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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

*REVISED DRAFT ARTICLES OF A FUTURE UNIDROIT CONVENTION
ON INTERNATIONAL INTERESTS IN MOBILE EQUIPMENT*

(proposed by the Drafting Group in the light of the Study Group's reading at its second session of the first set of draft articles established by the Sub-committee in conjunction with the recommendations of the Aviation Working Group):

COMMENTS

(by the Aviation Working Group and the
International Air Transport Association)

Rome, January 1997

INTRODUCTION

Subsequently to the comments to the revised draft articles of a future Unidroit Convention on International Interests in Mobile Equipment, as proposed by the Drafting Group of the Study Group in December 1996 (Study LXXII - Doc. 30), reproduced in Study LXXII - Doc. 32 and Doc. 32 Add. 1, the Unidroit Secretariat received additional comments from the Aviation Working Group and the International Air Transport Association. This paper reproduces these joint comments hereunder.



This memorandum will set forth the joint comments of the Aviation Working Group jointly organised by Airbus Industrie and The Boeing Company ("AWG") and the International Air Transport Association ("IATA") on the above-referenced revised draft articles ("revised text"). This is also the memorandum which is contemplated by, and is supplementary to, the joint AWG/IATA memorandum to the study group dated 13 December 1996 outlining certain recommendations relating to, *inter alia*, the general structure of the proposed convention ("AWG/IATA Memorandum"). See 1996 Unidroit Study LXXII - Doc. 31.

Part I will note certain general comments on or relating to the revised text. Part II will then set forth certain specific comments on the revised text.

Part I. General Comments relating to the Revised Text

We are encouraged by the progress made on the proposed convention as reflected in the revised text and, in particular, by the inclusion of Appendix IV in the distributed materials. The purpose of this commentary, together with the recommendations made in the AWG/IATA Memorandum, is to assist in the continuation of this progress. Our objective is to ensure that the proposed convention will be commercially acceptable to, and vigorously supported by, the air transport industry. This will be the case if, and only if, the proposed convention, taken as a whole, materially promotes the asset-based financing of aviation equipment. Put more concretely, the proposed convention will be a success, in our view, if it provides contracting states and transaction parties with the opportunity to substantially eliminate legal risks which are currently impediments to asset-based financing or which increase its costs. With this introduction, we would turn to our general comments as follows:-

1 Base/Umbrella Convention Plus Aircraft Equipment Protocol

The AWG/IATA Memorandum, jointly recommended that the format of the proposed legal instrument be modified so that it is comprised of a base/umbrella agreement which sets forth the basic legal framework applicable to all categories of equipment ("base/umbrella convention") accompanied by equipment-specific protocols, each containing rules specifically applicable to a particular category of equipment ("protocol"). Once a protocol enters into force, it would automatically incorporate the base/umbrella convention (as may be supplemented and modified by the protocol).

This commentary assumes the study groups acceptance of the base/umbrella convention plus protocol approach and the recommended terms of reference and processes for preparation of the protocol relating to airframes, aircraft engines and helicopters ("aircraft equipment protocol").

As a technical matter, certain amendments to the base/umbrella convention are required to reflect its relationship to the protocols.

2 Enhancement of Commercial Certainty/Promotion of Asset-Based Financing Principles

The proposed convention will materially facilitate asset-based financing only if the application of its rules, taken as a whole, is certain to produce a commercially acceptable result. A commercially acceptable result, in the context, is one in which asset-based financing principles are respected (to the extent the same are applicable by virtue of the positions taken by contracting states in the ratification process and the transaction parties in the contracting process).

In broad terms, three elements of the proposed convention raise questions and issues in this regard and therefore require attention:-

2.1 Necessity for Certain Timetables

The most fundamental of asset-based financing principles is the principle that, in exchange for a reduced interest or rental rate, a secured party/lessor will have the ability upon default to *promptly* take possession of the subject equipment and, in the case of asset-based debt financing, to convert the equipment into proceeds for application against the obligations secured. The international legal framework applicable to aircraft equipment financings, in many instances, in tension with this fundamental principle.

Our highest priority in participating in the proposed convention is to ensure that contracting states have the option of selecting rules which embody this fundamental principle, thereby permitting transaction parties in their countries to take greater advantage of international asset-based financing in connection with the acquisition of unprecedented amounts of required aircraft equipment in the coming years.

This fundamental principle is but abstract rhetoric if the actual timing element is undefined and potentially open-ended.¹ In direct terms, if this timing element is not addressed, both inside and

¹ There are countries in which complex litigation relating to an asset-based aircraft equipment transaction may take in excess of five years. Please consider the financial implications of this litigation delay risk and how the associated costs will be allocated to the transaction parties and (often governmental) credit support providers.

Assume that (i) an aircraft with a value and purchase price of US\$125,000,000 dollars is financed by a 15-year loan equal to 90% of the purchase price (US\$112,500,000), (ii) the interest rate on the loan, calculated on the basis of the above-mentioned fundamental principle of asset-based financing, is 8.5% per annum, (iii) in the first year of the transaction the debtor stopped making payments, (iv) the litigation relating to the availability of defenses to non-payment continued for 5 years, and (v) at year 5, the value of the aircraft had dropped such that the 10% equity cushion, to use the parlance, was not available to offset the lender's damages.

In over-simplified terms, the litigation delay has imposed a cost equal to the sum of (x) the amount of unpaid interest (US\$9,500,000 a year or, in the aggregate, US\$47,000,000) and (y) the anticipated return on the reinvestment or

outside the insolvency contexts, the proposed convention will have a marginal impact on credit, leasing and lending decisions and will thus be of marginal benefit to the air transport industry.²

The draft aviation text³ has recommended an *optional* timing component to three categories: (i) non-bankruptcy judicial remedies, (ii) repossession in the context of insolvency/bankruptcy, and (iii) de-registration and export of aircraft. The provisions are optional in the sense that they may be reserved upon by contracting states. In addition, these provisions would apply only, assuming no such reservation, to the extent expressly agreed to by the transaction parties. Except for the foregoing general observations, we will limit our comments to the first category mentioned above, as it is currently thought to be cross-applicable to non-aircraft equipment, was the subject of discussions at the last study group meeting, and is closely related to new Article 15 of the revised text. We assume that the second and third categories mentioned above will be addressed satisfactorily in the aircraft equipment protocol.

On the matter of non-bankruptcy judicial remedies, we are persuaded by the study group's reasoning that, in principle, a distinction between judicial proceedings *relating to the asset* on the one hand, and judicial proceedings *relating to ultimate liability*, on the other, is appropriate. Making this distinction, it has been said, would reduce the risk of non-compliance by contracting states and would to a significant degree alleviate due process type concerns. Article 15, which embodies this distinction, is in our view an exceptionally well-drafted and thoughtful initial step towards satisfactory resolution of these difficult issues.

With the recommended amendments set forth on the attached Appendix to this memorandum (which are explained in Part II below), we believe that Article 15 would be satisfactory in the base/umbrella convention. It is our firm view, however, that an optional timing element in respect of proceedings relating to the asset (but not to ultimate liability) needs to be included in the aircraft equipment protocol, and that it should be a period of 30 days from the date of the filing that initiates such proceedings.

2.2 Level of Detail/Role of Explanatory Materials

While we appreciate the advantages of keeping the proposed convention light and simple, this objective is in tension with the parallel objective of obtaining a high degree of commercial

redeployment of such unpaid amount (e.g., 5% (US\$475,000) or, in the aggregate, US\$2,375,000), that is approximately US\$50,000,000.

Ex ante knowledge of this possibility would make it rational for all involved to view the transaction as a partially unsecured credit transaction and to pay the higher costs and to take the greater risks associated therewith. The proposed convention, through the optional timetables, would give transaction parties and credit support providers the option of minimising these additional costs/risks.

² Conversely, if the proposed convention does address these timing elements, we would expect its impact to be significant. In particular, the proposed convention may well be an important step in opening up international capital markets to aircraft-equipment-backed financing. The timing element may make it possible for independent credit risk assessors, such as the major credit rating agencies, to assess the (non-political) risk in a transaction. See, e.g., Criteria for Enhanced Equipment Trust Certificates, Standard & Poor's Global Sector Review, 1995. This, in turn, would make it more likely that non-professional investors may become participants in transactions of this kind.

³ See 1996 Unidroit Study LXXII - Doc. 23, Annex 1. Hereinafter, this document will be referred to as the "draft aviation text".

certainty. In particular, we would note the numerous words, phrases and concepts included in the revised text,⁴ as well as points included in the draft aviation text but omitted from the revised text,⁵ which should be elaborated upon or included, as the case may be, in some fashion in the proposed convention.

Having said this, we are prepared to support the concept of official comments ("official comments") to, and an explanatory report ("explanatory report") on, each of the base/umbrella convention and the aircraft equipment protocol (collectively, "explanatory materials") as the appropriate vehicles to address this clash of important competing objectives.⁶

In addition to the practical difficulties of preparing these explanatory materials, which we believe are surmountable,⁷ one significant point remains: the relationship between the proposed convention and the explanatory materials.

While the revised text does not contain a provision referring to the proposed explanatory materials, we would submit that one is necessary. The key question is whether this provision, as suggested in Article 30(3) of the draft aviation text, is obligatory in nature or, following recent precedent,⁸ is permissive in nature. In view of the prevailing international rule that restricts recourse to supplementary means of treaty interpretation,⁹ we would suggest that, as regards the official

⁴ See, in particular, Articles 1 (*creation and effects of international interests*), 6(2) (*general principles on which the text is based, and otherwise applicable rules of private international law*), 7 (*creation under the convention--with no other formalities/requirements*), 12(1) (*procedural law*), 12(2) (*without reference to the court (or as proposed) or judicial processes*) (*to the extent wording permits declaration for one or more types of agreements*), 15--generally (as proposed)--15(1) (*facilities*), 15(2) (*establishment of default*), 15(3) (*immobilisation*), 26(5) (*special rules of insolvency law*), 28 (*by way of security*), and 31 (*bound by the assignment--without reference to otherwise applicable law*) of the revised text.

⁵ By way of example, see the definition annexure to the draft aviation text and, in particular, paragraphs (8) (*contractual rights and obligations*), (9) (*country of registration*), (10) (*courts*), (11) (*deregistration*), (17) (*insolvency proceedings*), (19) (*judicial proceedings*), (24) (*party*), (43) (*selected law*), (45) (*take possession*), and (46) (*mandatory rules*) of the such annexure.

⁶ The official comments would address *specific points* viewed as necessary to achieve a high degree of certainty and guidance in interpreting the base/umbrella convention and aircraft equipment protocol. The explanatory report would provide *general* background, discussion and illustration, as appropriate. Except as noted in the text of 2.2, the balance of this memorandum will simply refer to the collective term "explanatory materials". Work will be required to determine which matters ought to be addressed in the official comments and in the explanatory report.

⁷ We would suggest that detailed work on the explanatory materials on the base/umbrella convention commence at once, and that the same would be supplemented by the explanatory materials on the aircraft equipment protocol as soon as possible. It would be desirable to have initial drafts of these explanatory materials available for the final meeting of the study group in late 1997.

⁸ See, e.g., EC Convention on the Law Applicable to Contractual Obligations, 1980 (Giuliano and Lagarde Report (1980)), and Unidroit Convention on the International Return of Stolen or Illegally Exported Cultural Objects, 1995 (Explanatory Report prepared by Unidroit Secretariat).

⁹ See Article 32 of the Vienna Convention on the Law of Treaties, 1969 (Recourse to "supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion" generally inadmissible unless the text to be interpreted "leaves the meaning ambiguous or obscure" or "leads to a result which is manifestly absurd or unreasonable".)

comments, the former is appropriate in this context. We appreciate that this requires *some form of approval* of the official comments at the diplomatic conference,¹⁰ but believe that, on balance, the resulting degree of added commercial certainty justifies this effort.

2.3 Open Textured Provisions

There are a few important provisions in the revised text which are drafted in an open-textured manner.¹¹ Absent very considerable elaboration in the explanatory materials, this drafting approach would reduce the level of certainty derived from the application of the proposed convention. We believe that these provisions should be amended so that the final text, as supplemented by the explanatory materials, will be self-contained and explicit.

The need for this explicitness is reinforced by the fact that a few of these same provisions embody general concepts which may be completely novel to, and/or may be treated very differently in, certain jurisdictions. The two most noteworthy examples are the reference to (i) *good faith interpretation* in Article 6(1) of the revised text and (ii) exercising remedies in a *commercially reasonable manner* in Article 8(2) of the revised text. That is not to say that these concepts would not apply to a particular transaction, but that their application would depend on national law. More specifically, they would apply, if at all, by application of a provision referring to *otherwise applicable law* in cases in which the proposed convention (which is not intended as a comprehensive code) does not contain a rule. This concept should be made clear in the text and elaborated upon in the explanatory materials.

We fully appreciate that this emphasis on commercial certainty comes at the cost of limiting, to some extent, the development and maturation of the proposed convention's rules by means of international case law and associated jurisprudence. This limitation raises the important question faced in all legislation, but particularly in international legislation, of how to ensure that the same remains attuned and responsive to changing commercial practice as well as to revealed, but previously unforeseen, difficulties. Our proposed approach in this regard is to specifically contemplate *the periodic review of the relevant protocols* (which incorporates the base/umbrella convention) pursuant to procedures set up by, and under the guidance of, the Unidroit Secretariat. The results of such periodic reviews would, if appropriate, be proposed as amendments to the relevant protocol.¹²

¹⁰ We look forward to exploring the alternatives in this regard with the Unidroit Secretariat and other leaders in the field.

¹¹ We are using this phrase to denote provisions, or parts of provisions, which do not contain express rules of decision but rather take their respective meanings from or by reference to external or extrinsic sources or standards. See, in particular, Articles 6(1) (text interpreted to promote the observance of *good faith in international trade*), 6(2) (*general principles* on which the text is based for gap-filling purposes), 6(2) (remedies to be exercised in a *commercially reasonable manner*), 6(3) (*reasonable notice* required in connection with non-judicial sale), 9(2) (strict foreclosure permissible when the value of property is *reasonably commensurate* with the secured debt, and 11(1) (requirement, absent contrary agreement, that default be *substantial or persistent*) of the revised draft.

¹² See similar arrangements contemplated in Article 20 of the Unidroit Convention on the International Return of Stolen or Illegally Exported Cultural Objects, 1995.

3 Matters Relating to the International Registry System

In that point 9 of the introductory remarks to the revised text advises that the registry provisions will not be addressed at the upcoming study group meeting, such provisions have not been commented upon in this memorandum. AWG/IATA, therefore, reserve their position on these provisions. These matters will be taken up in the context of the next registry subgroup meeting. We would, however, note three broad points at this stage.

First, we would draw your specific attention to the relevant recommendations made in the AWG/IATA Memorandum.¹³

Second, we would express our agreement with point 4 of Appendix IV to the revised text, which indicates that certain registry system provisions specific to aircraft equipment would be included in aircraft equipment protocol. We would envisage the participation of the Chairman of the registry sub-group in the process of preparing these provisions so as to ensure coordination and consistency between the base/umbrella convention and the aircraft equipment protocol in this regard.

Third, in light of our continuing consultations and consensus building efforts, we would at this stage make one modification to a recommendation previously made by AWG relating to the international registry system, i.e., that a satellite registry¹⁴ designated by and located in each contracting state would be the exclusive point of entry into the international registry system for filings relating to aircraft registered (for nationality purposes under the Chicago Convention of 1994) in such contracting state.

We would jointly recommend that each contracting state have the *option of designating a satellite registry* and, absent such a designation (or upon the withdrawal of such a designation), that all filings made relating to aircraft with nationality in the relevant contracting state would be made with

We believe that the periodic review and proposed amendments, as appropriate, should be at the protocol, rather than the base/umbrella convention, level. This would permit the making of appropriate amendments on an equipment-specific basis that, in addition to providing greater flexibility, would recognise the independent development of separate industry financing and regulation.

¹³ See 1996 Unidroit Study LXXII - Doc. 32 at 3-4. These recommendations may be summarised as follows.

A distinction should be made between (i) the inter-governmental regulator of the international registry system (appointed by the Unidroit Governing Council) and (ii) the actual operator of the central registry. Such operator would be subject to the control and oversight of the appropriate inter-governmental regulating body.

To promote broad acceptance of the proposed convention in the international aviation community, IATA, through a newly formed special-purpose-dedicated subsidiary, should be proposed as the entity that will have responsibility for operating the central registry for an initial fixed period (subject to the above-mentioned inter-governmental oversight and regulation). These arrangements would have the added benefit of placing IATA in a position to undertake the necessary design and organisational work on the registry system. The information that will flow from such undertaking, in our view, is essential to informed decision making by the registry sub-group.

¹⁴ See Unidroit 1996 Study LXXII - Doc. 23 at 14-17.

On a related point, there have been objections to the term "satellite" registry. Thought should be given to whether a more acceptable term can be devised.

the central registry.¹⁵ This modification is in line with the important underlying principle of permitting contracting states to make policy-type decisions where doing so is consistent with the overall regime put in place by the proposed convention. In addition, it would have the concrete advantage of permitting certain newly formed or rapidly developing nations to immediately join the proposed convention rather than possibly being delayed by virtue of inadequate technical infrastructures. Finally, this modification would put in place a system consistent with, but in no way dependent upon, movement towards the bifurcation of aircraft registry functions between the regulation of safety and operational matters, on the one hand, and private property rights in aircraft equipment, on the other.¹⁶

4 Jurisdictional, Coordinative and Final Provisions

We note that the jurisdictional, coordinative and final provisions contained in Chapter IX of the draft aviation text have not been addressed in the revised text, but that these matters will be taken up at the upcoming study group meeting. We would therefore refer the study group to Articles 24-32 of the draft aviation text for our views on these matters, and note the importance of these provisions. These items need to be adequately addressed in the base/umbrella convention and/or the aircraft equipment protocol, as appropriate.

5 Reservations and Declarations made at Ratification

In view of the central role of reservations and declarations in the proposed convention, and the complex, policy-oriented nature of the provisions upon which reservations and declarations are expressly permitted, we would recommend that the relevant provisions of the revised text¹⁷ state that such reservations and/or declarations are to be made *at the time of ratification, acceptance or accession* (but not at the time of signature).

We anticipate that this approach would increase the likelihood of broad acceptance of the proposed convention at the diplomatic conference, followed by a deliberate, organised ratification procedure.

Part II Certain Specific Comments on the Revised Text

We have the following specific comments on the revised text for the reasons indicated below:-

Article 3 Connecting Factor

We are unclear as to what, if anything, is intended by this provision that would not be addressed by the jurisdictional provisions. Jurisdiction and applicability of the proposed convention, we submit, should be coterminous: a court located in a contracting state which has jurisdiction under the

¹⁵ It is acknowledged that one likely implication of this recommendation is the need for a fully functioning 24-hour central registry to accommodate time zone differences.

¹⁶ The mentioning of this consideration is not intended as endorsement or approval (or non-endorsement or non-approval) by AWG, IATA or any of their respective members of this potential bifurcation of registry functions. Our objective is simply to ensure that the proposed convention would be able to accommodate, and would be consistent with, such a development should it occur.

¹⁷ See Articles 12(2), 12(4), 15(3), 26(4), and 34(1) of the revised text, as well as relevant provisions of the aircraft equipment protocol (to be developed).

proposed convention would apply the convention to a dispute within its sphere of application. For the reasons previously indicated,¹⁸ the satisfaction of an internationality requirement, as such, should not be a condition to the application of the proposed convention since aircraft equipment (if not other mobile equipment) is *per se* international.

This proposed approach has the benefit of clarity, simplicity and a resulting broader sphere of application. It does, however, demand that very close attention be paid to the jurisdictional provisions. See, e.g., Article 24 of the draft aviation text.

Article 4 Reference to Defined Terms

See comments on Appendix below.

Article 5 Mandatory Provisions under the Proposed Convention

We reserve our position on this provision pending identification of the applicable mandatory Articles.

Article 6(1) Interpretation of the Proposed Convention

We would ask that the words "and the observation of good faith in international trade" be deleted from Article 6(1). As noted above, the absence of a good-faith standard in a number of jurisdictions, as well as the varying treatment of this concept in others, will result in uncertainty as to the meaning of the provision. In addition, the inclusion of this concept of *good-faith interpretation* is an undesirable perpetuation of an awkward historical compromise¹⁹ the meaning of which remains controversial.²⁰

It is, in sum, a potentially litigious provision which we view as inappropriate in a convention designed to provide clear, useful rules supporting international asset financing. This is to be contrasted with the possible application of a specific (and typically well-developed) good-faith standard (regarding contractual performance), derived from applicable national law. Such a standard may be applicable through the law selected by the parties to govern the contractual elements of the relevant agreement. See point 2 of Appendix IV to the revised text and comments on Article 6(2) immediately below.

Please insert a new sub-paragraph indicating the relationship between the text and the explanatory materials. See Article 30(3) of the draft aviation text and general comment 2.2 above.

¹⁸ See Unidroit 1996 Study LXXII - Doc. 23 at n. 17 (and accompanying text).

¹⁹ See Bonnell, at 83-84, in Commentary on the International Sales Law: The 1980 Vienna Sales Convention; see also Honnold, at 146, Uniform Law for International Sales under the 1980 United Nations Convention.

²⁰ See Farnsworth, at 18, in "The Convention on the International Sale of Goods from the Perspective of the Common Law Countries," in Corbone, La Vendita Internazionale; see also Rosett, "Critical Reflections on the United Nations Convention on Contracts for the International Sale of Goods," 45 Ohio St. L.J. 265, 289.

Article 6(2) Questions Not Addressed by the Proposed Convention

The desirability of the conventional reference to *general principles on which the text is based* as a source for gap filling depends on what exactly the explanatory materials say about such general principles²¹ and, as indicated, the relationship between the text and the explanatory materials. We would reiterate our view that courts (and transaction parties) should have as much guidance as possible as to the precise scope and meaning of proposed convention.

The second, subordinate source of gap filling is the reference to the *law applicable by virtue of the rules of private international law*. Once again, the specific text of the explanatory materials and its relationship with the proposed convention are important to proper assessment of this provision. In particular, the explanatory materials should make it clear that questions relating to the characterisation of the interest held by a transaction party for non-convention purposes (including national taxation and tort/strict liability purposes) would not be affected by the convention but rather would be left to national law.

Article 8(1) List of Basic Remedies Available to Chargee

As indicated in Appendix IV to the revised text, the aircraft equipment protocol would supplement this list by adding a provision that upon a chargee's taking possession of the object, de-registration and export rights would be available.²² This concept would also apply to a lessor or seller who has taken possession of leased or conditionally sold aircraft equipment.

Article 8(2) Manner in which Remedies are Exercised

As indicated in Part I above, we take issue with Article 8(2) and, in particular, with the open textured concept of a *commercially reasonable manner* of exercising remedies. We do so on the grounds that its interpretation (i) would be unclear, (ii) would vary quite widely between jurisdictions, (iii) would invite litigation, and (iv) could be used as inappropriate justification in support of decisions by courts to prefer their nationals in the context of international litigation.

²¹ We believe that such *general principles* are as follows: (i) the international recognition of security and leasing interests created under the proposed convention and the rights, remedies and priorities provided therein; (ii) the general facilitation of asset financing techniques on the basis of asset financing principles; (iii) the ability of parties to reach their own agreement on matters *inter partes*, including, in particular, the law to govern their contractual rights and obligations; and (iv) the ability of contracting states to reflect certain policy preferences through their decision to make, or not to make, certain reservations/declarations to the proposed convention.

²² This would be augmented by a provision in the aircraft equipment protocol providing for the concept of an *irrevocable power of attorney/de-registration request authorisation* which obligor may issue to obligee in respect of such deregistration and export rights. See Article 23(2) of the draft aviation text.

²³ This would be augmented by a provision in the aircraft equipment protocol providing for the concept of an *irrevocable power of attorney* which obligor may issue to obligee in respect of such deregistration and export rights. See Article 23(2) of the draft aviation text.

We believe that very fundamental questions²⁴ relating to the manner²⁵ in which remedies are exercised should not be left to national courts without adequate guidance. Moreover, we believe that transaction parties should be able to negotiate this matter with minimal, if any, policing, and have thus previously recommended *that the remedies specified in Article 8(1) would be exercisable to the extent and on the terms set forth in the relevant agreement.*

We would therefore suggest rewording Article 8(2) so as to state that remedies are to be exercised as agreed by the parties, but to make this subject to Article 8(3). Article 8(3), in turn, would set forth (i) the mandatory notice period for a non-judicial sale and, if appropriate, (ii) any other specific restrictions or limitations (applicable to all equipment) on the ability of the parties to reach agreement on these matters.²⁶

Article 8(3) Mandatory Restriction on Exercising Remedies

As suggested above, Article 8(3) should be the Article which specifically sets forth any mandatory provisions restrictions/limiting the ability of the parties to agree on the manner in which remedies would be exercised.

We would agree to a mandatory notice period in respect of a non-judicial sale, but believe that it should be explicit. We recommend a period of 10 days

We do not believe that additional restrictions should be placed on the ability of the parties to reach agreement on these matters and look forward to discussing this topic with others at the upcoming meeting.

Article 8(6) Notice of Sale to Interested Parties

Given the generality of the phrase "rights in the object" in Article 8(6)(c), please add that the writing shall have specifically referred to this provision.

²⁴ The explanatory materials should note, for example, that the fact that a better price could have been obtained by a sale at a different time or in a different method should not give rise to liability if the actual sale and method were consistent with the contractual agreement of the parties. One might reach a different conclusion if an undefined reasonable commercial manner test was applied to override the parties' express agreement.

²⁵ For the avoidance of doubt, this discussion of the *manner* in which remedies are exercised is distinct from the question of the availability or non-availability of non-judicial remedies. The latter issue is specifically addressed in Article 12(2) of the revised text.

²⁶ But see comments immediately below in Article 8(3) objecting to any additional restrictions relating to all categories of equipment. There may, however, be other appropriate mandatory restrictions on the manner in which remedies may be exercised for a specific type of equipment since, for example, there may be different types of markets and/or methods of sale for different types of equipment. Any such additional restrictions, in our view, should thus be contained in the applicable protocol.

²⁷ But see comments immediately below in Article 8(3) objecting to any additional restrictions relating to all categories of equipment. There may, however, be other appropriate mandatory restrictions on the manner in which remedies may be exercised for a specific type of equipment since, for example, there may be different types of markets and/or methods of sale for different types of equipment. Any such additional restrictions, in our view, should thus be contained in the applicable protocol.

Article 9(5) Surety Defences

We believe that this new provision should be deleted. The effect of so doing will be that the relevant questions would be subsumed under Article 6(2) and its reference to otherwise applicable rules of private international law. Such rules may, for example, view compliance with Article 8 as a relevant factor in considering the availability of certain surety defences. This would be made clear in the explanatory materials.

Article 10 Basic Remedies Available to Lessor/Seller

Let us start by saying that we are fully mindful and supportive of the expressed desire to respect the characterisation of a lease (whether operating or financial) and a conditional sale as retaining full ownership in jurisdictions where it does so and, in addition, of not jeopardising non-convention purpose characterisations of these types of interests.

Having said this, Article 10, which was drafted with such a characterisation in mind, may prove inadequate in jurisdictions which do not have well developed leasing law and/or which view a financial lease or conditional sale as having secured transaction characteristics.

Bearing in mind the competing issues, we would suggest the following revised wording (which is marked to indicated suggested changes):-

Article 10

1. - In the event of default by the buyer under a title reservation agreement or by the lessee under a leasing agreement, the seller or lessor, as the case may be, may exercise any one or more of the following remedies:-

- (a) terminate the obligor's right to possession of the object under the relevant agreement;
- (b) take possession of any object to which the relevant agreement relates;
- (c) to the extent applicable, take any of the actions specified in Article 8(1)(b) - (d).

2. - Any remedy given by the preceding paragraph (other than sub-paragraph (c) thereof as it relates to Article 8(1)(d)) may be exercised to the extent and on the terms specified in the relevant agreement.

Article 11 Defaults/Events Giving Rise to Rights and Remedies

Our comments on Article 11, are purely technical in nature and are designed to underscore that (i) rights and remedies are available to an obligee upon any agreed default or event and (ii) the concept of a "substantial or persistent default" is only relevant absent such an agreement by the transaction parties. Please revise the ordering of Articles 11(1) and 11(2), delete the word "other" in (new) Article 11(1), and change the paragraph cross-reference in (new) Article 11(2) from 2 to 1.

In addition, please add the words "and the judicial relief specified in Article 15" to the end of (new) Article 11(1) and (by cross-reference) to the body of (new) Article 11(2) to connect this concept to proposed Article 15(2). See Annex 1.

The proposed amended provision (which is marked to indicated suggested changes) would read as follows:-

Article 11

1. - The parties may provide in their agreement for any kind of default, or any event other than default, as giving rise to the rights and remedies specified in Articles 8 to 11 and the judicial relief specified in Article 15.

2. - In the absence of an agreement within paragraph 1, "default," for purposes of Articles 8-10 and 15, means a substantial or persistent default.

Article 12(2) Non-Judicial Remedies

On a drafting point, please add the words "or judicial processes" after the words "without reference to the court". The explanatory materials could expound upon the meaning of the resulting phrase "without reference to the court or judicial processes".

In the draft text, we introduced the concept of the "relevant contracting state" for the purpose of determining which contracting state's reservation would be relevant for certain rules of decision. In this context, we noted that the candidates were the countries in which the non-judicial remedies were exercised/or the country of aircraft registration. We will continue to consider the issue in view of the position expressed in Article 12(2).

Article 14 Relation with International Financial Leasing Convention

Point 6 of Appendix IV to the revised text notes that the relationship between treaties relating to aircraft equipment would be addressed in the aircraft equipment protocol.

We believe that, in the context of aircraft equipment, the proposed convention should supersede the International Financial Leasing Convention.

Article 15 Expedited Judicial Relief

Please see the proposed revised wording to this Article, on the attached Appendix to this memorandum. This proposed wording is marked to indicate suggested amendments.

In addition to the timing element discussed in Part I above, our suggested changes are of three kinds. First, the proposed text *specifies a standard* which, if met, would give rise to expedited judicial relief. See proposed Article 15(2) (and its relationship to Article 11). Second, the phrase "provisional or interim" has been deleted, with the concept being addressed by an *express statement regarding the availability of a full trial regarding ultimate liability* after the relevant expedited judicial relief has been granted. The reason for this is to avoid confusing this innovative concept-- prompt, judicially assisted remedies, though specified *sui generis* forms of relief, designed to retain or realise collateral value in advance of a full trial on the merits--with traditional notions of injunction relief and the particular national standards associated therewith. Third, *application of proceeds* has been added as an express form of relief.

As a final annotated point, we have noted the two additional matters specifically applicable to aircraft equipment that need to be addressed in the aircraft equipment protocol: de-registration and export of the relevant aircraft equipment.

Article 25 General Priority Rules

As a threshold point, we believe that a registered interest should always have priority over an unregistered consensual national interest, regardless of when the latter was granted. We therefore believe Article 25(4) should simply end after the word "obligor" on the third line.

A registered interest (whether a registered international interest or a registrable national interest) should, subject to Article 26(4) (preferred national interests - which prevail without being registered), always have priority over unregistered interests (whether registrable or not). We have recommended changes to Article 25(3) to that effect.

Please add a clarifying sentence to Article 25(1) to the effect that a subsequent amendment to or assignment of any initial registration shall not affect the priority ranking of the initial registration.

Finally, as previously commented upon and explained, we believe that Article 25(2) should not apply in the context of aircraft equipment financing.

Article 26 Certain Additional Provisions Relating to Effects as against Third Parties

We have two comments on the preferred national creditor rule specified in Article 26(4), which we agree with in general. First, the "non-consensual claim" which, depending on a contracting state's declaration, would prevail without filing should *exclude execution or attachment creditors*. (If they constitute registrable national interests, they would be subject to the first-to-file rule.) Second, we believe that any relevant declaration in a "subsequent amending instrument" *should only have perspective application*, that is, it should only apply to any interest registered after the effective date of any such instrument. This would be consistent with the objective of permitting parties to rely on publicly available information at the time of their transaction so as to accurately assess risks of competing claimants.

Please note the following additional comments on Article 26. We believe that the wording in square brackets in Article 26(1) should be deleted as being beyond the scope of the proposed convention. We also believe that the references to Article 26(5) in Articles 26(1) and (2) should be deleted. On a drafting point, please add the words "or assignor, as the case may be," after the word "obligor" in Article 25(3). This is consistent with the intention of Articles 26(2) and (5).

Finally, the study group should discuss, and the explanatory report should elaborate upon, the intent of the phrase "special rules of insolvency law" in Article 25(5). We believe the parenthetical in that paragraph needs to also cross-reference Articles 26(1) and (2). In any event, the provision would be substantially *overridden by the insolvency provision in the aircraft equipment protocol*, should the same be applicable.

Chapter VII Assignment of Registered International Interests

Before turning to the specific provisions, we would first set forth a few general comments.

First, introductory comment 13 to the revised text states that the drafting group took the view that it would not be advisable to attempt to deal with *charges of international interests*. Yet, Article 26 covers *assignment of such interests by way of security*. This is a rather fine distinction and one that presupposes a particular system of thought and terminology relating to assignments of contract rights. In any event, as the study group is well aware, we believe that the proposed convention must (i) cover security assignments (in the broad sense) in addition to absolute assignments and (ii) have certain specific rules applicable to security assignments. Subject to satisfactory resolution of the questions relating to the nature and import of the explanatory materials, we would think that item (i) above could be addressed therein.

Second, the provision of the aircraft equipment protocol dealing with the parties ability to choose the law governing contractual aspects²⁸ would also apply to the assignor/assignee contractual relation.

Third, we assume that the inclusion of Article 31 presupposes that, if the proposed convention is complied with, the relevant underlying interest *is assignable* without reference to the requirements of, or limitations imposed by, otherwise applicable law. The second gap filling clause of Article 6(2) would thus not apply to the question of assignability. If this is the case, we are in accord and believe that it should be made clear in the explanatory materials.

Article 28 Assignment Criteria

While Article 28(3) is appropriate for absolute assignments, we believe that it raises problems in the context of security assignments since the assignor may *retain certain rights*, such as indemnification and associated rights and even (as in certain tax-based financing structures) the right to a portion of the payment stream.

Article 29 Transfer of Rights and Priorities

For the reason mentioned immediately above, Article 29, in dealing with transferred *rights*, should distinguish between absolute and security assignments. In the case of security assignments, certain rights would be retained.

In addition, a modified *priority* rule is appropriate in the case of security assignments. An assignment by way of security should transfer a security assignor's priority position to its transferee *until a discharge is registered with respect to such assignment*, at which point the priority position would revert to the security assignor.

Article 30 Registration Amendment Notice

This provision should likewise distinguish between an absolute and a security assignment. In the case of a security assignment, the transferee might be identified as the "security holder", rather than the "new holder", of the interest.

²⁸ Certain proprietary questions relating to the assignor/assignee transaction would be addressed by complying with Article 28 of the revised text. That is, an assignment which complies with the formalities of Article 28 of the revised text would be valid in much the same way that an international interest *created* under Article 7 of the revised text would, without further act or the need to satisfy any other requirements, be valid and effective.

Please see relevant comment immediately below regarding obligor consents.

Article 31 Conditions to Binding Obligor to the Assignment

The view has previously been expressed that (i) in order to bind an obligor, it must consent to the relevant assignment, and (ii) in case of conflicting assignments, the obligor would be bound by the first assignment to which it has consented where a filing in respect of the same has been registered. Given the complexity of the issue, this view has previously been noted as provisional and subject to further consideration.

Without expressing a final position, we continue to consider this the better approach in the context of aircraft equipment finance. If this approach is followed, (i) Article 30(1) would note that, to be registrable, the registration amendment notice, would need to be accompanied by evidence of the obligor consent to the assignment and (ii) Article 31(a) would end with the phrase "and has consented in writing thereto".

Please delete Article 31(c), as it is inconsistent with the foregoing.

Article 32 Security Assignment Remedies

In what may be a drafting point, Article 32(1) should include a subclause (c) which makes clear that the references in Articles 8, 9 and 11 to 15 to the "object" are references to "rights assigned relating to the object". This is needed, in addition to the reason previously noted, to ensure that in the case where the assignor defaults but the obligor performs, the assignee simply moves into the position²⁹ of the assignor vis-à-vis the assignor.

Please add a provision that confirms that this Article is without prejudice to the right of security assignee under applicable law prior to a default.

Article 34 Registrable National Interests

Governmental tax lien should be included as a third category of potential registrable national interest, thereby permitting each contracting state to decide the extent to which such tax liens would (i) have priority without filing under Article 26(4), (ii) have priority on a first-to-file basis under the general priority rules, or (iii) be subordinate to any registered interest. This would treat tax liens the same as the two other categories of non-consensual claims: execution and attachment creditors (except that they could not have priority without filing) and liens securing payment for services rendered on the object.

Chapter X Special Provisions for Aircraft Property

See point 1 in Part I above.

²⁹ As a general matter, the elliptical method of dealing with security assignment rights in Article 32 would require supplementation in the explanatory materials. For example, the explanatory materials would need to elaborate upon the concept of *taking possession* of contract rights.

Chapters XI-XIII

See draft aviation text for our views on these chapters. In particular, see Article 24 and related definitions (jurisdiction), Articles 23(4) and (5) and 26 and related definitions (relationship with other Conventions), and Articles 25-32 and related definitions (final provisions) of the draft aviation text.

Definition Appendix

The definitions in Part II, together with other definitions specifically applicable to aircraft equipment, would be included in an appendix to aircraft equipment protocol.

The definition of "leasing agreement" would be amended in the aircraft equipment protocol to eliminate the three-year requirement.

Consideration should be given to whether the definition of "obligee" should, for certain purposes, include as assignee of the obligee. See, e.g., Article 15 of the revised text.

Representatives of AWG and IATA will be present at the upcoming study group meeting to elaborate upon and discuss the foregoing as appropriate.

We would note that the views expressed herein are subject to our continuing building activities.

Finally, we thank you very much for the opportunity to contribute to this important project.

*Article 15**

1. - A Contracting State shall ensure that facilities are available to an obligee to obtain speedy^A judicial relief of the kind specified in Article 15(3) upon the occurrence of an event specified in Article 15(2).
2. - The forms of judicial relief set forth in Article 15(3) shall be available upon the establishment by an obligee of a default or event giving rise to rights and remedies as specified in Article 11.^{**}
3. - The forms of judicial relief^{***} available before full trial shall include the following orders:-
 - (a) preservation of the value of the object;
 - (b) possession, custody or management of the object;
 - (c) sale or lease of the object;
 - (d) application of proceeds or retention of income, as the case may be, derived from the relief specific in paragraph(c); and
 - ^A(e) immobilisation of the object.
4. - The provisions of this Article 15 shall neither prejudice the rights of an obligor or an obligee to a subsequent full trial on the merits of any dispute and ultimate liability under the relevant agreement nor limit the availability of any other forms of judicial relief under applicable law.
5. - A Contracting State may declare at the time of ratification or accession that it will not apply the provisions of this Article 15 or the provisions of any protocol which sets forth the timetable applicable to the judicial relief specified in this Article 15.^{****}

* In the event that this Article 15 is re-cast as a final provision, as indicated by the annotations to the revised text, it shall nonetheless be referred to in Article 13. That is, the parties should have the ability to exclude, wholly or in part, any rights or remedies of an obligee hereunder.

** All questions surrounding the establishment of the relevant default or event (subject to evidentiary and other (non-timing) procedural rules of the forum), including the enforceability of waiver-of-defense-type provisions or the existence or non-existence of any materiality requirements, shall be determined under the law governing the relevant contract. In the aircraft equipment protocol, the transaction parties would be given the ability to select such governing law. These points should be confirmed in the explanatory materials.

*** Two additional matters specifically applicable to aircraft equipment need to be addressed in the aircraft equipment protocol: deregistration and export of the relevant aircraft equipment.

**** The relevant timetable recommended for inclusion in the aircraft equipment protocol relating to such judicial relief is a period of 30 days from the date of filing that initiates the relevant proceedings.

**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 Financière 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, leases 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.

GE Capital Aviation Services, a wholly owned subsidiary of GE Capital Services, which is in turn a wholly owned subsidiary of General Electric Company, is a global commercial aviation financial services company. As of December 31, 1995 the portfolio of aircraft managed by GECAS and its affiliates comprised approximately 890 aircraft, which are on lease to more than 157 lessors in 54 countries throughout the world. GECAS has recently announced that it has entered into a multi-year order for up to 259 new jet aircraft.

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 German 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.

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 company, 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 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 aerospace 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 U.S. government contractor with capabilities in missiles and space, electronics systems, military aircraft, helicopters and information systems management.

The Chase Manhattan Bank is a major banking establishment in the United States. Chase Manhattan has assets of almost \$300 Billion and \$20 Billion in shareholders' equity and serves over 25 million consumers in 39 states and has operations in 51 countries. The Chase Global Aerospace Group has specialized in providing aviation and aerospace advice and credit for over fifty years.

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.

Description of International Air Transport Association

The International Air Transport Association, an association incorporated by Act of Parliament of Canada, is an outcrop of the Chicago Conference of 1944. The purposes, objects and aims of the Association are

- (a) to promote safe, regular and economical air transport for the benefit of the peoples of the world, to foster air commerce and to study the problems connected therewith;
- (b) to provide means for collaboration among the air transport enterprises engaged directly or indirectly in international air transport service;
- (c) to co-operate with the International Civil Aviation Organization and other international organizations.

IATA's mission is to represent and serve the airline industry. In fulfilling that mission, IATA services *four* groups interested in the smooth operation of the world air transport system: airlines, governments, third parties (such as travel/cargo agents, or equipment and systems suppliers) and the general public.

- **Airlines** IATA offers joint ways - beyond the resources of any single company - to exploit opportunities and solve problems;
 - **Governments** Industry working standards are developed within IATA, IATA fosters safe and efficient air transport, IATA serves multilateralism
 - **Industry Associates/Partners** IATA serves as a collective link between airlines and other enterprises in the industry, such as passenger/cargo agents and equipment manufacturers;
 - **General Public** IATA simplifies the travel and shipping process.
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