

UK RATIFICATION OF THE CAPE TOWN CONVENTION: A WELCOME ADDITION OR A DAMP SQUIB?



Almost fifteen years after it was agreed, the Convention on International Interests in Mobile Equipment 2001 (Convention) and the Protocol to the Convention on Matters Specific to Aircraft Equipment (Protocol) (collectively known as the Cape Town Convention) is set to become law in the UK in the near future.

Earlier this year, the regulations implementing the Cape Town Convention (the **Regulations**¹) were laid before Parliament signalling the final stage of its passage towards enactment which we anticipate will be completed before the end of this year.

At first sight, this can be seen as positive progress that will align our local treatment of aircraft assets with a growingly recognised international standard. However, when put under closer scrutiny, this ratification seems to add no particular value to most affected stakeholders in the industry yet is likely to add even more red tape and bureaucracy to aircraft financing and leasing transactions.

In this Briefing we will explain why we think this is the case and will look at what impact the introduction of the Cape Town Convention may have on the UK aviation industry and what steps need to be taken as a consequence. For those readers who, thus far, have not had cause to concern themselves with the Cape Town Convention or for those who need a reminder, a brief summary of its purpose and application can be **found here**.

The Cape Town Convention and the UK: key provisions and their value proposition?

1. In a departure from its initial position, the Government has elected to adopt Alternative A under the Protocol.

The benefit of this decision, as opposed to adopting the more prescriptive Alternative B, is that:

- It enables creditors to exercise self-help remedies before, if necessary, resorting to court action.

1 http://www.legislation.gov.uk/ukxi/2015/912/pdfs/ukxi_20150912_en.pdf



- It is the preferred choice for creditors and forms one of the conditions for qualifying for the Cape Town discount, i.e. a discount of up to 10% in the premium charged by Export Credit Agencies for guaranteeing the financing of an aircraft.

In addition, the Government has chosen to make the other necessary declarations which should ensure that the Cape Town discount is available to qualifying UK airlines. Unfortunately, however, the selection of Alternative A is unlikely to benefit most UK airlines because of the Home County Rule², which, as far as we are aware, is not going to be abolished or amended as part of this ratification.

2. Lien rights, such as mechanics lien and the dreaded “fleet lien” under Section 88 of the Civil Aviation Act 1982³, will continue to have priority over international interest and do not need to be registered to have effect. Accordingly, the proposed ratification of the Convention and the creation of new international interests over aircraft assets will not do anything to improve financiers’ and lessors’ exposures in this regard.
3. The Government has failed to address the anomaly in the definition of an ‘aircraft object’⁴ which does not include uninstalled helicopter engines. The different treatment of helicopter engines under the Cape Town Convention is controversial and unhelpful to operators (who frequently switch

engines) and their lessors who, as a result, are required by their financiers to register prospective interests against installed engines in anticipation of their removal. This practice is also rather unusual because helicopter engines are less valuable than, for example, the rotors or gear boxes, which also do not qualify as aircraft objects at all. UK helicopter lessors and operators can now expect renewed and, needless to say, unwelcome pressure from financiers to record prospective interests against installed engines.

4. The Regulations are not retrospective and therefore pre-existing interests (e.g. leases) that would otherwise be registrable, need not be registered. Whilst this is in line with what all other ratifying countries have done in the past, it is good news for UK operators and therefore is welcome.
5. Finally, the Regulations address the conflict between the ruling in the Blue Sky⁵ case and the provisions of the Cape Town Convention. This aspect of the Regulation (which, admittedly, could have been brought into law independent of and much earlier than this ratification) should nonetheless be welcomed. Regulation 6 provides that an “*international interest has effect where the conditions of the (Cape Town) Convention are satisfied (with no requirement to determine whether a proprietary right has been validly created or transferred pursuant to the common law lex situs rule)*”. The

effect of this is likely to remove the requirement for the UK courts to ascertain whether an international interest has validly been created pursuant to the Cape Town Convention which should help to alleviate some creditors’ concerns regarding the use, and effectiveness, of English law mortgages.

What does it mean in practice?

The fact of the matter is that irrespective of whether this ratification is necessary or even desirable in the UK, it is going to happen and the Cape Town Convention will have effect in the UK in the near future. Therefore stakeholders in the industry and, in particular airlines and operators, need to get ready to be compliant with it and be able to administer registrations.

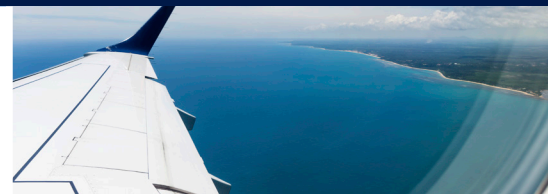
Due to the fact that the International Registry only includes consensual transactions, all parties to a transaction must approve the recording of an international interest in writing and to do so each party to a transaction (e.g. the seller, buyer, lender, lessee and/or sublessee) must register as a Transacting User Entity (**TUE**) and identify an individual within the organisation who will act as an administrator. Whilst registering as a TUE is unavoidable, the administration of registrations of international interests may be largely outsourced to a Professional User Entity (**PUE**), thereby reducing the overall administrative burden on the TUE.

2 A bilateral agreement entered into between the United States and the EC (as it was then known) in 1992 which prohibits any direct government support for the acquisition of large civil aircraft.

3 As demonstrated not too long ago in *Global Knafaim Leasing Limited and CGTSN Ltd v The CAA and Others*.

4 As defined in the Cape Town Convention, means airframes, aircraft engines and helicopters.

5 *Blue Sky One Limited & O’rs v Mahan Air & Ano’r* [2010] EWHC 631 (Comm), which reaffirmed the applicability of the lex situs rule to the creation of interests in aircraft.



How can HFW help?

We are registered as an Administrator on the International Registry (both in our London and Sydney offices) meaning that, subject to our appointment as a PUE, we can facilitate the registration of entities as TUE's and register International Interests and do so at any time of the day. We have acted in that capacity for clients and have experience in handling registrations and related matters for them, including conducting searches on the International Registry and providing title reports and legal opinions.

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