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The perfection and priority rules of the Cape Town Convention and the Aircraft Protocol

A comparative law analysis

Michel Deschamps*

This article presents an overview, from a comparative law perspective, of the rules of the Cape Town Convention and the Aircraft Protocol on the creation, perfection and priority of an international interest. Section 1 delineates the scope of the article and points out that the Cape Town Convention and the Aircraft Protocol must be read together; therefore, the analyses in the article refer only to the consolidated version of the two instruments. Section 2 summarises the rules for the constitution of each of the three categories of international interests contemplated by the Convention (a security interest granted under a security agreement, the ownership interest of a seller under a conditional sale and the interest of a lessor under a leasing agreement). Comparisons are made with national law, including on whether or in what circumstances a conditional sale or a lease will be characterised as a security interest. Section 3 deals with the effectiveness against third parties of an international interest: registration in the International Registry is the mode of perfection provided by the Convention. Moreover, the priority rules of the Convention are triggered only if the interest of at least one competing claimant has been registered in the International Registry. Section 4 examines the basic priority rule of the Convention: an international interest first registered in the International Registry takes priority over any other consensual interest not yet so registered, including an interest not registrable in that registry. Section 4 then examines a number of scenarios involving competing claims, including a competition between two chargees and a competition between a seller under a conditional sale and a chargee deriving its interest from the buyer under the conditional sale.

1. Introduction

This article examines from a comparative law perspective the perfection and priority rules of international interests constituted under the Convention on International Interests in Mobile

Equipment (the ‘Cape Town Convention’) as supplemented and modified by the Protocol on Matters Specific to Aircraft Equipment (the ‘Aircraft Protocol’). With respect to such matters, the Cape Town Convention and the Aircraft Protocol must be read as one single instrument. For sake of brevity, the term ‘Convention’ in this article refers to both the Cape Town Convention itself and the Aircraft Protocol.

Secured transactions laws generally comprise four categories of issues:

- the creation of a security interest (or another right or interest that performs the same functions);
- the effectiveness against third parties of a security interest (which on occasion will be referred to as ‘perfection’ in this article);

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- priority rules (that is, the rules governing priority as between competing claimants);
- the enforcement remedies available to a secured creditor in the event of default by the debtor of the secured obligation.

The article focuses on two of these issues, namely the perfection and priority rules of the Convention, with a comparison with the approaches taken on the same issues by national legal regimes of a common law or civil law tradition. As the validity of an interest is a prerequisite to its priority, the rules on the creation of an international interest need also to be reviewed. Enforcement matters are not the subject of this article but will be alluded to in the discussion of the distinctions between the various types of international interests. Conflicts of laws are of significant importance in the area of secured transactions but they are outside the scope of this article.

References to Articles without other mention are to the Articles of the consolidated text of the Cape Town Convention and the Aircraft Protocol (collectively referred to as the ‘Convention’, as specified above). The Official Commentary of the Convention prepared by Professor Sir Roy Goode (third edition published by UNIDROIT in July 2013)¹ is cited as the ‘Official Commentary’. This article assumes that the reader has a basic knowledge of the Convention and will not attempt to summarise its content.

As the comparisons with national law approaches are intended to be of a general nature, specific references will not be made to national laws, with the exception of the Uniform Commercial Code of the United States ('UCC'). The UCC is in effect the typical example of a secured transactions national regime which has expanded the traditional notion of security interest so as to include transactions using title as a security device. Reference will also be made to the UNCITRAL Legislative Guide on

Security Rights² (the ‘Uncitral Guide’) as it recommends that title transactions made for security purposes be subject to the same rules as those applicable to a security interest granted in the grantor’s own property.

2. Constitution of an international interest

In order to benefit from the Convention, a creditor must hold an ‘international interest’. The term embraces not only an agreement that creates or transfers a property interest or real right to secure an obligation such as a loan, but also an agreement where the property interest of the creditor is not arising from the agreement itself such as a conditional sale or a lease. The concept of international interest is even wider than the broad definition of security interest in the jurisdictions which define a security interest as any interest in property that secures payment of an obligation without regard to its form or to the person who has title to the property. Under the UCC, a lease not made for security purposes is not a security interest while it may be an international interest under the Convention.³

Three types of interests may qualify as international interests:⁴

- an interest in an aircraft object granted by a ‘chargor under a security agreement’ (the interest being designated as a ‘security interest’ or, at times in this article, a ‘charge’);

² United Nations Publication, Vienna, 2009. The Uncitral Guide was adopted by the United Nations Commission on International Trade Law at its fortieth session in 2007.

³ It must be noted, however, that in many jurisdictions which have adopted laws inspired by the UCC (such as in Canada) a long-term lease of movable property is subject to most of the rules governing security interests whether or not made for security purposes. By contrast, a short-term lease not made for security purposes may qualify as an international interest under the Convention even if it is outside the scope of the secured transactions laws of these jurisdictions.

¹ Unless otherwise noted, references to the Official Commentary are to the third edition.

⁴ Article 2.

- an interest in an aircraft object ‘vested in a person who is the conditional seller under a title reservation agreement’ (that is, the ownership interest of the seller which is retained until payment of the purchase price or performance of other obligations of the buyer);
- an interest ‘vested in a person who is the lessor under a leasing agreement’ (that is, the ownership or other interest of the lessor in the leased property).

One of the objectives of the Convention is to subject each of the three categories of interests to the same basic legal framework, even if it is not the case under national law. To a large extent, this basic framework is that which applies to secured transactions in the UCC and other legal systems which have been influenced by the UCC;⁵ the Uncitral Guide provides for a similar framework. Under the Convention, the priorities of a chargee, a conditional seller and a lessor are governed by priority rules conceptually falling under secured transactions laws, notwithstanding that the secured transactions regime of national law might not apply to each of them. Thus, a conditional seller or a lessor needs to register in the International Registry the conditional sale or the lease in order to fully protect its interest against competing claimants, even if no registration requirement is required for such protection under national law. Hence, under the Convention, the term ‘creditor’ denotes not only a chargee but also a conditional seller or a lessor.

Accordingly, an international interest contemplated by the Convention may result from any of the following three categories of agreements: a ‘security agreement’, a ‘title reservation agreement’ and a ‘leasing agreement’ (each being referred to in the Convention as an ‘agreement’⁶). They are examined below.

(a) Security agreement

Article 1(vv) defines a security agreement as follows:

‘security agreement’ means an agreement by which a chargor grants or agrees to grant to a chargee an interest (including an ownership interest) in or over an aircraft object to secure the performance of any existing or future obligation of the chargor or a third person;

This definition is in conformity with the traditional common law or civil law approach whereby a charge, a pledge or a hypothec is the grant of an interest or real right (*in rem right*) in property owned by the grantor⁷ as security for the performance of an obligation. A mortgage or a trust or fiduciary transfer for security purposes also falls under this approach as it transfers ownership or legal title to secure an obligation. Under the traditional approach, the ownership interest of a conditional seller or of a lessor is not however a security interest in the generic sense because that interest does not arise from the sale or lease agreement. The buyer or lessee has no property interest to grant as it is not the owner of the property: no such interest is conveyed by the buyer or lessee to the creditor of the obligation (namely, the seller or lessor).

The secured transactions regime of the UCC and other similar regimes now treat a conditional sale or a security lease as a security interest (or the equivalent).⁸ The Convention contemplates but does not mandate a similar treatment. The characterisation of the transaction is rather left to the applicable law.⁹ Under Article 5(3), ‘References to the applicable law are to the domestic rules of the law applicable by virtue of the rules of private international law of the forum State.’

For example, if litigation involving a conditional sale occurs in the United States, the

⁵ In addition to the United States, examples of this framework may be found in legislation adopted in Australia, Canada and New Zealand.

⁶ All such terms are defined in Article 1.

⁷ Or property in respect of which the grantor has or is deemed to have the power to grant an interest or real right.

⁸ Sections 1-201, 1-203, 9-109 and 9-202 of the UCC.

⁹ Article 2(3).

court will characterise the seller's reservation of title as a security interest. Under private international law, the characterisation of an issue is generally determined in accordance with the criteria of law of the forum (that is, the law of the jurisdiction of the court hearing the dispute). Thus, a court in the United States will refer to the UCC in its assessment of whether a transaction is a security interest. As the UCC treats a reservation of title as a security interest, the conditional sale will therefore be a security agreement under the Convention, and not a title reservation agreement. If, however, litigation occurs in England or in France, where retention of title is not a charge or a security interest strictly speaking, then for purposes of the Convention the conditional sale will be a title reservation agreement, and not a security agreement.

The characterisation of an agreement as a security agreement, a title reservation agreement or a leasing agreement is essentially relevant for enforcement matters. Under Chapter III of the Convention, the remedies of a creditor upon the debtor's default depend on whether the creditor is a chargee, a conditional seller or a lessor. If the creditor is a chargee, its core remedies are similar to those usually provided by national law: take possession of and manage the aircraft object and sell or lease same, subject however to notice requirements.¹⁰ To the extent the proceeds of realisation of the charge exceed the obligation secured, the excess must be distributed to the debtor or other creditors with a lower ranking interest. If the creditor is a conditional seller or a head lessor, its remedies are more straightforward: being the owner of the collateral, it may simply terminate the agreement and take possession of the aircraft object as owner thereof.¹¹ Moreover, the Convention does not require a conditional seller or lessor to account for any

surplus if it subsequently sells the object for a price greater than the amount owed to it at the time of termination of the agreement.

It is worth noting that Article 2(2) specifies that if a conditional sale or a leasing agreement is characterised by the applicable national law as a security interest, the seller or lessor cannot claim that it also benefits from the Convention remedies available to a seller or lessor. Its remedies will be those of a chargee. The principal consequence is that the creditor will have the obligation to remit the surplus of realisation to other parties entitled thereto under the Convention.

Article 10 sets out the requirements to be met for a security agreement to constitute an international interest: the agreement must be in writing, must relate to an aircraft object of which the chargor has power to dispose, must enable the aircraft object to be identified and must enable the secured obligations to be determined 'but without the need to state a sum or a maximum sum secured'. This phrase overrides the requirement of the civil law jurisdictions which mandate that the maximum amount permitted to be collected under a security agreement be stated in the agreement.¹² Where national law provides for such requirement, it is common practice to specify a maximum amount higher than that of the secured obligations; the purpose of this practice is to ensure that the creditor will remain fully secured in the event of an increase of these obligations.

Any agreement which under national law evidences an intent to create a security interest in an aircraft object is therefore an international interest, provided that it conforms to the requirements of Article 10. No other form requirement is necessary, even if additional formalities were to be prescribed by national

¹⁰ Article 12. Extra-judicial enforcement (self-help) is permitted unless the declaration made by the relevant Contracting State under Article 70 specifies that a court authorization is required.

¹¹ Article 14. A pub-lessor is in a similar position against a pub-lessee

¹² The same requirement is prescribed for a charge over real property in many common law jurisdictions. The maximum amount is also indicated in the information to be entered in the registry in which a filing or registration is made in respect of the charge. This allows searchers to ascertain independently the remaining equity in the charged property.

law. For example, if under a civil law jurisdiction a hypothec over an aircraft were invalid due to the hypothec not being in notarial form, the hypothec would still be recognised and qualify as an international interest under the Convention to the extent that the document sufficiently describes the aircraft and permits the determination of the obligations secured. Another example is a security agreement stating that the security interest will secure all present and future obligations of the chargor to the chargee, without further identification of these obligations (an ‘all obligations’ clause). Under the civil law of France, there is a controversy about the effectiveness of such a description of the secured obligations in a security agreement. The position under the Convention appears to be different¹³ and an ‘all obligations’ clause would be valid.

Conversely, an agreement which is a valid security agreement under national law will not necessarily qualify as an international interest. For example, in some secured transactions national laws, a security interest may be granted in all present and future assets of the grantor and no other description of the assets is needed for the validity of the security agreement.¹⁴ Under the Convention, this would not be sufficient and the lack of identification of the charged aircraft objects would prevent the security agreement from constituting an international interest. One could consider that a security agreement describing the charged assets as ‘all present and future assets’ of the chargor includes all aircraft objects owned or to be owned by the chargor and accordingly permits their identification: with such description, the fact that an aircraft belongs to the chargor necessarily entails that

¹³ Official Commentary, para. 476.

¹⁴ Section 9-108 of the UCC does not consider sufficient a description in a security agreement that merely states ‘all the debtor’s assets’ (but it is sufficient for filing purposes under Section 9-504 of the UCC). Referring to ‘all aircraft objects of the debtor present and future’ would however comply with Section 9-108. The Canadian secured transactions laws recognise the effectiveness of an ‘all assets’ clause in a security agreement.

the aircraft is subject to the security interest granted under the agreement. This analysis is however displaced by the Convention. Article 10 provides that an international interest is constituted where the agreement ‘enables the aircraft object to be identified’. Moreover, Article 8 requires the description to contain the ‘manufacturer’s serial number, the name of the manufacturer and its model designation’. Thus, the identification of the aircraft objects covered by the charge must be capable of being made by the terms of the agreement; the need to refer to evidence outside the agreement would not meet the identification criterion of the Convention.¹⁵

(b) Title reservation agreement

Article 1(zz) defines a title reservation agreement as ‘an agreement for the sale of an aircraft object on terms that ownership does not pass until fulfilment of the condition or conditions stated in the agreement’. This definition is broader than the corresponding definition of the legal systems providing that title retention only secures the purchase price payable by the buyer.¹⁶

The comments made in Section 2(a) of this article on the form requirements of a security agreement also apply to a title reservation agreement. Accordingly, a title reservation agreement which meets these requirements is an international interest under the Convention.

Again, it must be stressed that a title reservation agreement will not be treated as such under the Convention if it is characterised as a security interest under the applicable national law. The agreement will then fall under the security interest category. For example, retention of title under the UCC and other similar secured transactions laws is assimilated to a security interest taken by the seller in the goods sold to the buyer.¹⁷ For the purposes of such laws, the buyer is deemed to have

¹⁵ Official Commentary, para. 268 and 534.

¹⁶ The civil law of Quebec is an example of such a more restrictive definition.

¹⁷ Section 1-201 of the UCC.

acquired the ownership of the goods, subject to a security interest in favour of the seller. It has been said earlier that the seller will then be considered by the Convention as a chargee and not as a conditional seller; its remedies will be those provided in Article 12 (remedies of a chargee), and not Article 14 (remedies of a seller or lessor).

(c) *Leasing agreement*

Article 1(dd) defines a leasing agreement as follows:

'leasing agreement' means an agreement by which one person (the lessor) grants a right to possession or control of an aircraft object (with or without an option to purchase) to another person (the lessee) in return for a rental or other payment;

As mentioned above, the secured transactions laws of some States assimilate to a security interest the property interest of certain lessors in the leased property. The Convention goes beyond these national regimes. Indeed, a leasing agreement characterised as creating a security interest under national law will be a security agreement as well as an international interest under the Convention. However, many other leasing agreements will qualify as international interests in these States in which the Convention applies, even if they are not captured by the definition of security interest of their laws.

First, in a jurisdiction applying the UCC, a leasing agreement is a security interest only to the extent the lease is made for security purposes. Under the Convention, the security purpose criterion is not relevant for a leasing agreement to qualify as an international interest. As a result, in a UCC jurisdiction, a non-security lease will be under the Convention a leasing agreement, and not a security interest. This is so because under Article 2(3) the applicable national law determines whether a lease is to be characterized under the Convention as a leasing agreement or a security interest.

Second, in the jurisdictions which assimilate to a security interest a lease not made for security purposes, the assimilation applies only to long-term leases (e.g., a lease for

a term of more than one year).¹⁸ Under the Convention, the term of the lease is not relevant for a leasing agreement to be covered by the concept of international interest; a short term lease may also constitute an international interest, regardless of the purpose of the lease. Therefore, in these jurisdictions, a short-term non-security lease meeting the requirements of the Convention will constitute an international interest, but falling under the leasing agreement category.

Indeed, in jurisdictions where a lease is never a security interest, a leasing agreement contemplated by the Convention will still be an international interest.

3. Effectiveness against third parties

(a) *Scope of the Convention perfection rules*

For a security interest to be effective against persons other than the grantor of the interest, secured transactions laws generally provide that certain steps must be completed. In some legal systems, these steps are the same as those required for the creation of the interest; in other legal systems, additional requirements are prescribed. For sake of convenience, the term 'perfection' will be used to describe the fulfilment of the requirements to be met in order for an interest to be effective against third parties.

The fact that an interest has been perfected does not automatically result in the holder of the interest having priority over a competing claimant. Many legal regimes such as the UCC draw a sharp distinction between perfection and priority issues. Under these regimes, priority is determined by priority rules, not by perfection rules. Perfection may be a prerequisite to gain priority but a creditor who is the first in time to perfect will not *ipso facto* have a first ranking interest; the priority rules may assign a different ranking to the creditor.

The Convention addresses perfection in Chapter VIII, but only to the extent required to resolve priority disputes governed by the

¹⁸ The Canadian jurisdictions are an example of such assimilation.

Convention. Perfection for purposes outside the Convention generally is left to the applicable national law. Indeed, the registration in the International Registry is required for the holder of an international interest to obtain the best possible protection. Registration in the International Registry is the mode of perfection which triggers the priority rules of the Convention; as will be pointed out in Section 4 of this article, a competition between two claimants will not be resolved by the Convention rules if their respective interests have only been registered in a national registry for secured transactions.

This does not mean that an international interest must be perfected both under national law and under the Convention for the priority rules of the Convention to apply. Perfection by registration in the International Registry is sufficient for a creditor to benefit from the Convention and, accordingly, to override national law priority rules.

(b) Dual approach in insolvency

In the event of the insolvency of the debtor¹⁹, the Convention adopts a dual approach. On the one hand, an interest qualifying as an international interest will be effective under the Convention against an insolvency administrator of the debtor (e.g., a trustee in bankruptcy) if it is so effective under national law even if it has not been registered in the International Registry. On the other hand, an international interest registered in the International Registry will also be effective against an insolvency administrator even if the interest is not so effective under national law. The end result is that the interest of a creditor under an international interest will be effective against an insolvency administrator either if the creditor has registered its interest in the International Registry or if the creditor's interest is effective against the insolvency administrator under national law. For example, under legal systems that do not characterise a

¹⁹ It must be recalled that the term 'debtor' encompasses a chargor under a security agreement, a buyer under a conditional sale and a lessee under a leasing agreement.

lease as a security interest (or the equivalent for perfection purposes), the interest of the lessor will remain effective in the insolvency of the lessee even if it has not been registered under national law or in the International Registry.

4. Priority rules

The priority rules of the Convention are similar for each type of agreement, with the result that they are not impacted by the legal characterisation of the agreement. It must again be emphasised that the priority rules are triggered only if at least one of the competing interests has been registered in the International Registry. Where such rules apply, the Convention gives priority to the creditor who is the first in time to register.

The secured transactions laws of many legal systems are based on the same principle but generally provide for exceptions to that principle. For example, a possessory security interest in property of a certain type may prevail over a previously registered security interest in the same property. Another example is the 'purchase money security interest' concept found in national secured transactions laws such as the UCC. Under such laws a purchase-money security interest is a security interest in goods the acquisition of which has been financed by the creditor²⁰. Subject to the fulfilment of procedural requirements, a purchase-money security interest will rank ahead of a previously registered security interest in the same goods. The Convention does not contain any of these exceptions in relation to the priority of an international interest.²¹ The absence of exceptions to the 'first in time to register' principle provides greater certainty to a creditor who registers its interest in the International Registry.

²⁰ See also Section 4(b) of this article.

²¹ There is however such an exception in the priority rules of the Convention relating to competing assignments of associated rights. An assignment of an associated right of the nature of a purchase money obligation will rank ahead of any other assignment if first in time registered in the International Registry, even if the assignment would have priority under national law. See Article 49.

Reliance on registration by a creditor is not subject to its absence of knowledge of the existence of a previous unregistered interest: the priority of a registered interest applies even if the holder of that interest had ‘actual knowledge’ of the previous unregistered interest.²² On this issue, the Convention follows the approach taken by the UCC and other similar secured transactions national laws.

The Convention also disapplies the old common law rule which does not preserve the priority of a first mortgagee for future advances made after the first mortgagee has acquired knowledge of the existence of a second mortgage.²³ It is worth noting that the civil law of France does not have a general rule to the same effect.

If however none of the competing international interests has been registered in the International Registry, a priority dispute between competing claimants will not be resolved by the Convention; the ranking of the respective interests of the parties will then be determined by the applicable national law. Indeed, if the situation leading to the dispute crystallises at a time when no such interest has been registered in the International Registry, a holder of one of the competing interests should not be able to improve its position by a registration after such time in the International Registry. The Convention is silent on the issue but this principle is implied from the scheme and goals of secured transactions regimes.

It must however be borne in mind that registration in the International Registry is not a condition for an interest to qualify as an international interest; as just noted, registration is only required for the application of the priority rules of the Convention. These rules directly or indirectly address a large number of scenarios, including situations where an international interest competes with other

types of interests. The typical scenarios are examined below.

(a) Competition between two charges

As between competing international interests, the interest first in time registered in the International Registry has priority.²⁴ Therefore, in the simple case where a debtor would grant a charge over an aircraft to two different chargees, the first in time registered charge will prevail. This rule applies even if the other charge had been previously registered under law outside the Convention.

The priority rule of the Convention does not make distinctions between international interests granted to a chargee or vested in a conditional seller or lessor. Other considerations may however be relevant to the resolution of a priority dispute between a conditional seller or a lessor and a chargee; these scenarios are the subject of subsections (b) and (c) below.

(b) Competition between a title reservation agreement and a charge

A competition may occur between a conditional seller and the holder of a charge granted by the conditional buyer. Should the competition be resolved in the same manner as a competition between two chargees? The following scenario illustrates the issue. Suppose that A sells an aircraft to B under a title reservation agreement and that B subsequently grants to C a charge over the aircraft. Suppose also that the charge is registered in the International Registry before registration of the title reservation agreement (or that the title reservation agreement is not so registered at all). In the event of a failure by B to perform its obligations to both A (the seller) and C (the chargee), would A or C have priority with respect to the aircraft? In other words, would C’s charge prevail over A’s ownership interest?

A strict application of the first in time to register rule would give priority to the chargee: C’s charge has been registered before A’s interest. The general principle laid down

²² Article 42(2).

²³ Article 42(2)(b). The UCC and other similar regimes have also abolished that rule in respect of security interests in movable property. In the area of real property, the old rule subsists in some jurisdictions.

²⁴ Article 42(1).

by the Convention in priority matters applies to any international interest, regardless of its characterisation as a charge, a title reservation agreement or a leasing agreement. It is true that priority rules in the area of secured transactions are principally designed to govern disputes between creditors deriving their interests from the same debtor. This is however the case in the present scenario. Each of A and C is a creditor of the same debtor. The Convention defines the term ‘creditor’ as including a chargee and a conditional seller.²⁵ Likewise, under the definition of ‘debtor’, B is a debtor both in its capacity as chargor and conditional buyer.²⁶

The solution conferring priority to the chargee is in conformity with the treatment of a title reservation agreement under the Convention: a conditional seller is a creditor whose international interest consists of its ownership interest. Article 42(1) provides that ‘A registered interest has priority ... over an unregistered interest’; the logical consequence is that an unregistered title reservation agreement is not effective against the holder of a registered interest in the property which was the subject of the title reservation agreement. This analysis is also consistent with the policy of the secured transactions laws of the legal systems under which the priority rules must be the same for all of those who provide financing, irrespective of the legal technique which is employed. The Uncitral Guide is also of the same effect. The Convention has endorsed that policy by including in the concept of international interest not only a security interest in the strict sense but also a conditional sale and a leasing agreement.

It is also noteworthy that if a debtor transfers the ownership of an aircraft to a creditor to secure the performance of an obligation to the creditor, the transaction will be treated as a security agreement under the Convention.²⁷ It would be incongruous that ownership used

for security purposes be subject to the priority rules of the Convention where the interest arises from a security agreement but not where a seller retains title to secure the obligations of the buyer.

A second approach is nevertheless possible. Using the above example, one might argue that C’s charge could not provide C with greater rights than those enjoyed by B. The *nemo dat quod non habet* maxim would apply here: as B is not the owner of the aircraft (because of A’s title retention), C could not have acquired a valid charge. The registration in favour of C should not improve its position as registration cannot transform an invalid charge into a valid charge. In support of this second approach, one could also invoke Article 10(b): for an international interest to be constituted by way of a charge, the security agreement must relate ‘to an aircraft object of which the chargor ... has power to dispose’. In our scenario, A would contend that B did not have the power to dispose of the aircraft as the ownership of same had not been transferred to B.

The second approach has some merits but the better view is that it must not be retained. If a reservation of title were to remain effective against third parties without registration, there would be no need for the conditional seller to register its interest. This result cannot have been intended by the drafters of the Convention. Otherwise, the provisions on the registration of an international interest would be useless in respect of title reservation agreements. This second approach would deprive these provisions of any practical effect where the international interest consists of an ownership interest. The Convention attaches consequences not only to the registration of an international interest, but also to the lack of registration, without any distinction as to the category to which the interest belongs.

Giving priority to the chargee in the above example does not disregard the requirement that the debtor must have the power to dispose of the charged property. The effect of the priority rule of Article 42(2) is that the seller’s retention of title is not effective against

²⁵ Article 1(q).

²⁶ Article 1(r).

²⁷ Article 1 (vv). A security trust is an example of such a transfer.

the chargee due to the lack of registration. As a consequence, B (the buyer and also the chargor) is deemed to have acquired the power to dispose of the object.²⁸ Put differently, an unregistered conditional sale passes title as far as creditors under registered interests obtained from the buyer are concerned. Retention of title, although not characterised as a security interest, does not place the seller in a different position for priority purposes.

The net result of the priority rules of the Convention as applied to conditional sales is analogous to that obtained under secured transactions national regimes which treat title retention as a security interest. There is however a major exception to this analogy. Under these regimes, a purchase-money security interest²⁹ prevails over a previously registered security interest if certain conditions are met. As noted earlier, the concept of purchase-money security interest has not been incorporated into the priority rules of the Convention, except in relation to assignments.³⁰ The reason for this is that in many instances an international interest will secure an obligation which would be a purchase-money obligation under the national regimes having adopted the concept of purchase-money security interest. Still, there are circumstances where the Convention will yield to a result different from that achieved under regimes giving priority to a purchase-money security interest. Under the national regimes just mentioned, a title reservation agreement is a purchase-money security interest and may prevail over a charge granted by the buyer to a lender even if the reservation of title is registered after registration of the charge. As has been seen earlier, the opposite result is achieved under the Convention: a subsequently registered reservation of title cannot benefit from a priority

over a registered charge despite the fact that the reservation of title would qualify as a purchase-money security interest under national law and that the charge would not.

There remains to examine one important question in relation to the respective priorities of a conditional seller and a chargee whose security interest is derived from the conditional buyer. Would the result of the above analysis be different if the title of the conditional seller had been registered in the International Registry? Using the example discussed above, suppose that A has acquired full ownership of an aircraft object from supplier S and that the contract of sale between S and A has been registered in the International Registry. Suppose in addition, as in that example, that the reservation of title in the conditional sale between A and B has not been registered and that C has obtained from B and registered a charge over the aircraft. Would C be entitled to priority against A by reason of the lack of registration of the conditional sale, notwithstanding that the acquisition of the aircraft by A from S has been registered?

Upon a strict reading of the Convention, the conclusion giving priority to C is not altered by the fact that the sale between S and A has been previously registered: A has acquired the aircraft from S pursuant to a sale rendered effective against third parties; however, as against C, the title reservation in the conditional sale between A and B is not enforceable, with the result that B is deemed to have granted an effective charge to C.

This is the position advanced by the Official Commentary in a discussion on whether A benefits from a ‘cross-over’ protection, by having registered the title acquired from S. The Official Commentary expresses the view that such registration is not a substitute for the registration of the title reservation agreement. In the second edition of the Official Commentary, it was stated that ‘The purpose of registration of a sale is to protect the buyer against a subsequent disposition by the seller and against the seller’s insolvency, not to give

²⁸ Official Commentary, para. 2.158 and 472.

²⁹ Again, a purchase-money security interest is an interest that secures credit obtained or used for the purposes of financing the acquisition of movable property. A conditional seller’s reservation of title is a purchase-money security interest under national laws providing for that concept.

³⁰ See footnote 21.

protection against a purchaser from the buyer's own debtor...'.³¹ The third edition summarises the analysis as follows: 'In short, there is no cross-over protection: registration of one interest does not secure protection for the other'.³²

One may still ask if a court facing a similar scenario would come to the same conclusion in all circumstances. There are legal principles under the common law and the civil law which are not displaced by the Convention and may affect the priority rules provided for by secured transactions laws. A chargee who searches the International Registry will discover the registration of the sale between S and A. The chargee is then likely to enquire about B's title; if C is presented with a copy of the unregistered conditional sale between A and B but disregards the existence of the reservation of title, a court could be reluctant to permit C to benefit from the priority rule of Article 42(1). The court might find that C is knowingly participating in a violation of the contractual obligations of B, especially (as would normally be the case) if the conditional sale contains a covenant by B not to grant a charge over the aircraft until the obligations of B to A have been satisfied. In such a case, C might have committed the tort of inducing a breach of contract (under the common law) or be at fault (under the civil law) because of its participation in the breach of the obligations of B to A. Estoppel principles (under the common law) or *fin de non-recevoir* principles (under the civil law) may preclude C from relying on the priority rules of the Convention. There is a legal maxim that a person cannot be permitted to benefit from his or her own wrong.³³

(c) Competition between a leasing agreement and a charge

A competition between a lessor under a leasing agreement and a chargee under a charge

³¹ Official Commentary, second edition, para. 358; see also para. 472 and 476 of the same edition.

³² Official Commentary, para. 391. See also the discussion in para. 388–389.

³³ As a practical matter, a well orchestrated fraud would be required for the scenario under discussion to materialise where the chargee acts in a prudent manner.

granted by the lessee should be resolved in the same manner as described in the preceding Section 4(b). Such a competition may be illustrated using the same example, but with A being a lessor and B being a lessee. It has been emphasised that the priority rules of the Convention apply without distinction to any debtor, whether the debtor is a chargor, a conditional buyer or a lessee under a leasing agreement.

Therefore, a chargee deriving its charge from a lessee under a leasing agreement would prevail over the lessor.³⁴ This result is however a more challenging displacement of the *nemo dat* rule. Where the parties are a conditional seller and a conditional buyer, it is easy to understand that title is deemed to have passed if the retention of title has not been registered: a conditional sale remains an agreement intended to convey ownership at a certain point in time. The Convention priority rules as applied to a leasing agreement are more drastic: they may transform a lease into a transfer of ownership for priority purposes. Such transformation is even more astonishing if the lease is a short-term lease.

The approach of the Convention is not however unique. Legal systems that treat a security lease (or a long-term non-security lease) as a security interest have the practical effect of treating the lessee as owner of the leased property (to the extent that the lessor was the owner thereof at the time of the lease). In those systems, an unperfected lease to which secured transactions laws apply may also be treated as vesting the ownership of the leased property in a trustee in the bankruptcy of the lessee. That being said, factual circumstances affecting priority rules³⁵ are more susceptible to be encountered in a competition scenario where a lessee has granted a charge to a third party.

In addition, other considerations must be taken into account if the leasing agreement is a

³⁴ Official Commentary, para. 391. Particular circumstances such as those mentioned at the end of the discussion in Section 4(b) may however dictate a different conclusion.

³⁵ See again the discussion at the end of Section 4(b).

sublease, as the interest of a sublessor is not that of an owner. The following example highlights these considerations. Supplier S sells an aircraft to A who in turn leases the aircraft to B and the leasing agreement is registered. B subsequently subleases the aircraft to D and the sublease is not registered. Thereafter, D grants a charge to C and the charge is registered. What is the extent of C's priority?

Under the priority rule of Article 42(1), C's charge will prevail over sublessor B's interest. This means that as regards C, B's interest in the aircraft will be treated as having passed to D and having become subject to C's charge. But B's interest is only that of a lessee, not of an owner. Accordingly, C is not in the same position as if it had obtained a registered charge from a lessee under an unregistered leasing agreement made with a lessor who is the owner of the aircraft. As B only has a limited interest, the charge may only affect that limited interest. Therefore, the absence of registration of a sublease cannot of itself have the same consequence as the absence of registration of a head lease.

Indeed, in the above example, the ownership interest of the head lessor A will take priority over C's charge since the head lease has been registered. If the head lease had not been registered, the analysis becomes more complex. It is arguable that C's charge will affect the ownership interest of A, due to the lack of registration of both the head lease and the sublease. A different view may however be held, on the basis that the priority rules are designed to determine priority as between creditors deriving their rights from the same debtor. Essentially, the question is whether the lack of registration of a head lease may be invoked not only by a third party deriving its interest from the head lessee but also by a third party whose interest has been granted by the sublessee. The Convention does not provide a clear answer to that question.

(d) Competition between a creditor and an outright buyer

The International Registry is not a title registry but allows for the registration of an

outright sale of an aircraft object. With respect to the effectiveness of a sale against a creditor under an international interest (and the consequential priority rules), Article 42 of the Convention adopts a land registry approach. An international interest granted by a debtor and registered in the International Registry prior to the registration of a sale by the debtor will be effective against the buyer. On the other hand, the buyer under a sale registered in the International Registry will acquire the aircraft object free from a then unregistered interest granted by the seller (whether or not the interest is an international interest); this is so even if the international interest has been registered under law other than the Convention.

(d) Competition involving an internal transaction

Under Article 66(1), a Contracting State may declare that the Convention will not apply to an interest qualifying as international but arising from an 'internal transaction'. An internal transaction is essentially a transaction the main connecting factors of which point to the Contracting State making the declaration. The term is defined in Article 1(aa):

(aa) 'internal transaction' means a transaction of a type listed in Article 2(2)(a) to (c) where the centre of the main interests of all parties to such transaction is situated, and the relevant aircraft object under Article 3(4) is located, in the same Contracting State at the time of the conclusion of the contract and where the interest created by the transaction has been registered in a national registry in that Contracting State which has made a declaration under Article 66(1)

A declaration by a Contracting State under Article 66(1) cannot however exclude the priority rules of the Convention. As a result, these rules will govern an internal transaction as well. Thus, an international or national interest registered in the International Registry will prevail over another interest previously registered in a national registry for security interests.

(e) *Competition involving non-international interests*

Not all security interests or interests of conditional sellers or lessors are international interests. The best example of a ‘non-international interest’³⁶ consists of a security interest granted by an airline to a bank in all aircraft objects owned or to be owned in the future by the airline. This is possible under the laws of many jurisdictions but is not sufficient to identify the aircraft objects for purposes of Article 10(c), which requires that the agreement constituting the international interest ‘enables the aircraft object to be identified’. Under Article 12, the description of the aircraft object in the agreement must contain ‘its manufacturer’s serial number, the name of the manufacturer and its model designation’.

Two questions may be addressed in relation to a non-international interest: Do the priority rules of the Convention govern a dispute between a registered international interest and an unregistered non-international interest? Can the holder of a non-international interest benefit from the priority afforded by the Convention if that holder effects a registration in the International Registry against a particular aircraft object?

The first question must be answered in the affirmative. Under Article 42, a registered international interest has priority over any other interest other than a previously registered international interest. A non-international interest is necessarily subordinate to a registered international interest. However, if the international interest is not registered in the International Registry, a competition between that interest and a non-international interest will be resolved under law outside the Convention.

A negative answer must be given to the second question. A non-international interest does not enjoy the protection of the Convention. The protection benefits only to a valid international interest.³⁷ Therefore, if the

holder of a non-international interest effects a registration in the International Registry in respect of an aircraft object, this would not trigger in favour of that holder the priority rules of Article 42. These rules may defeat the ranking otherwise established by law outside the Convention but are not designed to grant priority to a non-international interest.

(f) *Competition involving proceeds*

By operation of law, the interest of a secured creditor in the charged property may extend to proceeds from the disposition of that property. Under the civil law, this may be achieved through the concept of real subrogation (*in rem* subrogation): an interest in property extends in certain circumstances to replacement property. Under the common law, the application of trust law may yield to the same result. In addition, the secured transactions laws of many jurisdictions specify that a security interest extends to proceeds derived from any dealing with the property subject to the security interest. Most of the time, security agreements will also specifically cover proceeds in the description of the collateral.

There are however differences among the various legal systems with respect of the types of assets that a secured creditor may claim as proceeds under general principles of law or because of a specific provision of secured transactions national laws. For example, the UCC has a definition of proceeds which is broader than the corresponding definition of the Canadian statutes which have specific proceeds rules. Moreover, the fact that a security interest under national law extends to the proceeds of the collateral does not always entail that the secured creditor has the same priority over the proceeds as over the original collateral.

The Convention adopts a straightforward approach to proceeds. Under Article 2(4), ‘An international interest in an aircraft object extends to proceeds of that aircraft object’. Under Article 42(7), the priority of an international interest registered in the International Registry ‘extends to proceeds’. The notion of proceeds

³⁶ This term is used for convenience purposes as it is not a defined term under the Convention.

³⁷ Official Commentary, para. 469.

in the Convention is however very limited. Article 1(j) defines proceeds as meaning ‘money or non-money proceeds of an aircraft object arising from the total or partial loss or physical destruction of the aircraft object or its total or partial confiscation, condemnation or requisition’. The definition essentially covers proceeds from casualty insurance or from expropriation.

All other forms of proceeds are excluded from the scope of the Convention. For example, law outside the Convention will determine the rights and priorities of a creditor under an international interest in an aircraft object with respect to proceeds such as a receivable arising from the sale or lease of the object by the debtor. Indeed, a conditional seller or a lessor need not to rely on other laws to establish its rights to payment under the conditional sale or lease.³⁸ The amounts payable by the buyer or lessee are already owed to the seller or lessor by reason of the contract between the parties.

On the other hand, if the chargor under an international interest leases the aircraft object covered by the charge, the rental payments owing by the lessee would constitute non-Convention proceeds. Regard must then be had to law outside the Convention to ascertain the rights and priorities of the chargee over such rental payments. Normally, the chargee will need to obtain under national law a valid and perfected security interest (or a security assignment) in the rental payments; registration of its interest in the International Registry will not perfect that security interest. The law applicable to these issues will be determined by the conflict-of-laws rules of the forum State. In some States, the relevant conflict rule points to the law of the location of the grantor of the security interest in the rental payments;³⁹ in other States, the conflict rule may lead to the law governing the lease under which the

³⁸ These rights are called “associated rights” by Article 1(h).

³⁹ The Uncitral Guide recommends the same conflict rule. The Uncitral Guide and these States do not however all define the location of the grantor in the same manner.

payments are due or to the laws of the place where the payments must be made or where the lessee is domiciled.

Even with respect to Convention proceeds, the creditor of an international interest will sometimes be required to take perfection steps under national law. Suppose that the interest of the creditor has been registered in the International Registry but that the aircraft object has been insured by an insurer located in a non-Convention State. To benefit from a priority over the insurance proceeds, the creditor will then be required to do whatever is necessary to achieve that goal under that law.⁴⁰

⁴⁰ Indeed, in many jurisdictions, it will be sufficient for the creditor to be named loss payee under the insurance policy.