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Property that Moves: Security over Moveable Personal Property and Cross-border Enforcement

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Contents

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Creditors with security interests in collateral that is highly valuable and mobile that cross jurisdictional boundaries face unique challenges if a debtor becomes insolvent.

The first part of the paper outlines the private international law rules which apply to such security interests in mobile property in cross-border insolvencies and attempts to resolve some of the problems created by these rules. It then analyses how the new International Registry alters the rules for countries that ratify the Convention and Aircraft Protocol. For countries that have not ratified the Convention, security interests over aircrafts continue to be governed by the rules of private international law, although other international initiatives such as the UNCITRAL Model Law on Cross Border Insolvency (Model Law) may be relevant.

The last part of the paper considers the Model Law in relation to security interests over mobile equipment in a cross-border insolvency and discusses recent developments concerning other high value stock, including rolling stock and space assets.

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Property that Moves: Security over Moveable Personal Property and Cross-border Enforcement

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1. Challenges facing security over mobile personal property in cross-border insolvency

1.1 Challenges: An overview

In a world of increasing globalisation, asset-based financing regularly involves debtors and creditors who are based in different jurisdictions. However, creditors with security interests over assets such as planes, trains or helicopters that are both very valuable and highly mobile, face unique challenges in the event of debtor insolvency. For when an asset is ultra-mobile property that frequently moves across state or national borders, a creditor may find it difficult, if not impossible, to enforce its rights if the debtor becomes insolvent when the asset is located in certain jurisdictions. This may be due to differences in property laws between different countries or because of underlying inadequacies in the administration and enforcement of legal actions within some jurisdictions. For example, security agreements over personal property can take many forms and not all jurisdictions recognise equivalent forms of security interests.[1] Uncertainty as to whether a creditor or financier will be able to assert rights and enforce its security ultimately discourages the provision of asset-based financing or at least increases the cost of credit for any finance advanced.

The difficulties in enforcing a security in a cross-border insolvency have long been recognised and there have been a number of largely unsuccessful attempts to harmonise national insolvency laws, at least in respect of proprietary security interests. However, as Rosalind Mason observed the "embedding of insolvency law in the commercial, financial and societal culture of a state together with the complex interaction of the range of law relevant to an insolvency administration tend to militate against harmonisation between states of the resolution of multi-state issues."[2]

Although these challenges exist for security interests over all types of high value, mobile property, initially the focus for reform was security interests over aircraft as the international aviation industry was actively pressing for a solution to be found. In addition, members of the aviation industry worked with the International Institute for the Unification of Private Law International Institute (UNIDROIT), as a form of "public / private partnership"[3] to develop an acceptable solution to both airlines and financiers.[4] This industry pressure, coupled with an acceptance, or at least an acknowledgment, of the significant difficulties in harmonising national laws in respect of mobile-asset financing, culminated in 2001 with the signing of

[1] See for example Douglas Arner, Charles D Booth, Paul Lejot & Berry FC Hsu "Property Rights, Collateral, Creditors Rights and Insolvency in East Asia" (2006-2007) 42 Tex Int L L J 515 for an overview of the types of securities recognised over movable property in 11 East Asian countries and Eva-Maria Kieninger (ed) *Security Rights in Moveable Property in European Private Law* (2004, Cambridge University Press, Cambridge) 9-16 for a discussion of securities rights within different jurisdictions in Europe.

[2] Rosalind Mason "Cross-Border Insolvency Law: Where Private International Law and Insolvency Law Meet" in Paul Omar (ed) *International Insolvency Law: Themes and Perspectives* (2008, Ashgate Publishing, Hampshire) 35.

[3] Martin J Stanford "The New Regimen: Its History and Future after South Africa" 1 (2004) European Review of Private Law 9, 13.

[4] See for example Professor Sir Roy Goode *Official Commentary of the Convention on International Interests in Mobile Equipment and Protocol therefore on Matters Specific to Aircraft Equipment-Revised Edition* (2008, UNIDROIT), Part 1; Martin J Stanford "The New Regimen: Its History and Future after South Africa" 1 (2004) European Review of Private Law 9 at 12-14 and Iwan Davies "The New *Lex Mercatoria*: International Interests in Mobile Equipment" 52 (2003) International and Comparative Law Quarterly, 151 at 157-163.

the UNIDROIT's Cape Town Convention on International Interests in Mobile Equipment (the Convention). At the same time, an associated protocol, the Protocol on Matters Specific to Aircraft Equipment ('the Aircraft Protocol') was also signed. The intention of the Convention was to establish a new type of security interest in mobile equipment, known as an 'international interest' that would be registered on a new International Registry (IR). In 2006 the IR with respect to aircraft objects came into existence.

The first part of the paper outlines the private international law rules which apply to such security interests in mobile property in cross-border insolvencies and various initiatives to resolve some of the problems created by these rules. It then analyses how the new IR alters the rules for countries that ratify the Convention and Aircraft Protocol. For countries that have not ratified the Convention, securities interests over aircraft continue to be governed by the rules of private international law, although other international initiatives such as the UNCITRAL Model Law on Cross-Border Insolvency (Model Law) may be relevant. Although the importance of initiative such as the European Union Insolvency Regulation 2000 is acknowledged, their regional application excludes them from the ambit of this paper. The last part of the paper considers the Model Law in relation to security interests over mobile equipment in a cross-border insolvency and gives an overview of the developments concerning other high value stock, including rolling stock and space assets.

2. Private international law

2.1 Location of collateral

The starting point in any commercial dispute which involves a security interest when the parties or the collateral are located in different jurisdictions is the rules of private international law. These rules determine in a cross-border situation a creditor's rights against a debtor in default and the respective rights of any holders of competing security interest over the same collateral. In the event that a court is required to resolve a dispute, the initial question is which jurisdiction's law will apply? Courts since the 19th century have resolved this conflict of laws question in favour of the law of the jurisdiction in which the collateral is located.[5] This principle is known as *lex rei situs.* The freedom of contract rule (that parties to a contract should be free to decide which jurisdiction's laws shall apply to that contract) generally does not apply in cross-border insolvencies as most jurisdictions exclude property law transactions, such as security agreements over personal property, from this rule.

Although the location of the collateral is the primary question under the *lex rei situs* principle, if the property has crossed a national border after the creation of the security interest, the rules of the country in which the security interest was created are still relevant. For example, consider the situation where a debtor has granted a security interest over a truck to a creditor in country 'X' and at the time of default and enforcement of the security interest, the truck is located in country 'Y'. The laws of X are relevant to determine the validity of the security interest between the debtor and creditor, while the laws of Y will determine the rights of the creditor as against other parties claiming an interest in the truck. If the laws of the two countries recognise similar types of security interest, with similar systems of priority, then the creditor's security interest will be recognised and its priority rights will be maintained. However, if Y does not recognise the type of security interest, such as an unregistered or equitable interest, then the creditor will have difficulty in asserting and enforcing its security interest.[6]

[5] Ronald CC Cumming, Catherine Walsh & Roderick J Wood *Essentials of Canadian Law: Personal Property Security Law* (2005, Irwin Law, Toronto) 120.

[6] Eva-Maria Kieninger (ed) *Security Rights in Moveable Property in European Private Law* (2004, Cambridge University Press, Cambridge) 17.

Further difficulties arise for property that frequently shifts internationally, such as aircrafts or satellites that in a practical sense have no fixed situs. The question then arises as to what point of time is the relevant time for assessing the location of the property? The general approach is to establish its location when the security interest over the property was created, although this can be difficult.

In summary the potential instability of security interests over property which involves cross-border or multi-state parties or ultra-mobile collateral essentially can be distilled to three interconnected issues.

- Uncertainty as to which country's laws apply to resolve any disputes as to the validity of a security interest; and

- Uncertainty as to which country's laws apply to enforce the security interest on the occurrence of an enforcement event such as the insolvency of the debtor; and

- Once the conflict of laws issues are resolved, in many jurisdictions, enforcement of the security interest may be problematic due to factors including differences in local laws, or underlying inadequacies in the administration and enforcement of actions within the applicable legal system.

2.2 Solutions to *Lex Rei Situs*

In a number of cross-border insolvencies, especially when creditors were located in the United States and Canada, economic pressures "on debtors and creditors to resolve these issues…produced novel pragmatic commercial solutions…based around protocols approved by the courts."[7] These one-off protocols were developed as ad hoc solutions for specific cross-border insolvencies. They benefit the creditors concerned by ensuring maximum return, but clearly do not address the underlying difficulties and tensions in cross-border insolvencies.

Non-governmental bodies such as the International Bar Association (IBA) have also attempted to increase co-operation in cross-border insolvencies. The IBA developed the Concordat that contained guidelines for cross-border insolvencies that courts and parties could adopt to assist to increase co-operation between judges in different jurisdictions.

Adding to the complexity in this area is the adoption in a number of countries of personal property security regimes based on the location of the debtor or grantor of the security interest. Resolving conflict of law questions based on the location of the debtor reduces uncertainty for creditors as it is possible to reasonably determine in advance which country's legal system and courts will apply or be utilised if enforcement of the security interest is necessary.

2.3 Exceptions to *Lex Rei Situs*

2.3.1 Personal property security (PPS) regimes

Debtor-based jurisdictions generally have adopted a functional personal property security regime based on Article 9 of the United States Uniform Commercial Code (UCC).[8] The UCC functional approach to secured transactions has been followed in other countries,

[7] Rosalind Mason, above n 2, 36.

[8] Although, the 2001 Revised Article 9 provides that security interests over certain assets, including goods, require a bifurcated approach. For while a secured party is required to 'file its financing statement where the debtor is located, while issues concerning the effect of perfection, non perfection or priority are governed by the law of the jurisdiction where the collateral is located. See Willa E Gibson *A Comprehensive Review of the Revised Article 9* (2007, Carolina Academic Press, North Carolina) 54.

most notably the common law provinces of Canada[9] and in New Zealand. It is significant that both the United States and Canada were early to develop uniform rules to deal with moveable assets, given that both countries have state or provincial constitutional structures as well as a federal legislature. Australia, another country that has states with substantial law making powers, is in the process of adopting a federal personal property security regime and registry.[10]

In terms of conflict of law issues, the Canadian,[11] New Zealand and Australian regimes take a similar approach with respect to mobile goods. In all three jurisdictions, the relevant statutes provide that the applicable law is the law of the jurisdiction where the debtor is located at the time of attachment "on the theory that this is the law which commercially reasonable third parties would expect to apply in view of the mobile nature of the collateral."[12] These exceptions to the *lex rei situs* rule, in all three jurisdictions, applies to goods that fall within the definition of mobile equipment set out in each statute and not whether the equipment in question in fact travels or moves across state or national boundaries. This adoption of an objective test based on the type of goods means that questions of proof as to whether collateral has moved boundaries are irrelevant. The other advantage of UCC Article 9 style regimes which have adopted a functional approach to secured transactions, is that they apply to a range of financing methods, including long term leases and retention of title.

2.3.2 Differences in PPS regimes

There are differences in the definition of mobile equipment between the three jurisdictions. For example in the Saskatchewan Personal Property Securities Act 1993, (although an identical provision exists in all of the Canadian provinces with personal property security regimes) the definition encompasses goods that are normally used in more than one jurisdiction, if the goods are equipment or inventory leased or held for lease by a debtor to others.[13] The Personal Property Securities Act 1999 enacted in New Zealand contains a similar definition.[14] The Personal Property Securities Act recently enacted in Australia provides that the validity, perfection and effect of perfection or non-perfection, of a security interest in goods is governed by the law of the jurisdiction of the grantor (debtor) is located in, when the security interest attaches to the goods, and the goods are of a kind that is normally used in more than one jurisdiction; and the goods are not used predominately for personal, domestic or household purposes.[15] The distinction found in the Canadian and New Zealand definition that excludes mobile goods that are not equipment or inventory leased or held for lease, does not exist in the new Australian PPSA. In reality, this distinction may make very little difference as most businesses are unlikely to have substantial mobile assets, other than assets which are either equipment or inventory. However, the absence of uniformity does highlight inconsistencies in domestic PPS regimes.

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[9] In 1999 with the enactment of the Newfoundland Personal Property Security Act, all of the common law provinces had implemented personal property security regimes and on-line electronic registries.

[10] Australia enacted its Personal Property Securities Act on the 14 December 2009, although it is not designated to come into force until 1 May 2011.

[11] For the purposes of this paper, reference will be made to the Canadian regime as represented by the Personal Property Securities Act 1993 (Saskatchewan). It should be noted that all of the common law provinces have individual Personal Property Securities Acts, however the provisions in each Act with respect to conflict of laws and mobile property are identical.

[12] Cuming, above n 5, 137.

[13] *Personal Property Securities Act 1993* (Saskatchewan) s 7(2)(a)(ii).

[14] *Personal Property Securities Act 1999* (NZ) s30 (b).

[15] *Personal Property Securities Act 2009* (Aust) s 238(3) (a)-(c).

2.3.3 Case study: Registration of security interest under New Zealand law

Currently under New Zealand law, pursuant to the Personal Property Securities Act 1999, a purchase money security interest over equipment, such as aircraft, can be perfected under the Act. As discussed above, the Act specifies that the validity, perfection and effect of perfection (and non-perfection) of a security interest, is governed by the law, including the conflicts of laws rules, of where the debtor is located[16] when the security interest attaches, if the security interest is over mobile equipment.[17] Accordingly, a purchase money security interest over aircraft is capable of being perfected under New Zealand law and would be governed by New Zealand law, if that is the location of the debtor. Further, provided the purchase money security interest is perfected, it would have priority over a non-purchase money security interest. [18] Accordingly, overseas based financiers of asset-based financing, provided their security interest had been perfected in accordance with the Act, would get priority over the interests of the other perfected security interests.

In March 2010, the New Zealand Government announced that New Zealand would become a party to the Convention and Aircraft Protocol. The advantages for financiers and the associated cost savings for New Zealand companies acquiring new aircrafts were identified as key benefits for New Zealand. In a *National Economic Analysis* document published by the Ministry of Transport, it is stated that "retaining the status quo would not provide international financiers with assured remedies in New Zealand for the recovery of their assets in the event of default, including the legal ability to require de-registration of an aircraft to facilitate its cross-border repossession."[19] The document continues that while it was acknowledged that such remedies could be introduced into domestic law without ratifying both instruments, this option "would exclude the commercial opportunity for the aviation industry to access more favourable finance rates on future aircraft acquisitions."[20]

Lending and security arrangements for high value equipment such as aircrafts often involve complex financing arrangements. Aircraft financing may involve tripartite structures using special purpose vehicles to separate ownership of the aircraft from its actual use. The financiers / lenders advance money to a special purpose vehicle to purchase the aircraft, which is often managed by a trust. The special vehicle then leases the aircraft to the airline company. More recently, export credit agencies are being used to finance future aircraft acquisitions.[21] In the *National Economic Analysis* document, reference is made to the Organisation for Economic Co-operation and Development's 'Sector Understanding on Export Credits for Civil Aviation' (OECD ASU). This Understanding permits export credit agencies of participant countries (which includes New Zealand) to offer favourable finance rates to aircraft operators for Category Two and Three aircraft.[22] Accession to the Convention and Aircraft Protocol, with its additional protection for financiers, potentially may reduce finance costs for such aircraft. However, for Category One aircraft, favourable financing rates under the OECD ASU are only available to airlines from countries that have acceded or ratified the Convention and Aircraft Protocol, subject to certain declarations. Category One aircraft include both narrow-body jet aircraft such as the Airbus A320,

[16] Section 29 defines for purposes of sections 30 to 33 that if a debtor is a body corporate, then it is located in the country of incorporation. If the debtor is not body corporate, then the debtor is located at the debtor's place of business, or if more than one, at the principal place of business or the debtor's principal residence if the debtor does not have a place of business.

[17] *Personal Property Security Act 1999* (NZ) s 30(b).

[18] *Personal Property Security Act 1999* (NZ) s 73.

[19] *National Interest Analysis: Convention on International Interests in Mobile Equipment 2001 and Protocol on Matters Specific to Aircraft Equipment 2001* (New Zealand Ministry of Transport, 4 March 2010) http://www.transport.govt.nz/ourwork/air/Documents/NIA%20for%20Parliamentary%20examination%2023%20March%202010.pdf (last accessed 1 June 2010) at [29].

[20] Ibid at [30].

[21] "Why export credit agencies make good banks" *Air Finance Journal* 314 (2008) 13.

[22] Category Two aircraft in the New Zealand context are turboprop airline aircraft and Category Three are helicopters and jet, piston, or turboprop general aviation aircraft and small airline aircraft.

Boeing 737-800 and wide body jet aircraft such as the Airbus A340, 350, 380 and the Boeing 747, 777 and 787.

On the 22 June 2010 the *Civil Aviation (Cape Town) Convention and Other Matters Amendment Act 2010* was enacted by the New Zealand Parliament and received Royal Assent on 30 June. Under this Act, the provisions of the Convention and Aircraft, subject to any declarations made by New Zealand are stated to have the force of law in New Zealand,[23] although the sections relating to these instruments at the time of writing are not yet in force.[24]

3. The UNIDROIT Convention on International Interests in Mobile Equipment

3.1 Convention

The background to and rationale for the development of the UNIDROIT Convention and the Aircraft Protocol, and their ultimate signing in Cape Town in 2001 have been comprehensively detailed elsewhere and do not need to be repeated here.[25] The following is simply intended to provide a summary of the key features of the Convention and Aircraft Protocol.[26]The Convention complements the UNIDROIT Convention on International Financial Leasing (May 1988) and Receivables Financing which was concluded at the same meeting. It was agreed and signed by twenty States in November 2001 with the objective of setting out high-level rules designed to address "the instability of security, title retention and leasing interests in mobile equipment of high unit value or particular economic significance."[27] The Convention is not equipment specific and instead it is categorised as a "framework treaty that establishes core provisions which are capable of being modified by equipment-specific protocols in order to adapt the Convention's structure to the particular requirements of specific industries."[28] Accordingly, before the Convention can come into force with respect to a specific type of equipment, an equipment specific protocol must be in place. To date, the Aircraft Protocol is the only protocol in force.

The approach taken by the drafters of the Convention is unusual. Instead of attempting to harmonise the laws in different jurisdictions, it provides for a new legal regime for international secured credit law. The central feature of the Convention is the creation of an international interest which is registrable on the IR. The development of this autonomous property interest known as an 'international interest' has been described as "radical and imaginative,"[29] and as representing a new *lex mercatoria*[30] for international secured transactions.

[23] *Civil Aviation (Cape Town) Convention and Other Matters Amendment Act 2010* (NZ) s 12 (new section 105 in the *Civil Aviation Act 1990* (NZ).
[24] *Civil Aviation (Cape Town) Convention and Other Matters Amendment Act 2010* (NZ) s 2(1)
[25] See Professor Sir Roy Goode *Official Commentary of the Convention on International Interests in Mobile Equipment and Protocol therefore on Matters Specific to Aircraft Equipment-Revised Edition* (2008, UNIDROIT), Part 1; Martin J Stanford "The New Regimen: Its History and Future after South Africa" 1- Rev (2004) European Review of Private Law 9; and Iwan Davies "The New *Lex Mercatoria*: International Interests in Mobile Equipment" 52 (2003) International and Comparative Law Quarterly, 151.
[26] See the *Official Commentary of the Convention on International Interests in Mobile Equipment and Protocol therefore on Matters Specific to Aircraft Equipment-Revised Edition,* above n 24 and Bob Wessels (ed) *Cross-Border Insolvency Law: An International Instruments and Commentary* (2007, Kluwer Law International) Part 4 for detailed examination of the Convention.
[27] Roy Goode "The International Interest as an Autonomous Property Interest" (2004) 1 European Review of Private Law 18, 18.
[28] http://www.unidroit.org/English/workprogramme/study072/main.htm (last accessed 10 May 2010).
[29] Ibid.
[30] Iwan Davies "The New *Lex Mercatoria*: International Interests in Mobile Equipment" 52 (2003) International and Comparative Law Quarterly 151 at 154.

3.2 International interests

Article 2 states that the "Convention provides for the *constitution* and *effects* of an *international interest* in certain categories of mobile equipment and associated rights'".

3.2.1 Constitution of an international interest

Articles 2 to 7 establish the following constituent elements of an international interest as a security interest:

(i) It must relate to mobile equipment that is an uniquely identifiable object and is within one of three categories of equipment covered by the Convention, and there is in force an applicable equipment specific protocol. The three categories are:

- aircraft objects (which encompasses airframes, aircraft engines and helicopters);
- railway rolling stock; and
- space assets, such as satellites; and

(ii) It must be

- granted by the chargor under a security agreement; or
- and is either vested in a person who is the conditional seller under a title reservation agreement; or
- vested in a person who is the lessor under a leasing agreement.

and relates to a equipment to which the charger, conditional seller or lessor has the power to dispose; and

(iii) must be in writing and in the case of a security agreement granted by charger enables the secured obligations to be determined.

Under Article 51, the Convention may be extended at a later date to other categories of personal property equipment, providing such equipment has the characteristics of high value, mobility and that individual items of equipment are uniquely identifiable.

Registration is not a requirement of the creation of an international interest. Instead, the Convention applies to the interest, if at the conclusion of the agreement providing for or creating the international interest, the debtor is situated in a contracting state. A contracting state is one that has ratified or assented to the Convention. The location of the creditor at this point of time is irrelevant for the purposes of the Convention. Guidance as to how to determine the location of the debtor is provided by Article 4 of the Convention. It provides that the debtor is situated in any contracting state under the law of which it is incorporated or formed, where it has its registered office or statutory seat, where it has its centre of administration or where it has its place of business. The term 'place of business' is further clarified as the principal place of business (if it has more than one place of business) or, if it has no place of business, then its habitual residence.

The constitution and effect of an international interest are satisfied by these minimum requirements. As an exercise of contractual autonomy the parties are left to determine the terms of the agreement, default events and remedies. Contracting states do not become involved in the resolution of disputes, although under the Convention, contracting states

are required to ensure that certain remedies are available to secured parties in the event of default. Remedies and enforcement are discussed later in part 3.8.

3.2.2 Effects of an international interest

Registration of an international interest in accordance with the Registration System provisions in Articles 18-26 of the Convention ensures that pursuant to Article 29, the registered interest "has priority over any other interest subsequently registered and over an unregistered interest" notwithstanding if the first registered interest was acquired or registered with actual knowledge of another interest, and irrespective of any value provided with such knowledge. Article 29 also contains the default rules for buyers or conditional buyers of assets which are subject to existing registered or unregistered security interests at the time of purchase. Subject to protection of subordinated interests, the holders of competing interests in the same assets can by agreement vary such rules.

Article 30 sets out the rules that apply in the event of insolvency. It provides:

1. In insolvency proceedings against the debtor an international interest is effective if prior to the commencement of the insolvency proceedings that interest was registered in conformity with this Convention.

2. Nothing in this Article impairs the effectiveness of an international interest in the insolvency proceedings where that interest is effective under the applicable law.

3. Nothing in this Article affects:

(a) any rules of law applicable in insolvency proceedings relating to the avoidance of a transaction as a preference or a transfer in fraud of creditors; or

(b) any rules of procedure relating to the enforcement of rights to property which are under the control or supervision of the insolvency administrator.

3.3 Aircraft protocol

The Aircraft Protocol modifies and supplements the Convention by the introduction of a more complex regime of rules that apply exclusively to aircraft objects. It also provides a creditor with two additional remedies that are discussed later in part 3.8. The Aircraft Protocol also contains measures that boost the rights and powers of creditors in the event of insolvency. Aircraft objects are comprised of airframes, aircraft engines and helicopters, with each of these terms separately defined. Generally excluded from the ambit of the Convention and Protocol are non-commercial aircraft objects such as planes and helicopters used by the military or smaller craft that normally would be reserved for personal use.[31]

[31] Article 1(2) of the Aircraft Protocol defines these terms.

'Aircraft engines' as aircraft engines (other than those used in military, customs or police services) powered by jet propulsion or turbine or piston technology and: (i) in the case of jet propulsion aircraft engines, have at least 1750 lb of thrust or its equivalent; and (ii) in the case of turbine-powered or piston-powered aircraft engines, have at least 550 rated take-off shaft horsepower or its equivalent, together with all modules and other installed, incorporated or attached accessories, parts and equipment and all data, manuals and records relating thereto; and

'Airframes means airframes (other than those used in military, customs or police services) that, when appropriate aircraft engines are installed thereon, are type certified by the competent aviation authority to transport: (i) at least eight (8) persons including crew; or (ii) goods in excess of 2750 kilograms, together with all installed, incorporated or attached accessories, parts and equipment (other than aircraft engines), and all data, manuals and records relating thereto; and

'helicopters' means heavier-than-air machines (other than those used in military, customs or police services) supported in flight chiefly by the reactions of the air on one or more power-driven rotors on substantially vertical axes and which are type certified by the competent aviation authority to transport: (i) at least five (5) persons including crew; or (ii) goods in excess of 450 kilograms, together with all installed, incorporated or attached accessories, parts and equipment (including rotors), and all data, manuals and records relating thereto.

3.4 Ratification process

Countries wishing to adopt the Convention and Aircraft Protocol need to ratify or accede to both instruments. The country is then known as a 'contracting state'. Although formally the Convention came into force on 1 April 2004, as it can not apply to a category of objects such as aircraft, until a relevant protocol is in effect, in practical terms it came into force on 1 March 2006. This is taken as the date the Aircraft Protocol came into force. At the time of writing 35 countries and the European Union have ratified, approved or acceded to the Convention[32] although not all of these countries have ratified the Aircraft Protocol.[33] 1 March 2006 was the date the International Registry went on line.

3.4.1 Ratification options

In terms of protection of creditor rights in collateral, the most important provision in the Aircraft Protocol is Article XI. Contracting states have the option (by way of declaration at the time of signing or by later addition) to specify which one of two alternative creditor protection regimes applies to that contracting state, although neither option applies, until the contracting state has made a declaration. A number of countries, including the United States, have not declared a selection between the options and therefore their national insolvency laws in this respect apply without modification.

The majority of contracting states have selected Alternative A, sometimes referred to as the 'hard option'. Alternative A requires an insolvency administrator of the debtor or the debtor to deliver possession of an aircraft object to a creditor or cure all defects at the earlier of two dates. These are either the end of a waiting period specified in the declaration by the contracting state, or the date when the creditor would be entitled to take possession of the aircraft object under the applicable national law of the contracting state (if the Protocol did not apply). The insolvency administrator or debtor is also required to maintain the aircraft object as to preserve its value until the creditor is able to take possession. New Zealand has selected Alternative A with a 60 day waiting period.

In contrast, Alternative B, the discretionary or 'soft' option states that the insolvency administrator or the debtor, upon the request of the creditor, gives notice to the creditor within a time limit specified in the declaration of the contracting state whether the debtor or administration will cure all defaults and agree to perform all future obligations, or give the creditor the opportunity to take possession of the aircraft object. The Aircraft Protocol sets out additional rights and procedures in respect of Alternative B including requiring a creditor to provide evidence of its international interest and registration thereof and gives creditors the power to apply to court for possession if the debtor or administrator fail to give over possession after giving notice.

Regardless of which option is selected, both alternatives effectively require an insolvent or bankrupt airline's default to be cured within specified time limits or the aircraft object will be repossessed by the creditor. In addition, providing that a contracting state has made a declaration, then the courts of the contracting state in which the aircraft object is located, are required, in accordance with the laws of that state, to co-operate to the maximum extent possible with the creditor.

[32] For a frequently updated list of countries that have implemented the Convention, dates of ratification and links to declarations see the UNIDROIT website: <http://www.unidroit.org/english/implement/i-2001-convention.pdf >.Note this number includes Gabon which assented to the Convention on 16 April 2010, but it does not come into force until 1 August 2010 (last accessed 1 June 2010).

[33] Countries which have acceded to the Convention, but not the Aircraft Protocol are Gabon, Kazakhstan, Syria, Togo and Zimbabwe. For a frequently updated list of countries that have implemented the Aircraft Protocol, along with relevant dates and links to specific country's declarations and elections see the UNIDROIT website: <http//www.unidroit.org/english/implement/i-2001-aircraftprotocol.pdf > (last accessed 1 June 2010)>

3.4.2 Protection on non-consensual rights

One important limitation is that the priority scheme in the insolvency proceedings is subject to any restriction in a declaration of the contracting state under Article 39(1) of the Convention to preserve the priority of non-consensual rights or interests before an interest registered under the IR. The term non-consensual rights encompass rights and interests such as tax liens, liens for airport and navigation charges and other such rights which arise by operation of law rather than by created or granted by contract. The problem that non-consensual rights have historically created for creditors is that in some jurisdictions, the creditor may not be aware of existences of such rights until they are exercised. This requirement for a contracting state to publicly identify which non-consensual rights are to be given in effect a 'super priority' should alert a creditor or financier to the existence of such rights.

A number of countries have declared a blanket protection of all non-consensual rights or interests which have and will in the future have priority over an interest in an object, which is equivalent to that of the holder of a registered international interest, under the domestic law of the contracting state. Others have reserved specific classes of non-consensual interests or rights. For example, the United Arab Emirates which ratified the Cape Town Convention and the Aircraft Protocol on 1 August 2008[34] protected liens in favour of airline workers for unpaid wages; liens in favour of any UAE state entity relating to unpaid taxes or other charges and liens in favour of repairers of an object in their possession.

A contracting state by declaration may also list certain non-consensual rights or interests that are registrable under the Convention as if the right or interest was an international interest.[35]

3.5 International registry

3.5.1 Establishment of international registry

In addition to the Convention and the Aircraft Protocol, the establishment and operation of the Registry is governed by the Regulations and Procedures for the IR.[36] The Regulations are issued by the Supervisory Authority that was established under the Convention to set up and oversee the Registry.[37] This role has been assumed by the International Civil Aviation Organisation (ICAO). The Supervisory Authority, through the ICAO has a contract for a five year period with Aviareto to be the Registrar of the IR. Aviareto is located in Dublin, Ireland[38] and is a joint venture between SITA (an air transport IT provider) and the Irish Government. Aviareto is performing these functions on a not for profit and cost recovery basis, as required by the Cape Town Convention. Since the Registry became operational in 2006, a significant number of aircraft objects have been registered.

3.5.2 Registrations to date

In the Registry's latest published annual report for the calendar year 2008[39] published on 29 January 2010, the Registrar stated:

[34] http://www.unidroit.org/english/implement/i-2001-aircraftprotocol.pdf (last accessed 1 June 2010).
[35] Cape Town Convention on International Interests in Mobile Equipment, Article 40.
[36] https://www.internationalregistry.aero/irWeb/Controller.jpf (last accessed 10 May 2010).
[37] The Regulations and Procedures for the International Registry are detailed in International Civil Aviation Organisation (ICAO) Document 9864.
[38] https://www.internationalregistry.aero/irWeb/Controller.jpf (last accessed 10 May 2010).
[39] International Registry of International Interests in Mobile Equipment "Third Annual Statistical Report—1 January 2008 to 31 December 2008" (29 January 2010, Aviarato Ltd, Dublin) https://www.internationalregistry.aero/irWeb/pageflows/work/Reports/DownloadAnnualReport/DownloadAnnualReportController.jpf (last accessed 10 May 2010).

[t]he Contracting States at the end of 2008 accounted for some 41% of all of the world's aircraft objects that potentially qualify for registration in the Registry. The United States of America, based on revenue, was the origin of 91% of all activity on the Registry. The remaining registry user activity and revenue originated from Ireland (2.6%) and the United Kingdom (1.2%), and seventy-one other countries.

At the end of 2008, 21,578 aircraft objects had interests registered against them recorded on the IR.[40] The Report also disclosed that a number of manufactures are regularly supplying the Registry with manufacturing serial numbers (MSN) of airframes, helicopters and engines with the result that over 273,000 MSNs are already stored on the Registry system. This information is available to users when making registrations.

3.6 Registration process[41]

The Registry is a web-based electronic registry that is available for registration and searching online 24 hours a day, seven days a week. Individuals and organisations who have an international interest or potential interest in an aircraft object as prescribed in Article 16 of the Convention, and Article III of the Protocol are able to register that interest or potential interest.

The Registry operates an 'object specific' system as registration and searching focuses on aircraft objects as identified by their MSN and other identifying elements, rather than on the basis of title to the aircraft object or the names of the parties to the security interest. One unique feature is the Convention and Aircraft Protocol's treatment of airframes and engines as separate objects. The consequence is that where a single security interest provides for a registrable interest in a specific aircraft, it may be necessary to complete a separate registration for the airframe and each engine.

For countries which have already adopted an electronic web based register for personal property securities, certain features of the IR will not seem surprising. First, the Registry is a notice register and not a document register. Instead of registering or filing the document creating the security interest, authorised users of the Registry record electronically the required information. The specific criteria that must be recorded are the name of the manufacturer, the MSN and the model designation. Individuals and organisations who wish to register interests on the IR are required to first apply to the Registry to become an "Approved Administrator User". This prior approval process regulates and controls who has access to upload and update information on the Registry. The rules governing access for individuals and corporations who wish to search the Registry are much less complex.

Completion of valid registration creates the priority for a specific interest over competing interests within contracting states. It is possible to register prospective international interests and potential assignments of international interests, a common feature in domestic personal property securities registries. It is also possible to register prospective sales by virtue of Article III of the Protocol. An interest that is first registered as a prospective international interest that later becomes an international interest is treated as having been registered from the date of the initial registration of the prospective international interest. This is provided for by the initial registration that was still valid at the date the interest became an international interest. This is a significant feature when priority over collateral is determined not by the date of the creation of the international interest, but by the date of registration. The practical result is that persons "who are engaged in negotiations for a contract involving an international interest in a particular aircraft object

[40] Ibid, 11.
[41] For a detailed analysis of the International Registry see Ronald CC Cuming "The International Registry for Interests in Aircraft: An Overview of its Structure" 11 (2006) Unif L Rev18.

may effect a registration as soon as the negotiations begin so as to establish the priority of the international interest, should the negotiations be successful."[42]

3.7 First to file priority rule

The 'first to file' approach to priority is found in Article 9 of the UCC and other personal property security registration systems which are based on the UCC as well as the terms 'attachment' and 'perfection'. Under the UCC (Article 9.322(a) a perfected security interest has priority over a conflicting unperfected security interest in the same property. A registered international interest will not only have priority over a later registered interest, but also against unregistered international interests irrespective of when such interests were created.

3.8 Enforcement rights

It was apparent that for the Convention and Aircraft Protocol to be successful, financiers and creditors must be able to enforce security interests efficiently and promptly. The provisions of both Instruments operate irrespective of whether an international interest has been registered, or not, as registration only determines the rights of a creditor against third parties. The default remedies contained in the Convention are only relevant to the extent that the parties have not provided otherwise in the security agreement between them, although any additional remedies as agreed between the parties must not be inconsistent with certain mandatory provisions.[43]

Both the Convention and the Aircraft Protocol contain remedy provisions. The remedies set out in the Convention apply to all mobile equipment, whereas the remedies in the Aircraft Protocol were developed to meet the unique characteristics of aircraft objects and only apply to aircraft objects. Chapter III of the Convention sets out a variety of remedies available upon default. Default is to be determined by the parties at any time in writing, or in the absence of such agreement, "default…means a default which substantially deprives the creditor of what it is entitled to expect under the agreement".[44]

Article 8 provides that a chargee may take possession or control of any object subject to the charge, may sell or lease, collect or receive income arising from the management or use of such object. Further, a chargee has the power to apply for a court order authorising or directing any of these remedies. Any remedy is required to be exercised in a commercially reasonable manner. This is defined as in accordance with the terms of the security agreement "except where that provision is manifestly unreasonable."[45] This requirement was amended in the Aircraft Protocol which overrode the Convention's initial provision that it was solely up to the parties to decide what is commercially reasonable.[46] The Article contains additional requirements requiring reasonable notice prior to sale, that any money collected as a result of the remedies is to be applied to repay the secured amount and requiring any surplus (after repayment and reasonable costs have been deducted) to be distributed in the following order. Firstly to be paid to any subsequent ranking registered interests or interests to which the chargee has notice and then to the charger.[47]

In addition, after an event of default, the chargee and all interested persons may agree that the object shall vest in the chargee in satisfaction of the debt and a chargee has the right to apply to the court for a vesting order. The only limitation is that the court must assure itself

[42] Ibid, 30.
[43] Cape Town Convention on International Interests in Mobile Equipment 2001, Article 15.
[44] Cape Town Convention on International Interests in Mobile Equipment 2001, Article 11.2.
[45] Cape Town Convention on International Interests in Mobile Equipment 2001, Article 8.3.
[46] Protocol on Matters Specific to Aircraft Equipment 2001, Article IX.3.
[47] Cape Town Convention on International Interests in Mobile Equipment 2001, Article 8.6.

that the amount owed to the chargee, including any amounts payable by the chargee to interested persons, are commensurate with the value of the object itself. In the case of a conditional seller or lessor, the remedies provided under Article 10 are termination, possession, (or repossession) or control of the object.

The Protocol contains remedies specific to aircrafts, provided that a contracting state has made a declaration 'opting in' to these remedies. These allow a creditor to the extent that a debtor has agreed, to procure the deregistration of an aircraft and its export and transport it out of the territory in which it is located.[48] The contracting state and government bodies are required to expeditiously co-operate with and assist with this process.[49]

3.9 Implementation

3.9.1 Declarations

As the Convention and Aircraft Protocol are private international instruments, albeit under the auspices of UNIDROT and ICAO, countries that decide to ratify or accede to the instruments, need to enact legislation to adopt the regime into domestic law and to amend existing statutes. In addition to the declaration as to which creditor right alternative (Alternative A or Alternative B as outlined above) is selected, ratifying or acceding countries have a discretion to make up to 20 declarations 'opting in' or 'opting out' of various articles of the Convention and Aircraft Protocol. This system allows some flexibility to meet domestic circumstances. Article 56 of the Convention and Article XXX of the Aircraft Protocol lists the possible declarations. Some declarations, such as the exclusion of internal transactions (see discussion below in part 3.9.2), which the domestic court has jurisdiction over and certain declarations regarding remedies[50] has to made at the time of ratification or accession.[51] This category includes declarations pursuant to Article 52 which applies when a contracting state has territorial units in which different systems of law are applicable. A contracting state in this circumstance may declare that the Convention extends to all, or only part of such units which must be identified. This Article allowed the European Union to accede to the Convention for some countries and not others. The second category of declarations under the Convention are those that can be made at any time. This includes declarations relating to non-consensual interests and rights having priority without registration.[52]

Certain declarations under the Aircraft Protocol are also required to be made at the time of accession, and in the absence of such declarations the relevant articles do not apply to the contracting states. These declarations encompass whether the parties can agree the law which is to govern their contractual rights and a requirement that the courts of a contracting state must co-operate to the maximum extent possible with foreign courts and foreign insolvency administrations. In addition, whether aviation authorities are required to assist a creditor in the exercise of the remedy of de-registration and the export of aircrafts, provided that such remedy is agreed to by the debtor.

3.9.2 New Zealand case study

New Zealand, which has a pre-existing domestic PPS regime, has a number of highly compatible features, such a default conflict of law rules based on the location of the debtor, a functional approach to security agreements and first to file, irrespective of notice approach to priority.

[48] Protocol on Matters Specific to Aircraft Equipment 2001, Article IX.1.
[49] Protocol on Matters Specific to Aircraft Equipment 2001, Article XIII.4.
[50] Cape Town Convention on International Interests in Mobile Equipment 2001, Article 54.
[51] Cape Town Convention on International Interests in Mobile Equipment 2001, Article 50.
[52] Cape Town Convention on International Interests in Mobile Equipment 2001, Articles 39 and 4.

However, a number of issues needed to be determined. Firstly, whether New Zealand would adopt a dual registration system? A security interest that satisfies the requirements of an international interest would generally be capable of being perfected on the country's domestic PPS registry as well as registered on the IR. If a contracting state adopts dual registration, then the security interest would be perfectible or registrable on both registers. However, registration under the domestic PPS register would need to be subordinated to registration on the IR. The alternative is a deemed registration process, whereby a creditor who has registered on the international registry is deemed to have registry in the location of the debtor, provided that such location is within a contracting state.

One advantage of a dual registration system is that secondary registration on a domestic registry may offer secured creditors additional protections and rights. For example, perfection under a domestic PPS register such as under New Zealand law allows parties to trace identifiable and traceable proceeds of an interest in the original collateral. A system of dual registration has been adopted in the United States and certain Canadian provinces, and this option is adopted in the New Zealand regime, although at the time of writing it is not yet in force.

Another issue is whether the Convention and Aircraft Protocol should apply to all security interests which fall within the definition of international interests, irrespective of whether the transaction involves domestic parties or aircraft that does not fly internationally. When New Zealand first proposed acceding to the Convention and Aircraft Protocol in 2006, the Government of that time agreed in principle to exclude security interests involving solely internal or domestic parties and collateral. However, given the potential for uncertainty created by excluding internal transactions from the IR, the Act that has just been enacted in New Zealand acceding to the Convention does not exclude internal transactions.

A number of other consequential amendments have been made to New Zealand's property and insolvency statutes. For example as a result of the decision to select Alternative A, an insolvency administrator is required to automatically transfer possession of the aircraft object to the creditor after the expiration of the 60 day period. However, the requisite legislative amendments to achieve this requirement may result in certain unwanted consequences. For these amendments may reduce the incentives for directors of an insolvent airline to place the company voluntarily into administration as the appointment of administrators is likely to be a defined event of default that triggers the power of a creditor to repossess aircraft. As the seizing of aircraft will invariably significantly reduce the potential for a successful voluntary administration, in terms of rescue or rehabilitation of that company, it is more likely that the directors will instead place the company into liquidation, unless the creditors agrees to vary its rights.[53]

4. Other international instruments

The Convention and Aircraft Protocol however only benefit creditors when the debtor is located in a contracting state and when the collateral can be categorised as an aircraft object. Asset-based financing agreements over other forms of collateral or where the debtor is not located in a contracting state will be governed by the conflict of laws rules as outlined above. However, a financier may be assisting in asserting its rights in respect of the collateral if the jurisdictions have enacted legislation based on the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency (the Model Law).[54]

[53] National Interest Analysis, above 19, 7.

[54] At the date of writing, twenty countries have enacted legislation based on the UNCITRAL Model Law on Cross-Border Insolvency. http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model_status.html (last accessed 1 June 2010).

4.1 UNCITRAL

The scope of the Model Law is generally restricted to matters of procedure applying to cross-border insolvencies. The objectives of the Model Law include:[55]

- effective mechanisms for dealing with cases of cross-border insolvency so as to promote co-operation between the courts and other competent authorities involved;
- fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested persons, including the debtor;
- protection and maximization of the value of the debtor's assets; and
- facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment.

The Model Law serves a legislative template that individual States are encouraged to incorporate into national laws, subject to any amendments to reflect individual national legal systems. However, in the Guide to Enactment (1997) which accompanied the Model Law, it is recommended 'that States make as few changes as possible in incorporating the Model Law into their legal systems.'[56]

It is envisaged that legislation passed by an enacting state that is based on the Model Law would apply in a number of cross-border insolvency situations. These include setting up systems to deal with in-bound requests for recognition of a foreign proceeding and outward-bound requests from a court or administrator in the enacting State for recognition of an insolvency proceeding commenced under the laws of the enacting State. Also, legislation based on the Model Law may include provisions providing for the co-ordination of concurrent proceedings in two or more States and participation of foreign creditors in insolvency proceedings taking place in the enacting State.

Allowing participation of foreign representatives and access for foreign creditors to the courts of the enacting country for the purpose of commencing insolvency proceedings or participating in such proceedings, allows representatives and creditors with security interests over mobile equipment increased certainty that security agreements will be able to be enforced and priorities maintained.

In terms of recognition of foreign proceedings, recognition by the courts of the enacting country is not automatic and depends on whether the enacting country recognises the 'foreign proceeding'. The Model Law requires this proceeding to have certain attributes. These include that it is "a collective judicial or administrative proceeding in a foreign State pursuant to a law relating to insolvency in which the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganisation or liquidation". In addition, a determination needs to be made as to whether the foreign proceeding is the 'foreign main proceeding' (being a proceeding taking place in the state where the debtor has the 'centre of its main interests'), or it is a 'foreign non-main proceeding'. A foreign non-main proceeding is a proceeding (other than a foreign main proceeding) which takes place in a State where the debtor has an establishment. An establishment is further defined as meaning any place of operation where the debtor carries out a non-transitory economic activity with human means and good or services.

A decision that a foreign proceeding can properly be categorised as a 'foreign main proceeding' has important consequences. Flowing from this decision are automatic

[55] Preamble to UNCITRAL Model Law on Cross-Border Insolvency 1997.
[56] Guide to the Enactment of the UNCITRAL Model Law on Cross-Border Insolvency 1997, Clause 12.

moratoria on individual creditor actions or executions involving the assets of the debtor and a freeze on any transactions (transfers, encumbering or otherwise dispose of) relating to those assets, other than in the ordinary course of business and subject to certain exceptions. In contrast, the relief afforded to foreign non-main proceedings under Articles 19 and 21 is discretionary. The term 'centre of main interest' is one that has its origins in European insolvency law and has attracted a significant degree of litigation and critique. However, its meaning in the context of legislation based on the Model Law has only recently received judicial attention. A good example of the approach taken by common law courts is a recent decision of the English High Court that considered both the criteria for properly categorising a proceeding as a 'foreign main proceeding' and the term 'centre of main interest.[57] The case involved the Cross-Border Insolvency Regulations 2006 which were adopted to give effect to the Model Law in Great Britain.

4.2 Rolling stock and space assets

A Protocol to the Convention on matters specific to Railway Rolling Stock (the Rail Protocol) was adopted in Luxembourg on 23 February 2007. However, as the International Registry with respect to railway rolling stock is not yet operational, the Rail Protocol is not in force. The Rail Protocol operates in a similar manner to the Aircraft Protocol, modifying and supplementing the provisions of the Convention with specific respect to railway rolling stock, although there are subtle, but significant differences between the two Protocols.[58] The UNIDROIT website observes that the Convention and Rail Protocol are "expected to be of considerable economic importance to States in Asia, Eastern Europe, Africa and South America for which railways and railway infrastructure play an important role in their economies."[59]

UNIDROIT also discloses on its website that another protocol dealing with space assets is under development. "This protocol will address the difficult task of applying the benefits of the Convention to space assets, which are increasingly being financed by private-sector investors rather than central governments, which are subject to a myriad of existing regulations under international treaties, and which are often physically located beyond terrestrial jurisdictions. The protocol is currently under consideration by an inter-governmental negotiation process which includes representation by private-sector financiers and the space industry."[60] Finally, UNIDROIT is undertaking preliminary studies to assess the need for a protocol dealing with secured financing over agricultural, construction and mining equipment.[61]

5. Conclusion

Uncertainty with respect to the validity and enforcement of security interests have been identified as a major check on financiers agreeing to provide finance in respect of high value and mobile collateral, or resulting in premiums on lending as a hedge against the risks involved. Accordingly, the Cape Town Convention and the associated Aircraft Protocol must be viewed as significant achievements when measured against a background militating against reform in this area. The success of the Convention and Aircraft Protocol can also be measured by the increasing number of jurisdictions acceding or ratifying both Instruments in recognition of the significant financial advantages afforded to airline companies located in those jurisdictions. Insolvency practitioners when dealing with an insolvent airline need to ascertain if it is located in a contracting state and the nature of any

[57] *Re Stanford International Bank Ltd & Ors* [2009] EWHC 1441 (Ch).
[58] See Roy Goode *The Convention on International Interests in Mobile Equipment and Luxembourg Protocol thereto on matters specific to railway rolling stock* (2008, UNIDROIT, Rome), Part 3 for a detailed review of the Rail Protocol.
[59] UNIDROIT: International Institute for the Unification of Private Law "International Interests in Mobile Equipment – Study LXXII" http://www.unidroit.org/English/workprogramme/study072/main.htm (last accessed 10 May 2010).
[60] Ibid.
[61] Ibid.

declarations made by the contracting state as accession or ratification to the Convention and Aircraft Protocol has significant implications for secured and unsecured creditors and the debtor airline alike.