

# **AN ANALYSIS OF THE ASSIGNMENT PROVISIONS UNDER THE CAPE TOWN CONVENTION**

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## **Abstract**

It has been nine years since both the Convention on International Interests in Mobile Equipment (the 'Convention') along with its implementing Protocol on Matters Specific to Aircraft Equipment (the 'Protocol') have come into force (collectively, the 'Instruments'). Since then, the Instruments have been achieving successful results in the facilitation of financing and leasing of mobile equipment. However, despite the progress made, they are not without their limitations and issues. After a careful analysis of the assignment provisions of the Instruments, this thesis identifies three potential problematic features: not focussing on the core Convention concept of the international interest, interpretative drafting problems, and the unusual requirement of the debtor's consent for an assignment to be effective against the debtor under the Instruments.

This Thesis will explore the issues identified above. In doing so, this thesis will analyze the extent to which the issues identified might stand as potential impediments against the Convention's main objective of facilitating efficient financing of mobile equipment.

## Résumé

Voilà neuf ans déjà que la Convention relative aux garanties internationales portant sur des matériels d'équipement mobiles (la « Convention ») ainsi que le Protocole portant sur les questions spécifiques aux matériels d'équipement aéronautiques (le « Protocole ») sont entrés en vigueur (ensemble, les « Instruments »). Depuis lors, les Instruments sont parvenus à des résultats concluants dans le domaine de la facilitation du financement et du crédit-bail de matériels d'équipement mobiles. Cependant, les progrès réalisés ne parviennent pas à occulter la présence de certaines limites ou controverses. À l'issue d'une analyse attentive des dispositions des Instruments, ce mémoire met en exergue trois éléments problématiques: une absence de prise en compte du concept d'"intérêt international qui se trouve au cœur de la Convention, des carences liées à la rédaction des dispositions et finalement le caractère inhabituel des critères sur le consentement imposées par les Instruments concernant l'obtention de l'accord du débiteur pour assurer un transfert effectif à l'encontre de ce même débiteur.

À la lumière des différents sujets identifiées ci-dessus, ce mémoire analysera dans quelle mesure ces derniers pourraient s'ériger comme de potentiels obstacles à l'encontre de l'objectif principal de la Convention que constitue la facilitation d'un financement efficace de l'équipement mobile.

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## Chapter I Introduction

The principal objective of the Convention on International Interests in Mobile Equipment, 2001 ("the Cape Town Convention")<sup>1</sup> is "to facilitate the efficient financing and leasing of mobile equipment."<sup>2</sup> It addresses a fundamental problem in relation to the financing of high value mobile equipment (such as aircraft) which move regularly across or beyond national frontiers: the need for a uniform international legal regime to govern security and related interests.<sup>3</sup>

Prior to the Convention, the legal regime governing security rights in mobile equipment was inherently unstable.<sup>4</sup> This is because the traditional *lex rei sitae* choice of law rule for property rights in tangible assets applies the law of the jurisdiction in which the asset is situated. The rule is unworkable for highly mobile equipment such as aircraft because the applicable law would change far too frequently.<sup>5</sup> A security interest validly created under the law of the jurisdiction where the asset was then situated might not be recognised in other jurisdictions.<sup>6</sup> Also, the jurisdiction in which the mobile equipment was located when the security interest was created might provide strong protection to creditors, but the equipment might be located at the time of default in a jurisdiction whose law is relatively "hostile" to security interests. Other more

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<sup>1</sup> *Convention on International Interests in Mobile Equipment*, 16 November 2001, ICAO Doc 9793 (entered into force 1 March 2006) [*Convention*].

<sup>2</sup> Professor Sir Roy Goode, *Convention on International Interests in Mobile Equipment And the Protocol Thereto on Matters Specific to aircraft equipment Official Commentary* 3rd ed (Rome :International Institute of For the Unification of Private Law (UNIDROIT), 2013 [*Convention Commentary*] at 2.1.

<sup>3</sup> Roy Goode, "From Acorn to Oak Tree: the Development of the Cape Town Convention and Protocols" (2012) 17:4 *Unif L Rev* 599 [*Goode Acorn to Oak tree*].

<sup>4</sup> Roy Goode, "Transnational Commercial Law and the influence of the Cape Town Convention and Aircraft Protocol" (2011) 50 *Can Bus LJ* at 189 [*Goode influence of the Cape Town*].

<sup>5</sup> ICAO, *Explanatory Report And Commentary on Draft [UNIDROIT] Convention On International Interests In Mobile Equipment And Draft Protocol Thereto On Matters Specific to Aircraft Equipment*, ICAO Doc DCME -IP/2 (2001) at 2.

<sup>6</sup> *Goode Acorn to Oak tree*, *supra* note 3 at 600.



stable connecting factors can and have been identified for determining the governing law such as the state where the aircraft is registered or the debtor is located. But even if agreement were reached on a uniform choice of law rule, this would not resolve problems created by the lack of uniformity in national secured transactions laws. For example, if a financier of mobile equipment were approached for funding and the applicable law was that of a jurisdiction that is hostile to security interests, it may decide to refuse the financing altogether or provide it only at a high cost.<sup>7</sup>

Given the huge amounts of money typically involved in the financing of mobile equipment, it is essential for secured creditors to have confidence that the relevant legal regime will respect their contractual and proprietary rights in the event of the debtor's default, provide them with efficient means to enforce those rights, and ensure that they have priority against competing claimants.<sup>8</sup>

The Cape Town Convention attempts to respond to these concerns by establishing an internationally uniform regime to govern the creation, effectiveness against third parties, priority and enforcement of security and similar rights in mobile e equipment. The Convention achieves this objective by recognizing a wholly *sui generis* property right called an 'international interest' which derives its force not from national law, but from the Convention. A creditor's international interest may be perfected against competing claimants by registration in an International Registry established for this purpose. Upon registration, it is accorded priority over subsequently

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<sup>7</sup> *Ibid*; Goode influence of the Cape Town, *supra* note 4 at 189.

<sup>8</sup> *Convention Commentary*, *supra* note 2 at 2.4.

registered interests and unregistered interests, is given protection in the event of the debtor's insolvency and is assured of enforceability in the event of the debtor's default.<sup>9</sup>

The Convention is not a stand-alone instrument but is intended to work in tandem with supporting equipment-specific Protocols. Three Protocols have been concluded so far - in relation to aircraft objects, railway rolling stock, and space assets respectively. To date, only the Aircraft Protocol is in effect; the more recently adopted Rail and Space Assets Protocols have not yet achieved support from a sufficient number of states to come into force.<sup>10</sup>

It has been nine years since the Convention and the Aircraft Protocol<sup>11</sup> have come into effect. Today, there are sixty nine contracting States,<sup>12</sup> strong testament to the enormous success of these instruments in overcoming the deficiencies of the national law regimes that previously applied.<sup>13</sup>

This thesis focuses on the provisions of the Convention and Aircraft Protocol relating to the assignment rights to payment or other performance under an agreement giving rise to an

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<sup>9</sup> Roy Goode, "The International Interest as an Autonomous Property Interest" (2004) 12:1 Eur R Priv L 18 [*Goode on International Interest*].

<sup>10</sup> *Convention Commentary*, *supra* note 2 at 2.12. See further the discussion on the relationship between the Convention and its Protocols in Section 2.2.1 of Chapter 2 of this thesis.

<sup>11</sup> *Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment*, 16 November 2001, ICAO Doc 9794 (entered into force 1 March 2006) [*Aircraft Protocol*].

<sup>12</sup> As of December 9, 2015. Up to date information on the implementation status of the Convention and Aircraft Protocol is available at <http://www.unidroit.org/status-2001capetown> and <http://www.unidroit.org/status-2001capetown-aircraft>.

<sup>13</sup> Patrick Käufer, "Cape Town Treaty: Economic Assessment and Benefits" (Paper delivered at the Cape Town Treaty Seminar, Bangkok, Thailand, 27 April, 2012), online: <[http://www.capetowntreatyforum.com/bangkok/2012/presentations/02\\_Kaufer\\_Cape\\_Town\\_Treaty\\_Seminar.pdf](http://www.capetowntreatyforum.com/bangkok/2012/presentations/02_Kaufer_Cape_Town_Treaty_Seminar.pdf)>.

international interest in an aircraft object subject to these instruments.<sup>14</sup> Before exploring the treatment of assignments specifically, it is necessary to have a basic overall understanding of the Convention. Chapter 2 will therefore discuss in greater detail the objectives of the Convention, its scope of application, the concept of the international interest, and the registration system.

Chapter 3 will then analyse the assignment provisions of the Convention and Aircraft Protocol, comparing them with national and other international law norms on the equivalent issues. Based on that analysis, this chapter identifies three potentially problematic issues.

First, the assignment provisions of the Convention do not focus on the core Convention concept of the international interest, but rather on associated rights to payment. Earlier drafts of the Convention provided that an assignment of the international interest would carry with it the related rights to payment ("associated rights").<sup>15</sup> These drafts conceived of the payment obligations associated with an international interest as accessory to the international interest. This approach was supported by several commentators.<sup>16</sup> However, objections were raised on the ground that this approach contradicted the widely accepted traditional legal doctrine that a

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<sup>14</sup> The reference to assignment here is limited to a contractual assignment and not an assignment by operation of law.

<sup>15</sup> The initial draft of Article 30 (1) of the Convention provided that "an assignment of an international interest in an object made in conformity with the preceding Article transfers to the assignee, to the extent agreed by the parties to the assignment: (a) all the interests and priorities of the assignor under this Convention; and b) all associated rights. The reference in paragraph 30(1)(b) must be read in conjunction with the definition of "associated rights" in Art. 1 (c) of the Convention as "all rights to payment or other performance by a debtor under an agreement which are secured by or associated with the object: see *Text of the Preliminary Draft, UNIDROIT Convention on International Interests in Mobile Equipment as Reviewed by the Drafting Committee, in First Joint Session Report*, UNIDROIT CGE/Int.Int./WP/16, ICAO Ref. LSC/ME-WP/27 app I (February 12, 1999) [*Text of the Preliminary Draft of the Cape Town Convention*].

<sup>16</sup> Comments on the Draft Convention presented by the International Bar Association Sub-Committee E8 on International Financial Law Reform DCME Doc. 9, September 2001; Diplomatic Conference To Adopt a mobile equipment Convention and an Aircraft Protocol Acts and Proceedings (Rome: The International Institute For the Unification of Private Law (UNIDROIT), 2006) at 112. [*Convention Acts and Proceedings*].

security or other property interest is an accessory to the transferred obligation. It was therefore proposed that the text should provide that the assignment of the associated rights transfers the related international interest and not vice versa.<sup>17</sup> In the end, the Convention adopted the conventional approach, and the focus of Chapter IX is on the assignment of associated rights.<sup>18</sup> Given that the Convention is not concerned with receivables financing, but with international interests, this thesis argues that the adoption of the conventional security-follows-obligation approach is questionable. This issue is addressed in detail in Section 3.3 of Chapter 3 of the thesis.

Second, in order for the debtor to be obligated to make payment to an assignee of associated rights, the Convention requires that a written notice of the assignment be given to the debtor identifying the associated rights to which it relates.<sup>19</sup> However, Article XV of the Aircraft Protocol modifies the Convention by also making the consent of the debtor a precondition to his duty to make payment to the assignee.<sup>20</sup> This additional requirement is also added by the Space Protocol.<sup>21</sup> The requirement that a debtor consent to an assignment in order to trigger the obligation to pay the assignee on notice is not found in the national assignment laws of most countries, nor does it appear in the UN Convention on the Assignment of Receivables.<sup>22</sup> It is a clear departure from national and international norms of assignment law. If the debtor does not

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<sup>17</sup> *Ibid* at 839, 880; Goode, *Influence of the Cape Town*, *supra* note 4 at 201.

<sup>18</sup> Art. 31 of the Convention provides that "except as otherwise agreed by the parties, an assignment of associated rights made in conformity with Article 32 also transfers to the assignee: a) the related international interest; and b) all the interests and priorities of the assignor under this Convention"; *Convention*, *supra* note 1.

<sup>19</sup> *Convention*, *supra* note 1, art 33(1).

<sup>20</sup> *Aircraft Protocol*, *supra* note 11, art XV.

<sup>21</sup> The Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Space Assets, 9 March, 2012 [*Space Protocol*], art XXIV.

<sup>22</sup> art 1690 CcF; art 1260 C civ; 2001 United Nations Convention on the Assignment of Receivables in International Trade, 12 December 2001, UN A/RES/56/81, arts 13,16 [*Receivables Convention*].

give his consent, the assignor may not be able find a willing assignee and the assignor's ability to use related rights to payment for financing may be defeated. This issue is discussed in detail in Section 3.2.3.2 of Chapter 3 of this thesis.

Third, the drafting of paragraph 1 of Article 35 of the Convention raises two interpretative problems. The paragraph incorrectly implies that an assignment of associated rights can be registered.<sup>23</sup> It also equates an assignment of associated rights and the related international interest with a registered assignment. This is incorrect since the assignment may not have been registered.<sup>24</sup> This issue is discussed in detail in Section 3.3 of Chapter 3 of the thesis.

The final chapter of this thesis concludes that these three problematic issues do not interfere so significantly with the goal of the Convention and Protocol to facilitate aircraft financing as to impair the overall success of these instruments in achieving that objective. Nonetheless, it will be seen that the second and third of the three problems summarized above create sufficient difficulties as to justify consideration being given to possible solutions despite the practical obstacles generally encountered in amending international instruments.

Finally, the thesis will put forward its concluding comments, and suggestions. After arriving at independent conclusions for each of the problematic features, this thesis concludes that the Convention is still a success.

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<sup>23</sup> Associated rights, being intangible, are not in themselves capable of registration. Neither can an assignment of associated rights be registered since an assignment of associated rights that is divorced from the related international interest is not within the scope of the Convention. This is because the Convention is concerned with international interests and registrations affecting international interests. It is not concerned with assignments of receivables standing alone: *Convention*, *supra* note 1, art 32(3); *Convention Commentary*, *supra* note 2 at 4.222.

<sup>24</sup> *Convention Commentary*, *supra* note 2 at 2.202(2).

## **Chapter II An overview of the Cape Town Convention**

### **2.1 Introduction**

Before discussing the assignment provisions, it is necessary to provide a general overview of the Cape Town Convention. This chapter will start by discussing the evolution and the objective of the Convention. It will also explore the relationship of the Convention with its supporting Protocols, as well as its relationship with national law. The Chapter will then examine the most salient features of the Convention: the international interest, and the international registration system.

### **2.2 Evolution of the Cape Town Project: From The Lex Situs Problem To Facilitating Asset Based Financing and Leasing**

The Cape Town Convention originated in a proposal made in June 1988 by Mr. T.B. Smith, a Canadian member of the Governing Council of the International Institute for the Unification of Private Law (UNIDROIT) to prepare an international instrument focused on mobile equipment.<sup>25</sup> According to Roy Goode, UNIDROIT's Governing Council will not approve a project unless it has received a positive answer to at least three questions: "is there a problem? is there a feasible solution? and is the project likely to receive a substantial measure of support not only from governments but from industry and other interested sectors?"<sup>26</sup> In the wake of Smith's proposal, Professor Ron Cuming of the University of Saskatchewan, an

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<sup>25</sup> Goode, *Acorn to Oak tree*, *supra* note 3 at 599. Unidroit is a Rome based, independent, inter-governmental organization. It was set up in 1926 as an auxiliary arm of the League of Nations, after whose dissolution it was re-established in 1940. Its purpose is to study and harmonize private and commercial law among States and groups of States. See online: [www.unidroit.org](http://www.unidroit.org).

<sup>26</sup> *Ibid*, at 600.

international expert on secured transactions, wrote to academic experts in eleven countries “setting out the possible parameters of the project.”<sup>27</sup> Based on the responses received, Professor Cuming conducted a detailed study which “showed that there were indeed serious problems in the taking of security over mobile equipment, and that it was desirable to have an international Convention to address these.”<sup>28</sup> Because Professor Cuming did not have the time to conduct empirical research, a questionnaire was sent out by UNIDROIT to about one thousand business and financial institutions; the responses “indicated that from the perspective of legal practitioners and industry interests, there were indeed ... quite serious problems in the financing of mobile equipment such as aircraft objects, railway rolling stock, and space assets for the resolution of which an international Convention was desirable.”<sup>29</sup>

Amongst the various problems identified, the most important related to the absence of an international regime to protect security and related interests in mobile equipment. As explained in the Introduction to this thesis, there is no guarantee that a security interest in mobile equipment that is effective under its law of origin will be recognized in other jurisdictions. The traditional conflict of laws rule that property rights in tangible movables are governed by the *lex rei sitae* (*lex situs*)<sup>30</sup> is not suitable for mobile assets that continuously change locations since the applicable law also keep changing, thereby reducing legal predictability and certainty.<sup>31</sup> Greater legal risk translates to greater cost, and Professor Cuming's study rightly noted that the the *lex rei*

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<sup>27</sup> *Ibid.*

<sup>28</sup> *Ibid.*, citing in note 1, R.C.C. Cuming, *International Regulation of Aspects of Security Interests in Mobile Equipment* (Rome: International Institute for the Unification of Private Law, 1989) [*Cuming Report*].

<sup>29</sup> *Ibid.*

<sup>30</sup> *Ibid.*

<sup>31</sup> *Convention Commentary*, *supra* note 2 at 2.5; Jeffrey Wool, "The Next Generation of International Aviation Finance Law: An Overview of the Proposed UNIDROIT Convention On International Interests In Mobile Equipment As Applied to Aircraft Equipment" (1999) 20 U Pa J Int'l Econ 517 [*Wool*].

*sitae* choice of law rule had an adverse effect on access to secured credit on the basis of collateral in the form of mobile equipment.<sup>32</sup>

The survey also identified problems with respect to the enforcement of security interests in mobile equipment on the debtor's default. A secured creditor may find that whereas the laws of its own state provide efficient remedies, the same may not be the case for other jurisdictions where it may need to take enforcement action.<sup>33</sup>

Thus, there was support for a uniform law project that would address the aforementioned problems. Following preliminary feasibility work, the Governing Council of UNIDROIT established a study group to draft uniform international rules on security interests in mobile equipment.<sup>34</sup>

The question then arose as to whether there was a sufficient economic interest in the project. The study group approached the aviation industry for advice.<sup>35</sup> Industry input was given over time through the coordinated comments<sup>36</sup> of an international group [called the Aviation

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<sup>32</sup> *Cuming Report*, *supra* note 28 at 26-27, 39; *Wool*, *Ibid*.

<sup>33</sup> *Goode Acorn to Oak tree*, *supra* note 3 at 601.

<sup>34</sup> *Ibid*; This group appointed a two-person sub committee consisting Professor Hervé Synvet of the University of Paris II and Professor Roy Goode.

<sup>35</sup> *Wool*, *supra* note 31 at 2.2; L. Weber & S. Espinola, "The Development of a new Convention relating to international interests in mobile equipment, in particular aircraft equipment- a joint ICAO-UNIDROIT Project" (1999) 4:2 *Unif L Rev* 464 [*L. Weber & Espinola*].

<sup>36</sup> *Wool*, *ibid*; Memorandum of the Aviation Working Group, UNIDROIT Doc. 16, Study LXXII (1995); Second Memorandum of the Aviation Working Group, UNIDROIT Doc. 23, Study LXXII (1996); Joint Comments by the Aviation Working Group and the International Air Transport Association, UNIDROIT Doc. 32, Study LXXII (1996).



Working Group (AWG)] composed of major aerospace manufacturers, leasing and financial institutions<sup>37</sup> as well as the International Air Transport Association (IATA).<sup>38</sup>

Both the AWG and the IATA promoted the project.<sup>39</sup> They were of the view that the establishment of an international legal regime would increase the availability of aviation-related credit, and reduce its costs, by "enhancing legal certainty " and creating more easily enforceable security rights in aircraft equipment. This in turn could facilitate the asset based financing and leasing of aircraft equipment.<sup>40</sup>

AWG and IATA also advised that the proposed legal regime would be more effective if it were composed of a basic Convention and supplementary protocols for each specific category of mobile equipment.<sup>41</sup> It was thought that the adoption of equipment specific protocols would better ensure that the specific needs of the concerned sector were addressed. AWG and IATA therefore put forward a proposal to establish a group to draft the protocol to be applicable to aircraft equipment, which was accepted by UNIDROIT.<sup>42</sup> It was at this time that the International Civil Aviation Organization (ICAO)<sup>43</sup> was asked to join the group.<sup>44</sup> ICAO,

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<sup>37</sup> *Wool, Ibid*; This group is called the Aviation Working Group (AWG) and was organized by the Airbus and The Boeing Company. This is the study group which consists of major aerospace manufacturers, financial institutions and lessors who took up the work on the application of the Convention to aircraft equipment transactions.

<sup>38</sup> IATA is the trade association of the world's airlines, representing about 250 airlines from over 150 countries; *L. Weber & Espinola, supra note 35* at 464; AWG and IATA had commissioned an independent study to assess the economic benefits of the project. See A. Saunders & I. Walter, "Economic Impact Assessment, A study Prepared Under the Auspices of INSEAD and the New York University Salomon Center, September 1998", (1998) 23:6 *Air & Space L* 339.

<sup>39</sup> *L. Weber & Espinola, Ibid.*

<sup>40</sup> *Ibid*; *Wool, supra note 31* at 2.2 & 2.2.1.

<sup>41</sup> *L. Weber & Espinola, supra note 35* at 465.

<sup>42</sup> *Ibid.*

<sup>43</sup> ICAO was formed by the virtue of the Convention on International Civil Aviation Organization (popularly known as the Chicago Convention), 7 December 1944, 15 UNTS 295, ICAO Doc 7300/6. Its principal objective is "to

together with UNIDROIT, AWG and IATA, set up the Aircraft Protocol Group in order to produce the first draft of the aircraft protocol. At the 32nd Assembly of the ICAO, the Legal Committee of ICAO was asked to work jointly with UNIDROIT, AWG and IATA to finalize the draft text with a view to its submission at a Diplomatic Conference.<sup>45</sup>

Thus, in the early 1990's, international unification of the regime of security rights in aircraft was the focus of law-making activities in the field of private international air law.<sup>46</sup> UNIDROIT's efforts, in combination with its aviation partners, eventually resulted in the simultaneous adoption of the Cape Town Convention and Aircraft Protocol.<sup>47</sup> They were both concluded at a Diplomatic Conference in Cape Town, South Africa on 16 November 2001 (collectively the 'Instruments'). After attracting the requisite number<sup>48</sup> of contracting state ratifications or adoptions, both the Convention and the Aircraft Protocol came into force on 1 March 2006.

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ensure safe and orderly growth of international civil aviation throughout the world"; Art. 44(a). For a detailed description of the organization's role, its rules, its place in the framework of international law, or its relations with other organizations, see Ludwig Weber, *International Civil Aviation Organization (ICAO)* (Netherlands: Kluwer Law International, 2012).

<sup>44</sup> L. Weber & Espinola, *supra* note 35 at 465.

<sup>45</sup> *Ibid* at 466.

<sup>46</sup> Ludwig J. Weber, "Recent Developments in International Air Law" (2004) 29:4-5 Air & Space L 280 [L. Weber].

<sup>47</sup> *Aircraft Protocol*, *supra* note 11.

<sup>48</sup> Both the Convention and the Aircraft Protocol took effect on March 1, 2006, when the required eight nations ratified the Protocol. These eight nations were Ethiopia, Ireland, Malaysia, Nigeria, Oman, Panama, Pakistan, and the United States. The Convention itself required only three ratifications to enter into force, but its effectiveness was contingent (with respect to aircraft objects) on the coming into force of the Aircraft Protocol; *Convention*, *supra* note 1, art 49 (1); *Aircraft Protocol*, *supra* note 11, art XXVIII.

### **2.2.1 The Two Instrument Structure: Relationship between the Convention and the Protocols**

The Cape Town Convention is not a stand-alone instrument. The Convention does not come into force with respect to any particular category of equipment until a Protocol has been adopted relating to that type of equipment. For any category of equipment covered by a Protocol, the Convention will take effect only between contracting States to the Protocol, and subject to the terms of that Protocol.<sup>49</sup> In the case of any inconsistency with the Convention, it is the Protocol that will prevail.<sup>50</sup> Thus, while the Convention provides a general conceptual framework, the specific terms of the protocols ultimately control.<sup>51</sup>

In addition to concluding the Aircraft Protocol, the three-week Diplomatic conference in Cape Town also laid the groundwork for two additional Protocols : one on Railway Rolling Stock and the other one on Space Assets.<sup>52</sup> Thus, at the time of the writing of this thesis, three Protocols have been concluded<sup>53</sup> (although only the Aircraft Protocol has achieved sufficient state support to come into effect). They are:

1) The Aircraft Protocol- As noted above, it was adopted at the Diplomatic Conference in Cape Town at the same time as the Convention. It covers mobile equipment consisting of

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<sup>49</sup> *Convention, ibid*, art 49 (1).

<sup>50</sup> *Ibid*, art 6(2).

<sup>51</sup> *Convention Commentary, supra note 2* at 2.12; *Wool, supra note 31* at 3.1; Christine Chinkin & Catherine Kessedjian, "The legal relationship between the proposed UNIDROIT Convention and its equipment-specific Protocols" (1999-2) *Unif L Rev* 324.

<sup>52</sup> Lorne S. Clark, "2001 Cape Town Convention on International Interests in Mobile Equipment and Aircraft Protocol : Internationalising Asset Based Financing Principles for The Acquisition of Aircraft and Engines" (2004) 69 *J Air L& Com* 4.

<sup>53</sup> *Convention Commentary, supra note 2* at 2.15.

airframes<sup>54</sup>, aircraft engines<sup>55</sup> and helicopters<sup>56</sup> [including all installed, incorporated or attached accessories, parts and equipment (in the case of airframes, other than engines) and all data, manuals and records relating thereto];

2) The Luxembourg Protocol<sup>57</sup> - It was concluded at a diplomatic Conference in Luxembourg in February 2007, and relates to railway rolling stock<sup>58</sup>; and

3) The Space Protocol<sup>59</sup> - It was adopted at a diplomatic Conference in Berlin in March 2012 and relates to Space Assets.<sup>60</sup>

Proposals have also been made for a fourth Protocol which would cover mobile agricultural, construction and mining equipment.<sup>61</sup>

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<sup>54</sup> Airframes that are typed certified to transport at least eight persons including crew or goods in excess of 2,750 kilograms; *Aircraft Protocol*, *supra* note 11 art 1 (2)(e).

<sup>55</sup> Aircraft engines must have at least 1.750 pounds of thrust if jet propulsion and at least 550 rated take-off shaft horsepower if turbine -powered or piston-powered; *Aircraft Protocol*, *Ibid* ,art 1 (2)(b).

<sup>56</sup> Helicopters need to be type certified to transport at least five persons including crew or goods in excess of 450 kilograms; *Aircraft Protocol*, *Ibid* ,art 1(2)(l).

<sup>57</sup> The Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Railway Rolling Stock 2007, 23 February 2007, 46 I.L.M. 662 [*Luxembourg Protocol*].

<sup>58</sup> These are defined as vehicles regardless of power, speed, size or carrying capacity that are movable on a fixed railway track or directly on/above/below a guideway that can be used for passenger transport, freight, or shunting: see *Luxembourg Protocol*, *supra* note 57, art 1(e); Roy Goode, *Convention on International Interests in Mobile Equipment And the Protocol Thereto on Matters Specific to Railway Rolling Stock Official Commentary* 2nd ed (Rome :International Institute of For the Unification of Private Law (UNIDROIT), 2014 at 5.6 [*Commentary to the Luxembourg Protocol*].

<sup>59</sup> *Space Protocol*, *supra* note 21.

<sup>60</sup> A space asset is defined to mean any man-made uniquely identifiable asset in space or designed to be launched into space that falls within one or more of the three categories mentioned in Article 1(2)(k) of the Space Protocol, i.e., a space craft, a payload, or a part of a spacecraft or a payload. A space asset includes all installed, incorporated or attached accessories, parts and equipment and all data, manuals, and records relating thereto: *Space Protocol*, *ibid* art I (k); For a detailed discussion, see Mark J. Sundahl, *The Cape Town Convention: Its Application to Space Assets and Relation to the Law of Outer Space* (Leiden: Martinus Nijhoff Publishers, 2013) at 2.2 [*Sundahl*].

<sup>61</sup> *Convention Commentary*, *supra* note 2 at 2.15; Resolution No.5 of the Luxembourg diplomatic Conference. This item is on the agenda of the upcoming Cape Town Convention Academic Conference to be held 8-9 September 2015 at the University of Oxford.

### 2.2.2 Objective of the Convention

The main objective of the Convention is to establish an internationally uniform legal framework for the financing and leasing of mobile equipment, thereby enhancing certainty and predictability. The Convention aims to bring economic benefits particularly to developing countries where financing mobile equipment was significantly costly, if not unavailable.<sup>62</sup>

More particularly, Roy Goode, the author of the Official Commentary on the Convention and its Protocols as well as the chairman of the Diplomatic Conference held in Cape Town, has identified the following key objectives of the Convention and its supporting Protocols:<sup>63</sup>

“1) To facilitate the acquisition and financing of 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 repossession;

3) To establish an electronic international registry 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 creditors in the debtor's insolvency;

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<sup>62</sup> *Convention Commentary*, *supra* note 2 at 2.1.

<sup>63</sup> *Ibid* at 2.6.

4) To ensure through the relevant Protocol that the particular needs of the industry sector concerned are met; and

5) By these means to give creditors greater confidence in the decision to grant credit, to enhance the credit rating of equipment receivables and reduce borrowing costs and credit insurance premiums.”

### **2.2.3 Relationship of the Convention/Protocol with national law**

In most cases, an interest that arises under national law pursuant to a security agreement, a title reservation agreement or a leasing agreement will simultaneously constitute an international interest under the Convention "co-existing" with the domestic interest.<sup>64</sup> But the status of the creditor's interest as an international interest under the Convention will give the creditor stronger rights than its status as a purely domestic interest since upon registration in the International Registry under the Convention, the international interest will override unregistered interests even if these are not capable of registration under the Convention. The priority of the interest is governed by the national law determined by the conflict rules of the forum only if it is unregistered and is not in competition with a registered interest.<sup>65</sup>

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<sup>64</sup>Goode on *International Interest*, *supra* note 9 at 24.

<sup>65</sup>*ibid*; Goode *influence of the Cape Town*, *supra* note 4 at 197.

## 2.3 Salient Features of the Convention

This Section of the chapter will discuss the most salient features of the Convention. It will begin by describing the conditions that need to be fulfilled for the Convention to apply. It will then analyze the concept of the international interest, and the registration system under the Convention.

### 2.3.1 Sphere of Application

The scope of application of the Convention is based on a combination of subject matter and territorial connections.

The following subject matter connection must be satisfied for the Convention to apply:

1) The parties must have entered into a security agreement, a title reservation agreement (conditional sale agreement) or a leasing agreement;<sup>66</sup>

2) The agreement must relate to a particular type of equipment as defined under the relevant Protocol (e.g., an airframe, an aircraft engine or a helicopter, railway rolling stock or space assets);<sup>67</sup>

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<sup>66</sup>*Convention, supra note 1* art 2(1) & (2). For a definition of a security agreement, title reservation agreement, and a leasing agreement, see discussion on international interest in this chapter.

<sup>67</sup>*Convention, ibid* art 2(3).

3) The particular equipment must be uniquely identifiable, or in the case of railway rolling stock, identifiable in one of the ways stipulated in Article V of the Luxembourg Protocol (Article 2(2), as implicitly modified by Article V;<sup>68</sup>

4) The agreement must be constituted according to the requirements stipulated by the Convention;<sup>69</sup> and

5) The debtor must be situated in a Contracting State at the time of conclusion of the agreement.<sup>70</sup> In order to ensure as wide a scope of application as possible, the debtor is deemed to be situated in a Contracting State if any one of the following conditions are met:

- a) it is incorporated, or formed, under the laws of a Contracting State;
- b) it is registered in, or has its statutory seat in, a Contracting State;
- c) it has its centre of administration in a Contracting State; or
- d) it has its principal place of business in a Contracting State.<sup>71</sup>

## **2.3.2 Creation of International Interest**

### **Background**

The providers of finance for mobile equipment typically utilize one of the following three types of transactions:

- 1) A loan secured by a security interest in the equipment;

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<sup>68</sup> For a discussion on identification of objects please see note 90.

<sup>69</sup> For an explanation of the formal requirements, please see the discussion on requirements for the constitution of an international interest in this thesis.

<sup>70</sup> *Convention, supra note 1*, art 3.

<sup>71</sup> *Ibid*, art 4.



2) A sale of the equipment under a title reservation agreement pursuant to which the seller reserves title until payment in full;

3) A lease of the equipment which may be either an operating lease or a finance lease with or without an option to purchase.<sup>72</sup>

As discussed earlier, mobile equipment by its very nature is constantly moving from one place to another,<sup>73</sup> making application of the traditional '*lex rei sitae*' choice of law rule unsuitable as it relies on the law of the place where the equipment is situated. Also, a central global registry for disclosing information about security rights or the reservation of title of a seller or lessor in mobile equipment did not exist prior to the Convention, which made a search for such rights difficult.<sup>74</sup> The Convention and its supporting Protocols attempt to solve these problems, first, by treating these types of proprietary rights as giving rise to an international interest which is internationally recognized, and, and second, by establishing an International Registry<sup>75</sup> where such international interests can be registered.<sup>76</sup>

### **2.3.2.1 What is an International Interest ?**

"An international interest is a right *in rem* arising under or resulting from an agreement."<sup>77</sup> It is a unique type of legal interest which is created under the Cape Town Convention. It comprises any of the following three types of interests:<sup>78</sup>

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<sup>72</sup> See generally, *Convention Commentary*, *supra* note 2.

<sup>73</sup> *Convention Commentary*, *supra* note 2 at 2.5.

<sup>74</sup> *Ibid.*

<sup>75</sup> See discussion on the International Registry in the later part of this chapter.

<sup>76</sup> *L. Weber*, *supra* note 46 at p. 290. See generally, *Convention*, *supra* note 1.

<sup>77</sup> *Convention Commentary*, *supra* note 2 at 2.41.

a) A security interest granted by a chargor under a security agreement:

A security interest is defined in the Convention as an interest created by a security agreement.<sup>79</sup> A security agreement is defined under the Convention as "an agreement by which a chargor grants or agrees to grant to a chargee an interest (including an ownership interest) in or over an object to secure the performance of any existing or future obligation of the chargor or a third person."<sup>80</sup> In other words, a security interest arises when a creditor (chargee) gives a loan to a debtor (chargor) and the debtor grants the creditor recourse to the debtor's property in the event that the debtor defaults and fails to pay back the loan. The debtor's property serves as collateral to secure the loan, and thereby assures the creditor, that in the event of default, the obligation will be repaid since it will have the right to realize the value of collateral and apply the proceeds in repayment of the loan.

b) The ownership right of a conditional seller under a title reservation agreement:

A title reservation agreement is defined under the Convention as an agreement to sell an object on terms that the ownership of the object will not pass until the condition(s) stated in the agreement are complied with.<sup>81</sup> In the event of default, the conditional seller can take back the item it had sold. One difference between a security agreement and a conditional sale agreement is that in the former, the creditor can take a security interest in any of the debtor's property whereas a conditional seller will only have recourse to the item he had sold on credit and to

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<sup>78</sup> *Convention, supra* note 1 art 2(2).

<sup>79</sup> *Ibid*, art 1 (jj).

<sup>80</sup> *Ibid*, art 1 (ii).

<sup>81</sup> *Ibid*, art 1(II).

which it has retained title to secure repayment of the purchase price.<sup>82</sup> The remedies that are available to a conditional seller upon default are a) to terminate the agreement and take possession of the object which was the subject of the agreement or b) apply for a court order to this effect if self-help is not permitted.<sup>83</sup>

c) the ownership of a lessor under a leasing agreement:

Leases are one of the most common methods used by airlines to acquire the use of aircraft. They are also used by telecommunications companies to acquire the use of satellite transponders. The Convention defines a lease agreement as "an agreement by which one person (the lessor) grants a right of possession or control of an object (with or without an option to purchase) to another person (the lessee) in return for a rental or other payment".<sup>84</sup> At the end of the lease period, the lessee has no right to use the leased equipment, and must return it to the lessor, unless the lease contains an option to purchase, which is exercised by the lessee. The right of the lessor to regain control of the equipment is provided for in the Convention.<sup>85</sup>

### **2.3.2.2 Characterisation of the agreement**

Most legal systems outside North America distinguish between security agreements, title retention agreements, and leasing agreements, treating a conditional seller or lessor as the full owner rather than a mere secured creditor. On the other hand, in countries such as Canada, the

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<sup>82</sup> *Sundahl, supra* note 60 at 2.1.2.

<sup>83</sup> *Convention, supra* note 1, art 10

<sup>84</sup> *Convention, Ibid*, art 1 (q).

<sup>85</sup> *Sundahl, supra* note 60 at 2.1.3.

United States, New Zealand, and Australia, the law adopts a functional and economic approach, treating certain leasing agreements, and title reservation agreements as forms of security, and characterizing the title of the conditional seller or lessor as limited to a security interest.<sup>86</sup> Because of these different approaches, it was recognized by the Convention drafters that it would not be possible to reach agreement on a uniform characterisation. The solution that was adopted was to leave the issue of whether the seller's or lessor's right should be characterized as a security interest to be dealt with under the applicable domestic law as determined by the rules of private international law of the forum State.<sup>87</sup> Therefore, if the relevant interest falls within the Convention's definition of a security interest or the interest of a conditional seller under a title retention agreement or a lessor under a leasing agreement, the Convention applies. It is then for the applicable law to decide whether the interest is to be recharacterised for the purposes of those provisions of the Convention that distinguish between security interests and the interest of a conditional seller or lessor.<sup>88</sup>

### **2.3.2.3 Constitution of an International Interest**

Article 7 of the Convention provides the following straightforward set of requirements for the constitution of an international interest:<sup>89</sup>

- a) the agreement creating the interest must be in writing;

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<sup>86</sup>*Convention Commentary*, *supra* note 2 at 2.51; *Wool*, *supra* note 31 at 4.1.2; Roy Goode, "Transcending the Boundaries of Earth and Space: The Preliminary Draft UNIDROIT Convention on International Interests in Mobile Equipment" (1998) 3:1 *Unif L Rev* 62.

<sup>87</sup>*Convention*, *supra* note 1 arts 2(4), 5(2) & 5(3); *Convention Commentary*, *Ibid*.

<sup>88</sup>*Convention Commentary*, *Ibid*.

<sup>89</sup>*Convention*, *supra* note 1 art 7.

b) the agreement must relate to an object which the chargor, conditional seller or lessor has the power to dispose of;

c) the description of the object in the agreement must be sufficient to enable the object to be identified in accordance with the relevant Protocol<sup>90</sup> (for example, for an aircraft object, the agreement must describe the object by reference to the manufacturer's serial number, the name of the manufacturer and the model designation etc.); and

d) where a security agreement is concerned, the value of the obligation secured by the security interest must be determinable, although a statement of the maximum sum capable of being secured by the security interest is not required to be mentioned.

#### **2.3.2.4 Autonomy of the International Interest**

The concept of an international interest under the Convention is autonomous in the sense that it is not dependent on national law. If the requirements of the Convention for the creation of an international interest are satisfied, the interest will be enforceable between the parties to the transaction in any Contracting State even if satisfaction of those conditions would

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<sup>90</sup> The Cape Town Convention and the Aircraft Protocol require the same unique identification criteria in describing the object for the purposes of both the constitution of the international interest in that object and for its registration. However, at the Luxembourg diplomatic conference that adopted the Rail Protocol, it was discussed for the first time that the unique identification of an object according to its serial number or the equivalent is essential to enable the international interest to be registered and searchable in an asset based registration system, this is not necessary for the constitution of an interest which is based on the off record agreement of the parties. As a result of this, the Space Protocol follows the Luxembourg Protocol in distinguishing the identification requirements for the agreement constituting an international interest in the described object from the identification requirements necessary for registration: *Space Protocol*, *supra* note 21, art VII & art XXX; *Luxembourg Protocol*, *supra* note 57, art V & art XIV; Howard Rosen, Martin Fleetwood & Benjamin von Bodungen "The Luxembourg Rail Protocol - Extending Cape Town Benefits to The Rail Industry" (2012) 17:4 Unif L Rev 612[ *Howard Rosen, Martin Fleetwood & Benjamin von Bodungen*]; Roy Goode, Convention on International Interests in Mobile Equipment and Protocol Thereto on Matters Specific to Space Assets Official Commentary (Rome: International Institute For the Unification of Private Law(UNIDROIT), 2013 [*Commentary to the Space Protocol*]at 5.31.

not suffice to create an interest under national law or would require further formalities in order to be effective. However, it is not wholly independent of national law as it is the applicable national law which will decide whether the basic requirements for a valid contract, such as capacity to contract, absence of fraud, mistake, illegality, etc. have been met.<sup>91</sup>

### **2.3.2.5 Other Categories of Interests**

In addition to international interests, the Convention addresses: prospective international interests; national interests; non-consensual rights or interests arising under national law and given priority without registration; registrable non-consensual rights or interests arising under national law; associated rights; and pre-existing rights or interests. Each of these six categories of interests are defined under Article 1 of the Convention and discussed below.

#### **a) Prospective International Interests**

A prospective international interest is an interest in an aircraft object that is intended to be created as an international interest upon the occurrence of a stated future event (which may include the debtor's acquisition of an interest in the object).<sup>92</sup> The occurrence of the event need not be certain but the mere fact that parties contemplate the grant of an international interest in the future is not enough to create a prospective international interest. There has to be actual negotiations relating to a uniquely identified object with the intention of creating an international interest in that object upon the occurrence of a stated event. The object must either be in

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<sup>91</sup> *Goode on International Interest*, *supra* note 9 at 24; *Wool*, *supra* note 31 at 4.1.1.

<sup>92</sup> *Convention*, *supra* note 1; art 1(y).

existence or have reached a stage in the manufacturing stage sufficient to conclude that it is equipment of a type falling within the Convention.<sup>93</sup>

The purpose of recognizing prospective international interests is to enable a creditor to register its interest in advance of the actual creation of the international interest. Thus, the Convention provides that a prospective international interest may be registered in the International Registry as an actual international interest. This registration will not have any legal effect until the prospective international interest becomes an actual international interest. However, once this happens, its ranking priority is effectively backdated to the time of registration of the prospective international interest.<sup>94</sup>

## **b) National Interests**

A national Interest is an interest held by a creditor in an object that is created by a domestic transaction and registered under a national registration system pursuant to a declaration<sup>95</sup> made by a Contracting State. A domestic transaction is one in which both the debtor and the creditor reside in the same Contracting State. Moreover, at the time of creation of the national interest, the relevant object must be located in the same Contracting State where the creditor's interest has been registered in the appropriate national registry.<sup>96</sup>

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<sup>93</sup> *Convention Commentary*, *supra* note 2 at 4.31.

<sup>94</sup> *Ibid* at 2.33 (2).

<sup>95</sup> *Convention*, *supra* note 1 art 50.

<sup>96</sup> *Convention Commentary*, *supra* note 2 at 2.33(3); See *The Cape Town Convention Briefing*, 25 August 2005, online: Norton Rose Fullbright <<http://www.nortonrosefulbright.com/knowledge/publications/11017/the-cape-town-convention-briefing>> [*Cape Town Convention Briefing*]; Roy Goode, "The Cape Town Convention on International Interests in Mobile Equipment: A Driving Force For International Asset-based Financing" (2002) 7 *Unif L Rev* at 6, online: International Institute For the Unification of Private Law <<http://www.unidroit.org/overview-2001capetown>> [*Goode Cape Town Overview*].

A national interest cannot be registered as an international interest, but notice of it can be registered in the International Registry<sup>97</sup>, thereby securing its priority in the same way as if it were a registered international interest.<sup>98</sup> Thus, it is important to register national interests in order to ensure the priority of the national interest over international interests subsequently registered.<sup>99</sup>

### **c) Non-consensual rights or interests arising under national law and given priority without registration**

This category covers rights or interests in an object which are conferred by operation of the law of a Contracting state on the provider of a public service<sup>100</sup> to secure the performance of an obligation where the Contracting State has made a declaration<sup>101</sup> that they have priority over any registered international interests, even though they are not themselves registered in the International Registry.<sup>102</sup> For example, national law may recognize a super-priority lien on an aircraft object to secure unpaid air navigation charges.

### **d) Registrable non-consensual rights or interests arising under national law**

This category refers to a non-consensual right or interest conferred by operation of the law of a Contracting State for the purpose of securing the performance of an obligation where

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<sup>97</sup> The International Registry is discussed later in the chapter.

<sup>98</sup> *Convention Commentary*, *supra* note 2 at 2.33(3).

<sup>99</sup> Priority under the Convention is discussed in Section 3.2.8 of Chapter 3 of this thesis.

<sup>100</sup> For example Euro Control. It is the European organization for the safety of air navigation. It was founded in 1960, and headquartered in the City of Brussels. It is an international organization working for pan-European air traffic management.

<sup>101</sup> *Convention*, *supra* note 1 art 39.

<sup>102</sup> *Convention Commentary*, *supra* note 2 at 2.33(4); *Cape Town Convention Briefing*, *supra* note 96; *Goode Cape Town Overview*, *supra* note 96.



the Contracting State makes a declaration<sup>103</sup> listing it as registrable in the International Registry established under the Convention. When such a right or interest is registered, its priority is treated the same way as a registered international interest, and therefore it will rank from the date of registration. An example of such a right or interest could be a judgment or order affecting equipment of a category to which the Convention applies or a statutory lien in favor of a repairer or warehouseman to secure payment of repair or storage charges.<sup>104</sup>

### **e) Associated Rights**

Associated rights are defined under Article 1 (c) of the Convention as "all rights to payment or other performance by a debtor under an agreement which are secured by or associated with the object." They are relevant only in the context of an assignment, and are discussed in detail in chapter Three of this thesis.

### **f) Pre-existing rights or interests**

A pre-existing right or interest is defined under Article 1(v) of the Convention as "a right or interest of any kind in or over an object created or arising before the effective date of the Convention", i.e., these are rights or interests that were created before the Convention came into effect. They are subject of a declaration by a Contracting State under article 60(3) of the Convention.

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<sup>103</sup> *Convention, supra* note 1 art 40.

<sup>104</sup> *Convention Commentary, supra* note 2 at 2.33(5); *Cape Town Convention Briefing, supra* note 96; *Goode Cape Town Overview, supra* note 96.

### 2.3.3 Registration of International Interests

This part of the chapter will discuss the registration system under the Convention. It will explore the nature of the International Registry and its features. It will then discuss the mechanics of the registration system.

#### 2.3.3.1 The International Registry<sup>105</sup>

##### Introduction

When the Cape Town Convention and the Aircraft Protocol came into effect as international law,<sup>106</sup> the International Registry<sup>107</sup> became operational. "Its role is to provide a functionally efficient and commercially acceptable method for setting the priority rights of competing claimants to property in which international interests are held."<sup>108</sup> It provides a venue "for the registration of, among other things, international interests, prospective international interests, registrable non-consensual rights and interests (such as Eurocontrol charges), assignments, prospective assignments, and subordination of interests, and notices of national

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<sup>105</sup> This thesis will give a general overview of the International Registry. However, for a detailed presentation and explanation of the practical and technical issues of the Registry system, see Practitioner's Guide to the Cape Town Convention and the Aircraft Protocol The Legal Advisory Panel of the Aviation Working Group, 2011[*Practitioner's Guide*] at p 49; *Advanced Contract and Opinion Practices under the Cape Town Convention, Cape Town Paper Series, Volume 2, The Legal Advisory Panel of the Aviation Working Group* (Portland: Hart Publishing, 2008), ch. 4; See generally, Prof. Dr Ludwig Weber, "The New International Registry for International Interests in aircraft equipment under the Cape Town Convention and Protocol of 2001" (2006) 55:1 ZLW 1; Joseph R. Standell, "The Role of the International Registry Task Force (I.R.T.F.) in the Development of the International Registry for interests in aircraft" (2006) Unif L Rev 8; Rob Cowan & Donald Gallagher, "The International Registry For Aircraft Equipment-The First Seven Years, What We have Learned" (2014) 45 Unif Comm Code L J 226; Jane K Winn, "The Cape Town Convention's International Registry: decoding the secrets of success in global electronic commerce" (2012) Volume 2012 Cape Town Convention J.

<sup>106</sup> *Convention, supra note 1*, art 49(1); *Aircraft Protocol, supra note 11*, art XXVIII(1)

<sup>107</sup> *Convention, Ibid*, art 16.

<sup>108</sup> Ronald C.C. Cuming, "Considerations in the design of an International Registry for interests in mobile equipment"(1999)4 Unif L Rev at 277 [*Cuming Consideration in the design of International Registry*].

interest relating to international interests.”<sup>109</sup> The operation of the International Registry is governed partly by the Convention, partly by the relevant Protocol, partly by the Regulations made under the Protocol, and partly by the rules for effecting registrations and searches.<sup>110</sup>

### **2.3.3.2 The Nature of The International Registry**

#### **2.3.3.2.1 Asset Based System**

The international registry record is organized and searchable by reference to the object to which the international interest relates as opposed to the name of the debtor. This makes sense not because of the principle of specificity (i.e., any real right must have a clearly defined object, also known as the speciality principle), but because of the need to enable searching to be conducted efficiently.<sup>111</sup> If the name of the debtor were instead used as the search criterion, the search would not disclose registered international interests created by a debtor who is a predecessor in title to the current owner since a searcher would typically conduct the search according to the name of the current owner and might not even know the names of any previous owners. Asset-based searching thus ensures that all international interests created by debtors anywhere in the chain of title will be disclosed. Ensuring the reliability and integrity of registry

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<sup>109</sup> *Convention*, *supra* note 1 art 16. Article XXXII (1) of the Space Protocol provides that the following additional items can be entered on the International Registry under the Space Protocol:

a) the recording of rights assignments and rights reassignments;  
b) the recording of acquisitions of debtor's rights by subrogation;  
c) the registration of public service notices and creditors notices under Article XXVII(1) and Article XXVII(4) of the Space Protocol.

<sup>110</sup> *Convention Commentary*, *supra* note 2 at 2.118.

<sup>111</sup> Sjef Van Erp, "The Cape Town Convention: a Model For a European System of Security Interests Registration?" (2004) 12:1 Eur R Priv L 98 at 3.2.4 [*Sjef Van Erp*].

searches in this way advances the principal objective of the Convention, i.e., facilitating asset-based financing and leasing.<sup>112</sup>

#### **2.3.3.2.2 Electronic notice filing registry system**

The International Registry is wholly electronic, and is operative twenty four hours a day, seven days a week. Therefore, no registry staff intervention is needed when it comes to effecting registrations, submitting and receiving search requests and issuing search certificates. Obviously, it can be expected that the system will have to be shut down to deal with maintenance and other malfunction for short periods of time.<sup>113</sup>

Article 17(2)(i) of the Convention states that the Registry must provide for "notice registration", and not contractual document registration. In a notice registration system, registration is effected by submitting to the Registry only the basic information about an interest arising under a transaction or prospective transaction. The actual agreement between the parties giving rise to that interest is not registered.<sup>114</sup> In the context of the Convention, notice registration means that the International Registry is a public record of the existence or potential existence of an interest of the kind addressed in the Convention and Protocols in a specified object and of the identity of the principal parties in the transaction.<sup>115</sup> Notice registration as opposed to document registration reflects the recognition that there is no commercial need to

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<sup>112</sup> *Convention Commentary*, *supra* note 2 at 2.117; *Wool*, *supra* note 31 at 4.5.2.

<sup>113</sup> *Goode Cape Town Overview*, *supra* note 96.

<sup>114</sup> Ronald C.C. Cuming, "The International Registry for Interests in Aircraft: An Overview of its structure" (2006)

<sup>115</sup> Unif L Rev 22 at p 26 [*Cuming International Registry Overview*].

<sup>115</sup> *Ibid.*

include detailed information about the agreement or relationship between the parties in the public record.<sup>116</sup>

By avoiding document filing, and keeping the registered information to a minimum, the system not only helps in the reduction of the costs of administration, but it also helps the creditors and debtors to maintain confidentiality when it comes to the details of their transactions.<sup>117</sup> Also, there is a direct relationship between the amount of information that must be included in a registration, and the incidence of error on the part of registrants in transmitting that information to the Registry so requiring only the basic information about a transaction to be entered reduces the risk of error.<sup>118</sup>

### **2.3.3.3 The Constitutional Features of the Registry**

Article 16 (2) of the Convention provides that there will be separate international registries for each of the different categories of object covered by the Convention. Each International Registry will have its own Supervisory Authority and Registrar. This section will discuss the privileges, immunities, and the liabilities of the Supervisory Authority and the Registrar.

#### **2.3.3.3.1 Supervisory Authority**

It is the responsibility of the Supervisory Authority to establish the Registry, and to appoint the Registrar.<sup>119</sup> This is a time consuming process given that detailed specifications

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<sup>116</sup> *Ibid.*

<sup>117</sup> *Convention Commentary*, *supra* note 2 at 2.122.

<sup>118</sup> *Cuming International Registry Overview*, *supra* note 114 at 28.

<sup>119</sup> *Convention*, *supra* note 1 art 17.

needs to be prepared, and tenders invited and evaluated. Moreover, the technology involved in the setting up of the Registry involves further delays as the system is tested, and any defects corrected. Therefore, it was necessary to provide for a Supervisory Authority to establish the Registry before the Convention and each relevant Protocol can come into force. To that end, the practice under the Convention was to establish a Preparatory Commission as a provisional Supervisory Authority.<sup>120</sup>

In the case of aircraft objects, pursuant to Resolution 2 of the Diplomatic Conference, a Preparatory Commission was set up as Provisional Supervisory Authority under the supervision and guidance of the ICAO Council. Upon the Convention and the Aircraft Protocol coming into force, the ICAO Council itself took over the role of the Supervisory Authority. It is advised by a Commission of Experts, a body called CESAIR which was established pursuant to Article XVII (4) of the Aircraft Protocol. Its Registrar is Aviareto.<sup>121</sup>

In the case of space objects, during the Berlin diplomatic conference for the adoption of the Space Protocol, Resolution 2 of the Diplomatic Conference resolved to invite the International Telecommunications Union (ITU)<sup>122</sup> to be the Supervisory Authority.<sup>123</sup> Resolution 1 provided a "fall-back" position stating that in the event of ITU not becoming the

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<sup>120</sup> *Convention Commentary*, *supra* note 2 at 2.115; *Commentary to the Space Protocol*, *supra* note 90 at 3.95.

<sup>121</sup> Aviareto Limited is based in Dublin (Ireland), and was established for the sole purpose of developing and operating the International Registry for aircraft equipment. In October 2009, the Council of ICAO had re-appointed Aviareto Limited to operate the International Registry for a second five year term from 2011 to 2016. For further details, reference should be made to the company's website at <http://www.aviareto.aero/>; *Convention Commentary*, *supra* note 2 at 4.121.

<sup>122</sup> ITU is a specialized agency of the United Nations that is responsible for issues that concern information and communication technologies. It is based in Geneva, Switzerland.

<sup>123</sup> *Resolution 2 Relating to the Establishment of the Supervisory Authority of the International Registry for Space Assets*, UNIDROIT Doc, DCME-SP-Doc.43, (9 March 2012), available at <<http://www.unidroit.org/english/workprogramme/study072/spaceprotocol/conference/documents/dcme-sp-43-e.pdf>>.

Supervisory Authority, the General Assembly of UNIDROIT would appoint another international organization as the Supervisory Authority.<sup>124</sup>

In the case of railway rolling stock, the Supervisory Authority for the International Registry is a body which still needs to be established by the representatives of State Parties as provided by Article XII of the Luxembourg Protocol. Meanwhile, the Preparatory Commission set up pursuant to Resolution 1 of the Luxembourg Diplomatic Conference is acting as Provisional Supervisory Authority under that Resolution.<sup>125</sup> The Supervisory Authority may establish a commission of experts and will be assisted by a Secretariat. Its Secretariat will be the Intergovernmental Organization for International Carriage by Rail (OTIF) who is to assist the Supervisory Authority in the discharge of its functions.<sup>126</sup>

Apart from the establishment of the International Registry and appointment of the Registrar, other responsibilities of the Supervisory Authority of the international registries of each of the different categories of object include:

1) ensuring that in the event of a change of Registrar, rights required for the continued effective operation of the International Registry will be assignable to the new Registrar;<sup>127</sup>

2) ensuring the publication of regulations dealing with the operation of the International Registry after consulting with the Contracting States;<sup>128</sup>

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<sup>124</sup> The same Resolution had also provided for the establishment of a Preparatory Commission under the guidance of the General Assembly of UNIDROIT. It was to be composed of people having the requisite knowledge and experience and nominated by one-third of the negotiating States. ICAO, OTIF and the ITU were invited to participate as observers.; *Commentary to the Space Protocol*, *supra* note 90 at 3.94-3.96.

<sup>125</sup> *Commentary to the Luxembourg Protocol*, *supra* note 58 at 3.37.

<sup>126</sup> OTIF is an intergovernmental organization that governs international rail transport; *Luxembourg Protocol*, *supra* note 57 art XII.

<sup>127</sup> *Convention*, *supra* note 1, art 17 (c).

<sup>128</sup> *Ibid*, art 17 (d).

3) establishing administrative procedures through which complaints concerning the operation of the International Registry can be made;<sup>129</sup>

4) supervising the Registrar and the operation of the International Registry;<sup>130</sup>

5) providing guidance to the Registrar;<sup>131</sup>

6) setting and periodically reviewing the fee structure for the services of the International Registry;<sup>132</sup>

7) doing all the necessary things to ensure that an efficient notice-based electronic registration system exists;<sup>133</sup> and

8) reporting to the Contracting States regarding the discharge of its obligations under the Convention and the relevant Protocol periodically.<sup>134</sup>

#### **2.3.3.3.2 Privileges and Immunities of the Supervisory Authority and the Registrar**

Under the Convention, the Supervisory Authority and its officers and employees enjoy immunity from legal or administrative responsibility as provided under the relevant Protocol. The Supervisory Authority is a subject of international law, and its legal personality is derived not from national but international law and thus has the freedom to enter into agreements with States. In the case of aircraft objects and space assets, both ICAO and ITU (if it accepts to be the Supervisory Authority), being specialized agencies of the United Nations, already enjoy international legal personality, and as such enjoy the privileges and immunities set out in the

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<sup>129</sup> *Ibid*, art 17 (e).

<sup>130</sup> *Ibid*, art 17 (f).

<sup>131</sup> *Ibid*, art 17 (g).

<sup>132</sup> *Ibid*, art 17 (h).

<sup>133</sup> *Ibid*, art 17 (i).

<sup>134</sup> *Ibid*, art 17 (j).



standard clauses in the 1947 UN Convention on the Privileges and Immunities of the Specialized Agencies, and in Annex III (for ICAO) and Annex IX (for ITU) of that Convention, with respect to countries that are parties to the Convention. These benefits include juridical personality and the capacity to contract, to acquire and dispose of immovable and movable property, and to institute legal proceedings.<sup>135</sup>

The Luxembourg Protocol is silent on the issue regarding the immunity of the Supervisory Authority. Its immunity must rest on the status it may have in international law as an organization established under an international Convention and enjoying international legal personality. The Protocol does address the immunity of the Secretariat, i.e. OTIF, and states that it will have legal personality, and will get to enjoy the same immunities and privileges that are conferred on the Supervisory Authority and International Registry under the Convention.<sup>136</sup>

The Registrar does not have immunity of any kind.<sup>137</sup>

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<sup>135</sup> *Convention*, *supra* note 1 art 27; *Convention Commentary*, *supra* note 2 at 2.152; *Commentary to the Space Protocol*, *supra* note 90 at 3.97.

<sup>136</sup> *Commentary to the Luxembourg Protocol*, *supra* note 58 at 3.38 & 3.39.

<sup>137</sup> *Goode Cape Town Overview*, *supra* note 96.

### 2.3.3.3 Liabilities of the Registrar

In contrast to the Supervisory Authority, the Registrar is strictly responsible for system malfunction as well as errors and omissions of the Registry staff. The liability for system malfunction is not absolute.<sup>138</sup> In his article entitled, "The Cape Town Convention on International Interests in Mobile Equipment: A Driving Force For International Asset-based Financing", Professor Roy Goode mentions that two liability models were considered. The first was that in "Article 79 of the Vienna Convention on Contracts for the International Sale of Goods and Article 7.1.7 of the UNIDROIT Principles of International Commercial Contracts, namely that a party's non-performance is due to an impediment beyond its control and that it could not reasonably be expected to have taken the impediment into account at the time of conclusion of the contract or to have avoided or overcome it or its consequences." The second model, as ultimately adopted in Article 28 of the Cape Town Convention, was derived from international conventions relating to matters such as oil pollution, carriage of noxious substances etc., where the impediment must be of an inevitable and irresistible nature. Given the fact that large sums of money are dependent on a secure system for the registration and searching of international interests, this strict test is narrowed by the requirement that the malfunction has to

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<sup>138</sup> Article 28(1) of the Convention stipulates that the Registrar has unlimited liability for errors and omissions, subject to certain caveats. The Aircraft Protocol does not make any changes to this rule, but in reality, the liability can only be met to the extent of any insurance in place. Article 28 (4) specifies that the Protocols will determine the level of required insurance. Aircraft Protocol stipulates that "it shall not be less than the maximum value of an aircraft object as determined by the Supervisory Authority. The Luxembourg Protocol takes a different route, and introduces certain specific insurance provisions in Article XV. The article specifies two limitations of liability. First, the liability of the Registrar shall not exceed five million Special Drawing Rights in any calendar year or such greater amount determined by the Supervisory Authority by regulations. Second, the Supervisory Authority has the discretion to decide the level of insurance required in the light of the liability it sets. See *Howard Rosen, Martin Fleetwood & Benjamin von Bodungen, supra* note 90 at 614 (for a discussion on differences between the Aircraft and Luxembourg Protocols).

be one which could not have been prevented from occurring by the use of the best practices available in the field of electronic registry design and operations.<sup>139</sup>

It is the responsibility of the Registrar to ensure appropriate hardware and software, regular maintenance, state-of-the-art protection against viruses, rapid identification and correction of a system malfunction, back-up of the data on the main site and back-up systems on other sites, and a secure system to prevent unauthorised interference with data that is stored. The Registrar, is however, understandably not responsible for the factual inaccuracy of registration information it receives or which it transmits in the form in which the information was received.<sup>140</sup>

#### **2.3.3.4 Mechanics/Modalities of Registration**

The preceding discussion focussed on the nature of the International Registry and its constitutional elements. This part will deal with the mechanics of the registration system.<sup>141</sup>

An international interest may be registered at the International Registry by either party to the transaction giving rise to the international interest. However, the consent of the other party has to be received prior to registration.<sup>142</sup> The registration will not be valid in the absence of such

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<sup>139</sup> *Convention, supra* note 1 art 28; *Goode Cape Town Overview, supra* note 96; *Convention Commentary, supra* note 2 at 4.179.

<sup>140</sup> *Ibid*; See generally *Cuming Consideration in the design of International Registry, supra* note 108.

<sup>141</sup> For fraudulent registrations, see Section 10.10 of the Procedures of the International Registry; ICAO, *Regulations and Procedures for the International Registry*, ICAO Doc 9864 (2014) [*Regulations & Procedures for the International Registry*].

<sup>142</sup> *Convention, supra* note 1, art 20(1).

consent.<sup>143</sup> The consent also needs to be submitted prior to registration to the Registrar electronically.<sup>144</sup> It is not the Registrar's duty to confirm the authenticity of the consent.<sup>145</sup> Amendments to a registration are also possible, and can be made by either party subject to the same conditions, including the consent requirement, applicable to initial registrations.<sup>146</sup>

In addition to the consent requirement, for a valid registration the asset needs to be sufficiently identified. As discussed above, the International Registry is searchable by asset and not by the name of the debtor. Therefore, a specific description of the asset is necessary.<sup>147</sup> Registration is considered to be complete only upon entry of the required information into the International Registry record so as to be searchable. A registration is searchable only when:

- 1) the International Registry has assigned to it a file number;
- 2) the registration information is stored in "durable form";
- 3) the registration is made publicly accessible through the registry; and
- 4) the asset is sufficiently described in the registration (as discussed above).<sup>148</sup>

"It is this critical moment of achieving a valid registration that determines the priority<sup>149</sup> of the international interest."<sup>150</sup>

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<sup>143</sup> *Ibid*, art 19(1).

<sup>144</sup> *Ibid*, art 18(1).

<sup>145</sup> *Ibid*, art 18(2).

<sup>146</sup> *Ibid*, art 16(3) & 20(1).

<sup>147</sup> *Ibid*, art 18 (1); *Supra* note 90 (For further details about asset identification).

<sup>148</sup> *Ibid*, art 19.

<sup>149</sup> Priority is explained in Section 3.2.8 of Chapter *Three*.

<sup>150</sup> *Sundahl*, *supra* note 60 at 2.5.2.

An important feature of the Cape Town registration system when it comes to aircraft objects is the different treatment of airframes and engines. In this respect, the Cape Town Convention differs from the provisions of the Convention on International Civil Aviation<sup>151</sup> which deals with nationality registration without distinguishing between airframes and engines. In contrast, under the Cape Town Convention and Aircraft Protocol, where a single transaction gives rise to a registrable interest in an airframe and its attached engines, it is necessary to effect separate registrations relating to the airframe and each of the engines.<sup>152</sup> This is because the engines attached to the airframe at the time of the creation of the interest will not necessarily remain attached to that airframe in the future and because engines as a matter of practice are often financed separately from the airframe.

The Convention and the relevant Protocols may "empower" a Contracting State to designate one or more entities as the compulsory or national entry points for submitting a registration to the International Registry instead of requiring registrations to be transmitted to the International Registry directly.<sup>153</sup> For instance, a Contracting State might wish to use its domestic registry for security interests as the entry point to the Registry. Under the aircraft registration regulations, a Contracting State may designate "authorizing entry points" or "direct entry points". If a registration is submitted through an authorizing entry point, authorization can then be given for the information to be further transmitted to the International Registry. On the other hand, information required for registration can be directly transmitted to the International

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<sup>151</sup> *Chicago Convention*, *supra* note 43, arts 17-21.

<sup>152</sup> *Cuming International Registry Overview*, *supra* note 114 at p 22.

<sup>153</sup> *Convention*, *supra* note 1, art 18.5; *Space Protocol*, *supra* note 21, art XXXI; *Luxembourg Protocol*, *supra* note 57, art XIII.

Registry.<sup>154</sup> A Contracting State is not allowed to designate an entry point to register a national interest or a registrable non-consensual right or an interest arising under the law of another State.<sup>155</sup>

### 2.3.3.5 Registration of Prospective International Interest

As stated earlier, a prospective international interest is an interest in an object that is intended to be created as an international interest upon the occurrence of a stated event.<sup>156</sup> Such an interest may be registered in the International Registry, and the subsequently created international interest will be treated as registered from the time of registration of the prospective international interest for the purposes of its priority ranking provided that that registration is still current immediately before the international interest is later constituted under Article 7 of the Convention.<sup>157</sup> When searching the International Registry, it is not possible to differentiate between an international interest and a prospective international interest: the search certificate merely indicates that the creditor named in the registration has acquired or intends to acquire an international interest in the object.<sup>158</sup> Consequently, searchers must make further inquiries in all cases to determine whether the registration reflects an actual or merely a prospective international interest. The goal of permitting advance registrations is to enable creditors to ensure that their priority ranking is protected at the earliest time possible. In practice this may not always be possible as some aircraft manufacturers have a policy of not permitting prospective

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<sup>154</sup> *Regulations and Procedures For the International Registry*, *supra* note 141 at s 12.

<sup>155</sup> *Aircraft Protocol*, *supra* note 11, art XIX; *Space Protocol*, *supra* note 21, art XXXI; *Luxembourg Protocol*, *supra* note 57, art XIII.

<sup>156</sup> *Convention*, *supra* note 1 art 1(y).

<sup>157</sup> *Ibid*, art 19(4).

<sup>158</sup> *Ibid*, art 22 (3).

international interests to be granted by a buyer in favour of its lender to be registered until the buyer has paid the purchase price in full.

## 2.4 Chapter Summary

This chapter examined the evolution and structure of the Cape Town Convention. It explored the relationship of the Convention with its supporting Protocols as well as its relationship with national law. It also examined the nature of the international interest, and the registration scheme under the Convention. The preceding discussion showed that at the heart of the Convention is the International Interest. Under the provisions of the Convention, an international interest:

- a) must be constituted in compliance with the creation provisions in order to become effective between the parties;
- b) must be perfected by registration in order to take effect against third parties; and
- c) through registration, given priority against subsequent registered interests and protected against general creditors in the event of the debtor's insolvency.<sup>159</sup>

The concept of the international interest together with the very efficient International Registry helps the Convention achieve its primary objective, that is, to increase access to and reduce the cost of financing for high value mobile equipment. Without registration, the protection of the international interest against competing claimants would not have been assured as the main objective of the registration requirement is to establish the priority of international

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<sup>159</sup> *Goode on international interest*, *supra* note 9 at 22.

interests and assignments based on the temporal order of registration.<sup>160</sup> The protection of the priority of registered international interests under the Convention, together with the provisions giving creditors access to effective default remedies, reduces the legal risk borne by creditors and thereby increases the likelihood that they will be prepared to extend credit .

With this background and basic knowledge of the Convention in mind, the next chapter of the thesis will focus specifically on the assignment provisions of the Convention and Protocols.

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<sup>160</sup> *Convention Commentary*, *supra* note 2 at 4.12.



## Chapter III ASSIGNMENT UNDER THE CAPE TOWN CONVENTION

This chapter will review the assignment provisions in Chapter IX of the Cape Town Convention and any related assignment provisions in the supplementary Protocols. It will also compare the assignment provisions under the Convention with the treatment accorded to the same issues by national law, with emphasis on the former. The chapter will then identify the potentially problematic features.

### 3.1 THE CONCEPT OF ASSIGNMENT<sup>161</sup>

Before we explore the treatment of assignments treated under the Cape Town Convention, it is useful to consider what is meant by an assignment in general private law. Kotz has described an assignment as "a transaction whereby a contractual right is transferred by its owner who is called the assignor, with or without the concurrence of the other party to the contract, to another person called the assignee."<sup>162</sup> For his part, Guest defines an assignment as "the transfer from one person (the assignor) to another (the assignee) of the whole or part of an existing right or interest in intangible property<sup>163</sup> presently owned by the assignor."<sup>164</sup>

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<sup>161</sup> There is no universal law of assignment. Different legal systems -national and international may understand the concept of assignment differently since legal incidents following from assignment may differ among different legal systems. In this thesis, the term "Assignment" is limited to contractual assignments as these are the types relevant to the Cape Town Convention.

<sup>162</sup> Hein Kotz, "Rights of Third Parties: Third Party Beneficiaries and Assignment" in Arthur T. Von Mehren, ed, *International Encyclopedia of Comparative Law* (Leiden. Boston: Mohr Siebeck, Tübingen: Martinus Nijhoff Publishers, 2008) at 52 [Kotz]. Also see, Greg Tolhurst, *The Assignment of Contractual Rights*, (Portland: Hart Publishing, 2006) [Tolhurst].

<sup>163</sup> Sometimes the term assignment might refer to the transfer of title in tangible property. This matter is beyond the scope of this thesis.

<sup>164</sup> A.G. Guest, *Guest on the Law of Assignment*, 1st ed (London: Sweet & Maxwell, 2012) at 1-01 [Guest].

The word transfer used in these definitions denotes that the assignor's right or interest in the assigned obligation is, depending on the nature of the assignment and its terms, removed from the assignor and acquired by the assignee.<sup>165</sup> After the assignment, the assignee can enforce the right or interest against the debtor on the assigned obligation to the extent that it has been transferred to him. The transfer could be voluntary or involuntary.<sup>166</sup> A transaction is properly termed an assignment only to the extent that it transfers to the assignee the ownership of the right originally vested in the assignor. Transfer is thus the principal feature of an assignment.<sup>167</sup> The transferred interest may amount to ownership of the entire interest held by the assignor in the assigned right, or ownership of a part of that interest.<sup>168</sup>

In common law jurisdictions, an assignment generally involves the transfer of what is termed a "chose in action." A chose in action is a common law legal concept used to describe "all personal rights of property which can only be claimed or enforced by action, and not by taking physical possession."<sup>169</sup> The term assignment thus covers the transfer of any type of intangible right, whether in the form of a monetary claim against the assignor's debtor or otherwise. In a similar vein, in civil law jurisdictions, the civil code often provides that the rules that govern the

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<sup>165</sup> *Ibid.*

<sup>166</sup> Guest, *supra* note 164 at 1-2. In a voluntary assignment, transfer will be one made with the agreement or consent of the assignor or at his direction. This thesis will deal only with voluntary assignment.

<sup>167</sup> *Tolhurst*, *supra* note 162 at 3.04.

<sup>168</sup> *Ibid.*

<sup>169</sup> *Torkington v. Magee* [1902] 2 K.B. 427, 430; reversed [1903] 1 K.B. 644; It includes a whole range of proprietary rights such as patent rights, copyright rights, claims arising out of a tort, of breach of contract, rights under a trust, an insurance policy, bill of lading etc. It must be a right that could be considered a species of property; *Kotz*, *supra* note 162 at 58.

assignment of claims also apply to the assignment of intangibles generally unless otherwise provided.<sup>170</sup>

## **Parties to an Assignment**

For the purposes of this thesis, the parties to an assignment will be referred to as the assignor and the assignee and the person who owes the assigned obligation to the original creditor or assignor will be referred to as the debtor. The assignment takes place when the assignor transfers the benefit of the obligation (i.e., the claim) owed to him by the debtor to the assignee.

## **3.2 Assignment under the Cape Town Convention**

### **3.2.1 Introduction**

Sale of loans by the originating bank to another bank is a common affair. The bank that purchases the loan has the right to receive the payments from the debtor in accordance with the terms of the loan. This purchasing bank not only buys the right to receive the payments, but also any security interest that the selling bank obtained to secure the loan. In the event of a default, the purchasing bank can foreclose on the debtor's collateral. The bank that had issued the loan initially is able to regain the money by selling the loan to another bank. For example, Bank X issues a loan to Company Y and secures this loan on Company Y's aircraft. Now, Bank X obtains a loan from Bank ABC. This loan that Bank X obtains from Bank ABC can be secured on Bank X's right to receive payment from Company Y. If Bank X defaults on its loan, then Bank ABC

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<sup>170</sup> See for example, German CC § 413, Swiss CO art. 174, Dutch New CC Book 3 art. 94. The French CC art 1689. deals with assignment of *créances*, the code provisions apply to the assignments of all intangible rights; *Kotz, Ibid.*

will be able to enforce its security interest by either notifying Company Y to make payments to Bank ABC or it can sell Bank X's right to receive payments. Such kinds of transactions where loans are sold together with the related security interest are very common in the modern financial world and they are characterised under the Convention as an assignment of associated rights.<sup>171</sup>

### **3.2.2 Definition of Assignment and Associated Rights under the Convention**

As indicated earlier, the concept of an assignment under the Convention is related to the concept of associated rights. Therefore, this section will first address the concept of associated rights.

#### **Definition of Associated Rights**

The term associated rights is defined under the Convention as "all rights to payment or other performance by a debtor under an agreement<sup>172</sup> which are secured by or associated with the object."<sup>173</sup> The concept of associated rights is limited by three factors. First, they are confined to rights to performance of obligations due from the debtor. Obligations that are due from third parties do not fall within the definition unless the debtor itself has undertaken in the agreement to procure their performance. Second, it is only performance due from the debtor under 'the agreement' that is relevant. Rights to performance by the debtor under other contracts do not qualify unless in the agreement itself, the debtor undertakes to perform its obligations under the

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<sup>171</sup> *Sundahl, supra* note 60 at 2.8.

<sup>172</sup> That is, a security agreement, a title reservation agreement or a leasing agreement; *Convention, supra* note 1 art 1(c).

<sup>173</sup> *Convention, Ibid*, art 1(c); Object refers to any categories of mobile equipment covered by the Convention subject to an international interest under the Convention.

other contracts. If the debtor agrees to perform obligations under other contracts, then subject to the third requirement, the rights to performance under those contracts also become associated rights under the agreement. Therefore, if the debtor enters into a loan agreement and a separate security agreement which secures performance under the loan agreement, the rights to such performance constitute associated rights. Third, the performance must be secured on or associated with the agreement.<sup>174</sup>

Associated rights should be related to the object, where they could be payment for the price of the object under a title reservation agreement, loan for the purchase of an aircraft object under a loan agreement or the rental of an object under a lease agreement together with the other related obligations arising under the applicable agreement.<sup>175</sup> These are types of agreements that give rise to an international interest under the Convention.

### **Kinds/categories of associated rights:**

Associated rights could be one of the following two kinds:<sup>176</sup>

1) Associated rights which are "object related" and related to the leasing or financing of an object. For example, rights to payment of the price of the object, repayment of an advance for the purchase of the goods etc.; and

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<sup>174</sup> *Convention Commentary*, *supra* note 2 at 4.219; Roy Goode, "The Priority rules under the Cape Town Convention and Protocols" (2012) 1 Cape Town J 95 [*Goode Priority Rules*].

<sup>175</sup> *Convention Commentary*, *supra* note 2 at 4.9.

<sup>176</sup> *Ibid* at 2.188.

2) Associated rights that are not so related. For example, rights to repayment of a non purchase money loan in an unrelated transaction which may have security over the object, but has got nothing to do with the financing, rental or associated obligations.

The difference between the above two categories of associated rights is not important when it comes to priority between assignees of different sets of associated rights related to different international interests. However, the distinction is of relevance when it comes to priority of competing assignments of associated rights related to the same international interest as it is limited to object-related rights.<sup>177</sup>

## **Definition of Assignment under the Convention**

When it comes to defining an assignment under the Convention, it involves conferring of the associated rights on the assignee as well. This is a limiting factor with respect to the scope of application of assignment under the Convention. It has to confer the associated rights. Thus, the Convention defines the term assignment 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."<sup>178</sup> Only assignments that are related to the international interest can be registered under the Cape Town Convention. The definition of assignment under the Convention is limited to contractual assignments, and do not include assignments by operation of law. Transfers by operation of law such as transfers under statutory provisions or on a statutory

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<sup>177</sup> *Ibid.* For a detailed discussion of the priority issues related to an assignment of international interest please see Section 3.2.8.1 of this Chapter.

<sup>178</sup> *Convention, supra note 1 art 1 (b).*

merger or amalgamation of two corporations which under the applicable law operates to transfer rights and liabilities do not fall within the definition of assignment, and are outside the scope of the Convention.<sup>179</sup>

The definition of an assignment under the Convention is broad, and it covers any form of contract by which the associated rights are conferred on another, whether by outright transfer of ownership, security transfer of ownership, a pledge, or a charge of the associated rights creating a right *in rem* without a transfer of ownership.<sup>180</sup> The decision as to whether a contract constitutes an assignment is to be made by an independent interpretation of the Convention, and not by the applicable law.<sup>181</sup> Per the definition of an assignment under the Convention, only a creditor (a chargee, a conditional seller or a lessor) can assign associated rights. An assignment by a lessee will not fall within the definition. However, if the lease contains an option to purchase, the lessee then becomes a prospective buyer, and can register and assign its rights. A lessee who grants a sub-lease can, as a sub-lessor, effect an assignment of its associated rights and a transfer of its international interest. The assignment and the transfer will then be governed by the Convention.<sup>182</sup>

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<sup>179</sup> *Practitioner's Guide*, *supra* note 105, page 22; *Convention Commentary*, *supra* note 2 at 2.187.

<sup>180</sup> *Convention Commentary*, *Ibid* at 4.8.

<sup>181</sup> *Ibid*.

<sup>182</sup> *Ibid*, at 4.216.

### 3.2.3 Formal Requirements for an Assignment of Associated Rights under the Convention

The Convention provides that an assignment of associated rights will transfer the related international interest, that is the security securing the associated rights only when the formalities specified under the Convention are satisfied. These formal requirements are as follows:<sup>183</sup>

- 1) The assignment must be in writing;
- 2) It must enable the associated rights to be identified, by referring to the contract under which the associated rights arose; and
- 3) It must indicate enable determination of the secured obligations where the purpose of the assignment is to create a security without the need to state the sum secured.

If the above requirements are not met, the assignment will be outside the Convention, and its effectiveness will be governed by the applicable law and not by the Convention.<sup>184</sup>

The formal requirements to constitute an assignment of associated rights under the Convention are the same as those for the creation of an international interest in Article 7 of the Convention except that what needs to be identified is not the object, but the associated rights.<sup>185</sup> It is up to the parties to decide whether to transfer the associated rights independent of the related international interest or not. However, as mentioned before, the Convention is applicable only to those assignments of associated rights which also transfer the related international

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<sup>183</sup> *Convention*, *supra* note 1, art 32 (1).

<sup>184</sup> *Convention Commentary*, *supra* note 2 at 4.239.

<sup>185</sup> See discussion on constitution of international interest in Chapter 2 of this thesis.



interest.<sup>186</sup> Further, a transfer of an international interest without conferring any of the associated rights will not be valid.<sup>187</sup> Unless a security interest is connected with the underlying obligation that is assigned, such a transfer is invalid.<sup>188</sup>

Parties are free to decide if they would like to transfer the associated rights without a transfer of the international interest. For example, assume A, an aircraft manufacturer, is a conditional seller under a title reservation agreement. A can assign his rights to future payments for the aircraft object from the buyer without transferring its ownership of the object to which the agreement relates. But, the Convention will not apply in this transaction because the assignment of the associated rights is separated/detached from the related international interest. "The effect of an assignment of associated rights divorced from the related international interest is that the Convention does not apply to the assignment at all."<sup>189</sup> The Cape Town Convention is not concerned with assignments of pure receivables. The primary focus of the Convention is on international interests and the registrations of international interests. Mere assignments of receivables will be dealt by national law including the 2001 UN Convention on the Assignment of Receivables in International Trade<sup>190</sup> should it come into force in a Contracting State.<sup>191</sup>

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<sup>186</sup> *Convention, supra* note 1, art 32 (3).

<sup>187</sup> *Ibid*, art 32 (2).

<sup>188</sup> *Sundahl, supra* note 60 at 2.8.1.

<sup>189</sup> *Convention Commentary, supra* note 2 at 4.222.

<sup>190</sup> *Receivables Convention, supra* note 22.

<sup>191</sup> *Convention Commentary, supra* note 2 at 4.222.

### **3.2.3.1 Formal Requirements : Comparison with non-Convention Assignment Law (Assignments in General)**

#### **Introduction**

Legal systems differ when it comes to prescribing formalities in order to obtain a fully effective assignment. Regardless of the nature or purpose of an assignment, legal systems prescribe formalities of one kind or the other. Sometimes it might so happen that an assignment could be fully effective between the assignor and the assignee, but because of the failure to comply with certain formalities, the same assignment may be invalid as against third parties including the debtor and the assignor's creditors. Different kinds of formal requirements may have to be satisfied in order to render an assignment effective. Failure on the part of an assignor or an assignee to notify the debtor or sometimes even the debtor's failure to acknowledge the assignment may be grounds to declare an assignment invalid. Then again, some formal requirements are imposed on certain particular types of assignments such as assignments which are made for securing money obligations which are discussed in detail below. Lastly, the sanctions for failing to comply with the formal requirements may also be different in different legal systems.<sup>192</sup> The following is a comparative survey of the formal requirements for an assignment with non Convention Assignment law.

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<sup>192</sup> *Kotz, supra* note 162 at 83.

In the Netherlands, the assignor's signature and the debtor's notification is required if a chose in action is transferred.<sup>193</sup> The Swiss Code of Obligations provides that all assignments must be in writing, but "the obligation to enter into an agreement to assign" will be valid even if made orally. In this scenario, we can see the difference between assignment as "a dispositive act by which the right is transferred to the assignee and the agreement underlying it; only the former must be in writing." What we can understand is that the purpose of this requirement is only to facilitate proof of the assignment in cases of the assignor's bankruptcy and when the debtor or a third party contests the assignment. Thus, the assignor is required to state his intention to assign in a letter to the assignee. The assignee's acceptance may not be in writing, and could be generally inferred from the circumstances.<sup>194</sup> It is also interesting to note that in some civil law jurisdictions, assignments valued at a certain amount are required to take the form of private writing (*acte sous seing privé*) or a notarial document (*acté notarié*). If such requirements are not followed, it will be sanctioned by excluding the testimony of the witnesses.<sup>195</sup>

## **Formal Requirements for assignments made for security purposes**

The form of formal requirements differs across different legal systems when it comes to an assignment made by the assignor to the assignee for the purpose of securing a debt that he

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<sup>193</sup> The New Civil Code of the Netherlands provides that if a chose of action is transferred, the delivery shall take the form of a deed of assignment which will require the debtor's signature as well as notification of the debtor; *Kotz*, *ibid* at 84.

<sup>194</sup> *Ibid*; The Old Code of Obligations of Switzerland had provided that an oral assignment between the assignor and the assignee will be valid, but it needs to be evidenced in a written document in order to be effective against third parties.

<sup>195</sup> *Ibid*; There are certain exceptions for example, commercial transactions and in those situations when the party relying on the oral agreement "starts off the evidence with a writing that renders probable the conclusion of the oral agreement (*commencement de preuve par écrit*).

owes. However, the reasons for bestowing or rather imposing such formal requirements on such assignments could be many. One reason could be protection of the other creditors of the assignor. For instance, a bank giving credit to a customer will be interested to know if the accounts given by the customer as security are still a part of his estate, and have not been assigned by him to somebody else. Such interest can be furnished by making the validity of the assignment contingent on the compliance with the formal requirements which can be easily be determined by prospective lenders.<sup>196</sup>

In some systems, compliance with the formalities is a precondition even to the *inter partes* effectiveness of the assignment. In the United States, under Article 9 of the Uniform Commercial Code (UCC),<sup>197</sup> an assignment is not enforceable against the debtor or third parties by the assignee, unless the assignor signs the security agreement describing the contract rights assigned.<sup>198</sup> Under the Civil Code of Quebec (CCQ), in cases of assignments of receivables by way of security, article 2696 requires that a security assignment must be granted in writing and signed by the parties on pain of absolute nullity. The writing must also describe the assigned claims and indicate the maximum sum secured by the security right.<sup>199</sup>

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<sup>196</sup> *Ibid* at 85.

<sup>197</sup> The Uniform Commercial Code (UCC) is a comprehensive code addressing most aspects of commercial law. The UCC text is written by commercial experts. It was established in 1952 and has been promulgated to harmonize the law of sales and other commercial transactions in all fifty states of the United States of America.

<sup>198</sup> § 9-203 (1) provides that "a security interest is not enforceable against the debtor or third parties with respect to the collateral and does not attach unless...the debtor has signed a security agreement which contains a description of the collateral"; UCC art 9 applies not just to security assignments, but also to the outright assignment ("sale") of accounts, chattel paper, payment intangibles, or promissory notes Art 9-109 (a)(3); *Kotz, supra* note 162 at 85.

<sup>199</sup> Catherine Walsh, "Receivables Financing and the Conflict of Laws: The UNCITRAL Draft Convention on the Assignment of Receivables in International Trade"(2001-2002) 106 Dick L Rev at 191 [*Walsh*]; art 2696 CCQ; The Civil Code also requires publication by registration of an outright assignment of claims where the assignment relates to a universality of claims art 1642 CCQ. See art 1641 for the formalities where a specific claim is assigned versus a universality of claims see art 1641 CCQ.

In Germany, an assignment is effective against third parties even when the agreement between the assignor and the assignee is oral. Under German law, assignments of contract rights are effective without any formal requirements such as writing, registration or debtor notification.<sup>200</sup>

## Remarks

One of the core differences between the laws of assignment of different jurisdictions is that some legal systems clearly differentiate between the effectiveness of an assignment as between the assignor and the assignee (*inter partes*) and as towards third parties (*erga omnes*), whereas other legal systems do not draw such a distinction.<sup>201</sup> The differences in the formal requirements prescribed by the various legal systems could be intended to fulfill different functions which are relevant to both the parties and third parties. As between parties, a formality rule could be imposed to protect an assignor by requiring a signed document signifying the seriousness of his undertaking. It may also be designed to reduce future disputes between the parties as to the scope of the receivables covered by the assignment contract. When it comes to third parties, especially third party creditors, a writing requirement such as a notarial instrument may help to solve problems of fraudulent collusion which exists in oral assignments. In those legal systems where priority is governed by the simple "first in time rule", the formality rule may be intended to establish a certain date for the ranking of competing assignments which thus helps in solving difficult evidentiary issues. Other formality rules such as the approach taken in the

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<sup>200</sup> Kotz, *supra* note 162 at 85.

<sup>201</sup> Stefan Vogenauer & Jan Kleinheisterkamp, eds, *Commentary on the Unidroit Principles of International Commercial Contracts (PICC)* (New York: Oxford University Press, 2009) at 990.

Civil Code of Quebec whereby there is the requirement of specifying the value or maximum value of the secured obligation in the context of a security assignment, may be directed towards limiting the value of the assignee's priority as regards competing claimants, thereby also limiting that assignee's monopolistic position in the provision of credit to the debtor.<sup>202</sup>

From the above discussion, we could see that there is a difference between the Cape Town Convention and the national legal systems when it comes to the formalities required to make a valid assignment under the Convention. The Convention strictly prescribes the requirements,<sup>203</sup> failing which an assignment will not have the effect of transferring the related international interest, and its effectiveness will be governed by the applicable law. The author is in favour of the requirements prescribed under the Convention. With the volume of commercial transaction taking place today, it will be difficult to satisfy an assignee with simply an oral declaration of the assignor's intention to assign. A document is necessary for the assignee so that the assignee can furnish the document as proof to the debtor that he is now the new creditor to whom the payment must be made. In the absence of such a document, it will be difficult for the assignee to enforce the assignment against the assignor's creditor or trustee in cases of bankruptcy.

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<sup>202</sup> *Walsh, supra* note 199 at 192.

<sup>203</sup> Article 32 (1) of the Cape Town Convention:

An Assignment of associated rights transfers the related interest only if it:

- a) is in writing;
- b) enables the associated rights to be identified under the contract from which they arise;
- c) in the case of an assignment by way of security, enables the obligations secured by the assignment to be determined in accordance with the Protocol but without the need to state a sum or maximum sum secured.

### 3.2.3.2 Debtor's Consent- Why is it required ?

Under the Cape Town Convention, in order for the debtor to make payment or give performance to the assignee, the Convention requires that a notice of the assignment in writing along with the authority of the assignor be given to the debtor, and it is required for the notice to identify the associated rights to which it relates.<sup>204</sup> Article XV of the Aircraft Protocol<sup>205</sup> modifies the Convention by also making the consent of the debtor a precondition to his duty to make payment or give other performance to the assignee. This requirement is added to the Convention by the Aircraft Protocol and the Space Protocol,<sup>206</sup> but not the Luxembourg Protocol.<sup>207</sup> This requirement that the debtor consent to an assignment is not found in the national assignment law of most States, nor does it appear in the UN Convention on the Assignment of Receivables. It is a clear departure from national and international norms for assignment. For an assignment to be effective against the debtor, notification of the debtor is generally sufficient. From the debtor's perspective, the assignee/debtor relationship is an involuntary one under most national laws and the Assignment Convention.<sup>208</sup> Why then is the consent of the debtor on the assigned obligation required for an assignment that will be effective against the debtor under the Convention and Aircraft and Space Protocols? There does not seem to be any sound commercial justification. One can argue that consent is required to achieve clarity in the relationship between an assignee and a debtor. The assignee might feel that his position is enhanced because he will be having a written consent of the debtor in his possession, and the debtor in principle will not be able to

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<sup>204</sup> *Convention*, *supra* note 1, art 33 (1).

<sup>205</sup> *Aircraft Protocol*, *supra* note 11, art XV.

<sup>206</sup> *Space Protocol*, *supra* note 21 art XXIV.

<sup>207</sup> *Luxembourg Protocol*, *supra* note 57.

<sup>208</sup> For example, art 1690 CcF; art 3:94 DCC; *Receivables Convention*, *supra* note 22 art 16.

object to the assignment or attack its validity. But, this argument is not persuasive because of two reasons: First, the consent may not identify the assignee. Second, the assignee's status is already evidenced because an effective assignment under the Convention has to be in writing. The assignee, by having the written document which describes the right to be transferred, and states the assignor's intention of transferring it to the assignee, can always furnish proof to the debtor (if the need arises) that he is now the new creditor to whom payment must be made.

One can also perhaps argue that the drafters of the Aircraft/Space Protocols might have taken this provision from the assignment provisions of the UNIDROIT Principles of International Commercial Contracts where the consent of the debtor (obligor) is required where the assigned obligation is of an essentially personal character<sup>209</sup> or Article 1260 (1) of the Italian Cc which provides that "a right cannot be assigned when it is of a strictly personal character."<sup>210</sup> Or perhaps, one can argue that the consent could be required if there is a change in the assignment whereby the debtor's obligations to the assignee has changed to some extent (for instance, if the assignee wants a more accelerated payment and the debtor has to pay \$5000 every month to the assignee instead of \$2000). But, these arguments aren't likely to hold water when it comes to the Cape Town Convention/Protocols because of two reasons:

1) With respect to the first example, the assigned obligations under the Convention do not constitute personal performance obligations, but rather monetary payment obligation; and

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<sup>209</sup> Unidroit Principles of International Commercial Contracts, art 9.1.7(2).

<sup>210</sup> *Kotz, supra* note 162 at 71.



2) With respect to the second example, it is an entirely different scenario which is not directly relevant to the basic issue of consent to the assignment.

The debtor might object to an assignment on the basis that for instance, the assignor might have been less strict when it comes to demanding timely payment of the debt than the assignee. But, in order to make money claims freely alienable, assignment law outside the Convention does not consider such small burdens sufficient to refuse to give effect to the assignment regardless of the debtor's consent.<sup>211</sup> In the case of money obligations as compared to obligations of a personal nature, it hardly makes any difference as to whom the debtor owes the obligation. If the debtor refuses to give his consent, there will be no assignment under the Convention, but not under most national and international laws.

The debtor's consent is not a prerequisite to the effectiveness of the assignment between the assignor and the assignee under the Convention/Protocol. The official commentary to the Convention states that the purpose of having a consent requirement in order for the assignment to be effective against the debtor is to handle those situations where a debtor is faced with notices from two competing assignees.<sup>212</sup> But, the situation of competing assignments will arise where the assignor assigns the same obligations successively to two different assignees either outright or by way of security. Usually, an assignment will contain a clause prohibiting the assignor from assigning the same obligation again, breach of the clause will only give rise to a claim for damages against the assignor by the first assignee, and will not prejudice the effectiveness of the second assignee's claim unless it somehow acted in collusion with the assignor. Other legal

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<sup>211</sup> *Ibid.*

<sup>212</sup> *Convention Commentary*, supra note 2 at 5.73.

systems deal with the problem of protecting a debtor who receives notices of assignments from competing assignments in various ways. For example, most provide that the debtor is discharged if he pays the assignee who is the first to notify him of the assignments.<sup>213</sup> Others say that the debtor is discharged by paying the money to a court, leaving it to the court to rule on which assignee is entitled to the payment. The Receivables Convention also has specific provisions to handle such situations.<sup>214</sup> Obviously, in such a scenario one cannot imagine that the court will order the debtor to make a double payment. The debtor will try to secure agreement between the competing assignees as to which of them should be paid. If he is not successful in his attempt, he can invoke local procedural law.<sup>215</sup> Moreover, article 33(2) of the Cape Town Convention states that "*Irrespective of any other ground on which payment or performance by the debtor discharges the latter from liability*, payment or performance shall be effective for this purpose if made in accordance with the preceding paragraph." This opening clause presumably preserves any procedures under local law that would allow the debtor to obtain a discharge by paying into court in the case where he receives notices of competing assignments.

What then possibly could be the reason behind having the debtor's consent to the assignment?

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<sup>213</sup> For example, Italian CC art 1265.

<sup>214</sup> *Receivables Convention*, *supra* note 22, art 17.

<sup>215</sup> *Convention Commentary*, *supra* note 2 at 5.73.

### 3.2.3.3 Notice to the Debtor

There is a clear distinction between the two requirements i.e., having to serve a notice of the assignment on the debtor in order to make an assignment effective against the debtor and having to have the consent of the debtor. We have already discussed the consent requirement above. Now, let us come to debtor notification.

Fundamentally, the agreement between the assignor and the assignee is sufficient to transfer the contract right to the assignee, and the consent of the debtor is not required. However, the Convention also requires that the debtor be notified in order for the debtor to have to make payment to the assignee. In some national legal systems serving a notice on the debtor is required even in order for the assignment to be effective as between the assignor and assignee. In most other legal systems, notification of the debtor is needed, as is the case under the Convention, only in order to enforce the assignment as against the debtor in the sense of obligating the debtor to pay the assignee. What follows is a brief comparative survey.

#### **France**

Article 1689 of the French Civil Code does not mention the name of the debtor, but states that under an assignment "delivery of the claim from assignor to the assignee is effected by delivery of the document evidencing the claim."<sup>216</sup> However, this does not come to the conclusion that where a claim is evidenced by a document, the assignment is rendered invalid unless the document is delivered to the assignee. A claim transferred without any delivery of the

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<sup>216</sup> Kotz, *supra* note 162 at 86.

document has been recognized by the French courts provided the parties have agreed between themselves. Article 1260 of the Italian Civil Code follows the same principle. But, all this applies only between parties to the assignment (*entre le cédant et le cessionnaire*).<sup>217</sup>

However, when it comes to the debtor, the assignment is considered to be complete only when the debtor has been notified of the assignment either by the assignor or the assignee. This point is of great significance in the Romanistic legal systems, and the French law could be considered as a representative of such a system on this point. The communication has to be through an official process server or, alternatively, when the assignment is accepted by the debtor by a notarial document.<sup>218</sup>

Such formalities under Article 1690 of the French Civil Code could be considered as justified on two grounds. Firstly, the notice to the debtor could be considered as the closest equivalent for taking possession of intangibles to taking possession of tangible goods which passes on physical delivery.<sup>219</sup> Through the debtor notification, the "debt is removed from the apparent possession of the original creditor and taken into the possession of the assignee." Moreover, if there are two successive assignees, priority will be given to the one, who gives notification to the debtor and "first took possession of the debt". Secondly, a prospective assignee can inquire of the debtor as to whether the debtor has been notified of a prior

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<sup>217</sup> *Ibid.*

<sup>218</sup> *Ibid.* The French Code has been used as a model by most civil codes and this rule has been used in some form or the other. Sometimes, the assignment is considered to be valid against third parties only when the debtor's acknowledgement is evidenced by laying down a "secure date" of the assignment in a public document. See Spanish Civil Code art. 1526; Brazilian Civil Code art. 1067; Chilean Civil Code art 1091 ss; Argentinian Civil Code art. 1454, 1459 ss.

<sup>219</sup> *Walsh, supra* note 199 at 168.

assignment. If no prior assignment exists, the assignee will be protected. This enables the prospective assignee to assess his priority risk.<sup>220</sup>

### **England**

In English common law (England and Wales), a written notice is considered necessary for a statutory assignment under the Law of the Property Act, 1925. However, this requirement is limited because a statutory assignment rendered invalid because of a failure to give written notice can still be upheld as an equitable assignment.<sup>221</sup> Without serving a notice to the debtor, the equitable assignment will be effective against the assignor as well as any other person who stands in the same shoes as the assignor such as a trustee in bankruptcy. A notice even though is not required for the effectiveness of an equitable assignment, is advisable. "It is only through the notification of the debtor that his *bona fides* can be destroyed and a subsequent payment by him to the assignor will be rendered ineffective *vis-a-vis* the assignee."<sup>222</sup> For purposes of ascertaining priority of successive assignees, a notice to the debtor is important as well.<sup>223</sup> This is however not the case when it comes to the Cape Town Convention. Priority of successive assignments under the Cape Town Convention is dealt with in detail towards the latter part of this chapter.

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<sup>220</sup> *Ibid*; Kotz, *supra* note 162 at 86. See, Roy Goode, Commercial Law, 2d ed (London: Penguin Books) at 705 [Goode].

<sup>221</sup> Guest, *supra* note 164 at 1-54; For a detailed analysis about requirement of notice for an equitable assignment, see Tolhurst, *supra* note 162 at 73-83.

<sup>222</sup> Kotz, *supra* note 162 at 87.

<sup>223</sup> *Ibid*. This is the well known rule in *Dearle v. Hall* (1828) 38, E.R. 475, 492 which is discussed later in this chapter with the issue of priority. Briefly, the rule could be explained with the help of an example. Q is owed money by P. He assigns his right to payment as security for a loan to R and then fraudulently assigns the same to S. Now, if S gave value and is the first one to give notice of his interest to P, S gets priority even though his assignment is last in time, and provided that S had no notice of the first assignment. Thus, a creditor assigns a money debt to an assignee as a security for a loan and then fraudulently, assigns the same to another assignee. The second assignee will get priority if he gave value and was the first to give notice of the assignment to the debtor, provided that at the time of his payment, he had no notice of the first assignment. Therefore, under this rule, priority is governed by a rule based on notice [*Dearle v. Hall*].

In Scandinavian countries, in principle, an assignment between the parties and against the debtor does not require any formalities. But, when it comes to assignments against other third parties, they will be valid only when the debtor has been notified. There is no particular form required to be followed when serving the notice on the debtor.<sup>224</sup>

## **Remarks**

Thus, from the above discussion, we can see that the Cape Town Convention when it comes to debtor notification has taken the same approach as national systems and is without any controversy. The Convention and its associated Protocols makes the debtor bound by the assignment only if the necessary notification has been given to the debtor. It is through this debtor notification, that the debtor can assess as to whether an effective assignment has been made or not.

### **3.2.4 Registration of an Assignment of International Interest**

Registration lies at the heart of the Cape Town Convention. The registration of an assignment of international interest is necessary for the assignee to avoid subordination to a subsequent assignee of the same international interest. The registration also enables the assignee to protect its title to the related international interest and the assigned associated rights in insolvency proceedings against the assignor.<sup>225</sup> An assignment of an international interest must be registered in the International Registry<sup>226</sup> under Article 16 (1)(b) of the Cape Town Convention in order to preserve priority against these classes of competing claimants. Either the

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<sup>224</sup> Kotz, *Ibid.*

<sup>225</sup> *Convention, supra* note 1, art 30 (1) & art 37.

<sup>226</sup> See Chapter 2 of this thesis for a detailed explanation of the International Registry.

assignor or the assignee may undertake the registration of an assignment. However, the other party must give his consent in writing and this consent needs to be transmitted electronically to the Registrar of the International Registry.<sup>227</sup> The consent need not be separate and may be embodied in the assignment itself. Obviously, in order to ensure priority, the assignee will want to register its interest. The consent of the debtor to an assignment under Article XV of the Aircraft Protocol need not be communicated electronically to the International Registry. The object to which the assigned rights relate, must be described in the manner required for the registration of an international interest.<sup>228</sup>

The International Registry is searchable by reference to the related object rather than by the name of the assignor (or the debtor in the context of registrations related to the international interest itself as opposed to assignments). Therefore, a specific description of the asset is necessary. It is through this asset based registry that searches to determine whether any other party has any registered interest in an asset is possible. A prospective lender, buyer or lender could just look for the asset at the Registry and will be able to ascertain whether there are any previously registered interests against the asset. The only disadvantage of an asset based registry is that the object needs to be described with specificity. The registration will be rendered invalid resulting in the loss of priority of the secured party if an error is made in the description of the object.<sup>229</sup>

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<sup>227</sup> *Convention*, *supra* note 1, art 18 (1) & 20 (1).

<sup>228</sup> *Ibid* at art 18 (1).

<sup>229</sup> *Sundahl*, *supra* note 60 at 2.5.2.

### 3.2.5 Registration of Prospective Assignment

Under the Cape Town Convention, international interests and assignments can be registered prospectively. If after a prospective international interest or assignment is registered, the prospective creditor or assignee has not given value or has not incurred a commitment to give value, the prospective debtor or assignor is entitled to require the prospective creditor or assignee to register a discharge of the registration by sending a written demand to do so to the address of the creditor or assignee stated in the registration. This could be explained with an example. A is negotiating a loan from B which will be secured on an aircraft engine. B registers a prospective international interest with the written consent of A. Later on, A decides not to go ahead with the transaction. If B did not give value, A has the right to require B to procure discharge of the registration.<sup>230</sup> If B refuses to discharge, A can go to court.

The situation with respect to the discharge of prospective international interests and prospective assignments is different when the value has been given by the creditor or assignee.<sup>231</sup> To explain by way of an example, A is willing to loan 20 million dollars to B. The loan is secured on an identified airframe which B is in the process of acquiring. A lends 2 million immediately to B and obtains B's written consent, A registers an international interest. Before B has completed its acquisition of the identified airframe, it decides not to go ahead with the loan transaction with respect to the balance of the 18 million dollars. B requests A to procure the discharge of the registration. A has the right to refuse having given value to the extent of 2

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<sup>230</sup> *Convention*, *supra* note 1 at art 25(2); *Sundahl*, *supra* note 60 at 2.83. *Convention Commentary*, *supra* note 2 at 4.166.

<sup>231</sup> *Convention Commentary*, *Ibid* at 4.163.



million dollars. The amount of the transaction is not part of the registry record so the fact that the loan secured is less than initially contemplated does not prejudice the debtor or assignor's access to financing. This is why the creditor/assignee can refuse.<sup>232</sup>

### **3.2.6 Assignment of unregistered interest**

In order to have priority, an assignee of associated rights related to an international interest should have it registered, whether or not the assigned international interest has itself been registered. The Official Commentary to the Cape Town Convention cites three reasons as to why registration is important for the assignee. Firstly, the assignee is protected against the holder of a subsequent international interest who has registered that interest and who would otherwise obtain priority over the assignee. Secondly, to protect the assignee against that holder's assignee and thirdly, in times of debtor's insolvency, to protect the assignee against the creditors.<sup>233</sup>

Under the regulations, registrations of assignments related to unregistered interests are allowed. Article 16(1)(b) of the Cape Town Convention, provides for the registration of assignments and prospective assignments of international interests and is silent on the matter whether such international interests needs to be registered or not.<sup>234</sup> Consistently with this, Article 31(1) of the Convention provides that an assignment of associated rights transfers the related international interest. Article 31(1) and Article 32 of the Convention is silent on the

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<sup>232</sup> One could raise the issue of whether a purchaser could realistically procure a loan from another lender for the remaining necessary amount (more substantial than the amount contributed by the first lender), when this second lender's registration will be subordinate to the first. However, this appears to be an unlikely scenario that would thus fall outside the scope of this thesis.

<sup>233</sup> *Convention Commentary*, supra note 2 at 2.197-2.198; Roy Goode, "The treatment of intangible assets under the Cape Town Convention and Protocols" (2013) Volume 2013 Cape Town Convention J 44 [*Roy Goode Treatment of intangible assets*].

<sup>234</sup> *Convention*, supra note 1, art 16(1).

matter as to whether the international interest has to be registered.<sup>235</sup> It is in conformity with this that registration of assignments of unregistered interests are permitted.<sup>236</sup> The duty of the debtor to make payment to the assignee is not dependent on the registration of the related international interest. An assignee is entitled to exercise default remedies under Article 34 even in relation to an unregistered international interest. A debtor who defaults in its performance can always be sued by the creditor of an unregistered international interest. In the same way, the creditor has the right to assign its rights and the assignee falling in the same shoes of the assignor has the right to exercise its remedies even if the assigned interest is not registered.<sup>237</sup>

### 3.2.7 Partial Assignments

Under the Cape Town Convention, the parties are free to agree on a partial assignment of the assignor's associated rights, for example, the right to assign some, but not all future rentals arising under a lease of the related object.<sup>238</sup> Under the contract from which they arise, the assigned rights must be identified,<sup>239</sup> and rights must also be identified in the notice that is given to the debtor before the debtor can be asked to make payment to the assignee.<sup>240</sup> It is up to the parties to decide on their respective rights concerning the related interest. However, a debtor may be affected by a partial assignment as he may be required to make partial payment to multiple partial assignees instead of to just one. Therefore, the consent of the debtor to a partial

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<sup>235</sup> *Convention, Ibid* at arts 31 (1) & 32.

<sup>236</sup> *Convention Commentary, supra* note 2 at 2.197.

<sup>237</sup> *Ibid* at 2.198.

<sup>238</sup> *Convention, supra* note 1, art 31 (2).

<sup>239</sup> *Ibid* art 32 (1) (b).

<sup>240</sup> *Ibid* art 33 (1) (b).

assignment must be obtained, although the failure to obtain the debtor's consent does not affect the validity of the assignment between the assignor and the assignee.<sup>241</sup>

### **3.2.8 Priority among competing international interests**

Priority rules are an important consideration for financiers. If a creditor is not confident that it will have a first priority security interest in the debtor's collateral, in order to protect itself in the event of the default or bankruptcy of its debtor, it will only lend money at a very high rate of interest<sup>242</sup> or will refuse to lend altogether. Moreover, depending on the applicable law, the ranking of the financier's interest may not be the same. An interest may be given first priority in one jurisdiction, but it may not be given the same status in another jurisdiction. Therefore, a financier will always be in doubt as to whether its interest will be given priority in cases where a debtor defaults or becomes bankrupt. The Cape Town Convention resolves this problem by adopting a universally applicable "first to file" priority rule. Priority under the Cape Town Convention is determined by the date of registration in the registry systems established under the relevant Protocol. The question of priority under the Convention can simply be reduced to a question as to who filed first. An international interest will be ranked according to its time of registration. Thus, Article 29 of the Convention provides:

"A registered interest has priority over any other interest subsequently registered and over an unregistered interest."<sup>243</sup>

There are two important parts that could be extracted from the "first to file rule." First, a registered international interest holder will have priority over any unregistered interest holder

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<sup>241</sup> *Convention Commentary*, *supra* note 2 at 2.194 & 4.227.

<sup>242</sup> *Sundahl*, *supra* note 60 at 2.6.1.

<sup>243</sup> *Convention*, *supra* note 1 at art 29 (1).

and second, if there are two holders of international interests, both having registered their interests in the same object and are competing "for the right to pursue remedies with respect to the asset", then the secured party who registers first will have priority. These rules apply regardless of whether the "prevailing party" had knowledge of the other security interest. For instance, even if Secured Party A was granted a security interest before Secured Party B, if B registers its interest first despite knowing the fact that A already had a security interest, it will have priority. The priority rules of the Cape Town Convention are not concerned with the subjective knowledge of the parties, instead they only directly look to the date of the registration of the international interest. The Convention is not concerned with priority competitions that involve only unregistered interests. They are governed by the applicable national law.<sup>244</sup>

### **3.2.8.1 Priorities among competing assignments**

The priority system under the Cape Town Convention for competing assignments is bifurcated. There are two different categories of assignment which attracts different priority rules. Before one can identify the applicable priority rule, it is important to know if the assignment in question falls within the scope of the Cape Town Convention or not. As mentioned earlier,<sup>245</sup> in so far as the Cape Town Convention is primarily concerned with international interests, an assignment of associated rights without the related international interest is outside the scope of the Convention and therefore the priority rules in Article 35 and 36 of the Convention will not be applied. The relationship between the associated rights and the

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<sup>244</sup> For instance, under the Uniform Commercial Code, priority goes to the party that first filed a financing statement with the appropriate Secretary of State's office or was the first to perfect a security interest (§ 9-322 (a)(1)). If neither security is perfected, priority goes to the first security interest to attach, the security interest that arose first (§9-322 (a)(3); *Sundahl, supra* note 60 at 2.6.1; *Convention, supra* note 1 art 29 (1)).

<sup>245</sup> See Chapter 1 of this thesis.

international interest needs to remain intact for the Convention to apply. If the link was never established, for instance, if only the associated rights were assigned or if the link was subsequently severed, the assignment will be outside the scope of the Convention.<sup>246</sup> They will not be protected by the Convention against loss of priority because they are no longer linked to the registered interest.

There are two sets of priority rules under Chapter IX of the Convention. They are:

- 1) Assignments of associated rights related to different international interests; and
- 2) Competing assignments derived from the same international interest.

#### **1) Assignments of associated rights related to different international interests**

This is concerned with the assignment of different sets of associated rights related to different international interests held by different creditors in the same object. It could be explained with the help of an example. Let us assume there are two agreements. Under Agreement 1, Debtor D grants an international interest to A which is registered. Subsequently, Debtor D grants an international interest in the same asset under agreement 2 to B which is also registered. A then assigns associated rights and the related international interest under agreement 1 to P. B then does the same under agreement 2 with Q. The question now arises as to who has priority as between P and Q ? The competition here is not between the successive assignments,

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<sup>246</sup> *Convention, supra* note 1 at art 32(3).

but between the assigned international interests. Under 31(1)(b), an assignee acquires the same priority as its assignor. Therefore, P will have priority over Q, because it acquired the priority of the international interest from A which was the first to be registered. The position would have been the same even if P had not registered the assignment in its favor and Q had registered its assignment and even if Q had registered its assignment before P."The priority of the two assignments of associated rights is governed by the order of registration of their respective international interests, not by the order of registration of the assignments of those interests."<sup>247</sup>

## **2) Competing assignments derived from the same international interest**

This is concerned with successive assignments of the same associated rights related to a single international interest to different assignees. The priority rules for such competing assignments are set out in Articles 35 and 36 of the Convention. They can be explained with the help of an example. Debtor D grants an international interest to A which is registered. Later, A assigns its associated rights and its international interest to P and then to Q. Now, Q registers the assignment in its favour first before the assignment to P has been registered. Thus, in this scenario, the competition is not between assignees of different associated rights related to different international interests. There is no competing international interest. The competition is between assignee of the same associated rights. The priority goes to Q since he was the first to register. This priority has important limitations:

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<sup>247</sup> *Convention Commentary*, *supra* note 2 at 2.200-2.202; *Roy Goode Treatment of intangible assets*, *supra* note 233 at 44; See generally *Practitioner's Guide*, *supra* note 105, page 19.

1) An assignee will not enjoy priority over another assignee if the contract under which the associated rights arise does not mention that the rights are secured by or associated with the object subject to the international interest.<sup>248</sup> As an illustration of this, let us assume a scenario where A issues a loan to a debtor D which is secured on an aircraft object owned by D. Then, A assigns the right to payment of the loan to X and subsequently assigns the same right to Y. Now, the priority between X and Y will not be governed by the Convention if the loan agreement under which the assigned rights arise does not mention that the loan obligation is secured by the aircraft object. The reason for this is that assuming X registered its assignment, it would be unfair to subordinate Y to X because Y would have had no way of knowing that the Convention governed priority in the absence of any statement in the loan agreement regarding the aircraft object and thus, Y would not know that it should search the registry to see if another assignee has already registered an assignment.<sup>249</sup> However, it is irrelevant to the operation of this priority rule if the first assignee found from other sources that the loan obligation relates to the object. If the loan agreement does not refer to the object, Y will not know that the loan was secured on or related to the object and thus would be completely oblivious to the existence of the international interest. In such a case, the priority rules under the Convention will not be applicable, and priority is left to be governed by the applicable law. Such a situation can be avoided only by having a statement in the loan contract saying that the associated rights assigned under that contract are secured by or associated with the object.<sup>250</sup> Thus, disclosure of the international interest in the assignment is of paramount importance.

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<sup>248</sup> *Convention*, *supra* note 1 art 36 (1) (a).

<sup>249</sup> *Convention Commentary*, *supra* note 2 at 4.254-4.255; *Sundahl*, *supra* note 60 at 2.8.4; *Roy Goode Treatment of intangible assets*, *supra* note 233 at 45.

<sup>250</sup> *Convention Commentary*, *Ibid* at 4.255.

2) The Convention priority rules apply only to the extent that the associated rights are related to an object.<sup>251</sup> Article 36 (2) of the Convention lists five categories of object-related rights. They are as follows:

a) A sum advanced and utilized for the purchase of the object;

For the Convention priority rules to apply, the money lent by a lender should be *intended* to be used and should be *actually* used for the purchase of the object. Money given to buy equipment that will be installed later on the object is considered to be *utilized* for the purchase of the object.

b) A sum advanced and utilised for the purchase of another object in which the assignor held another international interest if the assignor transferred that interest to the assignee and the assignment has been registered;

This section covers cross-collateralisation. An object serves as collateral for money given for the purchase of not only that object, but also other objects that are purchased later with additional advances. However, a separate international interest must be created in these later objects and this separate international interest must be assigned to an assignee and the assignment must be registered.

c) The price payable for the object;

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<sup>251</sup> *Convention, supra* note 1 at art 36 (1)(b).



- d) The rentals payable in respect of the object;
- e) Other obligations arising from a transaction referred in any of the preceding subparagraphs.

This category involves all ancillary obligations of the debtor under a transaction involving a security agreement, title reservation agreement or leasing agreement under which the primary obligations arise such as default interest, break-up penalties, enforcement costs, sums payable under indemnities etc. Obligations arising under separate contracts which are not object-related, will not fall under this category. It is immaterial if the debtor under the first agreement undertakes to perform them and the agreement secures their performance so that they are associated rights under that agreement as well as under other contract.<sup>252</sup>

The main purpose of this restriction is to ensure that an assignee does not get a chance to enjoy the Convention priority rights to payment which, though secured on an object, are not related to its acquisition or lease rental or to the purchase of another object. As mentioned before, the Cape Town Convention is concerned only with international interests and does not seek to regulate priorities between general receivables financiers. Priority between assignees of non-object related rights has instead been left to be governed by the applicable law.<sup>253</sup>

As explained previously, assignments of international interests can be registered prospectively. Just as in the case of priority competitions involving international interests, the

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<sup>252</sup> *Convention Commentary*, *supra* note 2 at 4.258.

<sup>253</sup> *Convention*, *supra* note 1 at art 36 (3); *Convention Commentary*, *Ibid* at 4.252.

relevant date for the purposes of applying the first-to-register priority rules will be the date of the prospective registration, not the date when the assignment was actually effected.<sup>254</sup>

### 3.2.8.2 Comparison of Priority Rules Under National Law

The comparison is undertaken to demonstrate the lack of uniformity in national law which makes a uniform solution such as that set out in the Cape Town Convention very attractive.

To solve priority problems, most legal systems as a starting point follow the principle "first in time is first in right" (*prior tempore potior jure*). However, they differ on the relevant event.<sup>255</sup>

#### **Scandinavian Countries**

In Scandinavian countries, a later assignee will get priority if he gives notice about his assignment first and the notice should be clear and unambiguous. Moreover, it does not matter if the later assignee had knowledge of the earlier assignment.<sup>256</sup>

#### **England**

In English common law, priority between successive assignees is governed by the rule laid down in *Dearle v. Hall*.<sup>257</sup> As explained before, under this rule, competing assignees are ranked according to the order of notification. Therefore, if a creditor assigns a money debt to an assignee and subsequently assigns the same debt in bad faith to another assignee, the second

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<sup>254</sup> *Convention, supra* note 1 at art 19(4) & 19(5).

<sup>255</sup> *Kotz, supra* note 162 at 100; *Walsh, supra* note 199 at 167.

<sup>256</sup> *Kotz, Ibid* at 101.

<sup>257</sup> *Dearle v. Hall, supra* note 223.

assignee will have priority provided he gave value and is the first to give notice and had no knowledge of the first assignment.<sup>258</sup> The idea behind this notification theory of priority in *Dearle v. Hall* is similar to the one laid down under article 1690 of the French Civil Code and is justified for the two reasons explained before.

The rule laid down in *Dearle v. Hall* i.e., the first-to-give notice priority is "effectively displaced" when a prior assignment has been registered or is registrable. The second assignee is assumed to have notice of the first assignment. Registration is not "comprehensively" available. A charge on the book debts of a company can be registered under the *Companies Act 1985*, but the Act does not extend to an outright sale of the book debts.<sup>259</sup> A general assignment of book debts by a sole trader or partnership firm can be registered, but this is not possible for specific assignments, for example, debts due from specified debtors or under specified contracts.<sup>260</sup>

### **Other Countries**

In some systems, a notice needs to be registered in a public registry in order to be effective against third parties and successive assignees are ranked on the order of registration.<sup>261</sup> Such registration protects assignees to preserve their priority status and also protects third parties

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<sup>258</sup> *Kotz, supra* note 162 at 102; *Walsh, supra* note 199 at 168; LS Sealy & RJA Hooley, *Commercial Law : Text, Cases, And Materials*, 4th ed (New York: Oxford University Press, 2009) at 1008.

<sup>259</sup> As to what constitutes a book debt, see *Shipley v Marshall* (1863) 14 CBNS 566; *Independent Automatic Sales Ltd v. Knowles & Foster* [1962] 3 All ER 27; *Paul & Frank Ltd v. Discount Bank (Overseas) Ltd* [1967] Ch 348; W.J., *Company Charges*, 2nd ed (England: Butterworths Law, 1996), ch 26.

<sup>260</sup> *Kotz, supra* note 162 at 102; *Walsh, supra* note 199 at 169.

<sup>261</sup> The general rule under the Personal Property Security Acts (PPSA) effective in the Canadian common law jurisdictions and three federal territories for example, Ontario PPSA, sections 20 (1) and 30(1). The same is also the general rule under Article 9 of the Uniform Commercial Code in the United States which influenced the Canadian PPSA see U.C.C. § 9-322 (a) (2000). The New Zealand Personal Property Securities Act 1999 also adopts the same general rule; *Walsh, Ibid* at 169. For a detailed analysis and understanding of the personal property security law, see Ronald C.C. Cumming, Catherine Walsh & Roderick J. Wood, *Personal Property Security Law*, 2nd ed (Toronto: Irwin Law Inc., 2012).

by enabling them to find out about prior assignments. However, there seems to be disagreement between systems that adopt this first-to-register rule on its appropriate scope.<sup>262</sup>

In order to decide a priority contest in Austrian and Swiss law systems, the date on which the first assignee reaches agreement with the assignor must be compared. This rule follows from pure property doctrine that once under the first assignment, the rights of the assignor are vested in the assignee, there is nothing that he can transfer to a second assignee or that the assignor's creditors or insolvency administrator can attach. But, there seems to be differences among systems who follow this technique when it comes to exceptions.<sup>263</sup>

## Remarks

As opined by Professor Sir Roy Goode and other leading practitioners in the field, the Cape Town priority rules that govern the priority of competing international interests where at least one of them is registered are simple, and clear.<sup>264</sup> They are designed to achieve commercial predictability. They are all set out in one article of the Convention i.e. Article 29. The rules that govern competitions between assignments of associated rights related to different international interests under Article 31 are straightforward as well since priority is based on the priority of the international interests to which they relate. The provisions relating to competitions between assignments of associated rights related to the same international interests are apparently more complex (as they are surrounded with detailed conditions and qualifications) but no problems in

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<sup>262</sup> Although the registration based priority rules under the Canadian PPSA and Article 9 of the Uniform Commercial Code have a lot of similarities, the revised Article 9(2000) of the Uniform Commercial Code has a lot more exceptions than its Canadian counterparts. For instance, assignments of deposit accounts (where a concept of *control* substitutes for registration-based priority under §9-312, §9-314, §9-327) and the outright assignment (sale) of "payment intangibles", loan receivables other than credit card receivables (effective automatically without registration under §9-309); *Walsh, Ibid* at 170; Ronald C.C. Cuming & Catherine Walsh, "Revised Article 9 of the Uniform Commercial Code: Implications for the Canadian Personal Property Security Acts" (2001) 16 BFLR 339.

<sup>263</sup> For instance in Austria, an assignment made for security purposes will not be effective unless the agreement is supplemented by an "overt act" such as notification of the debtor or an entry in the assignor's books; *Walsh, ibid* at 168; *Kotz, supra* note 162 at 104.

<sup>264</sup> *Goode Priority Rules, supra* note 174 at 108.

their application in practice have been identified so far. Any unforeseen problems that may arise in the future will obviously be dealt in the future.

### **3.3 Problems regarding the treatment of Assignment of Associated Rights under the Convention**

After a careful analysis of the assignment provisions of the Cape Town Convention and the Protocol above, we now come to discuss potential problematic features.

#### **i) Not focussing on International Interest**

As was emphasized above, the Cape Town Convention is principally concerned with facilitating the acquisition and financing of mobile equipment. It achieves this goal by creating the concept of an international interest, "a new and *sui generis* interest" that is independent of the various kinds of analogous rights created under national laws, and conferring on the holders of international interests a means of protecting their rights by registration in the International Registry.<sup>265</sup>

However, it has been seen that the assignment provisions in Chapter IX of the Convention do not focus on the core Convention concept of the international interest, but rather on "associated rights." Earlier drafts of the Convention provided<sup>266</sup> that an assignment of an international interest in an object would transfer to the assignee the associated rights if all the formal requirements for an assignment were complied with.<sup>267</sup> These drafts conceived of the payment obligations associated with an international interest as an accessory to the international

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<sup>265</sup> *Convention Commentary*, *supra* note 2 at 2.42; *L. Weber & Espinola*, *supra* note 35 at 463.

<sup>266</sup> *Text of the Preliminary Draft of the Cape Town Convention*, *supra* note 15 and accompanying text.

<sup>267</sup> *Goode influence of the Cape Town*, *supra* note 4 at 201.

interest. This approach was supported by several commentators.<sup>268</sup> Objections were raised on the ground that this "flouted" the basic principle of legal theory that a security interest registered as an international interest is an accessory to the obligations secured. It was proposed that the text should provide for the assignment of the associated rights to transfer the related international interest.<sup>269</sup> In the end, the Convention adopted the conventional approach, and the focus of its Chapter IX is on the assignment of associated rights.<sup>270</sup>

The Cape Town Convention is concerned with secured financing of physical assets,<sup>271</sup> and not to promote receivables financing as such for which the relevant instrument is the UN Convention on the Assignment of Receivables in International Trade.<sup>272</sup> As a general rule, it is acknowledged that international law instruments should respect well established concepts of national law to ensure widespread acceptance and comprehension. But, given the nature of the Cape Town Convention and its core objectives, this thesis argues that this application of the conventional security-follows-obligation approach could have been avoided. However, no damage was done. The effect of the text that was finally adopted is that the international interest cannot be assigned without an assignment of at least some of the associated rights, and an assignment of associated rights without an assignment of the international interest is outside the scope of the Convention.<sup>273</sup>

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<sup>268</sup> *Convention Acts and Proceedings*, *supra* note 16 and accompanying text.

<sup>269</sup> *Ibid* at 839, 880. The Delegations of the United Kingdom and The United States of America wanted the associated rights to carry the international interest as that would conform with most legal systems; *Roy Goode Treatment of intangible assets*, *supra* note 233 at 42.

<sup>270</sup> Art. 31 of the Convention provides that "except as otherwise agreed by the parties, an assignment of associated rights made in conformity with Article 32 also transfers to the assignee: a) the related international interest; and b) all the interests and priorities of the assignor under this Convention"; *Convention*, *supra* note 1.

<sup>271</sup> *Convention*, *supra* note 1 (Preamble to the Convention on International Interests in Mobile Equipment).

<sup>272</sup> *Receivables Convention*, *supra* note 22.

<sup>273</sup> *Convention*, *supra* note 1, art 31; *Goode influence of the Cape Town*, *supra* note 4 at 201.

## **ii) Interpretative problems with Article 35 of the Convention**

The Official Commentary to the Cape Town Convention has highlighted two important interpretative issues relating to the drafting of paragraph 1 of Article 35 of the Convention:

1) The phrase "where there are competing assignments of associated rights and at least one of the assignments includes the related international interest and is registered" in Article 35 (1) implies that it is the assignment of associated rights that is registered. On the contrary, such assignments cannot be registered under the Convention. Thus, the Official Commentary suggests that the phrase should be interpreted as saying: "Where there are competing assignments of associated rights and at least one of the assignments includes the related international interest and the assignment of that international interest is registered."

2) Article 35 requires references to a registered interest in the priority rules for competing international interests in Article 29 to be interpreted in the context of assignments:

a) "as if they were references to an assignment of the associated rights and the related registered interest"; and

b) "as if they were references to a registered assignment."

Thus, the Article seems to give two different meanings to the same cross-reference. It is incorrect - as paragraph (1) does - to equate "an assignment of associated rights and the related

international interest" with a registered assignment since the assignment may not have been registered. Therefore, as the Official Commentary suggests, the first meaning should be disregarded and only the second meaning should be applied to ensure the intended result, i.e., that a registered assignment will have priority over a subsequently registered assignment and over an unregistered assignment.<sup>274</sup>

### **iii) The consent of the Debtor is not necessary**

As discussed earlier, the requirement under the Aircraft and the Space Protocols that the debtor consent to an assignment is a clear departure from national and international norms for assignment for which there does not seem to be a sound commercial justification. If the debtor does not give his consent, the assignor will not be able to assign and there will be no assignment. Thus, the transaction of assignment of associated rights will not move forward, and the whole objective of the Cape Town Convention of facilitating the acquisition and financing of mobile equipment will be defeated.

## **3.4 Cape Town Convention's Relationship with the UN Convention on the Assignment of Receivables in International Trade**

The main purpose of the rules of the UN Convention on the Assignment of Receivables is to facilitate cross-border transactions that involve assignment of receivables.<sup>275</sup> As enshrined in its preamble, the UN Convention's primary purpose is to establish principles relating to

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<sup>274</sup> *Convention Commentary*, *supra* note 2 at 2.202(2).

<sup>275</sup> Harry C. Sigman & Edwin E. Smith, "Toward Facilitating Cross-Border Secured Financing and Securitization: An Analysis of the United Nations Convention on the Assignment of Receivables in International Trade", (2001-2002) 57 *Bus Lawyer* 727.



assignment of receivables that would create transparency and promote modernization of the law relating to assignment of receivables.<sup>276</sup> As discussed earlier, the Cape Town Convention is concerned with international interests in tangible assets (aircraft objects, railway rolling stock and space assets) and not with receivables as such. Reflecting this fact, "proceeds" under the Cape Town Convention are narrowly defined as money or non-money proceeds of an object arising from the total or partial loss or physical destruction of the object or its total/partial confiscation. Thus, the term "proceeds" is confined to insurance and other loss-related proceeds. General proceeds such as receivables arising from the sale of an object are not covered. If proceeds were not given a limited meaning under the Cape Town Convention, the assignment of the international interest by the creditor, and with it the right to any proceeds would have produced an "undesired clash" with the UN Convention on Assignment of Receivables.<sup>277</sup>

Article 45 bis of the Convention clearly states that the Cape Town Convention shall prevail over the UN Convention. The Commentary to the Cape Town Convention states that the impact of this Article is limited given the fact that the Cape Town Convention is concerned only with assignments of payment obligations related to international interests, and does not cover assignments detached from the related international interest. Accordingly, the Cape Town Convention defers to the UN Convention under Article 36 (3) i.e., priority between two assignees of non-object related associated rights which will be governed not by the Convention,

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<sup>276</sup> Preamble to the United Nations Convention on the Assignment of Receivables in International Trade.

<sup>277</sup> *Convention Commentary*; *supra* note 2 at 2.50.

but by the applicable law including any applicable provisions of the UN Convention on Assignment of Receivables.<sup>278</sup>

### **3.5 Assignments of Debtor's Rights Under the Space Protocol**

#### **3.5.1 Introduction**

Something that is not found in the Aircraft Protocol and the Railway Rolling Stock Protocol, but only in the Space Protocol is the provision for the assignment of so-called debtor's rights by way of a rights assignment. In the Aircraft Protocol, the creditor relies on the value of the aircraft at the time of providing credit. But, when it comes to extending credit for a space asset, enforcing a right of possession to an object in space, particularly satellites, is somewhat not practical because it does not make economic sense to bring an object back from space.<sup>279</sup> In the Space industry, it is a common practice that the creditor examines the revenue stream accruing to the debtor from its claims against third parties. The revenue that generates from the operation and control of a space asset is a major source of profit for the debtor. The debtor can pay off his debt through the revenue that is generated from the use of the space asset, and at the same time the creditor can have this revenue as additional collateral to carry out his risk analysis on the transaction.<sup>280</sup> To adapt to this practice, the Space Protocol defines debtor's rights as "rights to payment or other performance due or to become due to a debtor by any person with respect to a

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<sup>278</sup> *Ibid* at 4.306.

<sup>279</sup> *Draft Convention of the International Institute for the Unification of Private law on international interests in mobile equipment and preliminary draft protocol thereto on matters specific to space property (Report of the Secretariats of the United Nations Office for Outer Space Affairs and UNIDROIT, UN Doc. A/AC105/C.2/L.225 (2001) at 22; Daniel A Porras, "The Preliminary Draft Protocol to the Cape Town Convention on Matters Specific to Space Assets" (2009) 5:2 Convergence at 206.*

<sup>280</sup> Dr. Zhao Yun, " Revisiting Selected Issues in the Draft Protocol To the Cape Town Convention On Matters Specific to Space Assets" (2011) 76 Air L & Com 805.

space asset"<sup>281</sup> and allows for the recording of the assignment of debtor's rights, which is termed as rights assignment.<sup>282</sup> A rights assignment is defined by Article 1 (2)(h) of the Protocol as "a contract by which the debtor confers on the creditor an interest (including an ownership interest) in or over the whole or part of existing or future debtor's rights to secure the performance of, or in reduction or discharge of, any existing or future obligation of the debtor to the creditor which under the agreement creating or providing for the international interest is secured by or associated with the space asset to which the agreement relates." In other words, in order to have a rights assignment come within the scope of the Protocol, the rights of the debtor related to a particular space asset must be assigned in order to secure or discharge an obligation that is already secured on the same space asset.<sup>283</sup>

An important issue that had come up was regarding the priority of the assignee under a rights assignment. It was proposed that a rights assignment could be treated as an international interest and to register it accordingly.<sup>284</sup> However, this proposal was rejected for obvious reasons as it would go against an important element of the Convention i.e., protecting interests in uniquely identifiable physical assets. Also, by permitting rights assignment to be independently registered, the Convention would be extending to general receivables financing and to intangibles which are not uniquely identifiable by reference to a related object.<sup>285</sup> The solution that was carved out was to require a rights assignment in favor of a creditor to identify both the debtor's rights as well as the space assets to which those rights relate, thus linking the rights assignment to an international interest that was concurrently or previously granted to the creditor,

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<sup>281</sup> *Space Protocol*, *supra* note 21, art Art 1 (2) (a).

<sup>282</sup> Souichirou Kozuka & Fuki Taniguchi, "An Economic Assessment of the Space Assets Protocol to the Cape Town Convention" (2011) 16 Unif L Rev 927.

<sup>283</sup> *Sundahl*, *supra* note 60 at 2.9.1.

<sup>284</sup> *Roy Goode Treatment on intangible assets*, *supra* note 233 at 46.

<sup>285</sup> *Ibid.*

and to provide for the rights assignment to be recorded against the registration of the international interest.<sup>286</sup> This link between the rights assignment and the registered international interest is key to the priority of the rights assignment as it enables third parties to discover the recording of the rights assignment by simply searching against the space asset in the International Registry. This would not have been possible if the rights assignment were made registrable in isolation from the international interest.<sup>287</sup>

The above definition of a rights assignment covers only those assignments that are typically effected pursuant to a debtor-creditor relationship i.e., assignments by way of security and outright assignments in reduction or discharge of the debtor's obligations to the creditor. Sale of debtor's rights are not covered. This limitation is necessary to avoid a situation where the obligations secured by the international interest could be discharged, but the creditor continues to hold the assigned rights as security for other obligations, so that the linkage with the space asset giving rise to the assigned rights would be lost.<sup>288</sup>

### **3.5.2 Formalities of a Rights Assignment under the Space Protocol**

The formalities for an assignment of debtor's rights are kept to a minimum. There has to be a written agreement which includes electronic records. The writing must enable the debtor's rights as well as the space assets related to the debtor's rights be identified.<sup>289</sup> An additional requirement is imposed when debtor's rights are assigned to secure an obligation. In case of a

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<sup>286</sup> *Ibid.*

<sup>287</sup> *Ibid.*

<sup>288</sup> *Ibid.*

<sup>289</sup> *Space Protocol, supra* note 21, art IX (a) & (b).

rights assignment by security, the contract documenting the assignment must also provide information that enables the secured obligation to be determined, without needing to state a sum or a maximum sum secured.<sup>290</sup>

### **Obligor's duty to creditor**

Article XIV(1) lays down the conditions under which the obligor (grantor of the rights to the debtor) comes under a duty to give performance to the creditor. These conditions are the same as those of Article 33 of the Cape Town Convention: 1) the obligor needs to be given a written notice of the rights assignment by or with the authority of the debtor and 2) the notice should identify the debtor's rights.

### **3.5.3 Effect of a Rights Assignment under the Space Protocol**

The extent to which a rights assignment is effective to transfer the rights to the assignee is not determined by the Space Protocol, but by the applicable law.<sup>291</sup> The obligor (i.e., debtor's debtor) comes under an obligation to make payment or give other performance to the creditor only if he has been given a written notice of the rights assignment by or with the authority of the debtor. The written notice should also identify the debtor's rights.<sup>292</sup> Any defences or set-off rights that are available to the obligor are determined by the applicable law. However, the Protocol will render any written waiver by the obligor of all or any of the defences and rights of

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<sup>290</sup> *Ibid*, art IX (c).

<sup>291</sup> *Ibid*, art X (1).

<sup>292</sup> *Ibid*, art XIV (1).

set-off enforceable (with the exception of defences arising from fraudulent acts).<sup>293</sup> Future debtor rights may also be assigned and they take effect when they come into existence.<sup>294</sup>

### **3.5.4 Recording a Rights Assignment under the Space Protocol**

Just like the way a creditor would like to ensure priority of its international interest by registering it, in the same way, a creditor who is an assignee of the debtor's rights would want to record the assignment, thereby securing the priority of its interest in those rights. The assignee shall record the assignment by adding a record of the assignment to the registration of the related international interest.<sup>295</sup> However, this record can be added at the time of registration or afterwards by amending the registration.<sup>296</sup> The record of the rights assignment need not specifically describe the assigned rights, but could be expressed to cover all of debtor's rights. If it relates to only some of them, they will require to be identifiable.<sup>297</sup>

### **3.5.5 Priority of Rights Assignment under the Space Protocol**

The priority of competing rights assignments will be governed by the order of their recording, and not by the priority of the registered international interests against which they are recorded.<sup>298</sup> For instance, if a satellite operator A takes loans from multiple banks and provides the banks a security interest in the satellite. Additionally, he gives each of them a security interest by way of a rights assignment in the payment streams received from the transponder

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<sup>293</sup> *Ibid*, art X (2) & (3).

<sup>294</sup> *Ibid*, art XI.

<sup>295</sup> *Ibid*, art XII. (1).

<sup>296</sup> *Ibid*.

<sup>297</sup> *Roy Goode Treatment on intangible assets*, *supra* note 233 at 48; *Sundahl*, *supra* note 60 at 2.9.3.

<sup>298</sup> It mirrors the provisions of Art 29 of the Convention. See discussion on priority earlier in the chapter.

leases. Upon default, each bank will want to enforce its security interest against the lease payments. The bank that recorded its right assignment first will be given priority.<sup>299</sup>

In cases of prospective international interest, the rights assignment will be considered as unrecorded till the time the international interest comes into existence. The rights assignment will have priority from the time it was recorded so long as the registration of the prospective international interest was still current immediately before the international interest was constituted.<sup>300</sup>

## Remarks

The Assignment of debtor's rights provisions play a significant role in space financing. Given the fact that assignment of receivables are one of the most complex areas of law where national legal systems differ to the point of where there is not an agreed conflict of law rule to determine the applicable law, atleast when it comes to assignments linked to a space asset, the Space Protocol brings some assurance.<sup>301</sup>

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<sup>299</sup> *Sundahl, supra* note 60 at 2.9.4.

<sup>300</sup> *Space Protocol, supra* note 21, art XIII (2) ; For a discussion on prospective interest and registration of prospective interest see sections 2.3.2.5 and 2.3.3.5 of Chapter 2 of this thesis.

<sup>301</sup> *Roy Goode treatment of intangible assets, supra* note 233 at 47.

## CONCLUSION

The Cape Town Convention on International Interests in Mobile Equipment is designed to provide greatly enhanced security for lessors, conditional sellers, and financiers of types of mobile equipment covered by the Protocols to the Convention, namely, to date, aircraft objects, railway rolling stock, and space assets such as satellites. This thesis has shown that even though the Convention has significantly improved the legal framework, room for improvement remains. Chapter three of the thesis highlighted three problematic features of the assignment provisions of the Cape Town Convention and the Aircraft Protocol that deserves further attention: the failure to focus on the core Convention concept of international interest, interpretative problems with Article 35 of the Convention, and the requirement of the debtor's consent to an assignment under the Aircraft and Space Assets Protocols.

With respect to the first issue, given the fact that the Convention is principally concerned with the protection of international interests in mobile equipment, it was argued that the conventional security-follows-obligation approach taken in Chapter IX of the Convention is not optimal. However, as also demonstrated, no damage was done as the effect of the current text is that the international interest cannot be assigned without an assignment of at least some of the associated rights, while an assignment of associated rights without an assignment of the international interest is outside the scope of the Convention.

With respect to the other two issues, it was argued in Chapter three that requirement for the debtor to consent to an assignment under the Aircraft and Space Protocols, a requirement not



found in national or international assignment law is unnecessary. Moreover, chapter three also highlighted the confusing drafting of paragraph 1 of Article 35 of the Convention.

Accordingly, this thesis recommends that:

a) In the absence of any adequate justification, the requirement for the debtor's consent to an assignment in the Aircraft and Space Protocols should be deleted; and

b) Paragraph 1 of Article 35 should be amended to correct the interpretative problems that were identified.

However, it must be acknowledged that it would require an enormous expenditure of diplomatic resources to amend the Convention or its existing Protocols. Accordingly, a more modest suggestion would be to at least correct these two problems in any future Protocols.

The proposed amendment to correct the interpretative problems in the current language of paragraph 1 of Article 35 belongs to the category of general Convention provisions that do not involve equipment specific considerations. Therefore, the most feasible way of effectuating this amendment for the purpose of future protocols applicable would be to include it in the future protocols themselves.<sup>302</sup> Since the Convention and each of its Protocols are to be read and interpreted as a single instrument, and in the case of any inconsistency between the two, the

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<sup>302</sup> *Convention, supra* note 1 art 51 (This article allows for the extension of the Convention to additional categories of equipment).

Protocol is to prevail,<sup>303</sup> the Convention can always be indirectly amended in this way at least for the purpose of the future Protocols.

With respect to the requirement for the debtor's consent to an assignment, as mentioned earlier, this requirement is only found in the Aircraft and Space Protocols. The Luxembourg Protocol does not contain any such requirement. Therefore, it is proposed that any future Protocol (such as the mobile agricultural, construction and mining equipment Protocol currently under consideration by UNIDROIT)<sup>304</sup> should not include this requirement. Discussions amongst practitioners could also explore other alternative ways as to how these issues could be addressed.

Despite several problematic features, the Cape Town Convention should be considered a success both generally and in relation to its treatment of assignments.

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<sup>303</sup> *Convention Commentary*, *supra* note 2 at 2.12; *Convention*, *supra* note 1, art 49 (1)(b).

<sup>304</sup> *Convention Commentary*, *supra* note 2 at 2.15; Resolution No.5 of the Luxembourg Diplomatic Conference; As mentioned earlier, this item is on the agenda for the upcoming Cape Town Convention Academic Conference, 8-9 September 2015 at the University of Oxford.

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## **2.6 Theses and Dissertations**

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## **2.7 Websites**

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