

Cape Town Convention and Aircraft Protocol – UK Ratification A Step Closer

On Friday 6 December 2013, the UK Government published its long-awaited Response to its 2010 Call for Evidence on whether the UK should ratify the Cape Town Convention and Aircraft Protocol (together, the "CTC"). The Government has decided to proceed with ratification of the CTC, subject to a further consultation on implementation options. The Government has not included a target date for ratification in its Response.

Having considered the views of respondents to the Call for Evidence, the Government believes that treaty ratification would benefit the UK economy by creating a harmonised legal framework to register interests against helicopters, airframes and engines. The Government specifically refers to the possibility of UK airlines achieving lower financing costs in the capital markets, by virtue of the UK adopting the CTC. It also considers that financiers and manufacturers will benefit from being able to register separate interests against engines, as distinct objects from airframes, and from the services provided by the International Registry.

A link to a copy of the Government's Response is included [here](#)

Selected Issues

We highlight the following points from the Response which should be of interest to industry participants:

Export Credit Agency ("ECA") Supported Financing

In paragraph 3.7 of its Response, the Government indicates that "if the UK ratified the treaty with the necessary optional provisions" required under the OECD's Aircraft Sector Understanding ("ASU") rules for ECA supported financing of aircraft, then "UK airlines applying for export credit support would be eligible to be considered" for the discount on such financing available to borrowers in

countries which have implemented the CTC (each such country a "Contracting State"). There is no mention of the so-called "Home Country Rule" under which airlines in the countries which manufacture Boeing or Airbus aircraft have traditionally been unable to obtain support from the ECAs of such countries. Nevertheless, UK airlines could still benefit from the discount on ASU financings supported by other ECAs, for example, in relation to Embraer or Bombardier aircraft.

Enhanced Equipment Trust Certificates ("EETC") Financing

The Government recognises the increasing importance of the capital markets as a funding source for

airlines outside of the US and notes in paragraph 3.10 that treaty ratification "may reduce costs" for airlines seeking "to raise finance through the capital markets". The Government specifically refers to the EETC product (in paragraph 3.8) and the rating agencies' focus when reviewing airline EETC transactions on how quickly a creditor can recover the asset on a default, under the laws of the relevant airline's jurisdiction. This acknowledgement may influence the Government's decision on whether or not to adopt the CTC's insolvency provisions – see further below.

Insolvency Regime

In paragraph 3.12, the Government accepts that certain respondents felt

the UK would not need to adopt the treaty's optional insolvency provisions, specifically the "Alternative A" regime which prescribes a set period for an asset to be returned to the creditor or the relevant default cured, on a debtor insolvency (with most Contracting States which have adopted the regime selecting a 60 day period); the argument being that UK insolvency law is already "well respected" and offers "a good level of protection for creditors". It seems that the Government is undecided on whether to opt in to Alternative A, and accordingly, it will consult further on the insolvency options under the treaty.

If the Government chooses not to adopt Alternative A, then the impact of ratification on the rating agencies' assessment of any future UK airline EETC may be limited. Further, adoption of Alternative A (or equivalent) is one of the requirements for the discount under the OECD ASU.

Lex situs rule for aircraft mortgages

The Government does not consider that ratification will resolve the uncertainty caused by the *lex situs* rule as it applies to aircraft mortgages which are expressed to be governed by English law ("ELMs").

Under English law, the validity of the security interest created under a mortgage over an aircraft (or other tangible, movable asset) is governed by the law of the place where the asset is physically located at the time the mortgage becomes effective (the "*lex situs*"). This rule was confirmed

in the *Blue Sky* case¹, in which the court further held that the reference to *lex situs* in this context is a reference to the domestic law of the location of the asset, and not to its private international law. This has caused challenges for aircraft financiers, lessors and borrowers utilising ELMs, given the cross-border nature of aircraft leasing and financing.

The CTC provides for an "international interest", which may be created under a security agreement, lease agreement or conditional sale agreement, over an aircraft object, provided that the treaty rules, including debtor location or aircraft registration, are met. The physical location of the aircraft is not relevant to the creation of an international interest. The holder of an international interest will have the benefit of the treaty's creditor remedies, including on a debtor insolvency, which will be enforceable in a Contracting State (subject to the state's specific treaty declarations). An international interest may arise independently of any security or other interest under the national laws of a Contracting State.

Thus, if the UK adopts the CTC, then an ELM created by a mortgagor located in the UK or by any mortgagor over a UK registered aircraft should give rise to an international interest, in favour of the mortgagee, as long as the treaty requirements are satisfied.

However, while this outcome should give comfort to aircraft financiers and lessors generally, it does not wholly resolve the issues created by the *lex situs* rule for ELMs. For a mortgagee to be able to rely on the CTC's rights and remedies available to an ELM as an international interest against the relevant mortgagor (and to enforce against the aircraft), the jurisdiction of the mortgagor's location and/or the state of registration of the aircraft² must be a Contracting State. Unless the mortgagor happens to be located or the aircraft happens to be registered in the UK, UK ratification is not relevant to this position. Rather, what is relevant is whether other countries adopt the CTC (and which specific declarations they make).

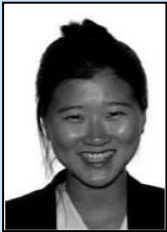
Treaty domestication

Finally, it should be noted that CTC ratification by the Government, as the executive of the UK, will not automatically lead to the treaty taking effect as a matter of national law (although it will be binding under international law on the state itself). Generally in the UK, a treaty needs to be enacted by Parliament, as the legislature, before it has direct effect in the courts (often referred to as "domestication" of a treaty) and against entities subject to UK law.

¹ *Blue Sky & Ors v Mahan Air* – the case was heard in two phases: [2009] EWHC 3314 (Comm) and [2010] EWHC 631 (Comm).

² Note also that the aircraft registration connecting factor does not cover engines so an international interest will not arise under the ELM over the engines unless the debtor connecting factor is met.

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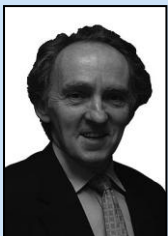
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