



UNIDROIT international summer school update Cape Town Convention – aircraft protocol

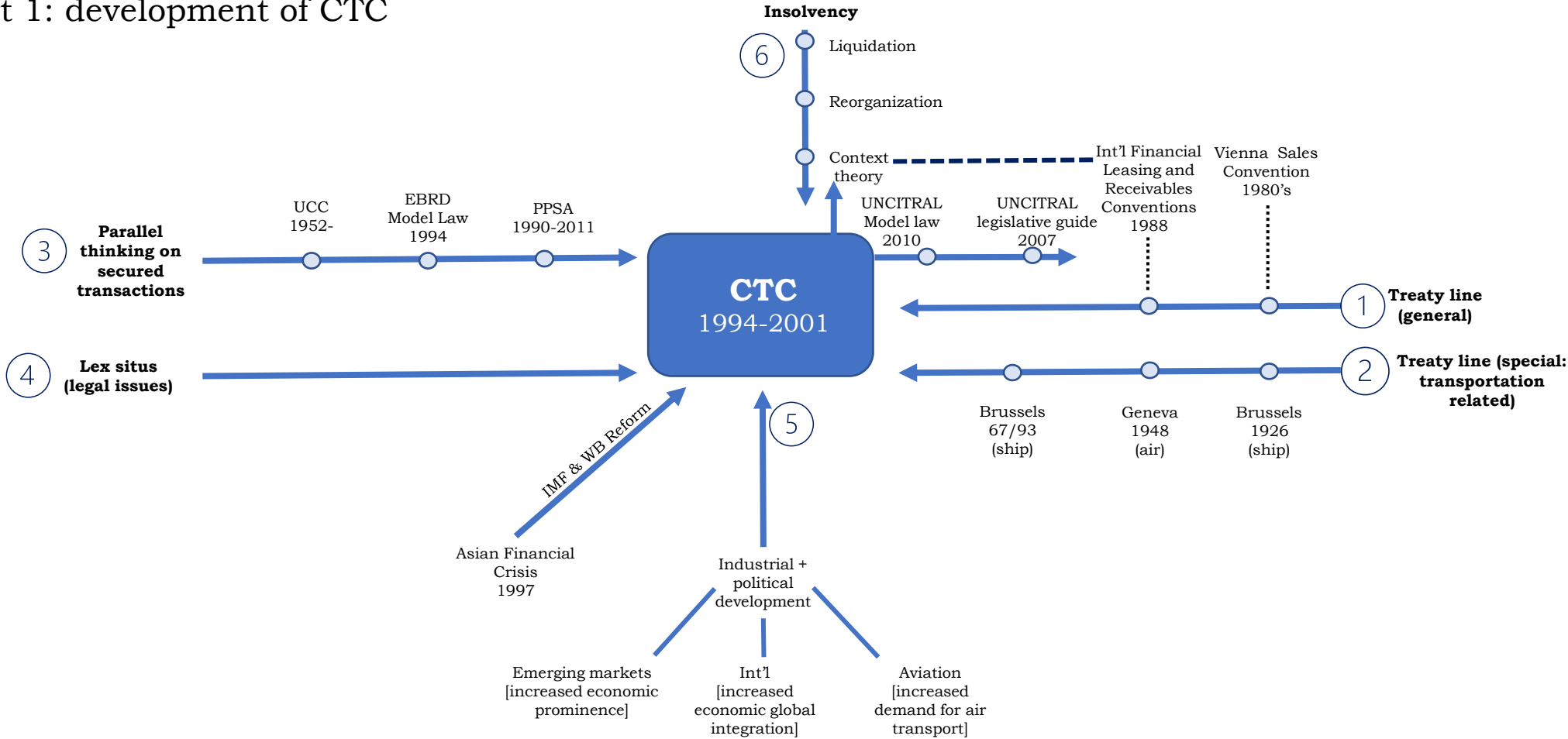
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Setting the scene

Cape Town Convention (‘CTC’) designed to facilitate asset-based financing and leasing of aviation equipment by increasing legal certainty and predictability

chart 1: development of CTC



Basic principles and content

- 1. The ‘Convention on International Interests in Mobile Equipment’ and the ‘Protocol on Matters specific to Aircraft Equipment,’ together referred to as the **Cape Town Treaty (CTC)**
- 2. CTC is a treaty designed to facilitate asset-based financing and leasing of aviation equipment, expand financing opportunities, and reduce costs – thereby providing substantial economic benefits
- Such economic benefits are dependent on a) which declarations are made, and b) compliance by the state
- 3. CTC does so by reducing a transactional risk and by enhancing legal predictability by establishing clear rules on the creation, priority (through the international registry), and enforcement of leasing and security rights in the case of default by the debtor
- 4. CTC is based on a high degree of party autonomy, giving the debtor and creditor the ability to agree on what constitutes a default and the applicable treaty remedies

Basic principles and content

- 5. CTC provides basic remedies including repossession, immobilization, deregistration, and, in the case of secured transactions, sale of aircraft equipment

- 6. Where ‘non-judicial’ remedies apply, see next slide, the exercise of remedies, including repossession and grounding, do not need a court order

- 7. Where a ‘speedy advanced relief order’ is obtained, see next slide, that order is to be recognized in all contracting states
 - The standard for obtaining such judicial relief is ‘adducing evidence of default’, rather than establishing a default after a full judicial proceeding, which would occur subsequently

- 8. CTC provides important rules which apply in the case of the debtors’ insolvency particularly where the debtor’s contracting state has opted into protocol, art. 11 (alternative A) -- which is fundamental to the economic benefits of CTC

application and structure of convention and protocol; approach to uniformity and purposeful use of declarations; international registry



fundamentally different approach to uniformity from all prior instruments, and which has been followed, since:



uniformity of concepts (international interest (property right)), constructs (basic enforcement rules, transfers, and much else) and institutional features (registry, dispute resolution), but non-uniformity on severable, policy issues (most economically important and thought, then, to be most politically sensitive, tied to legal traditions) through a purposeful system of declarations:

out of court enforcement ('without leave of the court')

remedies on insolvency (limiting enforcement stay)

expedited judicial relief (as creditor requests & w/ timetables)

powerful rights to de-register aircraft (unique int'l aviation law point)

choice of law on contractual items (now generally accepted)

non-consensual rights and interests (arising by law, not contract)

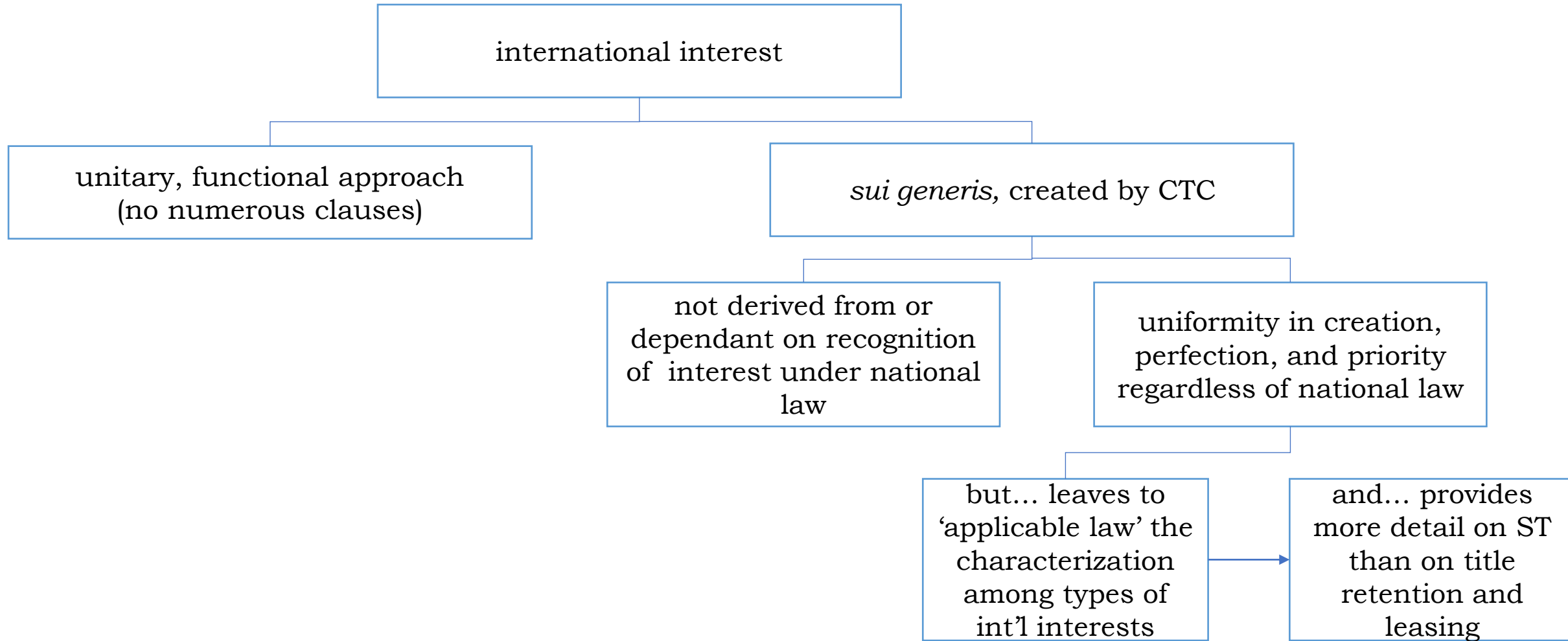
application and structure of convention and protocol; approach to uniformity and purposeful use of declarations; international registry



central role of international registry:

- fully electronic, many years ahead of its time
- notice based. Registration is not a condition to creation of the international interests.
- not protectionist

approach to uniformity and use of declarations



creation, attachment, and perfection of international interest under CTC



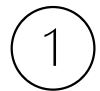
creation

- simple elements, four:
 - writing; power to dispose
 - enables identification w/ basic aircraft information
 - permits the secured obligations to be ‘determined’ without the need for a stated amount
- no adding of conditions (like notarization)



perfection

- simple, non-vetted e-registry in the international registry
- puts searchers of the registry on constructive notice that someone *may* have a prioritized property interest, which that searcher *should* investigate



priority

- simple first to file rule (protecting searching parties -- and a registering party can self-protect by searching its own registration), with a limited exception for declared non-consensual rights and interests

CTC international obligations

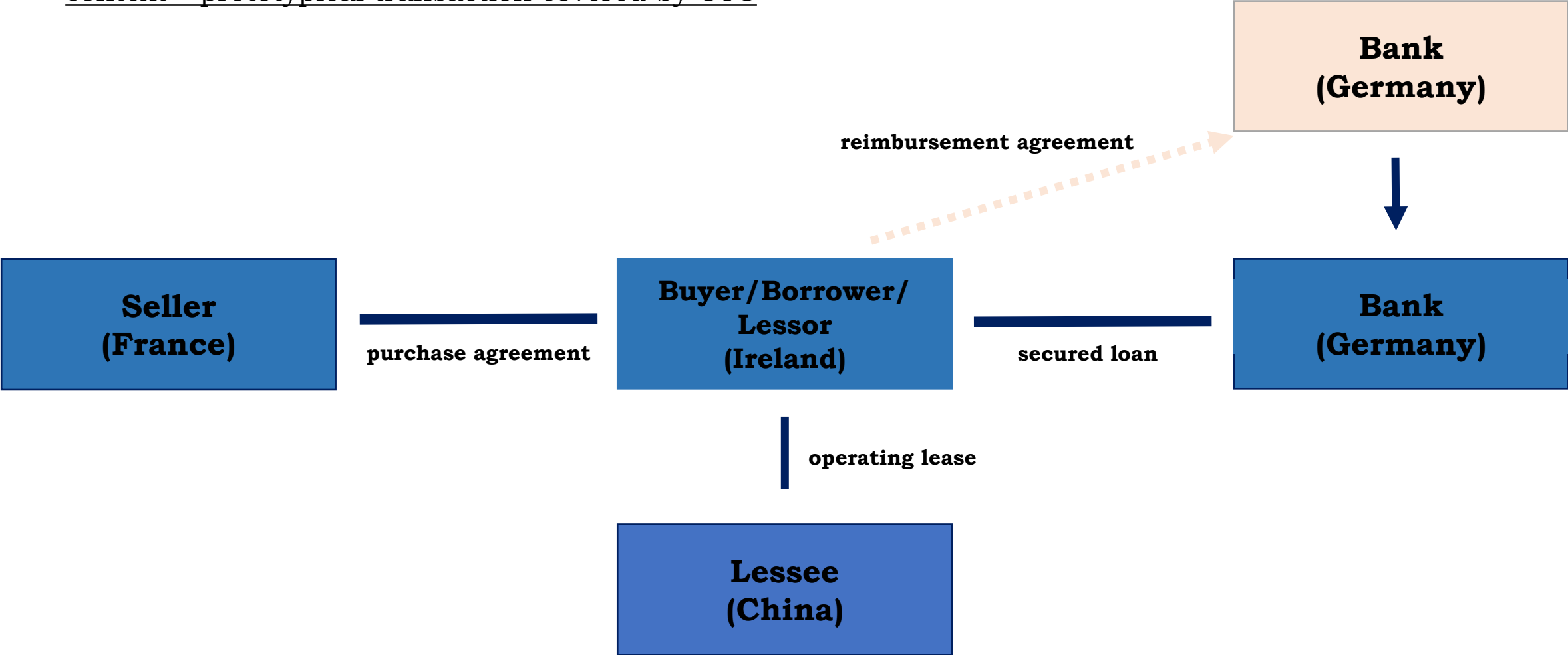
- 1. All contracting states must recognize the *sui generis* 'international interest' created by CTC, which is not dependent on or derived from national law. That is a leasing, conditional sale, or secured interest within the CTC definitions
- 2. All contracting states must enforce CTC remedies, and, depending upon the declarations made by a state, such remedies may be exercised without judicial intervention (see convention art. 54(2)) or pursuant to advanced speedy judicial relief (see convention, art. 13 and protocol, art. X)
- 3. CTC remedies are available in all contracting states, not only the state of the debtor – airline
- 4. Where 'non-judicial' remedies apply, the contracting state is to provide procedures for exercising remedies, including repossession and grounding, without the need for a court order

CTC international obligations

- 5. Where a declaration was made under protocol art. XIII, contracting states have an obligation to cooperate with a creditor in connection with export remedies
- 6. Where a contracting state is a Chicago Convention state of registry, there are a range of additional requirements in connection with the deregistration of aircraft, particularly where such contracting state has opted into protocol, art. XIII (IDERA)
- 7. Contracting states may not add additional conditions to the exercise of remedies, and civil aviation authorities are not to act in a quasi-judicial capacity. Their action is based on documentation and standards as set out in CTC

enforcement and insolvency under CTC and aircraft protocol

context – prototypical transaction covered by CTC



Assumption 1: Above transaction closes on 1 January 2017

Assumption 2: Lessee defaults under the operating lease, and becomes subject to insolvency proceedings on 1 January 2020

aircraft protocol

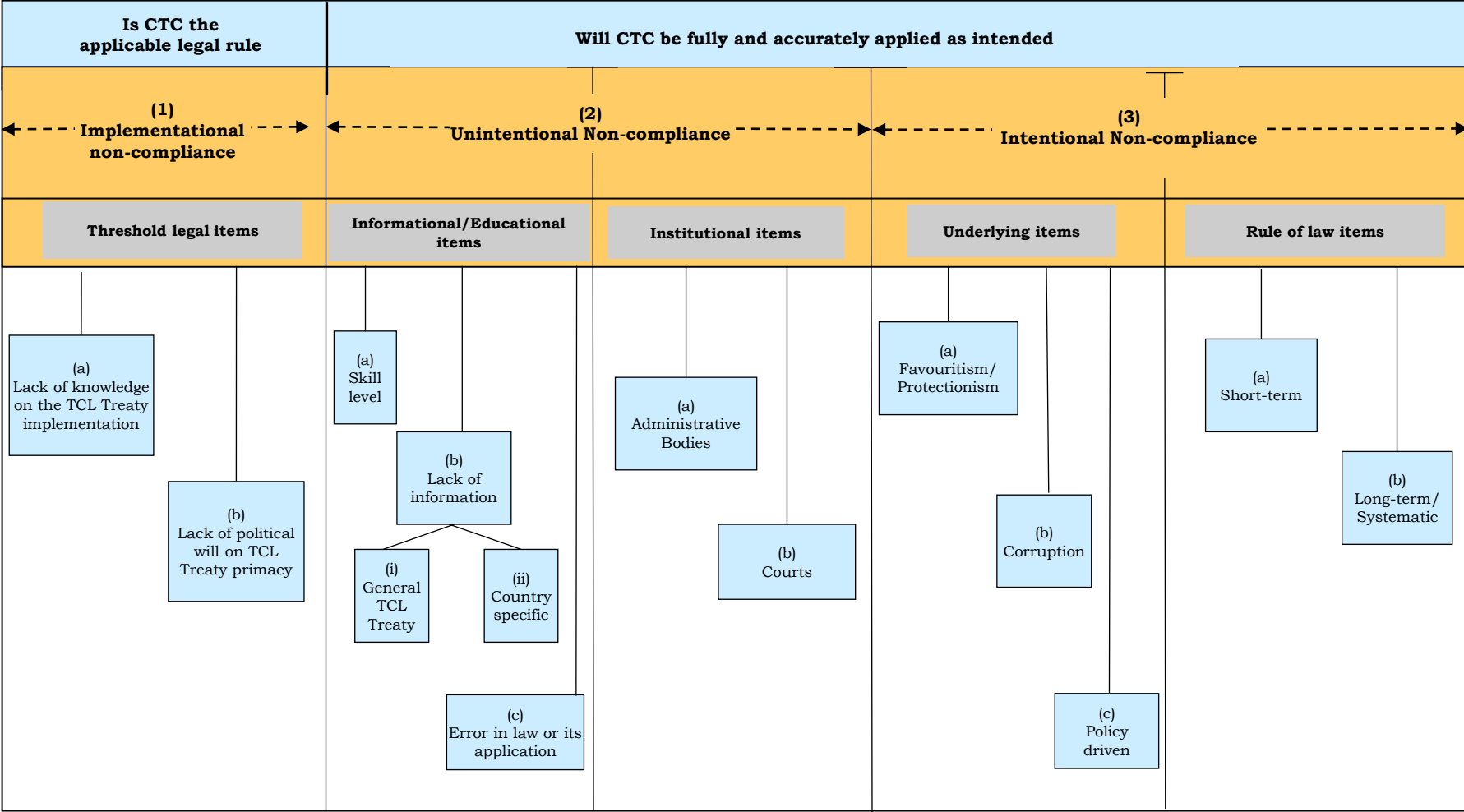
- There are various equipment specific protocols to CTC, the only one in force is the aircraft protocol ('the protocol')
- The convention and the protocol must be used together as a single instrument (article 49 (1(b)))
- Provides clear time-bound remedies to creditor on default or insolvency, thus facilitating aviation credit and reducing its cost. See slides 12 and 13
- Extends CTC to cover sale transactions, both as regards creation of the property interest (*sui generis*, see article V(1) and the effect of the transaction (see article V(2)). That extension permits comprehensive priority rules
- Internationalizes use of agency and other representation in CTC transactions (article VI)
- In addition to deregistration, adds the remedy of export and physical transfer (article IX(1)), regardless of whether the IDERA declaration was made
- On cross border insolvency, contains a clear choice of law rule applying the insolvency declaration made by the 'primary insolvency jurisdiction' (article XXX(4)) as well as a light, opt-in insolvency coordination (article XII)
- Overrides national law on accession regarding engines placed on airframes (aircraft) (article XIV)
- Renders enforceable waivers of sovereign immunity (article XXII)

- All **economic benefits** are dependent on a country making OECD qualifying declarations from the protocol at the time of ratification:
 1. Insolvency (Alt. A with no more than 60 day waiting period) – Protocol, Art. XI(3)
 2. Method of exercising remedies: remedies without leave of court, see Convention Art. 54(2), and/or judicial timetables, see Convention Art. 13 and Protocol Art. X
(10 – 30 calendar day rule)
 3. De-registration and export request authorization – Protocol, Art. XIII
5 calendar days
 4. Choice of law – Protocol, Art. VIII

economic impact

- harmonization of rules and simplification of creditor remedies (deregistration and repossession) mitigates risks related to disparate local law regimes on security interests
- reduces delays in the exercise of remedies by setting time periods (for countries via an opt-in declaration under the Aircraft Protocol)
- permits predictability in insolvency with opt-in Alternative A declaration which is modeled on, and improves upon, Section 1110 under US bankruptcy law
- results in greater availability of financing to airlines and more competitive pricing
- economic benefits are wholly conditioned on compliance with the treaty, including its full implementation with priority over conflicting law, see slides 15 and 16

Potential sources of non-compliance



ELEMENTS

Cape Town Convention COMPLIANCE INDEX

BY



A • W • G
AVIATION WORKING GROUP

$$\text{Score} = 5(\mathbf{A} + \mathbf{B}) + 2.5(\mathbf{C} + \mathbf{D} + \mathbf{E} + \mathbf{F})$$

WITH A **PRECEDENT-BASED ADJUSTMENT (PBA)**, AT LEVELS I, II OR III, BASED ON THE PREDICTIVE VALUE OF COURT CASES OR REPORTED ADMINISTRATIVE ACTION

Scoring: 100 (highest) to 20 (lowest)
Variable range: 5 (highest) to 1 (lowest)

100 - 88: **very high** probability level that the terms of CTC (with applicable declarations) will be substantially complied with

87 - 75: **high** probability level that the terms of CTC (with applicable declarations) will be substantially complied with

74 - 60: **medium** probability level that the terms of CTC (with applicable declarations) will be substantially complied with

59 and lower: **low** probability level that the terms of CTC (with applicable declarations) will be substantially complied with

Definitions -

A is legal implementation, meaning (i) steps to ensure that CTC, with declarations, prevails over conflicting national law (**primacy**), and (ii) that no regulatory gaps or inaccuracy exists which may adversely impact application (**completeness**)

B is (i) reported precedent, meaning (a) judicial decisions, and (b) administrative actions, and (ii) experience, advised by experts, in each case, applying and enforcing CTC

C is whether a country is and should remain eligible for a 'CTC discount' under the OECD Aircraft Sector Understanding and whether it has been removed from such eligibility due to non-compliance with CTC

D is whether a country has designated a 'communications channel' with AWG to consult on compliance issues, as and when they arise, and the extent to which the results of such consultations are timely and effective

E is the result of a jurisdictional analysis of legal rules and practices, other than those covered by variables A, B, and F, which indicate anticipated compliance with CTC, including those relating to aircraft repossession, enforcement of contractually agreed remedies and dispute resolution provisions, and strict application of commercial laws newly introduced into that jurisdiction

F is a weighing of select rule of law and political risk indices measuring, or materially relevant to, regulatory enforcement of existing law and protection of property rights

Precedent-Based Adjustment

Level I increases the weight of B by 0.6 and decreases the weights of each of E and F by 0.3 (low predictive value)

Level II increases the weight of B by 1 and decreases the weights of each of E and F by 0.5 (medium predictive value)

Level III increases the weight of B by 1.4 and decreases the weights of each of E and F by 0.7 (high predictive value)

Compliance index and transactional risk note: Where qualifying declarations have not been made, application of, and compliance with, CTC may not materially reduce transactional risk.

Methodological note and disclaimer: Please read the CTC Compliance Index Methodology available on the CTC Compliance Index website at <https://ctc-compliance-index.awg.aero>. This index is a high level assessment with speculative and predictive features (including what courts or other authorities may or may not do, acting on correct or incorrect legal analysis or impacted by other factors) which are inherently uncertain, and, thus, should not be relied upon by any party.

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