

**The Aircraft Protocol to the Cape Town Convention on
Aircraft Financing:
A Civil Lawyer's Perspective**

Submitted by:
Niclas von Planta

Faculty of Law
Institute of Air and Space Law
McGill University, Montreal

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ABSTRACT

The coming into force in March 2006 of the Convention on International Interests in Mobile Equipment (“Cape Town Convention”) and its protocol related to aircraft equipment (“Aircraft Protocol”) established a new international legal regime to facilitate the cross border financing of mobile equipment in general and aircraft frames and engines in particular. The implementation of a new legal regime inevitably brings with it a transitional period of uncertainty. Legal and business actors need time and experience to fully assimilate the new framework. The transitional challenge is magnified exponentially when the vehicle of reform is an international convention intended to have global scope. The wide diversity of legal traditions and business practices among States make the assimilation process particularly challenging. The challenge is even more acute in the case of the Cape Town Convention and Aircraft Protocol. These instruments straddle property, civil procedure, creditor and insolvency laws, areas of private law which traditionally have been particularly resistant to global harmonization efforts. In addition, the Convention establishes a new global institution – an international property rights registry - the first such attempt in private law.

This thesis has three intertwined goals. The first is to show that the Cape Town Convention and Aircraft Protocol are not neutral to legal tradition. Rather, they are primarily rooted in the statutory regimes adopted by the common law states and provinces of the United States and Canada over the latter half of the twentieth century. Secondly, this thesis seeks to ease the transition challenge this presents for civil law lawyers by giving a comparative overview of the Convention and Protocol which takes into account those aspects which civil law jurists may have difficulties in understanding. The third and final goal of this thesis is to contribute a deeper substantive understanding of the Convention and Protocol to the existing literature, much of which to date has been concerned – understandably – with general or preliminary implementation issues.

Résumé

L'entrée en vigueur en mars 2006 de la Convention relative aux garanties internationales portant sur des matériels d'équipement mobiles ("Convention du Cap") et de son Protocole relatif aux matériels d'équipement aéronautiques ("Protocole") en a établi un nouveau cadre juridique international simplifiant le financement transfrontalier d'équipement mobiles en général et des aéronefs et moteurs d'avion en particulier.

La mise en œuvre d'un nouveau cadre juridique apporte inévitablement une période passagère d'incertitude. Les acteurs juridiques et économiques ont besoin de temps et d'expérience afin de s'adapter à ce nouveau cadre, en particulier lorsque celui-ci a un impact mondial, les différences entre systèmes juridiques rendant plus compliqué cette mise en œuvre. Dans le cas de la Convention du Cap et de son Protocole l'ajustement est encore plus difficile. Ces textes concernent les droits mobiliers, des créanciers, des procédures civiles et des procédures d'insolvabilité, des domaines juridiques qui, dans le passé, ont été résistantes à une harmonisation globale. En outre, la Convention du Cap établit une nouvelle institution globale - un registre international pour les biens aéronautiques - la première dans le droit international privé.

Cette thèse a trois objectifs interconnectés. Le premier est de montrer que la Convention du Cap et son Protocole ne sont pas neutres en termes de traditions légales. Ils prennent leurs racines dans les codifications de droit adoptées par les pays du "Common Law" et les provinces des Etats-Unis et du Canada durant la deuxième moitié du 20ème siècle. Le second cherche à faciliter la compréhension pour les juristes en droit civil en leur donnant un aperçu comparatif de la Convention du Cap et de son Protocole qui reposent sur des principes du "Common Law". Le dernier objectif de la thèse est de contribuer à approfondir la compréhension de la Convention du Cap et de son Protocole par rapport à la littérature existante, qui s'est - à bon droit - concentrée sur des questions relatives à leur mise en œuvre.

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CHAPTER ONE: INTRODUCTION

I. Industry background

The commercial aviation industry entered into the second century of its existence coincidentally with the increased passenger demand produced by globalisation's dramatic expansion of markets. In its 2007 Global Market Forecast,¹ Airbus predicts an increase in world passenger traffic of 7.7% annually from 2007 to 2011. Boeing, in its 2008-2027 year Outlook, anticipates 5% average annual growth.² Cargo traffic over the same time period is expected to grow at a rate of between 5.8% (Airbus) and 6.1% (Boeing) annually.

The estimated number of aircraft needed to meet the predicted demand varies between 24,262 (Airbus) and 29,400 (Boeing) representing an aggregate cost in U.S. dollars (at today's values) of 2.8 Trillion (Airbus & Boeing). The number of passenger aircraft (with over hundred seats) in service is expected to increase from 13,284 today to 28,534 (Airbus) or even to 35,800³ in 2027 (Boeing).

II. Aircraft financing patterns

Prior to the advent of jet planes in the 1960s, the acquisition of new aircraft by commercial carriers was mainly financed by retained earnings or short-term bank loans. These financing sources proved to be insufficient to

¹ Global Market Forecast, 2007-2026, online: <http://www.airbus.com/en/corporate/gmf> (January 4, 2009).

² Current Market Outlook, 2008-2027, online: <http://www.boeing.com/commercial/cmo/> (January 4, 2009).

³ Starting from a higher level of passenger aircraft in Service today of 18,230; Boeing Outlook Summary, 2006 to 2026, online: http://www.boeing.com/commercial/cmo/pdf/Boeing_Outlook_Summary_2007.pdf (January 4, 2009)

finance the high acquisition costs of jetplanes.⁴ This continues to be the case today. According to the International Air Transport Association's ("IATA") Fact Sheet of December 2008⁵, the airline industry generated a net loss of approximately USD 5 billion in 2008 alone. The estimated loss was mostly generated in the United States⁶ and Africa, and did not include European and Asian airlines.⁷ For 2009, it is predicted that the airline industry will generate a loss of USD 2.5 billion.⁸ It is therefore expected that airlines in the foreseeable future will continue to be unable to finance aircraft purchases merely through cash flow, especially in light of the continuously increasing prices for civil aircraft. For example, the cost of an Airbus A320, one of the "workhorses" of civil aviation, has increased from USD 52.2 millions in 2001 to USD 58.8 millions in 2006. This reflects an increase of more than 10% within 5 years⁹, not to mention the high cost of the new generation of wide body aircraft such as the Airbus A380 which currently sells for USD 290.5 million¹⁰, or the balance sheet uncertainties created by instable fuel costs.

III. Sources of external financing

Airlines can obtain the necessary capital to renew or expand their fleets either through the equity market or through the secured credit market — with the latter including, from a business perspective, such functional

⁴ Donald Bunker, *International Aircraft Financing*, (Montreal: IATA, 2005) at 154 [Bunker, "International"].

⁵ Airline Industry Statistics, Fact sheet June 2006, online: <http://www.iata.org/pressroom/pr/2008-12-09-01.htm>, (January 4, 2009).

⁶ Since deregulation of the aviation industry in the United States 1978, 162 airlines declared bankruptcy, 22 of them in the last 5 years, United States Government Accountability Office, Report to Congressional Committee, Commercial Aviation (September 2005) at 8, online: <http://www.speednews.com/GAObankruptcy.pdf>, (June 7, 2006).

⁷ IATA New Financial Forecast, December 2008 online: http://www.iata.org/NR/rdonlyres/03FA3524-3E8E-4A20-8A55-C68A9B797330/0/Industry_Outlook_Dec08.pdf, (January 4, 2009).

⁸ CEO Brief, April 2008, online: http://www.iata.org/NR/rdonlyres/4B88C67F-B358-42D5-8ADB-FA6E9D8FA67E/0/ceo_brief_Apr08.pdf (January 4, 2009).

⁹ Development of Aircraft prices online: http://www.airguideonline.com/aircraft_prices.htm (January 2, 2009).

¹⁰ *Ibid.*

alternatives to traditional bank secured loans as financing leases and retention-of-title sales agreements which are often offered by aircraft manufacturers to promote the sale of their products. The secured credit market – in the expanded sense used here – is considered to be the more accessible option:¹¹ due to the fact, unlike an equity investor, a secured creditor can look to the value of the aircraft object acquired by its financing as a back-up source of repayment if the debtor defaults.¹² However, this assumption ultimately depends on the existence of a supportive legal framework. This challenge lies at the heart of this thesis.

IV. Goals and structure of the thesis

The goal of the Convention on International Interests in Mobile Equipment (“Cape Town Convention”)¹³ – in combination with the Aircraft Protocol – is to ensure the effectiveness and enforceability of security rights in aircraft objects on a global level. Chapter II of the thesis reviews the background to the Convention, showing why the existing diversity of legal approaches to security rights in and among common and civil law States made informal harmonization unlikely, thus paving the way for an international treaty solution. A second – and equally significant goal of this chapter – is to demonstrate that the legal framework of the Convention and Protocol are primarily founded on the model of the Uniform Commercial Code adopted by the U.S. at state level. From a practical viewpoint, this is a significant conclusion, as it means that for European civilian lawyers to understand the Cape Town Convention they must first understand its conceptual and policy roots in U.S. law.

¹¹ P. Deighton, “Sources of Finance” in A. Littlejohns & S. McGrail eds., *Aircraft Financing*, 3rd ed. (London: Euromoney, 1998) at 17.

¹² Among the secured credit possibilities, leases (and similar “off balance sheet” models) are often preferred as, when structured correctly, they can produce additional taxation, accounting and other business advantages.

¹³ Text of the adopted convention and protocol; online: <http://www.unidroit.org/english/conventions/mobile-equipment/main.htm#NR2> (January 2, 2009).

The uncertainties and complexity created by legal diversity can sometimes be resolved through global agreement on the applicable conflict of laws rules. Chapter III of the thesis shows that once again there is a lack of consensus among States on the two main concerns at this level in the context of aircraft financing: (i) the law applicable to the security right; and (ii) one State's recognition of a security right established under the law of another State. The limitations of the Convention on the International Recognition of Rights in Aircraft - which was the first attempt to resolve these concerns through international agreement - will also be addressed.

Chapter four sets out a substantive analysis of the Cape Town Convention and Aviation Protocol, describing its intended function and operation as well as its deficiencies. Since the Convention and Protocol were developed with the explicit goal of making aircraft financing more efficient and secure, the analysis will be tested against this goal. Chapter five completes the thesis with concluding remarks.

CHAPTER TWO: DISHARMONY AMONG NATIONAL SECURED TRANSACTIONS LAWS

It will be demonstrated below that there are many different legal approaches to regulating securities. The civil law was codified when the most common security on movables was the possessory pledge. It has therefore become the legal guideline and basis for most civil law countries thus not providing for a non-possessory lien on movables. During the middle of the last century however, civil law countries have discovered the need for giving lenders securities with respect to movables as well.¹⁴ This was normally achieved by allowing special categories of movables to become eligible to non-possessory securities.¹⁵ In English common law on the other hand, inspired by the laissez-fair utilitarianism, almost all security devices in use today in England received the official sanction by the courts at the end of the nineteenth century. This approach led to the development of Uniform Commercial Code Article 9 in the United States, which has become the basis for nearly all international harmonisation initiatives.

The principle resulting differences between Civil and Common law are (i) the absence of real publicity for third parties in the form of public registration of non-possessory security devices, (ii) a less market-oriented approach to the modalities of enforcements and (iii) the greater use of other transactional forms to fulfill the task of security, especially in the case of Germany, where the courts had to resort to the concept of a fiduciary or conditional sale.

¹⁴ Switzerland, for example, introduced the aircraft record providing for securities in aircraft in 1958 in the aftermath of its ratification of the Geneva Convention.

¹⁵ For example French Civil law, which introduced statutory devices for every possible movable. See: C. Walsh, *Secured Credit: A Topical Review and Analysis of the (English-Language) Foreign and Comparative Literature* (University of New Brunswick, Canada: 1999) at 39.

It must be mentioned that within the civil law “heritage” one has to distinguish between French and the German civil law tradition. Whereas French civil law is known to be open to the idea of security devices with respect to movables¹⁶, the German civil law¹⁷, although deriving from the same origin, has had much more difficulty in the past adopting the concept of non-possessory securities in movables.

I. The idea of security

The advantage to a creditor of securing a debt obligation derives from the fact that if a debtor becomes bankrupt, his unsecured creditors generally share what is left of his assets on a pro rata basis. In order to avoid equal sharing, individual creditors seek ways to be paid in full ahead of the insolvent debtors’ other creditors. Securing the debt obligation by taking a property interest in one or more of the debtor’s assets prior to insolvency enables a creditor to achieve this kind of “super-priority.” “Security must stand up on insolvency which is when it is needed most.”¹⁸ Hence, security is more important at the end than it is at the beginning of a financing relationship. It is the creditor’s concern (at the beginning) that it can assure payment ahead of all other creditors in the event of default, insolvency or bankruptcy of the debtor thereby minimising its risk of loss (at the end). Such security minimizes these risks because it enables the creditor to apply the liquidated value of the encumbered assets in satisfaction of the debtor’s obligation before all other creditors.

¹⁶ Nearly all evolution in French secured lending law is based on extra-codal statutory law and not on judicial intervention. See C. Walsh, *Secured Credit: A Topical Review and Analysis of the (English-Language) Foreign and Comparative Literature* (University of New Brunswick, Canada: 1999) at 39, also see Martin Gdanski, *Taking Security in France* (in Bridge and Stevens: Cross Border Security and Insolvency, Oxford University Press. 2001) at 59.

¹⁷ Burkhard Jäkel, *Outline of Security Interest under German Law* (in Bridge and Stevens: Cross Border Security and Insolvency, Oxford University Press. 2001) at 91.

¹⁸ P. R. Woods, *Comparative law of security and guarantees* (Sweet & Maxwell, London: 1995) at 3.

II. The security of security

In order to be sure of having an effective security right, the following legal issues must be clarified by the creditor before entering into a financing relationship with the debtor:

- What types of security are available under the applicable law? (i.e., what is the scope of the assets capable of being covered by the security, what types of debt obligations can be secured);
- What priority does the security give the secured creditor over other creditors, secured and unsecured, present and future?;
- What formal requirements have to be met to “perfect” the security, i.e., to make it effective both *inter partes* as well as against third parties?;
- Which enforcement remedies are available in the event of the debtor’s default?;
- How long and costly is the enforcement process likely to be? (e.g., are the secured creditor’s enforcement remedies against the encumbered assets subject to a stay in the event that bankruptcy proceedings are initiated against the debtor?)

The answers to all the above questions determine the extent of the legal risk a creditor assumes when lending money to the debtor. Although the basic idea of security is much the same everywhere, the conceptual approach to security in the U.S. and civil law Europe could not differ more.

III. Security in European civil law

The civil law tradition derives from classical Roman law as redefined in various modern European codifications.¹⁹ Although they differ in many

¹⁹ Bridge and Stevens: *Cross Border Security and Insolvency*, (Oxford University Press. 2001).

respects, all codes retain their affinity to the formal approach of the classical Roman law from which they are derived.

The development of the different European civil codes shows that while much attention was focused on the possessory pledge, generally none was devoted to non-possessory forms of security in movables.²⁰ The possessory pledge or pawn was derived from the Roman law *pignus*, and its validity required transfer of possession of the encumbered asset to the creditor. This requirement was upheld over the centuries.²¹ With the industrial revolution at the end of the eighteenth century, large quantities of loan capital were required to finance the expanding needs of a newly industrialised world. The Roman law *pignus* was ill-suited to meet the requirements of this new economy. Because transfer of possession to the creditor was necessary, it was impossible for the debtor to generate the necessary revenue from the encumbered assets to repay the creditor.

Some States, even in civil law Europe, recognized the need to offer creditors an effective non-possessory form of security in commercial and industrial assets. The German civil law judges “invented” or rediscovered (from Roman law) the fiduciary transfer of title (“*Sicherungsübereignung*”), which is now the predominant form of security in movables in Germany. French civil law adopted a more incremental and legislatively-led approach, specifying through ad hoc statutory enactment certain groups of movables capable of being encumbered by security.²² Nonetheless, both forms of security differed from their North American counterparts on a variety of

²⁰ Although Roman law was familiar with the fiduciary transfer of title and the hypothec, the former must be considered a contractual security as opposed to security in rem and the latter was only with respect to immovables. See: C. Walsh, *Secured Credit: A Topical Review and Analysis of the (English-Language) Foreign and Comparative Literature* (University of New Brunswick, Canada: 1999) at 38 [Walsh, “Review”].

²¹ *Twyne’s Case* (1601), 76 E.R. 809, cited in D.H. Bunker, *The Law of Aerospace finance in Canada* (Montreal, McGill: 1988) at 135 citing the [Bunker, “Canada”].

²² *Ibid.*

important issues, including establishment, third party effectiveness and enforcement.

1. General

German and German influenced civil law regimes distinguish between the contractual obligation of the parties and the security given by the debtor. The loan agreement between the debtor and creditor is considered to be separate and distinct from the legal relationship created by the debtor's grant of security in its assets to the creditor. The relevance of this two-contract theory is that both legal relationships are based on the respective contract and have to fulfil their respective formal requirements. The two contracts are further accessory to one another. Although a loan agreement can stand by itself, the security agreement derives its cause from the loan and can not exist without a valid loan agreement.

The collateral, however, can be any kind of asset, tangible or intangible, existing or future, variable or fixed. Depending on the collateral, the formal requirements may vary (e.g. for real estate a public deed is required for the security agreement²³) to validly establish ("perfect" in the meaning of UCC Article 9) the security, not only *inter partes* but also against third parties.

2. Effectiveness of the security right

Where the object of the security is an intangible obligation owed to the debtor (for example, the bank's obligations to the debtor on the debtor's bank accounts, the obligation of the debtor's customers to pay for goods or services rendered by the debtor), the required formalities for both the *inter partes* and third party effectiveness of the security right can normally be met by the simple execution of an assignment agreement signed by the debtor in favour of the secured creditor as assignee. However, for the assignee to

²³ Articles 824-841 of the Swiss Civil Code.

acquire the right to enforce an assigned claim against the assignor's contractual counterparty, the assignor has to notify him of the assignment so that he knows to whom he must now fulfil his obligation.

Where the object of the security is a real right in a tangible object (e.g. a car or an aircraft), the requirements are different. As mentioned before, civil law systems tend to favour the possessory pledge. In a pledge agreement, the second legal relationship between the creditor and the debtor is established by giving the secured creditor possession of the encumbered object.

Where the object of the security is an immovable, physical possession by the secured creditor is replaced by entering a notation of the security right in the register for immovables. Depending on the applicable civil law the security right is only treated as established, even between the parties, once entered into the register. In other words, the security right takes effect between the parties at the same moment – the moment of registration – that it takes effect against third parties. Validation and perfection of the security are one and the same step, not separate and distinct concepts. Furthermore, in most civil law systems, both sales and secured transactions in relation to immovables must be validated before a notary public before the documentation can be submitted to the register.

For certain categories of movables, notably ships and aircraft, special legislation has been put into place by many states to allow non-possessory security rights. In most cases, registers have been established that are similar to those for registration of real estate. However, the requirement for formal authentication before a notary public to validly establish the security right has typically not been carried over.

These specialised registers for movables operate as title registers in the same sense as registers for immovables. In other words, the effect of registration, not only for security rights but also for sales, is constituent and not only declaratory.

3. Priority of security interest

Due to the diversity of possible competing interests,²⁴ the subject of priorities is complex. For the purposes of this thesis, a general rather than an exhaustive overview must be sufficient.

In case of a possessory pledge, the question of priority is simple. Since the pledge requires dispossession of the debtor, there can be only one pledge in existence at any given time. There is usually no need to worry about a subsequent competing non-possessory security right, as a later secured creditor will usually wish to satisfy itself that the assets really exist and to do this he will usually confirm that the assets are still in the hands of the debtor. However, competitions with a prior non-possessory security right are conceivable. As a general rule, if possession was taken by the pledgee without knowledge of the existence of a security right established beforehand, the pledgee will prevail under the doctrine of good faith.

Priority issues become increasingly complex to the extent that different security rights can be established with regard to the same movable asset. The resolution of priorities can differ depending on whether the security takes the form of a nominate security device (e.g. hypothèques, mortgages, liens etc.) or involves the transfer or retention of title for the purposes of security (ownership, co-ownership) or involves purely contractual rights (e.g. quiet possession by a lessee, right to sale etc.). Because only certain groups of movables are made accessible for secured transactions by respective legislation, the rights which can be established are normally found in such legislation.

In theory, civil law follows a *numerus clausus* approach meaning that there are only a specified and limited number of security rights which are capable of legally existing. The Swiss Civil Code, for example, only provides

²⁴ See P.R. Wood, *Comparative Law of Security and Guarantees* (London, Sweet & Maxwell, 1995) at 165.

for the pawn when dealing with security rights in movables.²⁵ In practice, however, the fiduciary transfer of title – essentially a sale by the debtor to the creditor of a specified item or kind of assets on condition that title will be retransferred upon repayment of the debt - is used to achieve the function of security. This is still considered to comply with the principle of *numerus clausus* insofar as title is a recognized property right, albeit not a recognized security right.

4. Enforcement / Default remedies

Although they vary at the level of detail depending on the jurisdiction, civil law enforcement proceedings are generally court supervised proceedings and also require the assistance of other state authorities. There is typically reluctance to place control of the enforcement process directly in the hands of the creditor – sometimes called “self help” - because of the fear of abuse perceived to be inherent in the unequal nature of the debtor and creditor relationship.

To illustrate enforcement proceedings we shall use an example. A lends money to B and B gives A a collateral to secure the obligation. B is in default under the loan agreement. In order to enforce the security, A must seek help from the appropriate authorities.

A claims the outstanding amount from B in a judicial enforcement process directed against the security. Depending on the security, the court will order seizure to avoid B from selling or disposing of it in another way. This process normally ends in a judicial sale of the security. If the sale does not satisfy A in full, he has to claim the outstanding amount in a second process which, in case of non payment by B, will lead to bankruptcy proceedings. In that case the appropriate authority appoints a receiver (in most cases a government employee) who administers the business of the insolvent company. During the liquidation proceedings all of B's assets are sold,

²⁵ Article 884 of the Swiss Civil Code.

normally by public auction. This might include other assets over which security rights have been established. Every such asset will be sold in a separate proceeding to assure that secured creditors are satisfied according to their priority. The proceeds of the sale will first be used to pay for the auction and eventual taxes, thereafter to repay the established security (e.g. mortgage) and, if a surplus remains, it will be deposited in the estate. During the whole process A is not allowed to use “self help” to ensure his repayment.

In sum, the whole proceeding is in the hands of the receiver or the appropriate authority. Depending on the skills, workload and effort the person in charge has put into his work, creditors can expect to be repaid within a “decent” period of time. However, this is highly dependent not only on the authorities but also on the number of creditors, the volume of the assets as well as other factors.²⁶

IV. Security in North American common law

In contrast to European civil law systems, North American common law, under the influence of English common law, very soon anticipated the advantages of allowing security rights in movables to an evolving credit based open market society. In 1962, the first Uniform Commercial Code was adopted by all common law States of the United States. Although, it has been revised several times since its coming into force the basic principles – which are described below – remain the same. In Canada, a similar development took place when the Personal Property Security Act's (PPSA) was enacted in its common law jurisdictions. The PPSA's as well as the Uniform Commercial Code Article 9 (UCC Article 9) are based on the assumption that any goods or services with ascertainable and obtainable value in the marketplace are acceptable as a collateral and shall legally be treated in the same manner.

²⁶ The “Grounding of Swissair” in October 2001 led to one of the largest bankruptcy proceedings in Swiss legal history. Today, almost 8 years later, most of the creditors – secured or unsecured – still wait to receive their share of the estate.

1. Notion of security interest

One of the main differences between the two compared systems is that UCC Article 9 and its Canadian counterparts are not familiar with the *numerus clausus* concept of civil law.²⁷ In other words, any kind of interest against the collateral is considered a security interest. Civil lawyers often have difficulties in understanding that their North American counterparts are not bound to clearly distinguish between a limited number of security rights. Therefore, the notion of security interest must be considered as wider than the notion of security rights. The following definition of a security interest shall demonstrate this: A security interest is created through the consent of the debtor, who grants the creditor a special property interest in identified personal property.²⁸ It therefore includes any “special property interest” designated as such by the parties to the respective secured agreement.²⁹

Any goods or services can become a collateral and an unlimited security interest in them can be granted simultaneously to an unlimited number of secured creditors. These goods can be encumbered with past, present or future debts which comprise an entire estate or just specified categories or types of goods or services.³⁰

Further, proceeds resulting from a sale or other disposition of the collateral are presumed to be covered by U.C.C. Article 9. Article 9-306(1) states: “proceeds include whatever is received upon sale, exchange, collection or other disposition of collateral or proceeds.” Although economically logical, civil lawyers have great difficulty understanding this mechanism. For them the security is attached to the collateral (or asset) itself.

²⁷ Above III.3.

²⁸ W.H. Lawrence, W.H. Henning, R.W. Freyeremuth, *Understanding Secured Transactions* (New York: Matthew Bender & Co.: 1997) at 3 [Lawrence, “Secured Transactions”].

²⁹ U.C.C. sections 1-201 (37), 9-109.

³⁰ U.C.C. section 9-108; also B. Kozolchik & D.B. Furnish, “The OAS Model Law on Secured Transactions”: A Comparative Analysis at 6, online: http://www.americasnet.net/events/OAS/The_OAS_Model.pdf. (August 2, 2006).

In the event the collateral is sold, therefore, all rights to the security are transferred to the new owner as well.

2. Attachment and Perfection of security interest

The creation of a security interest is conditional to the fulfillment of three prerequisites: (i) a security agreement, (ii) value given by the secured party, and (iii) debtor rights in the collateral.³¹ If all these requirements have been met, the security interest “attaches.” Once the security interest attaches, it is deemed to be effective against the debtor.

The requirements for a valid security agreement are simple. It has to express the will of the parties to establish a security interest, it must be signed by the debtor and it has to provide a description of the collateral (the asset as well as the security interest established in the collateral). Given the circumstances that any value can be given as collateral, such descriptions can vary.

Article 9 also allows the parties to provide for a long business relationship by introducing clauses into their security agreements which reflect that intention. By introducing such a clause the security interest can also be established for future acquisitions of the debtor without having to amend the security agreement.³²

To ‘perfect’ a security interest under Article 9 means to render it effective against third parties. To perfect a security interest the secured party has to publicise its interest to the public. According to Article 9 a statement referring to the financing has to be filed with the appropriate public filing office of the state (public register). The main difference between these registers and the civil law registers is that under common law the security interest is created before its entry into the register. The register only provides protection against

³¹ Lawrence, Secured Transactions at 42.

³² Lawrence Secured Transactions at 62.

third party claims whereby the entry into the civil law register “creates” the security right.

3. Priority of security interests

Although a variety of security interests can be established under U.C.C. Article 9, the priority rules set forth are very simple. Similar to some civil law jurisdictions the “first to file or perfect” rule can be applied to distinguish the priority between secured creditors. It has to be pointed out, however, that a security interest can also be perfected without filing it. In the case of long business relationships where the collateral is not attached until the event of default, priority can be secured by filing the financial statement. In this case, the security interest is deemed to be perfected although no attachment has taken place. The time of filing it will determine its priority.

An exception to this general rule is made regarding purchase money security interest. If a buyer finances an acquisition with money borrowed, the security interest generated by such transaction is called purchase money security interest. It ranks prior to any other security interest. The reasoning behind this is that the debtor would not have been able to buy the collateral if it was not for the purchase money lent by the (secured) seller. In this case the secured seller will be ranked before any other secured creditor with respect to this collateral even if the collateral would fall under the collateral defined by the buyer and the other secured creditor.³³

4. Enforcement of security interests

As in civil law, the enforcement proceeding is triggered by the debtors’ default under the secured obligation. It has to be mentioned, however, that under common law it is left to the parties to define the “default” very much at their discretion. Depending on the bargaining power of the debtor at the time of the negotiations of the agreement, a wide range of

³³ Lawrence Secured Transactions at 200.

defaults can find their way into the agreement. Clauses as “at will” or when “deems itself insecure” can favour the creditor’s declaration of default enormously and cause much controversy.³⁴

The parties autonomy under common law allows to formulate default remedies, whereas under civil law the remedies are predefined by statutory law. As demonstrated above the enforcement process, under civil law is a formal and predefined process whereby under common law it depends on the formulation of the security agreement and its provisions dealing with the remedies. U.C.C. Article 9 207(4) gives the secured creditor the right to use or operate the collateral after an event of default. If this operation is to procure revenue, either a clause in the security agreement or a court order is required.³⁵ The same result can be achieved under civil law, but only if the court approves such request and an administrator (independent third party) is appointed. However, the process to achieve such court order is lengthy and the outcome is not certain.

U.C.C. Article 9 503 states that a secured creditor has the right to take possession and dispose of the collateral. Within certain boundaries (e.g. commercial reasonableness and the prohibition of the “breach of peace”) the creditor can dispose of the collateral as he deems best. Compared to the formal civil law system, the solution found by U.C.C. Article 9 appears to be economically more efficient as it allows the creditor to seek self help. It must be considered, however, that this “*laisser faire*” approach has to be balanced with a rigid system of consequences when creditors overstep their boundaries. The civil law avoids this by placing the whole process in the hand of courts and special authorities.

³⁴ Lawrence Secured Transactions at 334.

³⁵ *Ibid.*

V. Remarks

The above considerations have summarised some of the major aspects of both civil law and common law security rights/enforcement legislation with respect to movable property. It has been shown that not only in establishing security rights or interests but also in the enforcement process the two differ widely. While the civil law has attempted to even the odds by restricting the kinds of securities and the formal enforcement process, common law, with the implementation of U.C.C. Article 9 and its Canadian counterparts achieve a similar result by leaving most of these issues to the parties' autonomy and reasonableness. Both systems have proven to be valid and workable in their respective jurisdictions. As the common law system is less tied to State authorities and allows greater autonomy to the parties the Article 9 system has taken precedence in the process of international law making.³⁶

³⁶ See Walsh Review at 52.

CHAPTER THREE: NATIONAL DISHARMONY IN CONFLICT OF LAWS AND THE LIMITATIONS OF THE GENEVA CONVENTION

When a secured transaction is factually connected to multiple jurisdictions, complex and, correspondingly, costly questions arise regarding the applicable national law. When, as is the case in aviation finance, the collateral is a highly mobile asset, numerous foreign connecting factors are often present. In the absence of more specific legislative reform, the national conflict of laws regime in place in each State determines the applicable law and therefore the extent to which a security right in an aircraft that is brought into the territory of that state is given recognition and enforced.³⁷ Again, Article 9 and the PPSAs adopt a somewhat different choice of law approach from that taken in European civil law jurisdictions (and indeed by antecedent common law).

I. The *lex rei situs* rule

In most European civil law jurisdictions, as also in common law jurisdictions, the *lex rei situs* determines not only the nature of a thing, be it an immovable or chattel, but also the rights and obligations connected with it.³⁸ These include the creation or termination of security rights. The rationale for the *lex situs* rule is commercial certainty³⁹. Application of the law of the State where a thing is situated is the solution that most naturally accords with reasonable commercial expectations, particularly when one takes into

³⁷ Ronald C.C. Cuming, "International Regulation of Aspects of Security Interests in Mobile Equipment", Uniform Law Review (1991) at 75 [Cuming "Aspects"].

³⁸ „The only law which can effectively determine whether things shall be treated as movable or immovable is the law of the country which has control over the thing, that is, if the thing is tangible, the law of the country where it is situated“. :Dicey A.V. & Morris, J.H.C., *The Conflict of Laws*, vol. 2, 12th ed. By Collins, L. et al. (London: Sweet & Maxwell, 1993) at 915.

³⁹ Cuming Aspects at 79 citing Rabel, "The Conflict of Laws: A comparative study" (Ann Arbor: University of Michigan, 1985), Vol. 4, p. 30.

account the territorial limits on the law making power of states under international law.

What happens, however, if the encumbered asset changes its *situs*? Will the law of the new *situs* recognise and give effect to the security right created under the law of the original *situs*? And, if so, what priority will it have against competing third party claims?

1. Effect of a subsequent change of *situs*

Under European civil law, the general rule is that a foreign created security interest will be recognised only if it can be accommodated within the legal system of the new *situs*. With respect to the *numerus clausus* of possible security rights in movable property, recognition of foreign security rights is highly unlikely if not coming from another civil law *situs*. But even among civil law jurisdictions recognition is considered the exception, not the rule.⁴⁰

“The reason for these problems may well lie in the fact that all European legal systems start out with a principle of non-recognition of possessory rights, but have developed means of circumventing that principle. Because of the relatively recent history of this development, these means differ widely between the individual countries. This in turn makes it easier for legal opinion and courts alike to maintain that their legal system is still committed to the principle and to refuse recognition to foreign security rights on the ground that they contravene that principle.”⁴¹

Even if the law of the second *situs* recognises a security right created under the law of the original *situs*, it remains open what efficacy the

⁴⁰ Cuming Aspects at 83.

⁴¹ *Ibid*; citing Schilling, “Some European Decisions on Non-possessory Security Rights in Private International Law”, (1985), 34 International and Comparative Law Quarterly 87.

competent courts will award it. The most common approach is to transpose the security interest.⁴² This means to give it the priority status that similar types of security rights have under local law. Due to national differences in the legal treatment of priority issues, and the inability to confidently predict where the movable may be relocated to, the risk of a change of location creates significant uncertainty for secured creditors. The risk is obviously exacerbated when the encumbered asset is a highly mobile object as an aircraft which by its very nature is intended to move regularly among different jurisdictions.

Not only will the *in rem* effect of securities be transposed, but also any requirements of public disclosure – for example, requirements for public registration – applicable to local security rights of the same kind. Seeing that registration and similar publicity requirements are usually characterized as mandatory provisions (and therefore as part of the *ordre public*), the courts in the second *situs* will impose the same disclosure requirements on foreign security rights that apply to local rights. To do otherwise would result in giving foreign security rights a higher priority status against third parties than local rights.

In summary, the current *lex rei sitae* rule for choice of law makes it virtually impossible for secured creditors to ensure that a security right in a highly mobile asset like an aircraft will be recognized and given full priority in view of the need to satisfy the publicity and priority rules in force in all jurisdictions through which the aircraft might conceivably travel.

2. Choice of law for Perfection and Priority

Due to their federal character, the United States and Canada were faced with the problem of *conflits mobile* long before their European counterparts. As the states of the U.S. and Canadian provinces are sovereign in private law matters, the issue of the recognition to be accorded to security

⁴² Cuming Aspects at 85.

interests initially established in a different state or province had to be addressed at an early stage. Even before the enactment of Article 9 and the PPSAs, legislation was passed preserving the validity and third party effectiveness of a foreign security right for a specified period of time after the encumbered asset was relocated to the enacting jurisdiction. Depending on the statute and the jurisdiction, the grace period for re-perfection of the security right in accordance with the new *lex rei sitae* varied from 30 days to four months.⁴³

In addition to establishing a uniform substantive secured transactions law for the U.S. states and Canadian provinces, Article 9 of the UCC and the PPSA also addressed the conflict of law dimension. The legislator rejected the traditional *lex rei sitae* rule for “goods which are mobile and which are of a type normally used in more than one jurisdiction,” a category that clearly includes aircraft.⁴⁴ Instead, the law of the jurisdiction where the debtor is situated was chosen to govern issues relating to the perfection, the effect of perfection and non-perfection, and the priority of the security right.⁴⁵ The new rule was designed to avoid the legal uncertainty and lack of predictability that arose under the *lex rei sitae* approach owing to the continually changing *situs* of mobile goods. A debtor is not likely to change its location as frequently as the goods themselves.

The legislators of the PPSAs and the former version of Article 9 rejected the *lex situs* rule not only for issues relating to the validity and perfection of a security right but also for issues of public disclosure and priority. Their substitution of the law of the jurisdiction where the debtor is located was based on the assumption that secured creditors are more likely to conduct a search of the secured transactions registry located in the

⁴³ Cuming Aspects at 93.

⁴⁴ See former art. 9-101(3). For the PPSAs, see, e.g., S. 7 of the Ontario version.

⁴⁵ Id.

debtor's home jurisdiction than in the jurisdiction where the mobile goods happen to be located at the relevant time. In view of this underlying assumption, the drafters limited the debtor location rule to mobile goods that are held by the debtor as equipment, which would be the usual category for aircraft, or for lease. For consumer mobile goods, the traditional *lex rei sitae* rule still applies.⁴⁶ The Official comment to the mobile goods rule in former Article 9⁴⁷ described its effect as follows:

“each state other than that of the debtor's location in effect disclaims jurisdiction over mobile chattels even though they may be physically located within [that] state much of the time.”⁴⁸

Unfortunately, the legislators of the 2001 revision to Article 9 took a step backward. As noted above, under the former version, the law governing perfection and the effect of perfection or nonperfection as well as the priority of a security right in mobile goods was that of the jurisdiction where the debtor was located. Revised Article 9 has now eliminated the distinction between "mobile" and "ordinary" goods.⁴⁹ The result is a bifurcation of the applicable law. Issues of perfection – essentially where to file notice of the security right – are governed by the debtor location rule which has been extended under revised Article 9 to all types of collateral, both tangible and intangible.⁵⁰ However, the effect of perfection or non-perfection and priority of security rights in all tangible assets, including mobile goods, are governed by the traditional *lex rei sitae* rule.⁵¹ It follows that, in order to determine which laws will potentially govern the priority of a security right in an aircraft, one must

⁴⁶ Cuming Aspects at 107.

⁴⁷ Former art. 9 -301(1).

⁴⁸ Cuming Aspects at 107; citing *Uniform Commercial Code, 1978 Official Text*, Official Comment to Article 9-103, p. 637.

⁴⁹ Revised art. 9-301, cmts. 4, 7.

⁵⁰ Revised art. 9-301.

⁵¹ Revised art. 9-301(3).

first determine in which jurisdictions the aircraft will be located from time to time and thereafter sort out the approaches that those various jurisdictions adopt on both choice of law and the substantive requirements for perfection and priority. In other words, the old problems encountered with the application of the traditional *lex rei sitae* rule to aircraft and other mobile goods have been reinstated at least for issues of priority.

3. Recognition of foreign security rights under common law

The PPSA and former Article 9 regimes do not expressly address which foreign security rights qualify as such for the purposes of triggering the application of the statutory choice of law rules. This is left to common law which seems to have adopted a more flexible and liberal approach than its European civil law counterparts. The common law treats a foreign security interest as presumptively valid unless and until it is replaced by a new title acquired by a competing claimant in accordance with the new *lex situs*.⁵² This more liberal approach is possible because the spectrum of non-possessory security rights recognized both by common law and under the PPSA and Article 9 is very wide.

4. Conclusions

The PPSA and Article 9 approaches to the efficacy of foreign security rights combined with antecedent common law approach to recognition are more creditor-friendly than civil law and better designed to facilitate “cross boarder” financing transactions. Based on a strong belief in the economic virtues of a capitalistic society with credit financing as one of its engines and a less formal and more flexible approach to legal reform, these systems offer a more evolved response to the legal demands of a modern, globalised and credit-based environment than do their European civil law counterparts.

⁵² Cuming Aspects at 81, citing Morris, *Dicey and Morris on the Conflict of Laws*, 10th ed. (London: Stevens & Sons Ltd., 1980), Vol. 2, Rule 80, p. 562.

In the field of aviation finance, however, the need for a truly international framework to govern security in aircraft became pressing after the end of World War II. As observed in the Introduction to this thesis, the development of the jet-engine caused aircraft prices to rise significantly which in turn led to a larger demand for external capital to finance their acquisition. The first international attempt to support aviation finance and facilitate the recognition issues described above was the International Convention on the Recognition of Rights in Aircraft, signed in Geneva in 1948 (“Geneva Convention”).⁵³

II. The Geneva Convention

Driven by a strong economic interest in facilitating aircraft exports backed up by a sophisticated method of equipment financing, the United States was one of the first States to advocate an international standard of property rights in aircraft. One of the major concerns was the exposure of U.S.-financed aircraft to foreign jurisdictions with a hostile treatment of property rights in aircraft.⁵⁴ Furthermore, the technical development of aircraft as such and a strong demand by the insurance sector supported this development.⁵⁵ Using earlier draft conventions already prepared by CITEJA, the ICAO Legal Committee resumed efforts to prepare a convention on the international recognition of rights in aircraft. In 1948, the second ICAO Assembly in Geneva adopted the Convention on the International Recognition of Rights in Aircraft, which was signed by 14 states and came into force on September 17, 1953. Today, the Geneva Convention has been ratified by 87 States.⁵⁶

⁵³ Convention on the International Recognition of Rights in Aircraft, signed in Geneva, June 19, 1948, 310 U.N.T.S. 151, T.I.A.S. 2847, 4 U.S.T. 1830, ICAO Doc. 7620. For complete history see Report and Commentary of the Legal Committee of ICAO on the Draft Convention Concerning the International Recognition of Rights in Aircraft, ICAO Doc. 4627, LC/63.

⁵⁴ See N.M. Matte, *Treatise on Air-Aeronautical Law* (Toronto: Carswell, 1981) at 554.

⁵⁵ See I.P. Diederiks-Verschoor, *Introduction to Air Law* (Boston: Kluwer Law, 1991) at 161.

⁵⁶ Status January 2009.

The Geneva Convention seeks to provide a solution to the problems of recognising and enforcing financiers' rights in aircraft. The condition is that such rights have been created in accordance with the laws of the state where the aircraft is registered. The objectives of the Geneva Convention are:

- creditor protection for lenders who have financed the purchase of aircraft and obtained a collateral on the aircraft itself (mortgage);
- provision of rules defining priority of claims; and
- facilitation of the transfer of aircraft between national registers.⁵⁷

III. Scope of the Geneva Convention

1. Recognised rights / Protected rights

The Geneva Convention requires certain formalities to be met for international recognition of nationally registered rights, and it only recognises clearly specified rights.⁵⁸ It does not obligate Contracting States to alter their

⁵⁷ Articles I, III, IV, V, VII and IX of the Geneva Convention.

⁵⁸ Article I:

1. The Contracting States undertakes to recognise:

- a. rights of property in aircraft;
- b. rights to acquire aircraft by purchase coupled with possession of the aircraft;
- c. rights to possession of aircraft under leases of six months or more;
- d. mortgages, hypothèques and similar rights in aircraft which are contractually created as security for payment of an indebtedness;

provided such rights

- i) have been constituted in accordance with the law of the Contracting State in which the aircraft was registered as to the nationality at the time of their constitution, and
- ii) are regularly recorded in a public record of the Contracting State in which the aircraft is registered as to nationality.

The regularity of successive recordings in different Contracting States shall be determined in accordance as with the law of the State where the aircraft was registered as to nationality at the time of each recording.

2. Nothing in this Convention shall prevent the recognition of any rights in aircraft under the national law of any Contracting State; but Contracting States shall not admit or recognise any right as taking priority over the rights mentioned in paragraph 1 of this Article.

legislation related to property rights; it merely obligates Contracting States to recognise those implemented by other Contracting States. In order to be recognised, such rights have to be validly constituted and entered into a public record.⁵⁹ Normally, however, the national register (nationality) and the national record (rights on aircraft) are maintained by the same governmental authority.⁶⁰

The scope of protected rights is very broad. It covers ownership, conditional sale, long term leases, equipment trusts as well as mortgages and similar rights in aircraft. These rights have to be contractually established. Thus statutory, common law or judicial liens are exempted.

2. Registration of Rights

In order to be recognised, the right in the aircraft has to be recorded.⁶¹ If the right is not registered it will not be recognised and therefore will not enjoy any priority over registered rights.⁶² It must be emphasised that the validity and perfection as well as the registration process of the right in the aircraft is in line with the law of the state of registration. Hence, the Geneva Convention leaves the question, whether a real right comes into existence with the registration (constituent function) or by agreement between the parties with only subsequent registration (declaratory function) up to national law.

3. Privileged and Priority Claims

The Geneva Convention sets up clear priority rules for rights in aircraft. The ranking is as follows: 1) claims based on customs, immigration and air

⁵⁹ This record has to be clearly distinguished from national registers which refer to the nationality of an aircraft and were introduced by Article 18 of the Chicago Convention.

⁶⁰ E.g. Switzerland and Germany.

⁶¹ Geneva Convention Article I (d) ii.

⁶² This was the reason why the United Kingdom did not ratify the Geneva Convention. According to English, law airport charges and air navigation fees can take priority over any registered right even if they themselves are not registered. This could not have been upheld in the international context under the Geneva Convention.

navigation charges imposed by national law (Art. XII); 2) costs of judicial sale (Art. VII(6)b); 3) sale in respect of spare parts (Art. X); 4) salvage and preservation claims (Art. IV(1)a & b)⁶³, 5) claims arising from damage to persons on the ground (Art. VII(5)), 6) Article I rights, and 7) other rights according to their status under the national law of the aircraft.

The question which of the registered rights in Article I takes priority is left open by the Geneva Convention. It merely requires the Contracting State to recognise the registered rights whereby their priority is left to national law. It is therefore questionable, whether the state in which the enforcement proceedings will take place will respect the priority rules of the registration state.

4. Transfer of Aircraft between Registries

Article IX prohibits the transfer of an aircraft from a national register as well as the national record of a Contracting State unless all holders of recorded rights have been satisfied or consent to the transfer. No such consent is required in the case of a judicial sale as per Article VII which transfers clear and free title of the aircraft to the new owner.

5. Enforcement

In Article IV, the Geneva Convention solely provides for one manner of enforcement: judicial sale. The judicial sale confers clear title to the buyer.⁶⁴ Minima are set out for the publication and notification requirements of the judicial sale as well as the time lines to be respected.

6. Remarks

The main insufficiency of the Geneva Convention lies in the fact that it merely recognises certain foreign rights established in aircraft. These rights,

⁶³ These “priority claims” are rights *in rem* which have to be respected only if the *lex situs* (the law of the state where the rescue and preservation took place) recognises them as having priority.

⁶⁴ Geneva Convention Article VIII.

although covering the most common financing techniques, are not sufficient from today's perspective. Especially from a common law, perspective the Geneva Convention restricts methods of financing, due to the common law's wider range of interests as opposed to the *numerus clausus* of civil law.

The Geneva Convention replaces the *lex rei situs* principle with the *lex registry*. Although a very reliable and comprehensible solution, it has often provided problems with respect to the choice of registration of aircraft.

Thirdly, the only enforcement remedy provided for by the Geneva Convention is the judicial sale. It is known that an announced judicial sale is not under all circumstances the best way to sell an aircraft, moreover such procedure is very time consuming.

Lastly, the Geneva Convention, although very wide spread, has not been ratified by some major air faring nations as the United Kingdom, Canada, Australia, Japan and others. This has not facilitated aviation financing with these countries.

As a conclusion one can say that something had to be done in order to reform the legal framework for aviation finance. The Convention on International Interest in Mobile Equipment is replacing the Geneva Convention. It remains to be seen if this new Convention can replace the Geneva Convention and improve aviation finance. This will be the subject matter of the following chapter.

CHAPTER FOUR: THE CAPE TOWN CONVENTION AND THE AVIATION PROTOCOL

I. Analytical Methodology

The title of this thesis promises a critical overview over the Convention. In order to criticise, certain parameters need to be established according to which this is to be undertaken.

The simplest way, it would seem, to find such parameters is to analyse at the objectives the drafters of the Convention had in mind when undertaking the task to draft this Convention and see if, how and at what (legal) price they achieved their goals. However, the objectives are very specifically⁶⁵ defined and thus allow only to a limited extent to be taken as parameters for an evaluation. Instead, it may be interesting to establish who defined the objectives, or, in other words, who drafted the Convention.

Another instructive way to analyse the merits of the Convention is to mirror the provisions against the commonly used parameters such as practicability and fairness in the market environment, also taking into account different legal and cultural approaches.

The method applied here shall take all of the above into account and shall attempt to go one step further. It could be described as the conciliatory or translating method. Without anticipating the result of the first two methods one can imagine that the first method will lead to the conclusion that the Convention was drafted by the strong and valid interests of the (North American common law based) aviation industry; in other words, by companies that manufacture, sell or finance aircraft and are therefore mainly creditors in that context. Accordingly, the second analysis will reveal that, the

⁶⁵ Above under III.

Convention - due to its creditor driven drafting - neglects aspects of fairness towards the debtor and legal/cultural divergence.

1. Language / Terminology

Most of this “misunderstanding” is due to the fact that civil and North American common lawyers do not speak the same “language” when talking about secured transactions. While the formal civil approach refers to a real right, the functional approach refers to a security interest. Real rights established in an object under civil are governed by the *numerus clausus* principle. One can only establish real rights (*in rem*) in objects which are foreseen by the applicable code.

Security interests, however, follow a functional approach. Security interests are not defined by legal definition but by their effect. For example, under the Personal Property Securities Acts in Canada a transaction will give rise to a security interest if the following four requirements are satisfied: (i) the transaction creates or evidences a proprietary interest in an asset in favour of a creditor, (ii) the asset is personal property, (iii) the creditor’s proprietary interest functions to secure payment or performance of an obligation, and (iv) the interest arises out of an agreement between the parties.⁶⁶ The notion of security interest is therefore only partially comparable to what civil lawyers refer to as real right. It is an open definition as opposed to a strictly categorised definition of what qualifies as a real right.

By introducing International Interests that can be based on a security agreement, a conditional sale as well as on a leasing agreement, the Convention introduces a spectrum of interests which can hardly be characterised under the civil law. Although familiar with some of the concepts the civil law seems unable to reconcile these with its formal approach.

⁶⁶ R.C.C. Cumming & C. Walsh & R.J. Wood, *Personal Property Security Law*, (Toronto: Irwin Law, 2005) ,at 12.

The German (unofficial⁶⁷) translation of International Interest is “*Sicherungsrecht*” which, properly translated, means “security right.” Using this term, which is also used in the German legal language to describe security rights within the *numerus clausus*, confuses more than it actually helps to understand. From the author's point of view, the two notions interest and right have to be strictly distinguished, using the former only in context of the Convention and the latter only with respect to applicable national law. From a civil law perspective, one has nothing to do with the other.

2. Perception of the Convention

Another point of misunderstanding is the perception of the Convention. North Americans understand it as an extension of their UCC Article 9 or the PPSA to aircraft objects. However, Europeans struggle with the idea of adapting the new system into their own. Since the civil law system is very reluctant to host foreign legal traditions as has been demonstrated in the preceding two chapters, it is suggested not to even try. Not only the notion of “interest” but also, for example, the introduction of self-help remedies without the leave of court in case of default or insolvency of the debtor represents *terra nova* for most civil law jurisdictions. Especially the remedies offered to the creditor by the Convention can be considered as fundamentally deviating from what civil law refers to as fair trial or due process.

It therefore seems to be more appropriate to take the Convention for what it is: “a strange new legal animal which introduces a special regime for people who deal with aircraft.” If perceived as such, it is the author's opinion that civil law jurisdictions will be more willing and able to accept the new regime. On the other hand, this approach may lead to an interpretation of the Convention that was not intended by the drafters (e.g. using the applicable

⁶⁷ Although a German version of the official text of the Convention is available, it is not considered to be an official version and can therefore not be used to interpret the Convention.

national law, if applicable, to circumvent or amend provisions of the Convention), but it will most probably lead to a ratification.

II. Initiation process

Following a proposal by Mr. T.B. Smith, the Canadian member of the Governing Council of the International Institute for the Unification of Private Law (UNIDROIT), the Council commissioned a study to Prof. Ronald C.C. Cuming to research the need for international regulation of security interests in mobile equipment in 1988.⁶⁸⁶⁹ In 1994, the Aviation Working Group (AWG)⁷⁰, a not-for-profit legal entity comprising major aviation manufacturers, leasing companies and financial institutions, as well as IATA joined the UNIDROIT Initiative. Furthermore, a “Restricted Exploratory Working Group” to ascertain the need for and feasibility of uniform rules governing security interests in cross-border transactions was set up by UNIDROIT in 1997.⁷¹ An economic impact assessment was conducted.⁷² It was found that an internationally uniform legal regime would facilitate cross border financing; and hence the drafting of the Convention on International Interest in Mobile Equipment (Cape Town Convention or Convention) began. On November 16, 2001 the Convention was opened for signature in Cape Town, South Africa.

At a very early stage it, became apparent that the specific needs of all of the equipment in question required its own legal specialties. Therefore, special working groups for each group of equipment (e.g. aircraft, space assets and railway rolling stock) were established. During the process the initial idea to

⁶⁸ L. Weber & S. Espinosa, “The development of a new Convention relating to international interests in mobile equipment: a joint ICAO-Unidroit project”, *Uniform Law Review*, 1999 at 463.

⁶⁹ R.C.C. Cuming, “International Regulation of Aspects of Security Interests in Mobile Equipment”, *Uniform Law Review*, 1990.

⁷⁰ See under: <http://www.awg.aero>

⁷¹ Sir Roy Good, *Official Commentary on the Convention in International Interest in Mobile Equipment and Protocol thereto on Matters specific to Aircraft Equipment* Official Commentary (Rome: Unidroit, 2002), at 3 [Official Commentary].

⁷² A. Saunders & I. Walter, “Proposed Unidroit Convention on International Interest in Mobile Equipment as applicable to Aircraft Equipment through the Aircraft Equipment Protocol: Economic Impact Assessment”, INSEAD and New York University, 1998.

integrate all equipment into one convention was abandoned and it was agreed that a convention would create the common framework but respective protocols would amend and change the convention according to the needs of that specific type of equipment. The AWG was making the most progress because it could access not only ICAO and IATA, two worldwide acting and established institutions, but also because the aviation community itself was internationally organised and aware of the problem. So it came as no surprise that the aviation protocol was finished first.

The Convention was signed in Cape Town on November 16, 2001, by twenty States; it entered into force on April 1, 2001. The Protocol on Matters specific to Aircraft Equipment (the Protocol) entered into force on March 1, 2006 with the ratification of the eighth Contracting State. As of today⁷³ the Convention has been ratified by twenty six the Protocol by 24 States.⁷⁴

III. Objectives of the Convention

The objective of the Convention and its protocols is the efficient financing of mobile equipment.⁷⁵ It does so by implementing a legal regime which covers the three main forms of financing high value objects: i) a loan secured by a security interest in the object; ii) a sale under an agreement (title reservation agreement), in which the seller reserves ownership until payment in full; and iii) a lease, which may be either a finance lease or an operating lease and may or may not include an option to purchase. The regime focuses also on the enforcement of the rights of the creditor which, with respect to the huge outlays involved in financing such objects, seems appropriate. Thus the Convention is designed to give the creditor confidence that in case of the

⁷³ January 4, 2009.

⁷⁴ See under: www.unidroit.org/english/conventions/c-main.htm.

⁷⁵ Official Commentary at 5.

debtor's default in payment or other performance it can efficiently and effectively enforce its rights against the asset.

In the words of Sir Roy Goode⁷⁶, the author of the Official Commentary of the Convention and the chairman of the conference in Cape Town, the Convention and its supporting protocols are designed to meet the following key objectives:

1. To facilitate the acquisition and financing of economically important items of mobile equipment by providing for the creation of an International Interest which will be recognised in all Contracting States;
2. To provide the creditor with a range of basic default and insolvency-related remedies and, where there is evidence of default, a means of obtaining speedy interim relief pending final determination of its claim on the merits;
3. To establish an international electronic register for the registration of International Interests which will give notice of their existence to third parties and enable the creditor to preserve its priority against subsequently registered interests and against unregistered interests and the debtor's insolvency administrator;
4. To ensure through the relevant protocol that the particular needs of the industry sector concerned are met;

All of the above is meant to give intending creditors greater confidence in the decision to grant credit, enhance the credit rating of equipment receivables and reduce borrowing costs to the advantage of all interested parties.

⁷⁶ Official Commentary at 6.

IV. Sphere of Application of the Convention

Article 3 and 4 of the Convention and Article IV of the Protocol engage the sphere of application of the new regime. In order for the Convention to apply, the following conditions have to be met: (i) the parties have to have entered into an agreement according to Article 2(1) and (2) of the Convention, (ii) the agreement has to relate to certain types of equipment, which is defined by the relevant protocol (e.g. airframe, helicopter, aircraft engines, space assets or railway rolling stock), (iii) the agreement is constituted according to the requirements of Article 2(2) and 7, (iv) the debtor is situated in a Contracting State to the Convention, or the airframe or helicopter is registered in a Contracting State. If all these conditions are met, the Convention applies and an International Interest can be registered.

1. Agreements

The agreement between the parties forms the basis for the International Interest. Only certain agreements qualify or are within the scope of the Convention. Security interests other than those created by such agreement do not fall within the scope of the Convention and therefore do not create an International Interest.

The term agreement for the purposes of the Convention is defined in the definition section of the Convention as a security agreement, a title reservation agreement or a leasing agreement. In case of aviation equipment, Article III of the Protocol also extends the sphere of application of the Convention to sales. In this context it has to be pointed out that it is the applicable law as determined by the rules of private international law of the forum which will determine the legal qualification of an agreement.⁷⁷ As long as the agreement falls within one of the four categories (sale, lease, title

⁷⁷ Article 2(4), 5(2) and (3) of the Convention. As per Article 5(3) of the Convention the reference to the applicable national law refers to the domestic rules of the *forum* and thereby excluding *renvoi*.

retention or security agreement) it will be able to serve as a basis for an International Interest.

It is doubtful whether national law will actually have an impact in respect of the application of the Convention, as the result of the characterisation will only determine the applicability of chapter III of the Convention (relating to default remedies) and, secondly, as will be shown below, the courts will only have to determine whether – according to the applicable national law – the agreement falls within the definition created by the Convention. In this context, the Convention itself supplies the courts with the necessary definition and not the applicable national law. This characterisation must be considered as different from what at least civil lawyers mean by characterisation, which is the mechanism to include agreements into the framework of a code that are not specifically mentioned therein (e.g. leasing agreements).

1.1. Formal requirements

Before discussing the different kinds of agreements eligible to serve as basis for an International Interest, one must turn to Article 7 of the Convention that addresses the formal requirements. The agreement has to be (a) in writing, (b) relate to an object of which the debtor has power to dispose, (c) identify the object in conformity with the Protocol and (d) in case of a security agreement, enable the secured obligation to be determined but without stating a maximum amount. National law may not add any further requirements.⁷⁸ In Article V of the Protocol the same requirements can be found with respect to sales contracts.

It is questionable, which requirements are ment to be left with national law, since the Convention itself describes in a clearly defined catalogue what is required of the registrants to create (in case of a security agreement) or provide for (in case of title retention or a lease agreement) an

⁷⁸ Official Commentary at 65.

International Interest. So even if national law would, e.g. provide for a notarisation in order to establish a valid security agreement under national law, this would only concern a “national security agreement” and not a security agreement under the Convention. Due to its legal superiority as international law, national law must comply with the provisions of the Convention. This is also valid if national law might permit remedies more favourable for the creditor but which were regulated by the Convention. In such a case the Convention would take precedence over national law.

However, what is governed by national law, is the capacity to contract, the material validity of the agreement and the question whether the object is one of which the charger, conditional seller or lessor has power to dispose, insofar as this question is not regulated by the Convention itself.⁷⁹

In case of non-compliance with the requirements mentioned in Article 7 of the Convention, the interest would not be validly constituted as an International Interest and a registration would have no effect except as a prospective International Interest relating to an identified object.⁸⁰

1.2. Security agreements

A security agreement for the purposes of the Convention “means an agreement by which a chargor grants or agrees to grant to a chargee an interest (including ownership interest) in or over an object to secure the performance of any existing or future obligation of the charger or a third party.”⁸¹ This broad definition covers security by title transfer as well as pledges, a charge or any other form of consensual security, security for future

⁷⁹ „It is, for example, implicit in the Convention rules governing the registration and priority of the interest held by a lessor that the lessee is to be considered as having a power to dispose, and thus to grant a security interest which, if registered before the interest of the lessor, will take priority over a security interest granted by the lessor, for if the position were otherwise there would be little point in making the lessor’s interest a registerable international interest.”, Official Commentary at 67.

⁸⁰ Official Commentary at 65.

⁸¹ Article 1(ii) of the Convention.

and existing obligations and security for performance of the obligations of a third party as well as the chargor.⁸²

1.3. Title retention and leasing agreements

The distinction between title retention agreements and lease agreements may confuse the North American common lawyer in the context of secured transaction legislation, but most jurisdictions outside of North America treat the conditional seller or lessor as the full legal owner. This seems odd for Americans, as UCC Article 9 treats leases and conditional sales as a form of security, thereby only allowing the lessor or the conditional seller a limited security interest. But then again one must bear in mind that the Convention, although strongly based on UCC Article 9, needed also to address civil law jurisdiction which take a more formal approach.

With the three types of agreements the Convention covers nearly all possible ways of traditional aircraft financing. However, one was included by the Protocol which requires special attention: sales.

1.4. Sales

Article III of the Protocol extends the sphere of application of the Convention to sales, but only insofar the Convention provisions are appropriate to these.⁸³ At first glance this extension seems outside the initial scope of the Convention, seeing that its goal is to make aircraft objects accessible to secured financing transactions and an outright sale is not what is commonly considered a secured transaction. However, the influence of the North American common law can be felt here. The institution of purchase money security interest – which again is extraneous to most civil law systems – led to this development. In a nutshell, a purchase money security interest describes a situation in which a seller helps to finance the acquisition of equipment by the debtor. The buyer/debtor becomes the owner of the

⁸² Official Commentary at 57.

⁸³ Official Commentary at 184.

equipment, and the seller – if so agreed upon before the transaction – becomes the holder of a purchase money security interest. In case of insolvency or bankruptcy, the seller can take back the equipment. The equipment does not become part of the buyer's estate and therefore can not be accessed by other creditors. Outside of North America, the same results can be achieved with leasing or title retention agreements, with the difference that in these cases the seller remains the owner of the equipment until certain conditions are met.

It should be emphasized that the Convention refers to a sale with respect to an International Interest and to a sales contract with respect to a prospective International Interest. The latter is merely an agreement whether the former is the actual transfer of title. Therefore, in this context, the seller is considered to be the debtor and the buyer the creditor, as it is the seller who will be the holder of the interest and not the buyer.⁸⁴ However, a contract of sale may serve as the basis for a prospective International Interest. The same is true for a lease agreement which contains a purchase option of the lessee. In these cases, the prospective buyer as well as the lessee may register their prospective International Interest against the equipment, thereby avoiding being displaced by another buyer or prospective buyer to whom the lessor sells or agrees to sell the object and who registers first. Therefore, a person can be registered in two different capacities. In the case of a lessee under a lease containing a purchase option granting a sub-lease, the lessee/sub-lessor will register its prospective International Interest with respect to the purchase option and the International Interest as the lessor under the sub-lease. The two registrations have different functions: the first is to protect to lessee against a disposal of the object by the head-lessor and the second is to protect itself against such disposal of the sub-lessee.

⁸⁴ This will lead to a wide spread application of the Convention, as most civil aircraft are manufactured in the United States and are therefore sold from an American debtors.

Although Article III of the Protocol includes sales into the scope of the Convention it clearly defines to what extent. Only the Articles listed in Article III(1) and (2) will be applied to sales and prospective sales.

2. Equipment

Article 2 (3) of the Convention defines the scope of the Convention with respect to the equipment. Article I of the Protocol further defines these terms. The appropriate term to describe what is normally referred to as an aircraft would be “aircraft object”. This term includes airframes, aircraft engines and helicopters. The term “aircraft” however, for the purposes of the Convention, is only used in context of the Chicago Convention and refers to airframes (incl. engines) and helicopters.

2.1. Airframes and helicopters

An airframe according to Article I(e) of the Protocol “means airframes (other than those used in military, customs or police services) that, when appropriate aircraft engines are installed thereon, are type certified by the competent aviation authority to transport: (i) at least eight (8) persons including crew; or (ii) goods in excess of 2750 kilograms, together with all installed, incorporated or attached accessories, parts and equipment (other than aircraft engines), and all data, manuals and records relating thereto.” With the person and/or the cargo requirement the Convention assures that only airframes of certain size fall within its scope. The definition of helicopters according to Article I(l) is also drafted in a way that it only includes helicopters certified to carry at least five persons or cargo in excess of 450 kilograms. The reasoning behind it is the same as with the airframes: the Convention only seeks to cover high value equipment.

Both airframes and helicopters only fall within the scope of the Convention if not used for military, customs or police services. This exclusion was first used in the Chicago Convention to exclude State, as opposed to commercial, aircraft. However, this distinction should not exclude airframes or

helicopters that are used for mixed purposes, meaning commercial and otherwise.⁸⁵ In the opinion of the author, if this would have really been the intent of the Convention, the exclusion should not have been included in the Convention at all. The distinction between “mixed used” vis-vis aircraft only used for governmental purposes seems to be completely arbitrary, seeing that even fighter planes may be used for commercial purposes (e.g. transportation of tourists). If the intention of the drafters was to include the possibility for governments to finance their fleets by means of external funds, it should have been addressed explicitly since it widens the scope of application considerably.

2.2. Aircraft engines

The distinction between aircraft engines falling within the scope of the Convention and those excluded also is made by size, although the proper distinction is made by power. The exclusion of military, customs and police used engines is also integrated in the definition of Article I(b) of the Protocol. The cause for this distinction is the same as for airframes and helicopters.⁸⁶ An aircraft engine includes all modules and other installed and attached accessories, parts and equipment. Auxiliary Power Units (APU's) which do not supply propulsion but power to the main engine are not considered aircraft engines but part of the airframe.⁸⁷

By treating engines separately, the Convention was deemed to create new substantial property law. Under most jurisdictions a component loses its legal status as an identifiable individual object when mounted onto another object. Therefore, all possessory rights including security rights were dissolved. It was profusely debated whether such rights were to revive once the object was separated again. In most cases however, it was found that the

⁸⁵ Official Commentary at 180.

⁸⁶ Above IV.2.1.

⁸⁷ Official Commentary at 179.

property rights ceased to exist after accession or installation of the component part, leaving a financier with no protection after the installation. In order to give creditors security, the Convention introduces security interests in aircraft engines.

However, one must be aware that the Convention itself does not create any form of real right in aircraft engines or any other type of equipment to which it is applicable. What the Convention does, is to establish a legal regime which allows creditors to enforce certain remedies upon their defaulting debtors. In order to be eligible for these remedies a creditor has to register an International Interest following the respective provisions of the Convention. And such provisions of the Convention allow the creditor to register an International Interest in aircraft engines. The way Contracting States respect International Interests in their insolvency and bankruptcy proceedings is how International Interests are enforced and recognised. It is however not the national property law that recognises a new type of property interest in objects mounted onto other objects but – if at all – the applicable national enforcement, bankruptcy or insolvency law. The result is that national enforcement law is forced to recognise legal institutions which might be unknown to its proper legal system; it is putting the cart before the horse. Having in mind the disparity of legal systems, especially in the area of property law, this procedure seems to be the only solution in the context of international lawmaking.

Since aircraft engines are known to be exchanged on a regular basis and are of high value individually, it makes good sense to treat them separately and maintain their availability to serve as security in the context of a financing transaction even if mounted onto an airframe. It also has to be taken into account that aircraft engines are financed separately already today. Therefore, there is good reason to address the issue in the framework of an international convention and to update the law to the practices commonly used in aviation finance. One could question, whether it would not be

desirable at the same time to also include other components (e.g. navigation instruments, computer systems et al.) which also represent a category of high valuable equipment.

3. Location of the debtor / registration of aircraft

In addition to the above mentioned requirements for the applicability of the Convention the debtor has also to be situated in a Contracting State. Article 3(1) of the Convention, which sets forth this additional requirement, is further elaborated in Article 4. The cascade is the one commonly used to identify the location of a corporation: (i) law under which it (the debtor) was incorporated or formed, (ii) where the registered offices or the statutory seat is, (iii) where the centre of administration lies, or (iv) where the place of business is. The place of business is further defined by Article 4(2). In case of several places of business, the main place of business shall be relevant, if there is no place of business it shall be the place of habitual residence of the debtor. Article 4 is conceived to give the widest possible scope of applicability to the Convention.⁸⁸ The use of six different alternatives to satisfy the test of situation of the debtor shall ensure the achievement of this objective.

Article 4 applies only for the purposes of Article 3(1) and shall be inapplicable to Article 1(n) of the Convention (which refers to the centre of main interest in a transaction), Article 43(2)b (which determines jurisdiction), Article 52(5)a (which refers to territorial units) or Article 60(2)b (which refers to Article 1(v) only).⁸⁹

Article IV of the Protocol amends the Convention by adding an alternative connecting factor. It declares the Convention also applicable in relation to helicopters and airframes pertaining to an aircraft which are or will be registered (according to the Chicago Convention) in a Contracting State. Special attention must be paid to the last part of the sentence of Article IV(1).

⁸⁸ Official Commentary at 62.

⁸⁹ Official Commentary at 62.

It reads: “[...] where such registration is made pursuant to an agreement for registration of the aircraft it is deemed to have been effected at the time of the agreement.” This entails two possibilities: either (i) the airframe or helicopter was (and after the transaction still will be) registered in a Contracting State or (ii) they are not registered in a Contracting State initially but will be at the end of the transaction. In the latter case the (Prospective) International Interest will be registerable from the moment where the parties agree on the sale of the airframe or helicopter. However, in the case of aircraft engines that can not be registered in a aircraft register this alternative connecting factor is not applicable. This may lead to cases in which an airframe can be registered under the Convention and an aircraft engine can not.

4. Relevant time

Article 3 of the Convention stipulates that the relevant time to fulfil all of the above mentioned prerequisites for the application of the Convention is the moment of the conclusion of the agreement underlying the International Interest. The term conclusion is not further specified, and the Official Commentary also does not refer to it. It is therefore assumed that the “signing” of the agreement is the relevant moment and not the moment of the “meeting of the minds” which for some jurisdictions would constitute the conclusion of the agreement. This is in line with the formal requirements of Article 7 of the Convention.

V. Registration System of the Convention

The provisions related to the newly established International Registry can be found in Chapter IV, V, VI and VII of the Convention and chapter III of the Protocol.

1. General

Before discussing the provisions some general remarks regarding the established system as a whole must be made.

1.1. The term “registration”

The term “registration” is not a term of art in English.⁹⁰ At least three meanings can be associated with the term in this context: (i) “registration of data relating to a person or object in a governmental database (registration of cars in a registry in order to tax the holder or determine the responsible person of the car), (ii) creation of rights through “registration” in a governmental database (becoming the registered owner of an object through registration) and (iii) “registration” as a legal requirement to that must be met if rights in property created by contract or otherwise are to be enforceable against third parties. The third kind of “registration” does not create a right but is a legal prerequisite for the recognition of a right against third parties. This third meaning is the relevant meaning in the context of the Convention and the Protocol.

Article 29(1) of the Convention states that: “a registered interest has priority over any other interest subsequently registered and over an unregistered interest.” Thereby it is made clear that interests are not created by registration but only their priority with respect to other interests is determined by the registration. This is nothing else than the old Roman law rule of *qui prior in tempore potior in jure*, or, to describe it in a more common way “first come, first served.”

The Convention, however, extends that meaning of registration to the point that the Convention gives priority to an International Interest that is represented by a prospective registration (i.e., a registration effected before the International Interest was created). Registration therefore, is not a public record of the existence of an interest; it is a record of the potential existence of such an interest.⁹¹

⁹⁰ R. Cuming, *Considerations in the design of an International Registry for interest in mobile equipment*, Uniform Law Review, 1999/2, 275, at 276.

⁹¹ *Ibid.* at 277.

It is commonly recognised that registries as the one established by the Convention “give notice” of interests registered against an object to the public. As the registry is open to the public it is assumed that all persons know its content. The “notice principle” is based on the (assumed) knowledge of the public. This is only partially true for this registry. The Convention explicitly states⁹² that the priority of the registered interest is not dependent on the knowledge of any third party. The focus is on the fact of registration and not on the state of knowledge of the holder of a competing interest. So even if a third party knew of an interest before it was registered, that knowledge cannot be held against it.

1.2. Type of registry

In general, one has to distinguish between “document filing” and “notice filing” systems. The former requires the applicant to file all the documentation with respect to the registration. In case of a registry of rights against property the filing of the agreement which sets the cause of the right established must be submitted. Depending on the legal system the registrar further has to check the application as well as the corresponding documentation and decide if the right is register able. The public is allowed not only to search the registry but also to examine the documents giving rise to the created interest or right. The notice filing system however does not provide this much information. Typically, only the parties and some basic information concerning the transaction that give rise to the interest are registered in the data base.

The registry established under the Convention is a notice filing system. This allows it to be based on a computerised database and work more efficiently and with less personel. By avoiding checking documents, the registry also avoids any liability for false or refused entries.

⁹² Article 29 of the Convention.

1.3. Data and form of data to be submitted

The amount of data which needs to be submitted to the International Registry must be determined by the purpose it serves. As discussed above, the International Registry serves as a public notice system. It is meant to bring the fact that an interest is registered against an aircraft to the attention of third parties and to enable them to make further inquiries themselves. Therefore, the disclosure of the identity of the parties to the agreement underlying the International Interest (obligor and obligee) and a specific reference to the object should be sufficient. No further documentation would have to be filed to the registry, and in case of a prospective International Interest or prospective assignment can be filed.⁹³

As the International Registry is operated completely electronically, all correspondence and registration will be effected electronically. However, in case a registrant must pass through a designated entry point, this entry point might require documentation which has to be filed in hardcopy version.

2. Registration of an International Interest

After having established that the International Registry simply serves as a public notice system in order to establish priority, the actual registration process and the requirements which have to be met in order to obtain a registration shall now be analysed.

2.1. Consent to registration

The International Registry is an asset based registry. Therefore, interests are registered against objects and not persons (debtors). However, it is the owner of the object or the holder of the interest, respectively, who must consent to a change of its legal status. Article 20 of the Convention addresses the issue with respect to all possible situations arising under the new regime. The requirement of consent prior to registration provides for a

⁹³ One has to keep in mind, that in case of prospective International Interest as well as assignments the necessary documentation does not exist at the time when the registration is effected.

safeguard against improper registration.⁹⁴ As the International Registry is an electronic registry, the required consent will also be transmitted electronically. According to section 12(b) of the Procedures for the International Registry, issued by ICAO according to Article 18(1) of the Convention, all the necessary consents to a specific registration will be electronically requested from the involved parties. They will be given a 36-hour time period to consent. In case of approval the registration will be effective upon receipt of the last consent. If, however the necessary consent(s) are not submitted within the 36 hours period the registration will automatically be aborted and will not appear on any search result initiated thereafter.⁹⁵

2.2. Time of effectiveness

According to Article 20(2) of the protocol, a registration is complete upon entry of the required information into the International Registry data base so as to be searchable. It is assumed that the time period between submitting the relevant information to the International Registry and the moment it is actually available for a search is very short. As described above, the registrar's duty is purely administrative and does not demand any kind of verification of the data submitted. Having said this, there is no apparent reason – except the necessary time the electronic system requires to transfer the data into the main data base – that there should be a delay. A delay might however result due to other circumstances.

Depending on how a Contracting State chooses to organise the access to the International Registry some problems might arise.⁹⁶ There are two possible alternatives made available by the Convention and the Protocol to access the International Registry. A State may make a declaration according to Article XIX(1) of the Protocol and thereby designating one or

⁹⁴ Official Commentary at 1.

⁹⁵ Section 12(b) and (g) of the Procedures for the International Registry.

⁹⁶ The access to the International Registry is discussed below, see V.3 below.

more mandatory national “entry points.” If it does so, the access to the International Registry can only occur through this designated entry point.⁹⁷ In such a case, the creditor has to enter its International Interest indirectly. Thus, it has to rely on the accuracy and the speed of the organisation that it has to pass through, which might result in a delay in registration.⁹⁸ Furthermore, Article 18(5) of the Convention allows Contracting States to demand additional information - which would not be necessary for the purposes of the Convention - before a registration is transmitted from the entry point to the International Registry, which might result in further delay. If such a delay costs a creditor its priority with respect to other creditors it might result in damages. Since the designated entry points are not of the International Registry, their liability, operation and insurance requirements are nationally regulated. A claim in this respect therefore would have to be filed with the national courts of the country in question.

The above described risk of delay is fully carried by the registrant. It suffers the loss of priority if an International Interest is registered too late. However, this burden is lightened by the possibility to register prospective International Interests, in which case the previously registered prospective International Interest becomes an International Interest (dated as of the time when the prospective interest was registered) when the transaction is concluded.⁹⁹

2.3. Duration of registration

Article 21 of the Convention provides for the duration of registration. Parties may choose to stipulate a certain period of time when the registration shall be in effect. If not extended by agreement, this registration automatically

⁹⁷ Out of the 9 States which have ratified the Aviation Protocol until today, only the United States has made such a declaration in favor of the FAA.

⁹⁸ Article XX(4) of the protocol requires the designated entry points to be operated at least during working hours. In comparison the International Registry is operated on a 24/7 basis.

⁹⁹ This however is only the case if the information supplied is sufficient to also register an International Interest (Article 28(3) of the Convention).

expires at the end of such period. If the period is extended (before expiry), the registration retains its initial effect and priority. In the case such extension is filed to late, the priority status of the initial registration is lost and replaced by the time of the new registration.

Destruction of the object does not result in the automatic discharge of the registration, since under Article 29(6) the creditor's claim extends to the proceeds (including insurance proceeds) of the object.

Article 25 of the Convention describes the circumstances in which an International Interest shall be discharged. Such discharge does not result in a removal of the entry in the International Registry, but leads to a notation to the effect that the registered interest no longer exists. "That mechanism will ensure an accurate historical file."¹⁰⁰ Because only the holder of an International Interest can procure the discharge of an entry, Article 25 imposes an obligation onto the holder to discharge without undue delay if requested to do so by the debtor. Such request, however, is bound to either the fulfilment of the secured obligation or, in case of a Prospective International Interest, if the transaction did not take place. If the creditor does not comply with its obligation, the debtor may seek assistance of the competent courts.

2.4. Effect of registration

The International Registry was never designated to be a title registry. Transfer of title of the object is governed by the applicable national law. Furthermore, registration is not an element in the constitution of an International Interest. A registration in the International Registry is a perfection requirement to give public notice of the interest and to preserve the holder's priority. As International Interest can only be entered with the debtor's consent, the registration of a non-existing interest will only arise if

¹⁰⁰ Official Commentary at 99.

such consent was never actually given or the agreement it is related to is not valid under the applicable national law.

3. Entry points / access to registry

Subject to a declaration according to Article XIX of the Protocol, a Contracting State may decide on how the International Registry can be accessed by the registrants. If no declaration has been made, the registrants can access the International Registry themselves. If however a Contracting State decides to make a declaration and designates one or more entry points, registrants must send their applications for registration to said designated entities. It is worth mentioning that of the 26 countries which have ratified the Aviation Protocol until today, only the United States has made such a declaration, designating the Federal Aviation Administration (FAA) as entry point.

In addition, Article 18(5) of the Convention leaves it up to the Contracting States to specify further requirements to be satisfied before the information is transmitted to the International Registry. These additional requirements as well as the compulsory access through a designated entry point cannot be implemented with respect to International Interests against aircraft engines.¹⁰¹ The reason for this is that contrary to aircraft that must be registered within the aircraft register of the country whose flag they carry, no such registries exist for aircraft engines.

The registration of an International Interest against an aircraft shall only be effected through the channels designated by the state of registry of said aircraft. In other words, against an aircraft registered in the United States, International Interests can only be registered through the FAA. It is not permissible to register any International Interest against such aircraft directly with the International Registry. Although no explicit provision can be found in

¹⁰¹ Article XIX(2) of the Protocol.

either the Convention or the Protocol, this requirement apparently was inadvertently discarded during the drafting process.¹⁰²

4. The object

As the International Registry is an asset or object based registry, all International Interests are registered against the object. It is therefore of outmost importance that such object must be uniquely identified in order to avoid confusion. Article XX(1) of the Protocol provides the criteria which render each aircraft object uniquely identifiable. The criteria are: (i) manufacturer's serial number, (ii) model designation, and (iii) supplements needed to ensure uniqueness. Section 5.3 of the Regulations for the International Registry (Regulation), issued by ICAO as the supervision authority of the International Registry, further clarify these requirements and emphasise the information needed with respect to each transaction. Without going into the details, one fact is worth mentioning. In section 5.3 (d) ii, the Regulation refers to the national registration marks of an airframe or helicopter. This is to assure that the access requirements set up by each individual Contracting State will be respected. It is assumed that if a registrant would try to register an International Interest against a U.S. registered aircraft it would be refused, because such registrations would only be accepted coming from the FAA as designated entry point.

5. The Registrar

The designated Registrar for the first five years as per Article XVII(5) of the Protocol is Aviareto Ltd. located in Ireland. The Registrar has to provide for the establishment and operation of the International Registry. Its duties and responsibilities can be found in the Convention (Article 18 and 27), the Protocol (Article XVII and XX) and the Procedures and the Regulations for the International Registry.

¹⁰² Official Commentary at 212.

The purpose of the registry is to provide a notice of the possible existence of an International Interest and not to be a system through which property rights are created, so the of the Registrar's role is largely managerial. In line with these duties assigned to the Registrar, the liability regime provided for by the Convention and the Protocol, the Registrar is liable for acts or omissions which result directly in damages to third parties except where such damages are caused by inevitable malfunctions of the electronic system. In other words, Article 28 of the Conventions constitutes a strict liability regime with some defences (e.g. state of the art defence). Only compensatory damages are recoverable, and contributory negligence will be taken into account (Article 28(3) of the Convention).

The liability regime reflects the purely managerial duties of the Registrar. Since the Registrar does not have to verify any registration information, it can not be held liable for any consequences resulting therefrom. Even in the case of the required consent (Article 20 of the Convention) which the parties involved into a transaction have to give in order to register an International Interest, the duty of verification does not lie with the Registrar.¹⁰³

6. The Supervisory Authority

The registry is established and supervised by the Supervisory Authority. According to resolution No. 2 of the Final Act of the Cape Town Diplomatic Conference and the decision of the Council of ICAO, the Council assumed the function of Supervisory Authority upon the entry into force of the Protocol. In general, the duty of the Supervisory Authority can be described according to Article 17(2)i of the Convention as "doing all things necessary to ensure that an efficient notice-based electronic registration system exists to implement the objectives of the Convention and the Protocol."¹⁰⁴ This entailed

¹⁰³ Above V.2.1.

¹⁰⁴ R. Cuming, "The International Registry: An Overview of its Structure", *Uniform Law Review*, 2006, p. 24.

enactment of the necessary Regulations and Procedures and contracting with an entity that assumed the functions of the Registrar. The detailed catalogue of duties can be found at Article XVII of the Protocol. As a result of Article 27 of the Convention and Article XVII(3) of the Protocol, the Supervisory Authority enjoys the immunity of an international organisation from action brought by any person who has suffered damages as a result of failure of the Registrar. This immunity does not extend to the Registrar.¹⁰⁵

7. Certificates

As a result of a registration, discharge or amendment process with the International Register, the involved parties receive a certificate. Article 24 of the Convention declares that the value of such certificate shall be only “*prima facie*” evidence of the facts recited in the certificate. If however a person is misled by an erroneous certificate, it might be entitled to claim against the Registrar under Article 28(1).

VI. Priority rules and their effect on insolvency

Registering the International Interest is the first step towards security for the creditor. When registering an International Interest, much will depend on the priority the registered interest has with respect to other interests (international, national, registered or unregistered). The aim of the Convention is to establish clear and simple rules with clearly defined exceptions to comfort the creditor and give it the expected security. Chapter III of the Convention titles: Effects of an International Interest as against third parties. Article 29 and 30 of the Convention engage the priority of competing interests and the effects of insolvency and were drafted to address the above mentioned issues. Article XIV makes some modifications to the provisions of the Convention mainly with respect to the position of the buyer of an aircraft object.

¹⁰⁵ Above V.5.

1. General rule

The general rule forms the basis of the priority regime of the Convention.

“A registered interest has priority over any other registered interest subsequently registered and over an unregistered interest.”¹⁰⁶

The term “registered interest” is defined in Article 1(cc) of the Convention and includes International Interests, registerable rights or interests or interests specified in a notice of a national interest. This includes any interest registered pursuant to Chapter V of the Convention. In other words, any interest registerable under the Convention, be it consensual, non-consensual or simply a notice of a national interest has priority over any other registered interest subsequently registered and over an unregistered interest. However, the priority rules of the Convention do not relate to the priority rules foreseen by national law with respect to nationally registered interests or rights.

By substance, the above stated rule is twofold. The first part refers to priority between registered interests. In this case the first registered interest takes precedent over the subsequently registered one. “Registration is therefore a priority point, not merely a perfection requirement.”¹⁰⁷ The second part gives a registered interest priority over an unregistered interest. In case of a Prospective International Interest turning into an International Interest with the conclusion of the transaction, the moment of registration is and will remain the moment of initial registration of the Prospective International Interest.

According to Article 29(2)a and b of the Convention, the actual knowledge of the existence of an earlier interest which was not registered does not affect the priority of a later created registered interest, even if the

¹⁰⁶ Article 29(1) of the Convention.

¹⁰⁷ Official Commentary at 108.

registrant of the later registered interest was aware of the first. Disputes among creditors about what they knew at a certain point in time can therefore be avoided.

2. Priority between parties

The registration of an International Interest is not necessary to protect the creditor against its own debtor. The debtor will be aware of its obligation and therefore does not need to be “notified” by the International Registry. A lessee for example can not claim priority over its own lessor even if it did not register the lease with the International Registry. However, if the lessee leases the aircraft object to a sub-lessee, and the sub-lease is registered prior to the head-lease, the sub-lessee will have priority over the head-lessor.

3. Priority against third parties

In order to be protected against priority claims by third parties, the interest has to be registered with the International Registry. Even if a third party is aware of an interest, this does not prevent it from having priority if it registers first.

4. Exceptions

Paragraph 3 and 4 of Article 29 introduce two exceptions to the general rule stated above.

4.1. Article 29(3)

A buyer acquires its interest in an object subject to any registered interest at the time of acquisition but free from any unregistered interests. This is also valid for interests that are not registerable under the Convention. The intention behind this provision is to protect the outright buyer from hidden liens or any other hidden interest when purchasing an object. However, in the case of aircraft objects Article XIV modifies Article 29(3): As sales with respect to aircraft objects are registerable under the Protocol (but not under the Convention), the buyer of an aircraft object can register the sale with the International Registry and thereby protect itself. Thus the protection given to

the buyer under Article 29(3) of the Convention does not seem appropriate; therefore Article III of the Protocol excludes Article 29(3) of the Convention.

4.2. Article 29(4)

According to Article 29(4) a conditional buyer or lessee acquires its respective interest in or right over an object subject to an interest registered prior to the registration of the International Interest held by its conditional seller or lessor respectively but free from any interest not registered at that time, even if it is aware of such an interest. The basic principle is that parties shall not be affected by anything that is not in the registry. The exception is drafted to deal with two situations: the grant of a charge by a conditional seller or lessor and the grant of a lease followed by a sale and lease back from the buyer subject to the terms of the existing lease.¹⁰⁸

4.2.1. Charge by lessor/conditional seller

In the first case a lessor charges its interest (under the lease) to a creditor under a security agreement and, following a default, the creditor desires to recover possession of the object from the lessee in possession. The lessee is protected under Article 29(4) if the interest of its lessor was registered before the charge. If the lease was not registered beforehand, the creditor enjoys priority. A lessee who can not register its own interest can therefore rely on the registration of the lease by its lessor. The same is valid with respect to a conditional sale and also if the lessee or conditional buyer knew of the charge. In the latter case however – if the lease or conditional sale was not registered before the charge – the lessee and conditional buyer are unprotected from the enforcement of the charge, the existence of which they would have been able to ascertain by searching the registry.

¹⁰⁸ Official Commentary at 109.

4.2.2. Sale and lease back

The second case refers to a sale and lease back transaction. If the lessor wishes to refinance the aircraft object that it has already leased to a lessee, it will e.g. enter into a sale and lease back with a third party (the buyer). Hence, a head-lease and a sub-lease structure is established. The now sub-lease was registered before the sale and lease back transaction, now head-lease. The new (head-) lease will take effect subject to the now sub-lease. The effect of Article 29(4)b is that the sub-lessee is entitled to the right of quiet possession both against the sub-lessor and the buyer as head-lessor.

5. Subordination agreements

It remains at the discretion of the holder of International Interests to vary their priorities by agreement. However, an assignee is not bound by the subordination of its priority if the subordination was not registered at the time of the assignment. Even if not stated explicitly in the Convention and the Protocol, it must be assumed that the result would be the same if the assignee would have had knowledge of the not-registered subordination.

6. Proceeds

Proceeds according to Article 1(w) of the Convention include all monetary and non-monetary proceeds arising out of a physical complete or partial loss or loss of use and thus refer mainly to insurance proceeds. Proceeds resulting from a disposition of the object do not fall within that definition. As long as such proceeds can be identified, which is determined by the applicable national law, Article 29(6) applies the same rules as to the aircraft object from where they derive.

7. Effect on national property law

With reference to the applicable national law Article 29(7)a allows that rights in an item, other than an object (airframe, aircraft engine or helicopter), will not be affected by the Convention if the rights continue to exist after an

installation to an object. In these cases the nationally established rights are to be respected, and they do not become part of an International Interest established in the object even if the object they are installed on is subjected to such. If, however, the applicable national law follows the accession principle, these items fall within the scope of the International Interest related to the object.

As already pointed out in IV.2.2 above, neither the Convention nor the Protocol creates a new property law system. They establish a system in which creditors who finance a specifically designated kind of equipment are allowed to enjoy speedy and efficient default remedies against their debtors. However, Article XIV(3) of the Protocol states that rights and/or interests established in an aircraft engine are not to be affected by its installation on or removal from an airframe. The reference to rights in this context is made in order to cover the rights established by the applicable national law. The only means by which such rights or interests could be affected are those foreseen by the applicable national law of a Contracting State. By imposing an obligation onto Contracting States to respect that aircraft engines do not follow the common principle of accession, one could say that the Convention creates new substantial law for those Contracting States with respect to aircraft engines. However, the only obligation imposed on Contracting States is to respect that the Convention does not apply the accession principle for its own purposes. Hence, if the laws of a Contracting States comply with the Convention is not relevant, as the holder of an interest derives its protection from the Convention, not from the applicable national law.

8. Effect on insolvency

In principle an International Interest is effective in insolvency proceedings against the debtor if it was registered before the commencement of the insolvency proceedings. The term “commencement of insolvency proceedings” is defined in Article 1(d) of the Convention but is eventually determined by the applicable national insolvency law itself. “Effective” in this

context shall mean “that the international interest will be recognised as proprietary in nature and therefore in principle rank ahead of claims of unsecured creditors.”¹⁰⁹

What must be further mentioned is that even if an International Interest is not registered with the International Registry, it might still be effective in an insolvency proceeding against the debtor. In this context the unregistered International Interest can be effective as a national interest under the applicable national law. However, this extension of validation of the International Interest would require that the creditor has registered the interest according to the applicable national law. It is doubtful whether a creditor who has omitted to register with the International Registry has done so with a national register. Thus the extension of validity seems to only be of importance where an interest does not have to also be registered under the applicable national law.

By imposing the rules of paragraph 1 and 2, Article 30 overrides national insolvency law with respect to effectiveness of interests within its scope. Paragraph 3 clarifies that national law that shall determine if fraudulent acts or transactions as a preference have occurred and that the insolvency administrator will be in control of the proceeding. With respect to aircraft objects, however, Article 30(3) gives way to Article XI, Alternative A, paragraphs 9 and 10 of the Protocol¹¹⁰, if declared applicable by a Contracting State, with the consequence that no delay can be imposed on the exercise of the remedies beyond the specified waiting period.

VII. Non-consensual rights or interests

Article 39 and 40 of the Convention introduce two categories of non-consensual rights to which the Convention also applies. Article 39 speaks of

¹⁰⁹ Official Commentary at 114.

¹¹⁰ Below IX.4.1.

“rights having priority without registration” and Article 40 describes “registerable non-consensual rights or interests.”

1. Article 39

The scope of Article 39 is to allow Contracting States to declare non-consensual rights to take priority over registered International Interests without being registered and therefore without the knowledge of the involved parties. By allowing such exception, the drafters of the Convention discarded one of their paramount principles: reliability of the International Registry. The main purpose of establishing an International Registry was to give creditors certainty that no interests in or against the aircraft object exist that are not shown in the Registry. By allowing this exception, a creditor can not be certain that the entry in the International Registry reveals all the information needed to make its decision. The requirement to list the rights having such priority in the declaration and thereby informing the creditor of the potential risk is only of limited effect, as the declaration can be very general and may also cover rights which will be establishable under the applicable law in the future.

To reduce the impact of the exception, Contracting States can only declare non-consensual rights to take priority which would also do so in a national context. For example, unpaid air navigation charges allow the service provider in some jurisdictions a lien against aircraft of the debtor airline. Only these jurisdictions are allowed to make a declaration in this respect under the Convention.

Paragraph 1(b) declares that the right to arrest an aircraft object for amounts due to States, national entities or organisations fulfilling a public service shall not be affected by the Convention. However, the same principle as mentioned above is valid in this respect. The right of detention or arrest must first be provided for by the national law of the State making the declaration. It is of importance to understand that paragraph 1(b) extends application of Article 39 to consensual rights with respect to arrest or

detention. Therefore, the mentioned entities or States themselves are allowed to attach aircraft objects even if such right is “only” contractually agreed upon. The broad wording of paragraph allows such interpretation.¹¹¹

The mechanism of declaration is drafted in a way to give Contracting States as many options as possible. The declaration may be general or specific and it may cover categories of rights that are created after the deposition of the declaration. Further, non-consensual rights only have priority over registered International Interests if the declaration providing for such priority was deposited before the registration of the International Interest. This requirement, however, is put into perspective by paragraph 4 allowing Contracting States to declare that even if the declaration is deposited after the registration the non-consensual rights take priority.

2. Article 40

This Article allows Contracting States to declare that designated categories of non-consensual rights or interests can be registered as if they were International Interests. Those rights or interests will then be treated in all respects as International Interests. This means that in case of non-registration they will be subordinate to registered International Interests and their priority is determined by the national law.

As opposed to Article 39, Article 40 requires Contracting States to list the categories of the rights and interests, whereas Article 39 requires only a general description.

VIII. Assignments

One of the most complex areas of the new regime deals with the assignment of associated rights and the related International Interest. The relevant provisions can be found in Article 31 of the Convention and Article

¹¹¹ Also Official Commentary at 139.

XV of the Protocol. For the sake of clarity some general remarks must be made before discussing the merits of the provisions.

1. General

As already demonstrated in the introduction, the North American and European civil law differ in many respects, also with respect to assignments. As discovered earlier the Convention is heavily based on UCC Article 9, it is therefore necessary to “translate” certain principles into a language civil lawyers understand.

In general, an assignment is considered to be an agreement between the assignor and the assignee in which the assignor transfers some or all rights (the entire contract) to the assignee that it is entitled to under a separate contract with the debtor. Normally, the assigned rights are rights to receive payments or other performance by the debtor. After the assignment, the debtor may only pay to the assignee in order to discharge his obligation. A necessary requirement to execute this new constellation is that the debtor has to be notified of the assignment. Only then can it be expected of the debtor to pay the new creditor, the assignee. The assignment itself represents the transfer, whereas the underlying contract (*pactum de cedendo*) describes the reason for the assignment. The latter contract identifies the purpose of the assignment (for security reason or otherwise) which is a distinction of some importance to the Convention.

In addition to the assignment of the contractual obligation however, related rights (with respect to the assigned obligation) can also be transferred. For example, a chargee has advanced money to purchase an aircraft and secured the loan with a charge over said aircraft. In case of an assignment of the instalments to an assignee some jurisdictions also require the transfer of the charge to the assignee, as security rights are accessory to the secured obligation. The same principle is also found in the Convention.

Although the above may correspond with the view of most jurisdictions, some other points are regulated quite differently. For example, under French law an assignment is only effective if the debtor is notified, whereas under German and Swiss law the assignment is effective as soon as the assignor and the assignee have agreed on the terms. The effect of the different approaches is that under German and Swiss law the assignor can not validly re-assign the same obligation to a third assignee after the first agreement has been concluded, whereas under French law the assignor may do so until the notification has been received by the debtor. As another example, under the UCC Article 9 for the United States or the Canadian PPSA, the requirement for third party effectiveness (i.e. also against the debtor) is registration of the assignment in a public register, a requirement not known to most civil law systems, as under these systems assignments do not have to be registered at all in order to be effective.

One can imagine that regulating assignment in an international context is one of the most complex areas of law, and law making initiatives on an international level have had only limited success. The Convention tries to circumvent problems faced in this respect by allowing national law to remain sovereign in those areas where deemed necessary. It has to be kept in mind that the scope of the Convention – at least in the opinion of the author of this paper – is not designed to change a national legal system but merely to provide for an international regime which allows special types of equipment to benefit from a new regime if certain requirements are met. It is therefore important to define the areas where the new regime applies and which areas are left to the applicable national law in order to determine the scope of the Convention.

2. Assignment and associated rights

Article 31 of the Convention speaks of an assignment of associated rights. An assignment is defined in Article 1 of the Convention as “a contract which, whether by way of security or otherwise, confers on the assignee

associated rights with or without a transfer of the related International Interest.”

Thus, an assignment for the purposes of the Convention must be contractually agreed upon between the assignor and the assignee; assignments by law (subrogation) do not fall within the scope of the Convention but are regulated by the applicable national law. Apart from this distinction, the definition is quite broad. According to the Official Commentary it covers both transfers (of contractual rights) and charges or pledges (the actual security).¹¹²

If such an assignment is made for security purposes or otherwise is irrelevant as both are within the scope of the Convention. Further, the purpose of an assignment is only determinable if the underlying contract (*pactum de cedendo*) states the reason for the assignment, but the assignment as such cannot be categorised. However, the Convention due to its origin, pays a high level of attention to this distinction. As described above¹¹³ UCC Article 9 takes a functional approach towards security interests as opposed to the more formal approach of most civil law jurisdictions. The functionality is based on the idea that all legal constellations that serve a security purpose shall be treated as such, independent of their respective legal title. Once such security purpose is identified it falls within the scope of the designated legal framework of UCC Article 9. Therefore, the Convention, which is mainly derived from UCC Article 9, also makes a clear distinction in this respect.

The only real limiting factor with respect to the scope of application as foreseen by the Convention is that the assignment has to confer “associated rights” to the assignee. Associated rights are also defined in Article 1 of the Convention as “all rights to payment or other performance by a

¹¹² Official Commentary at 19.

¹¹³ Chapter two IV above.

debtor under an agreement (that is, a security agreement, a title reservation agreement or a leasing agreement) which are secured by or associated with the object (the object being an aircraft object and therefore an airframe, aircraft engine or a helicopter).” Three key prerequisites can be derived from this definition in order for the assignment to fall within the scope of the Convention: (i) the rights assignable have to be rights to payment or performance by the debtor; (ii) these rights also have to be established by an agreement (between the assignor and the debtor) and (iii) they are secured by or associated with the object. All assignments that do not fulfil these requirements do not fall within the scope of the Convention and are therefore regulated by applicable national law only. Whereas the first and the third requirement need further explanation, the second is self-explanatory and will therefore not be discussed below.

2.1. Rights to payment or performance by the debtor

Rights of payment or performance by the debtor are held by the creditor. It is therefore only the creditor who can assign these rights to another party (assignee). In the context of the Convention, a creditor is a chargee, a conditional seller or a lessor. However, since the Protocol extends the scope of application of the new regime to sales, a buyer can also register an International Interest and be a creditor. In the case of an option to purchase under a lease, a lessee can register a Prospective International Interest in that respect and therefore also assign such interest.

The rights assignable have to be such of performance or payment by the debtor. Not included therefore are rights to performance by third parties or rights to performance by the debtor under a different contract than the one entered into with the creditor.¹¹⁴ However, if the debtor undertakes in the

¹¹⁴ For the sake of clarity the term ‘agreement’ is used in the same context as in the Convention, describing the agreements within its scope (charge, conditional sale, lease and sale), whereas a contract shall describe a contractual relationship between the parties not falling within the scope of the Convention.

agreement itself to perform the obligations of the third party or of itself under the other contract, those obligations are included within the definition of associated rights, insofar the rights to such performance are secured on or associated with the object to which the agreement relates.

2.2. Associated with or secured by the object

Rights secured by the object refer to a security agreement by which the chargor grants security over the object to the chargee. They include rights to monetary and non-monetary performance such as default interest, maintenance, repair and insurance of the object.

Rights associated with the object refer to rights of payment or other performance by a conditional buyer under a title reservation agreement or by a lessee under a lease. Rights of performance not related to the transfer of ownership or the debtor's right to retain possession are not considered associated rights.¹¹⁵

3. Effect of assignment

Before discussing the merits of the applicable provisions, one has to be aware that the effect of assignment is twofold. If the assignment falls within the scope of the Convention, the Convention sets the rules, otherwise the applicable national law prevails. In other words, an assignment with no effect with respect to the Convention may be effective with respect to the applicable national law. As a general rule one can say that an assignment under the Convention becomes effective when registered with the International Registry. Only then shall the respective priority rules and enforcement remedies apply.

Article 31 of the Convention states that subject to the formal requirements of Article 32 an assignment of associated rights also transfers the related International Interest and all the interests and priorities related

¹¹⁵ Official Commentary at 117.

thereto held by the assignor to the assignee. The effect of such an assignment is, therefore the complete replacement of assignor by the assignee. This follows the common rule that security does not exist by itself, but is accessory to the secured rights.¹¹⁶ It is, however, left to the parties' discretion to assign only the associated rights without the International Interest. In such case the Convention does not apply, because it is devoted to International Interests and not to assignments as such.¹¹⁷ What the Convention does not allow, is the assignment of an International Interest created by a security agreement without the assignment of at least some of the associated rights.¹¹⁸ This makes sense, considering that the Convention's purpose is to create and regulate the transfer of International Interests.

Paragraph 2 allows the parties partially to assign associated rights and to agree to what extent the related International Interest is also assigned. In such a case the assigned rights must be identifiable under the contract from which they arise¹¹⁹ and must be identified before payment by the debtor can be requested.¹²⁰ Because the assignment is only partial, the parties must find an agreement to what extent the related International Interest is transferred. In the absence of an agreement, it is left to the applicable national law to determine the rights to the related International Interest. As a prerequisite for partial assignment the underlying obligation has to be dividable. This may be the case if only some of the monthly instalments under a lease are assigned while others are not, but also in the more complicated case of two separate contracts. In such scenario the debtor has entered into another contract but has undertaken in the agreement with the creditor to perform its obligation under the other contract. Therefore, the agreement

¹¹⁶ Official Commentary at 118.

¹¹⁷ Article 32(3) of the Convention.

¹¹⁸ Article 32(2) of the Convention.

¹¹⁹ Article 32(1)b of the Convention.

¹²⁰ Article 33(1)b of the Convention.

includes the debtor's obligation under the contract, so that a creditor's assignment of the debtor's obligation under the contract constitutes a partial agreement, although being a contract as a whole. In any case, however, the second contract has to be associated with or secured by the object. The assignor and assignee then have to find an agreement as to their respective rights concerning the related International Interest.

Paragraph 5 of Article 31 states that no instrument of reassignment is necessary in case of an assignment by way of security that is discharged to reassign the associated rights to the assignor. It is not mentioned explicitly, but such automatic reassignment also refers to the related International Interest.

4. Debtor's rights and duties

Article 31(3) and (4) describe the possibility to waive set-off rights and other defences available to the debtor, and Article 33 titles the debtor's duties to the assignee.

The Convention itself does not contain any rights of defence or set-off but refers only to the waiver of the same. The applicable national law is to determine the legal possibilities of the debtor. However, the Convention, by allowing the debtor to waive all or any of the defences and rights to set-off, overrides the otherwise applicable national law in that respect. The waiver will not be valid with respect to fraudulent acts on the part of the assignor.¹²¹

The scope of application of Article 33 only covers assignments which transfer the related International Interest. The debtor is only bound by the assignment once the assignor (or a person authorised by the assignor) has given written notice to the debtor identifying the assigned associated rights. From this moment on, a debtor is released from its obligations by payment or performance to the assignee. Paragraph 1 simply states that a debtor can

¹²¹ Article 31(4) speaks of the assignee but this must be considered a mistake.

only be required to perform to the assignee once the conditions are met, but does not explicitly forbid the debtor's performance to the assignee before all conditions have been met. If the debtor chooses to perform to the assignee before the conditions have been met, it does so at his own risk.

As none of the above is related to registration issues, paragraph 3 emphasises that Article 33 does not affect the priority of competing interests.

5. Formal requirements of assignment

Article 32 of the Convention contains the rules for the constitution of an assignment under the Convention. It is in line with the requirements of Article 7, which relates to agreements for establishing an International Interest. The main difference is that in case of an assignment it is not the object that has to be identified, but the associated rights which are to be transferred. The assignment must be in writing and must identify the assigned obligation. The term contract is used in Article 32(1)b instead of agreement to ensure that also obligations arising under other contracts that the debtor undertakes to perform under an agreement are covered. If not the requirements are not met, the related International Interest will not pass from the assignor to the assignee and the assignment itself falls outside the scope of the Convention. Its efficacy will then depend on the applicable national law.

In case of an assignment of an International Interest created by a security agreement (charge), the assignment also has to cover some or all of the associated rights.¹²² In case of a conditional sale or a lease an International Interest can be transferred without subsequently assigning the associated rights.

6. Priorities

The priority system with respect to assignment is twofold. One has to distinguish between the assignment of associated rights and the assignment

¹²² Supra note 118.

of the International Interest related to associated rights. But before one can identify the proper priority, one has to first determine if the assignment in question falls within the scope of the Convention. As said above, the Convention primarily relates to International Interests. It has been identified that the assignment of associated rights without the related International Interest does not fall within the scope of the Convention¹²³ and therefore will also not be governed by the priority rules stipulated in Article 35 and 36 of the Convention. This link between the associated rights and the International Interest has to remain intact at all times for the Convention to apply. If the link has never been established (e.g. when only associated rights are assigned) or if was subsequently detached (e.g. when an assignee of a conditional sale and the associated rights only assigns the International Interest), the assignment does not fall within the scope of the Convention.

Therefore, only two possibilities of competing assignments remain which fall within the scope of the convention: (i) competing assignments of registered International Interests (i.e. the registered International Interest is assigned with the associated rights) and (ii) competing registered assignments (i.e. the assignment of associated rights related to an International Interest is registered).

The first situation is a competition between an assignee of a registered interest and the assignee of a subsequently registered interest or, of an unregistered interest. Under such circumstances, the assignee of a registered interest has priority over an interest that was subsequently registered or was not registered at all.

The assignee takes the same priority as its assignor since it is the International Interest that has been assigned. The second situation concerns the priority between competing assignees of the same registered interest. In such case the associated rights were assigned. The rule for this scenario is

¹²³ Article 32(3) of the Convention.

that a registered assignment has priority over a subsequently registered and a non-registered assignment. In other words, in the first scenario the associated rights are related to the International Interest which was assigned, and in the second scenario the International Interest is related to the associated rights which were assigned. While the first scenario describes priorities of interests, the second describes priorities of assignments.

In the first scenario, Article 35(1), by referring to Article 29(1), states that a registered assignment of an International Interests has priority over a subsequently registered and an unregistered one. In the second scenario, Article 36 defines the priority. If competing assignments do not meet the requirements of Article 36 their priority against another assignee of those rights does not fall within the scope of the Convention and must be determined by the applicable national law.

According to Article 31(1) b, the assignment of associated rights also transfers the related International Interest and all the interests and priorities of the assignor to the assignee. Article 29(1) would give the registered assignee of such interest priority with respect to all rights secured by or associated with that interest.¹²⁴ “Article 36 qualifies that priority in two ways: first by requiring that the contract under which the associated rights arise states that they are secured by or associated with the object and secondly, by restricting the priority to associated rights relating to the financing transaction.”¹²⁵ Hence, in order to qualify for priority the contract has to be associated or secured by the object; of such contracts, only the ones relating to a financing transaction qualify.

6.1. Contracts secured by or associated with the object

Article 36(1) a uses the term 'contract' as opposed to 'agreement', which is defined by the Convention in Article 1(c). The intention is to cover

¹²⁴ As it does for the assignment of International Interests according to Article 35.

¹²⁵ Official Commentary at 129.

cases in which the debtor undertakes in the agreement to perform not only the obligations under the agreement but also those incurred to the creditor under any subsequent contract. The obligation under the contract thereby becomes part of the agreement if associated with or secured by the object¹²⁶, and hence in case of assignment the assignee would enjoy the same priority as the assignor. Article 36 restricts the application of such priority to cases in which the agreement causing the assignment is related to a finance transaction as per paragraph 2. The ratio of this provision is that an assignee of the contract, who had not know that the contract assigned to it was related to an object should be treated in the same manner as a assignee who advances funds especially for the acquisition of an object. This result, however, can be avoided by an express statement in the contract that the associated rights assigned under that contract are secured by or associated with the object.

6.2. Financing transactions

According to Article 36(2), the priority given to a registered assignee of an International Interest and the associated rights, is awarded only to the extent that the associated rights are object-related. This restriction covers essentially what is known in North American common law as purchase-money security interest.¹²⁷ The restriction was implemented in order to avoid that assignees have priority without having advanced funds in relation to the object. Paragraph 2(a) and (b) make this point specifically clear by requiring that the funds must have been utilised to purchase the object or the other object, respectively.

7. Effect of assignors insolvency

Article 37 extends Article 30 to this context entailing that the assignee's title to the assigned International Interest and to the associated

¹²⁶ Above VIII.2.2.

¹²⁷ Above IV.1.4.

rights is to be respected in the insolvency of the assignor as overriding the claims of the assignors general creditors and the insolvency administrator, if registered prior to the commencement of the insolvency proceedings or if otherwise effective under the applicable law. This is subject to the rules of insolvency law further specified in Article 30.¹²⁸

8. Subrogation of assignment

The Convention only deals with contractual assignment of International Interests and associated rights.¹²⁹ National law often provides for a right of subrogation in cases when payment to a creditor is made other than by the debtor (e.g. guarantor). The guarantor then replaces the debtor. Article 38 makes clear that the rights of the subrogee under the applicable law are unaffected. If, due to the subrogation, the subrogee also succeeds the creditor with respect to the International Interest, the subrogee becomes entitled to have such rights entered in the International Registry. The subrogee thereby replaces the creditor also with respect to priority of its International Interest. Paragraph 2 of Article 38 merely extends the rule of Article 29(5) to this context.¹³⁰

IX. Default remedies and enforcement

The core piece of the Convention is Chapter III: Default remedies. As elaborated above, the fundamental purpose of the Convention is to offer creditors the highest possible security when financing high value equipment. In this context much will depend upon the enforcement remedies. Everything else in the Convention is set up to serve this purpose. The registration system and the priority regime serve no other purpose than regulate who has the right to enforce and what kind of remedies such person can use. It therefore comes as no surprise that Chapter III of the Convention and Chapter II of the

¹²⁸ Official Commentary at 134.

¹²⁹ The only provision in which the Convention actually deals with subrogation is in Article 9(4): in the context of the discharge of the secured obligation by another person than the debtor.

¹³⁰ See above VI.

Protocol are the longest and most detailed. The Convention makes a clear distinction between the remedies available to a chargee and those available to the conditional seller or lessor. But before any remedies can be exercised the debtor must be in default.

1. Default of the debtor

The meaning of default is described in Article 11 of the Convention. The provision leaves it up to the parties to determine what behaviour constitutes a default. Only in case that the parties can not agree, paragraph 2 defines default as “a default which substantially deprives the creditor of what it is entitled to expect under the agreement.”

Article 11 creates a cascade. If the parties have defined default in the agreement a creditor may, upon such default, exercise the remedies provided for by the Convention, if however the behaviour of the debtor does not constitute an “agreed default”, it might nevertheless be considered as such, if it deprives the creditor of its expectations under the contract according to paragraph 2. These expectations are determined at the time of the conclusion of the agreement and not thereafter. Although the “agreed default” might determine more clearly what behaviour is expected of the debtor, for example in terms of payments within a specified period of time, paragraph 2 gives the creditor “*carte blanche*” to determine other behaviours which might have been forgotten to be defined during the drafting process of the agreement, by stating that such behaviour was not expected. Seeing that, depending on the declaration of the Contracting States, a creditor may enforce its rights under the Convention without the leave of court, the debtor is fully dependent on the discretion of the creditor.

A way to balance the interest of the creditor and the debtor would have been to include provisions into the Convention providing for a creditor's default and giving the debtor a right to the object. Such an attempt has been made by Article XVI of the Protocol, assuring the debtor's right of quiet possession in the absence of default. However, that right depends on the

terms of the agreement between the creditor and the debtor.¹³¹ Furthermore, a debtor is not entitled to quiet possession against the holder of any interest to which the debtor's interest is subordinate. Considering the bargaining power of the parties, the absence of a default clause for creditors, the availability of remedies without the leave of court and the fact that the debtor can not establish a real right in the object to protect its possession, the Convention seems rather unbalanced in this respect. Bearing in mind that the Convention was drafted to ease the worries of creditors, this should come as no surprise. However, a debtor who suffers damages due to an unauthorised infringement of its right of quiet possession may pursue its claim against the creditor under the applicable law.¹³² As satisfactory as this might sound, one must nevertheless be aware that most aircraft financing transactions are conducted through single purpose vehicles – companies established only to hold an interest in an object – a claim against such company most likely cannot cover for the damages incurred by a creditor's misbehaviour.

However, it remains to be examined how the Geneva Convention which provides for a real right of quiet possession enables the debtor to hold on to its possession.¹³³

2. Remedies

As already mentioned, the Convention draws a clear distinction between the remedies available to a chargee and those available to a lessor or conditional seller. The reason for this is that the interest held in the aircraft object is different. Whereby the interest of a lessor or a conditional seller in the aircraft object is title or ownership of the object, the chargee's interest is merely the charge over the object.

¹³¹ Article XVI(1) a of the Protocol.

¹³² Article XVI(5) of the Protocol.

¹³³ Below XI.

It should be emphasized that although the Protocol extends the application of the Convention to sales, none of the references made in Article III of the Protocol refer to Chapter III of the Convention and thereby to the remedies available to creditors of a registered sale. The reason is that asset-based default remedies do not feature in outright sales. The purpose to include sales into the framework of the Convention is to offer aircraft financiers the possibility (i) to find out who is the owner of the aircraft in question and (ii) to assure the buyer (creditor) to acquire good title of the aircraft. Neither does the International Registry replace national title registries nor does an entry into the International Registry transfer title with respect to airframes or helicopters,¹³⁴ but a registered International Interest in that respect might – depending on the applicable national law – establish *prima facie* evidence with respect to ownership.¹³⁵ Therefore, Chapter III of the Convention does not apply to registered International Interests with respect to sales.

2.1. Qualification of underlying agreement

Since the Convention designates different remedies for chargees (Article 8 and 9) and for conditional sellers or lessors (Article 10), the qualification of the agreement is relevant. Article 2(4) of the Convention provides the solution by leaving it to the applicable national law to determine what kind of agreement the parties have entered into. Especially in the context of transactions involving the United States, Canada and also New Zealand, one has to point out that these jurisdictions treat lease and conditional sales agreements as security agreements. Therefore, in proceedings involving the law of any of those jurisdictions, courts are most inclined to apply Articles 8 and 9, not Article 10.

¹³⁴ Since most jurisdictions follow the accession principle with respect to items mounted on another object, the Convention – by overriding such national law – establishes a title tracking register with respect to aircraft engines. See above IV.2.2.

¹³⁵ *Ibid.*

2.2. Remedies of the chargee

The remedies available to a chargee are listed in Article 8 and 9 of the Convention.

2.2.1. Article 8

Depending on a declaration of the Contracting State, these remedies are available without the leave of court: (i) take possession or control over the object charged to it; (ii) sell or grant a lease over such object; or (iii) collect or receive any income or profits arising from the management or use of any such object. All the mentioned remedies are only available if the debtor has consented to them. Moreover, the second remedy is only available if a Contracting State has not made a contrary declaration to that respect.¹³⁶ Normally, the consent of the debtor to these remedies will be included in the security agreement; however, for recourse to the court no such agreement is required.

Paragraph 3 is meant to shift the burden of proof to the debtor's side. The debtor has to prove that the remedy chosen or the way it is enforced is manifestly unreasonable. Article IX of the Protocol, however, denies applicability of paragraph 3 but extends the requirement of commercial reasonableness to all the remedies of the Convention. It is not clear if thereby the mandatory status which is granted to Article 8(3) by Article 15 is also denied applicability. From a good faith and a fair treatment point of view however, this cannot be the case.

If a chargee intends to sell or grant a lease of the object, it might interfere with the rights of other holders of interest in or over the object. Therefore, it shall give prior written notice of such intent to all interested persons. In the case of interest holders who are registered with the International Registry this does not present a problem, in cases in which

¹³⁶ Article 54(1) of the Convention.

unregistered interests are involved, however, the chargee has to be made aware of these by their respective holders. If such unregistered interest holders do not give written notice of their interest within a reasonable period of time prior to the sale or lease they lose their interest in the object according to Article 9(5).

Paragraphs 5 and 6 assure that a chargee may not receive a windfall from exercising his remedies. They state that any sum collected or received by the chargee as a result of the exercise of any remedy goes towards discharge of the secured obligation and all reasonable costs incurred during the enforcement process. Accordingly, any surplus is to be delivered to subsequent interest holders in order of priority as set forth in Article 29 of the Convention. In the case of multiple charges over the same object any chargee may, after a default, exercise the remedies of Article 8. A senior chargee overrides junior security interests, which then attach to the proceeds, and a sale by a junior chargee takes effect only subject to the senior registered interests.

2.2.2. Article 9

In addition to the remedies of Article 8, Article 9 authorises - subject to a default by the debtor - the object given in security to be vested in the chargee in or towards satisfaction of the secured obligation. This remedy is only exercisable with the agreement of all the interested persons or, alternatively, on an order of the court. As an exception, the agreement allowing this remedy cannot be made in advance.

The mechanism to assure that no windfall is suffered by the chargee is the same in both cases, although achieved in different manners. Whereas in paragraph 1 the agreement of all interested persons is required to guarantee an economic balance, in paragraph 3 the court has to decide if such transfer of ownership is commensurate. In the first case it will be the other interested persons, in the second case it will be the court that assures that the value of the object is not greatly in excess of the secured obligation.

In this respect the Convention overrides many national laws which prohibit the transfer of ownership of an object securing an obligation to the chargee in an event of default.

Paragraph 4 allows the chargor or any interested person to discharge the secured obligation prior to the sale of the object. If the sale has already taken place the right to discharge is lost. It remains effective if the object is leased by the chargee. In such case the discharge is subject to the rights of the lessee. If an interested person discharges the secured obligation in full, it becomes subrogee to the rights of the chargee.

The buyer of the object as well as the chargee to whom the object is vested in take free title of the object subject only to interests having priority over that of the chargee.

2.3. Remedies of the conditional seller and lessor

The remedies of Article 10 are not as detailed as those of Article 8 and 9, as a chargee, unlike a lessor or a conditional seller, is not the owner but only the holder of a security interest. A lessor or a conditional seller as the owner of an object only needs the remedies of termination of the agreement and repossession of the object. With the termination of a lease or a conditional sale, the lessee or conditional buyer respectively lose their right to possession of the object. Any claims that might arise (e.g. due to down-payments under a conditional sale or a lease with a purchase option) have to be pursued against the creditor *in personam* and give the debtor no right in or to withhold the object. The case in which a lessee has granted a sublease and the lessee is in default (derivative interest) is not regulated by the Convention but left to the applicable national law and the terms of the head-lease.

2.4. Additional remedies and procedural requirements

Article 12 determines that additional remedies permitted by the applicable law may also be exercised to the extent that they are consistent

with the mandatory provisions of Chapter III. The mandatory provisions are defined in Article 15¹³⁷ and include commercial reasonableness of all actions taken by the chargee, the notice requirement of interested persons in the case of a sale or lease of the object by the chargee, the imposition of securities by the court in the case of interim relief pending final determination and the applicability of the procedural law of the state where the remedies are exercised. According to the Protocol, some of these can nevertheless be excluded.¹³⁸

Although all the above mentioned mandatory provisions are related to the exercising creditor nothing prohibits that remedies in favour of the debtor might also find application through the applicable national law.

Article 13(2) was created to protect the debtor from any unauthorised behaviour of the creditor. Article 13(2) gives the courts the possibility to impose a security deposit or other obligations on the creditor to cover possible damages of the debtor in case of unlawful exercise of the remedy by the creditor. Nothing prevents that also debtor related remedies foreseen by the applicable national law are allowed under the Convention. Furthermore, in this special case, the imposition of a security deposit or other obligations onto the debtor are – at least from a Swiss legal point of view – procedural in nature and therefore fall within the scope of Article 14. Article 14, subject to a declaration by the Contracting State, in combination with Article 15 provides for the mandatory application of the procedural law of the place of exercise. It is not within the scope of this paper to examine whether procedural or substantive law shall prevail in such context, but it must be mentioned that the reference to remedies applicable under the applicable national law is unclear.

¹³⁷ Article 15 declares the following provisions of the Convention mandatory: Article 8(3) to (6), 9(3) and (4), 13(2) and 14.

¹³⁸ Article X(5) applies to Article 13(2), and Article IX(3) excludes the application of Article 8(3) for aircraft objects.

The exercise of any remedy, subject to a declaration of a Contracting State, must be made in conformity with the procedural law of the place of exercise. This shall not affect remedies which can be exercised without the leave of court, as without the involvement of a court, no procedural law applies. If, however, other authorities must be engaged in the exercise of such extra-judicial remedy, their respective administrative procedures must be respected.

3. Relief pending final determination

All remedies provided for by the Convention and the Protocol aim for the speedy solution of a situation which arises after a debtor is in default under an agreement. Judicial proceedings in general are very time-consuming when also taking into account that aircraft financing is a international discipline, this proves to be even more true. It is therefore of great importance for a creditor to be able to take control over the object at the earliest possible moment. It is the object and its value that needs to be preserved in order to minimise damages to the creditor in an event of default by the debtor. However, it is inherent to interim relief pending final determination that, if granted, interim relief prejudices not only the factual situation but also the outcome of the proceedings following thereafter. To balance the interest of the parties involved is of outmost importance in this respect.

Subject to a declaration by the Contracting State, a creditor (chargee as well as a conditional seller or lessor) may obtain a court order granting speedy relief. The court may order so, if the creditor brings evidence of the default by the debtor and if the debtor has at any time agreed to such speedy relief. The order can contain one or more of the following options: (i) preservation of the object and its value; (ii) possession, control or custody of the object; (iii) immobilisation of the object; and (iv) lease or management of the object and the income therefrom. All these remedies, except possibly for the last one, aim at the preservation of the value of the object and the

avoidance of unlawful interference by the debtor. The result of this interim relief however will be that the object will be grounded until final judgement on the merits of the claim. One has to be aware that during such time costs of maintenance, parking fees etc. are incurred without any income generated by the object. Furthermore, the value of an object stationed for a long period of time significantly decreases, especially in case of aircraft.

To avoid such standing time, the Convention foresees two possibilities: (i) granting the creditor the right to lease the object to a third party or managing the income of the object if still operated under the initial configuration or (ii) Article X(3) of the Protocol adds that if the creditor and debtor have at any time so agreed, the sale of the object may be granted. Both of these are interim relief measures, whereby in case of the second scenario the dispute of the parties will be limited to the proceeds of the sale of the object (if the object has actually been sold). The buyer of such object will acquire title free from any other interest over which the creditors International Interest had priority.¹³⁹ Granting the creditor the possibility to lease the object to a third party is not normally possible in an aviation context. The new lessee will have to operate an aircraft that is not registered (under the Chicago Convention) under its name, therefore it will be almost impossible to acquire the necessary insurance coverage to operate the aircraft. One could say that these problems can be solved by deregistering or reregistering the aircraft in favour of the new operator/lessee, but one has to keep in mind that Article 13 only speaks of interim relief measures. To deregister an aircraft, perhaps even exporting it to another jurisdiction and having it operated under a lease would most likely prejudice the outcome of the main proceedings. Therefore, the only real possibility in this context is the case in which the debtor can still operate the aircraft, while leaving the income to the creditor as per court order.

¹³⁹ Article X(4) of the Protocol.

The protection mechanism put into place for the debtor is twofold. First, the court may impose terms as it considers necessary to protect the debtor (this requirement can be excluded by agreement in writing between the parties¹⁴⁰) and secondly the court may require notice of the creditor's request to be given to any of the interested persons as per Article 1(m). As a general precaution measure paragraph 4 adds that all actions by the creditor shall be conducted in a commercially reasonable manner.

4. Remedies on insolvency

Article XI of the Protocol has been described as the economically most significant provision.¹⁴¹ Article XI, which modifies Article 30, provides for the efficacy of International Interests in case of insolvency of the debtor, then when it matters most.

The variety of choice of a Contracting State with respect to Article XI is as broad as it can be. It may choose not to make a declaration, in which case national insolvency law prevails over Article XI. Further, it can opt to apply Article XI either to all types of insolvency or only to certain types; it may also choose to which types alternative A and to which alternative B are applicable. If, however, one of the alternatives is chosen for a specific type of insolvency proceedings it must be applied in its entirety. This is because each set of rules represent a unit which makes it impracticable to select one or more without the others.¹⁴² Furthermore, according to Article IV(3) of the Protocol the parties themselves may exclude the provisions of Article XI in whole or partially as per their agreement. Such agreement has to be in writing according to Article 1(nn) of the Convention.

¹⁴⁰ Article X(5) of the Protocol.

¹⁴¹ Official Commentary at 199.

¹⁴² Official Commentary at 200.

Alternative A is referred to as the hard or rule-based of the two alternatives whereas alternative B is the soft or discretion-based one. By reading through both alternatives, one can understand why.

4.1. Alternative A

An insolvency-related event is defined in Article 1m of the Protocol. It covers the commencement of the insolvency proceedings as well as any other suspension of payment where the creditor is prevented to institute an insolvency proceeding by law or State action. It is the intention to cover all events in which the disposition of assets is taken out of the hands of the debtor or is restricted by law. On the occurrence of this event, no debtor default is necessary, the possession of the aircraft object must be transferred to the creditor by the end of a specified waiting period.¹⁴³ Until the aircraft object is in the possession of the creditor it is the responsibility of the insolvency administrator or the debtor, as applicable by the national insolvency law, to preserve the aircraft object and its value. Once possession is transferred to the creditor, the duty to take care of the aircraft object is governed by the applicable law.

However, the insolvency administrator or the debtor may retain possession of the aircraft object in case when it has cured all defaults (if applicable) and has agreed to perform all future obligations under the agreement. This is to assure that if left in the possession of the debtor the aircraft object will still be paid for.

Alternative A restricts the application of the applicable insolvency law by prohibiting the issuance of any order or action which might prevent or which delays the exercise of remedies after the expiry of the waiting period. Therefore, it is not possible for an insolvency court to suspend the insolvency proceeding with respect to aircraft objects beyond the waiting period.

¹⁴³ The average waiting period is between 30 and 60 days, depending on the declaration of the Contracting State, online: <http://www.unidroit.org/english/implementation/i-2001-aircraftprotocol.pdf> (January 2, 2009).

4.2. Alternative B

Alternative B is the more “relaxed” alternative of the two. It first requires the insolvency administrator or the debtor, upon request of the creditor, to give notice whether it will cure all defaults and perform all future obligations under the agreement and related transaction documents¹⁴⁴ or give the creditor the opportunity to take possession of the aircraft object. In cases in which the creditor takes possession of the aircraft object, the court may require any additional steps or the provision of any additional guarantee to be accorded to the applicable law. Furthermore, the creditor is required to provide evidence of its claim to the court. In alternative A this is not foreseen, as alternative A does not deal with court proceedings. However, alternative A, by not requesting such proof of registration, opens the door to another method of preserving the effectiveness of the International Interest on the debtor’s insolvency, being its effectiveness under the applicable law.¹⁴⁵ This would not be sufficient for alternative B to apply.

4.3. Insolvency assistance

The effect of Article XII of the Protocol appears to be very broad and unclear. Therefore, this provision as such can not be the legal basis of an obligation owed by and to courts. For that matter, further specification is needed in the implementing legislation of a Contracting State. However, Article XII is an opt-in provision which only applies if a Contracting State has made a declaration.

5. Deregistration and export request authorisation

Article XIII represents a great improvement in aviation finance. A common problem encountered was (and still is) that even if the creditor could

¹⁴⁴ The term „and related transaction documents“ is not found in alternative A. This term includes “promissory notes given as payment under the agreement or as security for payment, and documents which embody collateral contracts and undertakings forming part of the overall transaction between the parties.” See Official Commentary at 202.

¹⁴⁵ Article 30(2) of the Convention, VI.8 above and Official Commentary at 202.

repossess the aircraft object, it could not dispose of it as long as the debtor was entered in the register, as a lessee for example. In most jurisdictions, debtor's consent is required to deregister an aircraft, which, in cases in which legal proceedings have been initiated, is most likely to happen. The effect is that debtors were (and are) able to blackmail creditors during the proceedings. Even in cases in which such deregistration authorisation was signed by the debtor during the negotiations of the agreement, creditors could not fully rely thereon, because in many jurisdiction these authorisations are revocable at any time and not recordable with the register.

Article XIII, subject to a declaration of a Contracting State, provides for the efficacy of an irrevocable deregistration and export request authorisation. To facilitate the process, the Protocol annexes a sample of such authorisation. Subject to the applicable safety laws and regulations and the terms of the authorisation, a creditor has the right to deregister the aircraft object and export it. In cases in which the authorisation is recorded, the register authorities are required to deregister and export without a court order. To assure the cooperation of these authorities, paragraph 4 obliges them to co-operate with and assist the authorised party in the execution of this remedy. The authorisation, once given, cannot be revoked by the debtor even if the applicable law would allow it. In this respect the Convention overrides the applicable law.

X. Declarations by Contracting States

The Convention provides for declarations by its Contracting States on various matters. One has to distinguish between a declaration and a reservation. The latter is a unilateral act of a Contracting State purporting to exclude or modify a provision of a treaty and, unless authorised by the treaty itself, is not binding on other States unless they accepted it.¹⁴⁶ Reservations

¹⁴⁶ Article 2(1)d and 20 of the Vienna Convention.

are prohibited by the Convention.¹⁴⁷ A declaration on the other hand is a way of modifying the treaty which is foreseen by the treaty itself and therefore requires no acceptance by other States in order to be binding.

The Convention and the Protocol provides for a variety of declarations by Contracting States to make it suitable for their respective policy decisions. Most of these provisions are discussed in their specific context and are not further examined in this Chapter, some however require a closer look.

1. Overview

The declarations can be divided into: (i) opt-in, (ii) opt-out, (iii) mandatory and (iv) other declarations. The declarations are equipment-specific and cannot be made independently of the Protocol.¹⁴⁸

1.1. Opt-in declarations

In this respect a Contracting State is required to make a declaration, otherwise the relating provision does not apply with respect to that State. The relevant provisions are:

- Article 39: Non-consensual rights and interests having priority without registration;
- Article 40: Registerable non-consensual rights or interests
- Article 60: Application of Convention priority rules to pre-existing rights or interests.

1.2. Opt-out declarations

These declarations have to be made in order to exclude their application with respect to the Contracting State. Those provisions are:

¹⁴⁷ Article 56(1) of the Convention.

¹⁴⁸ As a general reference for this chapter see Official Commentary at 30. Although not cited word by word, the structure of this Chapter is derived from that source.

- Article 8(1)b: Power to lease a charged object while in the declaring State's territory (Article 54(1));
- Article 8(1), 9(1) and 10: Extrajudicial remedies (Article 54(2));
- Article 13: Interim relief (Article 55);
- Article 43: Jurisdiction under Article 13 (Article 55);
- Article 50: Application of the Convention to internal transactions.

1.3. Mandatory declarations

With respect to the following provisions a Contracting State is required to make a declaration:

- Article 48(2): Specifications required by Regional Economic Integration Organisations with respect to competences which are given to them by their member states;
- Article 54(2): Whether remedies may be exercised without the leave of court.

1.4. Other declarations

There are two declarations within this category:

- Article 52(1): Application of the Convention to one or more territorial units;
- Article 53: Designation of the relevant court for the purposes of Article 1 and Chapter XII.

2. Specific declarations

2.1. Article 54(2)

It is not the specific content of the provision which is of interest here but the impact a declaration by a Contracting State might have in this respect. Article 54(2) of the Convention states that a Contracting State can declare

that all remedies available to the creditor under the Convention¹⁴⁹ may only be exercised with the leave of court. As much will depend on the speedy relief in a situation where the debtor is in default or involved in an insolvency proceeding in terms of security for the creditor, Article 54(2) contravenes the objectives of the new regime.

By requiring the creditor to present the case before court precious time will be wasted. Even in States where the legal apparatus is reliable and efficiently working, a legal proceeding will require time. One can imagine the effect in a Contracting State which is not known for a sound legal regime. Proceedings will take very long and until an award has been rendered the aircraft object will have lost most of its value by standing on the ground.

2.2. Article 60

Article 60 deals with the transitional phase after the entry into force of the Convention and the respective Protocol and the protection of pre-Convention rights or interests. It shall be for a Contracting State to decide when the new regime will take over the national law with respect to the scope of the Convention.

The general principle is that the Convention shall not apply to any rights or interests pre-existing to the entry into force of the Convention or the Protocol, respectively. By declaration a Contracting State may render the new regime applicable to pre-existing rights or interests if a designated period of time has passed. In absence of such declaration, issues arising in relation to a pre-existing right or interest are governed by the applicable law, and the holder of such right is not affected by the Convention. However, even if a Contracting State decides to have the Convention applied to pre-existing national rights or interests, it can only do so with respect to the rules of priority. The reason for this mechanism is twofold: on one hand, one wants to

¹⁴⁹ Article XXXI of the Protocol extends the effect of the declaration to the remedies provided for by the Protocol.

avoid situations where International Interests are subordinate to pre-existing rights or interests for an undefined period of time, on the other hand creditors have to be given the opportunity to re-perfect their rights or interests within a reasonable period of time. In other words, after the designated period of time has elapsed the priority rules of the Convention will be applicable to all pre-existing rights or interests covered by the declaration, and creditors who have not registered their rights or interests with the International Registry will lose their priority. The fact that none of today's Contracting States have made a declaration in this respect leads to the conclusion that it is preferred to preserve the priority of a creditor by filing a notice of a national interest with the International Registry and not to have the Convention applied to national rights or interests as such.

XI. Relationship to other Conventions

The above discussion focussed on the Convention itself or the relationship between the rules of the Convention and the applicable national law. Although international treaties, once ratified, must also be seen as national law of the ratifying State, the Convention and the Protocol regulate their priority with respect to other specified Conventions in special provisions. The Convention, as it is applicable to a wider range of mobile equipment, addresses the United Nations Convention on the Assignment of Receivables in International Trade¹⁵⁰ and the UNIDROIT Convention on International Financial Leasing.¹⁵¹ The Protocol addresses conventions which relate to the aviation field, such as the Geneva Convention¹⁵², Convention for the Unification of Certain Rules Relating to the Precautionary Attachment of

¹⁵⁰ Article 45bis of the Convention.

¹⁵¹ Article 46 of the Convention which refers to Article XXV of the Protocol.

¹⁵² Article XXIII of the Protocol.

Aircraft (Rome Convention)¹⁵³ and also the UNIDROIT Convention on International Financial Leasing¹⁵⁴.

1. General rule

As a general rule the Convention states that it shall supersede all other conventions which may conflict with its provisions. It either does so by stating that it supersedes the respective convention in its entirety or just in cases of inconsistency. Of special interest in the context of this paper is the Geneva Convention.

2. The Geneva Convention

As described above¹⁵⁵ the Geneva Convention is a “recognition convention.” It provides for the international recognition of certain rights which have been established under the applicable national law by listing them as well as by introducing some organisational as well as legal prerequisites for the Contracting States to implement. The Geneva Convention has been adopted by 87 States and represents the “backbone” of aviation finance today.

Article XXIII of the Protocol states that it supersedes the Geneva Convention as it relates to aircraft, as defined in the Protocol, and aircraft objects. But with respect to rights or interests not covered or affected by the Convention, the Geneva Convention shall not be superseded.

2.1. Effect of Article XXIII

Article XXIII affects only Contracting States to the Convention and the relationship among themselves. It does not affect the rights or obligations of a Contracting State with a non-Contracting State to the Convention. However, it affects the relationship of a non-Contracting State and a

¹⁵³ Article XXIV of the Protocol.

¹⁵⁴ Article XXV of the Protocol.

¹⁵⁵ Chapter three under II.

Contracting State to the Convention if both are also Contracting States to the Geneva Convention. In this case the Convention becomes part of the national law of the Contracting State to the Convention and must therefore be recognised by the non-Contracting State under the provisions of the Geneva Convention.

2.2. Scope of application of the Geneva Convention

Two conditions have to be fulfilled in order for the Geneva Convention not to be superseded by the Convention and to still apply between two Contracting States of both Conventions: The Geneva Convention remains applicable for those issues which are (i) not covered or affected by the Convention and (ii) which do not relate to aircraft and to aircraft objects. It was however intended that all matters “related to creation, enforcement, perfection and priority of International Interest in aircraft and aircraft objects [should be governed by the Convention], while retaining the provisions of the Geneva Convention relating to the recognition of rights and interests which are not covered and affected by the present Convention[...].”¹⁵⁶ Hence the only provisions of the Geneva Convention that remain in force for a Contracting State are: (i) the recognition of rights of first ownership, (ii) priorities between two unregistered international interests and (iii) the extension of security rights in aircraft to spare parts as per Article X of the Geneva Convention.¹⁵⁷

¹⁵⁶ Official Commentary at 217.

¹⁵⁷ Official Commentary at 218.

CONCLUSION

The Convention and the Protocol provide for an efficient legal system to protect creditor's rights to allow financiers to use high value aircraft and aircraft engines as collateral for monies borrowed. The concept as such is not new and has been addressed by many national legal systems worldwide during the last century. In contrast, the goal of the Convention and the Protocol is to establish a system which will be applied in the same manner worldwide.

The Cape Town System derives from the common law and is based mainly on UCC Article 9. Therefore, for a civil lawyer many of the concepts introduced by the Convention and the Protocol may at first glance be difficult to understand and seem to be non-compliant with civil law traditions (e.g. the concept of security interest and its creation, self help remedies, debtor protection during enforcement proceedings, aircraft engines as legally distinct items, etc.). Depending on the changes to be introduced into the respective national laws and the declarations by the ratifying states, these 'theoretical' difficulties can be solved. However, the risk remains that with the making of such declarations (e.g. Remedies: Article 8, 9 and 10 of the Convention) a ratifying state could deprive the Convention and the Protocol of its main effect. The incentive for a state to ratify is minimal, as most of these civil law restrictions (i) strive mainly to protect individuals from the harshness of an enforcement proceeding and assure due process (e.g. self help remedies) or (ii) are theoretical in nature (e.g. concept of security interest or aircraft engine as distinct item). Financing aircraft is a highly specialised area of commercial law involving mostly companies being represented by competent legal advisors; therefore, statutory protection for defaulting debtors can be minimal.

Since its coming into force in March 2006, the Convention and the Protocol have been ratified by 24 states. Until today, the only country with a significant number of aircraft registered within the Cape Town System are the

United States of America. Obviously, the Convention would be more effective if the EU, Russia, Canada, Brazil and some particular jurisdictions in the Caribbean would join, but for now it seems that aviation finance has been saddled with increased complexity, thousands of dollars of filing fees, and little benefit in return.

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