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# The insolvency provisions of the Cape Town Convention and Protocols: historical and economic perspectives

Kristin van Zwieten\*

*The insolvency provisions of the Cape Town Convention and associated Protocols are considered integral to the achievement of the economic objectives of the Convention project. This article begins with the history of the insolvency provisions, tracing their evolution from a modest rule for the recognition of Convention interests in insolvency to a robust package of substantive rules on the effectiveness, priority, avoidance, and enforcement of Convention interests in insolvency proceedings. It then turns to consider the provisions in detail, illustrating their likely application with some hypothetical scenarios featuring airline and railroad debtors. The concluding section discusses the perceived significance of the insolvency provisions to the Convention project as a whole, and their predicted economic impact.*

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## 1. Introduction

Most commercial aircraft can be valued and manufacturers, lessors and lenders will, in many circumstances, base transactions on predictions of future values. The availability of the aircraft in case of default is the core of the problem. The asset cannot fully support the financing if the financier's right to the asset cannot be enforced in the jurisdiction where it happens to be at the time of default, if the rights of other creditors have priority in that jurisdiction, if repossession is held up by a bankruptcy moratorium or if significant delays in enforcement are a probability. Given the mobility of the asset this is something of a lottery. (McGairl, 1999)

This article is devoted to the insolvency provisions of the Convention on International Interests in Mobile Equipment (hereafter, the 'Convention') and the associated protocols for each of the three classes of equipment governed by the Convention: the 'Aircraft Protocol',<sup>1</sup> for

aircraft objects; the 'Luxembourg Protocol',<sup>2</sup> for railway rolling stock; the 'Space Protocol',<sup>3</sup> for space assets. To date, the Convention has come into force only in relation to aircraft objects, with the Luxembourg Protocol yet to come into force, and the text of the Space Protocol only recently finalised. In considering the likely operation and impact of the insolvency provisions of the Protocols, this article focuses almost exclusively on the Aircraft Protocol and Luxembourg Protocol, making only brief descriptive reference to the equivalent provisions of the Space Protocol.

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Jeffrey Wool for helpful comments on earlier drafts. All errors are mine.

<sup>1</sup> Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment (Cape Town, 2001), in force from 1 March 2006.

<sup>2</sup> Luxembourg Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Railway Rolling Stock (Luxembourg, 2007), not yet in force.

<sup>3</sup> Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Space Assets (Berlin, 2012), not yet in force.

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The article begins with the history of the insolvency provisions of the Convention and Protocols, tracing their evolution from a proposal for a modest rule on the recognition of Convention interests in insolvency to a robust package of rules on the effectiveness, priority, (to some extent) avoidance, and enforcement of Convention interests in insolvency proceedings. The article then turns to consider the operation of the insolvency provisions in more detail, illustrating their likely application with simple hypothetical scenarios involving airline and railroad debtors. The article concludes with a discussion of the perceived significance of the insolvency provisions to the Convention project as a whole, and their predicted economic impact.

## 2. The history of the insolvency provisions

### (a) *Humble beginnings*

The convention project was initially framed as one expected to have little impact on national insolvency regimes. The Canadian proposal that launched the UNIDROIT project recommended the establishment of a working group to consider the difficulties arising when a security interest in mobile equipment created under the laws of one state came into conflict with rights in the equipment created in another state, and the prospect of developing a convention to address those difficulties ‘without at the same time attempting to affect directly national bankruptcy laws and lien laws of the State parties to such a convention’.<sup>4</sup> The first report for the project, prepared by Professor Cuming, recommended a ‘hands-off’<sup>5</sup> approach to insolvency.

<sup>4</sup> See R Cuming, ‘International Regulation of Aspects of Security Interests in Mobile Equipment’ (hereafter, the ‘Cuming Report’), UNIDROIT Study LXXII, Doc 1, Rome, December 1989, 1–2.

<sup>5</sup> As later summarised in R Cuming, ‘Basic issues identified in response to the Questionnaire on an international regulation of aspects of security interests in mobile equipment’, UNIDROIT Study LXXII, Doc 4, Rome, February 1992, 9.

The Cuming Report proposed a convention that would include substantive rules on priority competitions between the holder of a security interest in mobile equipment and subsequent execution creditors or security interests, but leave the question of priority vis-à-vis any trustee in bankruptcy to existing conflict of law rules.<sup>6</sup> The convention could provide for the recognition of basic (seizure and sale) default remedies but would not regulate ‘procedural matters’ associated with their exercise,<sup>7</sup> leaving apparently undisturbed, for example, restrictions imposed on the exercise of default remedies by insolvency law. Additionally, security interests would remain vulnerable to avoidance (for example, as fraudulent or preferential transactions), or to the superior claims of preferential creditors, under the law of the insolvency forum.<sup>8</sup> In the survey that followed the Cuming Report, respondents expressed support for the inclusion of one substantive insolvency rule that would require security interests recognised as created under the proposed convention to be treated as security interests in insolvency proceedings. But they were otherwise reported to share the view that:

[W]hile bankruptcy law cannot be ignored, it is completely unrealistic to attempt to influence national bankruptcy law in any significant way through a Convention (or rules) dealing with the international recognition of security interests in mobile equipment.<sup>9</sup>

### (b) *Growing ambition: the joinder of the Aviation Working Group*

The ‘minimalist approach’<sup>10</sup> – to do no more than ensure the recognition of a conven-

<sup>6</sup> Cuming Report (n 4) Appendix A (‘Tentative Conclusions’), v.

<sup>7</sup> *Ibid* vi.

<sup>8</sup> *Ibid* 34–35.

<sup>9</sup> ‘Basic issues identified in response to the Questionnaire’ (n 5) 9–10.

<sup>10</sup> As described by Professor Cuming in ‘Basic issues identified in response to the Questionnaire’ (n 5) 10,

tion security interest as a security interest in insolvency proceedings – appears to have been a pragmatic response to the failure of previous European harmonisation initiatives in insolvency law.<sup>11</sup> Some stakeholders, however, perceived a tension between this approach and the underlying economic rationale for the convention project. The Cuming Report had been explicitly premised on an assumption (the validity of which was accepted by respondents to the subsequent survey)<sup>12</sup> that deficiencies in the legal framework that governed the treatment of security interests in moveables had adversely affected the availability of finance for high-value mobile equipment.<sup>13</sup> The working group initially appointed by UNIDROIT to explore the feasibility of the convention similarly explained the ‘utility’ of the convention project in these terms:

[T]he Working Group was satisfied that the absence of an international legal regimen governing security interests in mobile equipment created problems for sellers and lenders financing such equipment and

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and subsequently endorsed by the Study Group for the Preparation of Uniform Rules on Certain International Aspects of Security Interests in Mobile Equipment in their first ‘Summary Report’ (UNIDROIT Study LXXII, Doc 7, Rome, June 1993), [13]: ‘The Study Group was ... unanimous in its agreement that the Convention should in no way seek to displace national bankruptcy rules but should rather seek to ensure the survival of the international security interest in bankruptcy proceedings’.

<sup>11</sup> See Cuming Report (n 4) 33, and more recently Directorate-General for Internal Policies, *Harmonisation of Insolvency Law at EU Level* (European Parliament, Brussels, 2010).

<sup>12</sup> UNIDROIT Secretariat, ‘Analysis of the Replies to the Questionnaire on an International Regulation of Aspects of Security Interests in Mobile Equipment’, UNIDROIT Study LXXII, Doc 3, Rome, April 1991, Part I, [11]: ‘Many respondents considered the lack of an international system of law in this area a negative factor in decisions by lenders to sell on credit or take security interests in movables of a kind generally moved from one State to another and asserted that this resulted in higher credit charges.’

<sup>13</sup> Cuming Report (n 4) 4(iii), 39.

constituted a negative factor in the latter deciding whether to provide finance on the security of mobile equipment. In particular, it was noted that as a result *those who might otherwise have financed by way of conditional sale or loan were deterred from doing so*.<sup>14</sup>

Early in the convention drafting process, the aviation industry (as represented by the newly constituted Aviation Working Group, or ‘AWG’) questioned whether the capital cost reduction rationale would be adequately served by a convention that adopted a minimalist approach to insolvency. The AWG noted that the proposed convention would leave undisturbed those rules in national insolvency regimes that imposed procedural restrictions on the exercise of default remedies (eg mandatory stays that prohibited asset seizure or sale) and those ‘permitting attacks on security or the involuntary restructuring of debt, or granting priorities rights in respect of the secured/leased assets’, and argued that such rules had a ‘direct and significant impact’ on the availability of credit.<sup>15</sup> In other words, the convention would leave it to the law of the insolvency forum to determine questions of control and priority that might be expected to impact on the cost of secured credit,<sup>16</sup> thus imperilling the convention goal. The AWG suggested that more robust incursions into national insolvency

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<sup>14</sup> Restricted Exploratory Working Group to Examine the Feasibility of Drawing Up Uniform Rules on Certain International Aspects of Security Interests in Mobile Equipment, ‘Report’, UNIDROIT Study LXXII, Doc 5, Rome, March 1992, 2 (emphasis added).

<sup>15</sup> Airbus Industrie and the Boeing Company (for the AWG), ‘Memorandum’ (hereafter, ‘AWG Memorandum’), UNIDROIT Study LXXII, Doc 16, Rome, May 1995, 27 (citing credit rating agency evidence on the effect of amendments to §1110 of the US Bankruptcy Code, as to which see further below text to nn 32–33).

<sup>16</sup> For a review of the theoretical literature and empirical evidence on this question, see J Armour, ‘The Law and Economics Debate about Secured Lending: Lessons for European Lawmaking?’ (2008) 5 *European Company and Financial Law Review* (Special Volume: *The Future of Secured Lending in Europe*) 3.

regimes were required, if the goal of reducing the cost and enhancing the availability of asset-based finance was to be taken seriously.<sup>17</sup>

The AWG proposed the addition of a substantive insolvency rule to the draft convention. Adoption of the rule by contracting states would be optional.<sup>18</sup> Where adopted, the insolvency rule would perform two functions. The first function would be to regulate priority competitions between preferential creditors and the holder of a convention security interest. The rule would regulate priority competitions by adopting the position (favoured generally by the AWG) that a contracting state would have to register its categories of 'preferred national creditors' if it wished to ensure that such creditors would prevail over the holder of a prior registered convention security interest;<sup>19</sup> without registration by the contracting state, the security interest would not be vulnerable to such creditors (e.g. preferential creditors) in that state, including in insolvency.<sup>20</sup> This proposal was designed to increase certainty for financiers and lessors, enabling them to predict (and therefore price the risk of) a preferential debt carve-out.<sup>21</sup>

The second function of the AWG's proposed insolvency rule was to ensure a security interest holder's ability to seize the mobile equipment subject to security. The rule would provide that, where insolvency proceedings were commenced in a contracting state, the debtor would be given a limited time to either cure defaults under the finance/lease agreement or to return the equipment subject to the convention interest to the financier/lessor, after which time the exercise of default remedies would be permissible notwithstanding any restrictions on

enforcement that would otherwise be imposed by insolvency law.<sup>22</sup> This proposal borrowed from the US Bankruptcy Code, which affords some (secured) financiers and lessors of certain high-value mobile equipment, including some aircraft and railroad equipment, an escape from the automatic stay in a Chapter 11 reorganisation if defaults are not cured within a prescribed period.<sup>23</sup> The historical development of the US stay exceptions<sup>24</sup> has been explained by reference to a number of factors, including the perceived macro-economic significance of the targeted industries<sup>25</sup> and the high cost of the equipment (suggesting the need for

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<sup>22</sup> Ibid 10, [2.1], provided that the debtor/lessee agreed to this in the finance/lease contract ([2.2]); Annex 4-B.

<sup>23</sup> See 11 USC §1110 (for aircraft equipment and certain water carrier vessels), §1168 (rolling stock). Where applicable, the exceptions relieve the financier/lessor from making the case for lifting the stay in an 'adequate protection' hearing, avoiding the uncertainty of the adequate protection calculus: G Gerstell and K Hoff-Patrinis, 'Aviation Financing Problems Under Section 1110 of the Bankruptcy Code' (1987) 61 *Am Bankr LJ* 1, 4; see also K Gaunt, 'Caveat Lessor: US Aircraft Financiers Beware: 11 USC §1110 Expectations May Not Be Met in Cross-Border Insolvencies', (2009) 6 *International Law and Management Review* 43, 59–60.

<sup>24</sup> As to which, see generally Gerstell and Hoff-Patrinis, *ibid*, and G Ripple, 'Special Protection in the Air[Line Industry]: The Historical Development of Section 1110 of the Bankruptcy Code' (2002–03) 78 *Notre Dame L Rev* 281; L Goldman, M Album and M Ward, 'Repossessing the Spirit of St Louis: Expanding the Protection of Sections 1110 and 1168 of the Bankruptcy Code' (1985) 41 *Business Lawyer* 29.

<sup>25</sup> *ie* the transportation industries (at least for the Aircraft and Luxembourg Protocols). See J Kilborn, 'Thou Canst Not Fly High With Borrowed Wings: Airline Finance and Bankruptcy Code Section 1110' (1999–2000) 8 *Geo Mason L Rev* 41, 51; Goldman et al (n 24), 29–30; more generally A Saunders, A Srinivasan, I Walter and J Wool, 'The Economic Implications of International Secured Transactions Law Reform: A Case Study' (1999) 20(2) *U Pa J Int'l Econ L* 309, 313, 347.

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<sup>17</sup> AWG Memorandum (n 15) 27, and [2.3].

<sup>18</sup> 'Optional' in the sense that the provision would be available for take-up by a contracting state at the time of accession or ratification (by making a declaration to that effect). Where taken up, the provision would have the same force as any other provision of the convention.

<sup>19</sup> AWG Memorandum (n 15) section 7.

<sup>20</sup> *Ibid* section 10, [2.3].

<sup>21</sup> *Ibid* section 7, 'Rationale'.

external finance);<sup>26</sup> the particular susceptibility of the targeted industries to bankruptcy,<sup>27</sup> the mobility of the equipment and its depreciating nature,<sup>28</sup> including the risk of marked deterioration in its value where left unused<sup>29</sup> (suggesting that risks associated with the provision of external finance could deter financiers, absent a framework that ensures their ability to swiftly seize the equipment);<sup>30</sup> as well as the impact of organised lobbying efforts by affected industry groups.<sup>31</sup> Once enacted, some empirical evidence of the impact of these exceptions, including evidence of impact on the rating of bonds secured by assets falling within the scope of the exceptions,<sup>32</sup> bolstered the case for their

<sup>26</sup> Gaunt (n 23) 58; Gerstell and Hoff-Patrinou (n 23) 5; Ripple (n 24) 286. More generally, see Saunders et al (n 25) 312: '[T]he commercial air transport sector is an excellent example of an industry that, for technology-related reasons, is highly dependent on the availability and cost of external finance for its development and growth'.

<sup>27</sup> Gerstell and Hoff-Patrinou (n 23) 6; Ripple (n 24) 286.

<sup>28</sup> Saunders et al (n 25) 317; see also S Golbeck and V Linetsky, 'Asset Financing with Credit Risk', unpublished working paper 8 January 2012, available at <http://users.iems.northwestern.edu/~sgolbeck/assetfinancingjbf.pdf>, accessed 25 July 2012, on depreciation and on volatility in the secondary market for aircraft.

<sup>29</sup> Gerstell and Hoff-Patrinou (n 23) 5–6.

<sup>30</sup> See Gaunt (n 23) 77: 'Technologically advanced, expensive, rapidly depreciating and highly-mobile assets such as aircraft and aircraft engines have value as collateral largely to the degree that a financier can repossess them quickly and with minimal legal uncertainty upon debtor default, and then sell or re-lease the collateral'.

<sup>31</sup> E Posner, 'The Political Economy of the Bankruptcy Reform Act of 1978' (1997–98) 96 *Michigan L Rev* 47, 48 (noting the view that 1978 amendments to the §1110 exception reflected 'the influence of interest groups') and 59 (describing public choice theory on how interest groups influence legislative outcomes).

<sup>32</sup> See Kilborn (n 25) 63–64; Gaunt (n 23) 77–78; Saunders et al (n 25) 323, 333. See also the event study (on the impact of 1994 amendments to § 1110 on airline stock prices) noted in Saunders et al (n 25) 332, earlier reported in A Saunders and I Walter, 'Proposed UNIDROIT Convention on International Interests in Mobile Equipment, as applicable to aircraft equipment through the Aircraft Protocol: Economic Impact Assess-

retention. The AWG drew on this evidence to make the case for the inclusion of its robust insolvency provision in the draft convention.<sup>33</sup>

### 3. The outcome: the insolvency provisions of the Convention and Protocols

It was ultimately the more robust approach to insolvency that prevailed over the 'minimalist approach'<sup>34</sup> – to do no more than ensure the recognition of a convention interest in insolvency – envisaged in the early stages of the UNIDROIT project. The final text of the Convention includes the recognition rule endorsed by early drafters, but also has provisions on the priority of 'non-consensual rights and interests' (including preferential creditor claims), including in insolvency, and the operation of some avoidance rules. The AWG's most ambitious proposal, relating to the exercise of default remedies in insolvency, appears in the Protocol as an optional insolvency provision.<sup>35</sup> Its 'optional character' was a source of comfort for drafters, anxious to respect the perceived 'sensitivities of States' to interference with national insolvency law.<sup>36</sup> This provision is supported by a second (also optional) insolvency provision in the Protocols on cooperation between the courts of contracting states.<sup>37</sup>

The Convention and Protocols must be read together, as a 'single instrument' in relation to each category of mobile equipment or 'object' to which they apply (ie airframes, aircraft engines and helicopters; railway rolling

ment', September 1998, [www.awg.aero/assets/docs/EIA.pdf](http://www.awg.aero/assets/docs/EIA.pdf), accessed 25 July 2012.

<sup>33</sup> See n 15 above, and Study Group for the Preparation of Uniform Rules on International Interests in Mobile Equipment, 'Report', UNIDROIT 1996, Study LXXII – Doc 27, Rome, July 1996, [93].

<sup>34</sup> See text to n 10 above.

<sup>35</sup> Along with some softer alternatives (see below, text to n 67 and following).

<sup>36</sup> Study Group Report, July 1996 (n 33) [94]–[95].

<sup>37</sup> See below, text to n 120 and following.

stock; space assets).<sup>38</sup> They are examined separately here because the Convention insolvency provisions are mandatory ones, applicable except to the extent they are altered or added to through the take-up by a contracting state of the optional insolvency provisions of the Protocols.

(a) *The insolvency provisions of the Convention*

The basic insolvency rule of the Convention and Protocols is contained in Article 30 of the Convention. The article applies to ‘insolvency proceedings’, defined in Article 1(l) to mean:

[B]ankruptcy, liquidation or other collective judicial or administrative proceedings, including interim proceedings, in which the assets and affairs of the debtor are subject to control or supervision by a court for the purpose of reorganisation or liquidation.

As the Official Commentary explains, restructuring or workout arrangements effected informally, or by recourse to lender restructuring norms and/or contract (e.g. a contractually agreed standstill),<sup>39</sup> are excluded from this definition by its requirement of proceedings ‘subject to control or supervision by a court’.<sup>40</sup> The collectivity requirement is intended to exclude proceedings that are initiated for the enforcement of an individual creditor’s debt<sup>41</sup>

(eg proceedings for the court-sanctioned sale of company assets, or for the appointment of a receiver), affecting the general body of creditors only (if at all) as an incident of enforcement (eg by withdrawing an asset that would otherwise have remained with the debtor). Any doubts that may have otherwise arisen about the interpretation of this requirement seem likely to be answered by the additional requirement in Article 1(l) that proceedings be ‘for the purpose of reorganisation or liquidation’.<sup>42</sup> Two more fundamental points should also be made. First, Article 30 is silent on whether a court has jurisdiction to open such ‘insolvency proceedings’, and the territorial scope of such proceedings: this is left to the *lex concursus* (the law of the forum).<sup>43</sup> Secondly, Article 30 only applies where the Convention applies, which means that the ‘connecting factor’ that enlivens the Convention’s operation must be present if Article 30 is to be applied in insolvency proceedings in a contracting state. The ‘connecting factor’ under the Convention<sup>44</sup> is the location of the debtor at the time of the conclusion of the agreement that creates the interest in mobile equipment under the Convention – at that time, the debtor must be situated in a contracting state.<sup>45</sup>

Where applicable, Article 30 supplies the recognition rule initially requested by respondents to the survey to the Cuming Report. As

<sup>38</sup> Article 6(1) of the Convention. The Convention is applicable only with the accompanying Protocol for the relevant class of object (Article 49(1)), and in the event of any inconsistency between the two, the Protocol prevails (Article 6(2)). See R Goode, *Convention on international interests in mobile equipment and Protocol thereto on matters specific to aircraft equipment: Official Commentary* (hereafter, ‘Official Commentary’) (revised edn, UNIDROIT 2008) paras 2.9–2.11.

<sup>39</sup> See R Goode, *Principles of Corporate Insolvency Law* (4th edn, Sweet & Maxwell 2011) ch 12, ‘Restructurings’; J Armour and S Deakin, ‘Norms in Private Insolvency: The London Approach to the Resolution of Financial Distress’ (2001) 1 *Journal of Corporate Law Studies* 21.

<sup>40</sup> Official Commentary, Goode (n 38) para 4.18(2).

<sup>41</sup> Official Commentary, Goode (n 38) para 4.18(1):

‘[T]he proceeding is a collective proceeding, as opposed to an enforcement remedy primarily available to a particular creditor, such as receivership’.

<sup>42</sup> Thus avoiding the ambiguity in the definition of ‘insolvency proceedings’ in the European Insolvency Regulation (Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, Article 2(a), (b) and Article 1(1)).

<sup>43</sup> See Article 45, clarifying that the jurisdiction provisions in Chapter XII of the Convention do not apply to insolvency proceedings.

<sup>44</sup> An alternative ‘connecting factor’ is provided by the Aircraft Protocol: see Article IV.

<sup>45</sup> Article 3(1) of the Convention. Article 4 sets out how to determine where a debtor is situated (see further Example 1A immediately below).

### Example 1A

*Airline Co has always had its registered office in State A. State A is a contracting state under the Convention and has acceded to the Aircraft Protocol. Airline Co enters into an agreement for the lease of aircraft engines. A creditor's petition for the commencement of (court-controlled) liquidation proceedings is subsequently filed in State B, where Airline Co has assets and employees. State B is a contracting state under the Convention and has acceded to the Aircraft Protocol. State B is a member of the European Union.*

The liquidation proceedings are 'insolvency proceedings' within the meaning of Article 1(l). The question of whether liquidation proceedings can be opened for Airline Co in State B, and the territorial scope of those proceedings (ie whether they extend to assets situated outside State B) will be determined by reference to the law of State B together with the EC Regulation on Insolvency Proceedings (Council Regulation 1346/2000). If opened, the applicability of the Convention to the insolvency proceedings will turn on whether, at the time of entry into the lease agreement, Airline Co was situated in a contracting state under the Convention (Article 3(1)). Article 4(1) of the Convention provides that a debtor is situated in (*inter alia*) any contracting state where it has its registered office or statutory seat. Airline Co has its registered office in State A, a contracting state. Accordingly, Article 30 will be *prima facie* applicable.

noted above,<sup>46</sup> respondents indicated their preference for a rule that would ensure that a security interest recognised under the proposed convention would be recognised as a security interest in insolvency proceedings. This proposal is reflected in Article 30(1), which provides:

In insolvency proceedings against the debtor an international interest is effective if prior to the commencement of the insolvency proceedings that interest was registered in conformity with this Convention.

The 'international interest' is an interest, constituted in accordance with the Convention,<sup>47</sup> in the prescribed categories of mobile equipment and granted under a security agreement, title reservation agreement or lease.<sup>48</sup> Such interests will attract the operation of Article 30(1) only if they are registered under the Convention

registration regime. Article 30 neither provides for nor inhibits the recognition of an interest that is registrable but not registered under the Convention: the treatment of such an interest is simply left to the applicable law.<sup>49</sup>

Convention registration is, without more,<sup>50</sup> sufficient to render the international interest 'effective' in insolvency proceedings under Article 30(1). The Official Commentary suggests that 'effective' means 'proprietary in nature'<sup>51</sup> – that is, having some claim in or to the mobile equipment itself. Although the precise

<sup>46</sup> Text to n 9 above.

<sup>47</sup> ie in accordance with the formalities required by the Convention: Article 2(2) and Article 7.

<sup>48</sup> Article 1(o), Article 2 of the Convention.

<sup>49</sup> Article 30(2). It is in this sense that the rule in Article 30(1) is described in the Official Commentary, as a rule of validity, not invalidity (Official Commentary, Goode (n 38) para 4.209): the absence of registration under the Convention does not deprive an 'international interest' that would be recognised as effective under the applicable law of that recognition; it simply ensures the effectiveness of those international interests that *are* registered.

<sup>50</sup> ie whether or not it has also been registered or otherwise perfected in accordance with the requirements of the applicable law: Official Commentary, Goode (n 38) para 4.207.

<sup>51</sup> Official Commentary, Goode (n 38) para 4.209.

nature of the claim will vary (given that an 'international interest' may arise from a security, title retention or a lease agreement), the Official Commentary suggests that its proprietary character should at least ensure that it would 'in principle rank ahead of unsecured creditor claims'.<sup>52</sup> The Convention does, however, contemplate two ways in which the superiority of the registered international interest in insolvency proceedings can be compromised: first, by certain 'non-consensual rights or interests'; secondly by certain avoidance rules.

Article 39 governs priority competitions between the holder of a registered international interest and those who, under the law of a contracting state, have some 'non-consensual' right or interest (ie one not granted by the debtor) in the equipment the subject of the Convention interest. The rule applies in insolvency proceedings,<sup>53</sup> and therefore governs, *inter alia*, competitions between the holder of a registered international interest and creditors who have a preferential status under the insolvency law of the contracting state that affords them some right or interest in the mobile equipment in question. Article 39 gives effect to the AWG proposal that Convention interests be vulnerable to such non-consensual rights or interests only where the contracting state has publicly declared them to be so vulnerable. Article 39(1) permits a contracting state (by placing a declaration with the depository of the relevant Protocol)<sup>54</sup> to make registered international interests subject to the categories of 'non-consensual right or interest' that would have priority under its law over the domestic equivalent of the Convention interest (ie

those categories of non-consensual interest that ordinarily have priority over security, title reservation or lease interests under the law of the contracting state). Where such a declaration has been made, the declared categories of non-consensual right or interest have priority to the same extent<sup>55</sup> over the registered international interest. If such a declaration is not made,<sup>56</sup> the rights or interests do not enjoy such priority over the registered international interest, including in insolvency proceedings in the contracting state. As explained above, the rationale for the rule is to permit financing parties to 'assess and price'<sup>57</sup> the risk that a registered international interest will be vulnerable to non-consensual rights or claims in contracting states, although the extent to which financing parties are able to do so in the insolvency context will of course turn on their ability to predict which contracting states are likely to host insolvency proceedings for the debtor.<sup>58</sup>

The susceptibility of a registered international interest to avoidance under the insolvency law of a contracting state is governed by Article 30(3), which provides that nothing in Article 30 affects 'any rules of law applicable in insolvency proceedings relating to the avoidance of a transaction as a preference or a transfer in fraud of creditors'. The Official Commentary suggests that this provision is intended to do more than preserve the possibility of the avoidance of a registered international interest otherwise entitled to recognition in insolvency

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<sup>52</sup> *Ibid.* As the UNIDROIT Study Group acknowledged, the rule was 'predicated on the assumption that each State's insolvency law rules recognised the principle that parties other than the debtor might have proprietary interests in the assets involved and in general respected such proprietary interests, not therefore tending to confiscate them in the interests of the debtor's estate': Study Group Report, July 1996 (n 33) [91].

<sup>53</sup> Article 39(1)(a).

<sup>54</sup> Article 39(1).

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<sup>55</sup> That is to the extent that they would have priority over the domestic equivalent to the Convention interest, but no further: 'The Convention may not be used as a vehicle to expand such preferred rights' (Official Commentary, Goode (n 38) para 4.265).

<sup>56</sup> Ordinarily, prior to the debtor's entry into the agreement giving rise to the registered international interest (Article 39(3)), but note the exception in Article 39(4).

<sup>57</sup> Official Commentary, Goode (n 38) para 4.265; *ibid.*, text to n 21 above.

<sup>58</sup> Which is turn will be affected by the jurisdictional rules of contracting states on the opening of insolvency proceedings.

**Example 2A**

Assume the entry into force of the Luxembourg Protocol. Rail Co has its registered office in State A. State A is a contracting state under the Convention and has acceded to the Luxembourg Protocol. Rail Co agrees to purchase railway rolling stock under a conditional sale agreement with a manufacturer in State B. The manufacturer's interest is registrable under the Convention, and the manufacturer duly registers its interest in the International Registry for railway rolling stock, but not under any domestic registration regime. Under the law of both State A and State B, an interest under a conditional sale agreement must be perfected by registration. Reorganisation proceedings in relation to Rail Co are subsequently commenced in State A. Under the insolvency law of State A, the reorganisation proceedings encompass all assets of the company, wherever situated. At the time of the commencement of the proceedings, the railway rolling stock subject to the conditional sale agreement is located partly in State A and partly in State B. Under the law of State A, an automatic stay is imposed for one year from the commencement of reorganisation proceedings, precluding the repossession of property subject to a conditional sale agreement.

The manufacturer's interest in the rolling stock is a registered international interest under the Convention. State A is accordingly required by Article 30(1) to recognise the interest. It does not matter that under the law that would otherwise have been applied to determine the manufacturer's interest, registration under the domestic law of State A and/or State B would have been required to perfect the manufacturer's interest.

The recognition of the manufacturer's interest is subject to the application of certain avoidance rules under the insolvency law of State A (those enabling the setting aside of a transaction as a preference or a transfer in fraud of creditors). The manufacturer's registered interest may also be subject to the 'non-consensual rights or interests' that under State A's insolvency law would be recognised as having priority over an interest under a conditional sale agreement, but only if they were expressed to so apply in an Article 39 declaration by State A.

The automatic stay imposed by the insolvency law of State A will preclude the manufacturer from exercising its default enforcement remedies. (The insolvency administrator would likely attempt to resist any enforcement attempts made against Rail Co property situated elsewhere, including the rolling stock located in State B, by seeking the assistance of foreign courts). For formal relief from the stay, the manufacturer would need to look to the core insolvency provision of the Luxembourg Protocol, considered below.

proceedings: it is also intended to *exclude* the possibility of avoidance other than on the basis that the transaction was a 'preference or a transfer in fraud of creditors'.<sup>59</sup> So 'international interests' entitled to recognition under Article

30 (ie ones that are registered) are not, it seems, intended to be defeasible by the application of other types of avoidance rules.

A registered international interest that survives the application of any such avoidance rule is to be recognised as 'effective' in insolvency proceedings (Article 30), subject to the priority of any declared class of 'non-consensual right or interest' (Article 39). The recognition rule in Article 30 is concerned with the *substantive*

<sup>59</sup> Official Commentary, Goode (n 38) Illustration 27 and para 4.211; see also C Mooney, 'Insolvency Law as Credit Enhancement: Insolvency-related Provisions of the Cape Town Convention and the Aircraft Equipment Protocol' (2004) 13 *Int Insol Rev* 27, 36–37.

characterisation of a registered international interest – with the recognition of its ‘proprietary nature’. It is not concerned with the *procedure* that governs the exercise of default remedies against a debtor in insolvency proceedings,<sup>60</sup> leaving unaffected (for example) a stay that under the insolvency law of the contracting state operates to prohibit the enforcement of a right to seize the mobile equipment subject to a Convention interest from the debtor. (The more robust enforcement rule sought by the AWG – the rule that would require a debtor to cure defaults or to return the equipment within a prescribed period – appears in the Protocols as one of a range of insolvency rules available for take-up by contracting states, discussed in the next section).

*(b) The insolvency provisions of the Protocols*

The ‘highest priority’ for the AWG in the Convention drafting process was to ensure that contracting states would be offered rules that embraced the ‘fundamental principle’ that ‘in exchange for a reduced interest or rental rate, a secured party/lessor will have the ability upon default to *promptly* take possession of the subject equipment and, in the case of asset-based debt financing, to convert the equipment into proceeds’, including in insolvency.<sup>61</sup> Without this, the AWG argued, drafters could expect no more than a ‘marginal impact on credit, leasing and lending decisions’.<sup>62</sup> The drafters of the

Protocols responded by offering contracting states two insolvency provisions, the take-up of which is entirely optional. The first (core) provision relates directly to repossession of mobile equipment and the exercise of default remedies in insolvency in a contracting state; the second (supplementary) provision relates to the cooperation of the courts of other contracting states in the application of the core provision. Contracting states may choose to take up, by the making of a declaration, one or the other of the provisions, or neither.

The core insolvency provision of the Protocols (Article XI of the Aircraft Protocol, Article IX of the Luxembourg Protocol, and Article XXI of the Space Protocol) has been described as the ‘single most significant provision economically’<sup>63</sup> of the entire UNIDROIT project. Early drafts of the insolvency provision (as appeared in drafts of the Aircraft Protocol, which was finalised first and is the only Protocol currently in force) offered contracting states a single optional rule under which a debtor would be required to either cure all defaults or return the mobile equipment the subject of a Convention interest to the financier/lessor within a limited period of time (after which time default remedies would be exercisable).<sup>64</sup> After several states reported that the adoption of such an article would require ‘substantial modifications’ to their insolvency laws,<sup>65</sup> with some expressing concern about permitting the exercise of default remedies without the control or consent of the insolvency court or insolvency administrator,<sup>66</sup> it was resolved to

<sup>60</sup> This point is made expressly in Article 30(3) (b), which provides that nothing in Article 30 affects procedural rules relating to the ‘enforcement of rights to property which is under the control or supervision of the insolvency administrator’. (For the definition of insolvency administrator, see Article 1(k), incorporating among other things a ‘debtor in possession’ where permitted under the applicable insolvency law).

<sup>61</sup> ‘Revised Draft Articles of a Future Unidroit Convention on International Interests in Mobile Equipment: Comments by Aviation Working Group’, UNIDROIT Study LXXII, Doc 32 Add 2, Rome, January 1997, [2.1].

<sup>62</sup> *Ibid.*

<sup>63</sup> Official Commentary, Goode (n 38) para 5.54.

<sup>64</sup> See eg ‘Preliminary Draft Protocol on Matters Specific to Aircraft Equipment’, Article XII, in Steering and Revisions Committee, ‘Report’, UNIDROIT Study LXXII, Doc 41, Rome, September 1998.

<sup>65</sup> ‘Report: First Joint Session’, UNIDROIT CGE/Int Int /Report ICAO Ref LSC/ME-Report, Rome, 1–12 February 1999, [123].

<sup>66</sup> ‘Comments – submitted by the Government of Japan’, UNIDROIT Study LXXII, Doc 49, Rome, January 1999, [8]; see also ‘Report: Second Joint Session’, UNIDROIT CGE/Int Int/2-Report, 24 August–3 September 1999, Attachment E ‘Report

add an alternative to the 'hard' insolvency rule – a 'more flexible soft rule... which would allow judicial discretion under national insolvency laws'.<sup>67</sup>

The Aircraft and Space Protocols offer two formulations of the core insolvency provision ('Alternative A', the 'hard' rule, and the softer 'Alternative B'), to which the Luxembourg Protocol adds a third ('Alternative C', designed to offer a 'middle way' between Alternatives A and B).<sup>68</sup> Contracting states that take up the provision must decide which formulation to adopt, although they may apply one formulation to one kind of insolvency proceeding and another to a different kind of proceeding (e.g. reorganisation *v* liquidation proceedings).<sup>69</sup> To date, most contracting states to the Convention that have acceded to/ratified the Aircraft Protocol have made a declaration adopting Article XI (34 of 45 contracting states, or 75.55%, have done so).<sup>70</sup> Of these, all but Mexico adopted

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of the Insolvency Working Group', [2.2], describing the proposal of the French delegation ('The essential feature of this approach would be that it provided for judicial control and discretion in the realisation by an obligee of his security interest in an aircraft object'; Mooney (n 59) 38.

<sup>67</sup> 'Report: First Joint Session' (n 65) [123]; 'Report: Second Joint Session' (n 66) [5:61], following the recommendation of the 'Insolvency Working Group', afforded formal status during the First Joint Session, and made up of members from 12 states.

<sup>68</sup> Committee of governmental experts for the preparation of a draft protocol to the Convention on International Interests in Mobile Equipment on matters specific to railway rolling stock, 'Third Joint Session: Report', UNIDROIT Study LXXIII, Doc 13, Rome, June 2003, 12.

<sup>69</sup> They cannot, however, adopt a formulation only in part – so if Alternative A is declared applicable to liquidation proceedings in a contracting state, for example, it is applicable in its entirety: Article XXX(3) of the Aircraft Protocol (Luxembourg Protocol, Article XXVII(3); Space Protocol, Article XLI(4)); Official Commentary, Goode (n 38) para 5.56.

<sup>70</sup> States that have acceded to the Aircraft Protocol without making a declaration adopting Article XI include Albania, Belarus, Cameroon, Cuba, Ireland, Latvia, Malta, Kingdom of the Netherlands (Netherlands Antilles and Aruba), Saudi Arabia, and the USA

Alternative A (the 'hard' formulation) for all insolvency proceedings.<sup>71</sup> It should be noted however that the parties to an agreement giving rise to a Convention interest may choose to exclude the operation of the core insolvency provision where it would otherwise apply, or to vary its effects.<sup>72</sup>

Each Protocol states that the core insolvency provision is applicable 'only where a Contracting State that is the primary insolvency jurisdiction' has made a declaration adopting the provision (whether in its 'hard' form, or softer alternatives).<sup>73</sup> The qualification that the provision applies only where the state that is the *primary insolvency jurisdiction* has made a declaration warrants brief discussion. The phrase 'primary insolvency jurisdiction' is defined in Article I of each Protocol to mean:

[T]he Contracting State in which the centre of the debtor's main interests is situated, which for this purpose shall be deemed to be the place of the debtor's statutory seat or, if there is none, the place where the debtor is incorporated or formed, unless proved otherwise.<sup>74</sup>

This definition was inspired<sup>75</sup> by use of the 'centre of main interests' (or 'COMI') concept

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(but the USA has 11 USC §1110, see above n 23 and accompanying text).

<sup>71</sup> 'Declarations deposited under the Protocol to the Convention on International Interests in Mobile Equipment on Matters specific to Aircraft Equipment regarding Article XXX(3), at [www.unidroit.org/english/conventions/mobile-equipment/depositary-function/declarations/byarticle/articleXXX\(3\).htm](http://www.unidroit.org/english/conventions/mobile-equipment/depositary-function/declarations/byarticle/articleXXX(3).htm), accessed 25 July 2012. Mexico adopted Alternative B (as to which, see further below, text to n 103 and following).

<sup>72</sup> See Official Commentary, Goode (n 38) para 5.65, discussing Article IV(3) of the Aircraft Protocol (see also Article III of the Luxembourg Protocol; Article XVI of the Space Protocol).

<sup>73</sup> Aircraft Protocol Article XI(1); Luxembourg Protocol Article IX(1); Space Protocol Article XXI(1).

<sup>74</sup> Article I(2)(n) of the Aircraft Protocol; Article I(2), Luxembourg Protocol; Article I(2)(g), Space Protocol.

<sup>75</sup> 'Report of the Insolvency Working Group' (n 66) [2.6.3].

in the UNCITRAL Model Law on Cross-Border Insolvency,<sup>76</sup> which it then borrowed the concept from the EC Regulation on Insolvency Proceedings.<sup>77</sup> Like the Protocols, neither the EC Regulation nor the Model Law fully define COMI,<sup>78</sup> though both include a rebuttable presumption that the place of the debtor's registered office is the debtor's COMI.<sup>79</sup> The Protocol presumption is not identically worded, but 'statutory seat' is used in the Convention as the 'broad equivalent' of 'registered office',<sup>80</sup> and it has been suggested that the interpretation of COMI in the Protocols ought to be influenced by the case law on the interpretation of COMI in the EC Insolvency Regulation.<sup>81</sup>

<sup>76</sup> Which features the COMI test in its provisions on the recognition of foreign insolvency proceedings and the consequences of recognition: see UNCITRAL Model Law on Cross-Border Insolvency, Articles 17 and 20.

<sup>77</sup> Which features the COMI test as a jurisdictional hurdle for the opening of insolvency proceedings in Member States: see EC Regulation on Insolvency Proceedings, Council Regulation (EC) 1346/2000, Article 3.

<sup>78</sup> The European Commission is presently reconsidering the definition of COMI as part of its review of the Insolvency Regulation following the recommendation of the European Parliament that a fuller definition be added: 'Report of the European Parliament of 17 October 2011 with recommendations to the Commission on Insolvency Proceedings in the context of EU company law', at [www.europarl.europa.eu/sides/getDoc.do?type=REPORT&reference=A7-2011-0355&language=EN](http://www.europarl.europa.eu/sides/getDoc.do?type=REPORT&reference=A7-2011-0355&language=EN), accessed 25 July 2012, [2.2].

<sup>79</sup> See UNCITRAL Model Law, Article 16(3) ('In the absence of proof to the contrary, the debtor's registered office ... is presumed to be the centre of the debtor's main interests'); EC Regulation on Insolvency Proceedings, Article 3(1) ('In the case of a company or legal person, the place of the registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary').

<sup>80</sup> Official Commentary, Goode (n 38) para 4.58, discussing Article 4(1) of the Convention; see also 'Third Joint Session – Report', UNIDROIT CGE/Int. Int./3-Report, Rome, 20–21 March 2000, [281].

<sup>81</sup> 'In interpreting this aspect of Article XI, practitioners should take into account the leading jurisprudence under European law, particularly that of the European Court of Justice': Legal Advisory Panel of the Aviation Working Group, 'Practitioners' Guide to

Under the Protocols, the applicability of the core insolvency provision will turn initially on confirmation that the state where the debtor has its COMI has made the declaration adopting the provision (in whatever form).

The applicability of the core insolvency provision in a particular case is further premised on the occurrence of an 'insolvency-related event', which is primarily defined in the Protocols as the 'commencement of insolvency proceedings'.<sup>82</sup> Where insolvency proceedings are commenced in the COMI state that has made a declaration adopting the core insolvency provision, there will be a straightforward application of the provision to mobile equipment subject to a Convention interest in the insolvency proceedings. Where insolvency proceedings are commenced in a non-COMI contracting state, the position is somewhat more complicated. The Protocols elsewhere provide that 'the courts of Contracting States shall apply [the core insolvency provision] in conformity with the declaration made by the Contracting State which is the primary insolvency jurisdiction'.<sup>83</sup> The effect of this provision appears to be that a non-COMI contracting state that has also made a declaration adopting the core insolvency provision must apply the provision in the form adopted by the COMI state (so if the COMI state has adopted 'hard' Alternative A,

the Cape Town Convention and the Aircraft Protocol', 2011, at [www.awg.aero/assets/docs/Practitioner's%20Guide%20FINAL%20\\_4V\\_.pdf](http://www.awg.aero/assets/docs/Practitioner's%20Guide%20FINAL%20_4V_.pdf), accessed 25 July 2012.

<sup>82</sup> If the creditor's right to institute insolvency proceedings against the debtor or to exercise remedies under the Convention is prevented by law or State action, there will also be an 'insolvency-related event' if the debtor suspends or declares its intention to suspend payments: (Article I(2)(m)(ii) of the Aircraft Protocol; Article I(2)(c) of the Luxembourg Protocol; Article I(2)(d) of the Space Protocol). This alternative definition was designed to cater for state-controlled airlines that might not be subject to ordinary insolvency proceedings: 'Second Joint Session: Report' (n 66) [5:64]. For the definition of 'insolvency proceedings', see 'The insolvency provisions of the Convention', above.

<sup>83</sup> Aircraft Protocol Article XXX(4); Luxembourg Protocol, Article XXVII(4); Space Protocol, Article XLI, (5).

this must be applied in the insolvency proceedings in the non-COMI contracting state, even if that state's declaration adopted the softer Alternative B).<sup>84</sup> This provision would not however appear to have any effect in a non-COMI contracting state that has *not* made a declaration adopting the core insolvency provision. This interpretation follows from the substantive content of the provision, which imposes obligations on the 'insolvency administrator'<sup>85</sup> in the insolvency proceedings, and (in the case of the 'hard' Alternative A) provides that the exercise of default remedies by a Convention creditor cannot be prevented or delayed after a certain period of time.<sup>86</sup> If the provision were read as requiring only that the COMI state has made a declaration taking up the insolvency provision, and that insolvency proceedings have been commenced in any other contracting state, then the effect of the COMI state's declaration would be to impose obligations on the insolvency administrator and court of the other (non-COMI) state, although that state rejected take-up of the insolvency provision. The better view is that the COMI state's declaration has effect only in insolvency proceedings in that state and in other contracting states that have also made a declaration, with obligations imposed on other contracting states only where they have adopted the second (supplementary) insolvency provision of the Protocols, relating to cooperation with foreign insolvency courts and foreign insolvency administrators.<sup>87</sup> This point is exemplified by returning to Example 1A set out earlier in the paper, slightly modified, as shown in Example 1B on the next page.

<sup>84</sup> Official Commentary, Goode (n 38) para 5.120: 'So if there are secondary proceedings in another Contracting State relating to an aircraft object situated in that State the courts of that State must apply the version of Article XI selected by a declaration of the State of the primary insolvency jurisdiction.'

<sup>85</sup> See Article 1(k) of the Convention for the definition of insolvency administrator, which includes a debtor-in-possession where permitted by the applicable law: see above, n 60.

<sup>86</sup> See below, from text to n 88.

<sup>87</sup> See below, text to n 120.

Where applicable, the effect of the core insolvency provision of the Protocols in a particular case will depend on whether the provision is to be applied in its 'hard' form ('Alternative A') or softer forms. Under *Alternative A*, upon the occurrence of the insolvency-related event (again, most often the commencement of insolvency proceedings), the insolvency administrator<sup>88</sup> is given a prescribed 'waiting period' during which they must either (i) cure all defaults (and agree to perform all future obligations under the agreement giving rise to the Convention interest) or (ii) give possession<sup>89</sup> of the object to the 'creditor'.<sup>90</sup> To date, states adopting Alternative A have prescribed either a thirty-day or sixty-day waiting period.<sup>91</sup> Possession must be given by the earlier of the end of the waiting period and the date on which the creditor would otherwise be entitled to possession.<sup>92</sup> During the waiting period, the

<sup>88</sup> Or the debtor, 'as applicable': Aircraft Protocol, Article XI, 'Alternative A', (2) (Luxembourg Protocol, Article IX, 'Alternative A', (3); Space Protocol, Article XXI, 'Alternative A', (2)). This alternative appears designed to correspond with the alternative definition of 'insolvency-related event' in Article I (ie the declaration of intention to suspend payments or actual suspension, where a creditor cannot initiate insolvency proceedings) (see n 82 above). Where this is the relevant insolvency-related event, the obligations are imposed on the debtor directly.

<sup>89</sup> Or in the case of the Space Protocol, control: see Article XXI, 'Alternative A', (2).

<sup>90</sup> ie the holder of a Convention interest under a security, title reservation or lease agreement (see Article 1(i) of the Convention, and corresponding definitions of security, title reservation and leasing agreements). This definition does not require the interest to be registered, but it seems that if not registered the interest will have to be recognised as otherwise effective in the insolvency proceedings (ie because it is perfected in accordance with the requirements of the applicable law), as explained in the Official Commentary, Goode (n 38) para 5.61.

<sup>91</sup> Or, in the case of India, two calendar months: see 'Declarations deposited under the Protocol' (n 71).

<sup>92</sup> See Aircraft Protocol, Article XI, 'Alternative A', (2) (Luxembourg Protocol, Article IX, 'Alternative A', (3); Space Protocol, Article XXI, 'Alternative A', (2), subject to Article XXVI(2)).

**Example 1B**

*Airline Co has always had its registered office in State A. State A is a contracting state under the Convention and has acceded to the Aircraft Protocol. State A has made a declaration adopting Article XI of the Aircraft Protocol in Alternative A form for all insolvency proceedings. Airline Co enters into an agreement for the lease of aircraft engines. A creditor's petition for the commencement of (court-controlled) liquidation proceedings is subsequently filed in State B, where Airline Co has assets and employees. State B is also a contracting state under the Convention that has acceded to the Aircraft Protocol.*

The discussion of Example 1A confirmed that Article 30 of the Convention would be *prima facie* applicable in the insolvency proceedings in State B. The question of whether Article XI of the Aircraft Protocol has any application would appear to turn initially on whether a contracting state that is the 'primary insolvency jurisdiction' of Airline Co (that is, the place of Airline Co's COMI) has made a declaration taking up Article XI. Applying the COMI presumption in the Aircraft Protocol, the COMI of Airline Co would appear to be in State A, unless the presumption is rebutted. If State A is the place of Airline Co's COMI, then Article XI will apply on the commencement of insolvency proceedings (or another 'insolvency-related event') in State A because State A has made a declaration adopting Article XI. If State B has also made a declaration adopting Article XI of the Aircraft Protocol, then the declaration applies in the proceedings in State B, and in the form adopted by State A (ie 'Alternative A'). But if State B has not made a declaration adopting Article XI of the Aircraft Protocol, then the position of the liquidator or the insolvency court is not affected by State A's declaration, unless State B has made a declaration adopting the supplementary cooperation insolvency provision of the Aircraft Protocol (Article XII) (considered further below).

insolvency administrator<sup>93</sup> must preserve the object and 'maintain it and its value',<sup>94</sup> in accordance with the terms of the agreement,<sup>95</sup> and the entitlement of the creditor to apply under the applicable law for other interim relief is unaffected.<sup>96</sup> If the insolvency administrator cures all defaults during the waiting period but the debtor subsequently defaults again, no

second waiting period will apply.<sup>97</sup> After the expiration of the waiting period, no exercise of remedies permitted by the Convention or relevant Protocol can be further 'prevented or delayed'.<sup>98</sup> This would appear to require, at minimum, that the contracting state ensure the lifting of procedural restrictions that would be imposed by the applicable law on enforcement (eg a stay), otherwise preserved by Article 30 of the Convention.<sup>99</sup> If the insolvency administrator failed to either cure all defaults or give possession (despite the positive obligation to do

<sup>93</sup> Or debtor, 'as applicable', see n 88 above.

<sup>94</sup> Aircraft Protocol, Article XI, 'Alternative A', (5)(a) (Luxembourg Protocol, Article IX, 'Alternative A', (5)(a); Space Protocol, Article XXI, 'Alternative A', (6)(a). This does not mean the object cannot be used: Aircraft Protocol, Article XI, 'Alternative A', (6) (Luxembourg Protocol, Article IX, 'Alternative A', (6); Space Protocol, Article XXI, 'Alternative A', (7)).

<sup>95</sup> ie the security agreement, title reservation agreement or leasing agreement giving rise to the Convention interest (see Article 1(a) of the Convention).

<sup>96</sup> Aircraft Protocol, Article XI, 'Alternative A', (5)(b) (Luxembourg Protocol, Article IX, 'Alternative A', (5)(b); Space Protocol, Article XXI, 'Alternative A', (6)(b)).

<sup>97</sup> Aircraft Protocol, Article XI, 'Alternative A', (7) (Luxembourg Protocol, Article IX, 'Alternative A', (7); Space Protocol, Article XXI, 'Alternative A', (8)).

<sup>98</sup> Aircraft Protocol, Article XI, 'Alternative A', (9) (Luxembourg Protocol, Article IX, 'Alternative A', (9); Space Protocol, Article XXI, 'Alternative A', (9)).

<sup>99</sup> Aircraft Protocol, Article XI, 'Alternative A', (9) (Luxembourg Protocol, Article IX, 'Alternative A', (9); Space Protocol, Article XXI, 'Alternative A', (9)).

so), then the creditor would not be inhibited by any such restriction from exercising its default remedies.<sup>100</sup> This effect is illustrated by returning to Example 2A above, slightly modified, as shown in Example 2B on the next page.

The impact of non-consensual creditor claims on the operation of Alternative A is not entirely clear. Where a non-consensual creditor has an interest in Convention assets under the insolvency law of a contracting state,<sup>101</sup> then that state would likely require a Convention creditor seeking to exercise a default remedy that affects the non-consensual creditor's interest (eg a sale of the equipment) to involve or in some other way cooperate with the insolvency administrator to ensure the protection of the non-consensual interest.

Unlike Alternative A, under which the insolvency administrator's obligations are automatically triggered by the occurrence of the insolvency-related event (ie the commencement of proceedings),<sup>102</sup> the operation of *Alternative B* is predicated on the making of a 'request' by the creditor to the insolvency

administrator.<sup>103</sup> Additionally, it appears that a creditor is only entitled to make such a request under Alternative B if they are the holder of a *registered* Convention interest.<sup>104</sup> On receiving the request, the insolvency administrator is given a prescribed period (the duration of which is set by the contracting state when making the declaration) to give notice that it will either (i) cure all defaults (and agree to perform all future obligations under the agreement giving rise to the Convention interest) or (ii) give the creditor the opportunity to take possession<sup>105</sup> of the object 'in accordance with the applicable law'.<sup>106</sup> What is required to give an opportunity to take possession 'in accordance with the applicable law' will turn on the applicable law: if, for example, that law requires the approval of a court for the seizure or sale of the debtor's assets, then the creditor will need to overcome this hurdle in order to repossess the object. Indeed, the Official Commentary assumes that Alternative B will invariably involve some application by the creditor to a court,<sup>107</sup> and the provision itself provides that the applicable law may permit 'the court' to 'require the taking of any additional step or the provision of any additional guarantee'.<sup>108</sup>

<sup>100</sup> The view taken in the Official Commentary, Goode (n 38) para 4.212. The impact of this provision in contracting states that require judicial approval for the exercise of Convention/Protocol default remedies (as to which, see Article 54 of the Convention, and Official Commentary, Goode (n 38) para 4.325) is unclear. It might be argued that the core insolvency provision does not disturb the underlying character of a default remedy, with the result that any requirement of judicial approval for the exercise of a remedy (on the administrator's failure to return possession) would remain. But the obligation imposed by the core insolvency provision on a contracting state to ensure that the exercise of default remedies is not further prevented or delayed after the expiration of the waiting period would presumably require the state to ensure judicial approval is given and swiftly. An alternative interpretation would be that the obligation requires contracting states to remove the requirement to obtain judicial approval where the core insolvency provision applies and the waiting period has expired without defaults being cured or possession being given.

<sup>101</sup> To be recognised as effective against a Convention interest, the non-consensual interest must have been made the subject of a declaration by the contracting state under Article 39 (see above from text to n 53).

<sup>102</sup> See above from text to n 88.

<sup>103</sup> Or the debtor, as applicable (see n 88 above). See Aircraft Protocol, Article XI, 'Alternative B', (2) (Luxembourg Protocol, Article IX, 'Alternative B', (3)); Space Protocol, Article XXI, 'Alternative B', (2)); Official Commentary, Goode (n 38) para 5.62.

<sup>104</sup> Even if their interest, although unregistered, would otherwise be recognised as effective under the applicable law (cf the position under Alternative A, n 90 above). For the registration requirement, see Aircraft Protocol, Article XI, 'Alternative B', (4) (Luxembourg Protocol, Article IX, 'Alternative B', (5)); Space Protocol, Article XXI, 'Alternative B', (4)).

<sup>105</sup> Or, in the case of the Space Protocol, control and operation over the space asset: Article XXI, 'Alternative B', (2)(b).

<sup>106</sup> Aircraft Protocol, Article XI, 'Alternative B', (2)(b) (Luxembourg Protocol, Article IX, 'Alternative B', (3)(b)); Space Protocol, Article XXI, 'Alternative B', (2)(b)).

<sup>107</sup> (n 38) [5.63].

<sup>108</sup> Aircraft Protocol, Article XI, 'Alternative B', (3) (Luxembourg Protocol, Article IX, 'Alternative B', (4)); Space Protocol, Article XXI, 'Alternative B', (3)).

### Example 2B

*Assume the entry into force of the Luxembourg Protocol. Rail Co has its registered office in State A. State A is a contracting state under the Convention and has acceded to the Luxembourg Protocol. State A has made a declaration adopting Article IX of the Luxembourg Protocol in 'Alternative A' form for all insolvency proceedings. Rail Co agrees to purchase railway rolling stock under a conditional sale agreement with a manufacturer in State B. The manufacturer's interest is registrable under the Convention, and the manufacturer duly registers its interest in the International Registry for railway rolling stock. Reorganisation proceedings in relation to Rail Co are subsequently commenced in State A and an insolvency administrator appointed. Under the insolvency law of State A, the reorganisation proceedings encompass all assets of Rail Co, wherever situated. At the time of the commencement of the proceedings, the railway rolling stock subject to the conditional sale agreement is located partly in State A and partly in State B. Under the insolvency law of State A, an automatic stay is imposed for one year from the commencement of reorganisation proceedings, precluding the repossession of the rolling stock.*

The discussion of Example 2A confirmed that Article 30 of the Convention would require recognition of the manufacturer's registered Convention interest in the insolvency proceedings in State A. Applying the COMI presumption in the Luxembourg Protocol, State A will be presumed to be the 'primary insolvency jurisdiction' as it is the state in which Rail Co has its registered office. Assuming the presumption is not rebutted, Article IX of the Protocol will be applicable in the reorganisation proceedings in State A.

The effect of Article IX would be to require the insolvency administrator to either cure all defaults under the conditional sale agreement or return the rolling stock to the manufacturer within the waiting period (or the date on which the creditor would have otherwise been entitled to possession, whichever is earlier) prescribed by State A's declaration. The administrator's obligation to give back possession (if defaults are not cured) will extend to the rolling stock located in State B, since the insolvency proceedings encompass all assets wherever situated. But the administrator will presumably need to invoke the assistance of the courts of State B to do so, and his or her task will be made easier if State B has made a cooperation declaration under the Luxembourg Protocol (as to which, see further below). If defaults are not cured and possession is not given within the waiting period, the manufacturer may have recourse to the default remedies provided by the Convention and Protocol, and cannot be inhibited or delayed by the law of State A from doing so. This will require State A to ensure that the automatic stay (otherwise preserved by Article 30(3)) is displaced in these circumstances.

Alternative B does not contain an equivalent to the default remedies provision in Alternative A (that providing that the exercise of default remedies cannot be further delayed after the expiration of the waiting period).<sup>109</sup> Instead, it simply provides that if the administrator fails to give any notice in response to the creditor's

request, or gives notice that it will afford the creditor opportunity to take possession but fails to do so, the court 'may' permit the creditor to take possession of the equipment (subject to any conditions it imposes).<sup>110</sup> It has been suggested that the discretionary nature of this provision

<sup>109</sup> See text to n 98 above.

<sup>110</sup> Aircraft Protocol, Article XI, 'Alternative B', (5) (Luxembourg Protocol, Article IX, 'Alternative B', (6); Space Protocol, Article XXI, 'Alternative B', (5)).

means that it ‘establishes little more than a procedural structure under which a creditor may beg and plead for a court’s mercy’.<sup>111</sup>

*Alternative C* features only in the Luxembourg Protocol, and was designed as a ‘compromise’ between Alternatives A and B.<sup>112</sup> As in Alternative A, the obligation of the insolvency administrator<sup>113</sup> under Alternative C is triggered by the occurrence of an insolvency-related event (ie with no need for a request from the creditor).<sup>114</sup> As in Alternative B, Alternative C requires the administrator to either cure all defaults or provide the creditor with the ‘opportunity’ to take possession, ‘in accordance with the applicable law’, within a specified period (the ‘cure period’).<sup>115</sup> But the administrator can defer the obligation to give the creditor such opportunity by applying for an order ‘suspending’ the obligation for such time as the court orders (but no later than when the underlying agreement would have expired), provided that sums accruing to the creditor during the suspension period are paid,<sup>116</sup> and the rolling stock and its value are maintained.<sup>117</sup> After the expiration of the cure period or the further suspension period, where ordered, the exercise of the default remedies available to the creditor under the Convention and Proto-

col can no longer be prevented or delayed,<sup>118</sup> as in Alternative A. As noted above,<sup>119</sup> this provision appears to require the displacement (from the end of the cure or further suspension period) of procedural restrictions, such as a stay, that would otherwise bar the exercise of default remedies in insolvency. On this reading, the core difference between Alternative A and C appears to be the possibility of lengthy delays under the latter where a suspension order is made.

The core insolvency provision of the Protocols is buttressed by a second, supplementary provision on cooperation between contracting states. This provision (contained in Article XII of the Aircraft Protocol, Article X of the Luxembourg Protocol and Article XXII of the Space Protocol) is also an optional provision.<sup>120</sup> Where taken up, the effect of the supplementary insolvency provision is to impose an obligation on the courts of the contracting state (that is, the state that has adopted the cooperation provision) where assets subject to a Convention interest are situated to cooperate (in accordance with the law of that state) to the ‘maximum extent possible’ with foreign courts and foreign insolvency administrators who are carrying out, in a foreign contracting state, the core insolvency provision.<sup>121</sup> The effect can be illustrated by returning to Example 2B above. In that example, if State B had made a declaration under Article X of the Luxembourg

<sup>111</sup> Mooney (n 59) 38.

<sup>112</sup> Committee of governmental experts for the preparation of a draft protocol to the Convention on International Interests in Mobile Equipment on matters specific to railway rolling stock, ‘Second Joint Session: Report’, UNIDROIT Study LXXIII, Doc 7, Rome, August 2002, 12.

<sup>113</sup> Or the debtor, as applicable (n 88 above).

<sup>114</sup> Luxembourg Protocol, Article IX, ‘Alternative C’, (3).

<sup>115</sup> The duration of which is set by the contracting state when making the declaration adopting Alternative C: Article IX, ‘Alternative C’, (3), (15).

<sup>116</sup> Luxembourg Protocol, Article IX, ‘Alternative C’, (4).

<sup>117</sup> Luxembourg Protocol, Article IX, ‘Alternative C’, (6(a)). As under Alternative A, the entitlement of the creditor to apply under the applicable law for other (non-possessory) forms of interim relief is unaffected (6(b)).

<sup>118</sup> Luxembourg Protocol, Article IX, ‘Alternative C’, (10).

<sup>119</sup> Text to n 99 and following.

<sup>120</sup> Again, take-up occurs by declaration at the time of ratification/accession: see Aircraft Protocol, Article XXX(1); Luxembourg Protocol, Article XXVII(1); Space Protocol, Article XLI(2)(b).

<sup>121</sup> Aircraft Protocol, Article XII, (2); Luxembourg Protocol Article X(2); Space Protocol Article XXII(2) (but here the obligation is enlivened not only in a contracting state in which the space asset is situated, but also in any contracting state (that has adopted the cooperation provision) from which the space asset can be controlled, in which the debtor is located, in which the space asset is registered, which has issued a licence in relation to the space asset, or otherwise has a ‘close connection’ to the asset).

Protocol, the courts of State B would be obliged to cooperate to the maximum extent possible (in accordance with the law of State B) with the administrator in the reorganisation proceedings in State A, seeking to return possession of the rolling stock to the manufacturer.

*(c) The impact of the insolvency provisions*

The Convention project was expressly driven by a single instrumental goal: to positively impact on the cost and availability of finance for high-value mobile equipment.<sup>122</sup> Early drafters were satisfied that ‘the absence of an international legal regimen’ to govern security interests in mobile equipment had deterred the provision of such asset-based finance,<sup>123</sup> and that the creation of a convention to govern aspects of the validity and enforceability of security interests could accordingly have an ‘important, positive effect’ on the availability of this finance.<sup>124</sup> Over time, the question of the impact of the Convention on insolvency law – originally sidelined, with drafters promising to ‘in no way seek to displace national bankruptcy rules’<sup>125</sup> – came to be regarded as integral to the achievement of this objective. In this way, a convention that was initially expected to do no more than ensure the recognition of a Convention interest in insolvency proceedings evolved into one that offered, though a combination of mandatory and optional provisions, a package of substantive rules on the effectiveness, priority, (to some extent) avoidance, and enforcement of Convention interests in insolvency proceedings.

The first economic impact assessment (‘EIA’) of the Convention and Aircraft Protocol appeared in 1998, during the final stages of the drafting of the Convention,<sup>126</sup> and the second

in 2009 (three years after the Convention and Aircraft Protocol came into force).<sup>127</sup> The 1998 EIA identified three ‘key principles’ of asset-based financing – that a financier be assured (a) of the superiority of its interest in the financed/leased asset, (b) of its ability to promptly realise or redeploy the asset on default, and (c) that these rights would not be ‘qualified or modified in the context of bankruptcy’<sup>128</sup> – and concluded that all three were embodied in the draft Convention and Aircraft Protocol. Assuming ‘effective implementation’,<sup>129</sup> it predicted that the Convention and Aircraft Protocol would increase the availability of external finance where it would otherwise not have been available (because a financier or lessor would consider the risk too great,<sup>130</sup> given the challenges associated with the recognition or enforcement of property interests in a particular jurisdiction),<sup>131</sup> and reduce its cost where available, including by facilitating securitised financing (reasoning by analogy from evidence of the emergence of asset-backed bond products in US airline finance).<sup>132</sup> The 1998 EIA also identified a number of other potential economic benefits of the Convention and Aircraft Protocol, including a reduced need for sovereign guarantees of airline debt (flowing from the increased availability of external finance),<sup>133</sup> potentially leading to reduced levels of sover-

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impact assessment was commissioned by the AWG, the International Air Transport Association, and the International Civil Aviation Organisation.

<sup>127</sup> V Linetsky, ‘Economic Benefits of the Cape Town Treaty’, October 2009, available at [www.awg.aero/assets/docs/economicbenefitsofCapeTown.pdf](http://www.awg.aero/assets/docs/economicbenefitsofCapeTown.pdf), accessed 25 July 2012. The assessment was commissioned by the AWG.

<sup>128</sup> Saunders and Walter (n 32) 5–6.

<sup>129</sup> *Ibid* iv.

<sup>130</sup> ie too great to be priced in: *ibid* 6 noting limits to the extent to which interest rates can be raised (‘excessive rates can induce progressively higher risk-taking incentives by the borrower’).

<sup>131</sup> *Ibid* [2.1], [4.2], [4.6]–[4.7].

<sup>132</sup> *Ibid* [2.2]–[2.4], [3.1.3], [4.4] and below, text to n 139.

<sup>133</sup> *Ibid* [4.2].

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<sup>122</sup> See text to n 12 above and following, and Mooney (n 59) 28, 30.

<sup>123</sup> Text to n 14 above.

<sup>124</sup> ‘Basic issues identified in response to the Questionnaire’ (n 5) 2.

<sup>125</sup> See n 10 above.

<sup>126</sup> Saunders and Walter (n 32). The economic

eign debt,<sup>134</sup> and the possibility of discounts in the cost of export credit finance (flowing from the decreased risk for financiers).<sup>135</sup> The EIA predicted that the financing cost benefits, and related potential reductions in sovereign debt levels, would be most pronounced in emerging markets ‘whose systems do not currently reflect the asset-based financing principles’,<sup>136</sup> although the EIA identified other benefits that it predicted would be likely to be more pronounced for developed markets.<sup>137</sup>

The 1998 EIA emphasised the importance of the insolvency provisions of the Convention and Aircraft Protocol – ‘the treatment of a financier or lessor in the context of bankruptcy or insolvency proceedings... is the *litmus test of an asset-based financing*’<sup>138</sup> – and particularly the importance of the Protocol’s optional core insolvency provision. It was the core insolvency provision that formed the basis of the hypothesis that the Convention and Aircraft Protocol could promote the availability of asset-backed bond finance for airlines. This hypothesis was developed by analogy with the US case,<sup>139</sup> the EIA suggesting that the development of the exceptions to the automatic stay in Chapter 11 of the US Bankruptcy Code for aircraft and railroad assets (on which the core insolvency provision of the Protocols were modelled),<sup>140</sup> were integral to the availability<sup>141</sup> of bonds secured by those assets, and their (enhanced)

rating.<sup>142</sup> The posited relationship between the core insolvency provision and the availability of asset-backed bond finance was elsewhere summarised in this way:

The objective is to be able to create more rated transactions so as to attract insurance companies, investment funds and other non-specialist sources of finance. For this to be achieved, the procedure and timing for dealing with the period between a default and remarketing of the aircraft must be predicted with certainty. An investor with no specialist knowledge of the application of conflict of laws rules to foreign security interests or the particularities of bankruptcy proceedings across the world may nevertheless be happy to buy an asset based bond where these risks are condensed into an easily quantifiable proposition that the maximum period for which an aircraft will be unavailable between default and remarketing is a number of days established by international law.<sup>143</sup>

More generally, the impact of the insolvency provision on the availability of ordinary secured loans was considered in the 2009 EIA, which used a mathematical model<sup>144</sup> to explore the impact of the take-up of the insolvency provision on lender risk and financing costs for a hypothetical aircraft mortgage loan,<sup>145</sup> predicting that reduced repossession delays would

<sup>134</sup> Ibid [6.5].

<sup>135</sup> Ibid [4.3]. See further below, from text to n 148.

<sup>136</sup> Ibid (iv), see also [4.2], [6.5].

<sup>137</sup> Ibid (iv) (‘fleet-planning benefits’, and export and employment benefits).

<sup>138</sup> Ibid [3.1.3].

<sup>139</sup> Ibid [3.1.3].

<sup>140</sup> Text to n 23 above.

<sup>141</sup> ‘Importantly, many US-originated airline securitization packages are rated, and become marketable, by virtue of the fact that investors are protected by Section 1110 of the US Bankruptcy Code. Specifically, should an airline enter into Chapter 11 bankruptcy, the bondholders ... may repossess the collateral ... in the event the debtor does not resume payments’: Saunders and Walter (n 32) [2.3].

<sup>142</sup> Saunders and Walter (n 32) [2.4], reporting that credit rating agencies gave a rating enhancement (ie above the debtor’s corporate rating) of up to two notches on debt issues backed by securities falling within the scope of the stay exceptions; [4.4], anticipating even more dramatic effects for then ‘unrated or non-investment grade airlines and countries’, [4.8].

<sup>143</sup> S McGairl, ‘The Proposed UNIDROIT Convention: International Law for Asset Finance (Aircraft)’ (1999) 4 *Unif L Rev* 439, 449 (see also, 454–55).

<sup>144</sup> The ‘Dynamic Asset Financing Model’, developed by the author of the 2009 EIA (n 127).

<sup>145</sup> Of 12 years’ duration and ordinary terms: (n 127) 4.

have a 'significant' impact on both<sup>146</sup> (again, assuming 'effective implementation').<sup>147</sup>

The Convention only came into force in relation to aircraft equipment in 2006, and the evidence of its initial impact is unsurprisingly limited. There is evidence of the influence of the Convention and Aircraft Protocol on export credit finance, with the OECD Aircraft Sector Undertaking or 'ASU'<sup>148</sup> (a soft law arrangement<sup>149</sup> on the use of export credits for aircraft sales or leases) permitting a 'Cape Town discount' of up to 10% on the minimum premium rates required to be charged for officially supported export credits under the ASU.<sup>150</sup> The discount is available to operators of aircraft objects<sup>151</sup> in contracting states to the Convention, provided the state is listed on the 'Cape Town List'. To be listed, a state must not only be a contracting state to the Convention, but also have made certain 'qualifying declarations', including a declaration applying the core

insolvency provision of the Aircraft Protocol in its Alternative A ('hard') form to all insolvency proceedings (with a waiting period of no more than 60 calendar days),<sup>152</sup> and have implemented the Convention 'in its laws and regulations... in such a way that the Cape Town Convention commitments are appropriately translated into national law'.<sup>153</sup> Fifteen states are currently on the list,<sup>154</sup> including several African states that are presently classified by the UN as 'least developed countries'.<sup>155</sup> Non-listed states also benefited from an earlier policy of the Export-Import Bank of the United States (the official export credit agency of the US), which offered a one third discount in exposure fee on financings of US manufactured commercial aircraft for purchasers in countries that 'sign, ratify and implement' the Convention and Protocol<sup>156</sup> (India was among these beneficiaries).<sup>157</sup>

<sup>146</sup> As to lender risk, see (n 127) 10–11, predicting reduced repossession delay would have a significant impact on LGD (loss given default); as to cost to the borrower, see 13–16, predicting reductions in risk spreads and correspondingly upfront fees. See further V Linetsky, 'Accession to the Cape Town Convention by the UK: An Economic Impact Assessment Study', December 2010, available at [www.awg.aero/assets/docs/UKCTC%20Econ%20Impact%20Final%20Version.pdf](http://www.awg.aero/assets/docs/UKCTC%20Econ%20Impact%20Final%20Version.pdf), accessed 25 July 2012, 10–12.

<sup>147</sup> Linetsky (n 127) 4. See further below, text to n 169 and following.

<sup>148</sup> Group on the Sector Understanding for Civil Aircraft, 'Sector Understanding on Export Credits for Civil Aircraft', TAD/ASU(2011)1, available at [www.oecd.org/officialdocuments/displaydocumentpdf?cote=tad/asu\(2011\)1&doclanguage=en](http://www.oecd.org/officialdocuments/displaydocumentpdf?cote=tad/asu(2011)1&doclanguage=en), accessed 25 July 2012.

<sup>149</sup> Between OECD member participants and Brazil, subject to a 'home country rule', as to which see B Bjelic, 'Financing Airlines in the Wake of the Financial Markets Crisis' (2012) 21 *Journal of Air Transport Management* 10, 13.

<sup>150</sup> 'Sector Understanding' (n 148) Appendix II, Section 2(II).

<sup>151</sup> In relation to asset-backed transactions regarding aircraft objects within the scope of the Aircraft Protocol, provided the object is registered on the International Registry, 'Sector Understanding' (n 148) Appendix II, [35].

<sup>152</sup> 'Sector Understanding' (n 148) Appendix II, [37] and Annex I, [2](a).

<sup>153</sup> 'Sector Understanding' (n 148) Appendix II, [37].

<sup>154</sup> See 'Aircraft Sector Understanding: Cape Town Convention (CTC) Contracting Parties Qualifying for a CTC Discount', available at [www.oecd.org/document/t/57/0,3746,en\\_2649\\_34169\\_41823481\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/t/57/0,3746,en_2649_34169_41823481_1_1_1_1,00.html), accessed 25 July 2012.

<sup>155</sup> Ethiopia, Senegal, Angola and Rwanda, all of which feature on the Cape Town List.

<sup>156</sup> 'Ex-Im Bank Offers One-Third Reduction of its Exposure Fee on Export Financing for US Large Commercial Aircraft', 31 January 2003, available at [www.exim.gov/pressrelease\\_print.cfm/6F76B4BA-1032-5B0F-BDC2F28463DF4239/](http://www.exim.gov/pressrelease_print.cfm/6F76B4BA-1032-5B0F-BDC2F28463DF4239/), accessed 25 July 2012. The discount was overtaken by the 2007 ASU except in relation to grandfathered transactions: 'Report to the US Congress on Export Credit Competition and the Export-Import Bank of the United States for the period January 1, 2010 through December 31, 2010' (June 2011), at [www.exim.gov/about/reports/compet/documents/2010\\_Competitiveness\\_Report.pdf](http://www.exim.gov/about/reports/compet/documents/2010_Competitiveness_Report.pdf), accessed 25 July 2012, 33.

<sup>157</sup> 'Em-Im Bank Extends \$548.6 Million in Loan Guarantees to Support Boeing Aircraft Exports to India', 19 September 2008 at [www.exim.gov/pressrelease\\_print.cfm/7B830884-0F76-F06E-DCE9E37C5AA57F25/](http://www.exim.gov/pressrelease_print.cfm/7B830884-0F76-F06E-DCE9E37C5AA57F25/), accessed 25 July 2012, reporting that Air India 'saved over \$5 million on financing costs on this one transaction' by virtue of the implementation of the Convention and Protocol.

There is also some preliminary evidence of influence on the rating of debt securities supported by aircraft equipment collateral. The methodology used by rating agencies for the rating of equipment trust certificates ('ETCs') and enhanced equipment trust certificates ('EETCs') (US-developed debt products for the financing of railroad and airline equipment)<sup>158</sup> now includes analysis of the impact of the Convention on the rating of such products where issued outside the US. The Fitch rating methodology for EETCs in aircraft finance,<sup>159</sup> for example, focuses primarily on US-issued certificates and the impact of §1110 of the US Bankruptcy Code<sup>160</sup> on their rating, but concludes with a brief analysis of the rating of foreign issues. It suggests that non-US issues would be evaluated 'on a case-by-case basis, focusing in particular on the relative strength of the legal framework in the country of issue', but that the US-issue rating methodology could be applied where the issue country has 'an insolvency regime similar to Section 1110 which allows creditors to repossess aircraft in a timely fashion':

Fitch's EETC rating approach rests largely on creditors' ability to quickly repossess aircraft, and the influence this has on airlines' incentive to affirm aircraft in bankruptcy, so in the absence of this ability Fitch will adjust its methodology on a case-by-case basis.<sup>161</sup>

It concludes that the Convention could supply

such a legal framework (if adopted in the appropriate form,<sup>162</sup> i.e. by take-up of Alternative A, the equivalent to Section 1110), but only if properly implemented:

While similar to Section 1110, several issues relating to the Cape Town Treaty need to be resolved before Fitch will have comfort applying its full EETC methodology to transactions relying on the treaty. The main issue is that the Cape Town Treaty has not been sufficiently tested in court.<sup>163</sup>

The Moody's rating methodology for ETCs and EETCs in aircraft and railroad finance allows for a rating uplift of up to two notches where the home country of the debtor is a contracting state to the Convention and relevant Protocol,<sup>164</sup> but similarly cautions:

All but one [of the contracting states] have made declarations that are at least as enhancing to creditor rights as comparable provisions within Section 1110. However, for some contracting states to the Convention, the case law establishing precedent for the treatment of mobile equipment financings in reorganization is thin. Thus for financings subject to the Convention, we will subjectively consider whether to shade the two-notch uplift presently provided to financings subject to Section 1110 of Section 1168 [the railroad rolling stock provision] in the United States.<sup>165</sup>

In its recent rating of a \$587.5 million two-tranche equipment trust certificate issue to support the leasing of new aircraft by Emirates,<sup>166</sup> Moody's was influenced by the

<sup>158</sup> See Moody's Investors Service, 'Rating Methodology for Enhanced Equipment Trust and Equipment Trust Certificates', 28 December 2010, 2–3. The EETC evolved from the ETC, in which investors hold certificates in a trust that purchases equipment and leases it to the airline (or railroad, for which the ETC was originally developed: see D Billyou, 'Federal Railroad Equipment Legislation' (1951) 64(4) *Harvard Law Review* 608); the EETC offers certificates in tranches, 'each of which has a different risk/reward profile in terms of security and access to lease rental cash flows': P Morrell, *Airline Finance* (Ashgate 2007) 212.

<sup>159</sup> FitchRatings, 'Rating Aircraft Enhanced Equipment Trust Certificates', 15 September 2011.

<sup>160</sup> See above, text to n 23.

<sup>161</sup> FitchRatings (n 159) 19.

<sup>162</sup> *Ibid.*

<sup>163</sup> *Ibid.*

<sup>164</sup> Moody's Investors Service (n 158) Exhibit 1.

<sup>165</sup> *Ibid.*, Appendix F.

<sup>166</sup> See 'Moody's assigns A3 rating to A-tranche of Doric Nimrod Air Finance Alpha's 2012-1 EETC \$587.5 million of new pass-through certificates rated', Moody's Investor Service, 21 June 2012 at [www.moodys.com/research/Moodys-assigns-A3-rating-to-A-tranche-of-Doric-Nimrod-PR\\_248921](http://www.moodys.com/research/Moodys-assigns-A3-rating-to-A-tranche-of-Doric-Nimrod-PR_248921), accessed 30 July 2012.

applicability of the Convention and Aircraft Protocol in the form adopted by the United Arab Emirates (including the applicability of the core insolvency provision of the Protocol in Alternative A form, as adopted by the UAE),<sup>167</sup> and by its expectation of effective implementation of the Convention and Protocol:

The UAE adopted Cape Town in a manner that is intended to be favorable to creditors... [noting the adoption of Alternative A, *inter alia*]. However, there appears to be no record of enforcement of Cape Town in the UAE, leaving no case history from which to infer future outcomes if an enforcement of Cape Town was to be pursued for this transaction. Nevertheless, Moody's observes that Dubai law seems to support the rights of property owners, which implies that, under an event of default by Emirates, ... [the] owner of the aircraft, should be able to recover its aircraft. Moody's considers these factors in its ratings assignment.<sup>168</sup>

The theme that underpins all of the available material on the potential economic impact of the Convention project is 'implementation'. The predictions made in the economic impact assessments of 1998 and 2009 were explicitly premised on 'effective implementation';<sup>169</sup> the discount under the OECD Aircraft Sector Understanding for export credit finance depends on membership of the 'Cape Town

List', which turns on evidence of 'appropriate' implementation;<sup>170</sup> the transplant of the rating methodology used for US debt issues to foreign issues will turn on evidence or expectation of the satisfactory implementation of the insolvency provisions of the Convention and Protocols, as a substitute for provisions of the US Bankruptcy Code, by foreign courts.<sup>171</sup> The 1998 EIA predicted that the financing cost benefits of the Convention and Protocol would, assuming effective implementation, be most pronounced in those emerging markets 'whose systems do not currently reflect the asset-based financing principles',<sup>172</sup> ie in those markets that would otherwise not offer financiers assurance of the superiority of their interest in the asset and their ability to promptly realise it on default, including in insolvency. One of the questions raised by this hypothesis is whether and to what extent a jurisdiction that does not otherwise endorse these principles will be able to ensure their 'effective implementation' for discrete classes of Convention protected assets, within its existing institutional framework.

There appears to be some risk that the courts of a contracting state could initially resist giving full effect to the Convention or Protocols, although there does not yet appear to be any evidence of this in relation to the insolvency provisions specifically.<sup>173</sup> If and

<sup>167</sup> See 'Declarations lodged by the United Arab Emirates under the Aircraft Protocol at the time of deposit of its instrument of accession in respect thereof', at [www.unidroit.org/english/conventions/mobile-equipment/depositaryfunction/declarations/bycountry/unitedarabemirates.htm](http://www.unidroit.org/english/conventions/mobile-equipment/depositaryfunction/declarations/bycountry/unitedarabemirates.htm), accessed 30 July 2012.

<sup>168</sup> 'Moody's assigns A3 rating' (n 166) (emphasis added), also influenced by the Government of Dubai's previous approach to the restructuring of Dubai World, and some other features of the EETC structure, including cross-default provisions and the presence of an additional liquidity facility ('an additional six months of coverage of the liquidity facilities relative to that of EETCS issued by US carriers should mitigate potential increases in default risk in the event of delay in the enforcement of Cape Town as adopted by the UAE').

<sup>169</sup> See text to nn 129 and 147 above.

<sup>170</sup> See text to n 153.

<sup>171</sup> See text to nn 163 and 165 above.

<sup>172</sup> See above text to n 136; see also R Castillo-Triana, 'The Relevance of the Luxembourg Protocol for Central and South America' (2007) XII *Unif L Review* 461, 461: '[T]he regulation of international interests has profound relevance when it comes to stimulating the flow of capital worldwide for the benefit, in particular, of emerging markets where the legal status of security interests is not well developed'.

<sup>173</sup> There is, however, a report of some resistance by Nigerian courts to the exercise of repossession rights by aircraft lessors more generally: see NCAA Appeals to Judges on Injunctions against Airline Operators', 20 April 2012, at <http://dailyindependentnig.com/2012/04/ncaa-appeals-to-judges-on-injunctions-against-airline-operators/>, accessed 25 July 2012, noting reports of courts restraining repossession by injunction, contrary to the Convention; see also D Gray and A Marasco,

when it eventuates, this kind of implementation challenge could presumably be managed by internal capacity building efforts (eg judicial training) and the exertion of external pressure (eg robust monitoring of compliance;<sup>174</sup> the risk of de-listing under the ASU discount scheme).<sup>175</sup> More difficult perhaps may be implementation challenges that are attributed to resource constraints or other generalised weaknesses in a contracting state's institutional framework. Even in its 'hardest' form, the core insolvency provision of the Protocols may require an application to an insolvency court for approval of the exercise of a default remedy,<sup>176</sup> or for orders to protect the position of non-consensual creditors who have an interest in Convention assets<sup>177</sup> (which may also require the involvement and cooperation of the insolvency administrator, who in some states may be a government employee).<sup>178</sup> The extent to which such applications can be successfully insulated, for example, from a generalised problem of delay in courts or in the offices of

state-employed insolvency administrators is unclear. Of course, this kind of implementation challenge is not necessarily insurmountable. But it does seem that the path to Convention implementation in some emerging markets may be, at least initially, somewhat unpredictable.

For contracting states that already broadly adhere to the 'asset based financing principles' discussed above, there appears to be considerably less risk of ineffective implementation. But effective implementation may raise other questions about the position of Convention creditors compared with that of other secured creditors, title financiers or lessors in insolvency, and the relationship between the Convention and Protocol insolvency principles and the broader principles that underpin the insolvency law of a contracting state. Adopted in their strongest form, the Convention and Protocols offer a Convention creditor an opportunity<sup>179</sup> to escape a stay that might otherwise be imposed by a contracting state's insolvency law to prevent the exercise of default remedies. This will be so even where the imposition of a stay in that state reflects a prior judgment that creditors as a whole would likely do better under a stay than if the debtor's assets were immediately freed up for sale on a break-up basis. An observer might ask why the Convention insolvency privileges are necessary even in contracting states that are selective in entering debtors into reorganisation proceedings, and already offer secured creditors various forms of protection against harm (including the possibility of a judge-ordered escape from the stay) incurred during the proceedings.

One route to responding to this question might be to situate the Convention against the broader theoretical literature on the purpose of insolvency law in a market economy. It has

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'The Cape Town Convention: Where Is Canada' (2011) 24(2) *Air and Space Lawyer* 1, 20.

<sup>174</sup> The AWG is establishing a framework for ongoing monitoring of Convention and Aircraft Protocol case law.

<sup>175</sup> See text to n 153 above.

<sup>176</sup> ie where self-help is not available in law or in practice: see above n 100, and by way of example KN Kabraji and S Mumtaz, 'Pakistan', in *Aircraft Repossession and Enforcement: Practical Aspects*, vol 1, Kluwer Law International, The Netherlands, 2009, predicting that in practice self-help remedies (including those provided by the Convention) would be unlikely to be able to be exercised without judicial involvement in Pakistan (661).

<sup>177</sup> See above, text to n 101.

<sup>178</sup> As in India, for example, where the 'official liquidator' in compulsory liquidations is presently a government official permanently attached to each High Court (see Companies Act 1956, s 448, the reform of which is anticipated). Official liquidators suffer from resource constraints (see *Report of the High Level Committee on Law Relating to Insolvency and Winding up of Companies* (2000) in DP Mittal, *New Law Relating to Sick Industries* (Taxmann 2003) ch 3) such that their involvement in dealings with Convention assets might be expected to add delay.

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<sup>179</sup> After the expiration of a waiting period, where defaults are not cured within that period (text to n 90 above). Of course, a creditor may not wish to take this opportunity, for example because the market for the asset is weak (see Golbeck and Linetsky (n 28) above on volatility in the market for used aircraft).

been suggested<sup>180</sup> that insolvency law theory is evolving from an early focus on the efficiency challenges that arise on a debtor's insolvency<sup>181</sup> to concentrate more directly on the effects of insolvency outcomes on the cost of capital: 'Modern theory relates the results of a bankruptcy procedure to earlier stages in the life of the borrowing firm'.<sup>182</sup> In general terms the Convention project can be readily related to this literature: recall that the case for the Convention was built exclusively by reference to a capital cost reduction rationale.<sup>183</sup> But the specific focus of the drafters was a narrower one – facilitating the provision of a particular kind of finance (asset-based finance) in select industries – and perhaps more must be said to explain the privileging of this particular class of financier. In a paper on the core insolvency provision of the Aircraft Protocol, Wool and Littlejohns suggest a 'context theory' approach, in which the insolvency provision is understood by reference to the particular economic considerations that arise in the specific context of aircraft financing and airline insolvency.<sup>184</sup> The existing secondary literature points to two such considerations (in addition to those noted by Wool and Littlejohns). First, the *assets* targeted by the Convention have particular features (expensive, by definition mobile, and depreciating, with a special risk of deterioration in value where left unused/unmaintained)<sup>185</sup> that may mean that the ordinary protections offered by a contracting state's reorganisation law to secured creditors aggrieved by a stay will offer inadequate comfort to this class of puta-

tive financier. Secondly, the *firms* or industries targeted by the Convention and Protocols – or at least the Aircraft and Luxembourg Protocols – perform a function (transportation) that has particular macro-economic significance,<sup>186</sup> such that a state may have a special interest in encouraging the provision of finance to them. In the US, the development of exceptions to the automatic stay in Chapter 11 for financiers of railroad rolling stock (and later, aircraft equipment) has been linked to a need to encourage the provision of finance in industries perceived to be both essential<sup>187</sup> and at peculiar risk of insolvency.<sup>188</sup> The importance of these industries, and a state's preference for encouraging the provision of private (as opposed to state) finance for their operation, may help explain the broader case for the Convention insolvency privileges.

#### 4. Conclusion

Together the Convention and Protocols offer contracting states a robust package of rules on the effectiveness, recognition, (to some extent) avoidance, and enforcement of Convention interests in insolvency proceedings. These provisions are far more ambitious than those contemplated by early drafters. Their breadth and (in the case of the optional core insolvency provision) strength reflects the perceived centrality of insolvency risk to the cost and availability of asset-based finance, which the Convention was designed to improve and enhance. Widespread and effective implementation of the Convention and Protocols would substantially improve the position of asset-

<sup>180</sup> See A Schwartz, 'A Normative Theory of Bankruptcy' (2005) 91 *Va L Rev* 1199.

<sup>181</sup> Specifically the common pool problems explored in Thomas Jackson's *The Logic and Limits of Bankruptcy Law* (Harvard University Press 1986); Schwartz (n 180) 1201.

<sup>182</sup> Schwartz (n 180) 1203.

<sup>183</sup> Text to n 13 and following, and text to n 122.

<sup>184</sup> J Wool and A Littlejohns, 'Cape Town Treaty in the European Context: The Case for Alternative A, Article XI of the Aircraft Protocol' (2007–08) 24 *Air Finance Annual* 1, 2.

<sup>185</sup> Note 25 above and accompanying text.

<sup>186</sup> Notes 26, 27 and 29 above and accompanying text.

<sup>187</sup> Note 25 above citing Goldman, 29–30: 'The bankruptcy laws traditionally have afforded special treatment to certain lenders to targeted transportation industries, to encourage the financing necessary to capitalize and equip the industries deemed vital to the nation's growth and survival.'

<sup>188</sup> Note 27 above and accompanying text.

based financiers, otherwise facing ‘something of a lottery’<sup>189</sup> in relation to the treatment of their interests in high-value mobile equipment on a debtor’s insolvency. The improvement is predicted to be most dramatic in jurisdictions that do not otherwise endorse the ‘asset-based financing principles’<sup>190</sup> that underpin the Convention and Protocols, although it is in these jurisdictions that the assumption of ‘effective

implementation’ seems likely to be most tested. In jurisdictions that already broadly adhere to these principles, the insolvency provisions will still likely offer Convention creditors some privileges that the holders of other forms of security, title reservation or lease interests do not enjoy. These privileges may reflect particular features of the narrow class of assets and firms that are targeted by the Convention and Protocols. ■

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<sup>189</sup> McGairl (n 143) 439 (extracted at the very beginning of this article).

<sup>190</sup> Text to n 128 above.