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The treatment of intangible assets under the Cape Town Convention and Protocols

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The Cape Town Convention and its associated Protocols are primarily concerned with the protection of interests in tangible movables, namely aircraft objects, railway rolling stock and space assets. However, these instruments also contain important provisions on intangible assets related to such objects; indeed, in relation to space assets such rights, in the form of obligations owed to the debtor by third parties ('debtor's rights') and assigned to the creditor as additional security are potentially more valuable as collateral than the space asset itself. Yet national laws are ill-equipped to deal with such assignments in an international setting, since not only do they vary from country to country but there are fundamental disagreements as to the appropriate choice of law rule. This article analyses the complex provisions of the Convention and Space Protocol concerning the protection of dealings in intangible assets. Roy Goode acted as Rapporteur at the diplomatic Conference in Berlin in 2012 to adopt the Space Protocol. His Official Commentary on the Convention and Space Protocol was published by UNIDROIT in May 2013 and the third edition of his Official Commentary on the Convention and Aircraft Protocol in July 2013.

1. Introduction

The Convention on International Interests in Mobile Equipment, adopted in Cape Town in November 2001 and generally known as the Cape Town Convention, has three sets of rules affecting intangible assets:

(1) Rules governing interests in proceeds of objects to the extent that they take the form of intangibles - discussed in Section 2.

(2) Rules governing the assignment of associated rights or their acquisition by subrogation - discussed in Section 3.

(3) Rules regarding the exercise of remedies relating to intangibles, examined in Section 4.

To these sets of rules the Space Protocol adds a fourth, namely rules relating to the assignment and reassignment of debtor’s rights and the recording of such assignment and reassignments. These are examined in Section 5.

2. Claims to intangible proceeds

Article 2(5) provides that an international interest in an object extends to proceeds of that object, while under Article 29(6) any priority given to an interest by Article 29 extends to proceeds. But proceeds are narrowly defined, being limited to money or non-money proceeds of an object arising from its total or partial loss or destruction or its total or partial confiscation, condemnation or requisition. So the term does not extend to general proceeds, such as receivables arising from sale of an object which is governed by an international interest, for this would take the Convention outside

* Professor Sir Roy Goode QC is Emeritus Professor of Law in the University of Oxford and Emeritus Fellow of St John’s College, Oxford.

1 An international interest is an interest granted in an object (i.e. an aircraft object, railway rolling stock or a space asset) which is uniquely identifiable, the interest being granted by the chargor under a security agreement or vested in a person who is the conditional seller under a title reservation agreement or the lessor under a leasing agreement (Articles 1(o) and 2).

2 Article 1(w).
its primary focus, physical objects, and could lead to the application of the Convention to proceeds having no continuing linkage with the object from which they were derived. Proceeds as so defined will almost always take the form of a money payment that will end up in the creditor’s bank account and will thus constitute a claim against the bank. So if insurance proceeds are paid into the debtor’s bank account the creditor’s international interest extends to the claim on the bank and enjoys the same priority as in relation to the original object. However, even if the creditor holds the senior interest its right to the proceeds is not absolute. In particular, any right of set-off the bank may have under the applicable law is not controlled by Article 29, and the creditor will therefore take subject to the right of set-off if the applicable law so provides.

3. The assignment of associated rights; subrogation

The nature of associated rights

Associated rights are all rights to payment or other performance by a debtor under an agreement which are secured by or associated with the object. Rights are ‘secured by’ a security agreement or ‘associated with’ a title reservation or leasing agreement. Included among associated rights are the right to repayment of a secured loan, instalments of a purchase price and lease rentals, as well as rights to non-monetary performance, such as repair, insurance and the observance of negative obligations, including a prohibition against sale or lease of the object. Obligations of the debtor under other contracts with the creditor are not associated rights, even if secured by the agreement, unless the debtor also undertakes in the agreement itself to perform such obligations. Similarly obligations of third parties to the creditor, whether under the agreement or some other contract, are not associated rights in the hands of the creditor unless the debtor too undertakes performance in the agreement. The Convention rules cover the effects of assignment, the formalities for assignment, the position of the debtor vis-à-vis the assignee and the priority of assignments.

Debtor’s consent

Under national laws an assignment does not usually require the consent of the debtor, and the Convention takes the same approach, but to avoid disputes as to the efficacy of an assignment the Aircraft and Space Protocols require that the debtor consent to the assignment, though such consent may be given in advance and may be general in nature.

The tail wags the dog

The treatment of associated rights is in some respects confusing. This results from the fact that while earlier drafts of the Convention provided that the effect of an assignment of an interest was to transfer the associated rights as well, an approach supported by several commentators, conceptual purity was allowed to take precedence over observance of the fundamental purpose of the Convention, which is to protect international interests in physical assets, not to promote receivables financing as such. The logical course would have been to provide for the assignment of international interests and the registration of such assignments, coupled with a provision that an assignment of the international interest would carry with it the associated rights.

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3 That is, a security agreement, a title reservation agreement or a leasing agreement (Article 1(a)).
4 Article 1(c).
5 The formalities (Article 32) and the default remedies of the assignee in the event of default by the assignor track those laid down for international interests in Articles 7 and Chapter III of the Convention respectively.
6 Aircraft Protocol, Article XV; Space Protocol, Article XXIV. No such requirement is contained in the Luxembourg Protocol.
7 See, for example, the comment on what was then Article 31 by the International Bar Association Sub-Committee E8 on International Financial Law Reform, reproduced in the Acts and Proceedings of the diplomatic Conference, page 112. See also pages 20, 54, 83, 163 of the Acts and Proceedings.
But purists objected that this contravened a basic principle that a security interest was an accessory to the obligation secured, not the other way round.\(^8\) So we ended up with a situation in which the focus of Chapter IX of the Convention is the assignment of associated rights, which are intangibles and as such are not capable of independent registration, while the assignment of the related international interest is left trailing in the wake of the intangible.\(^9\)

There is little doubt that the result has been to make the provisions more complex than they should have been. It became necessary to include provisions as to the effect of assignment of associated rights independently of the related international interest - which are rightly taken outside the Convention - and of the assignment of an international interest independently of the related associated rights. The drafting itself slipped into references to a registered assignment of associated rights when in fact these are incapable of registration, despite the oddity of Article 16(2), which refers inappropriately to associated rights. Indeed ‘assignment’ is defined as an assignment of associated rights; nothing is said about the international interest. These problems could have been avoided by a simple provision that the assignment of an international interest carried with it the associated rights. Instead, we have exactly the reverse. Fortunately, with proper interpretative techniques the provisions work out surprisingly well. While Part 3 is devoted to remedies these are not couched in terms of enforcement of associated rights; indeed, these are dealt with only in the provisions on assignment and subrogation and, in the Protocols, on choice of law, though not there referred to as associated rights.

‘Assignment’

This is defined as ‘a contract which, whether by way of security or otherwise, confers on the assignee associated rights with or without a transfer of the related international interest.’\(^10\) So any conferment of associated rights by the creditor on a third party by agreement falls within the definition, whether it is absolute or by way of security and whether it takes the form of an assignment (in the sense of a transfer) or a charge, that is, a mere encumbrance not involving any transfer. It is usually clear whether a transaction is an assignment, but it is necessary to distinguish it from a novation, that is, a new agreement in which a new creditor is substituted for the old. This contrasts with an assignment, where the assignor-creditor remains in a contractual relationship with the debtor, whilst the assignee has no such relationship, incurs no positive obligations under the agreement and merely has a right to enforce the associated rights, subject to available defences and rights of set-off. Whether a transaction is an assignment or a novation is to be determined by reference to the Convention itself, not the applicable law.

There are hybrid transactions in which the creditor assigns its rights and also, with the consent of the debtor, transfers its obligations, wholly or in part, to another party. Such a transaction may be characterised as a novation under the applicable law but for the purposes of the Convention, which is concerned only with the transfer of the benefit of the associated rights, it is an assignment.

Categories of assignment of associated rights

Chapter IX of the Convention deals with two entirely distinct categories of assignment which attract different priority rules.\(^11\) The first concerns the assignment of different sets of associated rights related to different international interests held by different creditors in the same object, as where the debtor grants an international interest to A and B in succession, A assigns its rights to X and B assigns its rights to Y. Priority issues arising from this type of assignment are governed by Article 31(1)(b).

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\(^8\) See Acts and Proceedings, pages 839, 880.

\(^9\) An intermediate draft had provided that an assignment of the international interest would transfer the associated rights and an assignment of the associated rights would transfer the international interest, but this was not adopted.

\(^10\) Article 1(b).

\(^11\) See below.
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The second concerns successive assignments of the same associated rights related to a single international interest to different assignees. The priority of these competing assignments is governed by Articles 35 and 36. The two sets of priority rules are discussed below.

Assignment of unregistered international interest

An assignment can be taken of an unregistered international interest and the assignment can be registered and enforced against the debtor but the assignee will lose out to the holder of a subsequently registered international interest or that holder’s assignee and creditors in the debtor’s insolvency.12

Splitting the associated rights from the related international interest

Provided that the relative simple formalities for assignment are complied with13 an assignment of associated rights, unless otherwise agreed, also transfers to the assignee the related international interest and all the rights and priorities of the assignor under the Convention.14 The priorities referred to are those of the international interest vis-à-vis other interests under the priority rules in Article 29, whether or not such other interests are themselves international interests. An assignment of associated rights does not, however, carry the international interest if the parties otherwise agree or if the formal requirements laid down by Article 32(1) are not complied with. In either such case the Convention is inapplicable to the assignment of the associated rights,15 the effect of which is in general governed by the applicable law, though the Convention priority rules apply to the extent of subordinating such assignment to an assignment which is effective to transfer the international interest where the latter assignment is registered.16 By contrast a purported assignment of an international interest created or provided for by a security agreement is not valid unless some or all related associated rights are also assigned.17 The reason is that a security interest which does not secure any obligations of the debtor to the secured party is without content. This principle does not apply to an international interest held by a seller or lessor, who could in theory transfer title to the object without assigning the associated rights to the transferee but this would be of little value to the transferee unless the debtor defaulted, enabling the object to be repossessed.

Competing assignments derived from different international interests

Suppose that Debtor grants A an international interest, which is registered, after which Debtor grants B an international interest, which is also registered, and that B then assigns its associated rights and related international interest to Y,18 who registers the assignment, after which A assigns its associated rights and the related international interest to X, who registers it. In this case the competition is not between the successive assignments but between the assigned international interests. Accordingly X has priority by virtue of the priority of the international interest acquired from A as the first to register,19 and this despite the fact that is unaffected by the Convention, only that the interest does not qualify for protection under the Convention. So Article 29(1) provides that a registered interest (i.e. an interest registered under the Convention) has priority over an unregistered interest, and this is so even if the latter is incapable of registration because it is outside the scope of the Convention. The same rule applies to an assignment (Article 35(1)).

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12 Article 29(1).
13 See Article 32.
14 Article 31(1).
15 Article 32(3).
16 Article 35(1). The fact that an interest is not one to which the Convention applies does not mean that it
17 Article 32(2).
18 So long as the assignment of the associated rights conforms to Article 32 it is not necessary for the assignment to refer to the related international interest, which will pass automatically under Article 31(1).
19 Article 29(1). Though in general registration is confined to consensual interests, Article 40 empowers a Contracting State by declaration deposited with the Depositary (UNIDROIT) to list the categories of non-consensual right or interest which are to be registrable under the Convention as if these were international
the assignment to B was taken and registered first. The same principle applies if one of the two international interests is unregistered.

**Competing assignments derived from the same international interest**

In this scenario Debtor grants A an international interest, which is registered, after which A assigns its associated rights and the related international interest, first, to X, and, secondly, to Y, who registers the assignment in its favour before the assignment to X has been registered. Here there is no competing international interest; the competition is between the assignments and priority goes to Y as the first to register. However, this is subject to two important qualifications. First, the contract under which the associated rights arise must state that they are secured by or associated with the object. This requirement is aimed at an agreement under which the debtor has an obligation to perform not only the obligations under that agreement but also those incurred to the creditor under any other contract. The latter obligations become part of the associated rights under the original agreement and are secured by that agreement but if the later contract contained no reference to security an assignee of that contract would have no way of knowing that the obligations of the debtor under that contract were secured. So the first creditor’s priority is dependent on the later contract stating that the associated rights are secured by the object. Secondly, the priority applies only to the extent that the associated rights are related to an object in one of the ways specified in Article 36(2) – broadly where the associated rights represent payment of the price of the object, the advance of a loan for the purchase of the object (or in some cases the purchase of another object), the rental of an object or other obligations arising from the agreement and related to the object, such as maintenance, repair and insurance. The reason for this is that the Convention is not concerned to regulate priorities between general receivables financiers. The priority between two assignees of non-object-related associated rights is governed not by the Convention but by the applicable law.

**Acquisition of rights by subrogation**

Nothing in the Convention affects the acquisition of associated rights and the related international insurance by legal or contractual subrogation under the applicable law. Typical cases are where a surety discharges the debt of the principal debtor and becomes subrogated to the creditor’s securities or an insurer pays out a claim to its insured for loss or damage caused by a third party and becomes subrogated to the insured’s claim against the third party. There seems no reason why in a Contracting State rights of subrogation under the Convention itself should not fall within Article 38 as being part of the applicable law.

4. Remedies relating to intangibles

The provisions of the Convention confer remedies on chargees and assignees which

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20 Article 35, which applies the first-to-register rule in Article 29(1). For an analysis of the drafting deficiencies in Article 35 see the writer’s *Official Commentary on the Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Objects* (3rd edition, 2013, UNIDROIT) (‘Official Commentary’), paras 2.202(2) and 4.252.

21 Article 35(1). However, if neither assignment had included the international interest (either because it was excluded by the agreement of the parties or because the formalities of Article 32 had not been complied with) Article 35 would not apply, there being nothing to register.

22 Article 36(1)(a).

23 Article 36(1)(b).

24 Article 38.

25 Under Article 9(4) any ‘interested person’ (as defined by Article 1(m) of the Convention) other than the debtor who discharges a security interest by paying the creditor in full becomes subrogated to the rights of the chargee.
include rights to intangible property and the ability to earn intangible property. Leaving aside sale of a charged object, which is a one-off transaction, Article 8(1) empowers a chargee, on default by the chargor and to the extent that the chargor has at any time so agreed, to grant a lease of the charged object and/or to collect or receive any income or profits arising from its management or use. Alternatively the chargee can apply for a court order directing any of such acts. Where the chargor has itself granted a lease or sub-lease of the object the creditor can take over the chargor’s right to rentals under the lease or sub-lease lease and give notice to the lessee or sub-lessee to pay the rentals to the chargee instead of to the chargor. The creditor can also recover from the chargor any rentals collected by the chargor after the chargee has given notice of its intention to collect such rentals. Similar remedies are conferred on an assignee of associated rights against the assignor under a security assignment.

5. Assignments and reassignments of debtor’s rights

The most innovative of the provisions relating to dealings in intangible property are to be found not in the Convention but in the Space Protocol. Though the Convention is primarily concerned with asset-based finance, the practical difficulties of enforcing an international interest against an asset in outer space severely limit the value of the physical asset. Potentially more valuable to the creditor is the revenue stream accruing to the debtor from its claims against third parties (‘debtor’s rights’) arising, for example, from the grant of leases and licences of space assets, which the debtor then assigns to the creditor as additional collateral under a ‘rights assignment.’ So space financing is regarded as more in the nature of project finance than asset-based finance. There is no problem about making a rights assignment enforceable as between the parties and as against the (account) debtor. The key question that arose was how to protect the priority of the assignee under a rights assignment. The original proposal was to treat the rights assignment as if it were itself an international interest and to register it accordingly. That was rightly rejected as running counter to the central pillar of the Convention, namely to protect interests in uniquely identifiable physical assets. To allow independent registration of rights assignments would be to extend the Convention to general receivables financing, for which there was already a separate convention, and to apply it to intangibles which were in no sense uniquely identifiable.

The neat solution was to require a right assignment in favour of a creditor to identify both the debtor’s rights and the space asset to which those rights relate, thereby linking the rights assignment to an international interest concurrently or previously granted to the creditor, and to provide for the assignment to be recorded against registration of the international interest. This, of course, presupposes that the international interest has been registered. This linkage of the rights assignment to an international interest in the International Registry is fundamental to the priority of the rights assignment, for it enables third parties, by searching against the space asset in the International Registry, to discover the recording of the rights assignment, which would have been impossible if rights assignments had been made registrable in isolation from the international interest. For example, the debtor gives a security interest over a satellite to the creditor and, at the same time or subsequently, assigns debtor’s rights to the creditor, who registers the international interest and, upon taking the rights assignment, records it against registration of the international interest, with the priority effects described below. The Protocol extends the provisions on rights assignments to cover onward assignment

26 Article 8(1). For a detailed analysis of Article 8 see the Official Commentary, Goode (n 20) paras 2.84 et seq., 4.78 et seq.
27 Article 8(2).
28 Article 34.
30 Space Protocol, Article IX.
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The link between the rights assignment and the registered international interest must be maintained. Accordingly discharge of the registration of the international interest also discharges any recording forming part of that registration.

The provisions relating to the assignment of debtor’s rights constitute a most valuable element in space financing, because the assignment of receivables and other debts is one of the most complex areas of law on which national legal systems differ to the point where there is not even an agreed conflict of laws rule to determine the applicable law. So in the context of assignments linked to a space asset the Protocol brings certainty to an area hitherto bedevilled by insecurity.

Debtor’s rights

These are defined as ‘rights to payment or other performance due or to become due to a debtor by another person with respect to a space asset.’ The definition is very wide, covering not only the debtor’s contractual rights against third parties but other sources of rights relating to a space asset, including claims in tort and unjust enrichment, rights derived from assignment or subrogation and even government licences to the extent that these are capable of transfer. Moreover, it is not necessary that the space asset should be in existence at the time the rights arise. So debtor’s rights include the rights of the debtor under a contract for the manufacture and sale of a space asset or as operator under a contract with a services provider or as customer under a contract for the provision of ground services relating to an existing or projected space asset, as well as the debtor’s rights as ‘lessor’ under a lease capacity agreement or indefeasible right of use, any intellectual property rights it may have been granted, and its rights as insured under a contract of insurance covering the space asset. But the rights must relate to a space asset, whether in regard to its construction, purchase, launch or operation. Sums due to the debtor in respect of loans advanced or goods or services supplied which are unconnected to the space asset are not debtor’s rights and are incapable of being recorded against the registration of the international interest.

Rights assignment

This is defined by Article I(2)(h) of the Protocol as:

a contract by which the debtor confers on the creditor an interest (including an ownership interest) in or over the whole or part of existing or future debtor’s rights to secure the performance of, or in reduction or discharge of, any existing or future obligation of the debtor to the creditor which under the agreement creating or providing for the international interest is secured by or associated with the space asset to which the agreement relates.

It will be seen that the definition does not cover all assignments, only those typically effected pursuant to a debtor-creditor relationship, namely assignments by way of security and outright assignments in reduction or discharge of the debtor’s obligations to the creditor. So the sale of debtor’s rights falls outside the definition. This is a necessary limitation because otherwise there could be a situation in which the obligations secured by the international interest were discharged but the creditor would continue to hold the assigned rights as security for other obligations, so that the linkage with the space asset giving rise to the assigned rights would be lost.

Effects of a rights assignment

A rights assignment made in conformity with Article IX transfers to the creditor the

is not a true lease; the rights of the ‘lessee’ under it are purely contractual and the ‘lessor’ does not hold an international interest.

31 Article XII(5).
32 Article I(2)(a).
33 It is not usual for space assets such as transponders to be leased. Instead, the ‘lessee’ enters into a ‘capacity, lease agreement’ giving it an exclusive or limited access to transponder bandwidth. Such an agreement

34 Which requires that the debtor’s rights and the space asset to which they relate be identified and, in the
debtor’s rights the subject of the assignment to the extent permitted by the applicable law. This may raise questions as to the validity of the assignment where, for example, the assigned rights arise under a contract prohibiting assignment. The effectiveness of the assignment is not dependent on registration of the international interest or on the recording of the assignment against that registration, these being required solely to preserve the priority of the assignment. So the assignment is effective on its own as between the parties and against the debtor. The obligor (i.e. the debtor’s debtor) then comes under an obligation to make payment or give other performance to the creditor if, though only if, the obligor has been given notice of the rights assignment in writing by or with the authority of the debtor and the notice identifies the debtor’s rights. The applicable law determines the defences and rights of set-off available to the obligor against the creditor.

**Recording of the rights assignment**

The holder of an international interest or prospective international interest in a space asset who has acquired an interest in or over debtor’s rights under a rights assignment or by subrogation may, when registering the international interest or prospective international interest or subsequently by amendment to such registration, record the rights assignment or acquisition by subrogation. However, where what has been registered is only a prospective international interest the rights assignment will be treated as unrecorded until the international interest comes into existence, in which case the rights assignment has priority as from the time it was recorded so long as the registration of the prospective international interest was still current immediately before the international interest was constituted. This tracks the provisions of Article 19(4) of the Convention as to the deemed time of registration of an international interest into which a prospective international interest has ripened. The recording need not specify the assigned rights individually. It could be expressed to cover all the debtor’s rights but if it relates to only some of them they will need to be identifiable.

**Priority of rights assignment**

Rights assignments have priority over any other transfer of debtor’s rights (whether or not a rights assignment) except a rights assignment previously recorded. Priority is thus determined according to the date of recording, not according to the date of registration of the international interest against which the recording is made. So if an international interest in a space asset is granted to A and registered and is followed by registration of an interest in the same space asset in favour of B, who takes and records an assignment of debtor’s rights before A has recorded a similar assignment, B, though holding the junior international interest, has priority over A as to the debtor’s rights. Where the competing assignment is not accompanied by a grant of an international interest in the asset itself the creditor/assignee will be subordinated to a creditor/assignee who has also taken and registered an international interest in the space asset and recorded its assignment against the registration, and this despite the fact that the other creditor, having no international interest, had no means of recording the assignment in

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35 Article X.
36 Article XIV(1).
37 Article X(2).
38 Article XI, which is taken from Article 5(b) of the UNIDROIT Convention on International Factoring, 1988.
39 Article X.

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40 Article XIII(2).
41 In what follows this should be taken to include rights acquired by subrogation.
42 Article XIII(1), which follows mutatis mutandis Article 29(1) of the Convention as to the priority of a registered international interest.
its favour. For example, creditor A takes from the debtor an assignment of rental payable to the debtor under a capacity lease but does not negotiate the grant of an international interest. Subsequently creditor B takes an international interest and a rights assignment, registers the international interest and records the assignment. Creditor B has priority. This is deliberate policy. Since the assignment to creditor A does not feature in the register creditor B had no means of knowing of its existence. Moreover, a prudent creditor will not take an assignment of revenue derived from an asset without taking an interest in the asset itself, for its right to the revenue is lost once the debtor loses control to another creditor. Where the revenues assigned do not relate to the space asset at all the assignment is not a rights assignment and is incapable of protection under the Protocol.

The priority rules are qualified in one important respect. Among the rights that may be assigned under a rights assignment are the debtor’s rights under a policy of insurance covering loss of or damage to the space asset. But the creditor’s priority in respect of its international interest applies also to insurance proceeds, and the creditor may be in a better position relying on this priority than if it claims in its capacity of assignee under a rights assignment.

Rights reassignment

A rights reassignment can take one of two forms. The first, as the label suggests, is a contract by which the creditor transfers to the assignee, or an assignee transfers to a subsequent assignee, the whole or part of its rights and interest under a rights assignment. The second is where a rights assignment has been recorded as part of the registration of an international interest which is subsequently transferred in accordance with Articles 31 and 32 of the Convention. This operates as an automatic reassignment of debtor’s rights without the need of any contractual assignment, and carries with it the right to be shown in the record as assignee under the rights assignment, which in this context means the rights reassignee under the rights reassignment. This form of reassignment has more powerful effects than an assignment under Article X in that the reassignment is not controlled by the applicable law.

A reassignee, whether under Article X or under Article XII(4), can record the rights reassignment, though only as part of the registration of the assignment of the international interest to the person to whom the rights reassignment was made. So a reassignee who does not also acquire the related international interest cannot record the reassignment. This is in line with the policy that an assignment or reassignment cannot be recorded in isolation but must always be linked to the international interest to which the assigned rights relate.

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43 Article 29(6).
44 Article I(2)(i)(i).
45 Articles I(2)(i)(ii), XII(4).
46 It therefore more properly belongs to Article XV than to Article XII.
47 Article XII(4)(b).
48 Article XV(1).
49 Article XV(2).