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Security interests burdening transport vehicles – The Cape Town Convention and its implementation in national law

General Report

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Souichirou Kozuka
Professor of Law
Gakushuin University, Tokyo

Souichirou Kozuka

Introduction

The Cape Town Convention\(^1\) and its Aircraft Protocol\(^2\) has marked a remarkable success in terms of the number of States Parties and the volume of transactions. Only few other uniform law instruments have paralleled their achievements. Not only have they had a significant impact on the practice of aircraft financing, but also their intellectual influence on the designing of secured transactions law deserves careful analysis.

On the other hand, we note many important jurisdictions, in particular those belonging to the Civil Law family, have not become a Party to them. Further, the second and third Protocols to the Convention, on security interests in the railway rolling stocks\(^3\) and space assets\(^4\), respectively, have not met as much enthusiasm as the Aircraft Protocol yet, while Unidroit and some collaborators are making efforts to bring them into operation.

To explore into the theoretical and academic background of the Cape Town Convention, the general reporter picked up several issues with regard to the security interests in transport vehicles, in particular, aircraft. The issues cover from such interests’ formation to their registration, enforcement and finally their status in insolvency procedure. 12 national reports have been contributed, 4 from State Party jurisdictions to the Cape Town Convention\(^5\) and 8 from non-State Party jurisdictions.\(^6\)

One remark may be needed with regard to the terminology. Throughout this general report, as well as in all the national reports, the term “Cape Town Convention” is used to refer to the Convention and its Protocols as a whole. This can be justified not least because the Convention and Protocol should be read and interpreted together as a single instrument (art.6 of the Convention). When referring specifically to the Convention itself and not Protocols, the term “the

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5 Canada, Malaysia, The Netherlands and the United States.
6 England and Wales, Finland, France, Greece, Italy, Poland, Portugal and Switzerland.
"Convention" is used. The three Protocols are respectively mentioned by the common names “Aircraft Protocol”, “Rail Protocol” and “Space Assets Protocol.”

I. The Cape Town Convention as new type of uniform law instrument

The origin

The drafting of the Cape Town Convention started in 1994. Following the two UNIDROIT Conventions on leasing and factoring, it was one of the projects of UNIDROIT on unification of finance law. The original idea of drafting a general convention on security interests on mobile equipment, broadly covering every kind of high-value mobile assets, was abandoned at the early stage of the work. Instead, the “umbrella” structure of the Base Convention and three Protocols was adopted. The Base Convention and the first Protocol on Aircraft were adopted at the Diplomatic Conference in Cape Town in 2001, hence the popular name of the Convention after the name of the city. The second Protocol relating to the Railway Rolling Stocks was adopted in 2006, at the Diplomatic Conference in Luxembourg. As a result, the Protocol on the Railway Rolling Stocks acquired the popular name of the Luxembourg Protocol. The third Protocol, which applies the rules of the Cape Town Convention with necessary adaptations to the space business, was adopted in Berlin in 2012, and is known as the Space Assets Protocol, without celebrating the name of the city.

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The current status

The approach of concentrating first on the law of aircraft financing by drafting the Convention and Aircraft Protocol ahead of other protocols has proven to be successful. Both instruments entered into force in 2006, after the Aircraft Protocol became effective with its eighth State Party. Today, the Convention has 61 States Parties (including the European Union) and the Aircraft Protocol 55 States Parties. There is no doubt that the Convention and the Aircraft Protocol has come to form the integral part of the international air law in less than fifteen years of the
adoption.

Two other Protocols are on their way to catch up with the Aircraft Protocol. The Rail Protocol still has only one State Party, namely Luxembourg, in which state the International Registry is located. The Space Assets Protocol has four Signatories but no Party yet. Still, the Rail Working Group to promote the ratification and use of the Rail Protocol has attracted most of the major industry members and are discussing the financing scheme under the Rail Protocol. The Space Assets Protocol, on the other hand, is recognised as the first private law instrument in space law and has attracted much attention from the experts in space law.

*States with more than one jurisdiction*

The Cape Town Convention assumes that some State Party can be a state with multiple jurisdictions, and allows such a State to implement the Convention only in some of the jurisdictions, or the entire State. The choice is with the State becoming a Party to the Cape Town Convention, and the domestic procedure depends on the constitution or other relevant law of that State.

Canada has had a unique experience in this regard. While the air law is considered to fall under the federal jurisdiction according to the case law on the Constitution of Canada (*Loi constitutionnelle* de 1867), the property law (secured transactions law) and the Civil Code belong to the state jurisdiction. As a result, even after the federal government acceded to the Cape Town Convention, the effect took place only in those states that enacted implementing legislation. It will only be in November 2014, when the legislation in New Brunswick becomes effective, that the Convention and Aircraft Protocol will be applicable to the whole territory of Canada.

The European situation appears to be no less complex. The European Union claims the competence on the recognition and enforcement of judgements, insolvency and choice of law under the Treaty on the Functioning of the European Union and ratified the Convention and Aircraft Protocol as far as these matters are concerned. The result is that member states of the European Union may become a Party to the Convention and Aircraft Protocol only subject to the accession by the European Union. For example, because the European Union made no declaration as to the treatment of international interests under the insolvency procedure, member states may not opt in to Alternative A.

The complexity arose with regard to the ratification by the Kingdom of Netherlands. As detailed in the national report from The Netherlands, the Kingdom now consists of the European part and Caribbean part (Bonaire, Sint Eustatius and Saba) as well as three “countries,” namely Aruba, Curaçao and Sint Maarten. The Kingdom acceded to the Convention and Aircraft Protocol in May 2010 for “Aruba and the Netherlands Antilles,” based on the structure of the Kingdom at
that time. According to the Note Verbal of the government of the Netherlands, the Convention and Aircraft Protocol is now applicable to the Caribbean part of the Kingdom and three autonomous countries in the Caribbean region.

The emphasis of the policy intent

The Cape Town Convention was drafted in a very different manner from traditional uniform law instruments. It does not simply attempt to unify the laws of various jurisdictions by choosing one of the existent domestic laws or creating a “middle ground” rule among them. Rather, the drafters had the clear goal of establishing a legal framework conducive to asset-based financing that will bring about the economic benefit from larger availability of financing to the State Party. It was recognised that three principles were needed to achieve this goal: (1) transparency in the priority among secured interests, (2) the prompt enforcement of secured interests in case of default by the debtor, including the admissibility of private enforcement, and (3) the enforcement of the secured interests without being qualified or modified under the insolvency procedure.

One of the difficulties in producing an international instrument with such a strong policy goal is that the negotiating states may not reach a consensus on the desirable policy. Rather than adopting a compromised solution in the course of negotiations, and as a result mitigating the intended policy effect, the Cape Town Convention incorporated options in various provisions. The idea was to accommodate conflicting views on the policies at the stage of negotiations, and to postpone the decisions to the time when states ratify the Cape Town Convention and make declarations on whether or not to opt in or opt out. Under this mechanism, the economic benefit to be achieved will vary, depending on the set of rules opted by the ratifying states. In order to gauge the degree of achieved economic benefit, the “qualifying declarations” were devised under the framework of the Aircraft Sector Understanding of the OECD (Organisation for Economic Cooperation and Developments).

If the Cape Town Convention is expected to realise the economic benefit to the States Parties, it is obvious that formally adopting the rules in the instrument is not sufficient. Hence one of the drafters recently argued that the economic benefit will result not only from the drafting of the rules but also from the ensured implementation within the State Party (namely the exclusion of the existent law and regulation that can conflict with the Cape Town Convention) as well as the actual compliance (for example, enforcement through the court decisions) after the ratification.

Creation of a global scheme

Another unique feature of the Cape Town Convention is that it creates a global scheme of
International Registry. While the transparency of priority among security interests, the first of the three principles of asset based financing, can be achieved through the establishment of a reliable domestic registry, the International Registry accessible online for 24 hours/7 days basis ensured that the needed transparency is ensured in any State Party. It is useful, in particular, where the financiers are worried about the inefficiency of outdated registry system or corruption of registrar’s officers.

On the other hand, the establishment of the International Registry to be operated by the Registrar requires such number of registrations that will make the Registrar viable on fees paid upon registration and search. In other words, the global scheme needs a sufficient amount of volume in transactions. The national report of the United States argues that the registry procedure under the Aircraft Protocol, in particular the option for the State Party to designate an entry point, has enabled the ratification by the United States, which was essential in this regard.

II. Unifying a variety of domestic rules

Though the Cape Town Convention has some unique features as uniform law instrument, it is nonetheless an international private law instrument, with the effect of converging the domestic law rules that currently vary from one jurisdiction to another. However, such unification is achieved only on some issues. On other issues, the Cape Town Convention leaves options that are open to State Parties to choose through declaration. While it may be seen as the modest approach, the limited unification has been rather the norm under the traditional uniform law instruments, as is indicated by the frequent reference to “certain rules” in their title.

Mortgage over transport vehicles

The Cape Town Convention defines the “international interest” to be registered in the International Registry as including the interest under a security agreement, the title reserved by the conditional seller under a title reservation agreement, as well as the right of the lessor under a leasing agreement (art.2 (2) of the Convention). The first of these types of interests is the non-possessory security interest, which does not require the holder of the security interest to take possession of the secured object. While jurisdictions are divided over whether movables in general can be the subject of such non-possessory security interest, such an interest may be constituted and registered the relevant registry in all the reported jurisdictions as long as the aircraft is concerned.

In some jurisdictions, movable assets in general can be mortgaged and no special law is
needed with regards aircraft. Canada belong to this group, with the Personal Property Security 
Act (PPSA) in common law states and Code Civil in Québec. Poland may be said to be the same: 
although mortgage cannot be constituted in aircraft, railway rolling stock or space assets, unlike 
ships, registered pledge may be constituted in these transport vehicles. Registered pledge is 
distinguished from the regular pledge in that the possession need not be transferred to the pledgee 
but that registration with the registry operated by the district courts suffices. In the United States, 
security interests in transport vehicles may be created under the common law, though the general 
filings under the Uniform Commercial Code is available only to space assets, because secured 
transactions over rolling stock is to be filed with the Surface Transportation Board (STB). Prior 
to the ratification of the Convention and Aircraft Protocol, secured transactions over aircraft were, 
in a similar manner, to be filed with the Federal Aviation Authority (FAA).

Many other jurisdictions have special rules on aircraft mortgage with the registry for that 
purpose being established. England (Mortgaging of Aircraft Order 1972.25), Finland (Aviation 
Act (1194,2009), Greece (Law 1340/1983), Italy (Codice della navigazione), Portugal (Decreto 
No.20.062, 25 October 1930) and Switzerland (Loi fédérale sur le registre des aéronefs, du 7 
octobre 1959: LRA) are the jurisdictions of this group. Malaysia (Civil aviation regulations 1996) 
and the United States (FAA registry) are the States Parties to the Convention and Aircraft Protocol, 
but they also maintain their domestic registries for registering mortgages on aircraft. In Finland, 
the parallel system of enabling the creation of mortgages exists for railway rolling stock under 
the Vehicle Mortgage Act (810/1972).

Floating charges are usually not registrable with these registries, as noted in the national 
reports of England and Wales and Malaysia (Regulation 157). Though the concept of floating 
charge originated in England, somewhat similar kind of transaction has been used for financing 
the railway businesses in other jurisdictions, such as the gage général in Switzerland. Interestingly, 
the Swiss government has recently excluded the rolling stock from the subject of gage général in 
preparation for the entry into force of Rail Protocol. The Cape Town Convention does allow 
floating charges over the object and spare parts, in the case of Rail Protocol including the 
accessories to rolling stock, but the security interests under the Cape Town Convention do not 
extend to the whole enterprise. The apparently transitory status of the current Swiss law reflects 
such difference between the traditional financing and asset based financing.

As compared with these registration systems under the domestic law, the meaning of Cape 
Town Convention is twofold. As far as aircraft is concerned, there already exists domestic 
registration in each jurisdiction and the International Registry under the Cape Town Convention 
replaces at least some of its roles. As regards the space assets and, in many jurisdictions railway 
rolling stock as well, the International Registry is a novel scheme enabling the asset based 
registration of security interests in such mobile equipment.
For space assets, no state appears to have established a special registry for registration of security interests, though, as noted above, space assets might be registered in the general registry for security interests, as in the case of Canada, Poland and finally the United States (UCC Article 9). One national report (Switzerland) suggests that, in the absence of specific registry, pledge may be created through taking possession of the space asset, which by nature will be indirect possession through control from the ground.

Title-based security (Quasi-security)

Two other types of secured transactions governed by the Cape Town Convention are retention of title and lease. In jurisdictions where the **numerus clausus** rule is adopted for secured transactions, these transactions are not secured transactions. Still, the creditor’s interest can be secured through the title (ownership) to the object and is enforceable by termination of the contract accompanying recovery of the title (ownership). Hence, these transactions are known as “title-based security.” More functional terms are “quasi-sûretés” in Québec and “quasi-security interests” under the English law.

The major issue with respect to these title-based securities is whether or not to subject them to the same or parallel rules as the mortgage or **hypothèque**. In some jurisdictions, it is considered that a transaction-type of the same function must be regulated in the same manner, which may be called “functional approach.” In others, emphasis is given more on the differences in the form, in which case title-based security is not subjected to the same rules as the mortgage or **hypothèque**.

The well-known case of functionalist approach is the Article 9 of the Uniform Commercial Code (UCC) in the United States. However, as far as the lease is concerned, UCC Article 9 only applies to leases for security purposes, not to most of the leases that are not for security purposes. The PPSA of common law states in Canada has a larger scope of application and applies not only to transactions creating security interests but to non-financial lease of more than one year (except in Ontario). **Code Civil** of Québec distinguishes property law and contractual “quasi-sûretes”, but it is reported that generally the parallel rules apply to both, including the registration.

On the other hand, the traditional formalism is maintained in England, Greece and Poland. In England, finance leases, conditional sales agreements, hire-purchase agreements and retention of title clauses, collectively known as title-retention agreements, are not subject to registration, unless the court re-characterises the transaction as security interests. Nor are they governed by the same rules with regard to the enforcement as security interests. Further, operating leases are entirely out of the scope of mortgage registration. In a similar note, Greek report emphasises the distinction between the mortgage (simple and preferred mortgages) as property right (real right) on the one hand and leases and title-reservation agreements as contractual right on the other hand.
This is so notwithstanding that there is a special statute on aircraft leasing (Law 1665/1986, as amended). The Polish report echoes such a distinction as the basic thought, though it notes that a special rule for the conditional sale to become opposable vis-à-vis the buyer’s creditor through production of confirmation in writing with the authenticated date.

An interesting hybrid regulation is identified in Portugal, where the title reservation agreement and financial leasing over aircraft is subject to registration and the functional approach is emphasised. Though much to a limited extent, the functional approach towards retention of title and finance leases seems to find acceptance in Italy. It is reported that commentators tend to take into consideration the function to secure the credit of these transactions, but that these new thoughts have not affected the treatment in insolvency proceedings or enforcement yet.

It is important to note that the Cape Town Convention unifies these divergent rules only at minimum. The unification is achieved to the extent that the title reservation agreements and leases can be registered in the International Registry. It has gone even further than the US law, as any kind of lease is registrable. On the other hand, as far as the enforcement is concerned, the Cape Town Convention distinguishes the charges (Art.8 of the Convention) and title reservation agreements and leases (Art.10 of the Convention) and subjects the latter to the treatment as title based security. It is important to note that the distinction of the three types of international interests is to be made according to the applicable law (Art.2 (4) of the Convention). Thus, the meaning of “charge” or “lease” differs in those jurisdictions adopting the functional approach and those not, which means that the divergence in domestic law is not overcome.

**Enforcement of security and title-based security**

Whichever the kind of international interest may be, the Cape Town Convention entitles the creditor to a variety of remedies in case of default of the debtor. Besides the simple liquidation, the creditor may grant a lease of the object and collect or receive any income or profits arising from the management or use of the object (art.8 (1) of the Convention). It is also permitted to the creditor to satisfy the secured obligations by vesting the ownership of the object by the agreement of the chargee and other interested parties or by the court order (art.9 of the Convention). Further, if the international interest is a title reserved by the conditional seller or a lessor’s right (as opposed to an interest under a security agreement), there is no need for the creditor to pay the balance to the debtor even when the amount of the balance is larger than the amount of the secured obligation (compare art.10 with art.8 (6) of the Convention). The Aircraft Protocol even adds an aircraft-specific remedy to the list of available remedies, namely to procure the de-registration of

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7 Goode, Official Commentary, supra note para.4.101.
the aircraft and procure the export and physical transfer of the aircraft object from the territory in which it is situated (art.IX (1) of the Aircraft Protocol). Then the States Parties are required to choose as option through mandatory declaration whether these remedies are available out of the court or only through the court procedure (art.54 (2) of the Convention).

Again, the extent of the variety of available remedies is not the same in every jurisdiction. One of the jurisdictions that prepare an extensive list of remedies is England, where the reporter mentions the repossession of the asset, sale of the asset, foreclosure (satisfaction by the secured object through court order) and appointment of receiver as four main methods of enforcement for the security interest in the proper sense. PPSA in the common law states of Canada and the UCC Article 9 in the United States are generally consistent with the Cape Town Convention. Under the Greek law, the mortgagee of a preferred mortgage in aircraft may take possession of the aircraft without any court procedure, on condition that the mortgage is in the form of a notarial deed, which is regarded as one of the enforceable titles in Greece. In other jurisdictions, such as Poland, the pledgee of a registered pledge can avail itself of a more limited set of remedies, basically the judicial enforcement (judicial sale). The same is true with Italy and Portugal, where the agreement on satisfaction by the secured object (*pactum commissorium*) is not valid. Such an agreement is considered not to be valid under the Dutch Civil Code, either, which appears to have been one of the reasons why the Netherlands chose not to accede to the Cape Town Convention with the effect over the European part of the Kingdom. Under the *Code Civil* of Québec, it requires the court’s permission when the debtor has discharged half or more of the secured debt. Because of such difference between the Code Civil and the Cape Town Convention, Québec needed to change its law when Canada, upon accession, made the declaration under Article 54 (2) of the Convention to enforce international interests without resort to the court.

A few jurisdictions accommodate parties’ agreement on the variety of remedies. The Finnish report remarks on the parties’ freedom of agreement and affirm that the agreement, maybe as a clause in the financing agreement in practice, on the types of remedy available to the creditor is valid. Also in France, the reform of 2006 brought much flexibility to the secured transactions law so as to affirm the validity of agreement on satisfaction by secured object as well as to authorise the court to order transfer of the secured object as the remedy. The Swiss law is also generous in upholding the validity of an agreement on the manner of enforcement. The national report of Switzerland interestingly notes that, while in general an agreement on private enforcement is valid, it is not allowed with regard to the exercise of a mortgage in aircraft, due to the Geneva Convention on the international recognition of rights in aircraft.

The remedies available to the holder of the title-based security are even more divergent, reflecting the varying attitudes towards the functional approach. On the one hand, there are jurisdictions in which the form of title is emphasised and the creditor is given a larger power than
a mortgagee. England is the typical case, where the owner under a title-retention agreement (such as seller reserving the title or lessor under a lease) may reclaim the full ownership upon the occurrence of the repudiatory breach of the agreement. The remedy is available with or without the court procedure and the owner is under no obligation to account for the balance of the value of the object and the secured claim. The right of the conditional sellers and lessors in Italy is the same.

On the other side of the continuum stands the jurisdiction adopting the functional approach, most typically the United States. Poland is similar in that its law requires the payment for the balance between the value of the object and the remaining amount of claims when the creditor of a security or title-based security repossesses the object. Such a duty to pay for the balance can be waived by the agreement in case of a lease and conditional sale, but not in case of a registered pledge. Then, the hybrid solution seems to be taken by France, where the owner repossessing the object is required to pay the balance in the case of finance lease, but not with the reservation of title.

*The protection of the debtor’s interests*

One of the rationales behind regulating the enforcement of security and title-based security is the need to care about the debtor’s interest. The Cape Town Convention requires the creditor to exercise its right “in a commercially reasonable manner” (art.IX (3) of the Aircraft Protocol, art.VII (3) of the Rail Protocol, art.XVII (1) of the Space Assets Protocol). Seemingly in contrast, the national report for England and Wales point out that the mortgagee enjoys the “unfettered discretion” as to the timing of enforcement. However, the English law also assumes that the mortgagee must act fairly towards the mortgagor, and that the mortgagee having determined to proceed to the sale of the asset owes the duty to take reasonable care about achieving a proper price. As a result, it is predicted that the test of “commercially reasonable manner” may not cause much difficulties to English courts.

A somewhat different approach is taken in Italy, though in a limited context. Under the *Codice della navigazione*, the mortgagee of chattel mortgage over aircraft, as opposed to the general mortgage under the *Codice civile*, provides that the court may order the continued use of the aircraft against provision of the security and discharge the credit by the proceeds from such continued use.

*Events of default*

Under the recent practice of financing, default does not simply mean the failure to pay the
due monetary claim. Various covenants accompany the financing agreement and breach of those covenants constitute events of default, which entitles the creditor to request remedies. The Convention reflects such a practice by affirming the validity of an agreement between the creditor and debtor on the meaning of “default” (art.11 (1) of the Convention).

The same policy of freedom of agreement is adopted in Canada (both common law states and Québec), England, Finland, Switzerland and the United States. The English court seem to be one of the most generous in this regard, convinced of the view that the parties to the agreement are the best judge of the commercial fairness. On the other hand, some jurisdictions are skeptical about such an agreement. The Dutch report points to the “open-ended concept of ‘default’” under the Cape Town Convention that is different from the Civil Code of that country. In a similar note, the traditional concept of three types of “default”, namely the non-performance, impossibility of performance and delay in performance, is maintained in Portugal. Poland may be the same as the Polish report emphasises that only the monetary claim can be secured by the registered pledge, as opposed to a lease and conditional sale, which are governed by a larger extent of freedom of agreement. The Greek law is also negative about the freedom in defining “default” is an agreement.

The (in)significance of legal family and the role of the Cape Town Convention

As overviewed in this chapter, the law of security and title-based security interests is more than diverse among jurisdictions. It is interesting to note, in this respect, that the diversity does not correspond to the difference between the common law and Civil law. On the one hand there are issues such as the functional approach, over which the English and American law differ significantly. On the other hand, unlike the secured transactions law in general, the law on aircraft finance has historically responded to the practice in the specific sector, as shown in the fact that most jurisdictions have a special register for mortgages in aircraft. Further, recent reforms on secured transactions law, as in the 2006 law of France or 1996 law of Poland, have diminished the differences between the common law and Civil law.

As regards the divergences remaining somehow, the Cape Town Convention has achieved unification, but only modestly. It has ensured the registrability of title-based security as well as non-financial leases, which in many jurisdictions are not regarded as security interests. It also has validated the agreement on the meaning of “default,” besides stipulating a variety of remedies useful in the practice of aircraft finance. However, the Cape Town Convention has not gone beyond there and has reserved the option to be chosen by State Parties on, for example, the admissibility of private enforcement. Further, some important issues are left to the court, as in the case of characterisation of the transaction or interpretation of the requirement of “commercially
reasonable” manner in the enforcement.

III. Modernisation of the law on transport vehicle finance

Filing system for security interests

The Cape Town Convention has introduced the International Registry for registering the international interests. Although equivalent registers for security interests in aircraft are in existence in most jurisdictions, there is a large variety in the design of them.

As a matter of design of the registry, the International Registry under the Cape Town Convention is an asset-based registry. It is the rule in many jurisdictions, where the security interests are registered in the special registry, such as Finland (register maintained by the Finnish Transport Safety Agency (TraFi)), Greece (records maintained by the Civil Aviation Authority), Italy, and Switzerland. Even in the United States, where the debtor-based filing under the UCC Article 9 is widely in use, security interests in aircraft are filed with the FAA and those in railway rolling stocks with STB, both of which constitute asset-based filing. The Registry of Pledges in Poland is also asset-based, though the registry is of general nature, not specific to aircraft.

The opposite is true in Canada. The Canadian Registers under the PPSA (in common law states) and the Code Civil (of Québec) are debtor-based. More complicated situation is found in England, as there the floating charge cannot be registered in the Register of Aircraft Mortgages and must be registered with the debtor-based Register of Company Charges. Failure to do so will make the floating charge void against a liquidator, an administrator or a debtor of the company. The same problem used to exist in Malaysia, but adequately solved after Malaysia’s accession to the Convention and Aircraft Protocol. The International Interests in Mobile Equipment (Aircraft) Act 2006 (Act 659), which implements the Convention and Aircraft Protocol in Malaysia, explicitly excludes the application of the debtor-based registration of a charge under subsection 108 (3) of the Companies Act 1965 (Act 125). England will enjoy the same simplification in their registry system once the United Kingdom becomes a Party to the Convention.

A somewhat similar bifurcation of registries is observed in France. The financial lease (credit-bail) is publicised based on the Code monétaire et financier, which is a debtor-based publication, apart from the registry for gage in mobile assets.

In a State that has become Party to the Cape Town Convention, the International Registry under the relevant Protocols will substitute the existent domestic registry. It does not mean, however, that the domestic registry is abandoned. In Malaysia, all the Regulations based on the Civil Aviation Act 1969 have remained unchanged. The national report wonders whether there is
no problem of compliance arising from this and conclude that, while the regulations will be relevant to only internal transactions as defined in Article 1 (n) of the Convention, there can be a formal problem of non-compliance, as Malaysia has not made a declaration under Article 50 of the Convention to exclude its application to internal transactions.

Procedure and practice of filing

The general idea of having a registry for security interests is to determine the priorities among the competing interests by the timing of registration. The first to register will be granted the first priority, whether or not the first registrant had knowledge of the existence of an unregistered creditor. This is the rule clearly provided under the Cape Town Convention to achieve transparency of priorities (art.29 of the Convention). However, in some cases, the registration system under the domestic law has developed differently.

For example, Finland has developed a unique practice of filing. While the basic rule for filing with the registry for mortgage in aircraft requires that the secured amount is fixed, the demands for a more flexible arrangements arose. In order to meet such demands, according to the Finnish national report, the practice has developed to use a bearer bond not reflecting an actual debt to satisfy the formality. There are even forms made available on the website of the TraFi. Under such a practice, a mortgage becomes opposable vis-à-vis third parties (or “perfected” as termed in some jurisdictions) not by registering the mortgage but by acquiring a possession of a “bearer bond that contains the register authority’s entry concerning the mortgage.” The national report mentions that there was a proposal to make a reform to the current practice in 1992, but without any outcome.

In Switzerland, the derogation of practice from the law seems to exist in the opposite manner. The aircraft mortgage registry in Switzerland has a constitutive effect, entitling one who trusts the registration in good faith to the acquisition of right. Under this system, the priority is determined not by who registers first, but how the registration is made: even if the mortgage of the first rank is deleted as a result of discharge of the secured debt, the second ranked mortgage does not go up, unless otherwise agreed. The vacated first rank can be used by a new creditor appearing later, thus prevailing over the second ranked mortgagee who registered earlier. The Swiss report argues that the practice is closer to the Cape Town Convention by utilising the “agreement otherwise” to promote the second ranked mortgage to the first.

Multiple layers of special laws

If the derogation of practice from the statute is complicating, the parallel existence of more
than one system may as troublesome to creditors. It may be the case in Italy, where the charge under the 1993 Banking Law (Bank Charge), only available when bank is extending finance, is registered Tribunale independently from the ordinary aircraft chattel mortgage. The Italian report elaborates that the priority between two Bank Charges is determined by the first-to-file rule, whereas the priority between a Bank Charge and another right, including the aircraft chattel mortgage, depends on the ascertained date of the latter right and the date of registration of the Bank Charge.

To a lesser extent, the Greek law has some complications as well, because there are two types of mortgages: simple mortgage and preferred mortgage. Both are registered in the same Registry, and the priority is determined by the date of registration. However, the remedies available to the mortgagee are different. This might imply that the mortgagee of the lower priority needs to see which mortgage it is that is registered with the priority to it.

*The effects of the Cape Town Convention*

While the general idea of establishing registries for aircraft mortgage is almost commonly shared, the design, effects and practice of the registration differs so much from jurisdiction to jurisdiction. Often it is not sufficient to consult only one registry, and the creditor needs to be skilled enough to ensure the priority of its right. Not a few national reporters deplore that their law is outdated or unsatisfactory.

It is obvious that the International Registry under the Cape Town Convention can serve as modernisation of outdated or complicated domestic system. As a single and simple system, under which only the first-to-file rule applies, it will improve the practice of aircraft financing. Unlike the modest unification discussed above, the modernisation effect of the Cape Town Convention is significant, as no compromise has been made with the simplicity of first-to-file principle.

**IV. Creation of the competitive legal environment**

*Enforcement of security interests in insolvency proceedings: automatic stay and cram down*

An international interest under the Cape Town Convention can be exercised even after an insolvency procedure is commenced with the debtor, without being stayed automatically or by an order of the insolvency administrator (art.XI of the Aircraft Protocol; art.IX of the Rail Protocol; art.XXI of the Space Assets Protocol). Further, the Cape Town Convention requires that the

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8 All three Protocols provide alternatives that differ in the extent of the power that the creditor can
registered international interest remain effective under the insolvency procedure (art.30 (1) of the Convention). If the State Party in its declaration chooses an alternative more favourable to the creditor, the creditor’s position is even more strongly protected so that no obligation of the debtor may be modified without the consent of the creditor (alternative A of art.XI of the Aircraft Protocol; alternatives A and C of art.IX of the Rail Protocol; alternative A of art.XXI of the Space Assets Protocol). Such “bankruptcy remote” feature is one of the key elements of the Cape Town Convention.

The domestic laws usually distinguish among the insolvency procedure the liquidation-type and the reorganisation-type. The law of Finland is typical: while the mortgagee enjoys the “separatist” position in the liquidation-type bankruptcy procedure, its exercise of right is stayed by the commencement of reorganisation procedure. Italy is on the same line in that the general insolvency procedure for liquidation and extraordinary receivership for reorganisation differ on this issue. While the mortgagee is, in principle, not preempted under the general insolvency procedure, once the extraordinary receivership is opened, the mortgagee’s exercise is restrained. In England, the structure is similar in that liquidation and administration are distinguished and the enforcement of interests over assets is subject to consent of the administrator under the administration. However, the national report quotes an analysis that even under the administration, the emphasis will be on the interest of the secured creditor in balancing with the interests of other creditors and that, as a result, a leave to enforce should normally be granted. Further, the national report for England and Wales notes that the “creditor-friendly approach” of English insolvency law was well recognised by rating agencies in enabling the British Airways to place Enhanced Equipment Trust Certificates (EETC) in the US market without becoming a Party to the Cape Town Convention.

An interesting development in this regard is found in Portugal, where the new Insolvency and Recovery Code of 2004 (CIRE) has integrated the procedures of bankruptcy (liquidation) and restructure (recovery). Under the integrated “insolvency” procedure, the emphasis is placed more on reorganisation of the insolvent debtor and the exercise of rights is restrained.

Among the States Parties, the United States did not make any declaration under art.XI of the Aircraft Protocol. In such a case, according to art.30 (2) of the Convention, the applicable law determines the status of the international interest. Assuming that the applicable law is the US law, Art.1110 of Chapter 11 of the Bankruptcy Code of 1978 provides exactly the same rule as Alternative A under art.XI of the Aircraft Protocol, specifying a 60-day period. It must be

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exercise in case of insolvency of the debtor. However, even under an alternative less favourable to the creditor (Alternative B), the insolvency administrator or debtor in possession shall either cure all defaults and agree to perform all future obligations or give the creditor the opportunity to take possession of the secured object. Alternative C of art.IX of the Rail Protocol seems to be the only exception, which enables the insolvency administrator or the debtor to apply to the court for an order suspending its obligation.
emphasised that Chapter 11 of the Bankruptcy Code is a reorganisation process, and the basic principle there is that the exercise of any security interest is automatically stayed upon the commencement of the procedure and that the secured creditors form a class to vote on the reorganisation plan, subject to the possibility of cram down. There is a historical background in the United States, dating back to 1935, of adding then art.77 (j) to the Bankruptcy Act of 1898 (now art.1168 of the Bankruptcy Code) that allowed the owner of conditionally sold or leased railway rolling stock to take possession of the collateral even after the commencement of the reorganisation procedure.

Other two States Parties for which the national reports were supplied, Canada and Malaysia, both made a declaration opting in Alternative A under Art.XI of the Aircraft Protocol. In Canada, the federal laws on insolvency (Loi sur la faillite et l’insolvabilité, Loi sur les arrangements avec les créanciers des compagnies, and Loi sur les liquidation et les restructurations) were amended in order to implement Alternative A fully, since the latter federal laws were not compatible with Alternative A in that, for example, the secured creditor must notify its intention to exercise its right in advance and could be subject to a suspension. Malaysia also appear to have experienced modifications to its insolvency law by opting in Alternative A, but apparently no reference is made to insolvency statutes in the implementing law (International Interests in Mobile Equipment (Aircraft) Act of 2006) as being excluded. The compliance with the Convention and Aircraft Protocol will still be ensured by the general clause in the same Act stipulating that the Convention and Aircraft Protocol prevails in case of conflict with any domestic law.

**Title based security (quasi security) under insolvency proceedings**

Another interesting issue with regard to the law of insolvency is the status of title-based security. Here again, the problem of functional approach emerges. For example, France and Switzerland does not adopt the functional approach and do not recharacterise the title-based security transaction. As a result, the owner under a conditional sale or finance lease does not have to file its “claim” and are treated as the owner of the asset in the insolvency procedure. A similar approach is followed by Italy, where both the retention of title and lease agreements are subject to the insolvency administrator’s option to either maintain the agreement or terminate it.

A few jurisdictions report that the title-based security could be rather more disadvantaged than security interest holders. Under CIRE of Portugal, title reservation agreement is opposable in the insolvency procedure on condition that the agreement is in writing before the delivery of the asset. However, this rule does not apply to a lease agreement. Greek report also points to earlier court decisions that denied the effect of title reservation agreement in the insolvency procedure, though it also notes that the opposite view is becoming prevalent recently.
The solution of the Cape Town Convention on this issue is quite simple. The title in the conditional sale or lease is an international interest under the Convention and, therefore, shall be treated just as the security interest in insolvency procedure. If a State Party opts in Alternative A under Art.XI of the Aircraft Protocol, therefore, the holder of the title is not subject to stay of exercise of right or reorganisation plan modifying its right, still less cram down by the insolvency court. In some jurisdictions where the functional approach is not taken, it is simply equivalent to applying the basic rule.

The use of economic analysis

The insolvency-related rules of the Cape Town Convention is apparently creditor friendly. It could raise debates in a State that considers becoming a Party to it whether such a policy is acceptable to that State or not. The issue can be controversial, since the recent trends in thoughts of insolvency law is, as seen in the recent insolvency law of Portugal, to limit the creditors’ rights and ensure early reorganisation of the debtor, as otherwise the debtor’s business value will deteriorate quickly.

Hence, the Italian report emphasises that policy of Cape Town Convention can be justified only “in a restricted and highly specialized economic sector.” The French report also points out that, while most part of the Cape Town Convention is in line with the current French law, the rules on insolvency of the debtor differ significantly. Here, contrary to the traditional uniform law instruments that tend to produce either rules acceptable to the majority of the states or compromised rules, the Cape Town Convention posed a strong, if minority, policy and saw whether States would turn to such a policy. Theoretically, it may be seen as testing the uniform law instrument in the “law market” in which drafters of law compete with each other on how much support the produced law attracts.

It is for this reason that the drafters of the Cape Town Convention conducted an empirical economic study to find how beneficial the instrument could be to the debtor and, ultimately, the society as a whole. As the English report hints with regard to the creditor friendly English law, in the sector of aircraft financing, where asset based financing has become the mainstream, the enhanced status of the secured creditor will bring about the legal certainty and foreseeability, which in turn will be reflected in the advantageous conditions for finance that the debtor can avail itself of. The empirical study turn such a possibility of benefits to the debtors to the evidence of economic advantages, which seems to have made a significant success in convincing many States to ratify the Convention and Aircraft Protocol.

Against this background, it is interesting to see whether such use of economic empirical study is common, or at least accepted, in various jurisdictions. In many countries, “the economic
effect” in an abstract term seems to be one of the elements to be considered in the legislative process. However, the actual use of empirical study is not at all the rule. Even in the United States, where academics make much use of such a method, the national report notes that the use by the lawmaker is not customary. It may be safe to conclude that a combination of strong policy argument and the use of empirical study to support it is one of the innovating aspect of the Cape Town Convention.

V. Conclusion: The functions of the uniform law

The Cape Town Convention belongs to the efforts of unifying private laws of countries by producing international instruments, dating back to late nineteenth century. And it is one of the most successful of those instruments, at least judged from the number of States Parties. From the comparative study of relevant national laws, its unique and innovative feature has emerged.

First, the Cape Town Convention does unify the laws of secured transactions, in particular its formation, registration and enforcement upon default by the debtor. Its scope is broad enough to cover not only the security proper or “real rights” such as mortgage, hypothèque or pledge, but also title-based transactions that have functions equivalent to security. However, the unification by the Cape Town Convention in this respect has been rather modest. On some important issues, the options are open to States, on others the decision is left to the court.

On the other hand, the Cape Town Convention has other aspects than simple unification. One is to modernise the existent law of states, which are often outdated, complicated or maintained only by the practice unintended by the original lawmaker. Such modernisation aspect coincides with the fact that UNCITRAL, another international body to promote unification of commercial law, has recently added the modernisation of law to its mission. Another aspect of the Cape Town Convention is that it poses a seemingly controversial policy, in particular with regard to the status of security interests in insolvency procedure. The drafters then argued for justification of the policy by relying on the empirical economic study. Such an approach is exceptional under the tradition of uniform law instruments, but is commonly seen in more recent law “reform” in the area of financial and insolvency law, such as those advanced by the World Bank, European Bank for Reconstruction and Development or Organization of American States.

Finally, the third aspect of the Cape Town Convention is that it actually established a global scheme of International Registry. Though much neglected in the past, the international instruments producing such global schemes uniform law instruments, such as the International Fund for Oil Pollution, form a group of uniform law instruments that have gone beyond unifying the rules to be applied by the courts. With this type of international instruments, the economy of
scale counts: namely, the number of States Parties and volume of transactions are the key to ensure success in this regard. The Cape Town Convention has been extremely successful in this respect, supported by the industry, regulators (including the OECD) and the users of the scheme.