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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

*REVISED PROPOSALS FOR A FIRST SET OF DRAFT ARTICLES OF A
FUTURE UNIDROIT CONVENTION ON INTERNATIONAL INTERESTS
IN MOBILE EQUIPMENT*

(drawn up by the drafting group on the basis of the provisional conclusions
reached by the sub-committee at its second session):

COMMENTS

(by members of the Study Group and the Sub-committee and the international Organisations
and professional associations represented by observers thereon)

Rome, September 1995

INTRODUCTION

1. - Pursuant to the second session of the Sub-committee of the Unidroit Study Group for the preparation of a first draft of a proposed Unidroit Convention on International Interests in Mobile Equipment, the drafting group met in Oxford on 29 and 30 June 1995 in order to revise its proposals for a first set of draft articles, in particular in the light of the provisional conclusions reached by the Sub-committee at its second session.

2. - The drafting group's revised proposals were subsequently circulated for comment amongst all members of the Study Group and the Sub-committee as well as the international Organisations and professional associations represented by observers on the Study Group and the Sub-committee. As of 14 September 1995 comments had been received from Mr Vladislav A. Kouvshinov, Professor Charles W. Mooney, Jr. and Mr Thomas J. Whalen, *qua* members of the Sub-committee, and from Mr Gbolahan K. Olufon, *qua* member of the Study Group. This paper reproduces these comments, set out hereunder.



MR VLADISLAV A. KOUVSHINOV

Re Article 1, paragraph 2

The alternative wording of this paragraph in square brackets seems to be more adequate to the scope of the Convention because it reflects its "internationality" in a way that it is indicating directly the equipment of a kind normally used in more than one State in the course of business.

Re Article 8, paragraph 3

In order to avoid misunderstanding it seems to be better to say " ... the latter records ... " instead of " ... the international registration system records ... " because the international registration system may include "satellite" national registries, but in this case it is necessary to mention it clearly.

Re Article 8, paragraph 4

There is some kind of uncertainty in the word "irregularity": what period of time shall it cover? Besides, future rules of the body responsible for the international registry may provide for a specific period of time for delivery or transmittance of registration notices. It means the necessity to observe "regularity" instead.

Re Article 10

I feel it would be better to include a provision stipulating the necessity to prove the authenticity of the certificate in question in a case where there is a strong suspicion of forgery.

Re Article 12, paragraph 2

In order to avoid misunderstandings in the interpretation of the Convention in other languages it seems better to clarify the meaning of the word "advances" in this paragraph (e.g. by saying "advances in the payment of registration fees").

**PROFESSOR CHARLES W. MOONEY, JR. AND MR THOMAS J. WHALEN
(REPRESENTING THE GOVERNMENT OF THE UNITED STATES OF AMERICA)**

We are pleased to submit to the members of the Sub-committee and the Unidroit Secretariat our preliminary observations on the revised proposals (Doc. 18). We commend the drafting group for providing an outstanding product on which the Sub-committee may continue its deliberations. We also express our appreciation of the excellent report prepared by Airbus Industrie and The Boeing Company on behalf of the aviation working group.

Our observations are subject to further input from interested persons and groups in the United States as well as the continuing deliberations of the Sub-committee.

Re Article 1 - Sphere of application

Paragraph 1

The proposed articles of the Convention do not purport to regulate all aspects of the transactions to which they apply. To the extent that the Convention does not regulate certain aspects, presumably the local law applicable under the rules of private international law would apply. The Sub-committee may wish to consider whether paragraph 1 (or another provision) should provide explicitly that otherwise applicable law applies unless displaced by the particular provisions of the Convention.

Paragraph 2

The first version of paragraph 2 contemplates a list of specific types of equipment covered by the Convention. The alternative version of paragraph 2 (set out in square brackets) contemplates the Convention's applicability to "equipment . . . of a kind normally used in more than one State . . . , including" a list of examples of specific types of equipment covered.

The first version may have the advantage of certainty, inasmuch as it does not require a determination of mobility (*i.e.* where equipment is "normally used"). However, the first version harbours substantial potential for over- and under- inclusiveness, as well. For example,

a subset of a type of equipment listed may not be mobile. "Oil rigs" (which are included in the preliminary list) may include those of a type intended for production in a single location as well as those of a highly mobile type intended for drilling purposes. Consider also harvesting and other agricultural equipment (not mentioned in the preliminary list), which may be of the mobile or non-mobile variety. Equipment such as electrical generators also may be of the mobile variety used in construction or of a type intended for "permanent" use in a single location. If equipment such as oil rigs, harvesting equipment and electrical generators were listed, much non-mobile equipment would be covered by the Convention. If they were omitted, much mobile equipment would be excluded.

The first version also poses a risk that important categories of mobile equipment might be omitted from the list as a result of inadvertence or because equipment could be of a type that is not now in existence. Equipment used for entertainment (concerts, circuses and the like), construction equipment, harvesting equipment, trucks and cars are examples of equipment types currently not mentioned in the list in proposed paragraph 2. The feasibility of including trucks and cars may turn on the flexibility afforded Contracting States to determine the place and manner of registration for certain equipment, discussed in connection with Articles 2 and 8 below.

The alternative (bracketed) version reduces the problem of over-and under-inclusiveness, but at the price of somewhat less certainty. Accordingly, the Sub-committee may wish to consider other alternatives. For example, the Convention's scope might be limited to equipment that is *both* mobile and of a listed type. Or, it might be expanded to include equipment that is *either* mobile or of a listed type.

Finally, the sphere of application of the Convention cannot be resolved apart from the characteristics of the international register established under Article 2. If the register is to be organised and searchable strictly according to descriptions of equipment (e.g. "One (1) [manufacturer] cargo container, manufacturer's serial no. 12345"), it would be necessary to limit the Convention's scope to standardised types of equipment with manufacturers' serial numbers. If, in addition to an equipment description-based register, the register also can be organised and searchable according to the names of debtors, a broader sphere of application could be accommodated. We see considerable merit in a collateral description-based register for the types of equipment appropriate for such a register (e.g. aircraft, aircraft engines, ships, containers, cars, trucks). However, the Sub-committee may wish to consider the inclusion of other mobile equipment covered by a debtor name-based registry.

Paragraph 3

We assume that the interest in equipment under a title reservation agreement that is to be regulated by the Convention is the interest of the lessor or seller. However, as drafted, paragraph 3 also includes the interest of a buyer or lessee, which is an interest "arising under a title reservation agreement." The Sub-committee may wish to consider a clarification here.

Paragraph 3, 4 and 5

These proposed paragraphs provide that the Convention would apply to an interest arising under a security agreement (*i.e.* an interest securing an obligation) and an interest arising under a title reservation agreement (*i.e.* an interest under a sale agreement providing for a reservation of title pending the buyer's performance of its obligations and an interest under a leasing agreement, with or without an option to purchase). In general we applaud the broad scope provided by these provisions.

In some jurisdictions, such as the States of the United States, domestic law draws a distinction between two categories of title retention agreement denominated as "leases" - those that are the functional equivalent of security agreements (*e.g.* a lease with a nominal purchase option) and those that are so-called "true" leases. For background, see Professor R.C.C. Cuming's memorandum dated November 5, 1994, Doc. 8 ("Cuming Memo"), at 11-12. In those jurisdictions, true leases generally are not subject to a requirement of public notice (*e.g.* filing or registration) as a condition of effectiveness against third parties. In his Memo, Professor Cuming persuasively explained that a Convention would be unsatisfactory if it applied to interests created by traditional security agreements but did not apply to interests created under "leases" that are economically and functionally equivalent to security agreements. *Cuming Memo at 11*. He pointed out two means of addressing the problem. *Cuming Memo at 11*. Proposed Paragraphs 3 and 5 (a), however, embrace a third, very different solution - the inclusion of true leases as title reservation agreements subject to the Convention.

As one of us (Mooney) noted in an earlier submission (Doc. 14 Add. 2): "Depending on the substantive provisions that eventually emerge, the inclusion of 'true' leases . . . may jeopardise acceptance of the Convention in some States." In connection with the somewhat recent promulgation of Uniform Commercial Code Article 2A in the United States, the leasing industry in the United States expressed its strong opposition to imposing a filing requirement on true leases. While we generally favour a broad scope for the proposed Convention, we hope the Sub-committee will seriously consider any concerns of the leasing industry on this issue. As mentioned above in connection with the inclusion or exclusion of motor vehicles within the Convention's scope, the flexibility or lack thereof afforded a Contracting State to designate the location of registration could be a significant factor for the leasing industry in this connection.

The leasing industry's view of the Convention's coverage of true leases also may be affected by the consequences of the failure to register under the Convention. Will the failure to register subject a lessor's interest in the equipment to subordination to the lessee's creditors (or trustee in bankruptcy)? Or, will the failure to register merely deprive the lessor of the Convention's protections, while leaving its interest in the equipment subject to otherwise applicable law? Consider the following example. Lessor leases an item of equipment to Lessee for one month. Lessor inadvertently fails to register under the Convention. Two weeks later Lessee becomes a debtor in a bankruptcy proceeding. Is Lessor's interest in the equipment

valid against the trustee in bankruptcy? Does Lessor even have an unsecured claim in the proceedings? The current draft Convention does not address these questions. Article 12 of the draft does provide, however, that Lessor's interest would be subordinate to the interest of one who acquires an interest in the equipment from the debtor. (In a registration system that covers ownership as well as liens, as proposed by the aviation working group, presumably the lessor's failure to register a lease would be of no consequence to a buyer from the lessee; the buyer would be responsible for knowing that the lessee did not have record ownership.) The Sub-committee may wish to consider whether certain short-term leases should be excluded from the Convention or, at least, from its registration and priority rules.

Paragraph 6

Paragraph 6 appropriately excludes proceeds of equipment generally from the Convention's scope. Because proceeds of equipment could be virtually any type of property (money, bank accounts, intangible accounts receivable or real property), the inclusion of proceeds generally would not be consistent with the principal goals of the Convention and it would introduce unnecessary complexity. But the Sub-committee may wish to consider this issue further in two respects. First, proceeds that constitute mobile equipment otherwise covered by the Convention (e.g. new equipment received by a debtor that trades in equipment covered by the Convention) might be covered as such. Second, proceeds that are traceable from the equipment under otherwise applicable local law might be covered for the purposes of Article 13 (validity against creditors and a trustee in bankruptcy) only, but not for other purposes (e.g. priority over purchasers and transferees of proceeds).

Re Sphere of application: choice of applicable law

The draft does not include a test of internationality as a condition for the Convention's applicability. We encourage the Sub-committee to support this broad coverage of the Convention, while maintaining a practical respect for the proper domain of local law. However, the Sub-committee should consider carefully the draft's silence (with one exception, discussed below in connection with Article 13) on when a court should apply the Convention to a transaction. It is not reasonable to assume that a court sitting in a Contracting State, applying that State's otherwise applicable choice of law rules, would *always* apply the Convention to a transaction involving mobile equipment. Nor would it be reasonable to assume that a court sitting in a non-Contracting State would *never* apply the Convention to an appropriate transaction. Moreover, neither approach would necessarily reflect the best public policy.

The following table illustrates the possible application or non-application of the Convention to mobile equipment transactions within its sphere while taking account of three variables: whether or not the forum court sits in a Contracting State (C.S.) (column A), whether or not the debtor's location (e.g. the debtor's chief executive office or place of organisation) is in a Contracting State (column B), and whether or not the equipment is located in a Contracting State (column C).

Line	Col. A	Col. B	Col. C	Col. D	Col. E
	Loc. of Forum	Loc. of Debtor	Loc. of Equipment	Apply Conv. (Current)	Apply Conv. (New)
1	C.S.	Non-C.S.	Non-C.S.	Maybe	No
2	C.S.	C.S.	Non-C.S.	Maybe	Yes
3	C.S.	Non-C.S.	C.S.	Probably	Yes
4	C.S.	C.S.	C.S.	Yes	Yes
5	Non-C.S.	Non-C.S.	Non-C.S.	No	No
6	Non-C.S.	C.S.	Non-C.S.	Maybe	Yes
7	Non-C.S.	Non-C.S.	C.S.	Maybe	Yes
8	Non-C.S.	C.S.	C.S.	Maybe	Yes

Each line under column D reflects our estimation of whether, under the current draft Convention, a forum court would apply the Convention based on the variables under columns A, B and C as indicated in that line. With the exceptions of lines 4 and 5, we are uncertain; a forum court might or might not apply the Convention. Column 5 indicates whether a forum court would apply the Convention *assuming that* (i) the current draft were modified to include a choice of law rule to the effect that the Convention applies to transactions if either the debtor or the equipment is located in a Contracting State, and (ii) the forum applied that choice of law rule in the case before it. The results under column 5 indicate increased certainty and greater likelihood of the Convention's applicability when compared to the results in column 4.

Re Articles 2 and 8 - 11 - The International Register

Registration of an international interest is the principal element of the priority rules included in Article 12. To date there has never existed a broad-based international system of registration of property interests. Commercial interests may be wary of an untried system to be operated under administrative rules not yet in existence. States may be reluctant to embrace the Convention in absence of complete confidence in the international registration system. That confidence would require a thorough understanding of the system's operation and absolute assurances concerning the system's operators.

The Sub-committee may wish to explore alternatives to reliance solely on a Unidroit-sponsored international register. For example, each Contracting State might be permitted to select (in a protocol deposited with Unidroit) the proper office for registration of interests created by debtors or lessees who are located in that State. Once a comprehensive international register were up and running, a State might then choose the international register as the proper office for registration. Or, in the case of property (e.g. aircraft) that is the subject of a State's existing registry, that registry could be designated as the international register for the purposes

of the Convention. We also note that UNCITRAL is exploring the idea of an international register in connection with its study of receivables financing.

The design and operation of an international register will be a complicated and challenging task. We encourage the Sub-committee to consider the formation of a special task force to address the issues raised by an international register.

Re Articles 3 - 7 - Creation and effects of international interest between the parties

These articles provide an excellent framework and we support the general approach that they reflect.

We have some reservations concerning Article 6, paragraph 2, insofar as it permits a court to order that the equipment be awarded to the secured party in exchange for full satisfaction of the secured party's claims. That result is appropriate if the debtor so agrees. If the debtor does not agree, however, paragraph 2 nonetheless might be read to authorise such an application of the equipment even if the equipment were of a materially greater value than the secured party's claims. This remedy also seems inappropriate in the case of a true lease transaction.

The Sub-committee might consider whether Article 6 should (i) impose on the secured party an affirmative duty to give the debtor and junior interest holders advance notice of a proposed sale or lease, and (ii) explicitly provide that a secured party is liable in damages to a debtor or junior interest holder for the secured party's failure to comply with Article 6 (e.g. by selling the equipment on unreasonable terms).

Re Article 12 - Priorities

We prefer the "subordinate" phraseology employed in paragraph 2 over the "not valid against" approach of paragraphs 1 and 3 in the case of competing interests. The latter approach is appropriate, however, in the case of paragraph 4, where it is contemplated that the interest of a third party (e.g. a buyer) will cut off the unregistered interest. Perhaps paragraph 4 should be revised to make it clear that the interest of a third party is not an international interest; paragraphs 1, 2 and 3 deal with competing international interests.

We are unclear as to the intended meaning of the word "notice" as it is used in paragraph 2. "Notice" probably would be construed to mean constructive notice based on the registration of a subsequently registered interest. That would effectively force a secured party with an earlier-registered interest to conduct a search of the register before making each subsequent non-obligatory advance. The Sub-committee should consider whether this is a desirable policy. Also, if this is the intended meaning of notice, then the words "notice of" in paragraph 2 seem superfluous: an advance made after the "interest subsequently registered" would *always* be made with notice.

We note again that these priority rules could have particularly harsh consequences for a lessor that fails to register its interest if the lessor is actually the owner under a true lease.

Re Article 13 - Validity and effect of international interest

Article 13, paragraph 2 provides that registered international interests are valid against a debtor's creditors and trustee in bankruptcy. Paragraph 1 provides more generally for recognition of the validity and effects of an interest "to the extent provided in this Convention". Paragraph 1 directs only a "Contracting State" to recognise the validity and effects. That provision seems to suggest that only a forum in a Contracting State would apply the Convention in a proceeding before it. As explained above in connection with Article 1, we do not believe that assumption to be accurate. If, under otherwise applicable rules of private international law, a court in a non-Contracting State would apply the Convention to a proceeding involving an international interest, the Convention's directive to recognise international interests should not be limited by its terms to Contracting States. The Convention should facilitate its application as a matter of private international law in jurisdictions that have not adopted the Convention and, in particular, in commercial arbitrations. The Sub-committee may wish to consider more limiting language in paragraph 1.

Re Chapter VIII - Special provisions for aircraft and aircraft engines

We congratulate the aviation working group for its outstanding report and we encourage the Sub-committee to give each of its recommendations serious consideration. We generally support the idea of a separate part of the Convention that would apply to aircraft and aircraft engines. However, it may be too soon for the Sub-committee to reach conclusions on the specific proposals. The Sub-committee may wish to encourage the aviation working group to bring into the process representatives of airlines and other significant commercial users of aircraft not previously represented in the working group. If a representative group of all those affected by the proposals can reach a broad consensus, the drafting group and the Sub-committee then might move quickly toward the final text of a proposed Convention containing special provisions applicable to aircraft and aircraft engines.

MR GBOLAHAN K. OLUFON

I have perused the various documents enclosed, especially the revised proposals for a first set of draft articles on the matter.

I must commend the Sub-committee for the preparation of the revised first draft and the Aviation Group for their painstaking and brilliant effort.

While I agree with most of their inputs, I would like to add a few suggestions to some of the draft articles as below.

Comments on the revised first draft articles

Re Chapter III: Creation of an international interest

Re Article 3 (1) (c)

Sub-paragraph 1 (c) should include the word "secured party" so that sub-paragraph will now read as follows:

"(c) the secured party, the debtor, lessor or seller has rights in the equipment".

The reason for this inclusion is that the rights of the secured party are paramount and ought to be recognised even more than those of the debtor. Moreover, the thrust of the Convention is to protect the interests of the secured party as against those of the debtor.

Re Chapter V: Registration

Re Article 9 (3)

Paragraph 3 should be expanded to cover discharge by effluxion of time whereby a fixed period, i.e. five years, is stipulated after which the registration will lapse or be discharged if not renewed.

The reason for this is that the register will become too cluttered with outdated registrations which may not give the current status of the equipment, if there is no mechanism for its update.

Re Special provisions for aircraft and aircraft engines

Re Recommendations A5.1-5.3 in the aviation group memorandum

It is suggested that the issue of the mandatory time-frame within which courts having jurisdiction under the Convention would be required to determine issues brought before them relating to the Convention remedies should be reviewed.

It is hereby suggested that before any such court can issue the non-appealable final decisions, adequate notice must have been given to all interested parties.

The reason for the above suggestion is to ensure that the tenets of a fair hearing and the rule of law are observed by such courts.