Cape Town Convention for Ships: A Solution in Search of a Problem?

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What do these asset classes have in common?
Common Characteristics

- Big-ticket mobile equipment capable of moving from country-to-country, jurisdiction-to-jurisdiction, in regular course of business
- Similar financing techniques
- Secured and asset-based financing
- Mortgage financing
- Lease financing
- Security interests

Mobility of asset creates legal and credit risks for market participants
Recognition and priority of mortgage or security interest
Relative priority of competing liens
Recharacterization of leases
Unavailability of hostility of local courts
Bankruptcy risk
Which asset class does not belong with the other three?
• UNIDROIT Convention on International Interests in Mobile Equipment ("CTC")
  • Adopted: 2001
  • Entry into force: 2006
  • 68 Contracting States
  • Provides for the creation and recognition of an international interest in certain categories of mobile equipment
    ➢ Airframes, aircraft engines and helicopters
    ➢ Railway rolling stock
    ➢ Space assets
  • No coverage for ships

• UNIDROIT: International Institute for the Unification of Private Law
  • Established 1926 as auxiliary of the League of Nations
  • Re-established 1940 as independent body by mutual agreement of member states
  • Purpose: Foster modernization and harmonization of private commercial law
CTC Purposes and Objectives

- Facilitate acquisition, financing and leasing of mobile assets by resolving legal issues caused by their mobility, i.e., conflicting rules relating to the recognition, securing and enforcement of rights in the assets as they travel across jurisdictions.

- Provide predictability to market participants in asset-based transactions by creating a uniform set of rules relating to creation, perfection and priority of interests that will be universally recognized and protected.
  - Clarity on ranking of competing interests
  - Ability to promptly enforce rights against assets
  - Ability to enforce rights in bankruptcy

- Encourage creditors to grant credit
- Enhance credit rating of equipment receivables
- Reduce borrowing costs
• **CTC Protocols**

  • Implementation of CTC is through individual, industry-specific Protocols
    
    ➢ Protocol to the Convention on Matters Specific to Aircraft Equipment
      • Adopted: 2001
      • Entry into force: 2006
      • 59 Contracting States

    ➢ Protocol to the Convention on Matters Specific to Rolling Stock
      • Adopted: 2007
      • Not in force

    ➢ Protocol to the Convention on Matters Specific to Space Assets
      • Adopted: 2012
      • Not in force

  * CTC applies to a covered category of mobile assets only when the requisite Protocol has come into force.
“International Interest” in Mobile Assets

- Organizing principle of CTC
- A security-type interest created by or subject to security agreements, title reservation agreements, or lease agreements relating to specific assets designated under the Protocols
- Recorded on an International Registry
  - Registry operated under auspices of a Supervisory Authority specific to the mobile asset
  - Subject to certain exceptions, recordation ensures priority over subsequently registered interests, interests not registered, and debtor’s insolvency administrator
  - International Registry wholly automated and operative 24/7
CTC and Aircraft Protocol: Remedies

- Uniform remedies exercisable against debtors by lessors, conditional sellers and secured parties, as creditors, including
  - Taking possession of or controlling collateral
  - Selling or granting a lease of collateral
  - Collecting income or profits from collateral
  - Obtaining preliminary relief pending final determination on merits

- Insolvency remedies subject to “opt-in” by Contracting State
  - Alternative A - requires debtor to give possession to creditor following waiting period if defaults not cured
  - Alternative B - permits debtor to make election to perform or return equipment and requires court approval to permit creditor to take possession
  - Embedded concepts
    - Debtor will preserve value of collateral
    - Debtor will cure defaults
    - Debtor will surrender collateral
    - All within time periods set forth in Contracting State’s declaration
• CTC Financial Benefits for Aircraft Financing
  • Non-U.S. Airlines
    ➢ Lower borrowing costs, including premium discounts for U.S. Ex-Im Bank supported financings
    ➢ Increased financing opportunities, including access to enhanced equipment trust certificate (“EETC”) financings in the United States

• CTC Application to Ships
  • No current application, but long debate history
    ➢ 1996: “Registered ships” provisionally included in first draft of CTC
      • Maritime industry groups opposed and consideration deferred by UNIDROIT
    ➢ 2012: UNIDROIT resurrects issue during 91st Governing Council Session

(cont’d)
• CTC Application to Ships (cont’d)
  ➢ 2013: UNIDROIT preliminary study released at 92nd Governing Council Session
    • Reviewed issues involving security over ships in cross border context
    • Reviewed market responses
    • Reviewed existing international instruments, including
      • Brussels Convention for the Unification of Certain Rules of Law Relating to Maritime Liens and Mortgages of 1926
      • Geneva Convention on Maritime Liens and Mortgages of 1993
      • Conventions on the Arrest of Ships of 1952 and 1999
    • Discussed suitability of CTC System for consensual security over ships
    • Recommended further feasibility study on a new CTC Protocol covering ships
    • Lukewarm industry reception
  ➢ 2014: UNIDROIT assigns project “low priority” status during 93rd Governing Council Session
    • 2015: International Working Group (“IWG”) of Comité Maritime International (“CMI”) formed to study international ship financing practices
• **Looking Ahead**

• Issues and questions remain the same
  - Whether current cross-border ship finance practices are satisfactory and, if not, whether the international harmonization of those practices through the CTC provides a better working solution
  - Whether CTC can do for ship finance what it has done for aviation finance, e.g., lower borrowing costs and increased financing opportunities
  - Whether ship finance has a problem in need of a CTC solution, or is CTC a solution in search of a ship finance problem?

• Answers depend on whom you ask
  - Academics see crossover benefits for ship finance
  - Aviation finance professionals satisfied with CTC and Aircraft Protocol
  - Marine finance lawyers generally skeptical or opposed
    - Most prefer the status quo
• Maintenance of status quo seems likely
  ➢ Growth in size and sophistication of open registries
    • Top 7 registries now account for 61% of total DWT of world fleet
    • Established and widely known ship registration and mortgage recordation regimes
    • Properly recorded ship mortgages generally enforceable worldwide
  ➢ Market entry of alternative forms of ship finance
    • $20B during period 2010-14
    • Would credit be enhanced by application of CTC to ships?
    • Would borrowing costs be lowered by application of CTC to ships?
  ➢ Unregistered, non-consensual maritime liens against ships
    • Rules governed by law of the forum and based on local interests and preferences
    • International harmonization of maritime liens unlikely
    • Past efforts unsuccessful, e.g., 1993 Convention on Maritime Liens and Mortgages
Lack of prominent and influential industry sponsor
  • U.S. Ex-Im Bank led charge for CTC as a means of supporting exports to airlines in less developed countries
  • CTC and Aircrafts Protocol further supported by Aviation Working Group, Boeing and Airbus
  • No maritime sponsor on the horizon

• CMI IWG will conduct study and make recommendations

http://comitemaritime.org/Ship-Financing-Security-Practices/0,27150,115032,00.html
Thank you!

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