



## Bermuda Upgrades to First Class with the Cape Town Convention



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Bermuda is a well-known and respected jurisdiction for financing and registering aircraft. Accordingly, the government of Bermuda recognised that being party to the Convention on International Interests in Mobile Equipment and the related Protocol regarding Aircraft Equipment (known as the “Cape Town Convention”) was essential to retain its position as a leader in this field. On 25 July 2016, the Bermuda Senate gave final approval to the *Bermuda International Interests in Mobile Equipment (Cape Town Convention) Act, 2016* with the Governor’s assent being gazetted on 4 August, 2016. This domestic legislation will mean that the Cape Town Convention can now be extended by the United Kingdom to Bermuda. Such extension will likely take place in early 2017.

### What is the Cape Town Convention and why does it matter?

Essentially, the Cape Town Convention creates an international legal framework to facilitate asset based financing and leasing by providing certainty in respect of the financing and security of moveable objects such as aircraft. The Convention defines “aircraft objects” as aircraft frames, aircraft engines and helicopters. As aircraft are capable of being flown all over the world and not necessarily in the place where they are registered, multiple jurisdictions and multiple legal systems are often relevant to any financing or security in respect of such aircraft. The consequence of this is higher creditor risk and therefore higher costs of financing. The Cape Town Convention provides a framework in which the right of debtors and creditors (regardless of location) have certainty. That certainty results in increased flow of capital by expanding financing opportunities at reduced costs. The economic benefits to lessors, lessees and financing parties are substantial.

### How does the Cape Town Convention work?

Under the Cape Town Convention, an electronic International Registry has been created, which is open twenty-four hours a day, seven days a week. Creditors with an “international interest” in an aircraft object can register their interest on the International Registry provided that the debtor is located in and/or the aircraft is registered in a “Contracting State”.

A “Contracting State” is a jurisdiction which has ratified the Cape Town Convention. Currently there are 71 Contracting States to the Cape Town Convention. It should be noted that as an overseas territory, Bermuda is not a Contracting State but rather a “territorial unit” of a Contracting State, namely the United Kingdom. International interests registered on the International Registry take priority over subsequently registered



interests and also have priority over non-registered interests over the same assets. It is possible to vary such priority by registering subordination agreements on the International Registry.

Creditors can also file irrevocable deregistration and export authorisations (“IDERAs”), which are necessary in any default scenario where the creditor will need to enforce their security.

In addition to ease of registration, the International Registry also provides greater transparency as potential creditors can easily search the Register to identify prior security interests already granted.

### What does it mean for Bermuda?

Bermuda is already a leading aviation financing jurisdiction with numerous Bermuda companies used to finance and register aircraft. Bermuda is also the jurisdiction of choice for aviation asset backed securitizations. This is due to its sophisticated infrastructure, strong legislative structure and a respected department of civil aviation (with close to 770 aircraft on the Bermuda Aircraft Register). Being a party to the Cape Town Convention will further strengthen this position.

With the majority of aircraft on the Bermuda Aircraft Register being registered in the commercial category, the ability to secure financing at lower costs and potentially with the “Cape Town Discount” will facilitate the purchase of new aircraft by a number of airlines operating in the jurisdictions where Bermuda already has an “Article 83 bis” treaty in place (currently the Russian Federation, the Republic of Uzbekistan and the Republic of Azerbaijan).

As an overseas territory of the United Kingdom, Bermuda courts would have followed the law set out in the *Blue Sky* case<sup>1</sup>. This case provided that even if the parties had contractually agreed that the governing law of a mortgage is English law, if the jurisdiction where the aircraft was physically situated at the time the mortgage affixed did not recognise such a mortgage under its conflict of laws principles, the mortgage would not be valid (the “*lex situs* rule”). Bermuda has followed the UK’s lead and included in its domestic legislation a provision making it clear that where an international interest has been validly created and registered under the Cape Town Convention, it shall have effect in Bermuda regardless of the *lex situs* rule.

### Declarations Made by Bermuda – Creditor Friendly

Although Bermuda is an overseas territory of the UK, it was able to elect which declarations it wishes to make under the Convention. Conyers Dill & Pearman played an active role in the industry group which worked with the government and the Bermuda Civil Aviation Authority (“BCCA”) to determine which declarations should be made. Many of the declarations made are creditor friendly and include the following:

- ✦ Bermuda has elected to adopt Alternative A, which means that upon the occurrence of an insolvency event, the debtor must either give up possession of the aircraft to the creditor or cure the default within a set time period. The debtor is obligated to preserve the aircraft and maintain it and its value until such time as the creditor takes possession. Alternative A also means that a creditor can exercise self-help and does not need to obtain permission from the courts before taking possession.
- ✦ Adoption of Alternative A is one of the conditions required to comply with the OECD Aircraft Sector Understanding, which provides for a discount of up to 10% for a borrower in a Contracting State when applying for export credit finance (the so-called “Cape Town Discount”).

<sup>1</sup> *Blue Sky One Ltd. & Ors -v- Mahan Air and Anor* [2009][EWHC] 3314 (Comm)



- ✦ Adoption of IDERAs whereby, rather than the creditor having to apply to the court in order to deregister and export an aircraft, the debtor will provide an IDERA at the time of financing which is registered with the BCCA. The creditor will then become the sole person capable of exercising the deregistration and export rights.
- ✦ Speedy relief: the Bermuda courts will grant interim relief pending final determination within 10 calendar days to creditors applying for preservation of the aircraft.

### Local Security Filings

Currently, mortgages granted over an aircraft or an aircraft engine that is either owned by or leased to a Bermuda incorporated company can be registered on the Mortgage Registry maintained by the BCCA. Likewise, other security granted by the Bermuda company in respect of the aircraft (such as assignment of lease proceeds) can be registered at the Bermuda Registrar of Companies. Although most of these security documents will constitute an “international interest”, which can be registered on the International Registry, it is expected that most parties will elect a dual registration procedure and register on both the International Registry and the local registers. This will be beneficial in circumstances where:

- ✦ the aircraft may need to be repossessed in a non-Contracting State that does not recognise the Cape Town Convention;
- ✦ the debtor does not consent to registration on the International Register (no consent is needed to register on the Bermuda domestic registers); or
- ✦ it turns out the security did not actually constitute an “international interest” or should not have been registered under the Cape Town Convention.

Practically speaking until such time as there is case law supporting the application of the Cape Town Convention, most creditors will adopt the more cautious route of dual registrations.

### Flying First Class

The extension of the Cape Town Convention to Bermuda will be welcomed by airlines, financiers and leasing companies alike. It will enhance Bermuda’s already strong reputation for being “first class” in the offshore world for aircraft financings and registrations.



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