

Priority rules under Cape Town Convention *and* interaction with national rules

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06 January 2017





Presentation outline

1. Cape Town Convention – a brief outline
2. Priorities under the Cape Town Convention
 - The concept of ‘international interest’
 - The basic rule
 - Special priorities
3. Conclusions

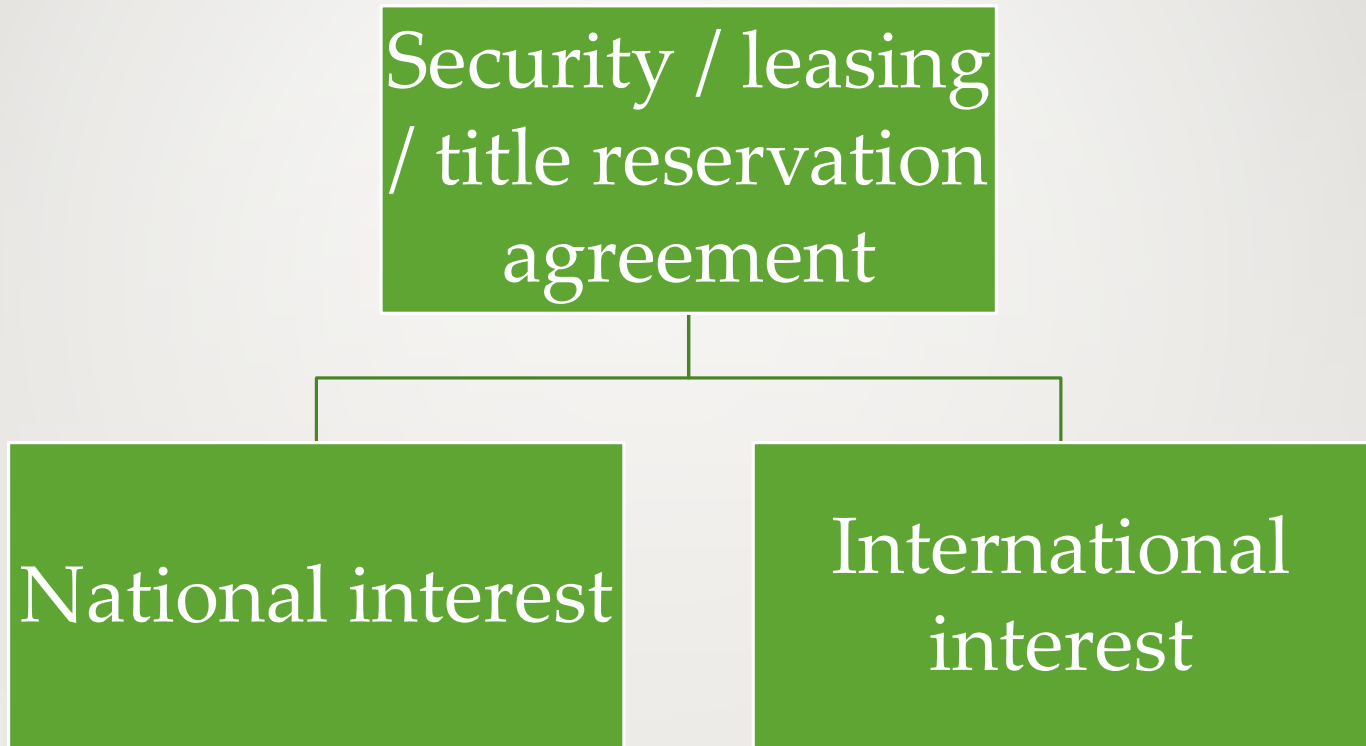
Cape Town Convention at a glance

- Provides for the creation of **international interests** in certain categories of **high-value** and uniquely-identifiable **mobile equipment**
- Protects financiers via convention-specific **default remedies**
- Establishes an **international registry** for filing various interests *against the mobile equipment* (not against the debtor!)

Mobile equipment covered



International interest (overview)



International interest (part 1)

- Arises automatically under complying agreement (*must be in writing, must identify the object and secured obligation, chargor/seller/lessor must have power to dispose*)
- Art. 6(3) of CTC UK Regulations 2015: *'international interest has effect...with no requirement to determine whether a proprietary right has been validly created or transferred pursuant to the common law lex situs rule'*.
- Can be registered in the International Registry

International interest (part 2)

- Registration of international interests in International Registry:
 - is **not required** to constitute an international interest
 - is **not required** to exercise remedies
 - is **not based** on any national registrations (e.g. National Register of Aircraft Mortgages in the UK)
 - is **required** to determine priorities

Priorities: the basic rule

- Art. 29(1): A registered interest has priority over
 - any subsequently registered interest (**first-in-time**)
 - unregistered interest (**registered over unregistered**)
- Priority is based on registration in the International Registry
 - Priority of competing **unregistered** interests *inter se* is governed by applicable law
 - BUT once any interest **becomes registered**, the basic rule (registered over unregistered) applies
 - How will domestic law resolve disputes involving unregistered international interests?

Priorities: the basic rule (continued)

- **Strong priority:** registered interests **trump** all unregistered interests (even those which are *not registrable* under CTC)
- **Objective priority:** applies regardless of knowledge of an interest created (but not registered) earlier
- Key objectives: simplicity and predictability

The basic rule in a domestic context

- **No internationality requirement:** priority position of a registered interest does not change in a purely domestic situation
- Domestic financiers:
 - must register to preserve priority
 - BUT are able to protect their priority position against competing foreign creditors (cf. the reverse scenario)

The basic rule in a domestic context (continued)

- Article 50(1) declarations: states may choose not to apply the CTC to internal transactions
- **BUT** even then convention priorities continue to apply – to avoid two parallel systems of priorities
- Domestic financiers may secure their priority by filing **notices of national interests** in the International Registry
- ‘Gateway’ rule: *“internal transaction” means a transaction...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 50(1)’*



Special Priorities (part 1)

Proceeds

- Any convention priority extends to proceeds (Art. 29(6))
- “Proceeds” are narrowly defined as *‘money or non-money proceeds of an object arising from the **total or partial loss or physical destruction** of the object or its **total or partial confiscation, condemnation or requisition**’*
- Convention does not determine the priority between Party A and Party B, where:
 - Party A holds a convention interest and claims insurance proceeds
 - Party B claims proceeds generally as receivables financier

Contractual subordination

- Holders of interests are free to vary their priority position vis-à-vis each other (Art. 29(5))
- Debtor's consent is not required
- Assignee of a subordinated interest is not bound by a subordination agreement unless at the time of assignment the subordination had been registered in the International Registry (Art. 29(5))
- Assignee's knowledge of subordination is irrelevant

Priority position of prospective international interest

- “Prospective international interest” (PII) – a separate registrable interest that is intended to become a ‘full’ international interest upon the occurrence of a certain event
- Once the registered PII becomes a ‘full’ international interest, the latter is treated as registered **from the moment of registration of the PII** (Art. 19(4))

Transitional provisions

- Pre-existing interests: any rights or interests that existed prior to the effective date of the CTC retain their priority (Art. 60(1))
- Contracting States may declare otherwise
- For UK debtors this means that priority extends to rights and interests created prior to 01 November 2015

No implied doctrine of accession

- Convention adopts a hands-off approach to:
 - rights in any items (other than standalone objects specified in the protocols) that **existed prior to their installation** on such objects – if upon installation they continue to exist under the applicable law; and
 - creation of **new rights** in items (other than standalone objects specified in the protocols) installed on such objects – where they are created under the applicable law

Priority in debtor's insolvency

- International interest survives in debtor's insolvency, **if registered** prior to the start of insolvency proceedings (Art. 30(1))
- An international interest **not so registered** survives in bankruptcy only if applicable law so provides (Art. 30(2))
- Convention does not affect:
 - applicable law rules relating to preference transactions and transfers in fraud of creditors
 - applicable law rules of procedure relating to the enforcement of property controlled by insolvency administrator



Special Priorities (part 2)

Debtor cannot trump its creditor

- This rule cannot be found in the convention – see Official Commentary, para 2.171
- A debtor who holds an international interest **cannot** rely on convention priorities to **obtain priority over its own creditor**
 - E.g. lessee cannot obtain priority by registering its interest (as sub-lessor) against sub-lessee before its own lessor registers its interest against it

Priority of certain non-consensual rights or interests

- Does not exist a priori
- Can be created by a declaration under:
 - **Art. 39: priority without registration**
 - In the UK extends to:
 - possessory liens in respect of work done on the aircraft
 - any right to arrest or detain the object under any enactment with effect in the UK
 - **Art. 40: registrable** non-consensual rights or interests (*'everything is within the system'*)

Outright buyers, conditional buyers and lessees

- Outright buyer of an object **takes free** from an unregistered interest, even if it has actual knowledge of such interest (Art. 29(3))
- Conditional buyer/lessee of an object **takes free** from any interest not registered prior to the registration of the relevant conditional sale/lease (Art. 29(4))
 - Conditional buyer/lessee have no registrable interest – rely on registration of seller's/lessor's interest

Application of CTC to outright sales

- Extended by the Aircraft and Space Protocols
- Allows registration of outright sales in the International Registry akin to international interests
- No priority issues in a chain of sales $A \Rightarrow B \Rightarrow C$
- But in other situations (competing sales by the **same seller**) allows to determine the priority between buyers via 'first-in-time', making priority system '*complete*'

No cross-over priority protection in case of outright sales

Registration by Party A as outright buyer	Registration by Party A as holder of international interest (lease)
Protects against a subsequent sale of the same object by the original seller	Protects against disposition by the lessee under the international interest
Does not protect against disposition by the lessee under the international interest	Does not protect against a subsequent sale of the same object by the original seller

Assignment of associated rights (AR) (part 1)

- Radical change of approach:
 - **Original concept** – transfer of international interest should carry with it associated rights
 - **Final text** – international interest should follow the right to payment/performance
- Limited to those rights to payment/other performance which are **secured by or associated with the object**
- Assignment of AR is **not registrable** – only assignment of international interest can be registered (Art. 16(1)(b)) and creates priority

Assignment of associated rights (AR) (part 2)

- Convention does not apply to assignments of AR which **do not transfer the corresponding international interest** (since these rights themselves are not registrable)
- Competing assignments of AR linked to **different international interests**: priority based on the priority of underlying international interests

Assignment of associated rights (AR) (part 3)

- Competing assignments of AR relating to the **same international interest**:
 - Basic rule (first-in-time, registered over unregistered) applied mutatis mutandis, **provided that**:
 - at least one assignment includes the international interest;
 - the underlying agreement states that AR are secured by or associated with the object – i.e. *debtor knows about the object*
 - priority is given only to the extent that AR (debts) are object-related – i.e. *debt created to purchase the object*
 - In all other cases (e.g. no assignment is registered/includes the international interest) – priority determined by applicable law

Priority in subrogation under applicable law (e.g. surety/insurer)

- Starting point:
 - Convention does not affect the acquisition of international interests or AR by subrogation under applicable law (Art. 38(1))
 - Acquisition of international interest by subrogation is registrable in the International Registry (Art. 16(1)(c))
- Priority position depends on linkage to international interest akin to assignments of AR (NB no express provision in the convention itself):
 - Subrogation relating to **different international interests** – priority based on priority of underlying international interests
 - Subrogation relating to the **same international interest** – determined by first-to-file rule (Official Commentary, para 2.208)

Conclusions

- Convention priorities do not rely on national law (no need to register with Companies House)
- Convention priorities are based on registration (CTC does not regulate priorities among unregistered interests)
- Convention priorities are linked to the mobile equipment (CTC does not regulate priorities of assignments without the international interest)

Conclusions (implications for national priority systems)

- Parallel systems of priorities are not feasible (same creditor may be both senior and junior)
- Registration-based system of priorities must not disadvantage parties who
 - (i) cannot reasonably be expected to consult the registry (*e.g. assignees of associated rights*)
 - (ii) cannot find information on the registry (*e.g. assignees in subordinations*)
- Inferences from the CTC (e.g. registration at all times to retain priority) must be made with caution: note the special scope of CTC



Thank you!