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Lex situs after *Blue Sky*: is the Cape Town Convention the solution?

William J Glaister, Robert Murphy, Marisa Chan, Ellie Dunne and Julian Acratopulo*

English law is one of the leading systems of law selected by parties to govern aircraft leasing and financing transactions, on the basis that it is a robust, yet flexible, regime under which creditors have clear rights and remedies. However, the recent Blue Sky litigation has highlighted the complexity of the conflict of laws position in many aviation deals and the English High Court's decision has confirmed that a different approach is required to meet the commercial expectations of industry participants and to maintain English law's competitive position. The Cape Town Convention is an international treaty designed to facilitate the cross-border financing and leasing of aviation equipment, by reducing creditor risk and enhancing legal predictability. This article considers whether its ratification by the UK will resolve the issues arising out of the Blue Sky litigation and the extent to which supplemental measures are required.

1. Introduction

The UK is one of the longest established centres of the aviation finance community and English law is one of the two prevailing systems of law selected by parties to govern their transactions within this market. There are typically several parties to an aviation financing (including leasing) transaction, who are often based in multiple jurisdictions and subject to different laws; the state of registration of the aircraft may be in another jurisdiction altogether; and, at any given time during the term of the transaction the aircraft may be physically located almost anywhere in the world. Financing is provided on a secured basis and the relevant financier looks to the aircraft as an essential element of its collateral package.

Against this international backdrop, English law (and, in particular, its security and insolvency laws) had been perceived as a robust, yet flexible, regime under which creditors have clear rights and remedies in respect of their claims against debtors and over any assets secured to them. Notably, as a starting point,

aviation financiers (including banks) will often seek to take a mortgage over the aircraft which is expressed to be governed by English law and subject to the jurisdiction of the English courts (hereinafter referred to as an 'ELM'), or an equivalent security interest. However, the recent *Blue Sky* litigation¹ has highlighted the complexity of the conflict of laws position in many aviation financings and has led to a reassessment of how in such transactions

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¹ *Blue Sky One Ltd & ors v Mahan Air and anor* - the case was heard in two phases, [2009] EWHC 3314 (Comm) and [2010] EWHC 631 (Comm).

a valid security interest over an aircraft may be obtained by means of an ELM, in particular, the practicalities of doing so.

The English High Court's decision in this case has confirmed, in our view, that a different approach is required, in order to meet the commercial expectations of parties involved in this market and to maintain English law's competitive place as one of the preferred legal systems for aviation and other cross-border secured financings.

The Cape Town Convention² (the 'Convention') is an international treaty designed to facilitate the cross-border financing and leasing of aviation (and other mobile) equipment, by reducing creditor risk and enhancing legal predictability. UK ratification of the Convention will undoubtedly mitigate the uncertainty of obtaining a valid security interest in aircraft, in a transaction where multiple laws and jurisdictions may be involved, and thereby should assist in maintaining English law's pre-eminent position. This article considers whether such ratification will resolve all the issues arising out of the *Blue Sky* litigation and whether any supplemental measures are required.

In order to answer this question, we will consider first the English law conflict rules relating to transfers of title to aircraft. The *Blue Sky* litigation will be examined together with other relevant case law. We will then consider the effect of the Convention, if ratified by the UK, on the position established by *Blue Sky*.

This article does not deal with the relationship between English property and conflict

of laws rules and the rules laid down by the EC Regulation on Insolvency Proceedings, Council Regulation (EC) No 1346/2000, in particular, Articles 2 and 5. This topic justifies a separate discussion unto itself. However, it should be noted that where the Regulation applies to a cross-border aircraft financing, whether or not the Cape Town Convention also applies, the effect of its rules on an ELM or other security interest expressed to be governed by English law must be considered.

2. Aircraft mortgages

(a) Secured financing

As mentioned above, in an aircraft financing, a 'security package' will be granted in favour of the financiers, to secure repayment of the financing. The individual elements of that package will depend on the features of the specific transaction, including the jurisdiction of incorporation of each of the owner and the operator and the state of registration of the aircraft. While this article examines the situation where the financiers seek to have a security interest over the aircraft by way of an ELM, this is only one aspect of their security package and the weight given to such mortgage will differ according to the transaction structure and the parties' requirements.

(b) Contractual and proprietary rights

Under English law, a mortgage agreement will create both contractual and proprietary rights. The creation, including validity, and content of each type of rights may be assessed using different laws.³ English law decides as a first

² The Convention on International Interests in Mobile Equipment, 2001, and the Protocol thereto on Matters specific to Aircraft Equipment, 2001 (the 'Aircraft Protocol'). Note that the Convention comprises general rules applicable to all relevant categories of equipment covered by the treaty, as supplemented or varied by a Protocol specific to each equipment class. In addition to the Aircraft Protocol for qualifying aircraft objects, there are two separate Protocols relating to rail assets and space assets which are not considered in this article. References in this article to the 'Cape Town Convention' or to the 'Convention' hereinafter are to the Convention in conjunction with the Aircraft Protocol, unless stated otherwise.

³ See Lord Collins with specialist editors, *Dicey, Morris and Collins on the Conflict of Laws* (14th edn, Sweet & Maxwell 2006), and 4th Supplement ('Dicey, Morris and Collins') 1166; See James Fawcett, Janeen Carruthers and Peter North, *Cheshire, North and Fawcett: Private International Law* (14th edn, OUP 2008) ('Cheshire, North and Fawcett'), 1211-1212.

step which law to use by applying English conflict of laws rules.

The choice of law rule for the applicable law governing contractual rights is fairly straightforward. It is usually the law chosen by the parties (which may be specified in a governing law clause in the mortgage agreement itself, or as otherwise agreed by the parties). This is referred to as the 'proper law of the contract'. The parties to a contract are free to choose the terms of the contract and the governing law. If such a choice is not made, the contractual aspects of a mortgage will be governed by the law of the country with which the mortgage is most closely connected.⁴

However, different and more complex considerations arise when the question relates to proprietary rights, as opposed to purely contractual rights. The proprietary aspects of a mortgage are a matter of property law alone and the chosen law of the parties may not be the applicable law governing the validity of property rights.

(c) Security interests; rights in rem

Property rights in assets are sometimes referred to as rights *in rem*. The advantage of a right *in rem* in an aircraft is that it gives the holder recourse to the asset if there is a default by the grantor. A valid security interest in an aircraft is a right *in rem*, normally granted by the owner of the aircraft to another party, to secure a debt or other obligation. Under English law, a security right *in rem* is particularly valuable in an insolvency of the owner grantor. It gives the holder, that is, the secured party, the right to obtain payment of the debt (or performance of any other secured obligation) out of the appro-

propriated property,⁵ in priority to other creditors of the owner. Generally speaking, the secured property is not included to the extent of the security in the pool of assets available for distribution to unsecured creditors.

(d) Transfer of title for purposes of security

Under English law, a mortgage is usually considered the most appropriate means of taking security over a tangible movable. It involves a transfer of title to the asset by the owner, as mortgagor, to the secured party, as mortgagee, subject to an obligation to re-transfer ownership upon satisfaction of the secured debt or other obligation (known as the 'equity of redemption'). Financiers select English law for the aircraft mortgage because this corresponds with the governing law of the principal transaction documents (specifically, the lease of the aircraft and the loan to the borrower), which in turn reflects English law's primacy in the aircraft financing market and in the wider aviation industry.

Further, the rights available to a mortgagee under English law are attractive to financiers, as they are perceived as well-established, robust and extensive. English law recognises self-help remedies, which the laws of many other jurisdictions do not, and the mortgage agreement is usually drafted to include a power of sale and other valuable enforcement provisions. Thus, their starting position when requesting asset security will often be an ELM over the aircraft. Whether or not title to the aircraft has been validly transferred under an ELM is a property law matter, as is the wider question of whether or not a valid security interest in the aircraft has been created.

⁴ See chapter titled 'England and Wales' in Graham McBain and Richard Hames, *Aircraft Finance, Registration, Security and Enforcement* (Sweet & Maxwell 2010) 12; See Contracts (Applicable Law) Act 1990 enacting the Rome Convention on the Law Applicable to Contractual Obligations of 19 June 1980; See Dicey, Morris and Collins (n 3) Chapter 32 on general rules relating to contracts.

⁵ Other than in the case of a lien which only allows possession of the property to be retained until the debt is discharged.

3. The conflict of laws rules – *lex situs* as the orthodox rule for transfers of title to tangible movables

(a) Aircraft as movables

It is worth noting that an English court, when tasked with determining a property question in a private international law context, will consider first whether the relevant item is movable or immovable under the applicable law. For instance, English law characterises aircraft as movables. However, this is not always the case under the laws of other countries and, therefore, at the outset of a cross-border property dispute, there may be a conflict of laws issue of characterisation.

When considering whether an aircraft is a movable or an immovable, English private international law looks to the law of the place where the aircraft is situated (the *lex situs*) at the relevant time.⁶ This article does not consider further the issues regarding characterisation of an aircraft as a movable or immovable under the applicable law, other than to emphasise that this initial determination may affect the central question of validity of the transfer of title in an aircraft under the applicable law.

(b) *Lex situs* – the English conflict rule applicable to the transfer of title to tangible movables

As a general rule of English conflict law, the applicable law governing the validity of a transfer of title to a tangible movable, whether by way of mortgage or outright sale, is the *lex situs*. Dicey, Morris and Collins in Rule 124 provide that:

The validity of a transfer of a tangible movable and its effect on the proprietary rights of the parties thereto and of those claiming under them in respect thereof are

governed by the law of the country where the movable is at the time of the transfer (*lex situs*).⁷

The leading authority for the application of the *lex situs* is *Cammell v Sewell*,⁸ and the English Courts have since been consistent in their application of the rule.⁹ More recent case law involving transfers of aircraft has also given effect to the *lex situs*. In *Kuwait Airways Corp v Iraqi Airways Co (No 6)*,¹⁰ Lord Nicholls applied the *lex situs* rule to a foreign confiscatory sale of ten aircraft. In *Air Foyle Ltd v Center Capital Ltd*,¹¹ the Court determined that the *lex situs* rule was applicable to the transfer of ownership of an aircraft. The case concerned an action to determine title to an aircraft, registered in Russia, which the claimant had bought at an auction in Holland, following orders for sale by the Dutch courts. Following the principles established in *Cammell v Sewell*,¹² the Court ruled that the *situs* of the aircraft was to be determined by the English conflict of laws rules, as it was situated in England. The *lex situs* also determined the validity of a transfer of a tangible movable and its effect on the proprietary rights of the parties thereto, and a transfer valid by the law of the state where the movable was at the time of the transfer would be valid and effective in England.

Furthermore, in *Dornoch Ltd v Westminster International BV (No 1)*,¹³ a case concerning various issues arising out of a contract of

⁷ Dicey, Morris and Collins (n 3) Rule 124.

⁸ (1858) 3 H&N 617; 157 ER 615.

⁹ See *Winkworth v Christie, Manson and Woods Ltd* [1980] Ch 496; *Macmillan Inc v Bishopsgate Investment Trust Plc and ors* (No. 3) [1996] 1 WLR 387 (CA); and *Glencore International AG and ors v Metro Trading International* [2001] 1 All ER (Comm) 103, all of which have applied *lex situs* and followed *Cammell v Sewell* (1858) 3 H&N 611; 157 ER 615.

¹⁰ [2002] UKHL 19, [2002] 2 AC 883, 1077 (Lord Nicholls).

¹¹ [2002] EWHC 2535 (Comm).

¹² (1858) 3 H&N 617; 157 ER 615.

¹³ [2009] EWHC 889 (Admty), [2009] 2 Lloyd's Rep 191.

⁶ Dicey, Morris and Collins (n 3) Rule 119; See *Air Foyle Ltd and Anor v Center Capital Ltd* [2002] EWHC 2535 (Comm) [41] (Gross J).

marine insurance, it was agreed between the parties that the *lex situs* applied to the transfer of a ship which was not registered at the relevant time.

Further, in understanding the scope and content of the *lex situs* as it stands under English law, the private international law doctrine of *renvoi* must also be taken into account; namely, whether the English Court will apply the entire law of the *situs* jurisdiction, including its choice of law rules, which may hold the law of another country as the applicable law governing the issue under consideration. In *Dornoch Ltd v Westminster International BV (No 2)*,¹⁴ a subsequent case concerning the same litigation relating to a contract of marine insurance, the application of the doctrine of *renvoi* was rejected. The application of *renvoi* was also rejected in the case of *The Islamic Republic of Iran v Berend*,¹⁵ which concerned the disputed ownership of a fragment of limestone relief located in France.

Finally, in *Blue Sky*, as discussed in Section 4 below, the English Court confirmed the application of the *lex situs* rule to the question of proprietary validity of aircraft mortgages, and held that *renvoi* was excluded in this context.¹⁶

(c) The inadequacy of the *lex situs* rule in the case of aircraft

Commentators have noted that traditional conflict of laws rules, such as the *lex situs* rule, are unsuitable to govern proprietary rights in mobile equipment.¹⁷ This failing is exemplified in the case of modern jet-powered aircraft,

which are capable of flying several thousand miles in a single journey, and which are operated by commercial airlines on routes which cross the borders of multiple countries. The physical location of an aircraft in commercial operation at any given time may be temporary; its link to a particular jurisdiction is often casual and transitory. The case for *lex situs* endorses the control of the *situs* jurisdiction over the relevant item of property. However, this argument seems misplaced and outdated in the case of aircraft or other mobile assets.

Further, in many instances involving aircraft, the *lex situs* will be difficult to determine, where the location of the aircraft is unknown or in dispute.¹⁸ In fact, it has been acknowledged that exceptions should be made to the *lex situs* rule.¹⁹ An exception to Rule 124 in Dicey, Morris and Collins provides that the *lex situs* will not apply where a tangible movable is in transit, and its *situs* is casual or not known.²⁰ Exception 2 to Rule 120(3) in Dicey, Morris and Collins further provides that a civil aircraft may at some times be deemed situate in its country of registration. While the commentary to this exception limits it to instances where an aircraft is in flight over the high seas or a *territorium nullius*,²¹ there is broader support for adopting the *lex registri* as the general rule for proprietary interests over registered aircraft.

Case law indicates that the *lex situs* has not always been the only possible choice of law rule for the transfer of movables. It is asserted that a uniform 'one-size-fits-all' choice of law rule for property interests in all classes of tangible movable property is not the ideal option and,

¹⁴ [2009] EWHC 1782 (Admlty), [2009] 2 Lloyd's Rep 420.

¹⁵ [2007] EWHC 132 (QB).

¹⁶ See Section 4(b) regarding the court's confirmation of the orthodox rule and its rejection of the doctrine of *renvoi* in *Blue Sky*.

¹⁷ Roy Goode, *Official Commentary on the Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment* (revised edn, UNIDROIT 2008) para 2.5. See also Graham McBain, David Osborne and John F Imhof Jr, chapter titled 'English Conflict of Laws and the Transfer of Air-

craft' in McBain (n 4) (hereinafter 'McBain, Osborne and Imhof Jr').

¹⁸ As was the case in *Blue Sky*, in respect of the second aircraft. See further Section 4.

¹⁹ Dicey, Morris and Collins (n 3) Exception to Rule 124; See also Cheshire, North and Fawcett (n 3) 1221-1222.

²⁰ See Dicey, Morris and Collins (n 3) Exception to Rule 124; 1170.

²¹ Dicey, Morris and Collins (n 3) Exception 2 to Rule 120(3).

in particular, the *lex situs* is unsuitable in the case of transfers of aircraft, as unique highly-mobile transportation assets. This was clearly evidenced by the issues surrounding the *Blue Sky* litigation.

(d) *Various rules to govern the transfer of movables*

Alternative conflict of laws rules to govern the validity of transfers of movables include:

- (a) *lex domicilii* (the law of the domicile);
- (b) *lex loci actus* (the law of the country of the instrument of transfer);
- (c) *lex actus* (the law of closest connection);
- (d) *lex registri* (the law of the register of the movable); or
- (e) the proper law of the transfer (applicable law as selected by the parties).

We will not consider the *lex domicilii* (that rights over movables are to be governed by the law of the owner's domicile) as it seems generally accepted that this no longer applies to particular transfers of tangible movables.²² Furthermore, the *lex loci actus* and *lex actus* can be discarded since they have never governed the transfer of tangible movables.²³ We consider that the proper law of the contract is the most suitable rule to replace the *lex situs*, as the applicable law governing the validity of the transfer of aircraft. As an alternative, the *lex registri* presents a robust option. Finally, as a further alternative, the *lex situs* including the doctrine of *renvoi* must also be considered. Each of the options presents its own challenges. We evaluate these options in Section 6(e) below as potential solutions to the problems arising from the *Blue Sky* litigation.

²² Cheshire, North and Fawcett (n 3) 1208–1209; and Janeen Carruthers, *The Transfer of Property in the Conflict of Laws: Choice of Law Rules concerning Inter Vivos Transfers of Property* (OUP 2005) 77–78.

²³ Cheshire, North and Fawcett (n 3) 1210–1211; Carruthers, *ibid* 77–79; McBain, Osborne and Imhof Jr (n 17) 7.

4. The *Blue Sky* litigation – *lex situs* confirmed for aircraft transfers; *renvoi* excluded

(a) *Background*

The *Blue Sky* litigation arose out of transactions entered into in 2006 against the backdrop of sanctions imposed by the US which prevented the sale or lease of US aircraft and aircraft containing significant components manufactured in the US to Iranian individuals or companies. Balli Group plc ('Balli'), a substantial international commodity trading group, controlled three English special purpose companies (Blue Sky One Ltd., Blue Sky Two Ltd., and Blue Sky Three Ltd.) which each acquired one Boeing 747-422 aircraft (together, the 'Package 1 aircraft') and leased them to an Armenian company (Blue Airways LLC), who in turn chartered the Package 1 aircraft to an Iranian private airline, Mahan Air ('Mahan').

Subsequently, PK Airfinance US Inc. ('PK'), agreed to make a loan to Balli in order to finance the acquisition of a further three Boeing 747-422 aircraft (the 'Package 2 aircraft'); as security for the loan, each of Blue Sky Two Ltd. and Blue Sky Three Ltd. mortgaged their Package 1 aircraft to PK, by way of an ELM. One of the mortgaged aircraft (referred to at trial as the 'second aircraft') was registered on the Armenian aviation register when the relevant ELM was executed but the aircraft's location at that date was disputed by the parties. The other mortgaged aircraft (referred to at trial as the 'third aircraft') was registered on the UK aviation register and was located in the Netherlands when the relevant ELM was executed.

By the autumn of 2007, the US Department of Commerce, Bureau of Industry and Security ('BIS') began to investigate the Package 1 aircraft leased by the Blue Sky special purpose companies to Blue Airways LLC, amidst concerns that control of the aircraft had been transferred to Mahan. In early 2008, the BIS issued a Temporary Denial Order ('TDO')

against Balli, its controlling family the Alaghbands, Blue Airways LLC and Mahan.

In the meantime, Mahan purported to effect a transfer of title to the Package 1 aircraft to Blue Sky Aviation Co. FZE ('FZE'), an Ajman company controlled by Mahan (under an option agreement with Balli) and subsequently de-registered the aircraft from the Armenian register, re-registering them on the Iranian register. The Balli parties (Balli and the Blue Sky special purpose companies) and PK brought proceedings in the English Court against Mahan and FZE. The Balli parties sought delivery up of the Package 1 aircraft and damages (for breach of contract, conversion and unlawful interference with property) and PK sought possession of the two mortgaged Package 1 aircraft.

In order to decide PK's claim, the English High Court had to determine whether the mortgage over each aircraft was effective to create a security interest. As explained previously, this is a matter of property law, so the Court did not look to the chosen law governing the contract (that is, English law). The Court had to consider what law governed this question, as a matter of English conflict of laws rules concerning property transactions.

(b) Lex situs applied and renvoi rejected

The Court confirmed that in the case of a transfer of title to tangible movables, the English choice of law rule is that the effectiveness of the transfer is to be determined by the *lex situs*, that is, the law of the place where the aircraft was physically located at the time the mortgage took effect. The *lex situs* is the orthodox rule.

The Court further held that the reference to the *lex situs* is to the domestic law of the place of location and not to its entire law, which would include the choice of law rules of the *situs* jurisdiction. In other words, the doctrine of *renvoi* did not apply.

In rejecting the doctrine of *renvoi*, Beatson J. expressed the view that to leave the *renvoi* doctrine to a case by case analysis depending on the identification of the policy behind the interna-

tional law of another country would produce a very uncertain legal regime.²⁴ It could mean that the identity of the applicable law could not be known without a judicial determination because the policy as to the applicability of *renvoi* in a given case would depend on the policy objectives of both the English choice of law and the relevant foreign law.

(c) Application to the dispute

In the case of the mortgage over the third aircraft, the *lex situs* was the law of the Netherlands.²⁵ As the Court was only concerned with Dutch domestic law, it held that 'where Dutch domestic law would apply, the mortgage ... would not create a valid mortgage (*hypothec*) under Dutch law'. Accordingly, the mortgage was held to be invalid as a matter of property law.²⁶ This was the case notwithstanding that the Court accepted that a Dutch court would apply English law as the *lex registri* (in accordance with its own choice of law rules), which would have led to the conclusion that the mortgage was valid as a matter of property law.

With regard to the second aircraft, the Court held that on the evidence, the location of the aircraft was not established and 'in the absence of proof of any other law, English law applies'. The mortgage therefore created a valid security interest.²⁷ Beatson J. did not explain why English law applied in this situation; for example, whether it was as the proper law of the contract or as the law of the forum (*lex fori*).

(d) Lex registri

The Court declined to apply *lex registri* as the appropriate choice of law rule to govern prop-

²⁴ *Blue Sky* Phase 2 judgment [2010] EWHC 631 (Comm) [185].

²⁵ *Ibid* [131] and [151]–[185].

²⁶ *Ibid* [73] and [131]. Note that the contractual validity of the mortgage was not affected by this determination.

²⁷ *Ibid* [130] and [202].

erty rights in aircraft,²⁸ holding that this was a 'bold submission' with 'virtually no support in English cases or commentaries' and referring to Dicey, Morris and Collins' statement that 'ascription of an artificial *situs*' is 'not compelling when the aircraft is either on or over the territory of a country.'²⁹

(e) *International airspace*

While the Court in *Blue Sky* referred to the exception to the *lex situs* rule in Dicey, Morris and Collins that *lex situs* will not apply where an aircraft is in flight over the high seas or a *territorium nullius*,³⁰ it did not go so far as to endorse the *lex registri* in such situations. This residual uncertainty is practically unhelpful for parties seeking to rely on an ELM, as aircraft financing transactions are often closed and security granted when the aircraft may be in international airspace (for operational and other reasons).

(f) *Outright transfers of title*

The Court in Phase 2 of the *Blue Sky* litigation expressly confirmed that the *lex situs* rule (excluding *renvoi*) prevails 'in the case of a transfer of title to tangible movables'.³¹ Therefore, it can be taken that this applies not only to mortgages (where title is transferred for the purpose of security, subject to the equity of redemption), but also to sales and other outright transfers.

As with a mortgage, a bill of sale may be a title transfer device (unless there is a physical transfer of the aircraft on sale, ie title transfer by delivery); in other words, both instruments have a contractual aspect and a property aspect. However, it is worth noting that in Phase 1 of the *Blue Sky* litigation, in the context of bills of

sale expressed to be governed by English law, the Court stated³² that on the question as to 'what law governs whether title to the aircraft was transferred', English law applies. While the Court did not confirm whether this was as a result of a particular property choice of law rule, the judge noted that the express provisions of the bills of sale, written agreements and further dealings showed that the parties 'intended to choose English law as the governing law'. Arguably, this could be taken to support the view that the proper law of the transfer should be the property choice of law rule for outright transfers of aircraft.

While it is accepted that, as a result of the course of the proceedings, the Court did not have full argument on the *lex situs* issue in Phase 1, it is unfortunate that the above statement as regards bills of sale gives rise to a contradiction within the overall decision.

(g) *Commercial impact of the Blue Sky litigation on aviation financing*

The decision in the *Blue Sky* litigation has led to grave concerns for the aviation industry in the UK and abroad, wherever English law is the chosen law of the transaction. Financiers invest in aircraft transactions on the expectation that they will be secured creditors, given the significant amount of capital required, the long term exposure they assume and other risk factors involved. Legal and commercial certainty regarding the transaction collateral is key, particularly given the financiers' lack of physical and jurisdictional control over the aircraft which may be operated anywhere in the world.

Following *Blue Sky*, wary financiers taking an ELM over an aircraft are now requiring a number of additional steps to be taken to ensure validity of the security. The effect of the *lex situs* rule is that, in order to be certain of a valid ELM as a matter of security law, the aircraft must be located in England (including English airspace) at the time of execution.

²⁸ Ibid [153]–[155].

²⁹ Ibid [154].

³⁰ Dicey, Morris and Collins (n 3) Exception 2 to Rule 120(3).

³¹ *Blue Sky* Phase 2 judgment [2010] EWHC 631 (Comm) [201].

³² *Blue Sky* Phase 1 judgment [2009] EWHC 3314 (Comm) [269]–[271].

However, this is often commercially impractical, as the relevant aircraft may be based elsewhere in the world and may not be operated on a route to England when the financing is being put in place. The expense of flying the aircraft to England is likely to be prohibitive and there may be other disadvantages, including operational, regulatory and tax concerns.

While it may be possible to take an ELM when the aircraft is located in a jurisdiction where the form of mortgage effectively creates a valid security interest over the aircraft under the domestic law of the *situs* jurisdiction, financiers must accept that such a security interest will not necessarily give rise to identical rights and remedies as an ELM executed when the aircraft is in England; that would only occur if the *lex situs* (domestic law) mirrors English law in respect of chattel mortgages. This is the inevitable result of the application of the *lex situs* rule, coupled with the exclusion of *renvoi*, as ordained by *Blue Sky*.

In summary, the highly movable nature of aircraft and the geographical location and operational requirements of the airlines means that often, an aircraft may not be able to be positioned in England at the time the ELM is taken, so the proprietary validity of the ELM (including its exact scope and the parties' rights and remedies) is uncertain and requires an analysis of the *lex situs*, which will be different in every transaction. This severely undermines any legal and commercial certainty gained by choosing English law at the outset.

In many transactions the aircraft may be in international airspace when the ELM is granted. As explained above, the Court in *Blue Sky* was not required to consider what law should apply to the proprietary validity of the ELM in such situation, that is, when there is no '*situs*' of the aircraft, therefore the position is uncertain. Certain parties are reluctant to rely on the alternative *lex registri* suggested by Dicey, Morris and Collins and other academic commentators, in the absence of clear case law. In any case, the *lex registri* alternative would still require an analysis of the *lex registri*, which again will be different in every transaction.

Certain commentators have welcomed the rejection of the doctrine of *renvoi* in the case of title to tangible movables, on the basis that this provides for a more certain legal regime.³³ However, as industry practitioners, our practical experience is that when legal counsel in the relevant *situs* jurisdiction is asked to confirm whether an ELM is valid as a security interest under the domestic law of such jurisdiction, the common response is that validity under the *lex situs* depends on whether the ELM is valid under English law (or the laws of another jurisdiction – often the state of aircraft registration). This is notwithstanding that such response (which we contend is not unreasonable on the part of such counsel) necessarily involves application of the choice of law rules of the *lex situs*, which *Blue Sky* prohibits. The confusion arises because the *Blue Sky* decision directs attention to the *lex situs* but then disregards what would happen if the *lex situs* were applied. This is doubly strange because one of the key rationales for deferring to the *lex situs* is that it is the jurisdiction with 'control' over the aircraft. Parties have struggled to obtain clear advice on this issue in a number of jurisdictions.³⁴

While in certain cases a security interest over the aircraft expressed to be governed by and validly created under the laws of the *situs* jurisdiction or under the state of registration (hereinafter referred to as a 'local law mortgage') may be acceptable to the parties, there may also be situations where such interest is inadequate or unavailable. For example, in

³³ See McBain, Osborne and Imhof Jr (n 17) 15. See also CJS Knight, '*Blue Sky One Ltd. v Mahan Air: renvoi and moveable property – another nail in the coffin?*' (2010) 4 Conveyancer and Property Lawyer 331.

³⁴ See UK Department of Business, Innovation and Skills, Call for Evidence, Summary of Responses, Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment (February 2010) 5 www.bis.gov.uk/assets/biscore/corporate/docs/c/11-539-call-summary-of-responses-mobile-aircraft-equipment accessed 28 July 2012, where it is noted that a number of respondents emphasised the unpredictability of legal outcomes where *lex situs* is applied.

some jurisdictions, a mortgage over movable property or over aircraft not registered in that jurisdiction (as in the Dutch example in *Blue Sky*) is not possible. In other jurisdictions, a local law mortgage may not grant the mortgagee equivalent rights and remedies as under an ELM, most notably in relation to self-help.

Further, as alluded to above, for reasons of transaction efficiency and certainty, financiers generally prefer to have a uniform security package; that is, to the greatest extent possible, they seek to have equivalent and consistent rights and remedies in respect of the transaction collateral in all their aircraft financings, regardless of the location and registration of the aircraft, the jurisdiction of incorporation of the airline and of any other obligors.

To summarise all of this in context – the aviation industry had lived with the *lex situs* rule for aircraft but the *Blue Sky* case brought it into sharper focus. It was also particularly disappointing in terms of the decision to reject *renvoi*, which some commentators have argued is not founded on a solid base of case law, and the loss of opportunity to develop the *lex registri* theory. The *Blue Sky* decision also came during a time when the industry had been shifting back towards placing a greater emphasis on mortgage security as part of the security package. Aircraft mortgages are part of the building blocks of a typical security package but have over the years been seen as something of an ancillary feature in most structures that are built on robust title based principles: a special purpose owner (whose shares are charged or mortgaged and often structured as an ‘orphan’ entity for even greater security) with a single purpose covenant package and bankruptcy remote structuring. Historically, lenders had viewed the aircraft mortgage as part of the package but perhaps not a core part. In the bank lending market and also in export credit financings, we have seen aircraft mortgages becoming a more prominent feature in reaction to a number of drivers, including in particular Basel II and III capital adequacy rules, the new OECD export credit aircraft sector understandings and changes in behav-

our as financiers in particular are under pressure from credit committees to ensure the maximum level of security in all scenarios.

Given these commercial expectations and in light of the above challenges involving a valid ELM and acceptable local law substitutes, the UK aviation industry as a whole, including UK-based legal practitioners active in the sector, is witnessing a shift in attention to other jurisdictions which are perceived by international financiers and operators as having simpler and unambiguous security and property laws. As a notable example, in numerous transactions since *Blue Sky*, parties have opted to take a mortgage expressed to be governed by New York law, in preference to an ELM, on the assumption that they do not need to concern themselves with the *lex situs* analysis and with the added advantages perceived to exist from the US’ ratification of the Convention. We note that once the choice has been made to use New York law for the aircraft mortgage and any other security agreements, it will often make commercial and transactional sense to document the entire transaction under New York law.

5. The Cape Town Convention

(a) Introduction to the Cape Town Convention

The Convention is intended to enhance and harmonise laws in respect of the financing, lease and sale of high value, mobile equipment. It provides a uniform set of rules for the constitution, protection, prioritisation and enforcement of certain rights in qualifying airframes, aircraft engines and helicopters and it establishes an electronic-based International Registry for registering certain interests in aircraft objects. In particular, the Convention offers a specific insolvency regime for aircraft (subject to an opt-in declaration by the relevant Contracting State).

The treaty came into effect in 2006, as regards aircraft objects,³⁵ and has been ratified by many of the world's leading economies (including China, Russia and the US) and other major jurisdictions which support aviation financing and leasing. While the UK has signed the Convention, it has not yet ratified or acceded to it, although we believe there are plans to do so.³⁶

(b) When does the Cape Town Convention apply to a transaction?

First, in accordance with treaty law, the Convention only applies as between states which have ratified or acceded to it (the 'Contracting States'). Further, the Convention will only apply to entities or individuals subject to the laws of a Contracting State to the extent that the treaty has been implemented or is otherwise effective under national law. In some cases, ratification by the government or other executive agency, including a monarch, may be sufficient. In other cases, a further legislative process may be required. For example, in the UK, treaty ratification by the government, as the executive, may bind the state in international law. However, as a general rule, for a treaty to become effective as a matter of national law, Parliament, as the legislature, must pass an act or other legislative instrument implementing the treaty. This process is sometimes referred to as 'domestication' of a treaty. Therefore, the first question to ask in a specific transaction is whether the Convention is effective under the national law of the relevant state.

The Convention will only apply to aviation transactions which fall within its scope. Broadly, it will apply if:

- (a) the transaction agreements create an 'international interest' in an 'aircraft object', as defined,³⁷ being an airframe, aircraft engine or helicopter which meets the minimum size requirements; and
- (b) the requisite 'connecting factors' are present.

(i) What is an international interest and how is it created?

The foremost innovation of the Convention is the concept of an 'international interest'. An international interest is an interest in an aircraft object which is either (i) granted by a chargor under a security agreement; (ii) vested in a person who is a conditional seller under a title reservation agreement; or (iii) vested in a person who is a lessor under a leasing agreement.³⁸

The formalities for creation of an international interest are deliberately simple.³⁹ An agreement must exist in writing which (i) creates or provides for the interest; (ii) relates to an object of which the chargor, conditional seller or lessor has the power to dispose; (iii) identifies the object in accordance with the Protocol terms; and, (iv) in the case of a security agreement, the secured obligations can be determined, but without need to state a sum or maximum sum secured. If these criteria are met, then an international interest will arise.

Under the treaty rules, it is an autonomous interest which exists independently of any interests created under national law.⁴⁰ In other words, there is no reference to or requirement to satisfy national law conditions for creation of interests. This is a crucial precept of the Convention and one which is examined in more detail in Section 6(d).

³⁵ The Convention only comes into force with respect to a category of equipment when the relevant Protocol for such equipment comes into force. The Aircraft Protocol came into force on 1 March 2006. For updated information and a list of Contracting States, refer to the Depository Update in this issue of the *Cape Town Convention Journal*, see page 147.

³⁶ See n 59.

³⁷ Aircraft Protocol, Article I (2)(2), Article I (b) and Article I(l).

³⁸ Convention, Article 2.

³⁹ Article 7.

⁴⁰ See Official Commentary, Goode (n 17) para 2.42.

(ii) *Are the connecting factors present?*

The legal location of the applicable debtor determines the applicability of the Convention to a transaction. The Convention applies when, at the time of the conclusion of the relevant agreement creating or providing for an international interest in an aircraft object, the debtor (the lessee, the chargor or the conditional buyer, as the case may be or, in the case of contracts of sale, the seller) is situated in a Contracting State.⁴¹

The Aircraft Protocol also extends the scope of the Convention in relation to airframes and helicopters, if such airframe or helicopter is, at the time of conclusion of the applicable agreement, registered or its registration has been agreed in the aircraft registry of a Contracting State.⁴² However, this alternative connecting factor does not apply to aircraft engines, for which there is no system of nationality registration.⁴³ As a result, if the debtor location connecting factor is not present, then the Convention may provide for a particular international interest to cover an airframe by virtue of the airframe connecting factor, but not its related engines.

(c) *What laws apply to transactions falling under the Cape Town Convention?*

As a starting point, the Convention makes no express provision for choice of law. Article VIII(2) of the Aircraft Protocol provides that parties in Contracting States may select the law that will govern their *contractual* rights and obligations.⁴⁴ The chosen law is deemed to be the domestic law of the designated State, excluding its conflict of laws rules; thus *renvoi* is excluded.

⁴¹ Convention, Article 3(1).

⁴² Protocol, Article IV(1).

⁴³ *Ibid.*

⁴⁴ Article VIII(2) provides that 'The parties to an agreement, or a contract of sale, or a related guarantee contract or subordination agreement may agree on the law which is to govern their contractual rights and obligations, wholly or in part.' See also Official Commentary, Goode (n 17) para 5.40.

ed.⁴⁵ It is important to understand, firstly, that this choice of law rule is only available if the State has opted into Article VIII by way of a declaration.⁴⁶ Otherwise the private international law rules of the forum state will apply.⁴⁷

Further, the Aircraft Protocol's reference to the proper law is limited to contractual rights and obligations; proprietary rights affecting third parties, including on the debtor's insolvency, are outside the scope of this rule. As stated above, the validity of the security interest under the ELM is such a property matter.

As neither the Convention nor the Aircraft Protocol pronounces a choice of law rule governing the creation and effectiveness of parties' *proprietary rights*, the question arises as to whether the application of the 'applicable law' should determine such proprietary interests. The Convention defines the 'applicable law' as 'the domestic law applicable by virtue of the rules of private international law of the forum state'.⁴⁸

The Convention expressly refers to the 'applicable law' in a number of respects,⁴⁹ for example, when categorising whether an international interest is a security agreement, title reservation agreement or lease agreement.⁵⁰ We understand that the treaty's draftsmen recognised the challenges of establishing 'uniform Convention categorisation' of agreements and therefore this exercise is assigned to the 'applicable law'.⁵¹ Commentators have noted that reference to the applicable law in the categorisation of an international interest under Article 2(4) of the Convention detracts from the

⁴⁵ Article VIII(3). See also Official Commentary, Goode (n 17) para 5.37.

⁴⁶ Article VIII(1).

⁴⁷ See Official Commentary, Goode (n 17) para 5.36.

⁴⁸ Convention, Article 5(2). See also Official Commentary, Goode (n 17) para 4.64.

⁴⁹ See Article 2(4), 5(2) and 5(3). See also Official Commentary, Goode (n 17) para 2.7.

⁵⁰ Article 2(4). See also Official Commentary, Goode (n 17) paras 4.50 and 4.51.

⁵¹ Official Commentary, Goode (n 17) para 2.36.

concept of an international interest as standing above the conflict of laws complexities.⁵²

Equally, it is for the 'applicable law to determine the *validity* of an agreement alleged to create or provide for an international interest'.⁵³ Supporters of the Convention view such reference as concerning *contractual* validity only, not validity of *property rights*. This follows from the central premise that the Convention is not interested in choice of law rules in respect of the *proprietary* aspects of international interests (or their underlying agreements), as its purpose was to dispense with the applicable law on such issues, by introducing substantive rules which do not rely on treatment under private international law, specifically the device of the international interest.⁵⁴ This position is considered further in Section 6(d).

6. The Cape Town Convention and the *Blue Sky* Case

(a) *An unqualified solution?*

Different considerations would have applied in the *Blue Sky* litigation had the transactions at issue been subject to the Convention. Let us assume that the UK had implemented the Convention before the mortgages over the two aircraft were executed. Both mortgagor companies (*Blue Sky Two Ltd.* and *Blue Sky Three Ltd.*) were English incorporated companies and thus would have satisfied the debtor location connecting factor.⁵⁵ It may be taken that each mortgage agreement would have satisfied the formal Convention requirements for con-

stitution of an international interest,⁵⁶ and the *lex situs* of each mortgaged aircraft would not have been relevant to this isolated question. It should also be noted that, as regards the third aircraft which was located in the Netherlands when the mortgage was executed, this was registered in the UK at the time, and therefore, the airframe connecting factor would also have been met.

Provided an ELM satisfies the formalistic conditions for creation of a security agreement as an 'international interest' and one of the connecting factors is met, the Convention's rights and remedies will be available to the mortgagee and enforceable under the laws of any Contracting State. The Convention's perfection and priority rules will apply to such ELM. This would be the case regardless of the availability of any rights and remedies under national law. In such case, the mortgagee might feel comfortable disregarding the question of whether the ELM was valid or not based on the *lex situs* requirements as prescribed by *Blue Sky*.

Thus, several industry participants have asserted that treaty ratification by the UK will cure the issues arising from the application of the *Blue Sky* decision to cross-border aircraft transactions where a valid security interest under an ELM is sought. Our view is that the UK's wholesale adoption of the Convention is helpful in addressing the *Blue Sky* problem, although does not wholly resolve it and some additional measures would be required in order to fully address the issues, ideally as part of the adoption of the Convention, as discussed below.

(b) *Application of Blue Sky to non-UK transactions and to engines*

First, for a mortgagee to be able to rely on the treaty rights and remedies available to the ELM *as an international interest* against the relevant mortgagor, as debtor (and to enforce against the aircraft), the jurisdiction of the debtor's location and/or the jurisdiction of the state of

⁵² See McBain, Osbourne and Imhof Jr (n 17) 25 which states that "It is somewhat disappointing that the Convention does not either provide an all embracing regime for the description and categorisation of international interest (possibly too radical) or, at least, provide for more a conclusive conflict of laws rule, preferably by reference to the *proper law of the transfer*'.

⁵³ See Official Commentary, Goode (n 17) para 2.7.

⁵⁴ Official Commentary, Goode (n 17) para 2.42.

⁵⁵ Convention, Articles 3 and 4.

⁵⁶ Article 7.

registration of the aircraft must have adopted the Convention, that is, such jurisdiction must be a Contracting State.

Unless the debtor happens to be located or the aircraft happens to be registered in the UK, UK ratification of the Convention is not relevant to this position. Rather, what is relevant is whether other countries adopt the treaty, including its insolvency provisions (which crucially require a specific 'opt-in' declaration by each Contracting State). So, even if the UK adopted the Convention, where the mortgagor is not located in the UK or the aircraft object is not registered in the UK, an ELM granted by the owner would not necessarily give rise to an international interest.

Further, as mentioned above, as regards aircraft engines, the airframe registration connecting factor is not sufficient. The mortgagor must be situated in the UK (or another Contracting State) for the purposes of the debtor location connecting factor or otherwise the ELM will not give rise to an international interest over the mortgaged engines.

In these instances, the *lex situs* rule as prescribed in the *Blue Sky* litigation would still be relevant. This is of concern to the aircraft financing industry as ELMs (and other English law governed documents) are widely used in aviation transactions where none of the parties are situated in or otherwise connected to the UK nor is the financed aircraft registered in the UK. In addition, the lacuna regarding any independent connecting factor for engines means engine financiers may only rely on a Convention international interest, in substitution for a valid ELM or other security interest under national law, where the debtor location connecting factor is met.⁵⁷

⁵⁷ Although we note that this places engine financiers in an equivalent position to financiers of the other categories of mobile equipment covered by the Convention, that is, rail assets and space assets, who may only rely upon the debtor location connecting factor to take advantage of the Convention; this is because the Aircraft Protocol extends the availability of the Convention solely by introduction of the asset registration connecting factor, Article IV(1) of the Protocol.

(c) UK legislative options

The UK Government has consulted with the industry on ratification of the Convention.⁵⁸ A recent announcement by the responsible governmental department indicates that ratification is more than likely.⁵⁹

UK ratification should extend to certain overseas territories,⁶⁰ including, in particular,

As mentioned above, because aviation engines typically are not registrable as independent objects on nationality registers, this connecting factor is necessarily restricted to registered airframes and helicopters. Similarly, we are not aware of any national rail asset or space asset registers.

⁵⁸ In July 2010, the Department for Business, Innovation and Skills, part of the UK government, issued a Call for Evidence regarding UK ratification of the Convention and Protocol, www.bis.gov.uk/Consultations/call-for-evidence-on-mobile-equipment-aircraft-protocol, accessed 28 July 2012. A full list of responses was published in February 2011, www.bis.gov.uk/assets/biscore/corporate/docs/c/call-full-responses-mobile-aircraft-equipment.pdf, accessed 28 July 2012.

⁵⁹ On 10 July 2012, at the Farnborough International Air Show, Mark Prisk, the Minister for Business and Enterprise made an announcement stating that 'Airbus, Rolls Royce, and Boeing and others have come to us and requested that the UK Government ratifies the Cape Town Convention and Aircraft Protocol. The aims of this are to bring speed, certainty and cost savings to the process of repossessing aircraft and engines, in cases of insolvency or default, where these assets are in a country whose legal system may not make that an easy process. The hope is that the benefits to financiers then result in reduced finance costs for airlines. I am pleased to confirm to you today that we are committed to ratifying the Convention. We first have some more work to do with business, following our Call for Evidence, to clarify the costs and benefits involved. And as part of our policy process we plan to consult on changes to the law needed for UK ratification. So we will be working closely with business to complete the process, as quickly as possible', www.bis.gov.uk/news/speeches/mark-prisk-ads-conference-farnborough-2012, accessed 28 July 2012.

⁶⁰ There are 14 UK Overseas Territories: Anguilla, British Antarctic Territory, Bermuda, British Indian Ocean Territory, British Virgin Islands, Cayman Islands, Falkland Islands, Gibraltar, Montserrat, Pitcairn Island, St Helena, Ascension Island and Tristan da Cunha, South Georgia and South Sandwich Islands, Sovereign Base Areas on Cyprus and Turks and Caicos Islands.

the Cayman Islands and Bermuda. Overseas Territories of the UK have no ability in their own right to become a party to the Convention and are wholly dependent on ratification by the UK. Only after UK ratification can an application be made to have the Convention extended to include such Overseas Territories. The Cayman Islands is an established offshore jurisdiction for aircraft financing transactions, by virtue of its reputable corporate, security and enforcement regimes and its high-density population of experienced professional service firms and advisors.⁶¹ Similarly, Bermuda is a recognised aviation financing jurisdiction, with clear ownership and registration systems.⁶²

If the UK ratifies, then most of the major aviation financing jurisdictions where aircraft are owned and registered and against which security is sought, would be covered by the treaty, as the Convention has already been adopted by Ireland, Singapore and the US. In addition, many countries seeking to develop and grow their aviation sectors have signed up to the treaty, such as Russia, China, Brazil and several African states. The vision of a harmonised security system for cross-border aircraft transactions may yet be achieved.

Assuming the UK ratifies, the next step would be treaty domestication.⁶³ At this stage, we consider that the implementing legislation

should include supplementary provisions to deal with certain of the residual issues relating to *Blue Sky* identified in this article (the 'UK Aviation Provisions').

In essence, our view is that, in order to retain English law's pre-eminent position as one of the preferred laws selected to govern aviation transactions and support the UK aviation industry, the negative impact of the *Blue Sky* litigation must be settled. This could be achieved in one of two ways.⁶⁴ The first is to ratify the Convention and introduce *Blue Sky* related legislation as part of its implementation into national law. The second is to introduce a separate bill⁶⁵ dealing solely with the *Blue Sky* position, detached from the treaty process. We favour the former 'Convention' route over the latter option for a variety of reasons. First, the objective of the Convention is to establish a standardised system of rights and remedies for secured aviation creditors. While the *Blue Sky* decision applies to any transfers of movables expressed to be governed by English law, its effect is most pronounced in the context of cross-border aircraft transactions. The conflict of laws issues which have arisen out of *Blue Sky* are precisely the concerns which the Convention seeks to address; arguably, the Convention is the most appropriate forum for resolution of *Blue Sky*. Secondly, the international advancement of the Convention is a continuing success story and those involved in its development may be able to lend their experience and resources to achieving UK implementation, including the adoption of the UK Aviation Provisions.

⁶¹ As Overseas Territories may not sign or ratify treaties independently of the UK, pending resolution by the UK, the Cayman Islands have enacted their own domestic legislation based on the Convention, known as the Cape Town Convention Law 2009, in an attempt to offer users an equivalent internal regime.

⁶² Interestingly, the Department for Business, Innovation and Skills' Call for Evidence was extended to Overseas Territories. Both the Cayman Islands Government and the Bermuda Department of Civil Aviation supported UK ratification and, by extension, ratification to other Overseas Territories.

⁶³ We note that the Aviation Working Group, the non-profit industry association which has spearheaded development of the Convention, has published a model ratification text and model implementing legislation for use by states, www.awg.aero/assets/docs/Implementation%20Resource%20Materials%20April_.pdf, accessed 28 July 2012.

⁶⁴ For procedural and other reasons, there is no longer any prospect of an appeal in the *Blue Sky* dispute. Therefore, we have focused on legislative solutions.

⁶⁵ We understand that the UK Government declined to include a provision regarding *Blue Sky* in the Civil Aviation Bill which is now progressing through the House of Lords, <http://services.parliament.uk/bills/2012-13/civilaviation.html>, accessed 28 July 2012.

(d) Residual Blue Sky issues – scope of UK Aviation Provisions

This section summarises the key aspects of the *Blue Sky* decision which are not resolved by the Convention terms but which may be addressed by supplementary legislation.

(i) Outright transfers

First, the *Blue Sky* decision applies not only to transfers of title to aircraft for security purposes but to outright transfers, that is, sales. Therefore, we submit that the UK Aviation Provisions should deal with such transfers. We consider that this extension is appropriate within the scope of the Convention as regards aircraft objects, given that the Aircraft Protocol specifically extends certain terms of the Convention to contracts of sale.

(ii) Aircraft engines

Secondly, the UK Aviation Provisions should seek to resolve the issues regarding mortgages and sales of engines which are expressed to be governed by English law, in circumstances where the owner is not in a Contracting State. The difficulties of securing and enforcing interests in respect of any aircraft object in a cross-border context involving multiple laws and jurisdictions are, in a sense, magnified when applied to engines which are, by their nature, highly mobile assets whether they are installed and operating on an airframe or detached and capable of being transported by other means.

However, while we acknowledge that the *lex situs* rule applies to transfers of other tangible movables, we assert that the UK Aviation Provisions should be restricted to aircraft objects as defined by the Convention (that is, qualifying airframes, engines and helicopters). This restriction conforms to the implementing legislation which should only deal with aircraft objects, given the scope of the Convention and specific Aircraft Protocol.⁶⁶ Further, we

⁶⁶ Although the question arises whether a similar approach could be followed in relation to rail assets,

consider that there is a strong argument that as unique transportation assets, aircraft objects may be distinguished from other chattels in terms of the application of the *lex situs* rule.⁶⁷

(iii) Choice of law rule

As discussed in Section 5(c), neither the Convention nor the Aircraft Protocol prescribes an express choice of law rule for proprietary interests. As explained above, a security interest is such a proprietary interest.

As mentioned above, commentators⁶⁸ have explained that the Convention deliberately avoids use of choice of law rules in favour of substantive rules, that is, by means of the international interest device, to deal with proprietary interests in qualifying aircraft objects. However, this arrangement will not assist in the case of an ELM over an engine executed by an owner in a non-Contracting State. UK ratification of the Convention will not provide a choice of law rule which *replaces* the English law choice of law rule for transfers of title to movables. Therefore, the UK Aviation Provisions should include an express choice of law rule which departs from the *lex situs* rule set out in *Blue Sky*.

(iv) Valid security interest under the applicable law?

As explained in Section 5(b)(i) above, the Convention establishes substantive rules regarding international interests; therefore, provided its formalities are satisfied, an international interest may arise, which will be a right *in rem*.⁶⁹ This will be the case whether or not a right *in rem* has been validly created under national law.⁷⁰

under the Rail Protocol, if ratified/acceded to by the UK.

⁶⁷ See Section 6(e)(iii) below.

⁶⁸ See C Forsyth 'Certainty Versus Uniformity: Renvoi in the Context of Movable Property' (2010) 6 *J Priv Int L* 637, Section D. This article specifically examines the conflict of laws decision in the *Blue Sky* litigation.

⁶⁹ See Official Commentary, Goode (n 17) para 2.31.

⁷⁰ See Official Commentary, Goode (n 17) para 4.69.

In particular, proponents of the Convention hold that the treaty's definition of a security agreement⁷¹ does not entail creation and existence of a right *in rem* under or by reference to national law. It is sufficient that, in accordance with the Convention provisions,⁷² the chargor grants to the chargee an interest in the relevant object to secure performance, provided that the other requirements for the formation of a valid contract are met, according to the applicable law.

In other words, assuming an aircraft owner enters an ELM which is contractually valid, but for some reason the mortgage does not create a valid security interest over the aircraft as a matter of English property law, if the Convention applies and its conditions are met,⁷³ then a valid international interest will still arise and be effective under the laws of any Contracting State. To expand, an equitable mortgage under English law which may arise because there has been a failure to create a valid legal mortgage would be sufficient to create an international interest.

However, other industry participants, including English law practitioners, have argued that the underlying interest under a 'security agreement', as defined in the Convention, necessitates the creation of a right *in rem* under the relevant law governing property matters, and contractual validity is not sufficient. If this position is accepted, then the next question is what law governs proprietary validity of the security agreement? Arguably, in the absence of an express choice of law rule for property matters, the 'applicable law' applies.⁷⁴

This would be the domestic law of the forum State, without reference to its private international law.⁷⁵ However, to ascertain the 'forum State' involves firstly applying the private international law rules of the forum which will point to a relevant State, the domestic laws of which will govern. So, taking an ELM over an aircraft, if the forum is England, then this would involve applying the *lex situs* rule as prescribed in *Blue Sky* (domestic law only), thus bringing us full circle in terms of the *Blue Sky* problem.

Further, if the requirements of the applicable law (which may be the *lex situs*, as analysed above) are not met, then this begs the question whether an international interest under an agreement expressed to be a security agreement could arise at all, if a right *in rem* in the aircraft object has not been granted.

We do not think that this argument has merit since the treaty's objectives and 'spirit' should be respected: to reach the conclusion that the Convention requires a valid security interest (or other right *in rem*) under a particular national law to exist prior to and for the constitution of an international interest would be wholly inconsistent with the aim of the Convention to provide an international regime which mitigates against the challenges of taking security over movables, such as aircraft objects, in a cross-border context, where a number of different (and conflicting) laws may apply at any given time. It does so by offering (a) an interest which seeks to disassociate itself from such laws; and (b) the holder of an international interest a set of rights and remedies which run parallel to any rights and remedies for national interests under national laws.⁷⁶

⁷¹ Article 1(ii) – a security agreement is defined as 'an agreement by which a chargor grants or agrees to grant to a chargee an interest (including an ownership interest) in or over an object to secure the performance of any existing or future obligation of the chargor or a third person'.

⁷² Article 2(2).

⁷³ Article 7.

⁷⁴ Article 5(2).

⁷⁵ Article 5(3).

⁷⁶ Article 5(2) of the Convention is helpful here. This states that 'questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based, or, in the absence of such principles, in conformity with the applicable law.'

(e) *UK Aviation Provisions*

Based on the above analysis, we propose that the UK Aviation Provisions should include:

- (a) The concept of a 'legal charge' over aircraft objects under English law⁷⁷ (the 'Aviation Charge'), being a statutory form of mortgage by which the owner of an aircraft object can transfer title for the purpose of security, subject to the equity of redemption, with equivalent rights and remedies available to mortgagees under existing ELMs; and
- (b) An express choice of law rule for such Aviation Charge and for outright transfers of title to and any other proprietary rights (including charges) in aircraft objects expressed to be governed and created under English law, which would be based on either:
 - (i) the proper law of the contract, as chosen by the parties; or
 - (ii) the entire law of the *lex registri*, including its conflict of laws rules; or
 - (iii) the entire law of the *lex situs*, including its conflict of laws rules.

The merits and weaknesses of each of these choice of laws rules are considered below. The reference to the entire law of either the *lex registri* or the *lex situs* is considered separately.

(i) *Proper law of the transfer, as chosen by the parties*

The proper law of the transfer is founded upon the applicable law as chosen by the parties. Dicey, Morris and Collins provide that the applicable law of the transfer is to be determined in accordance with the principles which determine the applicable law of the contract.⁷⁸ Founded upon the choice of the parties, the rule promotes party autonomy and commercial convenience. It is already recognised that the

proper law of the transfer is more appropriate when a tangible movable is in transit, and its *situs* is casual or unknown.⁷⁹

We acknowledge that Dicey, Morris and Collins highlight a number of reasons why the proprietary effects of a transfer are more important than the contractual effects and by implication the reasons against the proper law of the transfer as the choice of law rule that should govern the transfer of movables.⁸⁰ The most important of these is where issues arise where a third party claim is involved. It is not open to parties to derogate from rights conferred on third parties and the power of derogation is confined to relations between the original parties to a contract.⁸¹ For example, a transferor may fraudulently deliver an aircraft to a third party, instead of to the other party to the contract. In these circumstances, the transferor is liable in damages for breach of contract, but this does not address the question of title.⁸²

A rule extending choice of law as to the proprietary aspects of a transfer (or any other transaction) to third parties would certainly be a novel concept in English law and there is an absence of English case law on this issue. However, that is not to say that such a rule should be dismissed out of hand.⁸³ In particular, the engines issue identified above may only be adequately addressed by adoption of a choice of law rule based on the proper law of the transfer.

To the extent that the proper law of the transfer had not been chosen by the parties (for example, by absence of a governing law provision or agreement otherwise), the UK Aviation Provisions would need to provide for how the transaction should be governed, by a 'default' choice of law rule, possibly reverting to the *lex registri* or *lex situs* as discussed below. In the case

⁷⁹ Dicey, Morris and Collins (n 3) Exception to Rule 124, 1170.

⁸⁰ Dicey, Morris and Collins (n 3) 1167.

⁸¹ R Goode, 'Protection of Interests in Movables in Transnational Commercial Law' (1998) 3 *Uniform Law Review* 453, 462.

⁸² Dicey, Morris and Collins (n 3) 1167.

⁸³ See McBain, Osborne and Imhof Jr (n 17) 23.

⁷⁷ Similar to real estate statutory charges under the Law of Property Act 1925.

⁷⁸ Dicey, Morris and Collins (n 3) 1165.

of an Aviation Charge, the statutory form could require an express governing law provision.

Nonetheless, despite the concern of third party claims, the proper law of the transfer is a flexible means of facilitating financing and is designed to facilitate the freedom of the contracting parties to select the applicable governing law.⁸⁴ It is also noteworthy that the proper law of the transfer has been adopted in New York law in relation to the transfer of movables.

(ii) *Lex registri*

Under the Convention on International Civil Aircraft 1944 (the ‘Chicago Convention’), any civil aircraft engaged in international air navigation must be registered in its nationality register. While the *lex registri* (the law of the aircraft register) has never been adopted in English aviation legislation, Dicey, Morris and Collins note at Rule 120(3), Exception 2 that a ‘civil aircraft may at some times be deemed to be situate in its country of registration.’⁸⁵ As noted above, the commentary to this exception goes on to state that where an aircraft is ascribed a permanent (albeit artificial) *situs* in the country where it is registered, it avoids difficulties which could arise in the case of aircraft in flight over the high seas or a *territorium nullius*. We would also add that this would avoid disputes over the actual location of the aircraft, as was seen in the case of the second aircraft in *Blue Sky*. Moreover, it is an entirely rational conclusion, not only in circumstances where no state can be identified as having control over the asset at the relevant time (eg when the aircraft is in international airspace) but also, arguably, whenever the aircraft is flying over a state’s territory or is only temporarily in a state’s territory (eg for re-fuelling), when the state’s control is weak or transient, at best.

While the *lex registri* has not found favour in English case law, including *Blue Sky* and earlier

⁸⁴ Ibid 23.

⁸⁵ Dicey, Morris & Collins (n 3) Rule 120, Exception 2, 1131.

cases,⁸⁶ academic commentators have expressed disappointment with the reluctance of the courts on this point.⁸⁷ We also note the scarcity of cases examining this proposition, as opposed to a long line of authority rejecting it.⁸⁸

The primacy of the state of registration is accepted in the context of ships, which, like aircraft, are transportation assets which are generally required to be registered for safety, ownership and operational purposes. In many jurisdictions, a statutory mortgage over a ship may be validly created and perfected by registration in the ship mortgage registry.

The importance of aircraft registration has also been emphasised in the 1948 Geneva Convention on the Recognition of Rights in Aircraft (the ‘Geneva Convention’) which privileges the State of Registration for perfecting property rights over aircraft, including mortgages.⁸⁹ Furthermore, the UK Mortgage of Aircraft Order 1972⁹⁰ recognises the significance of the state of registration for secured aircraft creditors by providing for mortgages over UK registered aircraft to be filed on the CAA’s Aircraft Mortgages Register for the purposes of priority and notice to the world. It would seem a reasonable extension of this existing statutory protection to legislate for

⁸⁶ *Air Foyle Ltd v Center Capital Ltd* [2002] EWHC 2535 (Comm); *Kuwait Airways Corp v Iraqi Airways Co (No 6)* [2002] UKHL 19, [2002] 2 AC 883.

⁸⁷ See Forsyth (n 68) fn 7 where Professor Forsyth states ‘it is a pity that the common law could not be developed in this way since it is an eminently sensible solution.’

⁸⁸ In fact, we note that in *Dornoch Ltd v Westminster International BV (No 1)* [2009] EWHC 889 (Admlty), [2009] 2 Lloyd’s Rep 191, Tomlinson J observed at [103] that it was ‘likely that, so far as concerns questions of legal title, most systems of law would inevitably, in consequence of their own conflict rule, look to the law of the place of registration.’

⁸⁹ Article 1 of the Geneva Convention provides that a Contracting State will recognise various rights over aircraft ‘provided that such rights have been constituted in accordance with the law of the Contracting State in which the aircraft was registered as to nationality at the time of their constitution’.

⁹⁰ SI 1972/1268.

the proposed UK Aviation Charge. However, we consider that, while the *lex registri* initially appears to be an attractive law to govern the validity of transfers of commercial registered aircraft, it should not be the primary rule (although it should still be considered as the default rule in the absence of express choice of law by the parties, as suggested above). First, it will not be relevant in the case of a mortgage or other transfer of an engine nor will it apply to such transactions involving unregistered aircraft. Further, from a commercial perspective, even for registered airframes, if the *lex registri* was the prevailing law governing such transactions, parties in aircraft financings would still be required to undertake an analysis similar to the *lex situs* analysis, albeit with the advantage of increased certainty as the state of registration would be known in advance.

(iii) *Lex situs*

It is clear from the case law outlined in Section 3 above, that the *lex situs* enjoys a special status within the subject of conflict of laws. This is in part due to its longevity which has been exceeded by few other conflict of laws rules.⁹¹ The *lex situs* has the advantage of being a single and exclusive system that can act as an independent arbiter of conflicting claims.⁹²

However, as has already been suggested in this article, there are many inadequacies of the *lex situs* in relation to aircraft.⁹³ Our principal objection to the application of *lex situs* to aircraft is that the basic premise of the rule is that the state where the asset is located will have practical control, hence the laws of such state (and its courts) should prevail in respect of property matters involving the asset. However, this wholly pragmatic principle loses its relevance when applied to transportation assets

such as aircraft and ships, which are inherently peripatetic.⁹⁴

We see no reason why a special case cannot be made to treat aircraft objects, as unique transportation assets, as an exception to the orthodox rule. We acknowledge that such departure would be dealt with most appropriately by legislative means, such as by the UK Aviation Provisions, particularly as the courts have shown reluctance to intervene.

(iv) *Acceptance of renvoi*

It is suggested that, when considering whether the *lex registri* rule should be adopted for property matters regarding aircraft objects, or alternatively, whether the *lex situs* rule should be upheld, the doctrine of *renvoi* should be accepted; that is, the reference to the relevant law should be to its entire laws.

The English Court in *Blue Sky* dismissed *renvoi* and appeared to rely heavily upon the dictum of Millett J (as he then was) in *Macmillan Inc v Bishopsgate Investment Trust plc*, at first instance,⁹⁵ that the doctrine 'has often been criticised, and it is probably right to describe it as largely discredited'. However, we note that the English Court in other cases, including notably *Glencore International AG and ors v Metro Trading International*⁹⁶, and eminent academics⁹⁷ have shown support for the doctrine in the context of questions of title to movable property.

We do not attempt in this article to argue the finer conflict of laws points, such as the central aim of private international law of assuring uniformity of decision, wherever a dispute may be litigated, in respect of which we defer to experts in the field. Our position is based on commercial insight and practical

⁹⁴ A similar argument may be made in the case of goods in transit.

⁹⁵ [1995] 1 WLR 978 (Ch) 1008.

⁹⁶ [2001] 1 All ER (Comm) 103, [38]. See also *Winkworth v Christie, Manson and Woods Ltd* [1980] Ch 496, 514C-E.

⁹⁷ Including A Briggs, 'In Praise and Defence of Renvoi' (1998) 47 *ICLQ* 877 and Forsyth (n 68).

⁹¹ Carruthers (n 22) 229.

⁹² Cheshire, North and Fawcett (n 3) 1210.

⁹³ See Section 3(c).

experience gained as transactional lawyers in the aviation industry.

Taking the *lex situs* option, the rationale for deferring to the laws of the state where the asset is located is based on the premise that the courts of such state will have control over the asset and therefore should decide on the property effects of transactions involving the asset. While we object to this premise for aircraft objects,⁹⁸ if it is to be accepted, then it seems somewhat inconsistent to disregard the laws which the courts of the *situs* jurisdiction themselves would apply when deciding questions of property. But this is precisely what *Blue Sky* directs us to do.

As previously mentioned, since the *Blue Sky* decision, as aviation legal practitioners, we have frequently encountered problems when asking foreign legal counsel to opine on whether a mortgage or sale, expressed to be governed by English law, over an aircraft located in their jurisdiction, is valid as a matter of their (domestic) law. The answer is invariably that such mortgage or sale will be valid under such law, provided it is valid under English law. In many cases, this determination is supported by an assertion that the courts of the *situs* jurisdiction would apply English law to the question.

⁹⁸ See Section 6(e)(iii) above.

In fact, this was precisely the Dutch response in the case of the third aircraft in *Blue Sky*.

7. Conclusion

The *Blue Sky* litigation has highlighted the commercial impracticality of the *lex situs* rule (excluding *renvoi*) in the context of aircraft financing transactions and its continuing application has grave consequences for the UK aviation financing industry and for English law as one of the preferred governing laws for such transactions. The decision has been widely criticised as applying principles of law to aircraft mortgages and other property acts which are wholly inappropriate. These concerns have emphasised the need for an international security regime, such as the Convention which is designed to reduce the legal and commercial risks associated with cross-border aircraft financing.

Against this background, and apart from any general economic benefits which may be gained, there is a compelling and imperative case for UK ratification of the Convention. National implementation should include the supplementary legislation proposed in this article to deal with the residual *Blue Sky* issues which exact adoption of the Convention and Aircraft Protocol terms would not address. ■