

**INTRODUCTION TO THE CAPE TOWN CONVENTION
AND THE AIRCRAFT PROTOCOL
(ONE OR TWO CLASS MODULE FOR LAW SCHOOL COURSES
ON INTERNATIONAL BUSINESS TRANSACTIONS OR INTERNATIONAL FINANCIAL LAW)**

**** TEACHER'S MANUEL VERSION ****

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1. Introduction

These materials deal with the Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment, generally known as the Cape Town Convention and the Aircraft Protocol. The Convention and Aircraft Protocol deal with security interests in, title reservation transactions for, and leases of large commercial aircraft, helicopters, and aircraft engines. As of September 1, 2012, 51 Contracting States, including the United States, have become parties to the Convention and Aircraft Protocol.

While some of you may have studied security interests in personal property and equipment leasing during your law school studies, it is likely that for many more of you these are new subjects. For this reason, the approach of these materials is considerably less detailed than would be the case in a course in secured transactions or even a survey course in commercial law. The goal is to provide an introduction to how a detailed commercial law convention such as the Convention and Aircraft Protocol fits into the global legal landscape and a general overview of secured transactions and equipment leasing.

The Convention and Aircraft Protocol are separate instruments, but the Convention cannot enter into force in respect of a Contracting State in the absence of the Aircraft Protocol also entering into force. They are to be read as one instrument, with the Aircraft Protocol being the controlling instrument in case of any inconsistency. (Two additional protocols to the Convention have been adopted by diplomatic conferences, one on railway rolling stock and another on space assets, but neither is as yet in force.) At the diplomatic conference in Cape Town a resolution was adopted that called for the preparation of a consolidated text of the Convention and the Aircraft Protocol, combining the two instruments into a single instrument.

Citations to Articles (e.g., Art. 1(a)) in these materials are to the Consolidated Text, which is set out in the Appendix. References to the “Convention” are to the Convention and the Aircraft Protocol unless the context otherwise requires.

Additional Important Resources:

SIR ROY GOODE, OFFICIAL COMMENTARY (REV. ED. 2008);

LEGAL ADVISORY PANEL, AVIATION WORKING GROUP, PRACTITIONER’S GUIDE TO THE CAPE TOWN CONVENTION AND THE AIRCRAFT PROTOCOL (2011) available at http://www.vedderprice.com/index.cfm/fuseaction/pub.detail/object_id/efd5a1bf-115f-4abf-b46f-62b7de9803bd/PractitionersGuidetotheCapeTownConventionandtheAircraftProtocol.cfm.

2. A Roadmap to Secured Transactions Under Uniform Commercial Code Article 9

The following passage is an excerpt from STEVEN L. HARRIS & CHARLES W. MOONEY, JR., *SECURITY INTERESTS IN PERSONAL PROPERTY* 88-95 (5th ed. 2011). It introduces the subject of secured transactions under Uniform Commercial Code (“UCC”) Article 9. Article 9 had a substantial influence on the substance of the Convention. **(A) Background**

Article 9 of the Uniform Commercial Code substantially rewrote the law of secured transactions; it was the most revolutionary of the Articles of the UCC. By virtually abandoning the concept of “title,” UCC Article 2 required a drastic change in the focus of legal thinking about sales. But Article 9 even more sharply changed the focus of legal thought about secured transactions.

Prior to the UCC, a creditor seeking security had to choose among a bewildering variety of legal “devices”—pledge, chattel mortgage, conditional sale, trust receipt, assignment of accounts receivable, factor's lien. Each “device” operated within complex (and often unclear) rules governing its scope and the procedures for its validation and enforcement; the choice of the wrong “device” was subject to perils reminiscent of common-law pleading.

The UCC swept away the separate security “devices.” The old names (pledge, conditional sale) may still be used, but the label does not control the result. Instead, Article 9 prescribes general rules for all secured transactions, with some variations depending on the type of transaction. The decision to establish a unitary approach to secured transactions was one of the UCC's most important contributions to the legal system. The important questions that remain relate, for the most part, to whether the maximum possible benefit has been gained from what most agree was a brilliant idea.

Article 9 was the first part of the UCC to undergo significant revision by the UCC's sponsors. Although for a time the UCC's sponsors held the line against most proposed improvements in the UCC, by 1966 the pressure to modify Article 9 became irresistible. The work of the Article 9 Review Committee began in 1967; its efforts culminated in the 1972 Official Text. Without affecting the basic structure of Article 9, the 1972 revisions effected numerous changes (some of them very important) to the Article. The 1978 Official Text made additional material changes to Article 9 as it dealt with securities and other investment property. Article 9's treatment of investment property was overhauled in conjunction with the revision of Article 8 in 1994; its treatment of letters of credit was adjusted in conjunction with the revision of Article 5 in 1995.

In 1999 the UCC's sponsors approved Revised Article 9. Revised Article 9 is the product of nearly a decade of work—first by a Permanent Editorial Board

study committee, which in December, 1992, issued a report recommending revision, and then by a drafting committee that met fifteen times from 1993 to 1998. Even after Revised Article 9 was officially promulgated, the work continued: As interested persons stumbled across stylistic and other minor errors and occasionally spotted an error that was more substantive, the sponsors responded by correcting the Official Text and Comments. Following an intensive and unprecedented effort, Revised Article 9 was enacted in all 50 states and the District of Columbia. It became effective in all but four of the enacting jurisdictions on July 1, 2001, and in the remaining jurisdictions within six months thereafter.

Like the early drafting efforts and the 1972 revision, Revised Article 9 is informed by commercial practice. The conflicting interests affected by Article 9 have had able and alert representatives who invested time and energy to participate in the drafting and otherwise work toward improving the legal regulation of those interests. (Comparatively speaking, very few worry about sales law under Article 2; at least between commercial parties, the problems usually can be solved by contract.) The efforts to improve Article 9 did not stop with the enactment of the 1998 revision. In 2008 the sponsors began a process that resulted in a series of discrete amendments to Revised Article 9. These amendments (the “2010 Amendments”) currently are under consideration by a number of legislatures.

We turn now to an overview of the substance of Revised Article 9. You should read through this overview several times, to glean a general understanding of the principal terms and concepts. As the course progresses and the details mount up, reference to the overview may restore a needed perspective.

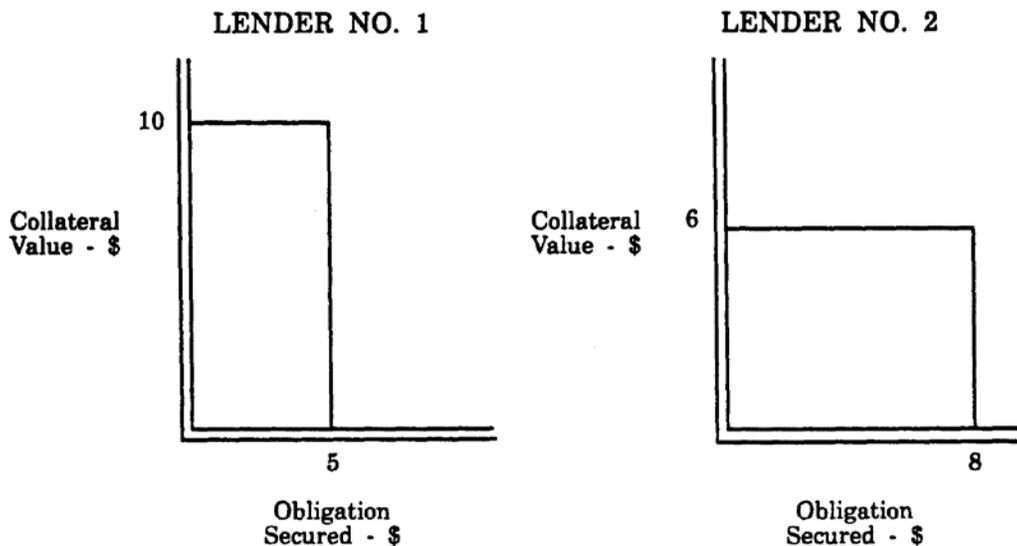
(B) Scope of Article 9; Security Interests in Collateral

Article 9 “applies to ... a transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract.” UCC 9–109(a)(1). This provision makes sense only if we consult UCC 1–201(b)(35), which defines the term “security interest,” in pertinent part, as “an interest in personal property or fixtures which secures payment or performance of an obligation.”¹ The broad reach of Article 9 is limited by various exclusions set forth in UCC 9–109(c) and (d). The scope of Article 9 is discussed in Chapter 5, *infra*.

¹Certain other transactions—consignments and sales of accounts, chattel paper, payment intangibles, and promissory notes—also are embraced by the definition of “security interest” and by Article 9’s basic scope provision, UCC 9–109(a). We shall defer consideration of those transactions for now and focus on interests that secure obligations.

Article 9 tells us nothing about the obligation that is secured, leaving that to other law. Although we usually think of the obligation as being a contractual promise to repay a loan or to pay the price of goods bought, in theory a security interest could secure virtually any obligation—liquidated or unliquidated, contingent or noncontingent.

“[T]he property subject to a security interest” is the “collateral.” UCC 9–102(a)(12). Property can be “carved up” in many ways. Two or more persons might own property “in common,” as owners of undivided fractional interests. Or, property can be divided temporally, as in a lease, where the lessee owns the right to use and possession during the lease term and the lessor owns the residual interest that remains at the end or the term. See UCC 2A–103(1)(m), (1)(q) (defining “leasehold interest” and “lessor’s residual interest”). A security interest that secures an obligation, however, can be measured in two dimensions at any given point in time: the *value of the collateral* and the *amount of the obligation secured*. The following figure illustrates these two dimensions:



As you can see, Lender #1 has a security interest in collateral valued at \$10 and is owed \$5; at this point in time Lender #1 is **oversecured**. Lender #2, on the other hand, is owed \$8 but its security interest extends only to collateral with a value of \$6; Lender #2 is **undersecured**. Keep in mind that the value of collateral securing an obligation can change (e.g., by appreciation, depreciation, or the acquisition of additional collateral), as can the amount of the obligation secured (e.g., by additional borrowings, the accrual of interest, and repayments).

(C) The Cast of Characters

The chief protagonists in a secured transaction are the “debtor” and the “secured party.” The secured party is “a person in whose favor a security interest has been created.” UCC 9–102(a)(72). The debtor is the “person having an interest, other than a security interest or other lien, in the collateral.” UCC 9–102(a)(28). Usually, the debtor is the sole owner of the collateral as well as the only person who owes the obligation that the collateral secures. However, there are many possible variations from this straightforward scenario. For example, a corporation might grant a security interest in collateral it owns to secure the indebtedness of its subsidiary. In this situation, the corporation is the debtor; the subsidiary, which owes the secured debt, is a non-debtor “obligor.” See UCC 9–102(a)(59) (defining “obligor”). Or, parents might cosign a promissory note with their child, thereby becoming obligated for the same debt as the child, while the child gives a security interest in collateral that he or she owns. Here, the child, who owns the collateral, is the debtor; each parent is an obligor, as is the child. See UCC 9–102, Comment 2.a.

The UCC also deals with the rights of some, but not all, third parties who may claim an interest in collateral covered by a security interest. We already have considered priority contests between a secured party, as a good faith purchaser, and a seller seeking to reclaim goods from a debtor-buyer who has voidable title. See Chapter 1, Section 3, *supra*. We also have taken note of the trustee in bankruptcy—often a significant player in secured credit when the debtor becomes financially distressed. Other third parties whose rights Article 9 addresses will be mentioned shortly in the discussion of priorities.

(D) Creation of a Security Interest: Attachment

The creation of a security interest under Article 9 is embodied in the concept of “attachment.” “A security interest attaches to collateral when it becomes enforceable against the debtor with respect to the collateral.” UCC 9–203(a). UCC 9–203(b) sets forth three conditions to enforceability, and thus to attachment. These conditions may be met in any order. First, “value” (UCC 1–204) must have been given. Second, the debtor must have “rights in the collateral.” Third, the debtor must agree that a security interest will attach *and* either the collateral must be in the secured party's possession or control or the debtor must have signed a security agreement (UCC 9–102(a)(73)) containing a description of the collateral (UCC 9–108). Until all these elements have been satisfied, a security interest does not attach and is not enforceable against the debtor or third parties with respect to the collateral. See UCC 9–203(a), (b). See generally Chapter 3, Section 2, *infra*.

Although not mentioned as a condition to attachment, the debtor's agreement must address the obligation that is secured by collateral—otherwise

one of the two dimensions that mark the borders of a security interest would be missing. Article 9 affords the parties considerable freedom to determine which obligations are secured: “A security agreement may provide that collateral secures ... future advances or other value.” UCC 9–204(c). In addition, “a security agreement may create or provide for a security interest in after-acquired collateral.” UCC 9–204(a).² But recall that no security interest can attach to the collateral under UCC 9–203(b) until the debtor has “rights” in it.

(E) Types of Collateral

Although Article 9's “unitary” approach to security interests generally treats all security interests the same, different types of collateral receive different treatment in several respects. Before mentioning some of those differences, which derive primarily from differences in the nature of the collateral and in the related financing patterns, it will be useful to identify the various “types” of Article 9 collateral. “Goods” are subdivided into “consumer goods,” “equipment,” “farm products,” and “inventory.” Intangible collateral includes “accounts,” “deposit accounts,” and “general intangibles.” Types of paper representing or embodying intangible rights include “chattel paper,” “documents,” and “instruments,” although “chattel paper” may be electronic rather than paper-based. Likewise, “investment property” such as stocks and bonds may be evidenced by paper or may be intangible. Goods affixed to real estate can become “fixtures,” although Article 9 leaves to real estate law the determination of what constitutes fixtures. See generally Chapter 8, Section 3, *infra*. Property acquired by a debtor upon the exchange or disposition of collateral, such as the account (right to payment) that arises when inventory is sold on unsecured credit, constitutes “proceeds.” See generally Chapter 3, Section 5, *infra*.

Although we shall revisit the various types of collateral later in these materials (most of them on several occasions), it would be useful for you to review the statutory definitions in UCC 9–102(a) at this point in your reading. The Comments to UCC 9–102, particularly Comments 4, 5, and 6, contain additional explanations of the terms.

(F) Perfection and Priority

A secured party who wishes to rely on the benefits of a security interest in collateral will be concerned about whether conflicting claims to the collateral could come ahead of its security interest. A baseline rule of Article 9 can be found in UCC 9–201: “Except as otherwise provided in [the Uniform Commercial Code], a security agreement is effective according to its terms between the parties,

²UCC 9–204(b) limits security interests in after-acquired consumer goods and commercial tort claims.

against purchasers of the collateral, and against creditors.” That (somewhat awkward) statement generally is understood to mean that an attached security interest in collateral will be senior to conflicting claims unless a provision in the UCC provides otherwise. Much of the remainder of this book is devoted to an examination of the substantial number of provisions otherwise.

In many cases a security interest's priority over other conflicting claims to collateral will depend on whether the security interest is “perfected.” Perfection occurs when a security interest has attached and when the applicable steps specified in Article 9, Part 3 (specifically, UCC 9–310 through UCC 9–316) have been taken. UCC 9–308(a). If those steps are taken before attachment, perfection occurs upon attachment. *Id.* Although there are some specialized means of perfection, the two principal means are (i) the filing of a “financing statement” and (ii) the secured party's taking possession of the collateral. A security interest in some types of collateral can be perfected by either filing or possession (e.g., goods); other types can be perfected only by filing (e.g., accounts) or only by possession (e.g., money). See generally Chapter 3, Section 3, *infra*.

Part 5 of Article 9 deals with filing. Of particular importance are UCC 9–502 (dealing with what to file—the contents of a financing statement) and UCC 9–501 (dealing with where to file). See also UCC 9–301 through UCC 9–307 (dealing with what state's law governs perfection and the effect of perfection or non-perfection). See generally Chapter 3, Section 4, *infra*.

Article 9 includes several important priority rules. For example, under UCC 9–317 certain non-ordinary course, good-faith buyers of collateral take free of an attached but unperfected security interest. Perhaps more important, the same section provides that an attached but unperfected security interest is subordinate to the rights of a “lien creditor.” (A “lien creditor” is a creditor with a judicial lien. See UCC 9–102(a)(52). We shall see in Chapter 7 that a debtor's trustee in bankruptcy can assume the seniority of a judicial lien creditor and set aside security interests that are unperfected when the debtor enters bankruptcy.) Under Article 9's priority rules, even perfected security interests are not perfect. For example, they usually are subordinate to competing Article 9 security interests under the first-in-time rule of UCC 9–322(a)(1), which, however, is subject to long list of exceptions. See generally Chapter 4, Section 1, *infra*. Also, perfected security interests in goods can be cut off by a “buyer in ordinary course of business.” UCC 1–201(b)(9); UCC 9–320(a). See generally Chapter 4, Section 2, *infra*.

Notwithstanding the apparent breadth of the baseline priority rule in UCC 9–201 and the large number of priority rules found elsewhere in the Article, many priority contests between Article 9 security interests and competing claimants to collateral are not addressed in Article 9 (or elsewhere in the UCC). Examples are

priority contests with federal tax liens and a growing variety of other statutory liens. See generally Chapter 8, Section 4, *infra*.

(G) Enforcement

The right and ability of a secured party to satisfy its claim out of the collateral already has been mentioned in general terms. Part 6 of Article 9 regulates in detail a secured party's enforcement rights. See generally Chapter 9, *infra*. These rights arise upon a debtor's "default." Just as Article 9 is silent concerning the nature and scope of the obligation secured by a security interest, so Article 9 does not define what constitutes a default in that obligation. Defining default is left primarily to the agreement of the debtor and secured party. In addition to failure to make a payment when due, sometimes with a grace period, typical defaults include the debtor's insolvency, bankruptcy, and breach of a loan covenant, and the existence of a conflicting lien on the collateral.

A menu of the rights and remedies of secured parties and debtors after default appears in UCC 9–601. Notwithstanding the UCC's general deference to freedom of contract, see UCC 1–103(a), Article 9 prohibits debtors from waiving certain of their rights before default. UCC 9–602. As an empirical matter, the secured party's most important enforcement tools are its rights (i) to collect on intangible collateral, such as accounts, from the obligors (called "account debtors"), (ii) to take possession of collateral on default, and (iii) to dispose of collateral (typically, by sale or lease). UCC 9–102(a)(3) (defining "account debtor"); UCC 9–607 (secured party's collection rights); UCC 9–609 (secured party's right to take possession); UCC 9–610 (disposition of collateral). In the case of collections and dispositions, the secured party is entitled to apply funds received to the obligation secured, leaving an obligation for a "deficiency" should the funds be insufficient. UCC 9–608(a)(4); UCC 9–615(d). The debtor is entitled to any "surplus" that remains after satisfaction of the secured obligation and certain junior security interests. *Id.* In addition, a secured party may propose to accept collateral in full or (except in consumer transactions) partial satisfaction of the secured debt, but the debtor and certain junior secured parties are entitled to object to that proposal, thereby forcing the secured creditor to turn to another remedy, such as disposition. UCC 9–620.

To increase the likelihood that a fair price will be obtained upon the disposition of collateral, the secured party must give advance notice of the disposition to the debtor and certain junior secured parties, see UCC 9–611(b), and every aspect of the disposition must be "commercially reasonable." UCC 9–610(b). Similarly, collections on intangible collateral must be undertaken in a commercially reasonable manner. UCC 9–607(c).

A debtor is entitled to "redeem" collateral at any time before the secured party disposes (or contracts to dispose) of the collateral, collects upon the

collateral, or accepts the collateral in satisfaction of the secured obligation. UCC 9–623. This redemption right derives from the “equity of redemption” developed by the English courts of equity with respect to real estate. It recognizes that at some point the debtor's equitable right must be “foreclosed.” Even today, people commonly use the term “debtor's equity” to refer to the positive remainder obtained when the amount of the secured obligation is subtracted from the value of the collateral and usually speak of “foreclosure” as the means of enforcing a lien. These terms can be traced historically to the foreclosure of a debtor's equity of redemption.

Depending on the circumstances, a secured party who fails to comply with Article 9 can be held liable to a debtor in damages, deprived of some or all of its claim for a deficiency, or subjected to judicial restraint. UCC 9–625; UCC 9–626. In consumer and consumer-goods transactions, noncomplying secured parties may be subjected to losses that bear no relationship to the amount of actual harm or damage (if any) caused by the noncompliance. See UCC 9–625(c)(2); UCC 9–626(b).

3. Overview of Convention and Aircraft Protocol

Following is a brief overview of the Convention.¹

a. Background

In 1988 the government of Canada proposed to the Governing Council of the International Institute for the Unification of Private Law (UNIDROIT) a feasibility study of a project for an international convention on the law of secured transactions for mobile equipment, such as aircraft and railroad rolling stock. The UNIDROIT Governing Council approved the study. Following that study a restricted working group and then a UNIDROIT study group continued to address both the benefits and the many difficult issues posed by such a project. During the work of the study group a subcommittee of that group invited several aircraft financing experts, representing a group of aircraft and aircraft engine manufacturers as well as financial institutions, to form the Aviation Working Group (AWG). The AWG later worked in cooperation with the International Air Transport Association (IATA). The AWG and IATA provided invaluable advice throughout the project. The study group completed its work in 1997 and produced a draft Convention and a draft Aircraft Protocol that addressed matters specific to aircraft and related financings.

Before the first governmental experts' meeting, UNIDROIT teamed up with the International Civil Aviation Organization (ICAO) and thereafter the project was jointly sponsored by the two organizations. In 1999 and 2000 a UNIDROIT Committee of Governmental Experts and a Subcommittee of the ICAO Legal Committee held three Joint

¹ This overview derives in part from Charles W. Mooney, Jr., *The Cape Town Convention: A New Era for Aircraft Financing*, 18 Air & Space Law. 4 (Summer 2003).

Sessions in Rome and Montreal to consider the draft Convention and Protocol. Subsequently a draft Convention and Protocol were approved by the Governing Council of UNIDROIT and the Council of ICAO for submission to a diplomatic conference.

In 2001 the government of South Africa hosted a diplomatic conference in Cape Town. The conference was jointly sponsored by UNIDROIT and ICAO. Sixty-eight states and fourteen international organizations participated in the diplomatic conference. On November 16, 2001, following almost three weeks of intensive work and negotiations, the Convention and the Aircraft Protocol were opened for signature.

As originally conceived, an international convention would regulate and facilitate secured financing of various types of mobile equipment. As the work of the study group advanced, however, it became apparent that a convention that would be satisfactory for one type of equipment would not necessarily be appropriate for another type. This realization led to the structure proposed by the study group, debated in the governmental meetings, and finally adopted at Cape Town. The Convention (sometimes called the “base” Convention) contains the basic legal regime for secured financing of equipment. The Protocol, then, contains specialized provisions necessary to adapt the Convention to the financing of aircraft and aircraft engines. The Convention cannot apply on a stand-alone basis; it can apply only in connection with a protocol covering a specific type of equipment.

The Convention establishes an international legal system for security interests (called “international interests” in the Convention) in aircraft objects—large airframes, aircraft engines, and helicopters (the definitions of these terms contain size requirements). The goal is to facilitate efficient secured financing. At the time the Convention was conceived and during its development, the manufacturers of commercial aircraft equipment expected to sell, and airlines worldwide expected to buy, trillions of dollars worth of products. But local domestic legal regimes in many states were (and some remain) inadequate to support secured, asset-based financing. Without needed law reforms, some desirable transactions would not take place and other financings would be completed only with higher financing costs. In some cases, financings would go forward only with the support of the sovereign credit of states in which airlines are based. The Convention and Protocol provide these necessary reforms.

In 2002 UNIDROIT published the Official Commentary to the Convention as approved for distribution by the UNIDROIT Governing Council pursuant to Resolution No. 5 adopted at the Diplomatic Conference. SIR ROY GOODE, OFFICIAL COMMENTARY (2002). A revised version was published in 2008. SIR ROY GOODE, OFFICIAL COMMENTARY (2008) (hereinafter cited as “O.C.”)

In many respects these instruments follow the philosophy and approach of UCC Article 9 on secured transactions, in effect in every state of the United States, as well various personal property security acts in effect in the provinces of Canada. The conformity of the Convention to principles of secured credit in North America is no accident. The United States delegation sought this result throughout the process for the simple reason that our legal regime for secured credit works, and it works well.

The Convention entered into force on March 1, 2006. The United States ratified the Convention in 2004.

b. Relationship Between Convention and Applicable Law: In General

An international interest is *sui generis* and “international” in character. *See* Art. 2(1). That is to say, it is created under the Convention. It is wholly independent of security devices under the applicable law. The Convention’s preamble specifies its purposes. It is to be interpreted taking into account its purposes, its “international character,” and the promotion of “uniformity and predictability.” Art. 5(1). The Convention provides that the applicable law is the domestic law that is “applicable by virtue of the rules of private international law in the forum state”—*i.e.*, the forum state’s choice-of-law rules. Art. 5(3). The Convention defers to the applicable law concerning general matters such as (i) a debtor’s power to contract and contractual defenses, (ii) liability in tort, (iii) the authority of a debtor’s agents or officers, and (iv) a debtor’s existence, organization and legal characteristics. In addition, the Convention does not override governmental regulations such as those governing safety.

c. Scope and Applicability

An international interest can be created under a security agreement, title reservation agreement, or leasing agreement (each a type of “agreement”). Art. 2(2). The applicable law determines how an agreement under which an international interest is created will be characterized. For example, under the UCC—the relevant law applicable in the United States—some agreements denominated as leases will be recharacterized as security agreements. An agreement with the same terms might be characterized as a lease in another state. The Convention also applies to a contract of sale of an aircraft object. Art. 6. The objects to which the Convention applies are “aircraft objects,” which are defined to include “airframes,” “aircraft engines,” and “helicopters.” *See* Art. 1 (defining these terms).

The Convention applies if the debtor “is situated in a Contracting State” at the time an agreement is concluded. Art. 3(1). There are four non-exclusive possibilities for a debtor’s location for this purpose. A debtor is situated in the Contracting State in which debtor: (i) “is incorporated or formed,” (ii) “has its registered office or statutory seat,” (iii) “has its centre of administration,” or (iv) “has its place of business” (“principal place of business,” if it has more than one). Art. 4(1), (2). The Convention also applies to a helicopter or airframe registered on the national register in a Contracting State. Art. 3(3).

The Convention generally applies even if the characteristics of a transaction, an object, or the parties have no “international” aspect. In effect, the type of equipment contemplated by the Convention is inherently “international” in character. However, a Contracting State may declare, at the time it becomes a party to the Convention, that the Convention will not apply to an “internal transaction.” Arts. 66(1); 1(n) (defining “internal transaction”). Even if a Contracting State makes such a declaration, however, the Convention’s provisions on registration and priority (discussed below) apply nonetheless. Art. 66(2). As a practical matter, although the Convention

is an international instrument, its principal purpose is to override and reform inadequate local domestic legal regimes, not to address “international” transactions.

d. Creation of International Interest

The formal requirements for creating an international interest are quite similar to the requirements for the attachment and enforceability of a security interest under UCC Article 9. Art. 10; UCC § 9-203(a), (b). An international interest is created pursuant to an “agreement,” which is defined to include a “security agreement,” “title reservation agreement,” or “leasing agreement.” Arts. 10; 1(a), (dd), (vv), (zz). An agreement must be in “writing,” although that term is defined so as to include records other than traditional paper-and-ink records. Arts. 10(a); 1(bbb). The agreement also must “relate[] to an object as to which the chargor, conditional seller or lessor has power to dispose.” Art. 10(b). And an agreement must “enable the aircraft object to be identified.” Art. 10(c). A description of an object for this purpose is both “necessary and sufficient” if it contains the object’s “manufacturer’s serial number, the name of the manufacturer and its model designation.” Art. 8. In addition, a security agreement must “enable the secured obligations to be determined” although it need not “state a sum or maximum sum secured.” Art. 10(d). Similar formal requirements are required for a contract of sale of an aircraft object. Art. 11.

The Convention builds on property interests (“real rights”) under applicable law. *See* Art. 10(b). But the Convention does not override or replace applicable law concerning issues such as a debtor’s property rights or power to transfer property. “An international interest in an object also extends to proceeds of that object.” Art. 2(4); 1(jj) (defining “proceeds”). This follows UCC sections 9-203; 9-315.

An assignment of associated rights also effects an assignment of the related international interest. Art. 44(1). This reflects the familiar rule that a lien securing a right to payment follows an assignment of the right. “Associated rights” include rights to payment or performance under an agreement, such as secured obligations, obligations to pay the price under a title reservation agreement, or rentals under a leasing agreement. Art. 1(h). There are formal requirements similar to those under Art. 10 which must be satisfied for an assignment of associated rights to carry with it the related international interest. Art. 45(1).

e. International Registry

The Convention provides for an international registry for the registration of (*i.e.*, to give public notice of) international interests. This should not be confused with the national registries for the nationality of civil aircraft under the Convention on International Civil Aviation, signed at Chicago on December 7, 1944 (“Chicago Convention”). The international registry is addressed in Chapters IV-VII of the Convention. ICAO is the supervisory authority for the international registry. Art. 27; Resolution No. 2 adopted at the diplomatic conference. In that connection ICAO has appointed Aviareto, a joint venture between SITA SC and the Government of Ireland, as the Registrar and operator of the international registry. The international registry’s website may be found at <https://www.internationalregistry.aero/>. In its capacity as supervisory

authority ICAO also has adopted regulations and procedures for the international registry. *See* Regulations and Procedures for the International Registry (4th ed. 2010), *available at* <https://www.internationalregistry.aero/irWeb/pageflows/work/UserDocumentation/DownloadUserDocumentationController.jspf?language=English> (hereinafter cited as “Reg. § X.X”)/

The international registry is an object-specific registry (*i.e.*, registrations are made against and searched by criteria such as the manufacturer, model, and serial number of an aircraft object). Arts. 32(6). Although this differs from the debtor-name filing system under UCC Article 9, Part 5, it is consistent with object-specific Federal Aviation Administration (FAA) Registry in the United States. But the international registry differs from the FAA conveyance registry in which actual transactional documentation is filed for recordation. The international registry is fully electronic, more closely resembling the state filing offices under the UCC Article 9 “notice-filing” system. A registration in the international registry contains only information describing the aircraft object, the parties, and the nature of the transaction

The Convention also addresses the relationship of the international registry to national registries under the Chicago Convention, such as the United States FAA Registry in Oklahoma City. A Contracting State may declare “designated entry points” within the Contracting State as a “portal” for the registration of international interests. Under legislation adopted in connection with its ratification of the Convention, the United States has designated the FAA Registry as its portal. Moreover, filings for recordation continue to be required with the FAA Registry. The international registry does not replace national registries under the Chicago Convention.

f. International Interest vs. Third-party Rights and Interests: Priority

The priority of international interests generally is based on the time of registration with the international registry of an international interest or prospective international interest. Art. 42. The priority of an international interest also extends to proceeds. Art. 42(7). This follows UCC § 9-322. An international interest that is registered before commencement of insolvency proceedings is effective in those proceedings. Art. 43(1). Even an unregistered international interest is effective in insolvency proceedings if it is effective under applicable law (*i.e.*, the Convention is a validating instrument, but it does not invalidate in insolvency proceedings interests that would be effective outside of the Convention). Art. 43(2). However, the Convention does not override avoidance rules applicable in insolvency proceedings (preferences or fraudulent transfers) or insolvency procedural rules. Art. 43(3). The Convention also contains rules dealing with priority between international interests and other interests arising under applicable law, such as nonconsensual rights and interests, and between competing assignments of associated rights. Arts. 49; 52; 53.

g. Default and Enforcement; Procedural Law

The Convention provides basic remedies for enforcement of an international interest created pursuant to a security agreement, including the right of the chargee (*i.e.*, the creditor under a security agreement) to take possession of the charged object, to sell or lease the object, or to collect or receive income or profits relating to the object. Art. 12(1). The set of remedies is

very similar in substance to the remedies available under UCC Article 9, Part 6. Remedies under the Convention must be exercised in a “commercially reasonable manner.” Art. 19; *compare, e.g.,* UCC § 9-610(b) (secured party’s disposition of collateral after default must be “commercially reasonable”). A remedy “exercised in conformity with a provision of the agreement” is deemed to be exercised in a commercially reasonable manner unless the “provision is manifestly unreasonable.” Art. 19. Remedies of conditional sellers and lessors under the Convention are limited to terminating an agreement or taking possession of the object or obtaining a court order for that relief. Art. 14. Otherwise the remedies are left to the applicable law. This approach is a result of the variety of remedial systems for these transactions among the various legal regimes.

Remedies under the Convention must “be exercised in conformity with the procedure prescribed by the law of the place where the remedy is to be exercised.” Art. 21. For example, in a jurisdiction that requires resort to judicial proceedings to recover possession of an object or to dispose of it, “self-help” remedies would not be available. In addition, a Contracting State may declare, at the time it becomes a party to the Convention, that any Convention remedy “may be exercised only with leave of the court.” Art. 70(2).

The Convention contains two alternative provisions for special relief in insolvency proceedings, which, if applicable, would override otherwise applicable insolvency law. Art. 23 (Alternatives A and B). These follow generally United States Bankruptcy Code section 1110). A Contracting State may choose to adopt either or neither of the alternatives. Arts.23(1); 71(3). The United States did not adopt either alternative. These alternatives recognize a point often lost on insolvency law experts. Insolvency law has a major impact outside of insolvency and, in particular, on the cost of credit. Additional remedies include the de-registration and export of an aircraft. Art. 25.

h. Relationship to Other International Conventions

The Convention prevails over the United Nations Convention on Assignment of Receivables in International Trade in respect of receivables that are associated rights relating to international interests in aircraft objects. Art. 59. The Convention supersedes the UNIDROIT Convention on International Financial Leasing. Art. 62. The Convention supersedes the Convention on the International Recognition of Rights in Aircraft, signed at Geneva on June 19, 1948, except “with respect to rights or interests not covered or affected by the . . . Convention.” Art. 60. Finally, the Convention supersedes the Convention for the Unification of Certain Rules Relating to the Precautionary Attachment of Aircraft, signed at Rome on May 29, 1933, subject to a Contracting State’s contrary declaration. Art. 61.

i. Jurisdiction and Related Matters

The Convention contains provisions relating to choice of forum and jurisdiction. *See* Arts. 54 (choice of forum); 55 (jurisdiction under Art. 20 relating to interim relief); 56 (orders against the registrar); 58 (Convention’s jurisdiction provisions do not apply to insolvency proceedings) A waiver of sovereign immunity is binding. Art. 57

j. Transition

The general rule is that the Convention “does not apply to a pre-existing right or interest.” Art. 60(1); *see* Art. 1(v) (defining “pre-existing right or interest” as a right or interest existing before the effective date of the Convention with respect to a Protocol). However, a Contracting State may declare a different transition rule, if its declaration specifies a date (not less than 3 years after its declaration) on which the Convention and relevant Protocol will apply to pre-existing rights and interests. Art. 60(2), (3). In that case creditors would have an opportunity to register their pre-existing rights or interests in the International Registry so as to preserve the pre-effective date priorities.

k. Conclusion

The Cape Town Convention and the Aircraft Equipment Protocol are superb examples of law reform at its best. Being widely ratified they have effectively exported UCC Article 9 to the world in the field of aircraft secured financing. This materially lowers the cost of financing for users in many areas of the world. It also assists in boosting the sales of manufacturers as well. The success in achieving such high quality of substantive law and the widespread adoption result from many factors, not the least of which was the dedication and skill provided by a number of individuals throughout the process. But one factor in particular stands out. The aviation industry was closely involved in the project almost from the beginning. And it was actively involved at every step along the way, continuing through the diplomatic conference. Finally, the AWG, led by Jeffrey Wool, continues to be the driving force behind the education and promotion necessary for continued and growing acceptance of the Convention.

4. Constitution (Creation) and Registration (Perfection) of International Interests

a. Constitution of an International Interest.

Problem 4.1. Integrity Airways Corp. (“IAC”), a Delaware corporation, executed a written security agreement dated September 3, 2012, granting a security interest in “one (1) Boeing Model 777F airframe, Manufacturer’s serial number 777-36” securing “all existing and future obligations of IAC to Piggibank, N.A.” Subsequently, Piggibank made a \$185 million loan to IAC, evidenced by a promissory note, dated September 3, 2012, payable to Piggibank in that amount and bearing interest at 6.3% per annum. The note provides that all principal and interest is due and payable on December 3, 2012. This was a “bridge” financing as IAC contemplated arranging for long-term financing before the maturity date. No other documents were executed and delivered and Piggibank took no further steps. On December 3 IAC failed to pay to Piggibank the principal and interest due on the promissory note. What are Piggibank’s remedies? *See* Convention Arts. 10; 8; 12.

Problem 4.1 *This simple problem has three functions. First, it briefly introduces students to the Convention framework for enforcing security interests, a topic explored in more depth in Section 7. Second, it drives home that the right to immediate enforcement against specific property of the debtor is a central underlying basis for obtaining a security interest in collateral to secure an obligation. It may be useful to compare the chargee's rights on default with those of an unsecured creditor in contrast to the chargee's right to resort to specific property immediately upon default. Third, it introduces the point that, notwithstanding the importance of registration for protection of an international interest vis-à-vis third parties, registration is not necessary for an international interest to be effective and enforceable as against the debtor.*

Article 10 sets out the formal requirements for constituting an international interest, such as the security interest which IAC has granted to Piggibank. Unless these requirements are met no international interest will be created or provided for. When the requirements are met, the international interest is enforceable. In this Problem, the security agreement is "in writing" and presumably IAC is the owner of the 777 airframe and consequently has "power to dispose." Because the security agreement describes the airframe by Manufacturer, model designation, and manufacturer's serial number in conformity with Article 8, it "enables the aircraft object to be identified." Finally, the broad description of the obligations secured by the airframe "enables the secured obligations to be determined." IAC is obligated to Piggibank under the promissory note evidencing the loan repayment obligation and Piggibank's international interest exists to secure that obligation. All three conditions of Article 10 have been satisfied. You may wish to note that the conditions need not be satisfied in any particular order.

Article 12 provides a menu of Piggibank's rights following IAC's. Piggibank is entitled inter alia to take possession of the airframe and to sell or lease it in a commercially reasonable manner. Arts. 12(1)(a), (b); 19.

b. Registration (Perfection) of International Interests

We saw in Section 4.a. that a security interest is not effective or enforceable until the conditions in Article 10 are satisfied. In this Section 4.b. we shall see that even if an international interest is enforceable, the holder of the international interest does not necessarily prevail over holders of competing claims to the collateral.

Problem 4.2. Piggibank established the financing arrangement with IAC as described in Problem 4.1. Subsequently, Sillibank became interested in providing financing to Main Motors. Sillibank obtained a list of aircraft owned by IAC, including the Boeing 777 airframe mentioned in Problem 4.1. Sillibank asks you, its counsel, to check the public record in the International Registry to discover whether, and to what extent, IAC's assets may be subject to security interests.

What does the public record reveal? Does it show whether the Boeing 777 is in fact subject to Piggibank's international interest? Does it show whether IAC is obligated to Piggibank and, if so, the amount of the obligation? *See* Arts. 26(a); 31(1)(a), (b); 32(2), (6); 33(1); Reg. § 5.4; 7.1; 7.2; 7.4.

Problem 4.2 *The search certificate against the Boeing 777 reflects only the particulars of the registration (description of airframe, parties, date and time of registration, and person entitled to discharge the registration). It does not show whether Piggibank has extended credit and, if so, how much is outstanding. This is the concept of “notice filing”—a searcher is put on notice that the relevant transaction may have occurred or may occur in the future.*

Problem 4.3. The transaction followed precisely the steps described in Problem 4.1. Before the documents were signed and the loan was made, however, Piggibank caused a registration of a prospective international interest in the Boeing 777 airframe to be effected in the international registry containing the information specified in Regulation section 5.4. After the loan was made, Lean, the holder of a judgment against IAC, caused the sheriff to levy on the Boeing 777. Is Lean’s execution lien senior or junior to Piggibank’s international interest in the airframe? See Art. 42(1); 1(aaa); Reg. § 5.4; O.C. Art. 29, ¶ 4.198, *Illustration 19*.

Problem 4.3. *The execution lien is junior. Article 42(1) provides that a registered international interest has priority over an unregistered interest. The execution lien is an unregistered interest. Art. 1(aaa). Had Piggibank failed to register its international interest before the execution lien attached to the Boeing 777, law other than the Convention would apply to the priority contest between the two unregistered interests. See O.C. Art. 29, ¶ 4.194 Under Article 9 of the UCC, the perfection step would be filing the security agreement with the FAA for recordation. See UCC § 9-311. If Piggibank failed to take that step, then the execution lien would be senior to Piggibank’s unperfected security interest. UCC § 9-317(a)(2).*

5. Priority of International Interests

The preceding Section dealt primarily with whether a security interest is enforceable the debtor and would withstand attack from judicial lien creditors. This Section deals with other claims to an aircraft object, primarily claims by holders of conflicting international interests and by buyers and lessees of the aircraft object from the debtor.

a. Competing International Interests

Problem 5.1. In the setting of Problem 4.1, on August 27 Piggibank, with the necessary consent of IAC, registered a prospective international interest in the Boeing 777 airframe. On August 30, IAC (without the knowledge or consent of Piggibank), executed a security agreement in favor of Sillibank, covering the Boeing 777, to secure all of IAC’s existing and future obligations to Sillibank, and on that date Sillibank loaned \$5 million to IAC. On August 31 Sillibank registered its international interest. On September 3 Piggibank obtained the security agreement and made the loan to IAC as described in Problem 4.1.

(a) IAC defaults on its obligations to Sillibank and Piggibank. Do both banks have an international interest in the Boeing 777? Is each security interest registered (perfected)? Whose

security interest is senior? *See* Arts. 42(1); 31(4) 32(4). What could the losing party have done to avoid the loss?

Problem 5.1(a) *Each of the banks has a registered international interest. Because Piggibank was the first to register its international interest, it has priority over the subsequently registered interest of Sillibank. Art. 42(1). Of course, when Sillibank registered its interest Piggibank had no interest at all—so there was no priority contest at that point in time. But once Piggibank’s interest subsequently came into existence, Piggibank’s interest achieved priority. Even though Piggibank’s registration was of a prospective interest, no further registration was required and its interest is treated as registered from the time the prospective interest was registered. Arts. 31(4); 32(4).*

Obviously, Sillibank should have conducted a search of the international registry. Had it done so it would have discovered Piggibank’s registration. It could have refused to advance funds unless Piggibank’s registration were discharged or its interest subordinated to that of Sillibank.

The point cannot be overemphasized: A prospective creditor should not lend on the strength of an object that is the subject of a registration even though, at the time of the loan, the debtor has not actually granted a competing international interest in that object. Viewed from the perspective of Piggibank, the lesson is that a prospective international interest holder can lock in its priority by registration, even though it has not yet closed the transaction.

(b) Would the result change if on September 3, at the time that Piggibank obtained its international interest and made the loan to IAC, the responsible loan officer for Piggibank knew about the August 30 transaction between IAC and Sillibank? *See* Art. 42(2); O.C. Art. 29, ¶¶ 4.183; 4.199, *Illustration 20*. What do you suppose is the policy reflected by this result?

Problem 5.1(b) *The result would not change; Piggibank’s knowledge would not disqualify it from achieving priority. Art. 42(2). As the Official Commentary explains, the underlying policy for this rule is based on the idea that everyone is deemed to know what is in the registry and the avoidance of factual disputes about knowledge. O.C. Art. 29, ¶ 4.183.*

b. International Interests and the Debtor’s Insolvency Administrator

In addition to achieving priority over any competing international interests, the holder of an international interest needs assurance that its interest will be respected in the insolvency proceeding of its debtor (chargor, conditional buyer, or lessee). Article 43(1) provides that an international interest is effective in the debtor’s insolvency proceeding if the interest is registered. Once again, registration is the key to priority. If the interest is not registered it may nonetheless be effective in the insolvency proceeding. If the interest is effective in the insolvency proceeding under the applicable law, the failure to register in the international registry does not impair that effectiveness. Art. 43(2). Finally, Article 43(3) provides that the article does not affect rules of law relating to avoidance of transactions as preferences or

fraudulent transfers and does not affect procedural rules on enforcement against property controlled or supervised by an insolvency administrator, such as a trustee in bankruptcy.

c. Buyers of Aircraft Objects

Problem 5.2. In the setting of Problem 5.1, on September 25 IAC sold the Boeing 777 to Buyer Airlines Co. (BAC) in a cash sale. BAC registered its interest under the contract of sale in the international registry on that same day. Following IAC's default on its obligations to Piggibank and Sillibank, they each judicially seek to take possession of the airframe from BAC.

(a) What result? *See* Arts. 6, 42(4); 12(1), (2).

Problem 5.2(a) *Because Piggibank's and Sillibank's interests are registered, BAC's interest is subordinate to those interests under Article 42(4). BAC should have searched the international registry and discovered the earlier registered interests. As against BAC, both banks are entitled to recover possession. Art. 12(1), (2). As between Piggibank and Sillibank, however, implicit in Piggibank's priority is the right to take possession as against Sillibank.*

(b) Now assume that Sillibank registered its interest on September 30 instead of on August 31. What result? *See* Art. 42(3). Would the result change if BAC had actual knowledge of Sillibank's interest?

Problem 5.2(b) *BAC's interest is senior to that of Sillibank. When BAC registered its interest on September 25 Sillibank's interest was unregistered and on September 30 Sillibank's interest became a subsequently registered interest. Under Article 42(3) BAC acquired its interest "free from" Sillibank's interest. Because BAC was a buyer, the result is that Sillibank lost its interest upon the registered sale to BAC. BAC's knowledge would not affect the result.*

Problem 5.3. In the setting of Problem 5.2, now assume that, instead of selling the airframe to BAC in a cash sale transaction, IAC, as conditional seller, entered into a title reservation agreement with BAC, as conditional buyer and on the same day IAC registered its interest in the international registry. Would the results differ under the variations posited in Problem 42(a) and (b)? *See* Art. 42(5).

Problem 5.3 *In this variation the operative rule is Article 42(5) instead of Article 42(3) or (4). Here, the relevant registration is that of the conditional seller, IAC, instead of a registered owner's interest as in Problem 5.2. But note that registration of a conditional seller's international interest under a title retention agreement serves the function of giving public notice not only of the conditional seller's international interest but also the conditional buyer's interest (although the conditional buyer does not hold an "international interest" as defined in Article 1(bb)). Applying Article 42(5) to the variations in Problem 5.2(a) and (b), the interest of BAC as conditional buyer vis-à-vis the interests (or not) of Piggibank and Sillibank is essentially the same as that of BAC as buyer-owner in Problem 4.2.*

6. Assignments of Associated Rights and International Interests

The term “associated rights” is defined to mean “all rights to payment or other performance by a debtor under an agreement which are secured by or associated with the aircraft object.” Art. 1(h). Assignments of associated right are enormously important features of aircraft financing. This is no doubt because leasing transactions play such an important role in aircraft financing and rental payments are associated rights arising out of a leasing agreement. The following passage explains the traditional structure of a “leveraged lease”—“leveraged” because the lessor borrows a substantial portion of the funds it uses to acquire the goods to be leased. It is excerpted from STEVEN L. HARRIS & CHARLES W. MOONEY, JR., *SECURITY INTERESTS IN PERSONAL PROPERTY* 83-84 (5th ed. 2011).

“Special Purpose Vehicle” Financing: Leveraged Leasing. Some very innovative forms of receivables financings involve the use of a type of borrower called a **special purpose vehicle** (“SPV”). In these financings the SPV, which may be a corporation, partnership, or trust, is organized for the specific purpose of participating in the financing.²⁴ **Leveraged leasing** is one such form of financing.

A business entity may choose to lease equipment instead of buying it for a variety of reasons (often including its inability to use the tax benefits of ownership, such as accelerated depreciation, because it lacks sufficient taxable income). For example, long-term leasing is a typical means by which airlines obtain the use of commercial aircraft. The lessor often will be an SPV (typically a trust) formed by “equity” investors who (through the SPV) invest in the equipment and lease it to the lessee. These investors often wish to obtain, through the SPV, the tax benefits of ownership that the lessee cannot use. The investors capitalize the SPV with only a portion (say, 20%) of the funds necessary to purchase the equipment. The SPV then borrows the additional necessary funds, pays for the equipment, and enters into a lease with the lessee. By causing the SPV to borrow a substantial portion of the purchase price (i.e., “leveraging” the investment), the investors achieve 100% of the tax benefits of ownership by putting up only a fraction of the cash necessary to buy the equipment. As collateral for its borrowing, the SPV grants to the lender a security interest in the equipment (subject to the lessee's rights under the lease, of course) and in the lease itself (including the rental stream, payable over time by the lessee).

Because the equipment and the lease are the SPV's only assets, the lender must be satisfied with the value of the equipment and the creditworthiness of the lessee.²⁵ The lessee is instructed to make the lease payments directly to the lender,

²⁴Hence the “vehicle” denomination, reflecting the SPV's role as a tool or implement necessary for the financing structure.

²⁵In some transactions the lessor is not an SPV but is an operating company that has other assets and other liabilities. In those transactions the debt of the lessor to the lender normally is **limited recourse** debt. That is, the lending agreement provides that the lender is entitled to look

as assignee of the lease, and those payments are applied by the lender against the SPV's secured debt. If for any reason (such as the lessee's default combined with unanticipated obsolescence of the equipment) the equipment and the lease are not adequate to satisfy the SPV's debt, then the lender will suffer a loss. It will have no recourse against any of the investors. If the lessee does not default and the secured debt is satisfied, then the SPV (and, indirectly, the investors) will be entitled to the **residual value** of the equipment at the end of the lease. The investors expect that value (combined with any tax savings arising out of the SPV's ownership of the equipment, which are passed on to the investors) to be sufficient for them to recover their investments and enjoy a return thereon. Depending on the value of the equipment at the end of the lease term, however, that expectation may or may not be realized. Because the lender's repayment turns on its ability to collect the rental stream from the lessee and on the value of the equipment, the lender must be assured that its security interest will withstand attack by any creditor of, or trustee in bankruptcy for, the SPV, any investor, or the lessee.

The problems relating to assignments of associated rights and international interests in this section are based on the following fact pattern.

On December 1 Lessor, situated in New York, bought and took delivery of a new Airbus A380 airframe. The sale was registered in the international registry the same day. Also on December 1, Lessor entered into a twelve-year lease of the airframe to Lessee, situated in Delaware, which agreed to pay semi-annual rental payments. That same day Lessor borrowed 75% of the cost of the airframe from Lender, which Lender advanced directly to the seller, Airbus. Lessor executed a security agreement covering the airframe and granting an international interest to Lender to secure its obligation to repay the loan. Lessor also signed a promissory note to evidence the loan. The note recited that it was secured by the airframe pursuant to the security agreement. Lessor also executed an assignment to Lender of all of its rights under the lease including all rentals payments and other associated rights to secure repayment of the loan. On December 1 Lender registered the lease, the security agreement, and the assignment of Lessor's international interest with the international registry. Lender did not file a financing statement in the New York UCC filing office.

In working through the problems keep in mind the respective concerns of Lessee, Lessor, and Lender. Lender wishes to ensure that its interests in the airframe and the associated rights are senior to any other interest holder, assignee, or creditor of Lessor (subject to Lessee's right to quiet possession of the airframe so long as it is not in default under the lease), senior to any buyer from Lessor or assignee or sublessee from Lessee, and effective in any insolvency proceeding of either Lessor or Lessee. Lessor wishes to ensure that its interest in the airframe is

only to the collateral—the equipment and the lease—for satisfaction of the debt. The lender is not entitled to satisfy the debt out of other assets of the lessor.

free and clear of any conflicting claims other than the interests of Lender and Lessee and that its rights under the lease are senior to any assignee or sublessee from Lessee and effective in any insolvency proceeding of Lessee. Lessee wishes to ensure that it will have quiet possession of the airframe so long as it is not in default under the lease or otherwise has agreed.

The registrations of interests and the registration of the assignment as described above and the operation of the provisions of the Convention serve to ensure that all of these concerns are appropriately addressed. But please do not underestimate the complexity of the analysis of the transaction under the Convention. The problems in this section barely scratch the surface of the Convention's very complex legal regime for assignments.

Problem 6.1. Assume that Lessor's assignment to Lender covered only "all associated rights in connection with the lease," but did not mention Lessor's international interest as the creditor under the leasing agreement. Would this impair or reduce Lender's rights and interest under the assignment? *See Arts. 1(q); 44(1); 45.*

Problem 6.1 *It would not impair or reduce Lenders rights or interest. Article 44(1) provides that an assignment of associated rights also transfers "the related international interest" (here, Lessor's rights and interest under the lease) and "all the interests and priorities of the assignor under this Convention."*

Problem 6.2. On December 10 Lessor executed a security agreement granting to Bank an enforceable security interest, securing existing indebtedness to Bank, in "all rights to payment of every nature now existing or hereafter arising." One of Lessor's rights to payment is its associated rights under the Lease. Bank perfected its security interest by filing a financing statement in the proper filing office in New York. Bank did not register in the international registry Lessor's assignment to Bank of Lessor's international interest. Lessor then defaulted on its obligation to Bank and (as a result of Lessee's default under the lease) Lessor defaulted on its obligation to Lender. Does Lender or does Bank have priority in Lessor's right to payment from Lessee? *See Arts. 45; 48(1); 42(1); 49.*

Problem 6.2 *Article 48(1) provides the operative rule here. It applies the first-to-register priority rules of Article 42 to competing assignments of associated rights when at least one competing assignment is accompanied by an assignment of the related international interest. The assignment from Lessor to Lender therefore qualifies. Bank received an assignment for security made pursuant to the security agreement, which we can assume would meet the formal requirements of Article 45. However, because Bank did not register the assignment in the international registry, applying Article 48(1) awards priority to Lender under Article 42(1).*

Note that Article 49 imposes a material limitation on the scope of the Article 48(1) priority rule. Article 48(1) applies only if the requirements of Article 49(1) are met. First, "the contract under which the associated rights arise" must "state[] that they are secured by or associated with the object." Art. 49(1)(a). Here, the lease obviously meets this test inasmuch as it provides that rentals are payable in connection with the lease of the airframe. Second, the priority rule applies only "to the extent that the associated rights are related to an aircraft

object.” Art. 49(1)(b). Article 48(2) explains when associated rights “are related to an aircraft object.” Here, the associated rights are the rentals payable under the lease and other related obligations, so the relatedness test clearly is satisfied. Article 48(1) applies and Lender has priority.

Problem 6.3. On December 20 Lender granted to Finance Co. (“FC”), a Delaware corporation, an enforceable security interest, securing existing indebtedness to FC, in “all rights to payment of every nature now existing or hereafter arising.” One of Lender’s rights to payment is its associated rights under the Lease, assigned to it by Lessor, and another is its right to payment under the promissory note made by Lessor and secured by the airframe. FC perfected its security interest by filing a financing statement in the proper filing office in Delaware. FC did not register in the international registry Lender’s assignment to FC of Lender’s international interest. On December 30 Lender sold to Bigbank the promissory note made by Lessor and that same day Bigbank registered the assignment of Lender’s international interest in the international registry, indexed against the airframe securing the note. Lender then defaulted on its debt to FC.

(a) Does FC or does Bigbank have priority in Lessor’s right to payment from Lessee? In Lender’s right to payment from Lessor (which is secured by Lessor’s right to payment from Lessee)? *See Arts. 45; 48(1); 42(1); 49.*

Problem 6.3(a) *Article 48(1) again provides the operative rule here. The first step is to identify the associated rights as to which the analysis should proceed. There are two sets. First is the lease and related associated rights and Lessor’s international interest under the lease. These belong to Lessor, not Lender, but are being assigned to Lender as security for the obligations of Lessor to Lender under the promissory note. Second is the promissory note that represents the relevant associated rights owed by Lessor to Lender and secured by Lender’s international interest in the airframe. First, under the analysis explained for Problem 6.2, Lender’s (as assignee from Lessor) associated rights under the lease and its (as assignee from Lessor) international interest under the Lease satisfy Article 49(1) and (2) and Article 48(1) applies. Second, because the note recites that it is secured by the airframe and Lender’s loan was made and used for the purchase of the airframe, Article 49(1) and (2) are satisfied and Article 48(1) applies. Because Bigbank registered the assignment to it of the international interest under the Lease and the international interest under the security agreement, Bigbank’s interest has priority over that of FC under Articles 48(1) and 42(1).*

(b) Now assume that the promissory note made by Lessor made no mention that it was secured by the airframe and that FC had no knowledge that it was so secured until after Lender’s default. Does the result in part (a) change? *See Arts. 45; 48(1); 42(1); 49; O.C.¶ 4.254, Illustration 33.*

Problem 6.3(b) *The result in part (a) does change. Now the promissory note does not satisfy Article 49(1)(a) because it makes no reference to the airframe, even though (1)(b) is satisfied because the note evidenced the loan made and used for the purchase of the airframe. Consequently, Article 49(3) applies and the priority between Bigbank and FC is governed by the*

applicable law. FC perfected its security interest by filing under New York law but Bigbank did not file. However, assuming that Bigbank took possession of the note and otherwise qualifies, it may have priority under UCC § 9-330(d), but that analysis is beyond the scope of this problem. It is enough for students to see that the applicable law, not the Convention, applies. Other matters may be left to a course that covers secured transactions.

At first blush it might seem odd that Bigbank, as the assignee of record of the lease (assigned by Lessor to Lender and reassigned by Lender to Bigbank, all reflected in the international registry) and the international interest in the airframe granted by Lessor, would not have the protection of the Convention. Of course, anyone that knows about the underlying security in the airframe could discover the assignments to Bigbank. But the point is that unless Lender had voluntarily informed FC of the relevant facts, FC would have had no way of knowing that it needed to search and register its assignments in the international registry. Similarly, another subsequent prospective purchaser would have no way of knowing of the need to search (or even which aircraft object to search against). The assignment provisions of the Convention are necessarily limited and that is the point of Article 49. The limitation is necessary because the Convention's assignment regime allows perfection and priority in intangible rights, such as rights to payment, through registration is a system that is strictly object related. Without the limitation, the secured, asset-based financing of receivables generally would be substantially impaired.

7. Default; Enforcement of International Interests

Problem 7.1. Piggibank established the financing arrangement with IAC as described in Problem 4.1. It is now January 15, 2013. IAC failed to repay the Piggibank loan on December 3, 2012, as required by the promissory note; no payments on the note have been made by IAC. Piggibank's loan officer has discussed the matter with IAC, which has asked for an extension of time on the note payment, but no agreement has been reached. You are counsel for Piggibank and the loan officer has asked you to assist Piggibank in obtaining possession of the Boeing 777 airframe as soon as practicable, taking into account all related risks and expenses.

(a) How would you advise Piggibank to proceed in taking possession? See Arts 12; 70.

Problem 7.1(a) *One significant decision to make at the outset is whether to proceed judicially or non-judicially (i.e., self-help). This choice is available because the United States has not made an Article 70 declaration requiring a chargee to proceed judicially. Article 12(1)(a) clearly entitles Piggibank to obtain possession following IAC's default. However, it is likely that taking possession by self-help would not be practical because of airport security issues and the inherent difficulties in taking possession of a large commercial aircraft. Article 19 requires Piggibank to proceed in a commercially reasonable manner, which could present serious problems in the case of a commercial airline's airframe located (presumably) in a secure airport. Better advice would be to proceed judicially under the procedures (such as replevin or*

sequestration) of a state where the airframe may be found. Alternatively, Piggibank may wish to explore an agreed, voluntary surrender by IAC of possession of the airframe.

(b) What other practical or strategic concerns would you raise with Piggibank?

Problem 7.1(b) *If IAC plans to continue its airline operations its use and possession of the Boeing 777 airframe may be essential. If that is the case, a judicial attempt to recover possession almost certainly would trigger a Chapter 11 reorganization petition. That would also suggest that IAC would not be likely to agree to a voluntary surrender of the airframe. As to the consequences of a Chapter 11 filing, see Problem 7.3 below.*

If it is the case that IAC does not need the airframe for its continued operations, then an agreed (even if inspired by judicial action) solution might be feasible.

For a financial institution such as Piggibank to acquire physical possession of the airframe would require substantial advance planning—storage, insurance, regulatory compliance, etc. Having a contractor such as an aircraft broker take possession might make more sense. Alternatively, Piggibank could consider finding a buyer for the airframe, selling it under Article 12 and recovering possession post-sale. As to the sale of the airframe, see Problem 7.2, below.

Problem 7.2. It is now January 25, 2013. Your firm has filed an action on behalf of Piggibank seeking a money judgment and possession of the Boeing 777. The loan officer believes that this move will force IAC's hand to decide on a Chapter 11, seek refinancing with another lender, or voluntarily surrender possession to Piggibank. In the meantime, you are making plans for a sale of the airframe.

(a) What steps will you take? For example, will you recommend a public sale (as in an auction) or a privately negotiated sale? Who would be likely buyers for the airframe? See Arts. 12(1), (2); 19.

Problem 7.2(a). *It is important to impress upon the students that one cannot know whether to conduct a private or public (auction) sale without knowing how the market for large commercial aircraft works. Unless counsel or the client happens to have this knowledge, an empirical investigation is needed to determine how best to encourage those who might be in the market for such a used aircraft. Are potential buyers likely to attend an auction? Because any sale must be made in a commercially reasonable manner (Article 19), that requirement must guide the analysis. Depending on the facts and circumstances, either method might be commercially reasonable or only one method might be commercially reasonable.*

If the commercial reasonableness of the sale is later challenged it would be necessary for the parties to adduce expert testimony as to the commercial reasonableness point. But that might be years hence. For that reason, ascertaining expert opinions and advice is an important aspect of

preparing for the sale. Think of the process as trial preparation in which the client is making the facts!

If Piggibank wishes to purchase, or bid on, the aircraft by “bidding in” its secured claim, then it may do so only at a “public” sale. This is made explicit in Article 9. See UCC § 9-610(c) & Comment 7. I believe that it is implicitly required under the Convention. Were a chargee to sell an aircraft to itself privately it would run afoul of the protections imbedded in Article 13 (discussed in connection with part (e) of this Problem). If Piggibank decides to bid, it should seriously consider obtaining an appraisal or other evidence of the range of prices that an unrelated third party would be likely to bid for the aircraft before determining the amount of its own bid. (Many think that obtaining an appraisal is good practice in every disposition.)

Chances are that due diligence would reveal that the likely universe of potential buyers are airlines that already have 777s in their fleets. The number probably would be sufficiently small that direct contact could be made with each of them to explore a possible sale.

(b) Who would you notify of a proposed sale? What information should the notice contain? See Art. 12(3), (4); 1(u), (z).

Problem 7.2(b). *The requirements for prior notice of a sale or lease of an aircraft object pursuant to Article 12(1) are found in Article 12(3) and (4). Notice of a sale or lease must be given to the debtor and to any guarantor of the secured obligation (i.e., “interested persons specified in Article 1(z)(i) and (ii)”). Art. 12(c). Notice must also be given to “any other person having rights in or over the aircraft object” (i.e., “interested persons specified in Article 1(z)(iii)”), but only if such person or persons have given the chargee notice of their rights a reasonable time before the sale or lease.*

The contents of the notice are not specified in the Convention. The requirement is to give “reasonable prior notice.” It is a fair reading of this requirement that both the timing and the content of a notice must be “reasonable.” Under Article 12(4), “ten or more working days prior written notice” is reasonable. As to content, a notice of a public sale should identify the location, date, and time of the sale so as to afford the debtor, a guarantor, or an interested person to attend and observe. In the case of a private sale the notice should at least specify the date on or after which a private sale will take place. This interpretation would be consistent with UCC § 9-613(1)(E). And this would allow a notified person to know the earliest possible time that its right to redeem the aircraft object, by paying in full the secured obligations, would expire

(c) Would you consider obtaining approval of any sale by the court in the pending case? See Art. 12(2).

Problem 7.2(c). *Given that the airframe may be worth more than \$200 million, court approval of the manner of sale would be prudent. Article 12(2) explicitly provides this opportunity to Piggibank.*

(d) Would you consider a sale to a foreign buyer? If so, what additional considerations would be involved. See Art. 15.

Problem 7.2(d). *Inasmuch as there is a relative scarcity of potential buyers of the Boeing 777, it might well be commercially unreasonable to exclude foreign buyers who might be interested in buying the airframe from consideration. Article 15 affords Piggibank the remedies of de-registration and export of the airframe.*

(e) What alternatives to a sale of the airframe would you consider? See Arts. 12(2); 13.

Problem 7.2(e). *Leasing would be a feasible alternative, especially if a suitable buyer is not available. An agreement with IAC that Piggibank would take ownership of the airframe in satisfaction of the secured obligations under Article 13 probably would not be feasible. The airframe appears to have a value that is considerably greater than the secured debt.*

Problem 7.3. It is now February 5, 2013. Today IAC filed a petition under Chapter 11 of the Bankruptcy Code in the U.S. Bankruptcy Court for the District of Delaware. What recommendations will you make to Piggibank? Consider section 1110 of the Bankruptcy Code. Note that IAC, as a debtor in possession in Chapter 11, has the powers and duties of a trustee.

11 U.S.C § 1110. Aircraft equipment and vessels

(a) (1) Except as provided in paragraph (2) and subject to subsection (b), the right of a secured party with a security interest in equipment described in paragraph (3), or of a lessor or conditional vendor of such equipment, to take possession of such equipment in compliance with a security agreement, lease, or conditional sale contract, and to enforce any of its other rights or remedies, under such security agreement, lease, or conditional sale contract, to sell, lease, or otherwise retain or dispose of such equipment, is not limited or otherwise affected by any other provision of this title or by any power of the court.

(2) The right to take possession and to enforce the other rights and remedies described in paragraph (1) shall be subject to section 362 if—

(A) before the date that is 60 days after the date of the order for relief under this chapter, the trustee, subject to the approval of the court, agrees to perform all obligations of the debtor under such security agreement, lease, or conditional sale contract; and

(B) any default, other than a default of a kind specified in section 365(b)(2), under such security agreement, lease, or conditional sale contract—

(i) that occurs before the date of the order is cured before the expiration of such 60-day period;

(ii) that occurs after the date of the order and before the expiration of such 60-day period is cured before the later of—

(I) the date that is 30 days after the date of the default; or

(II) the expiration of such 60-day period; and

(iii) that occurs on or after the expiration of such 60-day period is cured in compliance with the terms of such security agreement, lease, or conditional sale contract, if a cure is permitted under that agreement, lease, or contract.

(3) The equipment described in this paragraph—

(A) is—

(i) an aircraft, aircraft engine, propeller, appliance, or spare part (as defined in section 40102 of title 49) that is subject to a security interest granted by, leased to, or conditionally sold to a debtor that, at the time such transaction is entered into, holds an air carrier operating certificate issued pursuant to chapter 447 of title 49 for aircraft capable of carrying 10 or more individuals or 6,000 pounds or more of cargo; or

(ii) a vessel documented under chapter 121 of title 46 that is subject to a security interest granted by, leased to, or conditionally sold to a debtor that is a water carrier that, at the time such transaction is entered into, holds a certificate of public convenience and necessity or permit issued by the Department of Transportation; and

(B) includes all records and documents relating to such equipment that are required, under the terms of the security agreement, lease, or conditional sale contract, to be surrendered or returned by the debtor in connection with the surrender or return of such equipment.

(4) Paragraph (1) applies to a secured party, lessor, or conditional vendor acting in its own behalf or acting as trustee or otherwise in behalf of another party.

(b) The trustee and the secured party, lessor, or conditional vendor whose right to take possession is protected under subsection (a) may agree, subject to the approval of the court, to extend the 60-day period specified in subsection (a)(1).

(c) (1) In any case under this chapter, the trustee shall immediately surrender and return to a secured party, lessor, or conditional vendor, described in subsection (a)(1), equipment described in subsection (a)(3), if at any time after the date of the order for relief under this chapter such secured party, lessor, or conditional vendor is entitled pursuant to subsection (a)(1) to take possession of such equipment and makes a written demand for such possession to the trustee.

(2) At such time as the trustee is required under paragraph (1) to surrender and return equipment described in subsection (a)(3), any lease of such equipment, and any security agreement or conditional sale contract relating to such equipment, if such security agreement or conditional sale contract is an executory contract, shall be deemed rejected.

(d) With respect to equipment first placed in service on or before October 22, 1994, for purposes of this section—

(1) the term "lease" includes any written agreement with respect to which the lessor and the debtor, as lessee, have expressed in the agreement or in a

substantially contemporaneous writing that the agreement is to be treated as a lease for Federal income tax purposes; and

(2) the term "security interest" means a purchase-money equipment security interest.

Problem 7.3. *On reviewing section 1110 the students will see that in 60 days or less IAC must either cure all defaults or turn over the airframe to Piggibank. Given that IAC's default was a failure to pay the entire secured obligation when due, it is likely that IAC's only alternative to surrendering the airframe will be to refinance the loan to pay Piggibank in full.*

Note that the United States did not adopt either version of Article 23. That article, and particularly Alternative A, is based on section 1110.

APPENDIX I
CONSOLIDATED TEXT OF THE
CAPE TOWN CONVENTION AND AIRCRAFT PROTOCOL

APPENDIX II
EXCERPTS FROM OFFICIAL COMMENTARY (2008)

[Convention Article 29 (Consolidated Text Article 42)]

[Convention Article 36 (Consolidated Text Article 49)]

**APPENDIX III
EXCERPTS FROM
REGULATIONS AND PROCEDURES
FOR THE INTERNATIONAL REGISTRY**

Regulations and Procedures for the International Registry

Fourth Edition — 2010

International Civil Aviation Organization

* * *

5.4 The information required to effect the registration of an international interest, a prospective international interest, a notice of a national interest, or a registrable non-consensual right or interest is:

- (a) the identity and electronic signature of the registering person and a statement on whose behalf that person is acting;
- (b) the identity of the named parties;
- (c) the following information identifying the aircraft object:
 - (i) type of aircraft object;
 - (ii) manufacturer's name;
 - (iii) manufacturer's generic model designation; and
 - (iv) manufacturer's serial number assigned to the aircraft object;
- (d) in the case of an airframe or helicopter, the following information, if known:
 - (i) the current and, if different, intended State of Registry for nationality purposes; and
 - (ii) the current and, if different, intended aircraft nationality and registration marks assigned pursuant to the Chicago Convention;
- (e) the duration of the registration, if the registration is to lapse prior to the filing of a discharge;
- (f) in the case of an international interest or a prospective international interest, the consent of the named parties, given under an authorization; and
- (g) the names and electronic addresses of persons to which the Registrar is required to send information notices pursuant to Section 6.

* * *

7.1 Searches of the International Registry may be performed against:

- (a) a manufacturer's name;

- (b) a manufacturer's generic model designation; and
- (c) a manufacturer's serial number of an aircraft object; and in the case of an airframe or helicopter, against:
- (d) the State of Registry of the aircraft of which it is part; or
- (e) the nationality or registration mark.

Such information may be searched by means of a priority search or informational search, as set out in Sections 7.2 and 7.3, respectively. A Contracting State search may also be made, as set out in Section 7.5. A search may be performed by any person who complies with the International Registry Procedures, whether or not that searching person has a specific interest. All searches shall be performed by electronic means.

7.2 A "priority search" is a search for registration information using the three criteria specified in Article XX (1) of the Protocol, as set out in Sections 7.1 (a) to (c). Such information is searchable for purposes of Articles 19 (2) and (6) of the Convention and Article XX (1) of the Protocol.

* * *

7.4 A "priority search certificate" is a certificate issued in response to a priority search. It shall:

- (a) set out the information required by Article 22 (2) (a) or (b) of the Convention, as applicable, and comply with Article 22 (3) of the Convention;
- (b) in the case where Article 22 (2) (a) of the Convention applies, list the registered information in both:
 - (i) chronological order; and
 - (ii) a manner that indicates the transactional history of each registered interest; and
- (c) indicate the current holder of the right to discharge a registration and set out in chronological order when that right to discharge has been transferred and the parties executing such transfer.

* * *