aircraft maintenance or repair works) will continue to have priority over International Interests and, in common with many other jurisdictions, do not need to be registered on the International Registry in order for their priority status to be protected. The UK’s Article 39 Declaration will do nothing to improve financiers’ and lessors’ exposure in this regard.

Pre-Existing Rights and Interests

The Cape Town Convention will not apply retrospectively in the UK and therefore pre-existing interests (such as lease agreements and mortgages) that would otherwise be registrable on the International Registry following 1 November 2015 will retain their existing priority and do not need to be registered. This is welcome news for UK operators, financiers and lessors who will avoid the administrative burden of having to file International Interests in respect of all pre-existing interests in order to preserve the desired priority.

Self-Help Remedies and IDERAs

Self-help remedies allowing a creditor to take action against a debtor without leave of the court (provided that the debtor has previously agreed to the use of such remedies in the relevant transaction documents) are already permitted under English law and will continue to be permitted following the entry into force of the Regulations. The UK will also allow for deregistration and export of an aircraft by a lessor, owner or financier by the use of an irrevocable deregistration and export request authorisation (“IDERA”) in the form provided by the Cape Town Convention which must be recorded at the Civil Aviation Authority (“CAA”). UK airlines will need to be prepared to issue IDERAs on new transactions following entry into force of the Regulations. Despite the fact that pre-existing lessors, owners and financiers may have the ability to request an IDERA from the airline where the transaction documentation contains further assurance provisions pursuant to which such lessors, owners and financiers can request certain actions to be taken following ratification of the Cape Town Convention in the UK, an IDERA cannot be lodged with the CAA against an aircraft for which an International Interest was created prior to 1 November 2015. The CAA is expected to issue detailed guidance on the use and registration of IDERAs by 30 October 2015.

Taking Security and *Lex Situs*

Following the *Blue Sky*³ case, English law currently provides that a mortgage over an asset will only be valid under English law if it is validly created under the laws of the country in which the asset was

² The unwritten understanding between the ECAs of the UK, France, Germany and the U.S. which restricts export credit support for Boeing and Airbus aircraft acquired by UK, French, German, Spanish and U.S. airlines.

³ *Blue Sky One Ltd & Ors v Mahan Air and Anor* [2009][EWHC] 3314 (Comm) and [2010] EWHC 631 (Comm)

physically located at the time that the security interest was created (without regard to that country's conflict of laws principles) (the "*lex situs* rule"). Regulation 6 now provides that, to the extent that the Cape Town Convention applies to a transaction and the required conditions have been satisfied, it will be possible to create security over assets under the Cape Town Convention (existing in parallel with any security interest created under English law) regardless of the physical location of the asset thereby relieving the negative, and potentially costly, consequences associated with complying with the *lex situs* rule (such as requiring the asset to be flown into English airspace or another qualifying jurisdiction). As the experience of enforcing security interests under the Cape Town Convention is still relatively untested, some financiers may not be willing to rely on a valid security interest created under the Cape Town Convention alone, without also having the comfort of being having a fully enforceable local law security interest. We anticipate that this assessment by financiers will vary according to the jurisdiction in which the aircraft is registered.

Security under the Cape Town Convention can only be created either (i) where the debtor is situated in a Contracting State or (ii) if the aircraft is registered in such a jurisdiction. Where neither of these conditions are satisfied, the *lex situs* rule in relation to English law mortgages will continue to apply in order to ensure that a valid English law mortgage is created. Parties should also take into consideration whether there is a likelihood that the aircraft may need to be repossessed in a jurisdiction that has not ratified the Cape Town Convention (for example, a jurisdiction which might not recognise the concept of an International Interest but will recognise a mortgage) in which case it would be prudent to obtain a valid English law mortgage complying with the English law *lex situs* rule as well as, if possible, a local law mortgage in such jurisdiction.

Practical Implications

Many UK based financiers and lessors are already well versed in the requirements and procedures for registering International Interests on the International Registry based on their experience of transacting with assets, airlines and borrowers in jurisdictions which have already ratified the Cape Town Convention. It is primarily UK based operators or parties which have been solely involved in domestic transactions which will need to prepare to be compliant with and administer registrations in connection with the Cape Town Convention after 1 November 2015. All parties to a transaction (for example, the seller, the purchaser, the trustee acting on behalf of capital market investors, the financier, the lessor, the lessee, the sub-lessee, etc.) must approve the recording of an International Interest and to do so each party must register as a Transacting User Entity ("TUE") and identify an individual within the organisation who will act as an administrator. Whilst each relevant entity must register as a TUE, the administration of registrations of International Interests may be delegated to a Professional User Entity ("PUE") such as a law firm. We are registered as an Administrator on the International Registry and can assist by being appointed as a PUE to conduct searches on the International Registry and handle International Interest registrations and related matters.

Creditors must register International Interests created after 1 November 2015 otherwise they will be at risk of losing priority of such interests to others who register their interests first. It will also remain important to have properly perfected security interests and to ensure that all necessary registrations are effected at the International Registry as well as with the UK CAA and with Companies House in accordance with current practice.

If you have any questions about whether the Cape Town Convention applies to your transaction, how to register with the International Registry or in respect of any other topics covered in this article or require any further information or assistance, please contact:



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