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INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW

STUDY GROUP FOR THE PREPARATION OF UNIFORM RULES ON INTERNATIONAL INTERESTS IN MOBILE EQUIPMENT:

SUB-COMMITTEE FOR THE PREPARATION OF A FIRST DRAFT

MEMORANDUM

prepared jointly by

Airbus Industrie and The Boeing Company

on behalf of an

aviation working group

Rome, May 1995

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MEMORANDUM

prepared jointly by

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regarding Unidroit's proposed Convention on Security Interests in, and Title Reservations of, Mobile Equipment

Reference is made to clause 10(iv) of the summary report ("**summary report**") prepared by the Unidroit Secretariat summarising the decisions taken by the Unidroit Sub-committee ("**Unidroit**") currently preparing a draft convention on security interests in, and title reservations of, mobile equipment ("**proposed convention**") at its meeting held 29th November - 1st December, 1994.

Unidroit has requested that Airbus Industrie and The Boeing Company ("**organisers**") jointly organise the preparation of a memorandum, for consideration by the Unidroit drafting group convening in June to produce a second draft of the proposed convention ("**drafting group**"), setting forth a representative aviation industry view on the desired content of the proposed convention as the same relates to aircraft.

This memorandum, prepared in response to Unidroit's request, is the product of an international aviation industry working group ("**aviation working group**") assembled by the organisers.[1] This memorandum represents the **consensus views** of the

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1 In assembling the aviation working group, the organisers have attempted to identify a small but diverse group of experienced aircraft finance and leasing experts. Moreover, the group includes the three largest airframe and three large aircraft engine manufacturers--a group that has an interest in ensuring that the terms of the proposed convention, in addition to serving the needs of financiers and lessors, will be generally satisfactory to their customers, the world's operators of aircraft (and the proposed convention's debtors/lessees).

aviation working group.[2] The members of the aviation working group, listed alphabetically (with their nationalities noted parenthetically), are: Airbus Industrie (French, German, Spanish and UK consortium), Banque Indosuez (French), Douglas Aircraft Company (US), General Electric Aircraft Engines (US), International Lease Finance Corporation (US), Kreditanstalt für Wiederaufbau (German), Rolls Royce (UK), Snecma (French), The Boeing Company (US), The Long-Term Credit Bank of Japan Ltd. (Japan) and United Technologies Pratt & Whitney (US). (A brief description of the members of the aviation working group and their aviation related businesses is set forth in **Annex 1**.)

The aviation working group has also solicited commentary on this memorandum from a group of leading aviation finance legal experts[3] and, where practicable, have attempted to include in this memorandum views expressed in such commentary to the extent the same are consistent with the views of the aviation working group.

The aviation working group has undertaken this effort in view of the potential benefit to the aviation finance industry of improved international legal rules on security and leasing. Unidroit's efforts are seen as timely and important given the magnitude of credit to be extended and secured by aviation equipment in order to finance anticipated aircraft deliveries over the coming years. It is estimated by the major airframe manufacturers that the aggregate acquisition cost of aircraft and engine deliveries over the next twenty years may be in the range of US$900-1,000 Billion[4].

This memorandum is divided into three parts. In Part I the general approach of the aviation working group to the proposed convention is set forth, as well as the assumptions underlying this approach. Part II will then set forth specific recommendations on the proposed convention as the same relates to aircraft equipment and the rationale for such recommendations. (For convenience, a concise summary of these recommendations is set forth in **Annex 2**.) Part III will provide certain concluding comments.

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2 The aviation working group was provided with detailed background materials, including the first draft of the proposed convention and the summary report, as well as legal analysis. The aviation working group had numerous preliminary discussions before its substantive meeting in Paris on 11 April. Following this meeting, drafts of this memorandum, reflecting the decisions taken by the group, were circulated, commented upon and revised. Each member of the aviation working group has confirmed its agreement in general terms with the contents of the final form of this memorandum.

3 A draft of this memorandum, together with the summary report and the first draft of the proposed convention, was sent (with tight time requirements) for comment to over a dozen aviation finance legal experts based in Japan, England, France, Germany and United States. The commentary varied widely, addressing the broad contours of the proposed convention, political considerations relating to the future of the proposed convention, and the particular legal issues currently under consideration. While a number of the commentaries were quite supportative, and several comments raised therein have been incorporated (without attribution) into the memorandum (this note being intended as a recognition of their contribution), the views set forth in this memorandum should be viewed solely as those of the aviation working group.

4 See Airbus' Press Release dated 27 March 1995; Airbus' Global Market Forecast, March 1995; Boeing's Current Market Outlook, 1995 (Draft) (final version to be available in June 1995); and McDonnell Douglas Corporation's 1994-2013 Outlook for Commercial Aircraft (Draft) (final version to be available in June 1995). Copies of these materials will be sent to Unidroit in a supplemental mailing.

Part I General Approach of the Aviation Working Group to the Proposed Convention

1 Aircraft and Mobile Equipment

1.1 In this memorandum we set forth the comments and concerns which, if adequately addressed in the proposed convention, would in our view make the proposed convention materially beneficial from the perspective of financiers, lessors and operators of aircraft.[5] We suspect that certain of our comments may be consistent with the views of financiers, lessors and operators of other specifically identifiable, high value movables (i.e., ships, oil rigs, satellites and rolling stock)[6], but not to other types of "mobile equipment" (as defined in the proposed convention).

1.2 The scope of the proposed convention, beyond aviation equipment, is of importance to us to the extent that the same impacts the time required to produce the proposed convention, and the degree to which the proposed convention is ultimately acceptable to potential signatory countries. We thus urge the drafting group to consider (a) limiting the proposed convention to enumerated types of specifically identifiable high value mobile equipment (i.e., aircraft, aircraft engines, ships, oil rigs, satellites and rolling stock) and (b) making use, exclusively, of an asset registry.[7] The powerful priority rules envisaged under the proposed convention and, in particular, the consequences of non-filing, are more appropriate in the context of a system with these salient characteristics. In addition, the mandatory and optional (see point 2 immediately below) changes to national laws contemplated by the proposed convention will be less objectionable in such a convention given (i) the existence of established structured financing and leasing techniques in respect of such equipment and (ii) the magnitude of the benefits likely to be available as a result of the proposed convention in respect of the financing and leasing of such equipment.

2 International Legal Issues, Security/Leasing Issues and the Facilitation of Credit

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5 An important question, on which we would reserve pending further consideration, is the proper definition of "aircraft".

6 Certain of the comments set forth in this memorandum, however, are only suitable to aircraft/aircraft engine financing and leasing (e.g., points relating to the "de-registration" of aircraft, to the operation, financing and leasing of engines, and specifically relating to aviation finance structures, such as the centrality of lease assignments). The drafting group should consider whether supplementary rules to the proposed convention to address this category of points is appropriate.

7 We believe the clarity associated with a specific list of high value equipment is desirable in the context of a convention which is complex, supersedes important aspects of national law and affects property and priority rights in assets. More broadly, notwithstanding the differences noted in note 6 above, the similarities between specifically identifiable high value mobile equipment may very well prove sufficient to justify their treatment in an omnibus convention; contrariwise, the vast differences between such specifically identifiable high value items and other items merely "used" internationally (e.g., trucks), as well as financing techniques relating thereto, would appear to make a comprehensive convention covering both types of items unworkable or, at best, extraordinarily difficult.

2.1 We are fully aware of the original impetus for work on the proposed convention, namely, the potential implications of the lex situs rule in the context of movables, including problems associated with the recognition of "foreign" forms of security and leasing arrangements and potentially inequitable and/or unpredictable rules regarding priority disputes. These are very real problems,[8] and ones that are not adequately addressed by the current legal framework governing international aviation finance (a summary of which is set forth in the end note to this memorandum). * The proposed convention will also address a number of other important issues which arise in the context of international financing and leasing of mobile equipment, including jurisdictional issues. (The lex situs related issues, and all other issues distinctly international in nature, referred to collectively in this memorandum as "**international legal issues**".) We also appreciate that Unidroit, historically, has been primarily concerned with addressing international legal issues rather than championing national law reform as such.

2.2 By virtue of its substantive character, the proposed convention does, however, seek to amend national laws in certain respects (rather than simply referring to one of several possible choices of law to address a particular issue). It does so for two reasons. First, as Professor Cuming has concluded after his empirical study, certain national security laws do not provide sufficient flexibility, predictability or fairness between foreign security interests and domestic interests in mobile equipment.[9] Second, and as is most clearly seen in the context of setting forth in the proposed convention certain "basic remedies", such uniform changes to national law are necessary to ensure that international financiers and lessors are afforded certain basic commercially oriented rights regardless of the particular location of the mobile equipment from time to time. (All such national law issues which bear upon these basic commercial rights of financiers and lessors referred to collectively in this memorandum as "**security/leasing issues**"). In connection with the international regulation of highly mobile equipment, addressing such

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8 In addition to the problems associated with the lex situs rule applicable to all forms of mobile equipment financing, such as non-recognition of non-possessory security in certain jurisdictions and uncertainty relating to choice of law rules relating thereto, see generally Shilling, Some European Decision on Non-possessory Security Rights in Private International Law, 34 Int'l and Comp. Law Quarterly 87 (1985), and preferred (and undisclosed) local creditors, see generally Fawcett and Hugi, Hidden Liens: A Trap For the Unwary, 106 Banking Law Journal 212 (1988), a number of problems are particular to, or highly relevant in the context of, aircraft finance transactions. First, the extreme mobility of aircraft, and the fact that aircraft are often moving (and may even cross several jurisdictions) at the very moment of the creation of security, raise acute issues regarding the creation and loss of security rights. Second, the interplay between domestic security law and aviation filing and registrations systems may raise complex questions relating to the "perfection" of security. Third, engines and other parts are constantly being added to, and taken from, aircraft pursuant to complex interchange agreements which may affect title to, and/or security rights in, valuable parts and components of aircraft equipment.

9 See Analysis of the Replies to the Questionnaire of an International Regulation of Aspects of Security Interests in Mobile Equipment, prepared by the Unidroit Secretariat, April 1991, at page 1.

security/leasing issues is essential, and is wholly consistent with the basic objective of Unidroit to promote uniformity of law where appropriate [10] .

2.3 The general approach of the aviation working group to the proposed convention is that the value of the proposed convention is directly related to the extent to which its terms, by properly addressing international legal issues and security/leasing issues as needed, result in an increase in the availability of credit, and/or a reduction in the cost of such credit, to owners/operators of aircraft equipment.

Legal rules facilitate the extension of asset-based credit by, in addition to providing certainty, ensuring that the basic commercially oriented, and contractually agreed, rights of asset-based financiers and lessors are respected. At a minimum, this entails providing financiers/lessors with prompt access to assets on default and the ability to convert such assets to proceeds to satisfy contractual obligations. National legal systems vary widely on the degree to which they achieve these objectives and, correspondently, the extent to which they facilitate asset-based credit.[11]

2.4 The aviation working group believes that the proposed convention will maximise the facilitation of credit in a matter which is both appropriate and politically acceptable by (i) ensuring that international legal issues and basic security/legal issues are properly addressed through mandatory "**core provisions**" that form the base of the proposed convention and (ii) containing two "optional provisions" designed significantly to enhance security/leasing rights (by adding a greater degree of certainty that the relevant legal system will enforce and uphold the aircraft operator's, lessor's and financier's contractually expressed expectations), where needed, which enacting countries could "opt into" at the time of their respective enactment (and, further, in respect of which each airline/obligor could agree to or not in the course of its negotiations weighing the costs and benefits of such provisions).

As discussed in part II, the first of these optional provisions would ensure the unqualified recognition of a general choice of law provision regarding (a) contractual interpretation and governance and (b) contractual remedies - beyond the "basic minimum" convention remedies ("**contractual choice of law provision (optional)**"), and the second would address rights in respect of the asset in the context of insolvency and bankruptcy ("**international**

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10 See Statute of Unidroit, Article 1 (the purposes of the International Institute for the Unification of Private Law are to "examine ways of harmonising and coordinating the private law of States and of groups of States, and to prepare gradually for the adoption by the various States of uniform rules of private law").

11 One consequence of the wide qualitative difference between security law systems is the prevalence of "offshore" structured finance, that is, the creation of security/leasing structures centered on aircraft registration outside of an airline's domicile, often requiring the interposition of intermediary entities between creditors and debtors. These arrangements are costly (in terms of expenses and regulatory burden), and will be relatively less significant with improvements to security laws, such as those contemplated by the proposed convention.

insolvency provision (optional)"). (The contractual choice of law provision (optional) and the international insolvency provision (optional) collectively are referred to in this memorandum as the "**optional provisions**".) In addition, our suggested approach on priorities also contains, at the enacting country level, but not at the individual debtor/lessee level, this weighing of costs (in this case, in terms of limitations on locally preferred local creditors' rights) and benefits (facilitating credit to its nationals) approach.

2.5 This modular approach to the proposed convention would, first, mandatorily address the international and basic security/leasing issues which currently raise risks (and thus costs) in the financing and leasing of aircraft. Second, the proposed convention would give the enacting countries (and, independently, obligors/airlines therein) the option of facilitating the availability of credit in exchange for providing financiers and lessors with broader security/leasing rights through the terms of the optional provisions than would otherwise be available if the relevant country had adopted the proposed convention but failed to opt into the optional provisions. This approach, without requiring substantive changes where unnecessary, would permit a number of countries with newly developing laws or legal systems yet large aircraft demands[12] to create promptly a legal environment more conducive to the provision of asset-based credit.

Part II Specific Recommendations on the Proposed Convention and the Rationale Therefor

In view of the nature of aircraft equipment and customary financing and leasing structures involving aircraft equipment, as well as the objective of facilitating credits to owners/operators of aircraft equipment, the aviation working group could comment on the proposed convention (as summarised in the summary report) as follows:

A Core Provisions to be included in the Proposed Convention

Preliminary Notes - Except to the extent commented upon in this memorandum, the aviation working group agrees, in broad terms, with the points set forth in the summary report, and believes that the same should apply on a mandatory basis upon enactment by each country.

We would draw the drafting group's attention to the following particular points in the summary report, which are not referred to elsewhere in this memorandum, which we view as essential to the proper working of the proposed convention. First, the proposed convention must be centred on an

12 See materials referred to in Note 3 above. For example, it is estimated by certain manufacturers that the emerging markets of the former Soviet Union and Eastern Europe will need to finance aircraft acquisition costs in the order of $70 Billion over the next twenty years, and that during this same period China's acquisition costs alone may be in the range of US$100 Billion.

international asset registry ("**registry**")[13] which, subject to certain local priorities (see part A(7) below), will establish priorities on a first-to-file basis. (See clause 10(i) of the summary report.) Second, there should be no "internationality" requirement (i) in respect of the proposed convention generally (the same being conclusively satisfied solely by the fact that the equipment is "mobile equipment"), including in the context of priorities (see clauses 10(i) and (x) of the summary report)[14] and (ii) in respect of aircraft equipment, if not other mobile equipment, in the context of enforcement. See clause 10 (xvi) of the summary report. Third, a provision analogous[15] to Article 7(i)(a) of Unidroit Convention on International Financial Leasing regarding the perfection of security and leasing rights in the context of insolvency and bankruptcy proceedings should be included.

1 Title/Ownership Transfers

Recommendation

1.1 The international registry established pursuant to the proposed convention would contemplate the recordation of notices evidencing (not effectuating or

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13 The proposed convention in general, and registry filing requirements in particular, would apply on a prospective basis, that is, the same would apply only in respect of transactions commenced after enactment of proposal convention. Applying the proposed convention to existing transaction would, in addition to causing a degree of confusion and certain expense, potentially change the substantive rights, obligations and risk allocations from that bargained for by the transaction parties.

14 The aviation working group is mindful of the ongoing deliberations at Unidroit on the questions surrounding an "internationality" requirement, that is, the need for an "international element", however defined, to invoke all or part of the proposed convention, as well as the perceived theoretical basis for such a requirement under general principles of international law. Moreover, we acknowledge that, even in our industry, there are a limited number of countries, including Germany and Japan, in which domestic finance is available for a significant percentage of aircraft purchased/leased by its national airlines.

Notwithstanding these points, we believe strongly that aircraft finance transactions (if not other financings of "mobile equipment") are per se international in nature, and thus cannot be subject to any additional internationality requirement. See clause 10(x) of the summary report. Aircraft are simply too mobile, aircraft financings are too complex, and the need for commercial certainty and predictability is too great, to condition the applicability of the proposed convention on factual predicates of this kind. Moreover, certain of the suggested "internationality" criteria are of character that may from time to time be subject to changes not apparent to or known by the transaction parties (e.g. if there is an "international usage" requirement, the proposed convention applies or not depending upon route changes by the airlines, or whether an engine is subject to a domestic or foreign interchange arrangement (each of which may not be known by the financier/lessor); if there is an "international parties" requirement, the proposed convention applies or not depending upon, for example, the nationality of a lender's assignee (which may not be known to the debtor/lessor etc.)). The result would be uncertainty and, through potential application of duplicative legal regimes, additional cost.

Moreover, the imposition of an additional internationality requirement may (comparatively) prejudice the rights of domestic financiers/lessors, the very financiers/lessors that may have incentives to provide non-market based, advantageous financial terms to local debtors/lessees. Such additional requirements may thus be a disservice to parties both seeking to provide and receive the lowest cost of financing available.

15 We support the intent of this provision, but suggest that certain wording amendments be considered. Such provision provides that the "lessor's 'real rights' shall be 'valid' against the lessee's trustee in bankruptcy". We believe that the term "real rights" may give rise to difficulties attributable to the different rights of owners/lessors in different jurisdictions, and that reference to "validity", a term used at times to address different issues in different legal systems, may create uncertainty. We would suggest a rule based on the following principle: "an interest under a security agreement or title reservation agreement, created in accordance with the proposed convention, will be recognised and enforced in priority to the rights of creditors generally, and bankruptcy trustees/liquidators in particular".

constituting legally conclusive proof of) title/ownership transfers[16] of aircraft and aircraft engines (for this purpose which do not constitute "security interests" or "title reservation agreements" under the proposed convention), by manufacturer's serial number. The failure to file any such notice would render such transfer voidable as against third parties (and, if sanctioned by domestic insolvency law, as against bankruptcy liquidators/trustees) who have made a subsequent Unidroit filing in respect of the relevant aircraft equipment, but not as between the parties.

1.2 All purchasers of aircraft (and their financiers) would acquire their interest in such aircraft equipment subject to all interests previously recorded in the registry with respect thereto.

1.3 The foregoing recordation rules would have no effect on the registration or nationality of aircraft for purposes of The Chicago Convention of 1944 on International Civil Aviation (the "**Chicago Convention**"); that is, a recorded title transfer would not constitute a de-facto de-registration, the same only to occur in accordance with national de-registration laws. (See point 5.3 below relating to such national de-registration laws.)

Rationale

The benefits of including title/ownership transfers under the proposed convention are material and include (i) facilitating the sale and financing of used aircraft and aircraft engines, a significant industry segment,[17] through providing a means of tracking title to aircraft and aircraft engines and (ii) simplifying priority rules by eliminating potential contests between purchasers (who will be on notice of the existence of other interests by virtue of such title/ownership filings) and/or their financiers and the beneficiaries of such existing interests in aircraft and aircraft engines.

We believe that the principal objections previously put forth for excluding title/ownership transfers are not cogent or no longer apply. First, the decision taken by Unidroit to move to an asset registry removes most of the practical objections. Second, if properly drafted, transfer provisions will neither be inconsistent with the Chicago Convention nor otherwise impinge upon issues of interest to the country of aircraft registration. All aircraft will

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16 In addition to contractual transfers and conveyances, evidence of legal transfers (e.g., transfers by universal succession, such as by way of merger), including transfers resulting from foreclosures or court-ordered sales, will also be fileable with the registry.

17 The actual amount of financing for, and leasing of, used aircraft equipment is difficult to estimate. Such financings or leasing may take the form of (i) a "sale-leaseback" transaction, that is, a true sale of the aircraft by an airline to a lessor which, in turn, leases the same aircraft back the selling airline, (ii) the restructuring of existing financing or leasing arrangements in respect of an aircraft, or (iii) the financing of an airline's acquisition, or leasing, of a used aircraft previously operated by another airline. To provide a general point of reference, it is roughly estimated that approximately 25% of newly financed aircraft are subsequently refinanced. Based on our working estimate of new aircraft deliveries with a yearly aggregate acquisition cost of US$50 Billion, it may be assumed that yearly financing of used aircraft equipment in the medium term will equal approximately US$12.5 Billion.

retain their national registration, in accordance with the Chicago Convention[18], and accordingly the country of registry will continue to regulate all matters relating to the use, maintenance, insurance and operation of aircraft equipment.

Finally, the filing of title/ownership transfers in aircraft would be consistent with a significant number of national legal systems.[19]

2 Creation of Security/Leasing Rights and the Proposed Convention's Classification Scheme

Recommendation

2.1 The creation/validity of all fileable interests (that is, interests which secure debt obligations or which constitute title reservations) under the proposed convention shall be governed by the substantive law expressed to govern the subject contract (without the requirement of any connection between such selected law and such contract or that any other condition be satisfied in respect of such selection) and, absent such an express selection, by the private international law rules of the forum.

2.2 Once created, any such interest which meets certain (very) minimum standards applicable under the proposed convention to either security interests or title reservations, as the case may be, may be filed as such, entitling the interest holder to the enforcement, priority and other rights available to that class under the proposed convention.

2.3 A clear (and thus formalistic) distinction must be made between strict security and title reservations for convention classification purposes in order to avoid

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18 See generally Chapter III of the Chicago Convention, Articles 17 (aircraft have the nationality of the state in which they are registered) and 19 (the registration or transfer of registration of aircraft in any contractual state shall be made in accordance with its laws and regulations).

19 The following countries, among others, require or permit the filing or recordation of title/ownership transfers, the same having property or priority rights implications: Argentina, Article 45 Aeronautical Code; Austria, Article 16 Aviation Act 1957; Belgium, Law of 27 June 1937 and Royal Decree of 15 March 1954; Brazil, Chapter V Aeronautical Code; Canada; Chile, Article 44 Aeronautical Code; China, Rules on Nationality and Registration of Civil Aircraft; Colombia, Manual of Aeronautical Rules; Costa Rica, General Law of Civil Aviation; Denmark, Act N° 118 of 12 March 1993; Egypt, Decree N° 269 of 1978; France, Civil Aviation Code; Germany, General Ordinance on the Establishment and Keeping of the Register of German Aircraft; Greece, Articles 1192-1197 and 1199-1204 of the Civil Code; Guatemala, Law of Civil Aviation; Iceland, Law of Aviation (Act N° 34/1964); Israel, Aviation Regulations (Registration of Aircraft and their Markings) 1973; Italy, Article 156 Royal Decree N° 356 of 11 January 1925; Japan, Aviation Law N° 231, 1952; Luxembourg, Law of 29 March 1978; Mexico, Regulations of the Mexican Aeronautics Registry of 25 October 1951; Netherlands, Air Navigation Act and Air Navigation Order; New Zealand, Civil Aviation Authority Ordinance 1982; Peru, Civil Aeronautic Law 1988; the Philippines, Civil Aeronautics Law; Poland, Aviation Law of 31 May 1962; Portugal, Rules of Air Navigation 1930; South Africa, Regulation 12.5(1) of Government Notice N°4975 of 30 January 1976 as amended by Government Notice N°R517 of 13 March 1987 para 51; Spain, Law 48/1960 on Air Navigation; Sweden, Aircraft Register Order SFS 1986: 172; Switzerland, Federal Law on Civil Aviation of 21 December 1948; Taiwan, Regulations for Registration of Aircraft; Thailand, Air Navigation Act 1954; Turkey, Law of Civil Aviation N° 2920; UAE, Federal Civil Aviation Law of 10 July 1991; USA, s.501 Federal Aviation Act 1958; Uruguay, Aeronautic Code; Venezuela, Civil Aviation Law N° 24.766, 9 June 1955.

tax sensitivities in connection with tax-based financing structures.[20] Notwithstanding this distinction, the practical differences between the enforcement, priority and other proposed convention rights of holders of strict security as contrasted with title reservations, for commercial reasons, must be minimal. This hybrid approach, if somewhat unconventional, would be workable under two conditions. First, the proposed convention should not, by its terms, substantively address the sensitive issue of surplus and deficiency. Second, in the case of enforcement rights, the proposed convention should be non-exclusive in the sense that, beyond the broad and generally phrased "basic remedies", additional rights and remedies under the laws selected by the parties shall apply, if the country in which the forum sits has opted into the contractual choice of law provision (optional) (see point B(1) below), or under the private international laws of such forum, if such country in which it sits has not opted into such provision.

2.4 The proposed convention must contain an express provision to the effect that neither the scope of the proposed convention, nor the fact of any filings made thereunder, will affect, or be a factor in determining, the characterisation of the transaction for any purpose (including, without limitation, national tax purposes and tort and public liability purposes) not specifically addressed under the proposed convention.

Rationale

The background work done by Unidroit has made it abundantly clear that, in the context of the "creation" and "validity" of security and leasing rights, the prevalence and implications of the lex situs rule, as well as the degree of international inconsistency, requires that the proposed convention contain a rule of decision binding upon all enacting countries, regardless of the location of the equipment when created and from time-to-time. (There is a fair amount of ambiguity and casualness as to the usage of above-quoted legal terms. We are using them as a description of the law determining whether or not a proprietary interest (that is, a security interest or title retention) has vested, or remains vested, in the financier/titleholder, as the case may be, by virtue of a particular transaction. Put more precisely, we are using these terms to address (i) all aspects of the creation and formation of the interest, including all questions relating to whether something in the nature of the interest (or process of contract formation) would render the interest wholly or partially invalid [21] and (ii) all formalities required to create, or evidence the

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20 We have received comment that a further distinction between title reservation agreements which contemplate mandatory passage of title (e.g., conditional sale agreements) and those that do not (e.g., certain leases) may be desirable. Our provisional view is that such a distinction is not essential, but would ask that this point not be precluded should we specifically raise it with Unidroit in the coming period.

21 Subclause (i) is intended to cover roughly the same subject matter as Article 8 of Rome Convention on the Law Applicable to Contractual Obligations of 1980 ("Rome Convention") (material validity).

creation of, any contract or legal interest,[22] but not (a) questions relating to the "capacity" of parties to contract, (b) contractual governance and interpretation of inter parties rights (but see discussion in point B(1) regarding the contractual choice of law provision (optional) which, if elected, would (together with the mandatory "basic remedies") govern the same) and (c) matters relating to or affecting the rights and interests of third parties (such matters being addressed through the proposed convention's priority rules).

There are five alternatives on the general question of the creation and validity of (security/title reservation) interests under the proposed convention. Such interests could be created (i) under the existing national laws of the particular forum, including its national conflict of laws rules, (ii) under the national laws of the debtor's/lessee's domicile or principal place of business (possibly (though not necessarily)) including its national conflict of laws rules, (iii) under the national laws of the country of aircraft registration (possibly (though not necessarily)) including its national conflict of laws rules, (iv) pursuant to the substantive standards set out in a wholly stand alone convention (i.e., the proposed convention would set forth, within its text, all substantive requirements for the creation of interests) or (v) under the national laws contractually selected by the parties (possibly (though not necessarily)) including its national conflict of laws rules. We believe that each of possibilities (i)-(iv) is not feasible and/or is theoretically flawed[23], and that only possibility (v), that of respecting the contractually selected law, without reference to its conflict of laws rules[24], is consistent with aircraft finance practice as well as evolving theory and law in this area[25].

We respectfully take issue with views suggested in the summary report that the interests need to be "created under the proposed convention" if this is meant to imply that an interest, properly created under the selected law, some how does not exist unless and until it is registered. To assuage those who hold a contrary view, however, as well as to provide for a workable means

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22 Subclause (ii) is intended to cover roughly the same subject matter as Article 9 of the Rome Convention (formal validity).

23 The first possibility is problematic given the sheer diversity of such rules and, importantly, the lex situs problem. The second and third possibilities simply beg the question as to whether the country of the debtor's/lessee's domicile or principal place of business or the aircraft registration, as the case may be, recognises a particular form of security or leasing; if not, the proposed convention would not apply in respect to those forms of security. Moreover, the results of the application on each of these choice of law rules might very well lead to results which are not commercially acceptable in the context of aviation finance practice. The fourth possibility, that of a wholly stand-alone convention, would significantly increase the complexity of the proposed convention and would reduce the likelihood of prompt enactment.

24 Permitting the application of the conflict of laws rules under the laws contractually selected by the parties would, through renvoi, result in the very complexities and uncertainties which the proposed convention seeks to avoid. Since the contractually selected law will, in many instances, not be the law of the forum, public policy reasons for applying a conflict of laws rule are unlikely. Referring to the substantive law selected by the parties would avoid the uncertainty associated with a conflict of laws analysis and would provide the parties with certainty and predictability. This approach is consistent with the Rome Convention. See Article 15 thereof.

25 See citations contained in Note 50.

of distinguishing between strict security and title reservation for (priority and basic enforcement) convention purposes, we support the specification of additional (very) minimum requirements[26] the satisfaction of which (without implying whether an interest exists or not) are conditions to (i) the filing of interests with the registry and (ii) the invocation of the proposed convention's priority and basic enforcement rules.

A created interest, satisfying these additional requirements, would then be fileable as either a security interest or a title reservation. Given the centrality of tax-based structures in aviation finance[27] , and the importance of respecting differing national laws on the significance of, and rights associated with, title, we strongly support the position previously taken by certain leasing associations that, for classification proposes, a clear, formalistic distinction needs to be drawn between a security interest and title reservation agreements. (See the minimum convention requirements contained in note 26 which could also serve as the means of distinguishing between types of interests for classification purposes.) In addition, the proposed convention, by its terms, needs to ensure that filings made thereunder will not affect, or be a factor in determining, the characterisation of the transaction for tax, bankruptcy or public liability purposes[28].

Given the relative simplicity of the priority and basic enforcement terms contemplated by the proposed convention, as well as the similarity (indeed near identity) of commercial expectations of strict security interest holders and title holders (in the context of priority and (basic) enforcement), this required distinction should not present commercial objections to the proposed convention.

3 The Treatment of Lease Contracts

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26 It is necessary to provide a formalistic, yet quite minimal, requirement which serves to differentiate between security interests and title reservations for convention purposes. By way of suggestion, and to be phrased more technically, perhaps the convention requirement (i) for a security interest can be a writing containing obligations (which may be third party obligations) the non-performance of which entitles the interest holder to seize specifically identified assets title to which resides, or will reside, with the interest holder's contract counterparty in such writing and (ii) for a title reservation can be a writing containing obligations (which may be third party obligations) the non-performance of which entitles the interest holder to seize specifically identified assets title to which resides, or will reside, with such interest holder.

27 It is difficult to determine with precision the amount of annual tax based aircraft financing (roughly defined as financing structures, an important economic element of which is the value of the tax depreciation taken in respect of the financed asset). It is (conservatively) estimated that the annual amount of aircraft equipment subject to tax based financing during 1994 was approximately US$18 Billion.

28 Certain jurisdictions contain laws permitting public filings which are not intended to affect the "characterisation" of a filed interest. See, e.g., Section 9-408 of the Uniform Commercial Code (US) (filing(s) shall not of itself be a factor in determining whether or not the consignment or lease is intended as security).

In addition to not affecting tax characterisation, it is also crucial that the proposed convention, and filings made thereunder, not affect tort and public liability law. In the context of aircraft, certain national laws differ as to the applicable standards for an "owner's" versus "secured party's" potential liability for accidents. Insurance, possibly priced differently to reflect such different standards, guards against these liabilities. The proposed convention must remain neutral in this area so as to avoid unintentionally impacting this important area of law.

Recommendation

All lease contracts[29], regardless of duration or other terms and conditions, shall be included as title reservation agreements and thus covered by the proposed convention. No distinction between types or classes of leases, nor between leases and other types of title reservations, should be made.

Rationale

In view of the importance of leasing to aviation finance, the proposed convention must cover leasing arrangements to the same extent as traditional credit arrangements.

Attempting to draw distinctions between types of leases, on any grounds other than the duration, would result in intractable problems stemming from the vast differences in bailment law, as well as the relation and overlap between bailment law and security law, across jurisdictions. Even within well developed legal systems, the problems of, and uncertainties associated with, drawing distinctions between "true-operating leases", on the one hand, and "financial/security leases", on the other hand, have increased financing costs. Finally, delicate tax points, in both cross border and domestic tax financing structures, would also arise should any economically based distinction between types of leases be embodied in the proposed convention. The proposed convention should avoid this set of difficulties.

Simply excluding short term leases, by reference to duration, is not desirable in the context of aircraft finance. Exclusions from filing requirements for short term transactions are typically based on "cost" (in monetary and administrative terms). However, the costs associated with filing with the registry in the case of a six month lease of a US$50 million asset, with aggregate rentals in the millions of dollars, are justified (as they are in respect of a six month bridging loan secured by the same asset)[30]. Given these sums and values, lessors need protection, and thus would be required to look to procedures and filings required by national laws, including conflict of laws rules (which, it was hoped, would be superseded by the proposed convention). Thus, a short term lease exclusion would either (i) require a complex and inefficient dual system for regulating priority and enforcement rights in leases or (ii) provide a disincentive to enter into short term leases.

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29 In aircraft finance parlance, arrangements in which an aircraft operator contracts to make use of its aircraft equipment for the benefit of another, in exchange for a fee, yet retains possession (custody and control) of such aircraft equipment in providing such service are at times referred to as "wet leases" or "charters". These arrangements are neither bailments nor financings, in broadest sense of these terms, and thus should not be covered by the proposed convention.

30 It is nonetheless essential that the proposed convention, in general, and filings with the registry, in particular, not impose significant costs (such as percentage of asset value filing fees) on the parties, nor present unjustified administrative burdens. This is important for a variety of reasons including market practicalities. Both aircraft (for seasonal/market reasons) and engines (for operational reasons), for example, may be subject to quite short term leases. In essence, filings should be notice based, and thus simple, and should attract only nominal filing fees.

4 Lease Assignments and Other Associated Contract Rights

Recommendations

4.1 Security and absolute assignments of lease (and sub-lease) contracts shall be covered by the proposed convention, and filings with the asset registry shall be made by manufacturer's serial number of the leased aircraft.

4.2 As between the assignor (lessor) and the assignee (lender), the proposed convention's (a) party autonomy choice of law provision regarding the creation/validity of interests (see point 2 above), (b) first to file priority rule (in this context with no qualification for locally preferred creditors), (c) basic enforcement rules (properly altered, to the extent necessary to suit foreclosure upon, and exercise of remedies in respect of, general intangibles rather than against movable equipment) and (d) contractual choice of law provision (optional) regarding (i) contractual interpretation and governance and (ii) contractual remedies (beyond the "basic minimum" convention remedies)(see point B(1) below), shall each apply in respect of the lease assignment.

4.3 As between the obligor (lessee) and the assignee (lender), the law governing the assigned lease under the proposed convention (that is, the law selected by the parties, if the country in which the forum sits has opted into the contractual choice of law provision (optional) (see point B(1) below), or the private international law rules of such forum, if such country has not opted into such provision) shall govern (i) the assignability of the lease, (ii) the relationship between the assignee (lender) and the obligor (lessee), (iii) the conditions under which the assignment can be invoked by the assignee (lender) against the obligor (lessee) and (iv) any question whether the obligor's (lessee's) obligations have been discharged.[31]

4.4 The proposed convention need not cover any other types of associated contract rights, except insurance proceeds (as contemplated in the summary report), in that such rights cannot be properly filed by reference to the manufacturer's serial number for the aircraft and/or are not perceived as presenting security problems to financiers/titleholders.

(b) Rationale

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31 We have not expressed a view, and would specifically reserve, on the question as to whether (a) a substantive rule binding the obligor(lessee) to the assignment and providing a priority rule vis-à-vis the obligor (lessee) or (b) a choice of law provision (the law governing the assigned lease under the proposed convention) in respect of these two points is appropriate. In the event a substantive rule is selected, we would recommend a rule based on the following principle: "the obligor (lessee) shall be obliged to pay or perform, as the case may be, for the benefit of the assignee (lender), to the exclusion of the assignor (lessor) or any subsequent assignee, the assigned sums and obligations in respect of the assigned rights, to the extent of, and on the conditions set forth in, such assignment, if the obligor (lessee) has countersigned a notice from the assignor (lessor), or consented to such assignment, and a copy of such a countersigned notice of or consent to assignment has been filed with the registry (and has not been terminated pursuant to a filed termination statement executed by the assignee (lender)."

Unidroit has specifically requested the views of the aviation working group on whether the proposed convention should cover "associated rights", such as lease assignments and warranty assignments. We believe it should cover lease (and sub-lease) assignments (with filings in respect thereof being made against the manufacturer's serial number of the leased aircraft), but no other class of associated contract rights.

We appreciate the complexity involved in addressing security over intangibles, in general, and the added difficulties in addressing such issues in a convention which otherwise is restricted to in rem type rights in mobile equipment. Nonetheless, we believe that the time and effort required to address these issues are necessary in view of the value of assigned leases in customary aircraft finance transactions[32]. The following are our principal reasons. First, nearly all cross-border tax based financings involve an intermediary which assigns an extremely valuable contract right to the financier[33]. In number of jurisdictions (e.g., Japan) there is no public filing system in which to record this assignment, and thus no certainty is available to the assignee (lender) in respect of its priority vis-à-vis potential competing creditors of the assignor (lessor). Second, such financings are often "non-recourse" in the sense that in all probability a default by the assignor (lessor) under its loan agreement is attributable to a corresponding lease default by the obligor (lessee). Thus, an assignee (lender) will typically be in a contest in the obligor's (lessee's) jurisdiction attempting to exercise rights under the lease assignment simultaneously, and in connection, with its termination of the underlying lease, or its exercise of rights thereunder. Particularly in countries without well developed leasing law, and/or clear choice of law rules in respect of lease assignments, the obligor (lessee) has incentive to take issue with the validity of the assignee's (lender's) derivative lease rights. The proposed convention, including the optional provisions, would minimise the litigation risks. Third, the aircraft may be subject to a sub-lease by an airline located in a jurisdiction without well developed law regarding the assignment of general intangibles. The proposed convention, again in part through the option provisions, would facilitate such head-lease/sub-lease financing structures (which benefit airlines by assisting in their fleet planning and providing operational flexibility). Fourth, inclusion of lease assignments in the proposed convention would assist in ensuring the value underlying increasingly important "securitised" financing structures in which multiple

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32 It is (conservatively) estimated that US$170 Billion worth of aircraft equipment is, at any given time, subject to lease contracts, producing annual lease receivables in excess of US$20 Billion which are assigned as security in aircraft financing contracts.

33 By way of example, in a standard financing structure, rental payments from a twelve (12) year aircraft lease, with a present value of approximately $80 million may be assigned by a lessor to its lender as security for the debt incurred in connection with its acquisition of a US$100 million wide-body aircraft.

leases are pooled and sold or assigned by way of security[34]. Finally, the filing of lease assignments is consistent with existing national laws in a number of jurisdictions[35].

Of the plausible alternatives, we have recommended lease assignment provisions, both as regards rights and obligations between the assignor (lessor) and assignee (lender), as well as between the assignee (lender) and the lessee (obligor) which, in our view, would strike the appropriate balance between respecting party autonomy, providing certainty and following precedent,[36] and thus that serve the stated objective of facilitating credit.

5 Basic Remedies

Recommendations

5.1 To be materially beneficial, the basic (non-exclusive) remedies[37] under the proposed convention of possession/repossession/seizure, judicially supervised sale and judicial sale set forth in the summary report need to be available within an expedited time frame, and notwithstanding any contrary provisions of national law. We recommend, therefore, that the proposed convention provide a mandatory timetable in which courts having jurisdiction under the proposed convention would be required to determine issues brought before them relating to these basic remedies. In particular, we recommend that such courts (and their associated appellate systems) be required to issue non-appealable, final decisions in respect of the availability of (a) the grounding

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34 By way of an industry example, GPA Group plc, an aircraft leasing company, has securitised lease receivables in respect of over US$1.5 Billion in aircraft equipment over the past three years.

35 The following countries, among others, require or permit the filing or recordation of assignments of lease contracts, the same having implications regarding the priority of interests in respect of the assigned rights: Argentina, Article 45 Aeronautical Code; Austria (change of operator only), Article 16 Aviation Act 1957; Brazil, Article 128 and 137 Aeronautical Code; Canada (dependent on province); Chile (Aeronautical Code); China (if affects foreign exchange control), Provisional Regulations on the Monitoring of External Debt of 27 August 1987; Colombia, Manual of Aeronautical Rules; Costa Rica, General Law of Civil Aviation; Denmark (novation only), Registration Act; France, Civil Aviation Code; Greece, Article 80, para 2 of the Code of Aviation Law; Iceland (novation only), Article 2 of the Registration Act; Netherlands (Aircraft Record Act); New Zealand, Chattels Transfer Act 1924; Norway, Act on Aviation of 16 December 1960; Peru (Civil Aeronautic Law 1988); the Philippines (Civil Aeronautics Law); Poland (Aviation Law 1962); Portugal (Rules of Air Navigation); Spain, Law 48/1960 on Air Navigation; Sweden (novation only), Carriage by Air Act; Switzerland (on a novation - Federal Law on Civil Aviation); Taiwan (Regulations for Registration of Aircraft); Turkey, Civil Aviation Act Article 57; USA, Federal Aviation Act; Uruguay, Aeronautic Code; Venezuela, Civil Aviation Law.

36 Such recommendations are a blend of Article 12 of the Rome Convention and the party autonomy provisions suggested elsewhere in connection with the proposed convention.

37 We would emphasize that for commercial reasons these remedies must be non-exclusive, that is, the additional remedies available under the selected law (in the case the contractual choice of law provision (optional) is applicable) or under the private international law rules of the forum (in the case the contractual choice of law provision (optional) is not applicable), quite possibly including self-help remedies such as repossession, possessory management/receivership and private sale, must also be available to the transaction parties.

of the aircraft[38] (pending further litigation procedures) no later than five (5) days, and (b) the right of the financier/lessor to repossession/seizure, or to a judicially supervised sale/judicial sale, of the aircraft[39] no later than thirty (30) days, in each case of the date on which application is made to the court with in rem jurisdiction over the aircraft. [40]

5.2 Regarding the contentious self-help remedies, please see the discussion in point B(1) below concerning the contractual choice of law provision (optional).

5.3 The right to "deregister" the aircraft for Chicago Convention purposes, and to export the aircraft, in each case following a default are essential elements of the basic repossession, seizure and collateral realisation concepts contemplated by the proposed convention. These rights need to be available immediately upon "repossession", whenever the same shall occur, without the need for further governmental or regulatory action (e.g., separate review or proceedings by aviation authorities) and/or acquiesence by the airline (e.g., consent to such deregistration and export).

Rationale

In the event of a default by the debtor/lessee, the secured financier's/lessor's most fundamental commercially oriented right is to gain prompt access to the asset. This right in the sine qua non of asset based finance as such. Without addressing timing considerations, the proposed convention provides a theoretical right which lacks utility. In the context of a moveable asset, and particularly in the case of highly mobile equipment, the risks associated with continuing post default non-possession are significant, including a reduction in the value of, and the potential disappearance of, the subject assets. Leaving aside self-help measures which minimise these risks (which, in view of the public policy implications, we suggest addressing through the contractual choice of law provision (optional)), the principal means of

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38 For these purposes, we are using the commercial term "grounding" to denote a circumstance in which (a) the right of the debtor/lessee to the use and, at the financier's/lessor's option, possession of the relevant aircraft equipment is suspended and (b) control over the relevant aircraft equipment is transferred to the creditor/lessor (or the agents) under the supervision of the courts ordering such grounding.

39 All rights to possession/sale of any aircraft equipment must include the right to acquire and retain possession of all technical records relating to such aircraft equipment. Such records are essential to ascertaining the then current condition and value of the aircraft equipment and, perhaps more pressingly, will be needed by the financier/lessor in its efforts to obtain an "airworthiness" certificate--the issuance of which will be a condition to the physical removal of the aircraft equipment from the relevant jurisdiction.

40 As summarised in the end note, the Convention of 1993 for the Unification of Certain Rules relating to the Precautionary Arrest of Aircraft (the "Rome Convention") prevents the seizure of aircraft where such seizure would seriously interrupt public, commercial or state transportation. In that the terms of the Rome Convention may conflict with the remedies set forth above, the proposed convention should contain an express rejection of the rights and remedies accruing to an aircraft operator under the Rome Convention in the event that the same conflict with the remedies under the proposed convention.

addressing these risks require governmental intervention or cooperation of some kind, particularly when the subject asset (such as aircraft) provides public service. Our recommendations regarding timing of final court decisions are designed to ensure that the proposed convention's important basic substantive remedies are not undercut by byzantine implementation rules or intended or unintended delays resulting from national procedural rules.

Similarly, in the context of aircraft, national rules regarding deregistration of aircraft, and their export, are potential obstacles to the basic commercial rights of possession and sale.[41] Simply put, they should be viewed as essential components of these basic rights. The suggestion that de-registration and export be immediately available upon repossession would address these concerns yet require the most limited changes to the various national aviation laws.

6 Treatment of Security over, and Leasing of, Aircraft Engines

Recommendations

6.1 A separate or sub-registry shall be established for aircraft engines and, similar to airframes, all conveyances, security interests, title reservations (including all engine leases without further distinction) and lease assignments shall be filed by reference to the manufacturer's serial number of such engines. The same mandatory convention provisions (including its priority[42] rules and basic enforcement rules (except those relating to de-registration (which are inappropriate in that the Chicago Convention does not independently address engine registration/nationality)) and optional provisions shall apply to engines.

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41 Under the Chicago Convention, an aircraft registered in one contracting state cannot be concurrently registered in a second state, see Chapter III, Article 18, and the de-registration rules will be established by the country of registry. See Chapter III, Article 19. Thus, the inability to de-register the aircraft, in accordance with the laws of the country of registry, will significantly reduce the marketability of the aircraft since all potential purchasers or operators will be aware that, pending proper de-registration, the aircraft cannot be put into revenue generating service in any other jurisdiction.

42 As is noted in point 1 of the Report of the Aircraft Engine Subgroup, a special rule may be required in order to accommodate the situation in which aircraft and engine leasing arrangements contractually embody the "title transfer" approach (see generally point 6), that is, where the relevant contracts contemplate that title to specifically identified engines installed from time-to-time on an aircraft become part of that aircraft (i.e., the act of installation/removal constitute conveyances). Such a rule would be based on the following principle: "in the event that (a) an aircraft financier/lessor and an airline contractually agree that, upon installation of a specifically identified engine on specifically identified aircraft, title to such engine would be transferred to such financier/lessor and (b) such title transfer arrangements are expressly noted in the appropriate financing statement or title reservation statement, as the case may be, filed in the engine registry (the forms of such statements to contemplate such a notation) in respect of such engine, then such aircraft financier/lessor shall, in respect of such engine (if and so long as the same is installed on such aircraft), have priority over purchasers or financiers subsequently filing interests in respect of such specifically identified engines."

The implications of a qualification of this kind are complex. The aviation working group would thus reserve its position on the desirability of the special rule of this kind pending further consideration.

6.2 Interests in no other aircraft parts shall be fileable in a separate asset registry. All other parts attached to the airframes and/or the engines would be covered by the relevant airframe or engine filing, as the case may be. If a general debtor registry is established, and a specific list of mobile equipment is drawn up, a number of spare parts (including avionics and landing gear) should be included in this list. If so, the proposed convention would apply to such other parts to the extent they are specifically identified in filings with the debtor registry.

Rationale

Aircraft engines[43] are extremely valuable security assets, and the financing thereof is an important industry segment.[44] Security and leasing rights in respect of aircraft engines, however, present extraordinarily different problems for a variety of reasons. First, industry practice regarding the exchange and pooling of engines is complex. Engines are, for operational reasons (and at times in violation of contractual restrictions), frequently removed from airframes and replaced with "spare" engines (which may have been separately financed) or engines from a "pool" [45] to which other airlines contribute (which also may have been separately financed) or which (before being so removed) may have been part of the security in another aircraft). Second, national legal rules governing whether an important, indeed essential, accession becomes part of the asset vary widely. Third, the objective interest of financiers and lessors of specific engines may differ from that of an aircraft financier/lessor. Given these points, the aviation working group sought the specific recommendation of a sub-group of engine finance experts prior to making the recommendations set forth above. A final copy of the memorandum prepared by the engine sub-group is set forth as **Annex 3.**

The threshold question is whether the proposed convention should assume and promote the "**title tracking**" or the "**title transfer**" approach to engine finance. Title tracking is a short hand reference to a system in which a financier/lessor retains its property interest in, and priority in respect of, the specifically financed/leased engine, regardless of the location of the engine and whether or not it has been removed from the original airframe, has been subject to a pooling arrangement and/or has been attached to a different

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43 As with the definition of "aircraft", we would at this point reserve pending further consideration on the question of the proper definition of "engines".

44 The value of jet aircraft engines as a proportion of overall aircraft values ranges from approximately 15% to 20%, and in absolute terms the acquisition cost of new jet engines range from approximately $2.5 Million to $10 Million. It is estimated that yearly financing of jet engines, as components of aircraft or separately, equals approximately US$10 Billion.

45 While a number of these pooling arrangements contemplate the transfer of title to engines placed into the engine pool, others do not. An overlay on this point is that, absent a convention provision, the laws of the place of installation or the lex situs may govern the question of whether title has passed, as well as the relationship between the relevant provision in the pooling agreement and applicable contract and accessions law.

airframe. Conversely, the title transfer approach refers to a system in which the engines installed on the airframe from time to time are legally viewed as part of the airframe and, thus, that each act of installation or removal constitutes a "transfer" of such engine.

While we recognise that legal problems will persist unless all relevant actions occur and parties litigate in Unidroit or other title tracking jurisdictions, and that there are disadvantages[46], we recommend that Unidroit establish a separate system for specific engine recordation and thus promote the title tracking system. First, this approach is consistent with basic principles underlying secured financing generally. Second, it would recognise the interest of those financing specific engines. Third, it would require documentation and recordation of transfers (the title transfer approach does not lend itself to the same since the act of attachment may itself constitute a transfer)-imposing more discipline in this area involving multi million dollar engine exchanges. Fourth, the title transfer approach would (a) require many (title tracking) enacting countries, in effect, to amend their substantive conveyance law (while the title tracking approach merely requires that parties in title transfer jurisdictions record and file their transfers) and (b) raise tax points - each title transfer may constitute a taxable event.

7 General Priority Rules under the Proposed Convention

Recommendations

7.1 We fully support the first to file principle[47] without any limiting conditions relating to "internationality", that is, a filed interest would take priority over all prior unfiled interests and all subsequent interests, whether filed or unfiled, in each case in and with respect to the specifically identified aircraft.

7.2 As regards preferred national creditors, on the date of each country's enactment of the proposed convention, such country must record with Unidroit/the registry, in reasonable specificity, the categories of creditors, if any, which would have priority over a previously filed Unidroit interest. Although each country may add to this list from time to time (and must

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46 The disadvantages include the following: First, an aircraft financier/lessor exercising remedies need not simply locate the airframe but, in addition, must locate its specific engines. Second, a party exercising rights in respect of "its" engines attached on another airframe could interfere with the "primary" collateral of the other aircraft financier. (Note, however, that the airframe financier/lessor, to the exclusion of any engine financier/lessor, would have all "de-registration" rights) (See point 5 above.) Third, there are administrative and operational costs associated with requiring filings in connection with engine transfers (transfers may be permitted by financiers of spare engines so long as the spares engine financier receives fair value in exchange).

47 We would suggest that, in view of commercial and logistic imperatives, the proposed convention contain a "priority notice" concept. A party which files a notice of its intent to file a financing statement or a title reservation statement, as the case may be, within a certain number of days ((e.g. seven (7) days), "priority period") would have priority over any interest filed in the registry during the priority period (assuming that such financier/lessor actually filed the financing statement or title reservation statement at any time (including after the second filing) during the priority period).

further record, in reasonable specificity, such amendments from time to time), any such recorded change would only have prospective application.

7.3 The proposed convention should permit future advances, if contemplated in the originally financing or title reservation document evidenced by a Unidroit filing, such future advances to have the same priority under the proposed convention as the original advance. There is no need to state a "maximum secured amount", nor to provide by way of a priority rule for the protection of junior creditors. The ability to contractually subordinate an interest should, however, be contemplated by the proposed convention.

7.4 The priorities scheme should be conclusive for all purposes and should not permit subordination on grounds of prior knowledge of other security or lack of good faith. Similarly, since transfers must be filed, "good faith purchasers" would not prevail over filed security interests or filed title-holders.

Rationale

As mentioned, the first-to-file principle is the centrepiece of the priority structure[48]. Financiers, lessors and purchasers must be able to rely, without qualification, on filings and non-filings with the registry.

The question of priority disputes between filed interests and statutorily or judicially preferred national creditors, that is, creditors whose interests would prevail over previously filed security interests under national law, was described at length in the summary report. Our recommendation, in the context of aircraft, is somewhat different from the provisional decision taken by Unidroit.

There are a number of possible approaches to the question of nationally preferred creditors. First, the proposed convention can simply override local priorities (or at least certain classes of the same). Second, on the date of each country's enactment of the proposed convention, such country must record with Unidroit/the registry their categories of preferred creditors, and this group cannot be enlarged or modified. Third, on the date of each country's enactment of the proposed convention, such country must record with Unidroit/the registry the categories of preferred creditors. Although they may add to this list (and further record the same), any changes shall only have prospective application (thus each financier, while subject to

48 On a technical note, given that the asset registry will record both security interests and title reservations in the same asset, and that holder of title/obligee under a title reservation agreement (e.g., a lease) may be an obligor under a simultaneous or subsequent financing (e.g., a loan to the titleholder in connection with such leasing transaction), a priority rule which subordinates, or mechanism to subordinate, such a titleholder's interest to that of its mortgagee is required.

More broadly, the priority rules must accommodate contractual subordinations, that is, arrangements pursuant to which later security interests are given greater priority by agreement with the other registered security interest holder(s).

existing local preferred creditors, would be protected against changes in law). Fourth, each enacting country would simply need to record with Unidroit/the registry from time to time its preferred creditors, but their ability to do so would be without consequence. This alternative is not actually a change in priority -- but it might reduce uncertainty and transaction/litigation costs. Fifth, the proposed convention can simply defer to local creditors (or to certain classes of the same).

In our view, the proposed convention should embody a system in which maximum information is provided to financiers and lessors in order for them to calculate legal risks and appropriately price such risks in transactions. It is thought a system of this kind would benefit both debtors and creditors. In the context of priorities, the third alternative noted above reflects this approach[49]. At the time of a subject transaction, a financier or lessor can ascertain the "priority" risk in a transaction, price the same, and safely assume that a subsequent change in law will not undercut a principle assumption made by it in entering the transaction. (Absent such change in law protection, this risk will, disruptively, be allocated to the debtor/lessee in the form of a default or mandatory prepayment event.) Each enacting country could change its preferred creditors, but this act would not affect previous financiers/lessors. Countries unwilling to "qualify" their systems in this respect would disclose this fact (by broadly listing its classes of preferred creditors).

We believe that the requirement of stating a "maximum stated amount" (or some approximation thereof (such as, under French law, an estimated overall rate of return)) is unnecessary, inconsistent with the nature of the contemplated nature of registry (notice based) and, perhaps most noteworthy, not necessarily in the interest of junior creditors.

In civil law systems where the stating of a maximum figure (which will then be given priority from the date of the original advance) is required, practice is thought to be that of vastly overstating the amount likely to be owed under the financing documents to cover not only possible future advances but exchange rate fluctuation risk, possible hedging related losses and costs likely to be incurred should the exercise of remedies be necessary. An effect of these overstatements is often to discourage junior creditors from extending credit. Moreover, junior creditors are not in need of statutory protection of the kind being considered, in the context of aircraft finance, junior creditors are sophisticated parties that can simply identify the existence of prior creditors by searching the asset registry and, if appropriate, negotiate inter-creditor agreements with such creditors.

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49 We appreciate the potential complexity in devising a system which properly classifies and categorises types of preferred creditors, but believe that such a system is feasible and, if properly done, would (in addition to providing a clear priority rule) increase the information available to financiers/lessors and assist in their assessment of the legal risks present in contemplated transactions.

8 Jurisdiction to Resolve Disputes under the Proposed Convention

Recommendations

In addition to the courts noted in clause 10 (xix) of the summary report, courts located in the debtor's principal place of business need also have jurisdiction to resolve disputes under the proposed convention.

9 Matters related to the Registry

Recommendations

9.1 While we agree that the Unidroit Governing Counsel should have ultimate responsibility for the registry, a delegation of all operational matters regarding the registry needs to be made to an organisation with the resources properly to organise, manage and control the registry. It is premature to make a recommendation in this respect.

9.2 Civil aviation registries (or, as the case may be, such other applicable governmental authorities) in each enacting country should constitute "satellite offices" for purposes of the proposed convention. All filings with respect to an aircraft registered in an enacting country may be made with the satellite office in such country. Further thought should be given as to whether such filings may, in addition, be made with the central registry rather than with the relevant satellite office. (The existence and role of the satellite offices would not, however, detract from the concept of a "central" filing system; a filing, including one made through an eligible satellite office, has continuing force, and remains effective, notwithstanding changes from time-to-time in the physical or legal (i.e., the country of aircraft registry) location of the aircraft).

9.3 The registration system shall, as a general matter, be based on the concept of notice filing. Full documents need not be filed; rather, the forms of the filed statements (e.g., "financing statements", evidencing security interests; "title reservation statements", evidencing title reservations; and "transfer statements", evidencing title/ownership transfers) should contain sufficient information to put parties searching the registry on notice of the existence of prior interests in, or transfers of, the aircraft equipment. The registration system, however, should permit (at the parties' discretion and with their joint written authorisation) the filing of transaction documents (annexed to the filed financing/title reservation statements) which, by virtue of such attachment, shall for evidentiary purposes be presumed to be the agreed form of such documents.

9.4 The registry's rules should also specifically contemplate matters relating to removing/terminating filings that no longer exist, and other practicalities relating to the efficient operation of the registry and the notice based system contemplated thereby.

9.5 Filings with the registry (or appropriate satellite office) would replace/supersede all national security law filings (but not aircraft nationality filings) in respect of the subject aircraft equipment including those filings otherwise made with local aviation registries, mercantile registries and registries of deeds and documents.

10 **Relationship between the Proposed Convention and the Geneva Convention**

Recommendation

The issue of the relationship between the proposed convention and the Geneva Convention is an important question involving a number of complex legal and political considerations. The aviation working group would, at this point, reserve on this matter pending production of the second draft of the proposed convention. We will, in due course, provide Unidroit with a specific recommendation on this point.

B. Optional Provisions to be included in the Proposed Convention

The aviation working group urges Unidroit and the drafting group to include the following two optional provisions which, in our view, would place Unidroit and the proposed convention squarely in the forefront of the important efforts currently underway to promote international extensions of credit through legal reform. We believe that the inclusion of these provisions, while respecting national sovereignty and party autonomy through their optional character, will enable certain countries and their debtors/lessees to access credit at lower costs than would otherwise be available to them now and in the foreseeable future.

1 **Contractual Choice of Law Provision (Optional)**

Recommendation

1.1 On the enactment of the proposed convention, each country would have the option of including a provision requiring, without condition (except that the parties have expressly agreed to this provision in their contract (see below)) or qualification, that the substantive laws (that is, national laws without reference to conflict of law rules) selected by parties to a transaction shall govern their respective rights and duties. By electing this optional provision, such enacting country's national law (whether applied by its national courts or, through choice of law rules, by other national's courts (whether or not such other court sits in a nation which is a signatory to the proposed convention) shall, in the context of aircraft transactions, respect the parties' freedom to choose the substantive law to govern all matters of (i) contractual interpretation and governance and (ii) and contractual remedies including,

without limitation, self-help remedies (beyond the "basic minimum" convention remedies) such as repossession, possessory management/receivership and private sale. A recommended form of this contractual choice of law provision (optional) is attached as Annex 4-A.

1.2 This provision, if elected by a particular enacting country, would only apply if and to the extent that the debtor/lessee contractually agreed to the same in the specific financing/leasing contract.

Rationale

This optional provision has the following advantages. First, it would be consistent with and promote the legal acceptance of freedom of choice provisions[50]. Second, it would give international financiers and lessors the benefit of the certainty and predictability available through the application of well-developed and commercially recognized laws, thereby benefitting debtors/lessees currently paying higher financing and leasing costs attributable to legal uncertainty in their respective jurisdictions. Third, it would permit Unidroit to avoid imposing contentious self-help remedies on all enacting countries, thereby making the proposed convention more politically acceptable (and, moreover, would permit the transaction parties to select a law, at their discretion, which may or may not contemplate self-help).[51] Fourth, where important, this optional provision may provide the parties with certainty on the question of surpluses and deficiencies without expressly addressing this tax sensitive area in the text of the proposed convention.

In making this recommendation, we are mindful of the justifications put forth from time-to-time in various jurisdictions to limit, restrict or otherwise qualify express choice of law clauses[52]. We believe that, in the context of

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50 See, in particular, N.Y. Gen. Oblig. Law 5-1401 (regarding a contract in excess of $250,0000, parties may select New York law to "govern their rights and duties, in whole or in part, whether or not such contract... bears a reasonable relation" to New York), and Rome Convention, Article 3(1) (a "contract shall be governed by the law chosen by the parties").

51 In the context of aircraft finance, and particularly in view of the optional feature of our recommendation, it is thought that self-help remedies will not face the degree of resistance anticipated by some. We would note with interest that two major ship finance jurisdictions with civil law frameworks, Greece and Panama, have included self-help type remedies in their ship mortgage laws. See, Greek Legislative Directive ("LD") 2854/1954 and LD 2687/1953 (ships over 1,500 GRT) and LD 3899 1953 (ships between 500 and 1500 GRT) (Each creating "preferred mortgages" on ships with broader security rights than available in respect of non-ship mortgages). They did so because they were convinced that this was necessary for the purpose of financing their merchant fleet. In addition, two other major ship finance centers, Liberia and Cyprus, are based on systems which accept such self-help type remedies.

52 Limitations may, in certain systems of law, be placed on the contracting parties' ability to select laws which (i) are inconsistent with the "(fundamental) public policy" of the forum, (ii) are inconsistent with the "mandatory rules" of the forum, (iii) have no reasonable relationship to the contract or the issue in dispute, particularly if selected with the intent to avoid the application of the law of a jurisdiction with a more significant interest in the issue or dispute, (iv) if applied, would invalidate the contract, (v) attempt to alter the conflicts rule relating to the validity of their governing law clause (vi) affect the rights of third parties, (vii) address the technical legal validity of a contract (i.e., the legal capacity of the contract parties, the due authorisation of the transaction and, possibly, the due execution and delivery of documents), (viii) affect "property" (rather than "contract") elements or interests, and (ix) are inconsistent with applicable insolvency

multimillion dollar international financings of aircraft, between sophisticated commercial parties, represented by (often multiple) expert counsel, and regulated by international convention, these justifications are not compelling and/or are outweighed by the corresponding benefits of a freedom of contract rule. To respond briefly to the more common objections, we would note as follows. By selecting this provision, and in the context of aircraft financing, enacting countries are taking the decisions that promoting party autonomy and facilitating the availability of credit is consistent with, and constitutes an important of, their "fundamental public policy". In this content, sophisticated commercial parties may reasonably be viewed as not being in need of, and/or having bargained in respect of, the contents of "mandatory" rules. The need for commercial certainty and predictability, and often neutrality, are sufficient reasons in and of themselves for selecting law which is otherwise wholly unrelated to the parties and the transaction. Questions related to "validity" (i.e., would the selected law "invalidate" the contract or attempt to alter conflict of laws rules relating to the same) are the very subject of the proposed convention and are addressed elsewhere (see point A(2) above, as are the "rights of third parties" (see point A(7) above). Finally, by the terms of the proposed convention, national insolvency laws would not be affected, including by virtue of a choice of law provision, except, importantly, to the extent expressly addressed in the proposed convention (see lead-in to Part II(A) above and the discussion of the international insolvency provision (optional) immediately below).

Please note that we have suggested that the optional provision include title/ownership transfer agreements, as well as security agreements and title reservation agreements. We appreciate that the proposed convention is primarily designed to address security/leasing interests, but many aircraft financings involve both a title transfer and, immediately thereafter, creation of security/leasing interests. The proposed convention will therefore not provide a full solution (by removing the need for lex situs research in each transaction) unless it also clarifies lex situs problems on title transfers.

2 International Insolvency Provision (Optional)

Recommendations

2.1 On enactment of the proposed convention, each country would have the option of including a provision which would ensure that, in the event of insolvency type proceedings under its national laws, the debtor/lessee would be required either to cure all defaults within a specified time (and continue to perform its contractual obligations) or to return the aircraft equipment to the financier/lessor, and that the material rights of the financier/lessor would not otherwise be prejudiced in such insolvency proceedings. A recommended

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laws.

draft of the international insolvency provision (optional) is attached as Annex 4-B.

2.2 This provision, if elected by a particular enacting country, would only apply if and to the extent the debtor/lessee contractually agreed to the same in its specific financing/leasing contract.

2.3 Priority contests, in the context of insolvency proceedings, would be addressed in the same manner as priorities generally, that is, each enacting country would need to record, in reasonable detail, with Unidroit and the registry the classes of statutorily preferred creditors, if any, that would prevail over/compete with a holder of a filed Unidroit interest under its insolvency laws.

Rationale

The principal objective of security rights is to protect the financier in the event of the insolvency of its debtor. Yet insolvency laws in certain jurisdictions, for a variety of policy reasons (resuscitating insolvent debtors (and possible promoting local employment); preference for certain classes of creditors, or for unsecured creditors generally; generally disfavouring security; etc.), severely restrict the rights of security holders (and often titleholders/lessors). Such restrictions may be embodied in rules limiting the exercise of remedies, permitting attacks on security or the involuntary restructuring of debt, or granting priorities rights in respect of the secured/leased assets.

These insolvency laws have a direct and significant impact on the availability and cost of credit in particular jurisdictions, and to particular airlines [53]. For the reasons stated in Part I of this memorandum, namely, to provide individual countries and airlines with the option of increasing the availability and reducing the cost of credit secured by aircraft equipment, we would urge Unidroit to include the international insolvency provision (optional).

In making this recommendation, we would draw Unidroit's attention to the fact that, in the context of aircraft finance, it is often governmental entities themselves that assume the insolvency risk (e.g., the European, US and other export credit agencies[54] are, at times, the primary credit risk-taker--and holder of the ultimate security rights over the financed/leased aircraft) and/or pay higher financing or leasing costs as a result of the contents of insolvency

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53 See generally Moody's Investment Service's Moody's on Aircraft Finance (Higher Ratings for Equipment Trust and Pass Through Certificates, January 1995) (recent changes to Section 1110 of the US Bankruptcy Code, a provision giving aviation financiers and lessors certain preferred rights in insolvency proceedings, constituting a key factor in determining credit ratings on public debt securities secured by aircraft equipment); see also Airfinance Journal, March 1995, at p.10.

54 The export credit agencies have guaranteed or insured financing or leasing transactions in respect of several US$Billion in each of the past two years.

laws (e.g., government owned or controlled airlines or national guarantors[55]).

Part III Concluding Comments

We hope very much that Unidroit and the drafting group will give due consideration to the views set forth in this memorandum and, consequently, that the aviation working group will remain in a position to promote the commercial and political acceptance of the proposed convention.[56] In this regard, we would note that while we have kept certain governmental representatives (including certain European and US export credit agencies and certain representatives of Government departments) informed of our work, and are copying this memorandum to these export credit agencies and Government departments, essentially those Government departments responsible for overseeing their respective country's export credit agency, the views expressed herein are solely those of the aviation industry group.

We understand that our representative and the principal draftsman of this memorandum, Jeffrey Wool, will be meeting Professor Roy Goode, in his capacities as a member of the Unidroit Governing Council and as Chairman of the Sub-committee of the Unidroit Study Group responsible for the preparation of a first draft of the proposed Convention on International Interests in Mobile Equipment, on 16 May to discuss the contents of this paper. Please note that we are available to provide additional assistance as appropriate.

We will also endeavour to provide specific recommendations, as soon as practicable, on the points in this memorandum on which we have made a reservation. These points are (i) the definition of "aircraft", (ii) the definition of "engine", (iii) in the context of lease assignments, the requirements for, or alternatively a choice of law provision in respect of, an assignee's (lender's) "perfection" against an obligor (lessee), (iv) the recommended relationship between the proposed convention and the Geneva Convention, (v) the possible need for a supplemental priority and/or filing rule in the context of a contractually contemplated title transfer agreement involving aircraft engines and (vi) the organisation which might be delegated operational responsibility for the aircraft and aircraft engine registries.

Finally, but crucially, our group is also keenly interested in timing considerations regarding the proposed convention. While we understand the limited resources available to Unidroit, as well as the need to ensure that all views are fully and broadly discussed among the various constituencies, we would hope that a specific timetable for the project can be agreed upon which would enable our group to continue its vigorous and concerted effort to facilitate the acceptance and future enactment of the proposed convention.

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55 It is estimated, for example, that the Bank of China has guaranteed financing or leasing transactions in respect of approximately $10 Billion in aircraft finance to Chinese airlines over the last five years.

56 We believe that it is particularly important to solicit the views and advice of commercial and legal experts from countries and regions that have not been actively involved in the process of formulating preliminary views on the scope and substance of the proposed convention but that have large demand for aircraft, such as Asia, Eastern Europe and Latin America.

We would ask that Unidroit give thought to timing matters and inform us of its detailed views after the drafting group meeting in June.

We appreciate the opportunity to express the views of the aviation working group on these matters and to participate directly in the process of producing a commercially oriented and legally sound convention on security and leasing rights over aircraft equipment.

Sincerely yours,

Benoît Debains
Vice President, Customer Finance
Airbus Industrie

Scott Schairer
Assistant Treasurer
The Boeing Company

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N.B. THIS PAGE HAS BEEN INCLUDED FOR PURPOSES OF CLARITY AND LEGIBILITY.

[PLEASE REFER TO PREVIOUS PAGE FOR AIRBUS/BOEING SIGNATURE.]

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A secured creditor/lessor has a property right, with a certain priority, in specific aviation assets which, upon the obligor's default, it intends to seize promptly. In the case of secured credit, the creditor aims to convert such assets into proceeds for application against the obligations secured. The most important existing sources of law, in the context of aviation finance, relating to these rights are:

(a) the applicable international aviation conventions to the extent in effect in the relevant jurisdictions (the "**Aviation Conventions**");

(b) national secured transaction/leasing law in the relevant countries ("**National Security Laws**");

(c) national laws used to decide international issues, such as whether to (i) recognise foreign forms of security (whether or not expressed to be governed by a foreign law and whether or not such a governing law clause is valid thereunder), (ii) apply its own priority rules if there are domestic creditors in competition with a foreign creditor/lessor of an asset which has moved its territory, and (iii) permit the attachment or seizure by a foreign creditor/lessor of assets located in its territory ("**National Conflict of Law Rules**");

(d) national bankruptcy/insolvency law which generally limits access to a bankrupt's assets and, in certain countries, may permit the involuntary restructuring of financial obligations ("**National Bankruptcy Laws**");

(e) national laws relating to the de-registration and export of aircraft property ("**National De-registration Laws**"); and

(f) national taxation law regarding the requirements for depreciation of assets ("**National Taxation Laws**").

(The national laws referred to in clauses (b) - (f), collectively, the "**National Laws**").

1 The starting point for review is the Aviation Conventions, in general, and the Convention of 1948 on the International Recognition of Rights in Aircraft (the "**Geneva Convention**"), in particular. The Geneva Convention is principally (though not exclusively) a conflict of laws convention: each of the ratifying countries will "recognise" security and leasing (if in excess of six months) rights which (i) have been "constituted in accordance with the law of the contracting state in which the aircraft is registered" at the time the rights were created and (ii) are "regularly recorded in a public record" of the contracting state which is the country of registry.

These general points follow from the above and the text of Geneva Convention:

1.1 The Geneva Convention refers to the substantive law of the country of registry on questions of the proper creation, perfection and priority of security/leasing. It does not, except on a few points (mostly related to judicially arranged sale of aircraft), add to otherwise applicable National Laws. If the National Laws are weak, do not exist, or do not recognise a foreign form of security, the Geneva Convention is of little assistance. The country of registry can also prohibit the recording of any rights not recognised under its own National Security laws.

1.2 The Geneva Convention only applies if both the country of litigation and the country of registry have ratified the Convention. In addition to a number of developed countries (e.g. the United Kingdom, Japan and Canada), many important developing countries with large and potentially large demands for aircraft have not ratified the Geneva Convention, including China, India, Russia and Indonesia.

1.3 The Geneva Convention has no effect if the country of registry does not have a proper system for "regularly recording" security rights or leases, as the case may be.

1.4 The Geneva Convention does not adequately cover security rights in respect of engines (and other spare parts). To be covered engines, unrealistically, need to (i) be stored in a specified place, (ii) be identified as being subject to the security and (iii) remain in the stored location.

1.5 The Geneva Convention does not clearly provide for security rights relating to lease assignments or other contract rights.

1.6 The Geneva Convention does not affect the basic provisions of National Bankruptcy Law which relate to the repossession of aircraft or the restructuring of financial obligations.

The Chicago Convention of 1944 on International Civil Aviation (the "**Chicago Convention**") is tangentially related to our analysis. Under the Chicago Convention - which has been adopted by virtually all nations - (i) an aircraft will have

the nationality of the contracting state of registry, (ii) an aircraft cannot be validly registered in more than one contracting state at any one time, (iii) the contracting state of registry may establish its own rules regarding (a) the registration of aircraft in its registry and (b) the transfer of registration from its registry, (iv) all internationally operated aircraft are to bear identifying nationality and registration markings and (v) contracting states have a wide range of discretion regarding rule-making in connection with registration requirements (e.g. maintenance and operational standards). An important point relating to the Chicago Convention to bear in mind in the financing context is that the country of registry, through its National De-registration Laws, may be able to limit the secured party/lessor's ability to realise the value of its security/property by, among other things, requiring operator/lessee consent to or otherwise restricting de-registration.

Finally, the Convention of 1933 for the Unification of Certain Rules Relating to the Precautionary Arrest of Aircraft (the "**Rome Convention**") needs to be considered. The Rome Convention seeks to prevent the seizure of aircraft where such seizure would seriously interrupt public, commercial, or state transportation. In particular, no aircraft that is "actually in service on a regular line of public transport" or is "appropriated to the carriage of persons or goods" may be seized in a contracting state. Only a limited number of states have ratified the Rome Convention (e.g. France and Germany). None of the countries mentioned in clause 1.2 above relating to the Geneva Convention have ratified the Rome Convention.

2 The security rights of secured parties/lessors will be determined under the National Laws of one or more countries. This is so for two reasons. First, the Geneva Convention is a conflict of laws convention which will direct courts to apply a body of National Laws (that is, to apply those of the country of registry). Second, for a variety of reasons noted above, the Geneva Convention may not apply. The first category of National Laws to consider are the National Security Laws, which vary widely. Principal differences among systems of law include the following:

2.1 the acceptable forms of, and the formalities required to create, security devices;

2.2 the discretion given to the parties to agree on contractual remedies in general, and the availability of self-help (i.e. non-court supervised) remedies, in particular;

2.3 the priority given to perfected security vis-à-vis preferred class of creditors (e.g. tax and materialmen liens) and trustees/liquidators in bankruptcy (see also National Bankruptcy Law below);

2.4 the assignability of, and required method of assignment for, contractual intangible rights related to aircraft (e.g., lease assignments, warranty rights and insurance rights) and the effect of such assignments; and

2.5 the degree of development of leasing law as a comprehensive body of law.

3 The category of National Conflict of Laws Rules is perhaps the most complex. A number of problem areas are traceable to the so-called "lex situs" rule which applies in a number of countries. Under the lex situs rule, the law governing rights in moveable items is the law where such item is located at any given time. This would include the creation or loss of security rights. Since an aircraft is constantly moving, under this doctrine, the law regarding security rights is constantly changing.

Questions (taken from Unidroit material) which immediately follow from the existence of the lex situs rule are:

3.1 Would a security interest or a lease validly created in country 1 be recognised in country 2 (into which the aircraft has moved) if such security interest or lease would be invalid or differently characterised if created in country 2.

3.2 Assuming that a security interest or lease created in country 1 would be valid in country 2 (into which the aircraft has moved), would the secured party/lessor be subject to priority disputes with new interests arising in country 2 (for example, euro-control liens arising in country 2). Is this problem alleviated, if filings are made in country 2.

Other issues that arise under the National Conflict of Laws Rules include whether the courts of country 2 (into which the aircraft has moved) will permit a secured creditor/lessor to attach or seize the aircraft subject to security or a lease validly created/perfected in country 1.

4 National Bankruptcy Laws potentially impact the rights of secured creditors/lessor in a number of ways. Most significantly such laws may:

4.1 permit a liquidator/trustee to attack the security (or, which is less likely, leasing arrangements) on grounds that (i) the form of security/leasing is not recognised under National Security Laws, (ii) such security/leasing was not properly formalised or perfected under National Security Laws and/or National Conflict of Laws Rules or (iii) such security/leasing was entered into on preferential/fraudulent terms;

4.2 limit or prohibit the secured party/lessor's access to the collateral/asset after the commencement of proceedings, possibly for significant periods of time and during which the collateral/asset may be declining in value as a result of poor maintenance;

4.3 permit the restructuring of financial obligations; and/or

4.4 provide that certain classes of creditors rank ahead of security holders in respect of their collateral.

5 As for National De-registration Law, see 1 above. In addition, certain rights in favour of junior creditors to block de-registration by a senior creditor in a number of countries is of note.

6 National Taxation Laws, and the difference between National Taxation Laws, are often the determinant of the form of secured financing/leasing selected. Under many National Taxation Laws, the form of the transaction is critical to the availability of tax benefits; under other National Taxation Laws, the economics of the transaction is central.

Annex 1

Description of Members of Aviation Working Group (listed alphabetically)

Airbus Industrie G.I.E. is a major international supplier of large civil aircraft organised as a consortium of four leading European aerospace companies - Aerospatiale Société Industrielle Nationale (France), Daimler-Benz Aerospace Airbus GmbH (Germany), Construcciones Aeronauticas S.A. (Spain) and British Aerospace (Operations) Limited (England). Airbus Industrie G.I.E. is primarily engaged in the leadership and coordination of the design, development, certification, assembly, marketing, sale and support of the Airbus family of airliners, namely the Airbus A300, A310, A319, A320, A321, A330 and A340 projects and derivatives.

Banque Indosuez is a wholly owned subsidiary of Compagnie Financiere de Suez, Banque Indosuez, a major merchant banking institution with offices in 65 countries. The bank's Indosuez Aerospace Group has broad experience in aircraft finance, including debt finance, operating and tax leasing, export credit supported finance and equity arrangement.

GE Aircraft Engines is a division of General Electric Company, a U.S. company that, among other things, provides a wide variety of aviation-related products and services. General Electric Company is a major manufacturer and supplier of large and small jet engines for airframe manufacturers, airlines, leasing companies, and military aircraft. Also, CFM International, a joint company of General Electric Company and SNECMA of France, is a major manufacturer of mid-sized commercial and military jet engines. In addition, GE Capital Aviation Services, a wholly owned subsidiary of General Electric Company, lease over 950 aircraft and provides other aircraft related services (including aircraft financing and spare engine leasing services) to more than 150 airlines around the world.

International Lease Finance Corporation ("ILFC") is a large commercial aircraft leasing company based in Los Angeles, California with over 300 aircraft leased to over 75 airlines all over the world. Since 1973 ILFC has engaged in over 700 transactions involving the lease or sale of commercial aircraft to more than 140 airlines. As of December 31, 1994, ILFC had committed to purchase 236 additional aircraft deliverable through 2000 at an estimated aggregate purchase price of $13.4 billion and had options to purchase an additional 51 aircraft for delivery through 2001 at an estimated aggregate purchase price of $2.8 billion.

Kreditanstalt für Wiederaufbau ("KfW") was established in 1948 as a corporation under public law. It is a bank with responsibilities in economic policy. KfW extends loans and grants (i) to promote the German economy both at home and abroad and (ii) to support the Federal Government in its Financial Cooperation with developing countries. KfW's aerospace financing forms an important part of the bank's overall export and project financing activities to promote German industries. KfW's total assets in 1994 exceeded DM 256 billion.

McDonnell Douglas Corporation, headquartered in St Louis, Missouri, is a major aerospace company, producing both military and commercial aircraft and helicopters, as well as missiles, space and electronic systems. Commercial jet aircraft currently in production include the MD-80 and MD-90 twinjets and the MD-11 trijet.

Pratt & Whitney, a division of United Technologies Corporation, Hartford, Connecticut, is an aerospace manufacturer engaged in the production of military and commercial jet engines, small gas turbine engines, rocket engines and space propulsion systems, and engines for commuter aircraft. Pratt & Whitney also provides customer support, engineering services, and specialised engine maintenance and overhaul and repair service.

Rolls Royce plc is a major power systems companies, operating through its aerospace and industrial power groups. The Aerospace Group, which now includes the Allison Engine Company, has a significant fleet of engines, powering aircraft and helicopters for both commercial and military applications. Rolls-Royce plc is engaged in aircraft engine leasing through Rolls-Royce Leasing and Rolls-Royce & Partners Finance Limited. Rolls-Royce & Partners Finance Limited has a portfolio of more than 40 spare engines, which support lease arrangements with 23 lessors worldwide.

SNECMA comprises a group of six (6) major aerospace companies that operate in both civil and military markets. The SNECMA Group's core business is propulsion, spanning the design, production and marketing of aircraft and rocket engines, as well as engine components, repair and maintenance. The SNECMA Group is involved in a number of major aerospace programs, including Rafale high performance fighter, new Airbus and Boeing Jetliners and the ARIANE launch vehicle.

The Boeing Company based in Seattle, Washington, is a major aeropsace firm engaged in, among other things, the business of manufacturing and selling commercial jet transport. Jetliners currently in production include the 737, 747, 757, 767 and 777. Boeing is also a major US government contractor with capabilities in missiles and space, electronics systems, military aircraft, helicopters and information systems management.

The Long-Term Credit Bank of Japan, Ltd., a Japanese banking organisation, directly and by way of its ownership interests in Japan leasing Corp., LTCB International Leasing, GPA and Capstar, covers all relevant aspects of the commercial jet finance and leasing markets on a global basis. It maintains currently an industry related loan portfolio in excess of US$ 2 billion.

Annex 2

Summary of Recommendations of the Aviation Working Group

A Core Provisions to be included in the Proposed Convention

Preliminary Notes - Except to the extent commented upon in this memorandum, the aviation working group agrees, in broad terms, with the points set forth in the summary report, and believes that the same should apply on a mandatory basis upon enactment by each country.

We would draw the drafting group's attention to the following particular points in the summary report, which are not referred to elsewhere in this memorandum, which we view as essential to the proper working of the proposed convention. First, the proposed convention must be centred on an international asset registry ("**registry**") which, subject to certain local priorities (see part A(7) below), will establish priorities on a first-to-file basis. (See clause 10(i) of the summary report.) Second, there should be no "internationality" requirement (i) in respect of the proposed convention generally (the same being conclusively satisfied solely by the fact that the equipment is "mobile equipment"), including in the context of priorities (see clauses 10(i) and (x) of the summary report) and (ii) in respect of aircraft equipment, if not other mobile equipment, in the context of enforcement. See clause 10 (xvi) of the summary report. Third, a provision analogous to Article 7(i)(a) of Unidroit Convention on International Financial Leasing regarding the perfection of security and leasing rights in the context of insolvency and bankruptcy proceedings should be included.

1.1 The international registry established pursuant to the proposed convention would contemplate the recordation of notices evidencing (not effectuating or constituting legally conclusive proof of) title/ownership transfers of aircraft and aircraft engines (for this purpose which do not constitute "security interests" or "title reservation agreements" under the proposed convention), by manufacturer's serial number. The failure to file any such notice would render such transfer voidable as against third parties (and, if sanctioned by domestic insolvency law, as against bankruptcy liquidators/trustees) who have made a subsequent Unidroit filing in respect of the relevant aircraft equipment, but not as between the parties.

1.2 All purchasers of aircraft (and their financiers) would acquire their interest in such aircraft equipment subject to all interests previously recorded in the registry with respect thereto.

1.3 The foregoing recordation rules would have no effect on the registration or nationality of aircraft for purposes of The Chicago Convention of 1944 on International Civil Aviation (the "**Chicago Convention**"); that is, a recorded title transfer would not constitute a de-facto de-registration, the same only to occur in accordance with national de-registration laws. (See point 5.3 below relating to such national de-registration laws.)

2.1 The creation/validity of all fileable interests (that is, interests which secure debt obligations or which constitute title reservations) under the proposed convention shall be governed by the substantive law expressed to govern the subject contract (without the requirement of any connection between such selected law and such contract or that any other condition be satisfied in respect of such selection) and, absent such an express selection, by the private international law rules of the forum.

2.2 Once created, any such interest which meets certain (very) minimum standards applicable under the proposed convention to either security interests or title reservations, as the case may be, may be filed as such, entitling the interest holder to the enforcement, priority and other rights available to that class under the proposed convention.

2.3 A clear (and thus formalistic) distinction must be made between strict security and title reservations for convention classification purposes in order to avoid tax sensitivities in connection with tax-based financing structures. Notwithstanding this distinction, the practical differences between the enforcement, priority and other proposed convention rights of holders of strict security as contrasted with title reservations, for commercial reasons, must be minimal. This hybrid approach, if somewhat unconventional, would be workable under two conditions. First, the proposed convention should not, by its terms, substantively address the sensitive issue of surplus and deficiency. Second, in the case of enforcement rights, the proposed convention should be non-exclusive in the sense that, beyond the broad and generally phrased "basic remedies", additional rights and remedies under the laws selected by the parties shall apply, if the country in which the forum sits has opted into the contractual choice of law provision (optional) (see point B(1) below), or under the private international laws of such forum, if such country in which it sits has not opted into such provision.

2.4 The proposed convention must contain an express provision to the effect that neither the scope of the proposed convention, nor the fact of any filings made thereunder, will affect, or be a factor in determining, the characterisation of the transaction for any purpose (including, without limitation, national tax purposes and tort and public liability purposes) not specifically addressed under the proposed convention.

3.1 All lease contracts, regardless of duration or other terms and conditions, shall be included as title reservation agreements and thus covered by the proposed

convention. No distinction between types or classes of leases, nor between leases and other types of title reservations, should be made.

4.1 Security and absolute assignments of lease (and sub-lease) contracts shall be covered by the proposed convention, and filings with the asset registry shall be made by manufacturer's serial number of the leased aircraft.

4.2 As between the assignor (lessor) and the assignee (lender), the proposed convention's (a) party autonomy choice of law provision regarding the creation/validity of interests (see point 2 above), (b) first to file priority rule (in this context with no qualification for locally preferred creditors), (c) basic enforcement rules (properly altered, to the extent necessary to suit foreclosure upon, and exercise of remedies in respect of, general intangibles rather than against movable equipment) and (d) contractual choice of law provision (optional) regarding (i) contractual interpretation and governance and (ii) contractual remedies (beyond the "basic minimum" convention remedies)(see point B(1) below), shall each apply in respect of the lease assignment.

4.3 As between the obligor (lessee) and the assignee (lender), the law governing the assigned lease under the proposed convention (that is, the law selected by the parties, if the country in which the forum sits has opted into the contractual choice of law provision (optional) (see point B(1) below), or the private international law rules of such forum, if such country has not opted into such provision) shall govern (i) the assignability of the lease, (ii) the relationship between the assignee (lender) and the obligor (lessee), (iii) the conditions under which the assignment can be invoked by the assignee (lender) against the obligor (lessee) and (iv) any question whether the obligor's (lessee's) obligations have been discharged.

4.4 The proposed convention need not cover any other types of associated contract rights, except insurance proceeds (as contemplated in the summary report), in that such rights cannot be properly filed by reference to the manufacturer's serial number for the aircraft and/or are not perceived as presenting security problems to financiers/titleholders.

5.1 To be materially beneficial, the basic (non-exclusive) remedies under the proposed convention of possession/repossession/seizure, judicially supervised sale and judicial sale set forth in the summary report need to be available within an expedited time frame, and notwithstanding any contrary provisions of national law. We recommend, therefore, that the proposed convention provide a mandatory timetable in which courts having jurisdiction under the proposed convention would be required to determine issues brought before them relating to these basic remedies. In particular, we recommend that such courts (and their associated appellate systems) be required to issue non-appealable, final decisions in respect of the availability of (a) the grounding of the aircraft (pending further litigation procedures) no later than five (5)

days, and (b) the right of the financier/lessor to repossession/seizure, or to a judicially supervised sale/judicial sale, of the aircraft no later than thirty (30) days, in each case of the date on which application is made to the court with in rem jurisdiction over the aircraft.

5.2 Regarding the contentious self-help remedies, please see the discussion in point B(1) below concerning the contractual choice of law provision (optional).

5.3 The right to "deregister" the aircraft for Chicago Convention purposes, and to export the aircraft, in each case following a default are essential elements of the basic repossession, seizure and collateral realisation concepts contemplated by the proposed convention. These rights need to be available immediately upon "repossession", whenever the same shall occur, without the need for further governmental or regulatory action (e.g., separate review or proceedings by aviation authorities) and/or acquiesence by the airline (e.g., consent to such deregistration and export).

6.1 A separate or sub-registry shall be established for aircraft engines and, similar to airframes, all conveyances, security interests, title reservations (including all engine leases without further distinction) and lease assignments shall be filed by reference to the manufacturer's serial number of such engines. The same mandatory convention provisions (including its priority rules and basic enforcement rules (except those relating to de-registration (which are inappropriate in that the Chicago Convention does not independently address engine registration/nationality)) and optional provisions shall apply to engines.

6.2 Interests in no other aircraft parts shall be fileable in a separate asset registry. All other parts attached to the airframes and/or the engines would be covered by the relevant airframe or engine filing, as the case may be. If a general debtor registry is established, and a specific list of mobile equipment is drawn up, a number of spare parts (including avionics and landing gear) should be included in this list. If so, the proposed convention would apply to such other parts to the extent they are specifically identified in filings with the debtor registry.

7.1 We fully support the first to file principle without any limiting conditions relating to "internationality", that is, a filed interest would take priority over all prior unfiled interests and all subsequent interests, whether filed or unfiled, in each case in and with respect to the specifically identified aircraft.

7.2 As regards preferred national creditors, on the date of each country's enactment of the proposed convention, such country must record with Unidroit/the registry, in reasonable specificity, the categories of creditors, if any, which would have priority over a previously filed Unidroit interest. Although each country may add to this list from time to time (and must

further record, in reasonable specificity, such amendments from time to time), any such recorded change would only have prospective application.

7.3 The proposed convention should permit future advances, if contemplated in the originally financing or title reservation document evidenced by a Unidroit filing, such future advances to have the same priority under the proposed convention as the original advance. There is no need to state a "maximum secured amount", nor to provide by way of a priority rule for the protection of junior creditors. The ability to contractually subordinate an interest should, however, be contemplated by the proposed convention.

7.4 The priorities scheme should be conclusive for all purposes and should not permit subordination on grounds of prior knowledge of other security or lack of good faith. Similarly, since transfers must be filed, "good faith purchasers" would not prevail over filed security interests or filed title-holders.

8 In addition to the courts noted in clause 10 (xix) of the summary report, courts located in the debtor's principal place of business need also have jurisdiction to resolve disputes under the proposed convention.

9.1 While we agree that the Unidroit Governing Counsel should have ultimate responsibility for the registry, a delegation of all operational matters regarding the registry needs to be made to an organisation with the resources properly to organise, manage and control the registry. It is premature to make a recommendation in this respect.

9.2 Civil aviation registries (or, as the case may be, such other applicable governmental authorities) in each enacting country should constitute "satellite offices" for purposes of the proposed convention. All filings with respect to an aircraft registered in an enacting country may be made with the satellite office in such country. Further thought should be given as to whether such filings may, in addition, be made with the central registry rather than with the relevant satellite office. (The existence and role of the satellite offices would not, however, detract from the concept of a "central" filing system; a filing, including one made through an eligible satellite office, has continuing force, and remains effective, notwithstanding changes from time-to-time in the physical or legal (i.e., the country of aircraft registry) location of the aircraft).

9.3 The registration system shall, as a general matter, be based on the concept of notice filing. Full documents need not be filed; rather, the forms of the filed statements (e.g., "financing statements", evidencing security interests; "title reservation statements", evidencing title reservations; and "transfer statements", evidencing title/ownership transfers) should contain sufficient information to put parties searching the registry on notice of the existence of prior interests in, or transfers of, the aircraft equipment. The registration

system, however, should permit (at the parties' discretion and with their joint written authorisation) the filing of transaction documents (annexed to the filed financing/title reservation statements) which, by virtue of such attachment, shall for evidentiary purposes be presumed to be the agreed form of such documents.

9.4 The registry's rules should also specifically contemplate matters relating to removing/terminating filings that no longer exist, and other practicalities relating to the efficient operation of the registry and the notice based system contemplated thereby.

9.5 Filings with the registry (or appropriate satellite office) would replace/supersede all national security law filings (but not aircraft nationality filings) in respect of the subject aircraft equipment including those filings otherwise made with local aviation registries, mercantile registries and registries of deeds and documents.

10 The issue of the relationship between the proposed convention and the Geneva Convention is an important question involving a number of complex legal and political considerations. The aviation working group would, at this point, reserve on this matter pending production of the second draft of the proposed convention. We will, in due course, provide Unidroit with a specific recommendation on this point.

B. Optional Provisions to be included in the Proposed Convention

The aviation working group urges Unidroit and the drafting group to include the following two optional provisions which, in our view, would place Unidroit and the proposed convention squarely in the forefront of the important efforts currently underway to promote international extensions of credit through legal reform. We believe that the inclusion of these provisions, while respecting national sovereignty and party autonomy through their optional character, will enable certain countries and their debtors/lessees to access credit at lower costs than would otherwise be available to them now and in the foreseeable future.

1.1 On the enactment of the proposed convention, each country would have the option of including a provision requiring, without condition (except that the parties have expressly agreed to this provision in their contract (see below)) or qualification, that the substantive laws (that is, national laws without reference to conflict of law rules) selected by parties to a transaction shall govern their respective rights and duties. By electing this optional provision, such enacting country's national law (whether applied by its national courts or, through choice of law rules, by other national's courts (whether or not such other court sits in a nation which is a signatory to the proposed convention) shall, in the context of aircraft transactions, respect the parties'

freedom to choose the substantive law to govern all matters of (i) contractual interpretation and governance and (ii) and contractual remedies including, without limitation, self-help remedies (beyond the "basic minimum" convention remedies) such as repossession, possessory management/receivership and private sale. A recommended form of this contractual choice of law provision (optional) is attached as Annex 4-A.

1.2 This provision, if elected by a particular enacting country, would only apply if and to the extent that the debtor/lessee contractually agreed to the same in the specific financing/leasing contract.

2.1 On enactment of the proposed convention, each country would have the option of including a provision which would ensure that, in the event of insolvency type proceedings under its national laws, the debtor/lessee would be required either to cure all defaults within a specified time (and continue to perform its contractual obligations) or to return the aircraft equipment to the financier/lessor, and that the material rights of the financier/lessor would not otherwise be prejudiced in such insolvency proceedings. A recommended draft of the international insolvency provision (optional) is attached as Annex 4-B.

2.2 This provision, if elected by a particular enacting country, would only apply if and to the extent the debtor/lessee contractually agreed to the same in its specific financing/leasing contract.

2.3 Priority contests, in the context of insolvency proceedings, would be addressed in the same manner as priorities generally, that is, each enacting country would need to record, in reasonable detail, with Unidroit and the registry the classes of statutorily preferred creditors, if any, that would prevail over/compete with a holder of a filed Unidroit interest under its insolvency laws.

REPORT OF THE AIRCRAFT ENGINE SUBGROUP OF THE UNIDROIT AVIATION GROUP

MEMBERS: Miles Cowdrey, Rolls Royce
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The Subgroup met by telephone to consider the question of whether or not the Aviation Group Memorandum requested from the Aviation Industry Group (a/k/a the "Core Participants," hereinafter the "Group") should include a position with respect to aircraft engine title registration and the recordation of security interests and leasehold interests in aircraft engines. The Subgroup has unanimously decided to endorse in principle the "Title Tracking Approach." This approach calls for the development of an international aircraft engine registry that will record engine ownership and title conveyances as well as other interests in aircraft engines, including security interests, leasehold interests, and aircraft engine lease assignments. This engine registry would parallel the international aircraft registry being advocated by the Group.

The Group as a whole debated at length the merits of the Title Tracking Approach but was unable to reach consensus, due primarily to the fact that (a) current aircraft leasing practice, especially operating leases and engine pooling arrangements, would be inconsistent with an international title/security interest recordation system, and (b) the laws of various states differ dramatically in the treatment of aircraft engines, as some states (e.g., Germany) apply the "Title Transfer Approach" that provides for engine ownership passing to the aircraft owner when installed (the act of installing constituting a "conveyance/transfer" for domestic law purposes). The inability to reach a consensus led to the creation of the Subgroup.

The decision of the Subgroup to endorse the Title Tracking Approach was unanimous but was subject to the following two exceptions, which are submitted for further consideration by the Group as a whole:

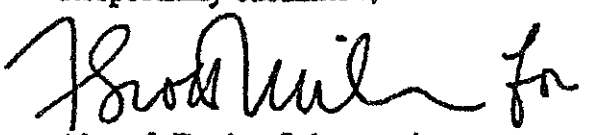
1. It is important that the Convention permit the parties to an aircraft lease to agree that title to a spare engine owned by a third party and subsequently attached to the aircraft will transfer to the owner of the aircraft and that title to the engine coming off the wing will be transferred to the owner of that third party engine owner. In order to maintain the sanctity of (and add order to) the Title Tracking System, it is the opinion of the Group members who are engine financiers that this agreement can and should only be effective as against those spare engine providers who consent to such an arrangement in advance, and only against spare engines identified in advance.

2. The fact that an engine owner (lessor) has perfected its security (ownership) interest in an engine by filing under the Convention should not restrict an airframe owner's ability to de-register and remove an aircraft on which said engine is attached from any jurisdiction following an event of default or a natural lease expiration. It is important that the Convention permit such repossession and de-registration of an airframe by an airframe owner.

It was felt by the Subgroup that, except as noted above, the development of the Title Tracking System would result in dramatic improvements to a very vague area of law and that the development of an international standard would provide a baseline from which parties could freely negotiate engine ownership, transfer, and subleasing rights (and limitations) within the confines of the system. While it is felt that the Title Tracking System will create a greater burden on aircraft lessors and financiers to develop, negotiate, and thereafter manage engine use covenants and restrictions, it is the opinion of the Subgroup that: (a) a clear system of recordation of engine ownership and other interests far outweigh the administrative burden that would be created initially, and (b) the ability of operators to acquire spare engines will be enhanced over time as engine financiers become accustomed to a clear international standard. It was also the opinion of the Subgroup that the Title Tracking System should be developed notwithstanding the fact that it would conflict with the local laws of numerous states, as the benefits of an international standard far outweigh the problems created by the inconsistencies of the laws of individual states.

Regarding spare parts and other aircraft related items, the Group should consider whether the added complexity (to the Unidroit process) of a separate debtor-register to cover security interests in spare parts is justified by the anticipated financing benefits. If so, it is the opinion of the Subgroup that a debtor-register should be created to provide for the recordation of security and leasehold interests in aircraft spare parts by type, quantity, and location only. In this fashion, a spare parts financier's interest would extend only to so many of the specific type of parts as he has identified in his filing and which are in the designated location from time to time. Parts identified in the filing but not at the designated location would not be covered until returned to the designated location. This is similar to current U.S. law and practice. Insofar as an ownership register is concerned, the administrative burden that would be created by developing a system of recordation of ownership of every spare part would be too great to justify: the number of types of parts, let alone the number of all parts, would be too great to manage.

Respectfully submitted,



Aircraft Engine Subcommittee

Annex 4-A

Contractual Choice of Law Provision (Optional)*

The laws (excluding the conflict of laws rules) selected by the parties ("**selected law**") to any security agreement, title reservation agreement or title ownership/transfer agreement evidenced by a filing with the registry ("**agreement**") and the other transaction parties to govern their respective rights and obligations under the agreement and all other documents or instruments expressly contemplated thereby ("**transaction documents**") shall, without qualification, govern such rights and obligations (including, without limitation, all questions and issues relating to the interpretation of the transaction documents, performance under the transaction documents, whether a breach has occurred under the transaction documents and, if so, what rights and remedies are available as a result thereof (including, without limitation, whether and under what conditions remedies (such as self-help remedies (including repossession and possessory management/receivership) and private sale) may be exercised without judicial assistance, approval or intervention), various ways of extinguishing obligations, and prescriptions and limitation of actions and consequences of nullity of the agreement or other transaction documents)), whether or not there is a connection or relationship between the subject transaction or the parties thereto and the selected law and without the need of satisfying any other condition or requirement.

The foregoing shall constitute the national law of the enacting country, and shall be applied by, in addition to courts of such enacting country, any other court, through its private international law, applying the law of such enacting country.

* This provision is intended as a rough, conceptual provision which (i) will need to be conformed to reflect the terminology of the proposed convention and (ii) may require further elaboration.

Annex 4-B

International Insolvency Provision (Optional)

Notwithstanding the bankruptcy laws, insolvency laws, or any other similar laws affecting creditors rights generally in effect from time-to-time in the contracting state or any provisions of any such laws ("**insolvency laws**"), if and to the extent that the debtor/lessee ("**obligor**") has specifically agreed to the same with its financier/lessor ("**obligee**") in a security agreement or title reservation agreement ("**agreement**") filed with the registry and relating to specific aircraft equipment ("**aircraft**") (i) upon the earlier of (x) thirty (30) days after the commencement of bankruptcy, insolvency or any other similar proceedings affecting creditors generally in respect of the obligor or its assets generally, or the date on which the obligor declares its intention to or actually suspends payments or impose a moratorium on the payment of debt/rental obligations in respect of creditors generally (the "**insolvency proceedings**") and (y) the date, if any, on which, under the insolvency laws, the obligor would be required to cure all defaults under the agreement or return the aircraft to the obligee (such earlier date, the "**cure/return date**"), the obligor shall cure all such defaults or return the aircraft to the obligee in accordance with, and in the physical condition required by, the agreement, (ii) no enforcement action, or other exercise of remedies, by the obligee (or its assignee) against the obligor or the aircraft (or any related aircraft equipment collateral) in respect of any breach under the agreement after the cure/return date shall be stayed, blocked, prevented or otherwise delayed and (iii) no contractual obligations of the obligor under the agreement may be restructured, amended or modified without the express consent of the obligee.

Notwithstanding any insolvency law, no class of creditors or other persons other than those listed immediately below ("**preferred creditors**") shall have any rights or interests in the aircraft (or any related aircraft equipment collateral), and the only rights and interests of such preferred creditors are as listed immediately below:

preferred creditors: [_____]

rights and interests of preferred creditors: [_____]

If during the pendency of insolvency proceedings the aircraft is moved to a contracting state ("**secondary contracting state**") other than the contracting state in which the primary insolvency proceeding are occurring ("**primary contracting state**"), the secondary contracting state shall, on an expedited basis, cooperate with the primary contracting state in ensuring compliance with the provisions set forth above.

* This provision is intended as a rough, conceptual provision which (i) will need to be conformed to reflect the terminology of the proposed convention and (ii) requires elaboration generally.