

The Cape Town Registry Workshop

HELD AT UNIDROIT, ROME – 21 FEBRUARY 2005

INTRODUCTION

An event, entitled the “The Cape Town Registry Workshop”, was held at the headquarters of UNIDROIT in Rome on 21 February 2005. Its purpose was twofold. First, it gave those participants working on registration under the Cape Town Convention¹ (“the Convention”) and its Protocol on matters specific to Aircraft (“the Aircraft Protocol”) a chance to share their experiences with participants working on other Cape Town Registries². Second, a presentation, given by Mr Ad TOET (from the Community of European Railway and Infrastructure Companies) on investment issues facing the rail sector in Central and Eastern Europe, demonstrated the practical importance of a further Protocol to the Convention – on matters specific to railway rolling stock (“the Rail Protocol”).

Mr Jeffrey WOOL, Secretary to and General Counsel of the Aviation Working Group (“the AWG”) (a group of aviation experts) and Mr Henrik KJELLIN of the office of the Permanent Representation of Sweden to the European Union co-chaired the event.

THE CAPE TOWN CONVENTION, PROTOCOLS AND REGISTRIES

Many readers will be familiar with the Convention. It establishes an international legal regime for the creation, enforcement and priority of security interests in three categories of mobile equipment – aircraft equipment,³ railway rolling stock and space assets. The Convention applies to each category through a separate Protocol. Fundamental to the effectiveness of the regime is an international registration system. The Convention provides for the establishment and operation of International Registries for the registration of “international interests”⁴ in the category of equipment to which each Protocol applies. Each Protocol may make different provisions for registration in relation to each category of equipment.⁵ Each International

¹ The *Convention on International Interests in Mobile Equipment* opened for signature at diplomatic Conference held in Cape Town from 29 October to 16 November 2001.

² “Cape Town Registries” is used to describe the International Registries established for the purposes of the Convention or any Protocol associated with it.

³ The category of equipment referred to in this article as “aircraft equipment” is described in Article 2(3)(a) of the Convention as comprising “... airframes, aircraft engines and helicopters”.

⁴ “International interest” is defined in Article 2 of the Convention.

⁵ Article 16(2) of the Convention provides that “[D]ifferent international registries may be established for different categories of object and associated rights.”

Registry will be administered by a Registrar under the superintendence of a Supervisory Authority. Registration provisions made by the Convention and relevant Protocols will be supplemented by regulations made or approved by the Supervisory Authority. If an international interest has been validly created, registration will determine priorities on a first-to-register basis.

In November 2001, when the Convention was opened for signature, only the Aircraft Protocol had been drafted. Work on the two remaining Protocols continues. UNIDROIT and the International Intergovernmental Organisation for International Carriage by Rail ("OTIF") are working towards the adoption of the Rail Protocol in the not too distant future.

PRINCIPLES UNDERLYING THE CAPE TOWN REGISTRIES

The first subject to be discussed was the basic principles underlying the Cape Town Registries. Thinking had evolved since work began in 1996. Principles now accepted as basic – such as their electronic nature – had once been highly contentious. The influence of the rapidly developing law of electronic commerce on the registration system continued to be significant. Not only did the developing law affect *it*, the law of the International Registry – the first wholly electronic means of determining rights in private property created by a commercial transaction – might *itself* be an influence.

A key legal question had been what a Registry was for. It soon became clear that its purpose was to establish priority between competing interests. Accordingly, the basic function of the "Supervisory Authority"⁶ was to ensure that the Registry's function of determining priority was implemented efficiently and economically. The system must be notice-based, simple and clear. Although registration must be sufficient to put parties on notice of registered interests, accuracy (*i.e.* the factual truth of what was on the Registry) had to be balanced against the need for economy. In the case of the Aircraft Protocol, that balancing act had come down in favour of an economical, as opposed to an over-protective, solution. The Convention's unique requirement for two party consent to registration will achieve sufficient protection where a Registry is to be used by sophisticated parties.

STRUCTURE OF LEGAL RULES

Before discussing the structure of legal rules under the Aircraft Protocol – *i.e.* the hierarchy of Convention, Protocol and regulations – and the role and scope of the regulations, participants considered the obligations the Convention places on the Supervisory Authority. One provision,⁷ which requires it to "... do all things necessary to ensure that an efficient notice-based electronic registration system exists to implement the objectives of this Convention and the Protocol; ..." appeared to envisage the role that regulations under that Article would have, though it did not *explicitly* refer to them. One regulation, currently in draft, showed how regulations could be used to fill gaps. This provided that no "registry user entity" or "administrator" of that entity was to have access to the International Registry unless that "entity" and "administrator" were first "approved" as such by the Registrar in compliance with the regulations and International Registry "procedures". Though there was no specific provision in the Convention relating to "user access" or the need to be an "approved user", this regulation appeared to fulfil the Convention's expectations.

⁶ The functions of "the Supervisory Authority" (and of the Registrar who operates the Registry under the superintendence of the Supervisory Authority) are described in Article 17 of the Convention.

⁷ Article 17(2)(i).

At a lower level than regulations were "procedures". Draft regulations under the Aircraft Protocol currently provide that the Registrar shall propose that International Registry "procedures" be established to address matters relating to the technical operation and administrative processes of the Registry. These deal, for example, with matters such as computer software.

THE REGISTRATION PROCESS

A detailed description was given of the provision made under the regulations for registration itself. Either debtor or creditor could, as they agreed between themselves, initiate a registration. Both parties named in a registration would be "approved users" of the Registry system. Each "registered user entity" would have an "administrator" who could approve a number of "authorised registry users" – persons who have the authority and status to create registrations. Approval will be a wholly electronic process. "Users" will have electronic signatures.

What is not yet clear is how far an administrator can authorise more than one person to make a registration without producing confusion as to whether consent has been given. This issue is more acute in the context of consent to registration than the initiation of registration. It has been resolved by permitting broad authorisation to initiate but limiting authorisation for consent to only one party.

NUMBERS OF REGISTRATIONS

Asked what assumptions there were concerning the likely number of registrations and searches in the Registries per annum, a Workshop participant representing the International Society of Aviation Telecommunications ("SITA") replied that, for aircraft, approximately 50,000 Registry transactions were expected per annum – a very low number in terms of a data base for registrations. The registration fees were in the process of being finalised but were likely to be in the order of \$150 per annum for registering (and being issued with a certificate) as an administrator and \$100 or less for registering interests arising from a transaction.

TRANSITIONAL PROVISIONS

Considering whether interests in being at the time a Registry came into existence should be the subject of registration (and its associated cost), a member of the AWG replied that, though failure to register an *existing* security interest ought not to result in loss of priority, registration should be encouraged. It would not be too onerous provided fees were not high. Registration enabled notice of interests to be given. The greater the extent of registration the more likely it would be that the Register would fulfil the function of a single reference point for those wishing to have information about security interests in aircraft.

LIABILITY AND INSURANCE

Turning to the need for insurance cover for the activities of the Registrar, the Workshop agreed that evidence from current activities in registries world-wide implied that the incidence of data failure leading to financial loss was rare. There was even less evidence of successful legal action having been taken to recover such loss. The need for insurance had nevertheless been regarded as a significant issue whenever the Cape Town Registries were under discussion.

There was less agreement as to whether the risk of financial loss and the consequent need for the Registrar to have insurance cover would or would not be increased by registering, at

more or less the same time, a large number of interests in one asset, or a group of assets arising from one transaction.

As to the nature of the loss insured the Workshop agreed it was direct, rather than consequential or indirect loss, for which insurance was required under the Convention.

THE RAIL AND SPACE PROTOCOLS

The Chairman invited comments on particular aspects of the Aircraft Protocol and their relevance to provision that might be made in the Rail Protocol and in the preliminary draft Protocol on matters relating to space assets ("the Space Protocol") on similar matters.

Mr Gerfried MUTZ, Chairman of the Working Group on the Rail Protocol, observed that there was a limit to how far lessons learned from the Aircraft Protocol could be applied wholesale to the International Registry to be established under the Rail Protocol. There was, for example, a difference between the Aircraft and the Rail Protocol as to the identity of Supervisory Authority. This, in part, resulted from the difference between the Intergovernmental Civil Aviation Organisation ("ICAO") – an organisation with world wide membership and OTIF – with a much smaller membership. The structure of Registry and Supervisory Authority was common to both Protocols but no decision had yet been taken in the Rail Protocol as to the identity of the Registrar or the Supervisory Authority – or as to what their liability or immunity should be. Those and many other matters remain unresolved. Draft regulations have been produced though they do not provide for an administrator or authorised users.

A further difference was the relative lack of information relevant to the financial implications of the Rail Registry– for instance, as to likely numbers of registration. Another, likely to affect registration, was the comparative difficulty of establishing universal identification criteria. A relatively simple matter for the Aircraft Registry, establishing "unique identity" for objects in respect of which registrations would be made was much less so for rail and space. In the case of "aircraft objects" there were internationally recognised manufacturers' serial numbers and model descriptions.

A fundamental question was the level of detail necessary. In the case of the Space Protocol it was more difficult if provision was to be made for registration against a large number of component parts. A possible solution might be for registration to be made simply against transponders and satellites or against satellites only, deemed as incorporating every component part *except* such specified component parts that the parties agreed should be treated separately.

Perhaps the fundamental question to be satisfied in relation to unique identifiability under each Protocol was whether the financing of any single part of an object was so significant as to require it to be uniquely identifiable.

Additionally, in relation to space, there was not only the question of what assets should be on the Register but whether there was a need to register valuable related rights.

RELATIONSHIP BETWEEN PROTOCOLS AND REGULATIONS

Workshop members working on the Aircraft and Rail Protocols next discussed whether Protocols should in principle be more detailed, thus leaving fewer gaps to be filled by regulations. That could be beneficial. Where detail might be termed "political" rather than "technical", it was surely appropriate for it to be included in a Protocol, adopted at a diplomatic Conference. Regulations could then provide for "technical" detail.

Another guiding principle might, however, be to avoid putting *anything* in a Protocol that might have later to be amended, since changes required holding a further diplomatic Conference.

Perhaps a Protocol was the correct place for primary duties and responsibilities, whilst the “nuts and bolts” of the registration system was for regulations.

INVESTMENT ISSUES – THE RAIL SECTOR IN CENTRAL AND EASTERN EUROPE

Mr Ad Toet from the Community of European Railway and Infrastructure Companies (“the CER”) gave a presentation outlining investment issues facing the rail sector in Central and Eastern Europe (also described in a position paper before the Workshop entitled “Rolling Stock Financing in Central and Eastern European Countries”⁸). Mr Toet highlighted the extent and urgent nature of this challenge as well as how the establishment of the Rail Registry (provided it had a reasonable fee structure) might assist with its possible solution.

The position paper analyses, and offers a detailed explanation of, the current plans of Central and Eastern European States which have either acceded, or hope to accede, to the EU (“CEECs”) for investment in rolling stock before 2012. It was produced as a response to the EU Commission’s request for information about the extent and urgency of the need for investment in rolling stock in CEECs so as to inform the Commission’s transport policy.

CEECs will not only have to implement existing EU legislation affecting the rail transport sector, they will also have to prepare themselves for new EU legislation which is to liberalise it. Though these companies face other challenges, including the need for investment in infrastructure, they regard their most significant challenge as the financing of rolling stock.

Rolling stock of those CER members in CEECs whose investment plans are described in the position paper⁹ has suffered from a significant backlog in investment. It was, on average, 28 years old. Breaking this average down, the statistics were even more alarming. Out of a total of about 12,000 locomotives, only 290 were under 10 years old. If this backlog in investment is not addressed the whole system will come to a grinding halt.

CER companies in CEECs are planning to invest in large numbers of new locomotives, electric or diesel multiple units and passenger coaches as well as in the modernisation of existing rolling stock in these categories. A capital investment of approximately 10 billion euros is required before 2012 (excluding investment in freight wagons for which private finance may more easily be obtained) simply in order to keep the present level of operations in being.

Council Directive 91/440/EEC (“91/440”) on the development of the Community’s railways provides that railway companies within the EU are *entitled* to a sound financial basis so as to enable them to fund necessary investments. Though the new member States in which they are located are therefore *obliged* to create conditions which allow the companies to operate in a viable manner, regrettably, it is a fact that these companies do not presently have such a basis – and that it will not be easy to achieve.

The means of raising investment open to these companies is subject to relevant EU legislation, such as that on competition and state aids. Existing cross-subsidies between freight and passenger operations may therefore present a problem. In the new member States freight

⁸ This position paper is to be found on the CER website at: < [http://www.cer.be/files/Rolling Stock CEEC-134650A.pdf](http://www.cer.be/files/Rolling%20Stock%20CEEC-134650A.pdf)> .

⁹ These are: Estonia, Latvia, Lithuania, Czech Republic, Hungary, Poland, Slovakia, Slovenia, Bulgaria, Romania and Croatia.

operations were often obliged to subsidise passenger operations. EU legislation prevents cross-subsidy *by passenger to* freight operations but does not address cross-subsidy of passenger operations *by freight* (since, before the most recent accessions, this did not happen). Governments in the CEECs are taking action to reduce the burden on freight operations – which will not apply to new entrants to the freight sector in those States when the liberalisation of markets takes place shortly.

The rail sector, which has so far relied entirely on State funds for investment, now needs, in the liberalised EU sector, to be able to attract funding autonomously. In order to replace the sector's dependency on State funding for investment, new financing instruments must be conceived. The imminent liberalisation of the rail freight sector implies that, if companies are obliged by their national Governments to continue cross subsidies, they will not be able to compete with new freight operators entering the market.

In response to the question as to whether all CER companies were State owned, Mr Toet explained that, with one exception – the Estonian railway company which was fully privatised – they were, though the Slovak companies and others had privatisation plans for the future. Attitudes to investment are changing in the “traditional” EU States. Liberalisation is gaining speed but it was still easier for those States, than the CEECs, to attract private investment. That situation could be improved by the financial benefits likely to result from the establishment of a Registry for railway rolling stock. It could enable asset based financing (even though currently possible with no Registry in place) at lower cost. It could also facilitate the administrative procedure connected with using assets for financing. Interested parties would in principle be prepared to participate in a Registry for those reasons.

INSTITUTIONAL SUPPORT

Finally, the Workshop turned to consider the question of institutional support for the Cape Town Registries. A participant from the banking sector considered some Banks might be willing to reduce their exposure fee by more than one-third when lending to airlines located in States which had ratified the Convention and Protocol. On this positive note the Chairman brought the Workshop to a close, thanking the UNIDROIT Secretariat for organising a most informative and useful event.

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