*Cape Town Convention Journal,* 2018
Vol. 7

# Implications of CTC for Use of Trusts in Aircraft Finance and Leasing Transactions

**Kenneth Gray and Jeffrey Wool***

## Abstract

*Article VI of the Aircraft Protocol endorses the use of trusts in transactions subject to the Cape Town Convention. It requires, as autonomous treaty law, each contracting state to recognise trusts validly created under the substantive law under which the trust was constituted, whether or not trusts are known to or accepted by the national law of that contracting state and regardless of its pre-Cape Town Convention conflict of laws rules. The foregoing applies equally to national law structures analogous to trusts. Background to, analysis supporting, and the legal implications of, these conclusions are set out in this article.*

## Introduction

Trusts occupy a central role in the financing and leasing of aircraft equipment. That fact gave rise to the need for Article VI of the Aircraft Protocol[1] ('Protocol') to the 2001 Convention on International Interests in Mobile Equipment ('Convention'), which reads, in part, as follows:

> A person may enter into an agreement or a sale, and register an international interest in, or a sale of, an aircraft object, in … [a] trust or other representative capacity. In such case, that person is entitled to assert rights and interests under the Convention.[2]

This article examines the intent, text, and implications of that key provision (Article VI). It uses the term 'trust' to include the wide range of analogous structures seen around the world, to which the reasoning and conclusions herein apply *mutatis mutandis*.[3]

* Kenneth Gray is a consultant at Norton Rose Fulbright. Jeffrey Wool is secretary general of the Aviation Working Group, a professor at the University of Washington School of law, and senior research fellow at Harris Manchester College, Oxford. The authors thank Philip Wood for his pioneering work on trusts and his comments on this paper, and professor Roy Goode for sharing his penetrating insights on the Cape Town Convention and trusts, including the thinking behind his treatment of this topic in the Official Commentary.

1 2001 Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment.

2 While Article VI also covers and endorses the use of agency, that topic is outside the scope of this article.

3 Including a range of fiduciary arrangements (such as *Fiducies* (France and Luxembourg), *Fideicomiso* (many Latin American countries), *Bewind* (South Africa), and *Amaana* (Saudi Arabia)), in all of which one person holds the property for the benefit of another, the beneficiary. In other structures, however, such as *Stichtin*g (Netherlands), there is no beneficiary.

Section I provides background by outlining the essential characteristics of trusts, and the overall global treatment of trusts, and, in the case of international transactions, the conflict of laws rules relating thereto, in each case prior to the changes effected by the Convention and the Protocol (jointly referred to as 'CTC'). It then summarises the well-established use of trusts in international aircraft financing and leasing transactions, which was assumed in the drafting and negotiation of Article VI, and, accordingly, gives content to a general principle underlying the treaty with gap-filling implications. Section II then sets out the core legal principle that each contracting state is required, as autonomous treaty law, to recognise trusts validly created under the substantive law under which the trust was constituted, whether or not trusts are known to or accepted by the national law of that contracting state and regardless of its pre-CTC conflict of laws rules. It also addresses the scope of that recognition. Section III concludes by applying the analysis to a hypothetical transaction.

## I. Trusts – basic concepts and principles

### *A. A brief history of the trust in English Law*

The English law of trusts can be traced back to the Norman invasion of England in 1066, although the principles stretch back into antiquity, to the Roman law of *fideicommissum*. Originally known as 'uses', trusts conveyed the ownership of the property to a party, the 'feoffee', to be held for the benefit of a beneficiary, the 'cestui que trust'. The use had many applications: landowners participating in crusades could retain ownership of their property whilst allowing others to cultivate it whilst they went to war; clergy who had taken a vow of poverty could reside in monasteries whilst avoiding their ownership. As the beneficiaries had no estate in the property, the property the subject of the uses was protected from the claims of their creditors. Therein lies the historical objection to the trust: in certain contexts, it may undermine rights that creditors might have against the property of their debtors.

In England, uses developed into trusts in the eighteenth century. With the advent of the industrial revolution and a burgeoning middle class, anxious to ensure that property could be bestowed on their lineage for generations to come, the use of the trust increased dramatically. Land could be left to children and subsequent generations without the risk of that property being undesirably disposed of.

Although the motor for the development of trust in practice and in law has been rights to real property, particularly on inheritance, the concept has easily lent itself to use in commercial transactions. The ring-fencing of the trust property from the claims of creditors makes it a useful and popular tool. Trusts are commonly used as a way of holding investments on behalf of large and mutable categories of beneficiaries, protecting assets from the insolvency either of their legal owners or of those for whose benefit they are held. In an era of increasing globalisation, trusts provide an easy mechanism for dealing with cross-border issues where multiple jurisdictions have an incidence on the ownership or use of the asset. They have been described by Maitland as 'the greatest and most distinctive achievement performed by Englishmen in the field of jurisprudence'.[4]

By contrast, in some civil law jurisdictions, the use of trusts to shelter assets from creditors, and particularly government authorities, has led to their being described as having a 'sulphurous

[4] Frederic William Maitland, *Selected Historical Essays of F.W. Maitland* (Helen Cam ed, CUP 1957) 129.

reputation'.[5] Some view that sheltering as historically central to the creation of the trust.[6] There is also suspicion that cross-border trusts may be used to attempt to circumvent mandatory rules of inheritance, in particular the *réserve héréditaire*, the part of testators' estates which they are unable freely to dispose of.

### *B. The characteristics of an English trust*

The creation of a trust under English law is easy. Three certainties must be observed: those of intention (a trust was intended to be created), of subject-matter (the trust property must be properly demarcated) and of objects (there is clarity as to who are beneficiaries even if they cannot be individually identified).[7] There is no requirement for the creation to be in writing or for contractual formalities to be complied with. There is no need for the beneficiary even to be aware of the trust. There is no limitation on who may be a trustee.

An English law trust divides the ownership of an asset between legal and beneficial. Absent a trust, legal ownership of an asset is usually manifested by its apparent ownership – by the entity that has its possession, or (for certain assets) in whose name it is registered. It can normally be established by a third party with relative ease, by inspecting the asset or (if relevant) the register. In the case of a contractual chose in action, the third party may analyse the underlying documentation. There are, of course, certain exceptions, such as leases and contracts of bailment. Security might impair the ownership of the asset by the possessor.

However, with a trust, the analysis is more complex. The possession of the asset will lie not with the legal, but with the beneficial, owner. If registered, the registry may reveal the identity, not of the economic owner, but of the legal owner of the asset, who may have no economic interest in it. For a third party, establishing the nature of each party's interests in the asset will be more complex. It is this lack of transparency which makes many jurisdictions suspicious of the trust.[8]

The essential benefits of an English trust stem from the division of the title into legal and beneficial and are twofold:

(a) The trustee owns only the legal title to the property: on its insolvency, that property will not form part of the trustee's insolvency estate and remains available for the beneficiary; and

(b) The beneficiary enjoys the trust property without being encumbered with the risks, or permitted the rights, associated with legal ownership. In particular, the beneficiary does not have the power to dispose of the trust property. The beneficiary not having the legal title to the trust property, on its insolvency, its creditors may be unable to require the realisation of the trust property to recover the debts owing to them. Any action they take may be limited to the beneficiary's interest in the property and not to the legal title.

(c) English law sharply distinguishes the powers of a bare trustee from those of an active

[5] Philippe Marini, 'Enfin la fiducie à la française' (2007) 20 Recueil Dalloz 1347, 1348.

[6] For example, Martinez argues that 'it can be proved today, without any risk of error, that the trust was born in the pursuit of an illegal purpose: the transfer of lands to bogus intermediaries, avoiding in that way the payment of taxes and the enforcement of the laws governing *mortmain*'. See Ignacio Arroyo Martinez, 'Trust and the Civil Law' (1982) 42 La L Rev 1709, 1714.

[7] *Knight v Knight* [1840] 3 Beav 148.

[8] See section II(C) below: in contrast, the CTC International Registry has the facility for naming parties in a trust capacity, thus putting third parties on notice.

> trustee, ie one having management powers. A bare trustee is a mere nominee who is obliged to conform to the instructions of the beneficiary. By contrast a trustee under an active trust has full management powers, including the power to dispose of the trust property. It is important to emphasise that, for both trusts, it is the trustee that has power to dispose of the trust property albeit that its rights to do so might be curtailed by the terms of the trust.[9]

The principal objection to an English law trust is its potential obscurantism: it may lead intending creditors to form an inaccurate assessment of the financial condition of their counterparties since assets ostensibly owned by those counterparties might actually be held for the benefit of others and so not be available, on the debtor's insolvency, to their creditors. A vivid illustration of this is the House of Lords decision in the *Quistclose case*.[10] A lender, Q, advanced a loan to a borrower, R, for the express purpose of enabling R to pay dividends to its shareholders. The loan proceeds were credited to a separate account of R with its bankers, B, but R went into liquidation before any dividends were paid. B sought to set off the sums standing to the credit of R's account against debts owing by R to B. The House of Lords, however, held that the facts of the case led to the creation of a constructive trust over the disbursed loan in favour of Q until such time as it was applied for its contractual purpose and so denied B their claim to set off. B may have been unaware of the constructive trust. The case illustrates the way in which trusts (of which a creditor may be unaware) may dilute the assets of a debtor and, so, the rights of set-off to which the creditor might otherwise have been entitled.

### *C. Specific trusts*

As a general rule, an English trust must have a beneficiary: somebody must be able to enforce the trust. There are certain exceptions to the rule (mainly relating to charitable trusts) but a non-charitable purpose trust will be void. The definition of a non-charitable purpose, the reasons for the courts' hostility to trusts for such a purpose and the many, rather esoteric exceptions to the rule (the promotion of fox-hunting, the saying of masses, the upkeep of monuments and so on) would require a lengthy separate paper. For current purposes, the requirement that an English trust must have a beneficiary immediately requires the tax and accounting position of that beneficiary to be analysed when a trust is used in a particular financing structure.

The unavailability of non-charitable purpose trusts in common law jurisdictions has led to the development of the so-called 'orphan trust'. An orphan trust is a limited liability company set up in a common law jurisdiction, whose shares are held by its parent on trust, typically for a charity. It is a misnomer in that the limited liability company itself is not a direct party to the trust. Orphan trusts are used to create tax neutral, insolvency remote structures and are discussed in more detail below.

### *D. Trusts in civil law jurisdictions*

Although the trust is usually seen as a device conceived under English or other common law legal principles, and in spite of the hostility manifested to that concept by several civil law jurists, the concept of fiduciary obligations owed by the owner of property to a third party exists in many civil law jurisdictions. For example:

(a) The Roman Law fideicommissum existed in French law until the introduction of the Napoleonic Code in 1804. Over 200 years later, in 2007, that concept was effectively resuscitated

[9] See, for example, *Akers v Samba Financial Group* [2017] UKSC 6 discussed further at section I(E).

[10] *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567.

when the Code was amended to introduce a similar, but new, concept, the *fiducie*. The new Article 2011 of the Civil Code provides:

> The *fiducie* is the process by which one or more entities transfer property, rights or securities, or a combination of property, rights or securities, present or future, to one or more *fiduciaries* who hold them separately from their own property, acting with a specific purpose for the benefit of one or more *bénéficiaires.*

(b) Luxembourg redefined the concept of a fiduciary contract in its law of 27 July 2003:

> A fiduciary contract within the meaning of the present title is a contract by which a person, the *fiduciant*, agrees with another person, the *fiduciaire,* that, subject to the obligations determined by the parties, the *fiduciaire* becomes the owner of assets which shall form a fiduciary property.[11]

(c) Many Latin American countries have a concept of a *fideicomiso*, defined (for example) in Panama as 'an irrevocable agency whereby determined property is transferred to a person called the *fiduciario*, for this person to dispose of them according to the instructions of the *fideicomitente*, for the benefit of a third party, called *fideicomisario.*'[12]

(d) Saudi Arabian law recognises a contractual arrangement known as an *amaana*, under which the *amin* owns property in respect of which it owes personal duties of care to the beneficiary but in which the beneficiary has no separate proprietary interest.

We have avoided translating the name of each instrument as to use the word 'trust' in its English sense would be misleading. The concepts are fundamentally different in that the instruments are contractual in nature and do not create a proprietary interest in the asset in favour of the beneficiary. Title in these jurisdictions is unitary and indivisible. The similarity to the trust is restricted to the fiduciary nature of the obligations assumed by the owner of the trust property to its beneficiaries and in the ring fencing of the assets on the insolvency of the owner.

So far we have discussed trust-like structures in which title to the trust property is held by one person who is obliged to use it for the benefit of another. There are a number of other entities in different jurisdictions which have similarities to a trust but follow a different model of ownership.

(a) The Dutch *stichting* is a foundation set up by notarised deed which does not have any beneficiaries. It may have a charitable purpose. A *stichting* may be used by a financial institution as a means of controlling assets while not having legal ownership or consolidating the assets on their financial statements. The equivalent under English law would be a purpose trust which (as described in section I(C)) is likely to be void. An orphan trust, as described in section I(C) is often used to achieve the same end, but is structurally significantly different. *Stichtings* are also common in the Dutch territories in the Caribbean formerly known as the Netherlands Antilles.[13]

---

[11] Loi no A124 du 27 juillet 2003 relative au trust et aux contrats fiduciaries, art 5.

[12] Ley no 17 del 20 febrero, 1941 sobre fideicomiso, art 1.

[13] For a full discussion of the trust in European law, see David J Hayton, Sebastianus Constantinus Johannes Josephus Kortmann and HLE Verhagen, *Principles of European Trust Law* (Kluwer Law International 1999).

(b) South African law provides for a different trust-like structure – the *bewind* trust. The founder makes a disposition to the beneficiaries and vests the administration of the assets in the administrator or trustee (the *bewindhebber*). The beneficiary retains all proprietary rights to the trust assets but its ability to deal with the same is restricted by the *bewind* structure, at least until the occurrence of some condition which allows the rights to the administration of the asset to be transferred to the beneficiaries. The *bewindhebber* has no proprietary interests over the assets. *Bewinds* are commonly used for testamentary dispositions to minors or for the administration of properties owned by partnerships (for example,the premises of a law firm).

### *E. The Hague Convention on the Law applicable to Trusts*

Globalisation has resulted in purported trustees, beneficiaries and trust assets moving from state to state and finding themselves in jurisdictions where the concept of a trust, as embodied by the relevant instrument, may not exist, leading to the potential for the disruption of the proprietary rights and fiduciary obligations attaching to them. The multiplicity of the ways in which trust-like fiduciary obligations are manifested has been a deterrent to any attempt to create a single trust structure recognised internationally. Instead the concentration has been on encouraging the recognition of foreign trusts. In particular, the 1985 Convention on the Law Applicable to Trusts and on Their Recognition (the 'Hague Convention') seeks to encourage that recognition.

The Hague Convention does not set out to introduce the arrangement similar to a trust (or a *fiducie*) into the domestic law of its contracting states: given the cultural chasm in this area described previously, to create a unitary system would be impossible. Instead, it seeks to establish common conflict of laws principles on the laws applicable to trusts. Although the Hague Convention has (as at today's date) been ratified by only fourteen jurisdictions,[14] it sets out a useful framework for considering how trusts to which Article VI of the Protocol refers may be treated on a cross-border basis.

The Hague Convention applies to a wide variety of trust arrangements, differing in the manner of their creation, in the identity of the parties and in the areas of law to which they are expressed to apply. It may apply in heavily regulated areas of the law, such as inheritance, where many jurisdictions have mandatory rules. In many jurisdictions, where there is no legislation relating to the administration of trusts, there is a concern that trusts may be used to avoid such mandatory provisions and that protection for beneficiaries and other third parties may be inadequate. The fear that foreign law trusts may be used with the Hague Convention to circumvent such rules may explain the relatively low number of civil law jurisdictions that have ratified it. However, notwithstanding such concerns, the utility of the trust in the conduct of certain business and banking affairs was recognised in France as being of sufficient importance for the *fiducie* to be introduced, but in a highly restricted and regulated manner. The *fiduciaires* must be either credit institutions, investment companies, insurers, portfolio managers or lawyers and the *fiducie* itself must be registered with the tax authorities; moreover, the government maintains a national register of *fiducies* which, although not open for public inspection, can be consulted by the administration. *Fiducies* cannot be used for certain purposes such as estate planning. Limiting the scope of application of the *fiducie* has made it palatable in France. The use of the trust in aircraft finance (as will be seen in section I(F) below) is limited to well-understood, arm's length, commercial arrangements that are far removed from the abuses that worry some civil jurists. Working within the context of the CTC, with the priority system and the

[14] Australia, Cyprus, eight provinces of Canada, Hong Kong, Italy, Luxembourg, Liechtenstein, Malta, Monaco, the Netherlands (European territory only), Panama, San Marino, Switzerland and the United Kingdom (including 12 dependent territories and crown dependencies).

registry, the objections to a trust on the grounds of a lack of transparency fall away.

Article 2 of the Hague Convention defines a trust in broad terms:

> For the purposes of this Convention, the term 'trust' refers to the legal relationships created – *inter vivos* or on death – by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose.
>
> A trust has the following characteristics:
>
> (a) the assets constitute a separate fund and are not a part of the trustee's own estate;
>
> (b) title to the trust assets stands in the name of the trustee or in the name of another person on behalf of the trustee;
>
> (c) the trustee has the power and the duty, in respect of which he is accountable, to manage, employ or dispose of the assets in accordance with the terms of the trust and the special duties imposed upon him by law.
>
> The reservation by the settlor of certain rights and powers, and the fact that the trustee may himself have rights as a beneficiary, are not necessarily inconsistent with the existence of a trust.

The definition is endorsed in paragraph 3.83 of the Official Commentary ('OC')[15] and is wide enough to encompass not only the English trust, but also the *fiducies, fideicomisos* and *amaanas* described in section I(D). However, because Article 2 requires the title to the assets to be in the name of the trustee for the benefit of a beneficiary, the Hague Convention will not apply to *stichtings* in the Netherland or to *bewinds* in South Africa. In contrast, Article VI of the Protocol, referring to 'agency, trust or other representative capacities', does extend to *bewinds* as there is no requirement for any proprietary rights on the part of the designated party. A *stichting*, where there is no member beneficiary of the foundation, would not be caught by that definition. The entity will be acting on its own behalf and not in a representative capacity.

Insofar as the conflict of laws rules are concerned, the guiding principle of the Hague Convention is set out in Article 6: 'A trust shall be governed by the law chosen by the settlor. The choice must be express or be implied….'. We may assume that in trusts created in the field of aircraft finance, there will always be an express choice of law. Article 6, however, needs to be read in the light of Article 4 which provides that 'The Convention does not apply to preliminary issues relating to the validity of wills or of other acts by virtue of which assets are transferred to the trustee.' Under the English conflict of law rules, the *lex situs* will apply to these issues. It is important to distinguish between:

(a) the validity of the transfer of the property to the trustee;

(b) the validity of the declaration of trust;

(c) the recognition of the trust; and

[15] Roy Goode, *Convention on International Interests in Mobile Equipment and Protocol Thereto on Matters Specific to Aircraft Equipment: Official Commentary* (4th edn, UNIDROIT 2019).

(d) the validity of any disposition of the property by the trustee to a third party.

The Supreme Court of the United Kingdom addressed these issues in *Akers v Samba Financial Group*.[16] T was the registered owner of certain shares in five Saudi Arabian banks. The situs of those registered shares was therefore Saudi Arabia. T entered into arrangements under which he agreed to hold those shares on trust for B, a Cayman Islands company. Those trust arrangements were governed by the laws of the Cayman Islands. Shortly after B went into liquidation, T purported to transfer all the shares to its creditor, C to discharge his personal liabilities. The Cayman Islands has ratified the Hague Convention but Saudi Arabia has not. Saudi Arabian law would not recognise the division of the title to the shares into legal and equitable and would not have recognised any interest of C in those shares. After extensive consideration of the Convention, its *travaux préparatoires* and English case law, the Supreme Court held as follows.

(a) The validity of the transfer of the property to the trustee, before it becomes subject to the trust, is a matter for the *lex situs*, Saudi Arabia.

(b) The validity of the declaration of the trust is a matter for its applicable law. 'It is clear therefore, that in the eyes of English law, a trust may be created, exist and be enforceable in respect of assets located in a jurisdiction, the law of which does not recognise trusts in any form.'[17]

(c) Contracting states must recognise the trust under its applicable law. Article 11 expands on what is meant by the recognition of the trust and is considered further below.

(d) the validity of the disposition of the trust property to a third party is a matter for the *lex situs*. In the case in question, if the transfer of the shares by T to C was valid under the laws of Saudi Arabia, an English court will not impugn the validity of that transfer, even if made in breach of T's fiduciary duties under the trust:

> Where under the *lex situs* of the relevant trust property the effect of a transfer of the property by the trustee to a third party is to override any equitable interest which would otherwise subsist, that effect should be recognised as giving the transferee a defence to any claim by the beneficiary, whether proprietary or simply restitutionary: *Macmillan Inc v Bishopsgate Investment Trust plc (No 3)* [1996] 1 WLR 387.[18]

The rights and obligations of trustees and beneficiaries under trust arrangements depend on their governing law. It is necessary to consider what is meant by 'recognition' when requiring one jurisdiction to recognise a trust created under the laws of another. The Hague Convention addresses this at Article 11:

> A trust created in accordance with the law specified by the preceding Chapter shall be recognised as a trust.

[16] *Akers* (n 9).

[17] ibid [34] (Lord Mance SCJ).

[18] ibid [20] (Lord Mance SCJ).

> Such recognition shall imply, as a minimum, that the trust property constitutes a separate fund, that the trustee may sue and be sued in his capacity as trustee, and that he may appear or act in this capacity before a notary or any person acting in an official capacity.
>
> In so far as the law applicable to the trust requires or provides, such recognition shall imply, in particular:
>
> (a) that personal creditors of the trustee shall have no recourse against the trust assets;
>
> (b) that the trust assets shall not form part of the trustee's estate upon his insolvency or bankruptcy;
>
> (c) that the trust assets shall not form part of the matrimonial property of the trustee or his spouse nor part of the trustee's estate upon his death;
>
> (d) that the trust assets may be recovered when the trustee, in breach of trust, has mingled trust assets with his own property or has alienated trust assets. However, the rights and obligations of any third party holder of the assets shall remain subject to the law determined by the choice of law rules of the forum.

Thus the trust assets are deemed to be protected from claims of the creditors of the trustee and on its insolvency. However, as seen in *Akers*, any party to whom the trustee voluntarily disposes of the trust asset will take free from the trust, on the assumption that the disposition is valid under the choice of law rules of the forum. It is perhaps curious that the trust can be defeated by a voluntary disposition in breach of the trustee's fiduciary obligations but not by a judicially mandated involuntary disposition on the trustee's insolvency.

Article 15 of the Hague Convention goes on to provide that the requirement that a trust be recognised does not prevent the application of provisions of the law designated by the conflict of laws rules of the forum, in so far as those provisions cannot be derogated from by voluntary act, relating (amongst other things) to (i) the transfer of title to property and security interests in property, (ii) the protection of creditors in matters of insolvency and (iii) the protection, in other respects, of third parties acting in good faith. It is not immediately obvious how this interacts with the minimum requirements set out in Article 11, particularly on the insolvency of the trustee. It has been suggested that the reference to matters of insolvency in Article 15 should only be applied to 'the protection of creditors on the *beneficiary's* insolvency, not that of the trustee'.[19] Whether it is legitimate to add the italicised words is perhaps academic if we assume that the trustee will always have been appointed in, and be subject to the insolvency laws of, a jurisdiction in which the concept of the English trust is well established. In any event, Article 15 of the Hague Convention goes on to provide that '[i]f recognition of a trust is prevented by application of the preceding paragraph, the court shall try to give effect to the objects of the trust by other means': presumably by seeking to trace the proceeds of the disposition of the trust property for the benefit of the beneficiary. It is too early to speak of trends, but it is interesting that when required to choose between Articles 11 and 15 of the Hague Convention, the Supreme Court elected to privilege the rights of the disponee of the trust property under the laws of Saudi Arabia, being the law designated by the English conflict of laws rules as being that applicable to the disposition. This mirrors the general English rule that a purchaser in good faith will take title

[19] Lord Collins of Mapesbury (ed), *Dicey, Morris & Collins on the Conflict of Laws* (15th edn, Sweet & Maxwell 2012) [29-031].

free of any equitable interests of which it has no notice.

The conflicting priorities between a purchaser of an asset and the beneficiary for whom it is held on trust, as vividly demonstrated in *Akers*, is easily resolved in the case of an aircraft object to which the Convention and the Protocol applies. Let us imagine that, in *Akers*, the trust property consisted of, not shares, but an aircraft object. Upon the sale of the aircraft object by the trustee to Samba, and upon registration of that sale in accordance with the Protocol, the system of priorities embodied by the Convention and the Protocol make it incontestable that Samba would take title to the aircraft object free from the interests of the beneficiary. It is only when the sale has not been registered that the conflict of laws rules of the forum come into play.

### *F. The use of trusts in aircraft finance and leasing transactions*

Trusts are commonly used in aircraft finance and leasing structures in a number of circumstances:

(a) orphan trusts;

(b) a security trust, where a trustee holds security over an asset (whether an aircraft object or a contract) on behalf of an indeterminate class of creditors, such as a syndicate of lenders; and

(c) an ownership trust where a trustee holds the title to the aircraft object on trust for its beneficial or economic owners.

Orphan trusts are used in aircraft finance structures primarily as entities which can hold legal title to the aircraft, effectively ring-fencing it and protecting the financiers' interests in the aircraft from the claims of competing creditors of an insolvent lessee. They are particularly used as lessors in finance lease structures and need to be tax and accounting neutral and insolvency remote structures. The trust, in an orphan trust, is one created over the shares of the single purpose entity set up to own the aircraft for this purpose. The aircraft objects themselves are not the subject of the trust.

Where the financing for an aircraft is supplied by a syndicate of lenders, it is common, where the applicable laws so permit, for the security package granted to the lenders to be vested in a trustee acting on their behalf. That security package would typically consist of a mortgage or other security interest over the aircraft (and/or its constituent objects) and an assignment of the lease(s) entered into in respect of the aircraft, as well as certain other collateral contracts (such as insurance and re-insurance policies, contractual warranties made available by the airframe and engine manufacturers and bank accounts). In capital markets structures, trustees will also often hold security over aircraft and/or contracts on behalf of the noteholders. The benefit of having a trustee holding the security may be summarised as follows.

(a) It permits the underlying creditors to transfer their debt freely without prejudicing the priority of their interests in the security. There is no need for any security to be re-executed on such a transfer and the transferee will obtain the rights previously held by the transferor.

(b) The rights of the underlying creditors to the security package will be unaffected by the insolvency of the trustee.

(c) It facilitates enforcement by entrusting the management of the process to the trustee (although it may be subject to contractual restrictions in the deed appointing it). A purchaser

of the secured asset need only deal with the trustee and does not need to concern itself with the underlying beneficiaries.

In an ownership trust, the legal title to the aircraft is held by a trustee for the benefit of the economic owner. Ownership trusts may be created for a number of reasons.

(a) They can be set up for the purposes of enabling the registration of an aircraft with a particular aviation authority that runs an ownership register. For example, party (B) situated in Ruritania wishes to register an aircraft of which it is the outright owner with the Federal Aviation Administration of the United States of America ('FAA'). Under the FAA rules, an aircraft may only be registered if it is legally owned by a US citizen. B transfers title to a trustee (T) situated in (for example) Delaware which declares that it is holding the title to the aircraft on trust for B. The aircraft is thereby entitled to be registered with the FAA but B has not disposed of its economic interests in the aircraft.

(b) They facilitate trading in aircraft. Continuing the example set out in the preceding paragraph: at the request of B, T has leased the aircraft to lessee L. B now wishes to dispose of its economic interests in the aircraft to purchaser P. Absent the trust arrangements, that disposition would necessarily have needed to have been effected by a sale of the aircraft with a contemporaneous novation of the lease. However, by virtue of the trust having been put into place, there is no need to transfer the legal title to the aircraft or the lease agreement since both are held by the trustee. The disposition can be effected by transferring B's beneficial interests under the trust to P. By a similar process, trusts facilitate the trading of fractional interests in aircraft.

## II. Mandatory recognition of trusts based on Article VI

### *A. Documentary history leading to, and of, Article VI*

The treatment of trusts under the CTC can be traced to 1996, when the term and concept first appeared in the 'draft aviation text'. At paragraph 24 of the definition annexure thereto, the term 'party' included trusts. In that document, a 'party', thus a person or entity acting in a trust capacity, had all rights and obligations under the CTC.[20] The draft aviation text was an impactful document during the early study group stage, as seen by the establishment of an aviation grouping, the aircraft protocol group (AWG, IATA, and ICAO) to propose its full integration into the work of the study group. The resulting document[21] retained the same trust concept, which was then considered by the steering and revision committee, which did the initial work setting out content for the newly agreed Convention plus Protocol structure.[22] Within that group, the trust concept was endorsed; indeed, consideration was given to having the trust concept moved to the Convention, to apply to all assets covered by the CTC. While that was not done, and the trust concept remained in the Protocol, each other protocol

[20] UNIDROIT, *Study LXXII – Doc. 23* (1996).

[21] Attached to UNIDROIT, *Study LXXID – Doc. 1* (1998) (the relevant provision appearing in that publication as Article VII).

[22] UNIDROIT, *Study LXXII – Doc. 41* (1998) [92].

adopted an identical version of the final Protocol text, Article VI.[23]

The final version of Article VI was not substantially revised from the form presented to governments at the commencement of international negotiation of CTC in 1998.[24] Article VI was not revised during the diplomatic conference to adopt the CTC in 2001.

The OC addresses Article VI in a manner which reflects its importance and sets out principles for its interpretation. It makes the simple, declarative statements that all contracting states must recognise a validly created foreign trust, whether it is a concept recognised by their national law or not, and that Article VI 'must be interpreted broadly [given] the intent to permit a person to take any action – entering into agreements, enforcing them or registering them with the International Registry – in a … trust capacity'.[25] The OC concisely captures the policy basis for the use of trusts and the need for its broad interpretation: the central role in international financing and leasing of aircraft.

The treatment of trusts continued to the creation of the International Registry, in which, from the outset on entry into force in 2006, parties could register interests 'in a trust capacity', and, in fact, there has been consistent and nearly universal practice that trustees do that.

The foregoing, taken together, shows a 15-year process in which trusts were strongly and without qualification endorsed in theory, the legal texts, and implementation of the International Registry. The broad use of trusts, in line with, and advancing, aviation finance and leasing, was a 'general principle' of CTC. The implications of that are set out below.

### *B. Analysis of the text and intent of Article VI*

To iterate: Article VI states that 'a person may enter into an agreement or a sale, and register an international interest in, or a sale of, an aircraft object, in … [a] trust or other representative capacity. In such case, that person is entitled to assert rights and interests under the Convention'.

On its face, Article VI addresses with endorsement the following functions: contracting and registration.[26] The former necessarily (given the CTC's property-based content) carries with it the right to hold property covered by the CTC. The OC makes clear that enforcement is also a necessary function, as without that, Article VI has no practical effect. Thus, the express provision, and a necessary interpretation of it, and without recourse to general principles for gap filling, permits, and prevents objection as such to, the following CTC actions by a trustee acting in that capacity (the 'express functions'):

- ability (of trustee as such) to contract and hold property in a representative capacity, that is to say on behalf of the trust beneficiaries;
- ability to sue and be sued;
- ability to register CTC interests; and

[23] See the 2007 Luxembourg Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Railway Rolling Stock, Article IV – Representative capacities; 2012 Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Space Assets, Article VI – Representative capacities.

[24] UNIDROIT, *CGE/Int.Int./Report* (First Joint Session, 1999) [116]; UNIDROIT, *CGE/Int.Int./2-Report* (Second Joint Session, 1999) [5:12]; UNIDROIT, *CGE/Int.Int./3-Report* (Third Joint Session, 2000) [182]-[183].

[25] OC (n 15) [5.33].

[26] The OC makes clear that when a trustee makes a CTC registration, 'it is not open to the beneficiaries … to make a separate registration of the same interest'. See OC (n 15) [5.33].

— ability to enforce CTC rights and exercise CTC remedies.

There are two additional functions, and two further elements relating to trusts (as applied to the CTC) that need to be addressed prior to setting out CTC-related general rules on trusts. These items, which require a summary and application to trusts of CTC rules of interpretation and residual gap-filling, are:

— the power to dispose of the trustee;

— the identity of the beneficiaries and the transferability of beneficial interests;

— claims by a creditor of trustee against the trust assets; and

— enforcement of CTC rights and remedies by trust beneficiaries.

The CTC's approach to interpretation and residual gap-filing is found in Article 5 of the Convention. Much has been written on this topic, so we simply summarise. The CTC is to be interpreted in light of its purposes as set forth in its preamble, together with its international character and the need for uniformity and predictability (together, 'general international purposes'). Questions concerning matters governed by the CTC that are not expressly addressed ('gaps') are, in the first instance, addressed in conformity with the CTC general principles ('general principles'), if any, and, absent any such general principles, in conformity with applicable law (avoiding *renvoi).*

The general international purposes relevant to our subject include facilitating asset-based financing and leasing (Convention preamble), adapting the Convention through the Protocol to meet the particular needs of aircraft finance (Protocol preamble), and promoting party autonomy (Convention preamble).

Because Article VI permits a trustee to enter into an agreement or a sale and register an international interest in, or sale of, an object, in a representative capacity, it follows ineluctably that contracting states must recognise that the relevant property is being held on behalf of the persons the trustee is representing: the beneficiaries. Who the beneficiaries may be, their rights under the trust and their ability to transfer their beneficial rights is a question for the law under which the trust was constituted. That must be recognised by contracting states to give effect to Article VI.

In addition to having the right to dispose of aircraft equipment,[27] a trustee has a power to dispose, thus satisfying an element needed to create an international interest and effect a sale. In this context, there is no need to rely on Professor's Goode's long-standing general argument that a power arises by virtue of the Convention's priority rules. That power to dispose derives from legal title, not the beneficial interest in the trust, and subsists whether the trust is classified as a bare or an active trust.

Article VI does not address whether personal creditors of a trustee have recourse against assets held on trust. As noted above, the inability for them to do so is fundamental to the concept of a trust, and even the Hague Convention states that trust recognition 'shall imply … that personal creditors of the trustee shall have no recourse against trust assets'.[28] Applying the CTC's general international purposes, we conclude that Article VI must prevent such creditor from gaining access to trust property, that is, to an aircraft leased by a trust, or held as security by a security trustee, governed by the CTC except, of course, to the extent that that creditor has priority in accordance with the provisions of the CTC.

[27] Assuming a trust validly created under the law expressed to govern it (and that its terms permit such disposition).

[28] Hague Convention, Article 11(a).

In our view, the CTC rules of interpretation and gap filling are less clear as to whether a beneficiary can enforce trust rights against counterparties in addition to (the clear case) of the trustee's ability to do so. Neither the general international purposes nor the trust-endorsing general principle compels an answer. Accordingly, under the CTC gap filling rules, that question is for the applicable law, as defined above.[29]

### *C. Core legal principles contained in, and which follow from, Article VI*

Having outlined the extent to which the intent, text, and implications of the CTC endorse trusts in functional (and, regarding the last two items above, conceptual) terms, attention turns to the two pivotal questions whose answers determine the core legal principles that follow from Article VI and their practical application. They are as follows.

(a) Does CTC's endorsement of trusts result in rules of substance, created *sui generis* though the instruments (like that of an international interest), whose effectiveness in transactions governed by the CTC constitutes a treaty obligation – which necessarily entails that, where the CTC has primacy over conflicting national law, substantive national trust law is created by the CTC and substantive prior trust law, to the extent of conflict, is superseded?

(b) Does CTC's endorsement of trusts require, as autonomous treaty law, each contracting state to recognise trusts validly created under the substantive law under which the trust was constituted, whether or not trusts are known to or accepted by the national law of that contracting state and regardless of its pre-CTC conflict of laws rules, filling in any gaps with reference to that constituting substantive law?

For Article VI to have meaning, at least one of these questions must be answered in the affirmative. We conclude the same intent, text, and implications outlined above conclusively establish that the answer to question (a) is negative but that the answer to question (b) is affirmative. The reasoning behind that conclusion includes the following. First, Article VI has insufficient detail to create a body of substantive law. It is unrealistic to assume, and there is no legislative history supporting, the view that the CTC's general principles-based gap-filling mechanism was contemplated to give the needed context to a robust body of substantive law, serving the CTC pillar of providing commercial predictability. Secondly, and following from the first point but with even sharper implication, since trust law around the world is so varied, and, indeed, many countries do not have developed bodies of trust law, such general principles-based gap-filling would raise as many questions as it answers, which, again, is inconsistent with that commercial predictability objective. Thirdly, the history of the law in this field, in particular, the Hague Convention, and its recognition-based approach, shaped baseline (if preliminary) thought during the process of negotiating and agreeing Article VI. The fact that the legislative history is not express on the point is best understood by how ingrained, and non-controversial, a recognition-based approach was during the developmental process. As set out immediately below, and fully in line with the CTC's treatment of similar issues (such as choice of law and jurisdiction), the change to prior law effected by the CTC for these types of issues focused on substantially reducing, if not wholly eliminating, restrictions in the prior rule – to serve the needs of international aircraft financing and leasing.

Taking Article VI's mandatory rule of recognition as given, what is the extent of the treaty-based

[29] Without limiting the CTC priority rules, in this case, that a registered interest (with priority of that of the trustee) would also have priority over the property rights in the trust asset held by the beneficiary.

recognition requirement, and, as a subsidiary point, are there limits or qualifications on this requirement? We consider these questions at two levels: first, based on inconsistencies with prior law; and, secondly, based on more formal restrictions. We do so in light of the broad, sweeping, and unqualified nature of Article VI. There is no need to dwell on level one: that recognition could be limited or qualified if inconsistent with prior law. That can be disposed of peremptorily. Following basic principles of treaty interpretation, to the extent of its express terms, the CTC unequivocally overrides prior law and fills any lacuna in that law. In short, all contracting states, as autonomous treaty law, have the duty to and must recognise trusts validly created under the substantive law under which the trust was constituted, to the extent such trusts directly or indirectly affect the rights, powers, and obligations created or permitted by the CTC, whether or not trusts are known to or accepted by the national law of that contracting state and regardless of its pre-CTC conflict of laws rules. It is important to emphasise here that we are limiting ourselves to the recognition of the trust once constituted and to the effectiveness of any action taken by the trustee in accordance with the CTC. The validity of the constitution of the trust and the respective rights and obligations of beneficiaries and trustees against each other are matters for the applicable law.

Turning to the more formal aspects, is there a sound argument in favour of qualifying the Article VI explicit absolute recognition rule, and, if so, on what grounds and with what burden? This question is focused explicitly on the requirement that a validly constituted trust be recognised by a contracting state. The rights of a trustee in respect of any registration of an international interest or sale, and the effectiveness of any such registration, will be subject to the same limitations (such as the avoidance of a transaction as a preference or a transfer in fraud of creditors or to any rules of procedure relating to the enforcement of rights to property which is under the control or supervision of the insolvency administrator) as would be the case for any other party. We conclude that there is no argument for otherwise limiting the rule that a trust must be recognised, as the three exceptions seen elsewhere – public policy, illegality, or a closer connection with another jurisdiction – are irrelevant by definition within the context of the CTC. Our reasoning is as follows. First, the CTC is sufficiently narrow and precise that public policy and illegality concerns do not arise. For a contracting state, the CTC embodies a public policy to permit the use of trusts and that, regardless of its pre-CTC law, such use may no longer be deemed illegal. That is precisely why these general terms do not appear anywhere in the CTC, including in its choice of law clause. The CTC's internationality requirement is the basis of its rejection of 'closer connection' arguments, including in its jurisdiction clause. Secondly, the historical sensitivities to trusts noted in section I(A) above simply do not apply in the context of the CTC. Many are related to subjects such as inheritance, family law, and taxation. The CTC, in contrast, deals with sophisticated parties working in a field anchored in party autonomy. Thirdly, the concerns about lack of creditor knowledge and notice are substantially ameliorated by the use of the CTC International registry, including descriptions of parties acting in a trust capacity. Fourthly, the types of negotiated subject matter limitations found in the Hague Convention[30] are squarely addressed in the CTC, and, thus, are expressly overridden, as noted above.

## III. Concluding hypothetical: implications of CTC recognition of trusts

We conclude by setting out a straight-forward illustration of the application of the CTC to trust-based structures that follows from our analysis.

[30] Such as application of mandatory rules of the forum in the context of transfers of title to, and security interests in, property, rights on insolvency, and the rights and protections of third parties.

### *A. Trust hypothetical to examine scope of trust recognition*

- Islandia and Ruritania are CTC contracting states

- T, as trustee, and G, as grantor and beneficiary, enter into a trust agreement expressed to be governed by the law of Ruritania. The trust is valid under that law, and the agreement confers on the trustee the authority to enter into and enforce contracts (including the sale of all right, title and interest, whether legal or beneficial in the property held by the trustee, provided that the beneficiary instructs the trustee to do so).

- G funds the trust and instructs T to enter into a purchase agreement as buyer with S (who is situated in Islandia, a CTC contracting state, whose national law does not recognise trusts) as seller and a lease to LE (who also is situated in Islandia) with respect to an aircraft object. T does so, and T and S register the sale on the International Registry ('IR') and T and LE register the lease on the IR. T then grants a security interest over the aircraft object (which at the time was on the aircraft registry of Islandia) to lender B.

- LE defaults under the lease, which precipitates a default by T under the security agreement. T seeks to enforce the lease international interest against LE in Islandia. B seeks to enforce the mortgage international interest against T in Islandia.

- C, creditors of T through unrelated transactions with a judgement in Ruritania relating thereto, brings a legal action in Islandia seeking to attach the aircraft object. The CTC does not afford C any rights against the aircraft, whether under Article 40 or otherwise.

### *B. Summary of effects of trust in hypothetical*

Islandia must enforce the lease international interest, even though its national law does not recognise trusts and regardless of its pre-CTC conflict of laws rules involving foreign trusts. The trust was validly created under the laws of Ruritania, and under Article VI of the Protocol, Islandia is bound to recognise the international interest created in favour of T and the enforcement of that interest by T. Islandia must enforce the international interest in favour of B, for the reasons expressed above. C's claim must be rejected to the extent that its acceptance would defeat the purpose of the trust to which Article VI relates.