

# THE BENEFITS THAT RATIFICATION OF THE CAPE TOWN CONVENTION CAN HOLD FOR SOUTH AFRICA AND WHAT NEEDS TO BE DONE TO ACHIEVE IMPLEMENTATION OF THE CONVENTION

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## 1. PURPOSE

The purpose of this presentation is to highlight the benefits that ratification and implementation of the Cape Town Convention and associated Aircraft Equipment Protocol can hold for South African airlines and aircraft leasing companies and what choices and actions are necessary by South Africa to achieve an implementation of the Convention that will secure the maximum benefit for the afore-mentioned South African companies.

## 2. BACKGROUND

The 1<sup>st</sup> of April 2004 is a significant date in the annals of South African Aviation History. On this date, the first, and so far only, international treaty or convention relating to aviation, and bearing the name of a South African city came into force. This Treaty is the so-called **Cape Town Convention on the International**

**Interests in Mobile Equipment (the Convention)** with it's supporting **Aircraft Equipment Protocol (the Protocol)**. The Protocol, however, only came into operation on 1<sup>st</sup> March 2006. Cape Town has thus joined the select group of international cities such as Chicago, Paris, Rome and Montreal to have an aviation related treaty named in its honour.

The Cape Town Convention was concluded at a Diplomatic Conference held in Cape Town in November 2001. The two sponsoring organizations behind the Conference were the International Institute for the Unification of Private Law (UNIDROIT) and the International Civil Aviation Organisation (ICAO).

## 3. AIM OF CAPE TOWN CONVENTION

The Cape Town Convention is truly a unique international treaty where a concerted effort has been made to create an international system of secured financing law that reflects the needs of the international financing community. The focus of the Convention is on the practical needs of parties and persons affected by secured financing transactions, and not the concepts and structures of any particular national legal system. If one had to draw parallels between the legal concepts contained in the Convention and those of any national legal system, the closest match would be with US and Canadian law. The reason for this is that these two jurisdictions have a long history of leasing transactions dating back to the start of the railways and have responded by developing legal concepts that reflect the needs of their respective business communities.

The aim of the Convention is to reduce the financial risk to creditors by providing secure and readily enforceable rights in easily identifiable, high value mobile equipment, such as aircraft. The Convention is also intended to apply to cross border financing and leasing transactions, where the application of the law of the place where the aircraft is found at

time of default does not adequately provide for the settlement of disputes concerning the validity, enforceability and priority ranking of security rights. The Convention furnishes a creditor with a basic set of default remedies that may be exercised in the event of a debtors default. Where the Convention is implemented in the manner intended by its drafters, creditors will be able to reduce the interest rate they must charge to account for the risk and this will result in reductions in the financing and leasing costs that airlines pay.

The essential features of the Convention and Protocol are the establishment of an international interest which is created when certain conditions listed in the Convention and Protocol are met. This international interest in an aircraft object can become vested in an aircraft lessor (under a leasing agreement), a conditional seller (under a title reservation agreement) or a chargor (under a security agreement). Registration is not required for the creation of the international interest – but rather to safeguard the priority of the holder of an international interest in relation to third parties.

The Convention and Protocol also allows Contracting States to adopt many of the “self help re-possession remedies” that are currently inserted into contractual agreements for the financing and leasing of aircraft that in many legal jurisdictions (except for certain Anglo Saxon countries) rely on the co-operation of the purchaser or lessee in order to successfully obtain the de-registration of the aircraft and repatriation of the aircraft. The Convention also creates an international registry for the registration, amendment, extension or discharge of “international interests” and other related rights. The international registry operated by Aviareto is situated in Ireland and came on line on 1 March 2006.

Internationally, the issue of obtaining agreement on and implementation of measures to recognize rights in aircraft has been slow. The first attempts to negotiate and implement a treaty commenced in 1925, and continued until 1948 with the coming into operation of the Geneva Convention on International Recognition of Rights in Aircraft (the “Geneva Convention”).

#### **4. GENEVA CONVENTION**

In essence the Geneva Convention is a conflict of laws treaty containing provisions to overcome the potential conflict amongst different laws governing the security interest according to the location of the aircraft.

The Geneva Convention links the creation of a security interest in an aircraft and its recognition in other contracting States to the law of the State where the aircraft is registered. South Africa ratified the Geneva Convention and implemented the treaty by way of the Convention on the International Rights in Aircraft Act No 59 of 1993, which creates the basis for the current “aircraft mortgaging” system in place today.

However, the Geneva Convention was never ratified by many of the most influential aviation powers, such as the United States and the United Kingdom and its usefulness in securing rights in aircraft is limited. For this reason, UNIDROIT devised the new system which was presented to the delegates at the Conference in Cape Town in 2001.

The main obstacle to obtaining agreement on and support for an international treaty has been the differences between the Continental “Civil Law” System used by the nations of Continental Europe and the Anglo Saxon “Common Law” System used by the United Kingdom, United States and some other ex British dominions or colonies. The challenge of creating legal concepts that could be accommodated and implemented in both Civil and Common Law jurisdictions was also present during the drafting and negotiation of the Cape Town Convention.

## 5. BENEFITS BESTOWED BY THE CONVENTION.

The implementation and ratification of the Convention by South Africa will mainly benefit those sectors of our Industry which purchase and/or lease in or out large commercial aircraft, such as South African Airways, Safair, BA/Comair, 1 Time and Nationwide.

**For Lessors.** For South African lessors of large commercial aircraft, the Convention and the Protocol provide a range of basic, non judicial and expeditious default remedies that can be utilised when the Lessee defaults, but the speed and simplicity of the remedies depends to a large degree on the “declarations” that South Africa makes in terms of Article XXX of the Protocol, as is more fully discussed hereunder. The remedies provided for in the Convention and Protocol are only meant as interim relief pending a final determination of the dispute or claim. These remedies will however allow lessors to quickly recover their aircraft. Lastly, the application of the Convention and the Protocol to aircraft engines will overcome the existing world wide uncertainty regarding the security of aircraft engines which up to now could not be registered in any public registry.

**For Airlines.** For those South African operators that lease in or purchase aircraft, once South Africa ratifies the Convention and Protocol (and executes it into South African Law) they will be able to secure better financing rates from concerns such as Ex-Im Bank of the United States due to much lower exposure fees. Ex-Im Bank has recently been offering a one third reduction in its “exposure” fee to airlines or aircraft purchasers in countries that have ratified the Convention

## 6. DIMINISHED INTEREST?

Whilst this Convention and Protocol was being negotiated, Transnet and South African Airways strongly supported its development and for this reason South Africa offered to host the final conference where the Treaty was adopted.

However, since hosting the Conference, for no good reason, general interest in South Africa regarding the Convention seems to have waned and thus far neither the instruments of ratification for both the Convention and the Protocol have been deposited nor the legislation necessary to execute the Treaty into South African law been promulgated. The main reason for South Africa failing to ratify and implement the Convention is more a lack of knowledge regarding the content of the Convention and understanding of what needs to be done to implement it, than anything else.

## 7. RATIFICATION

As regards ratification, the required process is set out in Article 47 of the Convention and Article XXV, Chapter VI of the Protocol. Both instruments of ratification are relatively simple to draft and file with UNIDROIT.

Prior to the deposition of instruments of ratification for both the Convention and the Protocol, South Africa will have to make various decisions regarding “declarations” that may be made at the time of ratification. Although some of these declarations can be made at any time and some at the time of acceptance, approval or accession to the Convention or Protocol, for the purpose of this presentation it will be presumed that all declarations will be made at time of ratification. There are three basic types of declarations, namely-

- **Opt-in declarations.** Declarations necessary to make a provision of the Convention / Protocol binding in a Contracting State.

- **Opt-out declarations.** Declarations necessary to prevent a particular provision from becoming binding in a Contracting State.
- **Other declarations.** Declarations such as those made in terms of Article 48 (2) and 53 of the Convention.

When the issue of declarations is considered, care will have to be exercised to ensure that each declaration made is as far as possible in line with current South African Law and where a declaration is not, that it will not conflict with the South African Constitution. The other major consideration is whether the content of the declaration will afford South African lessors protection for their assets and allow South African airlines/lessors to qualify for rate reductions on the aircraft that they purchase.

## 8. SPECIFIC ISSUES RELATING TO DECLARATIONS

Specific issues regarding some of the more important declarations will now be examined.

**Categories of Non Consensual Rights having priority over a registered international interest.** Article 39 of the Convention provides that Contracting States can make a declaration listing generally or specifically which categories of non consensual rights or interests under that States law have priority over a registered international interest. (In the Convention, a “non consensual right or interest” is defined as ”a right or interest conferred under the law of a Contracting State which has made a declaration under Article 39 to secure the performance of an obligation, including an obligation to a State, State entity or an intergovernmental or private organization.”)

Despite there being some legal debate regarding the true nature of a repairers lien, it is clear that if no specific declaration is made to give priority to the right of retention of repairers, an international interest will have precedence over this type of lien. With respect to this issue, South Africa probably has two options. It can either make a declaration that liens, although not registered in the International Registry have priority over an international registered right or a declaration can be made that in terms of Article 40 of the Convention, a lien is a non consensual right that can be registered in the International Registry.

Furthermore, consideration will have to be given as to what should happen to the preferential right bestowed upon a mortgagee in terms of the **Convention on the Rights in Aircraft Act, No 59 of 1993**. Should a declaration be made to give priority to this preferential right over an international interest? It is submitted that either a declaration should be made or the **Convention on the Rights in Aircraft Act, No 59 of 1993** should be repealed in its entirety, to eradicate contradictions between the new and the old system, the Cape Town Convention, 2004 and the Geneva Convention, 1948.

It is submitted that the best approach would be to repeal the Rights in Aircraft Act in its entirety, and introduce an entirely new aircraft registration system. This issue will be further discussed later in this presentation.

**Extra Judicial remedies for the repossession of aircraft.** South Africa is also going to have to decide how it is going to deal with the issue of so-called” self help repossession” of aircraft granted to chargees, conditional sellers and lessors. This is probably one of the most complex and legally controversial issues addressed in the Protocol that must be considered prior to any declaration being filed.

The current practice in South Africa in lease agreements entered into between South African Lessors and South African or foreign Lessee's (based on US legal principles) is that where a Lessee commits an "Event of Default", the Lessor may re-possess the aircraft and remove the same "...without the necessity for first initiating proceedings or by summary proceedings or other method under applicable law all without liability accruing to lessor for or by reason of such entering and taking of possession..."

If South Africa declares under Article XXX (2) of the Protocol that it will apply the whole of Article X, the creditor or lessor, in the event of default, by the debtor/lessee will be entitled, provided that at any time the parties have so agreed, without first obtaining a court order, (and even if the debtor /lessee at the time of re-possession objects thereto), to retake possession or control of any charged asset, to sell or re- lease the asset, to collect or receive income from the management or use of the asset, to accept transfer of the asset and to de-register and export the aircraft.

As described above, South Africa like other legal jurisdictions whose secured financing law was copied from English practice, has adopted the traditional form of the English agreements, without giving the legal concepts enshrined in those agreements any formal legal recognition. The Convention for the first time tries to formalize these concepts. Indeed the right to re-possess on default is one of the remedies of critical importance for the success of the Cape Town Convention. However, if one asks any South African lawyer whether the so-called "self help re-possession" remedies are part of South African Law, the reply will be that they are not. Indeed the current position in South African law is that wherever a dispute arises over possession or ownership of movable property such dispute must be referred to a court. However, protracted litigation, following default can be a major impediment to asset based finance. Therefore, if South Africa is going to establish fertile ground for secured financial transactions it will have to see whether the extra judicial remedies for the re-possessing of aircraft can be accommodated into our law, and if they can, decide how this can be done.

It is submitted that our law should be able to accommodate this legal concept. Although Section 34 (Access to courts) of the Constitution Act No 108 of 1996 provides that everyone has the right to have a dispute that can be resolved by application of law decided in a fair public hearing before a court, it is however submitted that section 36 (Limitation of rights) allows section 34 to be limited by legislation where there is a important reason to do so. Therefore, it would be possible to amend the Common Law by statute. However, if South Africa totally rejects the concept of supplying creditors with swift and uncomplicated ways of recovering their aircraft assets, the intent behind and benefits accruing from the Convention and Protocol will be lost. South African aviation companies will then probably forfeit any benefit in terms of the Convention.

**Deregistration and Export Request Authorisation.** Article XIII of the Protocol provides that where a debtor has issued an irrevocable de-registration and export request authorization (substantially in the form attached to the Protocol), such authorization has been submitted to the local registry, such local registry shall expeditiously co-operate with and assist the authorized party in the exercise of the remedies specified in Article IX.

This measure is directly linked to the issue of the extra judicial remedies for the repossession of aircraft, as deregistration by an aviation authority forms part of the process followed by a creditor to re-possess an aircraft and repatriate it.

The current South African leasing practice is that in most lease agreements it is provided that Foreign Lessees are required to provide either a Power of Attorney or Letter of" No

Objection to Deregistration” in terms of which the Lessee consents to the De-registration of the aircraft from the foreign register. (The same practice is followed when a foreign lessor leases an aircraft to a South African lessee and the aircraft is placed on the South African Civil Aircraft Register).

However, the policy of the South African Civil Aviation Authority (SACAA) is that whenever a dispute arises over the possession or ownership of an aircraft registered on the South African Register, the SACAA will not deregister the aircraft without an order by a competent court instructing it to do so.

If South Africa declares under Article XXX (2) of the Protocol that it will apply the whole of Article X (apply the non judicial re-possession measures), then legislation will have to be enacted to the effect that as long as the necessary documentation is filed with the SACAA, the SACAA shall remove the aircraft from the South African Civil Aircraft Register.

**Insolvency Proceedings.** The Convention contains provisions regulating the effects of insolvency (Article 30) and the Protocol stipulates remedies on insolvency (Article XI). The basic tenet of Article 30 is that in the case of insolvency proceedings against the debtor, international interests – if duly registered at the International Registry prior to the commencement of the proceedings, will be effective. This means that the international interest will rank ahead of the “preferent claims” of unsecured creditors provided for in the Insolvency Act No 24 of 1936. Article 30 does however state that the Article does not effect the domestic rules of law relating to impeachable dispositions.

The Protocol allows Contracting States a choice (by way of a declaration in terms of Article XXX (3)) that a state will apply one of two insolvency remedies.

**Alternative A.** If the insolvency administrator /debtor is unable to cure all defaults and agree to perform all future obligations within the waiting period, the administrator must give the creditor the opportunity to take possession of the aircraft. The court has no powers of intervention to stay the enforcement. The insolvency administrator / debtor must preserve the aircraft and maintain it and its value until the creditor is given the opportunity to take possession of the aircraft.

**Alternative B.** The insolvency administrator /debtor must give notice to the creditor within the waiting period whether it is able to cure all defaults and agree to perform all future obligations or if it will give the creditor the opportunity to take possession of the aircraft. If the insolvency administrator / debtor does not give notice, the court may permit the creditor to take possession upon such terms as the court may determine.

South Africa has the right to chose either alternative or apply our own insolvency rules in terms of the Insolvency Act. Ex-Im Bank has however indicated that it supports “Alternative A” the so-called “hard regime” and a waiting period of 60 days. However “Alternative B” is probably more compatible with our legal practice and will allow for some judicial discretion to protect creditors. As a declaration adopting Alternative B will better received by aircraft financiers and lessors than an adoption of our own insolvency law requirements, it is recommended that South Africa adopt this alternative.

## **9. INTERFACING OF INTERNATIONAL AND NATIONAL REGISTRIES**

The Convention and the Protocol through the creation of international interests and prospective international interests, have established totally new legal concepts which are unfamiliar to the South African Aircraft Registration system.

Regulations will therefore have to be promulgated to establish the structure and processes of the South African operation of a local registry which will serve as the “entry point “ for authorized filings to the International Registry. This Registry will most probably be managed by the SACAA, along the lines of the current Aircraft Registry. These regulations must set out the requirements for affecting a registration, the process for making searches and issuing search certificates and the mechanisms to ensure the confidentiality of the documents of the International Registry other than information and documents relating to registration.

## **10. MAIN ACT AND MISCELLANEOUS LEGISLATIVE ISSUES.**

In order for South Africa to benefit from Cape Town Convention and the Aircraft Protocol, our Government will have to promulgate an Act of Parliament providing for the application of the Convention in South Africa, and all matters ancillary thereto. It would be appropriate to call the Act, “The Convention on the International Interests in Mobile Equipment Act.”

As the Convention and the Protocol are detailed, the body of the Act could be relatively brief with the Convention and the Protocol being attached as schedules to the Act.

The Act enabling the Cape Town Convention must also make provision for the power of the Minister (of Transport) to introduce regulations to allow for the administration of the new financial security structures.

## **11. CONCLUSION**

It is submitted that the chance to ratify and implement the Cape Town Convention and the Aircraft Protocol presents a golden opportunity for South Africa to acknowledge a treaty named after one of our country’s main cities as well as allow the domestic aviation industry to benefit in the manner described above. Ratification by making the appropriate declarations and implementation of the Convention and the Protocol in line with these declarations will enable South Africa to secure its place and aircraft assets in the highly competitive and volatile global aviation market.