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INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW

STUDY GROUP FOR THE PREPARATION OF
UNIFORM RULES ON CERTAIN INTERNATIONAL ASPECTS OF
SECURITY INTERESTS IN MOBILE EQUIPMENT

SUB-COMMITTEE FOR THE PREPARATION OF A FIRST DRAFT

PROPOSALS FOR A FIRST DRAFT

(drawn up by the Chairman and a member of the
sub-committee on the basis of the provisional conclusions
reached by the sub-committee at its first session):

COMMENTS

(by Mr Thomas J. Whalen, Professor Rolf Herber and The Boeing Company)

Rome, November 1994

INTRODUCTION

Subsequently to the comments to the small drafting group's proposals for a first draft of the proposed Unidroit Convention on International Interests in Mobile Equipment grouped together in paper LXXII-Doc. 14, the Unidroit Secretariat received additional comments from Mr Thomas J. Whalen, representative of the Department of State of the United States of America on both the study group and the sub-committee ; from Professor Rolf Herber, representative of the International Maritime Committee on these two groups, and from Mr Scott Scherer, Assistant Treasurer, The Boeing Company, which had been represented by Mr Jeffrey Wool as a guest at the first session of the sub-committee. This paper reproduces these comments, set out hereunder.



MR THOMAS J. WHALEN

1. — Since the concept of a non-possessory security interest is alien to some States, it may be too ambitious to cover "classes" of mobile equipment, like fleet mortgages. It may be more acceptable to limit a security interest to a single piece of equipment, described with particularity in the filing in the registry.

While this would be a step back from U.C.C. concepts, it may encourage some States to take the first small step of accepting the notion of non-possessory security interests (see Draft Art. 3 (b)).

2. — The Draft seems to embrace a general definition of "mobile equipment" which I think is too general. The definition should, in my opinion, be further limited, so we know just what "equipment" may be registered and covered by the Convention.

3. — I support the apparent view of the drafters that the "international interest" does *not* come into being until registration. This is more than simply *perfection* of "an international interest".

4. — While Article 5 does not appear to be complete, I believe preliminarily that the Convention should have some basic substantive enforcement remedies. Remedies should not totally be left to local law. It is unclear what is meant by "effects of that interest". Does it mean that a State agrees to enforce the remedies provided in the security agreement? What is meant by "effects"?



PROFESSOR ROLF HERBER

The following proposals result from my personal impressions ⁽¹⁾ as to the developments up to now:

The CMI appreciates the work done by Unidroit in the preparation of a Convention dealing with uniform rules on certain international aspects of security interests in mobile equipment. It welcomes, in particular, the opportunity given to the CMI to collaborate in this task.

Security interests in mobile equipment are of particular interest in the maritime context. There, however, a great part of the problem existing in general international trade is already solved by the legal concepts of mortgages over ships and maritime liens. They provide for the legal possibility for securing claims against the owner or someone closely related with the ship's employment by a right *in rem* on the ship which enables the creditor to seek payment of his claim out of the vessel.

(1) *Note by the Unidroit Secretariat:* In his letter of 20 October communicating these comments Professor Herber indicated that these, while they had been submitted to the Executive Committee of the C.M.I. for information, did not represent the considered opinion of the C.M.I. but were rather to be read as reflecting his personal feelings at the present time.

The legal institute of maritime mortgages as well as of maritime liens is the subject of three International Conventions, which – it is true – have not received until now great participation. A first Convention dated 1926 has received 24 ratifications or accessions; among the member States are, for example, Belgium, France, Italy, Poland, Spain. Important shipping States are, however, not Parties to the Convention. The second Convention was adopted at a Brussels Conference in 1967; it has not entered into force because it received ratifications only by Denmark, Norway and Sweden. In view of this situation UNCTAD convened, on the basis of lengthy preparatory work by a Joint Intergovernmental Group of Experts, a Diplomatic Conference in 1993 which adopted a new International Convention of 6 May 1993, the International Convention on Maritime Liens and Mortgages, 1993. It is hoped that this Convention, which is largely based on a Draft Convention prepared by the CMI and adopted at its Conference in Lisbon in 1985, will meet with greater participation from maritime States.

Irrespective however of the rather reluctant acceptance of the existing International Conventions, the maritime laws of practically every country provide for mortgages over ships and maritime liens. The need and purpose of the aforementioned international unification relates mainly to the unification and abbreviation of the lists of maritime liens which take preference over mortgages, thus to secure the position of the creditor of a loan given to the owner and secured by a mortgage.

In view of the fact that registered ships are already subject to the aforementioned rules providing for legally protected charges and that the desirable unification is on the way, in particular by means of the modern Convention recently adopted in 1993, it would seem advisable to keep registered ships out of the scope of the general Convention being prepared by Unidroit. This has already been considered during the previous meetings in Rome and led to a provisional decision to provide for the exception of ships, still however put in brackets.

It may be mentioned already here that the proposed Unidroit Convention, even after the exclusion of registered ships, will have a considerable bearing on maritime trade by the inclusion of non-registered ships and, mainly, of containers and maritime equipment other than registered vessels.

As to the exclusion of vessels, I understand the decision for the moment to be to defer a final conclusion, since it may depend on the structure of the future Convention whether it could be of benefit to creditors of maritime mortgages to enter these rights into an additional register under the proposed Unidroit Convention in order to extend their recognition. In this case, however, a condition would be that the charge on the vessel as such would not be changed by the Convention, but only the scope of its recognition.

As to the present draft I can submit, because of its incomplete character, only preliminary remarks. In principle, we agree with the concept that certain kinds of mobile equipment have to be defined in order to circumscribe the scope of application. Whether the definition given under Art. 1, para. 2, *litt. a*) is exact enough to define the kinds of movables seems doubtful. If one follows – which seems from the draft to be the case – the concept that recognition of the charge is based on registration, the precise definition as to the movables subject to entry in this register could be made in the context of Art. 3. But even there the description of the equipment charged (Art. 3, *litt. d*) is rather vague. We deem it, however, essential that commerce knows which particular kinds of equipment are possibly subject to charges under the Convention and of an entry in the register. Only under this condition is it feasible to protect the charge, if it is registered; as only under these strict and narrow conditions can someone who acquires new rights in mobile equipment be expected to consult the register. Therefore a clearer definition of the mobile equipment – at least by an enumeration of classes of movables – is needed to our mind.

The inclusion, as proposed, of title reservation agreements is welcomed in principle. It would give another reason to include ships; however, the relationship between the title reservation agreement and existing and future charges have to be clarified in this case.

I would like to abstain from further comments at the present moment. Since CMI has been invited to participate in the future discussions we would prefer first to follow the discussion and wait for the decision as to which kind of concept will be followed by the working group. The present draft only gives some introductory definitions. Whether they are sufficient, precise and clear enough can only be judged after knowing whether the final draft will follow the concept of providing for a separate charge created by the Convention or whether it will only extend the application of existing charges. Furthermore, it should be known first what effects the entry in the register will have with respect to acquisitions in good faith by third parties.



MR SCOTT SCHERER

In connection with the above-identified proposed Convention, we have received and reviewed (i) the Summary Report prepared by the Unidroit Secretariat, in respect of meetings of February 14-16, 1994, designated Study LXXII-Doc. 12 (the "February Summary"), (ii) the Proposals for a First Draft, in respect of the meeting of July 11, 1994 of the drafting sub-committee, designated Study LXXII-Doc. 13 (the "First Draft") and (iii) the draft Agenda for the meetings of November 29 - December 1, 1994 (the "Agenda").

Let us start by referring to our letter to you, dated February 11, 1994 (the "Boeing Letter"), and reiterating our comment therein that we are prepared enthusiastically to support a Convention that addresses the practical problems encountered in customary aircraft financing transactions. A copy of the Boeing Letter is attached hereto. ⁽²⁾

We note that the First Draft does not attempt to incorporate specific rules which are necessary in the context of aircraft financing transactions. While we appreciate the need of the diversely constituted working group first to reach consensus on fundamental conceptual principles, we would like to emphasise again that because of the existence of well developed, and internationally recognised, aviation financing techniques, aircraft-specific rules are essential to the commercial acceptability of the proposed Convention.

We are encouraged by the sub-committee's express recognition, as summarised in point 6(xiii) of the February Summary, of the need for supplementary rules for aircraft. We note that point 3 of the Agenda contemplates the possibility of referring the drafting of such supplementary rules to one or more experts under the supervision of the sub-committee. The primary purpose of this letter is to indicate our support for such an arrangement, and to make the following recommendations related thereto:

1. Scope of the Supplementary Rules

The supplementary rules could either (a) defer to, and exist in tandem with, the rules set forth in the Geneva Convention or (b) supersede and replace the Geneva Convention. We believe that the latter approach is desirable because the effort required to gain consensus within the international aircraft financing community on legal and commercial matters of this magnitude would only be justified if the Convention is broad and materially improves upon the existing legal regime.

As to the specific content of these supplementary rules, we would first refer you to the contents of the Boeing Letter. In our view, the Convention, as applied to aircraft, should have the general characteristics set forth in the Boeing Letter. While we understand the need for sensitivity to the concepts and premises of diverse legal systems, the Convention must address customary aviation financing techniques.

⁽²⁾ *Note by the Unidroit Secretariat:* The text of this letter, which was signed by Ms Lorrie D. Scott, Senior Attorney, The Boeing Company, is set out in an Appendix to this paper.

Though legal systems vary widely, most major systems have long histories of recognising the need to have specific commercial law rules which reflect prevailing commercial practice. Aircraft finance practice offers the working group an opportunity to bridge the conceptual gaps between the differing national systems while simultaneously following a basic principle recognised in most domestic systems: commercial rules need to reflect commercial practice.

2. *Procedure for Drafting of Supplementary Rules*

We believe that referring the drafting of the supplementary aircraft rules to industry experts, under the supervision of the sub-committee, is appropriate, and will facilitate the high degree of multilateral legal agreement that is only possible in an industry-specific forum. Assuming that we reach agreement on an approach, and on a timetable for completion of this effort, we would suggest that Mr Jeffrey Wool, together with an expert from Continental Europe, to be nominated by Unidroit following consultation with Continental European members of the sub-committee, and an expert from Asia, jointly produce a first draft of the supplementary aircraft rules. As you may know, Mr Wool practices with Perkins Coie and is also an affiliate professor at the University of Washington as well as the Coordinator of the University's Comparative Commercial Law Institute. We expect that he would work closely with the U.S. State Department and the other North American representatives, as well as our group of industry correspondents.

We also propose that the expert drafting group be charged with producing a first draft of the supplementary aircraft rules by the next Unidroit session for consideration, at that time, by the sub-committee.

We will elaborate on these matters as contributors to Mr Wool's presentation at the November 28, 1994 symposium, and will also be available to address the committee, should that be appropriate, during the sessions from November 29 - December 1, 1994.

APPENDIX

TEXT OF THE LETTER OF 11 FEBRUARY 1994 FROM LORRIE D. SCOTT, SENIOR ATTORNEY, THE BOEING COMPANY TO UNIDROIT

In view of the potential significance of the above-identified Convention to the field of aircraft finance, we wish to comment, in broad terms, on the Convention as it relates to aircraft. These comments are based upon, among other things, the Summary Report of the March 8-10, 1993 meeting of the Study Group prepared by the Unidroit Secretariat and the Explanatory Memorandum of Professor Cuming relating thereto dated November 5, 1993.

We are prepared enthusiastically to support a Convention, centred on an international registry which determines priorities, if such Convention functionally addresses the practical problems encountered in customary aircraft financing transactions. We believe that such a Convention would, as regards aircraft and aircraft engines, have the following characteristics:

1. *Nature and Scope of the Convention*

Filings in respect of all security transactions (regardless of form), operating leasing transactions, and conveyances of rights and interests in aircraft/engines, whether the aircraft/engines are equipment or inventory of the debtor, shall be made with satellite offices of a central international registry (the "Registry") (regardless of whether or not the country of registration has a system for security/leasing/conveyance filings).

The applicable validity, perfection and priority rules will be those of the Convention, not the country of aircraft registration.

All non-property matters currently regulated by the applicable system and rules of the country of registration (e.g., airworthiness, maintenance, registration requirements and operational requirements) will continue to be so regulated except for rules in respect of the relationship between the exercise of remedies by financiers/lessors and the deregistration and export of the aircraft/engines. Such deregistration and export rules shall be addressed in the Convention.

2. *Related Contract Rights*

In addition to aircraft and engines, the Convention would apply to contract rights granted as security in aircraft finance transactions (e.g., lease assignments, warranty assignments, insurance assignments and contract rights in respect of proceeds).

3. *Geographical Application*

Given the futility of separating domestic from international aircraft finance transactions, the Convention would apply even in a purely domestic context.

4. *Priorities*

The Convention shall have a clear first-to-file priority rule in respect of conveyances, contractual security and non-contractual security involving governmental creditors (e.g., Eurocontrol and other tax creditors). Substantive or conflicts rules in respect of other non-contract creditors should be considered. The concept of good faith purchasers has no application.

5. *Non-bankruptcy Enforcement*

The Convention would (a) include substantive rules, providing no less party autonomy than under UCC §§ 9-500 *et seq.*, which permits private enforcement, with minimal court involvement (or would permit signatory countries to opt out of such substantive rules in favour of their corresponding domestic rules, including those in respect of private international law) and (b) permit the parties to supplement these rules by selecting the law to govern their *inter partes* relations, and the characterisation of their relations and resulting rights and obligations.

6. *Validity in Bankruptcy*

Without otherwise affecting applicable insolvency laws, international security interests and leases shall remain valid/enforceable notwithstanding the debtor's bankruptcy and shall be senior to the rights of the debtor's trustee/unsecured creditors.

7. *Miscellaneous*

The system should be notice-based not requiring the filing of financial details. Filing/search criteria for aircraft and engines shall be made by, or with reference to, the manufacturer's serial number therefor. The Registry will have satellite offices where original conveyance, security and leasing documentation are filed, with references to all filed documentation being immediately transmitted electronically throughout the system. Significant attention should be given to the possibility of permitting direct electronic filings as part of a 24-hour network.

The forum and procedures for dispute resolution, and the law to govern supplementary matters, selected by the parties shall be recognised by signatory countries, and judgments rendered by such selected forum shall be enforced in signatory countries on an expedited basis.

The Convention should cover specifically identified after-acquired property (and have a corresponding "dual-status" purchase money exception) and permit future advances.

We appreciate that a Convention with the contours set forth above is beyond what is currently contemplated. We also realise that more is entailed by our comments than what is required to address the original impetus for the proposed Convention, namely, countering the inherent difficulties of the *lex situs* rule in the case of mobile equipment. We feel strongly, however, that the time and effort required to settle on, and gain acceptance for, a new Convention is only justified if the end result is a pragmatic regime that addresses, in a comprehensive fashion, the needs of the international aviation finance community. In addition, we think that such a Convention will be workable only if it is based upon modern technologies that make possible the use of accessible satellite offices and/or direct electronic filings. Otherwise we risk creating a system which is unusable from the perspective of many countries due to time zone differences.

We would ask you to balance these comments against competing interests and concerns and reach a general decision as to whether a broad, functional Convention based upon modern technologies is feasible in the reasonably near term. If it is not, we would recommend the exclusion of aircraft and engines from the Convention with efforts being spent, perhaps, on broadening and strengthening the existing international security regime.

Please note that in formulating our comments we have consulted with a small but diverse group of industry participants including The Long-Term Credit Bank of Japan, Ltd., a Japanese aviation financier, and GE Capital Aviation Services Ltd., an Irish lease management company. This consultation process was designed to elicit a realistic cross-section of certain industry views. Our representative, Jeffrey Wool of Perkins Coie, is available at your February 14 meeting to address in more detail the commercial and legal rationale for the views and recommendations set forth above.