



Legal Update

INSIDE THIS ISSUE:

Aruba's Aircraft Industry	1
Collateral unenforceable?	1
Cape Town Convention	2
Why Register in Aruba?	2
Conclusion	3
Who we are	3
Contact details	3

Security rights in aircraft may prove to be unenforceable due to different conflict of law rules applied in different jurisdictions

The Cape Town Convention, establishing an international regime for security rights on aircraft became applicable to Aruba on September 1, 2010

Spotlight on Aruba's Thriving Aircraft Financing Industry

Introduction

This month marks the first anniversary of the entry into force in Aruba of the Cape Town Convention on International Interests in Mobile Equipment and the Protocol thereto on Matters specific to Aircraft Equipment (together the **Cape Town Convention**). The Cape Town Convention covers various categories of mobile equipment, including (parts of) aircraft, space assets and railroad rolling stock, and has currently been ratified by 47 contracting states. Our legal update will only address that part of the Cape Town Convention that applies to aircraft.

Aircraft collateral may be unenforceable without treaty

In aviation finance, the primary collateral usually consists of security rights on the aircraft, which are constantly crossing borders. Without an applicable treaty, this collateral may be unenforceable, as different legal systems apply conflicting conflict of law rules. As a result, the courts where the aircraft is located when foreclosure is sought may not recognize the security interests created thereon. To illustrate, the English High Court of Justice recently held in *Blue Sky One Ltd. and Others v Mahan Air and Another* that the law determining the validity of a mortgage on an aircraft is the law of the jurisdiction where the aircraft was located at the time the mortgage deed was executed (*lex rei situs*). As a result, the English law governed mortgage on an aircraft was held to be invalid because at the time of execution of the mortgage deed the aircraft was located in the Netherlands and the mortgage was deemed not effective under domestic Dutch law since it did not comply with certain formalities required under Dutch law. The English court disregarded the Dutch conflict rules, which would have pointed to English law as the law of the jurisdiction where the aircraft was registered on the relevant date (*lex registri*). Consequently, the mortgage was unenforceable and the mortgagee could not foreclose on the aircraft. The Cape Town Convention reduces this perplexing legal uncertainty by establishing a framework for international interests on (parts of) aircraft that must be recognized and enforced in all contracting states.

Cape Town Convention

The Cape Town Convention applies if three requirements are met: (i) parties have entered into a security agreement, conditional sale agreement or lease agreement creating an international interest that satisfies the formalities prescribed in the Cape Town Convention (a **Security Agreement**), (ii) such agreement relates to (a) airframes (including parts and equipment installed or attached thereto); (b) aircraft engines; or (c) helicopters, that each must meet specific minimum

LIST OF 66 CONTRACTING STATES TO CAPE TOWN CONVENTION:

Afghanistan, Albania, Angola, Aruba, Bangladesh, Belarus (as per October 1, 2011), Burundi (pending)*, Cameroon, Canada (pending), Cape Verde, Chile (pending), China, Colombia, Congo (pending), Costa Rica (as per December 1, 2011), Cuba, Curaçao, Ethiopia, Fiji, France (pending), Gabon, Germany (pending), Ghana (pending), India, Indonesia, Ireland, Italy (pending), Jamaica (pending), Jordan, Kazakhstan, Kenya, Latvia, Lesotho (pending), Luxembourg, Malaysia, Malta, Mexico, Mongolia, New Zealand, Nigeria, Norway, Oman, Pakistan, Panama, Russian Federation, Rwanda, Saudi Arabia, Senegal, Seychelles, Singapore, South Africa, Sudan (pending), South Sudan (pending), St. Maarten, Switzerland (pending), Syrian Arabic Republic, Tajikistan, Togo, Tonga (pending), Turkey (as per December 1, 2011), Ukraine (pending), United Arab Emirates, United Kingdom (pending), United Republic of Tanzania, United States of America, Zimbabwe

* pending means not yet ratified

Aruba has become a premier jurisdiction for the registration of aircraft and will become even more attractive with the entry into force of the Cape Town Convention

size requirements (**aircraft objects**); and (iii) at the time of entering into such agreement, the debtor has its corporate seat or principal place of business in a contracting state or, alternatively, the airframe or helicopter is registered in the nationality register of a contracting state. The location of the aircraft, that determined the unfortunate outcome in the Blue Sky case, is therefore not relevant for applicability of the Cape Town Convention.

The Cape Town Convention creates rules for the recognition in all contracting states of international interests in aircraft that are created if the following formalities have been complied with: (a) the Security Agreement is in writing, (b) the debtor has the power to dispose of the aircraft object, (c) the aircraft object is specifically identified in the Security Agreement in conformity with the Aircraft Protocol, and (d) the secured obligations can be determined pursuant to the Security Agreement. International interests are constituted even if these formalities would not be sufficient to create interests under otherwise applicable national law. International interests extend to insurance proceeds and other loss-related proceeds of an aircraft object, but not to other proceeds, e.g. proceeds received from the sale of the object.

An International Registry has been established in Ireland for the registration of these international interests. To perfect the international interests, an electronic notice must be filed by the debtor or beneficiary with the International Registry. The other party must consent in writing to the filing. Interestingly, future interests can also be registered in the International Registry, and no additional registration is needed when a future interest becomes an existing interest. The security interest shall be treated as registered at the time of registration of the future interest. The priority rules are straightforward: the first to register its interest in the International Registry has priority, generally regardless of its actual knowledge of any prior unregistered interests or interests that are registered in national aircraft registers.

The default remedies under the Cape Town Convention are more flexible than under many national laws, and especially more flexible than in most civil law jurisdictions, including national Aruban law. The holder of an international interest may in case of default, to the extent the debtor has at any time so agreed, (i) take possession or control of an aircraft object; (ii) sell or grant a lease of such object; and (iii) collect or receive any income or profits arising from the management or use of such object. The creditor can in case of default also take ownership of the aircraft object in satisfaction of the debt, but only if the debtor consents thereto after the default has occurred.

Why register in Aruba?

Aruba is part of the Kingdom of the Netherlands and has a stable political and legal system, with the Dutch Supreme Court located in The Hague as the highest appeal court. Aruba has over the last decade become a premier jurisdiction for the registration of aircraft. The tax climate in Aruba is favorable for the registration of aircraft: Aruba has created a special vehicle that can, inter alia, be used to own or lease aircraft, the Aruba Exempt Corporation (*Aruba vrijgestelde vennootschap*), which can be subject to a minimal corporate income tax rate and to a large extent be exempted from most other taxes. Aruban authorities are business friendly: if all paperwork is in order, aircraft can be registered in Aruba in as little as one week. Aruba applies high safety standards; it is rated a category 1 jurisdiction by the US FAA. At this time, 85 aircraft and helicopters are registered in Aruba. The recent entering into force of the Cape Town Convention can be expected to further enhance Aruba's standing as a premier off-shore aircraft financing jurisdiction.

47 contracting states have ratified the Cape Town Convention as of today and many more are expected to join

Conclusion

By registering an aircraft in Aruba, or by using an Aruban entity to own an aircraft, more certainty can be obtained with respect to the enforceability of security rights created on aircraft through applicability of the Cape Town Convention. The security rights will be recognized and enforced in all contracting states. However, in order to ensure that the security rights will also be enforceable in jurisdictions that have not (yet) ratified the Cape Town Convention, it remains advisable, if possible and depending on where the aircraft is generally operated, to also make sure that the security rights are recognized under the law of the jurisdiction of registration of the aircraft and the law of the location of the aircraft at the time of execution of the security agreement.

Who we are

Sprenger & Associates is a Netherlands, Dutch Caribbean and Suriname boutique law firm based in New York and founded by Helena Sprenger. Helena was a partner at the international law firm Allen & Overy LLP and headed its Dutch and Netherlands Antilles law practice in New York for over 10 years.

We advise our clients, mostly international corporations and financial institutions, including UBS, Morgan Stanley, Credit Suisse, Goldman Sachs, Bank of America, Banco Santander and Rabobank, on matters of Dutch Caribbean, Dutch and Suriname law in the context of international capital markets, corporate and cross-border finance transactions, including aircraft financing.

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