

## CAPE TOWN CONVENTION OF 2001

In light of changes in the aviation sector, asset-based financing and leasing are the methods of choice for financing the acquisition and use of aircraft equipment. These financing techniques presuppose the existence of effective legal rights, particularly those relating to the ability to promptly enforce contractual terms. Current national laws, however, are often inconsistent with the principles underlying asset-based financing and leasing. The implicit costs of an inadequate legal framework in this area are significant. These problems have been addressed in the international legal texts discussed below.

### **I DIPLOMATIC CONFERENCE AND CURRENT STATUS**

On 16 November 2001, a Diplomatic Conference held in Cape Town, South Africa, under the co-sponsorship of the International Civil Aviation Organization (“**I.C.A.O.**”) and the International Institute for the Unification of Private Law (“**UNIDROIT**”), adopted an international treaty (“**Cape Town Convention**”) specifically designed to facilitate asset-based financing and leasing.

Fifty-three (53) States, including most major aviation States, signed the Final Act of that Conference. These texts, in final form, may be downloaded free of charge from the UNIDROIT website, [www.unidroit.org](http://www.unidroit.org) (“**UNIDROIT Website**”) or purchased in bound form via the I.C.A.O. website, [www.icao.org](http://www.icao.org) (“**I.C.A.O. Website**”). They are also attached to the Official Commentary authorised by the Diplomatic Conference (Resolution 5), which is available for purchase via the UNIDROIT Website.

The Cape Town Convention (technically, the Convention on International Interests in Mobile Equipment, “**Convention**”), as applied to aircraft equipment through a protocol (“**Protocol**”), came into force three months after the eighth ratification, acceptance, approval of, or accession to, the Protocol (for simplicity, each a “**Ratification**”). That occurred on 1<sup>st</sup> March 2006.)

Ratification procedures are accelerating around the world. The following countries, by order of the date of deposit: Panama (20.7.03), Ethiopia (21.11.03), Nigeria (16.12.03), Pakistan (21.01.04), the United States (28.10.04), Oman (21.03.05), Ireland (29.07.05), Malaysia (02.11.05), Senegal (09.01.06), Angola (30.04.06), Afghanistan (25.07.06), Kenya (13.10.06), Mongolia (19.10.06), South Africa (18.01.07), Colombia (19.02.07), Indonesia (16.03.07), Mexico (31.07.07), Syrian Arab Republic (07.08.07)\*, Cape Verde (29.09.07), Albania (30.10.2007), India (31.03.08), United Arab Emirates (29.04.08), Luxembourg (27.06.08), Saudi Arabia (27.06.08), Zimbabwe (13.05.08)\*, Bangladesh (15.12.08), Kazakhstan (21.01.08)\*, Singapore (28.01.09), Cuba (28.01.09), United Republic of Tanzania (30.01.09), China (03.02.09), European Community (28.04.09), Rwanda (28.01.10) and Togo (25.01.10)\* have deposited their instrument of Ratification/Accession with UNIDROIT, the Depositary. The Protocol entered into force on 1<sup>st</sup> March 2006, following the eighth ratification, by Malaysia.

On 28 May 2004, an Irish company, Aviareto, with the support of the Irish government, was selected by the Preparatory Commission to host the International Registry under the Cape Town Convention. The International Registry became operational coincident with the entry into force of the Protocol (01.03.06). ICAO has recently extended Aviareto’s contract to operate the International Registry through June 2016.

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\* To date, only the Convention has been ratified, not the Aircraft Protocol.

I.C.A.O., with Unidroit's cooperation, has sent out a formal administrative, ratification–assistance package under an I.C.A.O. State Letter (“**I.C.A.O. Cape Town Package**”). The I.C.A.O. Cape Town Package includes the following technical materials prepared by Unidroit, as Depositary: (i) a model form of ratification, acceptance, or approval instrument (only for use prior to the entry into force of the relevant text), (ii) a model form of accession instrument (accession may occur prior to, and must (for non-signatories) occur after, entry into force of the relevant text), and (iii) an explanatory memorandum to, and forms which may be used in making, declarations (see part IV below).

Aviation Working Group (“**A.W.G.**”) is actively working with other interested parties on obtaining national Ratifications.

## **II INTERNATIONAL LEGAL FRAMEWORK**

The legal structure consists of a generalised base Convention supplemented by separate, controlling protocols. The first protocol covers “aircraft objects”, defined as airframes, aircraft engines, and helicopters, each with a minimum size/power requirement. Thus, the Cape Town Convention (as applied to aircraft) is thus made up of two instruments: the Convention and the Protocol. As noted, entry into force of the Protocol is thus the operative event.

The Diplomatic Conference (Resolution 1) authorised the drafting of a working–purpose consolidation of the Convention and Protocol that will not be subject to national ratification, but will be useful in practice. (“**Consolidated Text**”). The Consolidated Text is available on the above–noted UNIDROIT website.

The Cape Town Convention establishes a commercially oriented, comprehensive international legal framework relating to the creation, priority and enforcement of security and leasing interests in aircraft equipment. It also contains bankruptcy rules that protect contract rights in the context of insolvency.

The central features of this system are as follows. First, a uniform criteria for creating an “international interest” (i.e., a security agreement, title reservation agreement, or leasing agreement) in aircraft equipment is specified. Second, a first–to–file priority rule based on an electronic, notice–based International Registry, created by the treaty system itself, applies. Third, default remedies are available to creditors, and, absent default or contrary agreement, quiet possession rights are granted to debtors. Fourth, jurisdictional rules are provided.

The economic value of the Cape Town Convention in any particular State can be enhanced by the making of certain declarations when ratifying. The key declarations, considered from an economic perspective, relate to (i) the enforcement of rights in insolvency, (ii) non–judicial and expedited remedies, (iii) the ability of parties to choose the law applicable to their contractual relations, and (iv) facilitative rules for de–registration and export through use of an internationally sanctioned form. These provisions contain features that may be necessary, if not sufficient, conditions to accessing capital markets in certain circumstances.

## **III ECONOMIC BENEFITS OF THE CAPE TOWN CONVENTION**

An independent study of the anticipated benefits of the Cape Town Convention was commissioned on behalf of the A.W.G., I.A.T.A., and I.C.A.O. and undertaken under the joint auspices of New York University and INSEAD (“**Economic Impact Assessment**”). The Economic Impact Assessment concluded the following:

“The Cape Town Convention will reduce risk applicable to asset-based financing and leasing transactions by establishing an international legal framework, backed by treaty relations and, where necessary, implementing domestic laws. The risk reduction will increase the availability and reduce the cost of aviation credit, thus broadening the spectrum of financing alternatives available to aircraft operators.”

((Note: As financing is typically a condition to the acquisition and use of aircraft equipment, the Cape Town Convention will also contribute to improved safety by assisting airlines in many jurisdictions in their efforts to modernise and upgrade their fleets.))

“Beneficiaries of the Cape Town Convention include:

1. governments – first through reduced debt levels to governments whose credit in the form of sovereign guarantees or national debt is used to finance aircraft acquisitions, secondly as risk reductions to governments providing export credit supporting aircraft sales, and thirdly to enhance privatisation potential where applicable;
2. airlines – through reduced financing costs and enhanced access to funds and funding sources, increased operating efficiency and improved profitability;
3. commercial aircraft manufacturers and their suppliers – through higher sales, output and employment levels, as well as expanded markets;
4. aviation industry investors – through increased returns on, and higher valuations of, investments, as well as enhanced security; and
5. passengers and other end users – by pass-through price reductions and increased levels of service.”

“The cost-savings and external debt-level reduction benefits are slanted in favour of developing economies, whose systems do not currently reflect asset-based financing principles. In these countries, the [Cape Town] Convention would generate the greatest relative improvement. Conversely, the fleet planning, export and employment related benefits are, as a general proposition, slanted in favour of developed economies.”

An aspect of these economic benefits has recently been expressly confirmed. One major export credit agency has been offering to reduce its initial fee by up to 1/3 if an airline is located in a State that has ratified and effectively implemented the Cape Town Convention (including certain declarations).

AWG is pleased that the recently concluded new agreement on export credit will (following the grandfathering period therein) provide ‘**Cape Town discounts**’, whether a transaction is supported by the Brazilian, Canadian, EU or US export credit agencies, assuming a set of ‘**qualifying declarations**’ has been made. This endorses the long-standing view of AWG that application of the Cape Town Convention reduces transaction risk, and, thus, should be reflected in the terms of the credit. It will also help establish a level playing field among manufacturers in this area, which had previously been marked by differing approaches among the ECAs.

In 2009, AWG commissioned an additional study dealing with the economic benefits of the Cape Town Treaty. That study focuses on airline benefits, and strictly assumes application of the

insolvency rule found in Protocol, Art. XI, Alternative A. It can be downloaded from the AWG website, [www.awg.aero](http://www.awg.aero).

In short, the Cape Town Convention will provide significant help in satisfying the unprecedented demand for new aircraft equipment over the next twenty years, with an estimated value exceeding US \$1,200 billion.

#### **IV IMPORTANCE OF AND RECOMMENDATIONS ON DECLARATIONS – ANNEX 1**

UNIDROIT, as Depositary for the Convention and Protocol, has prepared an **Explanatory Memorandum** for the assistance of States in making such declarations. That Explanatory Memorandum contains a series of forms that may (without limitation) be used in making such declarations. Copies of the Explanatory Memorandum are available from the UNIDROIT Secretariat upon request or from the UNIDROIT Website. It has also been included in the I.C.A.O Cape Town Package.

A.W.G. has prepared a **matrix** that notes the **optimal declarations from an economic perspective**. That matrix, which may be used by States in weighing economic versus other policy considerations, has been updated to include cross-referencing with the UNIDROIT forms to enhance coordination. It is attached as annex 1, with the cross-reference to UNIDROIT's forms appearing in Column A thereof.

#### **V TECHNICAL ASSISTANCE ON RATIFICATION (ACCESSION) – ANNEX 2**

The A.W.G. provides technical assistance in analyzing the provisions of the text, as well as the choice reflected in the various permitted declarations, upon request, to the maximum extent possible, given time and other resource limitations. To enhance efficiency, the A.W.G. has drafted a model ratification (accession) instrument. That model, which refers to the UNIDROIT forms on declarations and takes as a starting point the declarations set out in the A.W.G. matrix (see annex 1), is attached as **annex 2**. The model is available in English (**annex 2A**) and in French (**annex 2B**). This model may be downloaded and used – without A.W.G. consent. States and industry participants wishing to consult with the A.W.G. on these items should contact the A.W.G. Secretary, Jeffrey Wool (+44 207 8327107).

#### **VI IMPLEMENTATION – INCLUDING MODEL NATIONAL IMPLEMENTING LEGISLATION – ANNEX 3**

Under the legal systems of numerous States, the Convention and Protocol obtain the force of national law coincident with that State's Ratification, without further action. In these States, international treaties constitute the highest form of law (constitutional law excepted), and, thus, their legal force are not dependent upon national implementing law. Rather they take "direct effect" or have "direct application" in that State upon Ratification. In other States, some form of implementing legislation is required to "transform" or "incorporate" these international legal instruments into national law ("**National Implementing Legislation**").

In States that require National Implementing Legislation, we strongly recommend use of "**stand-alone**" legislation. That recommendation is made, subject to any particular national procedures that dictate a different approach, for the following reasons. The Convention and Protocol are complex, if concise, instruments that embody *sui generis* concepts, that is, concepts created by the instruments themselves. Use of the exact treaty wording, in their negotiated form and context, is essential to their uniform and internationalized interpretation (as required by Article 5(1) of the

Convention). The texts also contain a large number of defined and otherwise technical terms. Substantively amending various pieces of domestic legislation – which contain different terminology and reflect national legal principles – and attempting to conform them to the Convention and Protocol would likely produce less legal clarity, consistency and order than would otherwise be the case.

Attached as **annex 3** is a form of model National Implementing Legislation, which we prepared for consideration and development by those States that require such legislation. We recommend that this legislation be “standalone”, for the reasons noted above. We further recommended that the formal legislative document, which attaches the legislation, contain a provision to the effect that the “*attached legislation supercedes all national law to the extent the latter is inconsistent with the former*” (“**Supersession Clause**”). Finally, consideration should be given to listing (without limiting the general Supersession Clause) the specific parts of national law so superseded.

The model National Implementing Legislation was prepared starting with the Consolidated Text, amending that document to (i) remove administrative and other treaty provisions inappropriate in the context of national legislation, and (ii) the reflect the declarations recommended in the A.W.G./I.A.T.A. declarations matrix (annex 1).

Attached as **annex 3A** is a **short form of stand-alone implementing legislation**. It is a suggested starting point for such legislation as may be required in the context of national law.

## **VII SUMMARY OF THE CONVENTION AND PROTOCOL – ANNEX 4**

A Chapter-by-Chapter summary of the Convention (integrating the Protocol provisions) is attached as **annex 4**. It sets forth the underlying principles of, and key concepts contained in, each chapter of the Convention (integrating the Protocol). It is descriptive and intended for use as a resource for Ratification processes, not as an exhaustive commentary on the texts. It does not purport to address matters of interpretation within the scope of the Official commentary.