

The Convention of Cape Town: The Creation of International Interests in Mobile Equipment

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This special issue of the European Review of Private Law concerns the Convention on International Interests in Mobile Equipment (CIME or Convention), the Aircraft Equipment Protocol (AEP or Protocol), the draft Railway Rolling Stock Protocol and the draft Space Assets Protocol. The principal objective of the Convention is to facilitate the financing of the acquisition and use of high-value mobile equipment and to make such equipment more available. For that purpose this instrument provides an international regime for the enforcement, registration and protection of international interests in mobile equipment. The CIME, however, is a framework Convention incorporating general provisions. The CIME relates only to certain categories of mobile equipment, which are defined in separate Protocols. The Protocols are designed to supplement and modify the Convention to meet the specific requirements of various kinds of mobile equipment. In general, the term mobile equipment encompasses objects which by their very nature are used internationally, for example aircraft, satellites, trains, containers and ships. The Aircraft Equipment Protocol, which only relates to aircraft equipment, is the first Protocol that has been completed. The Railway Rolling Stock Protocol and Space Assets Protocol are already at an advanced stage of preparation with a view to adoption in due course. Furthermore, Protocols for registered ships, movable oilrigs, containers and trucks may follow.

The CIME and the AEP¹ were concluded at a Diplomatic Conference in Cape Town, South Africa in November 2001.² At this moment in time Ethiopia, Nigeria, Panama and Pakistan have already ratified the CIME and AEP. Many other States, including Canada, India, South Africa and the USA, are in the midst of ratification procedures with regard to adopting these instruments. Furthermore, it is interesting to note that the European Bank for Reconstruction and Development is willing to

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¹ R.M. GOODE, *Official Commentary on the Convention on International Interests in Mobile Equipment and Protocol thereto on Matters specific to Aircraft Equipment*, UNIDROIT, Rome 2002. The Official Commentary clarifies the complex structure and detailed contents of the CIME and the AEP. It is a useful, neutral and unbiased source that has been prepared most diligently to comply fully with the reasoning and ideas of the Diplomatic Conference (<www.unidroit.org>). See for further details, B.P. HONNEBIER, 'Bookreview', in *AILA* Vol. XXVIII, No. 6 (*Air and Space Law*) 2003, p 334.

² <<http://www.unidroit.org/english/presentation/main.htm#NR10>>.

provide the Russian Federation with technical assistance in relation to the acceptance and implementation of the Convention.³

In addition, the new regime explicitly provides that a Regional Economic Integration Organization (REIO) may ratify these documents. Therefore, the European Commission⁴ has put the acceptance of the CIME and AEP on its agenda. Currently, it is co-ordinating with the fifteen Member States of the European Union with a view to the signing and conclusion of specific articles of the Convention and Protocol. These provisions concern jurisdiction, recognition, enforcement of judgements and insolvency matters.⁵ The great importance of the Commission's project lies in the fact that the European Commission has come to the conclusion that the Convention and Aircraft Equipment Protocol will be advantageous to the financiers, airline companies and consumers of the member states.⁶ It endorses the view that the CIME/AEP will provide for the needed solid uniform European property regime which will make the financing of aircraft objects more available and less costly.⁷ This point of view has persuaded the European Commission to instigate the necessary procedure. When a REIO accepts the CIME/AEP it has the rights and obligations of a Contracting State, to the extent that the REIO has competence over the matters governed by the Convention. Some of the Member States, however, questioned the European Union's competence to conclude international agreements, particularly in relation to the substantive insolvency provisions of the CIME/AEP. Nevertheless, the European Commission and these states recently ended this dispute concerning competence as regards the texts. Therefore, the Commission could push forward its proposal to accept the Convention and Protocol to the Council of the European

³ Aviation Working Group, *Information Bulletin* 2, 2003.

⁴ The European Union actively participated in the drafting of the CIME/AEP at the Diplomatic Conference in Cape Town. See European Parliament, Working Document, PE 332.602, 6 October 2003; EU Bulletin, 3-2003, Transport (22/22); Council of the European Union, Doc. 15904/1/02, 14 February 2003; Commission of the European Communities, Doc. SEC (2002) 1308, 17 December 2002.

⁵ The member states have transferred power to the Community concerning matters covered by Council Regulation (EC) Nos. 44/2001, 22 December 2000 on jurisdiction and the recognition and enforcement of judgements in civil and commercial matters and 1346/2000, 29 May 2000 on insolvency proceedings. This includes matters covered by the following provisions: Arts 1(d), (h), (k) and (1), 13, 30, 37, 53 and 55, and Chapter XII of the Convention. Also Arts I(2)(m) and (n), X, XI, XII, XXI, XXII and XXX of the Protocol.

⁶ The European Council has also authorized the Commission to open negotiations for the adoption of the Railway Rolling Stock Protocol. Justice and Home Affairs, Doc 6162/03 (Presse 42), 27-28 February 2003.

⁷ For the European Commission's position on aerospace in general and on civil aviation in particular, see *A Coherent Framework for Aerospace-A Response to the STAR 21 Report*, COM (2003) 600, 13 October 2003.

Union in order to obtain its required approval. Consequently, most likely the European Union's acceptance⁸ of specific articles of these instruments will take place in the near future. Furthermore, the road leading to the ratification of the other articles of the Convention and Protocol by the individual European Member States has been cleared. Moreover, in the future the regime of these documents can be used as a stepping-stone towards the unification of any other existing European security interests.

Besides, some Courts that are directly located in or indirectly connected to the European Union already apply the new regime of the CIME/AEP. For example, in 2002 a Court of Appeal in the Netherlands decided that the general Dutch property law doctrine of 'Accession' (*Natrekking*) does not apply to aircraft engines that are attached to large aircraft which are registered in the national Registry.⁹ This important decision is entirely in line with the new regime of the Convention of Cape Town and Aircraft Equipment Protocol which provide for the separate financing and registration of these objects (Article I(2)(c) AEP). The ruling is completely in conflict, however, with the controversial national view concerning the doctrine of accession and aircraft engines. This inaccurate view contends that in all circumstances the ownership of an aircraft engine passes to the owner of an airframe as soon as it is attached to it.¹⁰ Later in time, the Court of First Instance of the country Aruba, which is an autonomous part of the Kingdom of the Netherlands in South America, ruled in the same manner as the Dutch Court of Appeal. This case, however, concerned the financing of aircraft engines that are attached to small aircraft that are not registered in the Registry.¹¹

The Convention will enter into force on 1 April 2004, which is three months following the deposit of the third instrument of ratification.¹² It is only valid,

⁸ The signing and conclusion of the CIME/AEP by the European Union will not have any consequences for Denmark.

⁹ Dutch law makes a sharp distinction between the financing of registrable and non-registrable aircraft. The Dutch Civil Code contains a special property regime for large aircraft which are registered in the national Registry (Art. 8:3a Civil Code). This regime, however, does not cover small non-registrable aircraft. Small aircraft are governed by the general property regime of the Dutch Civil Code that applies to movable property.

¹⁰ See for this view A.I.M. VAN MIERLO, 'Dutch security rights in aircraft and engines', in *AILA* Vol. XVII, No. 2 (*Air & Space Law*) 1992, p 112; B.J.H. CRANS, 'Analysis of the merits of the proposed UNIDROIT Convention on International Interests in Mobile Equipment and Aircraft Equipment Protocol on the Basis of a Fictional Scenario', in *AILA* Vol. XXV, No. 2 (*Air & Space Law*) 2000, p 51.

¹¹ *AAR Aircraft & Engine Group/Aerowings, Gerechtshof*, Den Bosch, the Netherlands, 15 August 2002. See also *Volvo Aero Leasing/AVIA Air*, Interim Injunction Proceedings, Court of First Instance of Aruba, 25 June, 2003, No. 121. Also the UNIDROIT Convention on International Financial Leasing (Convention of Ottawa, 1999) recognises that presently aircraft engines are leased and registered separately from the airframes (Art. 7(3) CIFL).

¹² Nigeria was the third State to ratify the Convention and Protocol on 16 December 2003.

however, as regards a category of objects to which a Protocol applies (Article 49(1) CIME). This means that the Convention cannot operate independently from the relevant Protocol. The AEP will be the first Protocol to enter into force. For that purpose it requires ratification by eight States (Article XXVI(5) AEP). As has been mentioned above, four States have already accepted it. It is expected that both the CIME and AEP will have entered into force by mid-2004.

In international practice the following three legal devices are used most frequently in relation to the financing of mobile equipment: a loan secured by a security interest in the object, a conditional sale under a title reservation agreement and a lease agreement. If these methods of finance are to work effectively, reduce economic risk and incite the availability of money from the private financial institutions they require a secure legal regime. Considering the substantial funds needed for the financing of the acquisition or use of mobile equipment, it is imperative that this regime protects the financier's rights when the debtor defaults. The problem is, however, that presently there exists a great variety of municipal conflict of laws rules regarding the recognition, enforcement and priority status of foreign proprietary interests in mobile equipment. As a result of the absence of a uniform conflict of laws rule there is a large degree of legal uncertainty at the international level and in particular at the European level. The reason for this is that traditionally most Member States of the European Union apply the *lex situs*, also known as the *lex rei sitae*, conflict of laws rule in relation to the recognition of property rights in movables.¹³ In general it is the law of the *situs* where the equipment is situated at the time that the property right is created which is applicable. These European jurisdictions require, however, that the characterisation of the kinds of foreign interests that may be protected in the forum state is addressed by means of a subsequent transposition. Therefore, the prospective recognition, enforcement and priority status of a foreign security interest depends on its similarity to an existing national proprietary right of the new *situs*. In a practical sense, however, mobile equipment does *not* have a specific *situs*. It is continuously moving from state to state in the course of business, or, in the case of space assets, it is not physically connected to any state at all. Consequently, there is a danger that each time mobile equipment crosses a border the interest constituted therein will not be recognised or enforced. For that reason, the *lex situs* rule is considered to be manifestly inadequate in relation to mobile equipment. The possibility that the rights of the financier may not be upheld abroad is regarded as a considerable economic risk. It will negatively influence the

¹³ B.P. HONNEBIER, 'The Convention on International Interests in Mobile Equipment and Aircraft Equipment Protocol will encourage European property law reform', in *Edinburgh Law Review* 8, 2004, p 115. See also E.-M. KIENINGER, 'Securities in movable property within the Common Market', in *ERPL* Vol. 4, No. 1 (*European Review of Private Law*) 1996, p 43.

financier's confidence in the international transaction. As great economic risk leads to substantial costs, the *lex situs* rule hinders the financing of mobile equipment. Furthermore, the existing 'Convention on the Recognition of Rights in Aircraft (Geneva Convention, 1948)' is inadequate. Although it endorses the view that the *lex situs* is unsatisfactory and replaces it by the more identifiable *lex registry* conflict of laws rule, its applicability is highly conditional upon specific circumstances. For example, it has *not* been ratified at a global level. Moreover, a third of the Member States of the European Union have not accepted it.

Besides, even if a 'satisfactory' uniform conflict of laws rule could be created, it could not solve the problem that presently national property laws dominate the financing of mobile equipment. In general there is a great diversity of property law regimes at the international level and in particular at the European level. More specifically, in the European Union there is no uniform law dealing with security interests in mobile equipment. Moreover, previous international attempts at codifying secured interests in aircraft have been unsuccessful. Particularly, the complexity and diversity of the national European property rights have accounted for this fact. The past has proved how difficult it is to transcend the dogmatic issues that exist in the legal proprietary regimes of the European states. The reason for this is that many European jurisdictions are very restrictive with regard to the creation and effects of security interests, as they have closed proprietary regimes (*numerus clausus*). Furthermore, presently some European states are still hostile to non-possessory security interests, due to the lack of publicity.¹⁴ As a result, the financier's proprietary interests differ from state to state and accordingly it is uncertain as to whether its rights can be upheld against third parties in other European countries. Consequently, the absence of uniformity in the European Union (EU) in relation to the security interests of the financier creates barriers to international commercial activity. Therefore, the EU needs a secure international system of law to facilitate the use of the above-mentioned three legal devices, which in turn will make the financing of mobile equipment more easily available and at lower costs.

The CIME/AEP and the forthcoming Protocols resolve the problems at hand. They contain a set of uniform substantive provisions relating to property law. As noted above, these instruments introduce rules in respect of the recognition, enforcement and priority status of interests in mobile equipment. For this purpose, the CIME/AEP provides for the creation of an autonomous international interest which has a proprietary character (*ius in rem*). The Convention has a pragmatic approach in relation to the establishment of such an interest. The definition of an

¹⁴ A substitution for possession in order to achieve publicity is registration; this is often a requirement for the creation of a security right (e.g. France, England); in the case of retention of title publicity is, with the exception of Switzerland, always absent.

international interest accommodates both the traditional civil law and the functional common law systems of property law. The international interest encompasses the following national legal devices: (a) security agreements; (b) title reservation agreements and (c) various forms of leasing agreements and the equivalent thereof. As mentioned above, these are the methods of finance which are used most often in respect of mobile equipment. Additionally, the regime of the CIME and its Protocols lays down the extensive remedies of the holder of an international interest. Furthermore, the Convention establishes an International Registry at which an international interest may be entered. Following international registration, and depending on its priority status the holder can exercise its international interest against any party in any Contracting State. This rule applies both in the case of and outside the insolvency of the debtor.

This special edition of the European Law Review addresses the financing of the various categories of mobile equipment as follows. First, Martin Stanford (UNIDROIT Secretariat, Italy) introduces the Convention, its history and future after Cape Town. Next Sir Roy Goode (University of Oxford, United Kingdom) discusses the international interest as an autonomous security interest. Afterwards, Howard Rosen (Legalease, Switzerland) focuses on the Railway Rolling Stock Protocol and Olivier Ribbelink (T.M.C. Asser Institute, the Netherlands) addresses the Space Assets Protocol. Furthermore, Patrick Honnebier (University of Utrecht, the Netherlands), Arthur Salomons (University of Amsterdam, the Netherlands) and Vincent Sagaert (University of Antwerp and Catholic University of Louvain, Belgium) examine the implications of the Convention and its Protocols for national property law regimes. Finally, Sjef van Erp (University of Maastricht, the Netherlands) discusses the newly created International Registry.