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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:

COMMENTS

(by members of the sub-committee)

Rome, June 1995

INTRODUCTION

Pursuant to the invitation extended to them by the Sub-committee of the Unidroit Study Group for the preparation of uniform rules on international interests in mobile equipment, on the occasion of its second session, held in Rome from 29 November to 1 December 1994, Airbus Industrie and The Boeing Company jointly prepared a memorandum on behalf of an aviation working group for the consideration of the Sub-committee and the small drafting group thereof. This memorandum (Study LXXII - Doc. 16) set out a representative aviation industry view on the desired content of the proposed Convention as the same related to aircraft. It was circulated, with a request for comments, amongst all member of the Sub-committee as well as those international Organisations and professional associations represented by observers thereon. It was indicated that those comments received by 16 June 1995 would be laid before the second session of the small drafting group, held in Oxford on 29 and 30 June 1995, while those received afterwards would be referred direct to the Sub-committee at its third session. In the event by the 16 June deadline comments had been received from two members of the Sub-committee, Mr Vladislav A. Kouvshinov and Mr Thomas J. Whalen. Their comments are set out hereunder.



MR VLADISLAV A. KOUVSHINOV

1. - The recommendation that the proposed Convention must be centred on an *international asset registry*, subject to *certain local priorities*, and on the basis of a *first-to-file* principle coincides with the general approach of the Sub-committee.
2. - It is dubious that there should be *no internationality requirement*, since one of the main points of the application of the proposed Convention is to deal with the mobile equipment which "normally" (in a normal, usual way of business) is moved or used in different States. The problem, it seems, may be solved by including a provision in the Convention permitting interested States to register domestic interests in the international registry.
3. - The recommendation *to limit the scope of the Convention with high value movables (i.e. aircraft, ships, oil rigs, satellites and rolling stock)* seems to be attractive from the point of view of practical interest to the Convention of business community with multi-billion dollars turnover. However, in this case the Convention needs some specific provisions such as de-registration of aircraft etc.
4. - The idea of the *recordation of notices evidencing and not effectuating ownership transfers of the mobile equipment* needs to be examined carefully, since one can meet two different kinds of legal treatment: one for security interests (security rights) which are created

when registered in the international registry and another for recorded transfer of ownership with informative effect only.

5. - In connection with the previous comment the question arises: the creation of all interests (let us say "rights", which continental law is accustomed to) shall be *governed by the Convention or by the local substantive law?*

6. - The recommendation "that *no distinction between types of leases, nor between leases and other types of title reservation, should be made*" seems to be very practical in order to avoid misunderstanding which may occur due to differences in national legal systems.

7. - The recommendation to incorporate the *provision of optional character for contractual choice of applicable law* seems to be worthwhile too. And it needs to be added with the provision on possibility to settle disputes through arbitration proceedings and not exclusively through judicial proceedings.

8. - Analysis of recommendations shows that the *legal technical terminology usual for Common law* (such as "self-help remedies" etc.) is applied. For the sake of future broader adoption of the Convention by different States it is important that the Drafting Group consisting of its members representing both Common law and Continental law should try to work out more "neutral", "functional" legal terminology for the Convention.



MR THOMAS J. WHALEN

1. - The Memorandum seems to me to address the important issues and concerns of the aircraft financing and manufacturing community.

2. - The difficult task of the Drafting Committee of the Unidroit Security Interest Convention will be to develop a universally acceptable Convention covering various forms of mobile equipment, the financing of which may not have reached the sophistication of aircraft financing. The other difficulty I foresee is that there is a risk of non-acceptability by many States if the Convention has the effect of "adding" too much to the national law of States or "displacing" too much of their national law. Therefore, it seems to me that the Unidroit Drafting Committee will ultimately need to settle on provisions which will likely find acceptability by a majority of States. I think that the Unidroit Convention to be successful and widely accepted must be too simple and certain in coverage. The somewhat complicated, sophisticated, and constantly developing aircraft financing techniques may be difficult to incorporate in a Convention which is designed to cover mobile equipment generally. It may be very difficult for States to accept complicated financing techniques, when some States have not even adopted the concept of non-possessory security interests.

With these general considerations in mind, I offer my comments on the Aviation Group's memorandum:

3. - *Part I:*

(a) § 1.2. Because of the difficulties we have had in developing a definition of "Mobile Equipment" for coverage purposes, I am coming to the conclusion, as § 1.2 states, that the Convention should be limited to enumerated high-value equipment like aircraft and aircraft engines. In general, I also share the opinion stated in footnote 7. It may be wise to consider a mechanism whereby a body credited by the Convention could be empowered to add high-value equipment to coverage under the Convention which meets specified Convention standards.

(b) § 1.2. While the memorandum sets forth several cogent arguments for the creation of an asset-based registry, my tentative view is that it is not essential to the objectives of the Convention and that only a lien-registry should be created. An asset-based registry seems to me to go beyond the scope of the Convention. In addition, from my dialogue with other non-aircraft equipment manufacturers, there will be a great resistance to a form of product registration.

(c) § 2.4. My general view on optional provisions is that they tend to undermine uniformity and certainty and could negate the "core" provisions of the Convention. See my comments on the contract optional provisions, paragraph 4(k). I recognise that reservations and optional provisions are quite common and are often proposed to obtain adherence to a Convention. However, I do not think they work (as optional provisions) in this Convention.

4. - *Part II:*

(a) *Title/Ownership Transfers.* § 1.1., pp. 6-7.

At a very early stage, I tended to favour the concept of an asset and lien registry for aircraft and other big-ticket items like earth-moving equipment. However, I believe that there are at least three obstacles to this proposal: (1) the Unidroit mandate is to deal with "security interests", not issues of title conveyance, contracts of sale, etc.; (2) the concept of an international rule on the failure to register as affecting title seems a major invasion of domestic law as well as a possible conflict with International Conventions in place dealing with the sale of goods; and (3) many major U.S. equipment manufacturers oppose equipment title registration for a variety of business reasons.

I understand the important benefit that the Aviation Group believes will result from a title/lien registry. For example, purchaser A of aircraft engine GE4 from Seller B could look into the Unidroit registry for "liens" on GE4 and if there are no liens registered, purchaser A would be protected in a contest with any unregistered lienholders. However, Purchaser A would still be open to the risk that Seller B did not own GE4 and therefore cannot pass good title. As the Memorandum states implicitly, this is not much of a risk when the engine is new, and the Seller is GE, but there could be a risk in the case of "used aircraft and aircraft engines."

I think this proposal will be difficult to implement for the reasons I state above. I also believe that it will be difficult to persuade many States that the concept of a title/asset registry in a Unidroit Convention does not invade national registration principles long in place as a consequence of the Chicago Convention.

I do not fully understand how the group's proposal would work while preserving national registration under the Chicago Convention. However, I am prepared to accept their views on this point. The Aviation Group has no doubt studied the point in depth and concluded that "transfer provisions" can be properly drafted so as not to be inconsistent with the Chicago Convention or otherwise impinge upon issues of interest to the country of aircraft registration. *Memorandum*, p. 8.

However, I think it will take a major effort on the part of Unidroit to persuade contracting States to accept a title registry as part of this Convention. I think the Unidroit Convention must select battle grounds it can win and avoid as many controversial issues as it can, to achieve universal acceptance of the "core" objective of creating a regime where security interests created in one contracting State will be recognised and enforced in another.

(b) *Creating of Security Leasing Rights*, Memorandum, pp. 9-12

(1) I understand the importance to the Aviation Group that contract substantive law selection (party autonomy) should prevail so that jurisdictions which have well-formed law on security interests/lease can be selected. While the trend in the United States is to uphold contract law selection, I am not certain that this is generally the case in other jurisdictions.

The issue I foresee which needs to be resolved arises when a lender in one State seeks to enforce a Convention security interest in another State. Will it be easier for the debtor to frustrate enforcement by claiming that the security interest was not valid under the place of creation, or will it be easier for him to claim that the security interest does not meet the standards of the Convention? I am inclined to the view that national law should govern the security interest in a wholly domestic situation, and that the Convention would control in an international situation (without inquiry as to whether the security interest was valid in the place of creation). Thus, although I believe that this is a very difficult and important threshold question, I share the views of the group as stated in § 2.2, but have reservations about the wisdom of § 2.1.

(2) § 2.3. While I recognise that tax considerations drive most aircraft financings, I do not believe the Convention should be constructed with specific tax considerations in mind, if only for the reason that tax laws change which could affect financing structures (e.g., Japanese leases). The Convention must, it seems to me, cover "strict security," which I take to mean *in rem* rights in property to secure payment of the loan, and title reservation systems common in civil law countries.

I share the views of the Aviation Group that the Convention's remedies should not be exclusive: that a lender may in the forum State invoke additional contract remedies, which the forum will either enforce or not, according to its law. However, at the very least the lender will have its Convention remedies. I understand that a key premise in § 2.3 is acceptance

of § 2.1 (about which I have some reservations). I am inclined to leave "additional contract remedies" to domestic, forum law which might include "contract remedies." I have not yet decided upon a precise delineation of "Convention" remedies, but am inclined to the view that deficiencies and surpluses should be covered by the Convention. In a deficiency situation arising from a foreclosure sale under the Convention, there will no doubt be "findings" of a deficiency which should be given recognition. Similarly, if there is a foreclosure under the Convention remedies, and a surplus, what, as a practical matter, should the Court do with the surplus? The Convention may need to address these points.

(3) § 2.4. While I do not have a problem with this recommendation, I question whether it is necessary, since national tax and liability issues are not what this Convention is about.

(4) *Rationale*, pp. 10-12.

Another alternative which is not stated, and which the Unidroit Drafting Committee was at one point considering is the validity of a security interest under the law of the place of creation. I agree generally with the Aviation Group's delineation of what is meant by "creation and validity" of a security interest. *pp. 10-11*. I do not think it is correct that the Unidroit Committee has taken a position, even provisionally, that a security interest, properly created under national law, does not exist until it is registered. *p. 11*. My understanding is that the provisional view of the Unidroit Committee is that the Convention is not triggered as to a security interest (meeting the standards of the Convention) until it is registered.

On the issue of a separate classification for "strict security" and "title reservation" (*p. 12*), I do not appreciate the *need* to file specifically as "security interest" or as "title reservation."

(c) *Treatment of Lease Contracts*, p. 12. I agree with the recommendation of the Aviation Group on this point. Even though a lessor, in an operating lease, is not considered a holder of a security interest in the equipment, I think, for the reasons stated in the Memorandum, all leases should be covered and the term "security interest" for the purposes of the Convention should be defined to include leases.

(d) *Lease Assignments and Other Contract Rights*, p. 14. I recognise the importance of lease assignments and perhaps other contract rights to the aircraft financing community. I also believe that logistically it should not be difficult to register a lease assignment with the equipment involved.

Notwithstanding the above, I think lease assignments as a contract right are beyond the scope of *in rem* property rights which the Convention was intended to cover. I am also concerned about the application of Convention *remedies* to lease assignments, that is, what Convention remedy should be provided to implement the "security" provided by the lease assignment. In addition, other Conventions may address aspects of "lease assignment" giving rise to conflicts.

(e) *Basic Remedies*, p. 16

(1) I am persuaded by the Aviation Group's Memorandum that there should be a timetable for the implementation of a Convention remedy such as judicial sale. I also recognise the importance of deregistration and export rights and the need for their specific inclusion in the remedies section of the Convention, which I think can be accomplished. I agree with § 5.3 on this point.

(2) Rationale: As I noted above in (1) I agree with the recommendation in principle and the rationale.

(f) *Treatment of Security Over Aircraft and Engines*, p. 18.

(1) I agree that the Convention should cover aircraft engines (including engine leases) subject only to my reservations about lease assignments and optional contract rights.

(2) I agree that the Convention should apply to no other aircraft "parts." As above indicated, I believe that, in the end, to avoid uncertainty, specific mobile equipment must be listed as covered by the Convention. I would not include in this list aircraft parts such as avionics and landing gear.

(3) While I am familiar with the prevalence of engine interchange agreements and title transfer practices, the decision to be made here is whether the Convention should be drafted to accommodate current practices or whether in the interest of uniformity, certainty and consistency, practices should be altered to comply with the Convention. For this reason, and some of the reasons stated in the Aviation Group Memorandum, I favour the "title tracking" approach.

(g) *General Priority Rules*, p. 18

(1) Preliminarily, I note that the Priority Rules have not yet been discussed in depth by the Unidroit Drafting Committee, simply because the members of the Committee believed, I think correctly, that definitive priority rules could not be decided upon until other issues were resolved.

(2) With respect to recommendation § 7.1, I agree with the Aviation Group's view with one possible exception. I have not settled in my own mind the appropriate priority of a security interest filed under the Convention, where a wholly domestic dispute is at issue. This may be a theoretical problem and not a real one. I cannot conceive that any experienced attorney would file in the Convention registry and not at the same time file in the domestic registry as well (or otherwise comply with national law). The problem may exist, however, where the State does not have a lien registry, in which case the issue will be whether a Convention State must recognise the filed Convention security interest and give it effect in a wholly domestic dispute. This is an open and I think a difficult issue. Regarding "nationally preferred" creditors, see paragraph (6) below.

Several members of the Unidroit Committee believe that registration is a ministerial act, and that a lender in a transaction in a non-contracting State will still be able to register his lien in the Convention registry. In principle I agree that a previously filed security interest (say in France) should trump a Convention interest filed after France became a party to the Convention (if the earlier interest complied with Convention standards).

(3) Aside from the concept of an asset/title registry and the notion that title should be tracked in the registry (which I addressed above), I agree with the recommendation of § 7.4.

(4) With respect to the proposal to require a State to record its national preferred creditors § 7.2, I think that this will be unworkable and very difficult to oversee and implement. Few States I believe will adhere to a Convention whereby its national preferred creditors (tax liens/mechanic's liens/hangarkeepers' liens) will lose their rights because of the State's failure to file the list, or that its own law will be trumped because it was enacted after a Convention interest has been filed. Lenders, I think, will need to rely, as they do today, on opinions of counsel as to the rights of national preferred creditors in priority to its filed Convention security interest.

(5) While I am persuaded that "stated maximum amounts" are probably not workable, § 7.3, given the traditions of Civil law States to require this, this is not a major point in the larger scheme of things. If it is important or central to the acceptance of the Convention by civil law countries, this is a point I would be inclined to yield on.

(h) *Jurisdiction to Resolve Disputes*, p. 23. Although I have not studied or thought at length about all the implications of § 8, I tend to agree. Certainly a lender should be able to go to the debtor's principal place of business to seek repossession through *in personam* injunctive relief and enforcement of his Convention and contract rights. However, the Convention will deal with *in rem* rights and *in rem* remedies, which is not to say that Convention *rights* cannot be adjudicated in places other than the *situs* of the equipment as a matter of comity and conflicts of law. I do not think that the Unidroit Committee believes that the Convention remedies should be exclusive. See §§ (xii) and (xiii) of the Summary Report.

(i) *Matters related to the Registry*, p. 23

I generally agree with the recommendations of the Group. I envisage satellite offices where filings can be made electronically which will automatically be networked with the central registry.

I do have reservations about the need to file transactional documents. Most aircraft transactions are voluminous. I do not think it worthwhile that the registry should be overwhelmed with paper.

(j) *The Geneva Convention*, p. 21

The views of the Aviation Group on this point will be important. This is a very difficult issue. There are several alternatives: (1) where the Unidroit Convention comes into

force in a State, it supersedes the Geneva Convention; (2) where the Unidroit Convention comes into force, it applies, except as to aircraft, in those States where the Geneva Convention is in force; and (3) where the Unidroit and Geneva Conventions are both in place, there should be a provision in the Unidroit Convention to reconcile both Conventions leaving in place provisions of the Geneva Convention not displaced by the Unidroit Convention.

If the Aviation Group's proposals are accepted as to a title/asset registry and contract autonomy, it is difficult to see how the Geneva Convention could be reconciled with such principles.

(k) *Optional Provision on Contract Choice of Law*, p. 24.

(1) The theory of contract law selection, as I understand it, is that in effect the parties, *as a matter of contract*, incorporate as a part of their contract the substantive law of a particular jurisdiction. While it has been common to incorporate "substantive law" into a contract, I think it is difficult to provide contractually for *remedies*, especially where the remedies need to be implemented in a jurisdiction which does not recognise the remedy. If the rights under the Convention are essentially *in rem*, then what is essential is that the forum of the *situs* of the equipment recognise that *right* under the Convention and enforce it.

(2) In a financing contract establishing New York law as the governing law (where the Lender seeks to repossess the aircraft in Italy), the Optional Contract provision is in effect asking Italy to proceed in accordance with New York law including New York remedies which may not be available in Italy, including "*self help*". Such an optional contract provision would tend to supplant Convention remedies (and maybe some rights) by contract. It is one thing to have party autonomy as to what the parties agree to; it is quite another to say, when the parties have a dispute, that the contract remedies prevail over any national statutory or legislative act. In effect the Aviation Group's Memorandum appears to be saying that I want the help of your courts (Italy) to perfect my rights, but I want you to do what *our* contract says should be done by way of remedy, even though you do not do this kind of thing in Italy. With the optional contract provision, the Convention also becomes a "choice of law" contract/law selection Convention, which is not, I believe, what the Unidroit Drafting Committee believes it is undertaking. In addition, the effect of this provision might be to supplant the Convention rights and remedies (except priorities) by contract.

(l) *Optional Insolvency Provision*, p. 26.

This is in effect the incorporation of § 1110 rights under U.S. Bankruptcy Law into the Convention by optional contract provision.

Leaving aside the Group's proposal about national preferred creditors which I discussed above, it is my view that there should be a "mandatory" Convention provision that the Convention security interest will prevail over any bankruptcy trustee or insolvency receiver. This I believe is the provisional view of the Drafting Committee. I also agree that some timetable for relief should also be introduced in the Convention. I think however that incorporating § 1110 may be asking for too much. I share the concern of the Aviation Group that the lenders need to be protected from vagaries of national insolvency laws.

Based upon my conversations with delegates and lawyers from many nations, I believe that most States will accept a Convention provision recognising and enforcing a Convention security interest in preference to the rights of a Bankruptcy Trustee, at least if the transaction was 3 to 6 months before the Bankruptcy to negate any preference or fraud upon unsecured creditors.

5. - *Part III:*

Concluding Comment, p. 24

I am sure that all concerned with this Unidroit Convention will appreciate the thoughtful and informed proposals contained in this Memorandum.

6. - *Annex 2*

Summary

This section is a summary of the prior pages. My comments have been given on these points. However, I think internationality is a more serious point than the Aviation Group believes. Customarily at least, it has been understood that there should be an inter-State international element before nations are empowered to regulate it by an International Convention. This kind of issue has recently developed in the United States, where our Supreme Court set aside federal legislation, because the matter being regulated was wholly intrastate (guns carried near schools); and there was not a substantial effect on interstate commerce.

It would certainly be easier for all concerned if the involvement of a certain *specie* of mobile equipment *per se* satisfied internationality, a view which has been provisionally taken by the Unidroit Drafting Committee. I am less certain that this is enough. *Summary § A.*

7. - *Annex 3*

(a) I have noted the comments in Annex 3, and have previously discussed my preference for the "title tracking" approach.

(b) I am in substantial agreement with the views contained in Annex 3. I do not believe the Convention should cover spare parts in any respect because of the administrative burden involved.

8. - *Annex 4 - 4B.* I believe I have discussed these optional provisions previously.