



Australian Government

Department of Infrastructure and Transport

CAPE TOWN CONVENTION

2010 Consultation Paper

Implementation options, pre-existing interests, courts and insolvency issues

The 2001 *Convention on International Interests in Mobile Equipment* and the associated *Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment* (Cape Town Convention) facilitates the financing of aircraft by providing a homogenous securities framework encompassing a set of basic remedies in the event of debtor default, and an international register for creditors to register their securities interests and secure the priority of their interest against other parties.

In 2007 the Organisation for Economic Co-operation and Development (OECD) developed a new ‘Sector Understanding on Export Credits for Civil Aircraft’ (ASU), to which Australia is a participant. Under the ASU, Australian airlines may have access to a fee discount from export credit agencies from the European Union, the United States, Japan, Brazil and Canada for the purchase of aircraft objects, provided Australia becomes party to the Cape Town Convention and makes a number of specified declarations upon accession.

Following the passage of the *Personal Property Securities Act 2009* (PPS Act), a key consideration for the Australian Government in assessing the merits of the treaty is to ensure that any interaction between the Cape Town Convention and PPS Act does not create burdensome or duplicated regulatory requirements for industry.

Implementation Models

To this end, the Government has identified three possible models to implement the Cape Town Convention in Australia:

Model A – Give the Cape Town Convention force of law and provide for the treaty to prevail over the PPS Act where inconsistencies arise

This model is the simplest option to implement and provides certainty with regards to qualification for a ‘fee discount’ under the Convention and ASU. In practice, Model A will require stakeholders to have a strong understanding of both the PPS Act and the Cape Town Convention. Industry may therefore need to engage legal expertise to understand their rights and obligations in relation to securities interests in aircraft objects if the treaty were adopted in this way.

Model A has recently been applied by New Zealand upon acceding to the Cape Town Convention. Noting the similarities between the Australian and New Zealand jurisdictions in relation to the regulation of PPS and a mutual commitment to regulatory harmonisation,¹ it may be in Australia’s best interests to adopt Model A and further align the aviation financing regimes of the two countries.

¹ See the Memorandum of Understanding on Coordination of Business Law at http://www.treasury.gov.au/documents/1073/PDF/Business_law_MOU.pdf

Model B – Amend the PPS Act to incorporate Cape Town Convention rules

Model B will require detailed amendments to be made to the PPS Act to adapt the treaty rules into existing domestic law. When compared with Models A and C, Model B may provide stakeholders with more clarification in relation to their rights and obligations arising under the PPS Act and the Cape Town Convention.

On the other hand, by ‘adapting’ the treaty rules into existing domestic law rather than adopting the treaty text in its original form, this model puts Australia’s qualification for the Cape Town Convention ‘fee discount’ at risk. As airline access to a fee discount for the purchase of aircraft is a significant driver for accession, the prospect of not being eligible for the discount is a significant drawback for Model B.

The nature of the changes required to be made to the PPS Act under Model B will demand extensive consultation with stakeholders and will be a resource-intensive exercise if pursued. This will have implications for the Government’s ability to implement the Convention quickly and in accordance with stakeholder expectations around timing.

Model C – Combine Models A and B and enact parts of the Convention, while implementing the rest through amendments to the PPS Act

This model balances the above two approaches by giving parts of the Cape Town Convention force of law and implementing the remainder through amendments to the PPS Act. As with Model A, stakeholders will be required to be familiar with both the PPS Act and Cape Town Convention with regards to security interests in aircraft. However, this complexity may be exacerbated by Model C as it may be difficult to determine which instrument provides the relevant rule at any given time.

Information sought

Questions:

- Which model appears to be the most appropriate for industry in the current legislative context?
- Is industry already in the practice of engaging legal practitioners to handle its financial affairs?

Insolvency

As previously noted, in order to qualify for a fee discount, Australia is required to make a number of ‘declarations’ upon accession to the Cape Town Convention. This requirement includes adherence to the ‘Alternative A’² insolvency regime under the treaty, which requires a debtor to automatically transfer possession of the aircraft object to the secured creditor after a waiting period of a maximum 60 days. Under this regime, the Australian courts would have no powers to delay or prevent the enforcement of this remedy.

To allow for Alternative A to prevail over existing insolvency laws where aircraft objects are concerned, debtors need to be aware that existing options to manage insolvency and company restructures will be impacted. That is, if Australia accedes to the Cape Town Convention, a debtor airline’s insolvency rights and obligations under *Corporations Act 2001* may be affected as follows:

Liquidation

Under existing Australian law, the rights of secured creditors to enforce their securities are not affected by liquidation. Alternative A will therefore not alter the law in respect of liquidations.

Voluntary administration

Where a debtor company enters into voluntary administration, a secured creditor is (generally) currently prohibited from enforcing its security until a Deed of Company Arrangement (Deed) is

² Previous stakeholder consultations have indicated the majority of industry is comfortable with adopting Alternative A upon accession.

established, the administration ends, or a decision to wind-up the company has been made. This normally occurs within 25 business days; however this ‘decision period’ may be extended by the courts. An extension of the decision period would not be unexpected in the case of the administration of an airline.

Following accession applying Alternative A, a secured creditor will be entitled to enforce its security after 60 calendar days and without court interference, regardless of whether a debtor has entered voluntary administration and the non-consensual stay is in place.

The ability of a secured creditor to enforce their security during voluntary administration could adversely impact the prospects of a successful Deed to reorganise the debtor company.

The alteration of secured creditors’ rights (by altering their bargaining power), may also adversely impact upon a debtor’s ability to negotiate informal reorganisation arrangements in advance of formal administration.

Information sought

The Government is seeking industry views about the expected impact of accession on existing *Corporations Act 2001* provisions dealing with company restructure and the enforcement of remedies.

Question:

- Is industry willing to forego some of the benefits of existing debtor-friendly stays on the enforcement of remedies during the voluntary administration period – with consequential impacts on the prospects of successful informal and formal reorganisations – in return for the benefits available under the Cape Town Convention?

Pre-existing rights and interests

By default, the Cape Town Convention does not apply to those rights and interests that exist in relation to an aircraft object *before* the treaty comes into force in Australia. However, upon accession, Australia has the option to apply the treaty to pre-existing rights and interests by making a declaration under Article 60 of the Convention.

If Australia makes this declaration, the Convention priority rules will not apply before a period of at least three years from a date specified in the declaration. After that period, those rules will apply in relation to those rights and interests that came into existence before the effective date of the Convention. This timeframe is intended to allow holders of pre-existing rights or interests a reasonable period to re-perfect their interest by registering it in the International Registry. Administrative costs will inevitably be higher for industry (to allow for the registration of pre-existing interests) if the Convention is applied in this way.

If Australia decides not to make an Article 60 declaration, the priority of security interests created after accession will need to be determined as against pre-Convention rights and interests, under the applicable domestic law. This would require those holding post-Convention international interests to determine the existence of such interests (although advice to date suggests this practice is not uncommon in the existing financing environment). The Convention would continue to govern priority between those interests arising after accession.

Currently, no ratifying countries have applied the treaty to pre-existing rights or interests.

Information sought

Question:

- Would industry like to see the Convention apply to pre-existing rights or interests, or should these interests continue to be governed by domestic law after accession?

Court jurisdiction

Article 53 of the Convention allows Australia to nominate a court or courts which would have jurisdiction under the Convention.

Government consideration of this issue has indicated that the Federal Court, as well as the Supreme Courts of States and Territories, may be best placed to hear cases involving Cape Town Convention matters. This determination is based on the following factors:

- i. relevant legal limits to jurisdiction – no particular limits identified to date;
- ii. whether a particular court (or courts) have relevant expertise in Cape Town Convention issues – jurisdiction is currently conferred on the Federal Court and the courts of State and Territories for other PPS matters that do not involve aircraft objects;
- iii. the complexity, size and importance of the issues involved – cases are expected to be complex in nature and involve substantial amounts of money;
- iv. likely workload – only a few cases involving Cape Town Convention issues are expected to arise, particularly if Alternative A is adopted; and
- v. convenience for litigants – it is anticipated that access to courts by litigants will be facilitated by spreading jurisdiction across the Commonwealth, States and Territories. The views of stakeholders as to their preferred forum would be of value in this regard.

Information sought

Questions:

- Is industry comfortable with the proposal to allocate jurisdiction to the Federal Court and Supreme Courts of the States and Territories to hear matters arising under Cape Town Convention?
- Alternatively, does industry have a preference about which courts should hold jurisdiction?

Further information

The texts of the Cape Town Convention and its associated Protocol are available at the UNIDROIT Website:

<http://www.unidroit.org/english/conventions/c-main.htm>

A copy of the 2008 Consultation Paper released by the Department of Infrastructure and Transport can be found here:

http://www.infrastructure.gov.au/aviation/international/consultation_cape_town.aspx

Comments

Please provide any comments by email to <shahreen.leech@infrastructure.gov.au> or by fax to 02 6274 6749 by **Wednesday 22 December 2010**. Please contact Shahreen Leech at the abovementioned email address or on (02) 6274 6995 if you have any questions about this consultation paper or the Cape Town Convention more generally.

The outcome of this round of consultations will be considered by the Department of Infrastructure and Transport in partnership with the Personal Property Securities Branch of the Attorney General's Department and included as advice to the Australian Government on the merits and risks of the Convention.