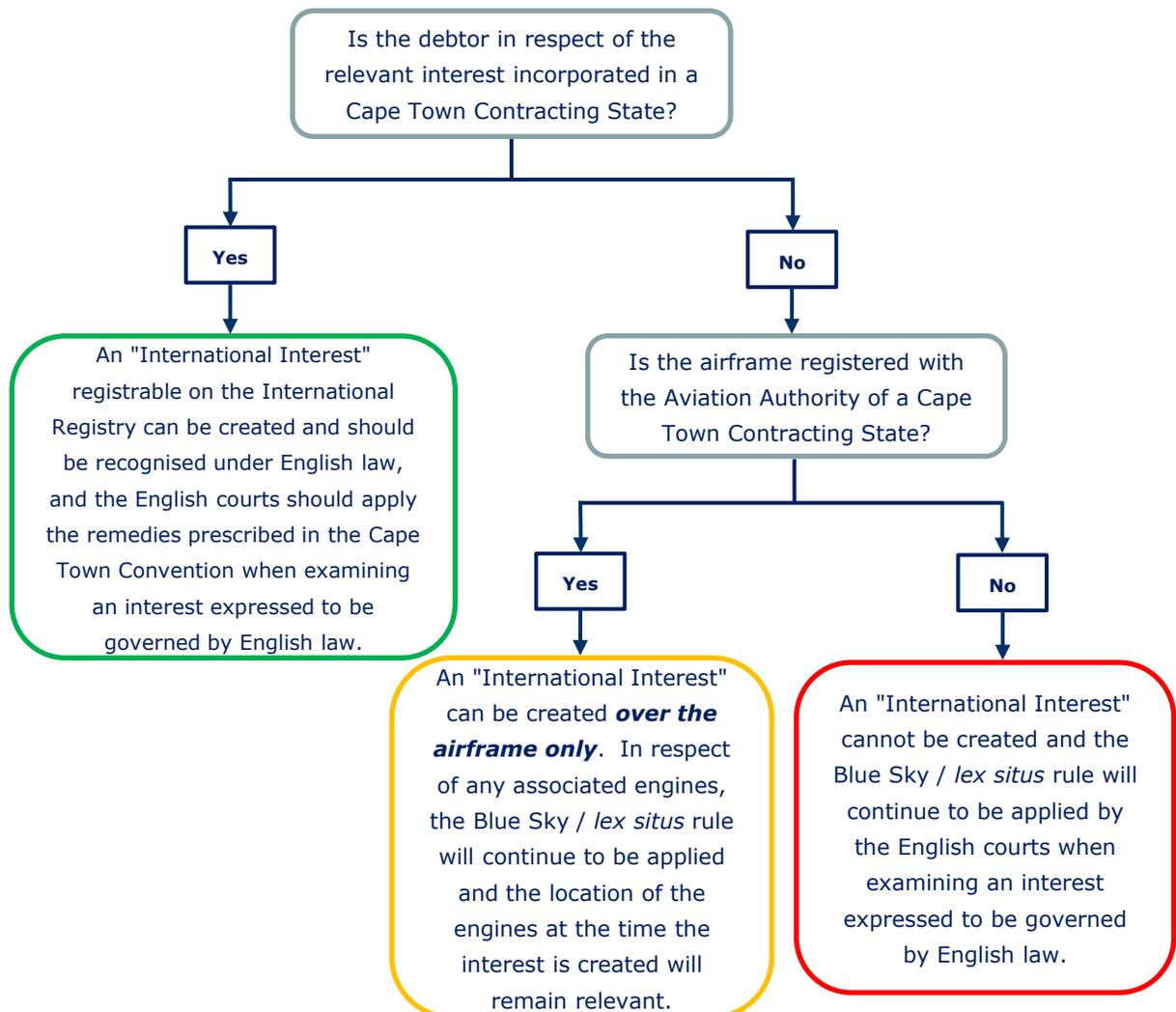


On 27 July 2015 the UK Government formally ratified the Cape Town Convention and Aircraft Protocol (together, the "Convention") by submitting instruments of ratification to Unidroit. This ratification will come into effect on 1 November 2015 and also extends to the Cayman Islands, Gibraltar and Guernsey. As the Cayman Islands in particular is a popular jurisdiction for aircraft-owning special purpose vehicles, a wide range of new transactions will become subject to the Convention.

This briefing note outlines some of the significant points that will affect the application of English law to aircraft finance transactions.

Creation of Interests in Aircraft Assets under Agreements Governed by English Law

International Interests and the *lex situs* rule are explained below in the section **Taking security and the *lex situs* rule**. The flow chart below summarises whether a registrable International Interest can be created and whether the Blue Sky / *lex situs* rule continues to apply. The key development is that for these purposes, from 1 November 2015 the Cayman Islands, Gibraltar, Guernsey and the UK will all be Cape Town Contracting States.



Taking security and the *lex situs* rule

The judgment in the *Blue Sky* case¹ confirmed that, as a matter of English law, the *lex situs* rule² applies in determining the valid creation of security over moveable assets (such as an English law mortgage over an aircraft). As a consequence of the ruling, an aircraft is required, at the time the security is created, to be either in (a) England (or English airspace), or (b) a "qualifying jurisdiction" whose domestic laws recognise the creation of an English law mortgage.

In order to implement the Convention with proper effect in the UK, the UK government has, in Regulation 6 of the Aircraft Equipment (Cape Town Convention) Regulations 2015 (the "**Regulations**"), confirmed the status of International Interests and contracts of sale³ under the Convention *vis-à-vis* the *lex situs* rule. Regulation 6 will apply to security agreements, lease agreements, title reservation agreements, sales and contracts of sale. It will provide that an International Interest will be recognised as a matter of English law and will have effect as a valid International Interest where the conditions of the Convention have been met, with no further requirement to determine whether the *lex situs* rule has been satisfied.

From 1 November 2015, the Regulations will have the effect of rendering the *lex situs* rule inapplicable under English law to the extent that the "connecting factor"⁴ applicable to a particular transaction is that the debtor⁵ in respect of the International Interest is incorporated in a contracting state to the Convention. In such cases, the courts of England will only consider whether the conditions of the Convention have been satisfied in determining if an International Interest has been validly created.

If, however, the only connecting factor is that the aircraft is registered on the aircraft registry of a contracting state, the situation will be different. While the *lex situs* rule will not apply in determining the validity of the International Interest created over the airframe, it will continue to apply in determining the validity of the International Interest over the engines.⁶ The flow-chart at the beginning of this briefing note illustrates the effect of the Regulations on English law and the *lex situs* rule in relation to the creation of International Interests.

Governing law of aircraft mortgages

From 1 November 2015, a mortgage governed by English law may be created without reference to the *lex situs* rule in:

- (a) transactions in which the mortgagor (as debtor) is incorporated in a contracting state to the Convention (noting in particular that from such date, the Cayman Islands will also be a contracting state), or
- (b) limited cases where the parties wish to create a mortgage over an airframe only and the airframe is registered in a contracting state.

In all other scenarios, if the relevant asset is not located in England or a qualifying jurisdiction at the time of creation of the mortgage, we would expect the current practice of using mortgages governed by laws other than English law (for example New York and/or relevant local law) to continue.

1 *Blue Sky One Limited & O'rs v Mahan Air & Ano'r* [2010] EWHC (Comm).

2 The English High Court held that aircraft should not be treated differently from other tangible assets and that it is the *lex situs* – the jurisdiction in which the aircraft is physically situated at the time the mortgage is created – of the aircraft which determines whether a mortgage is validly created over it. If an aircraft is registered in a different jurisdiction to its *lex situs*, a mortgage which is valid under the laws of the state of registration but which is not valid under the domestic laws of the *lex situs* jurisdiction will not be valid under English law.

3 "**International Interests**" are, broadly, security-type interests created by or subject to security agreements, lease agreements and title reservation agreements relating to aircraft objects. Contracts of sale are not International Interests under the Convention or the Regulations, but are afforded certain benefits under both the Convention and the Regulations, such as the registration system and the priority rules. Therefore, for the purposes of this briefing note, the term "International Interest" is deemed to include a buyer's interest under a contract of sale.

4 A "**connecting factor**" is a prerequisite for determining if the Convention and its protections apply to a particular transaction. There are two ways in which a transaction involving aircraft objects may have a connecting factor. The first is the jurisdiction of incorporation of the debtor being in a contracting state to the Convention. The second is the state of registration of the aircraft.

5 Under the Convention, a "**debtor**" is either (a) the lessee, the chargor or the conditional buyer under a lease, security agreement or title reservation agreement respectively, or (b) the seller under a contract of sale.

6 Technically, it is the airframe and not the engines which are registered on the aviation authority register. As such, the only way in which engines can have a connecting factor to the Convention and therefore render the *lex situs* rule inapplicable in determining the validity of an interest created over the engines is if the connecting factor is that the debtor is incorporated in a contracting state.

The International Registry

The "International Registry" is a centralised online registry system located in Dublin, Ireland, for the registration of International Interests. It enables interested parties to search for any interests registered against a particular aircraft object. Registered International Interests and interests of buyers under contracts of sale are given priority based on the order of registration, subject to any rights and interests under a state's local law given priority by operation of local law (and not by contract). In the UK, the rights and interests which would have priority over an International Interest are (a) possessory liens in respect of work carried out on an aircraft (e.g., a repairer's lien), and (b) any right to detain the aircraft prescribed by any law with effect in the UK (e.g. a UK airport's right to detain an aircraft for unpaid airport charges).

No retrospective registrations

Note that the Convention registration rules will not apply retrospectively, insofar as interests existing prior to 1 November 2015 will not need to be registered on the International Registry in order to retain any existing priority.

Debtors subject to UK insolvency regimes

The UK Government has elected to adopt Alternative A of Article XI of the Protocol. If a creditor has correctly created a registrable International Interest and the debtor is subject to a UK insolvency regime, the adoption of Alternative A will require a debtor either to return the aircraft to the creditor within 60 days, or to cure the breach of contract. Alternative A promotes cheaper funding and lower lease rates by assisting creditors. In addition, the Convention's self-help remedies will be available to creditors of debtors subject to a UK insolvency regime without the need for leave of the court.

Additional considerations for aircraft registered with the UK Civil Aviation Authority

The Convention also raises a number of other considerations for aircraft financiers and airlines alike in relation to aircraft registered with the UK Civil Aviation Authority (the "CAA").

IDERAs

Irrevocable de-registration and export request authorisations ("**IDERAs**") will be effective in the UK through ratification of the Convention. An IDERA is an irrevocable authorisation from the operator of an aircraft for a specified creditor to deregister an aircraft from the applicable aviation authority's nationality register following a default and then to export the aircraft. The creditor will be able to request deregistration of the aircraft from the CAA's nationality register and, absent any safety concerns, the CAA will effect deregistration of the aircraft.

Registration of security interests

International Interests granted by UK companies will not, in themselves or by way solely of being International Interests, need to be registered at the relevant UK Companies House. However, any International Interest which is a security document and which contains a mortgage or charge will continue to require registration at Companies House. In addition, if an aircraft is registered on the CAA register, any security over the aircraft will need to be registered on the CAA register in line with current practice.

Eurocontrol and the fleet lien rule

It is well established that Eurocontrol is entitled to a lien over an aircraft for any unpaid Eurocontrol charges. Ratification of the Convention in the UK will not affect this, nor will it affect the UK's fleet lien rule or offer any new protection to airlines against the risk of arrest of aircraft in the UK for non-payment of such charges.

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