

COMMENTS ON THE DRAFT CONVENTION AND THE DRAFT PROTOCOL

(Presented by the United States)

The United States submits the following proposals for technical revisions of the Convention and the Aircraft Protocol as well as additional observations. In some instances we have proposed revised text. In other cases we have identified policy concerns and issues for consideration by the diplomatic conference.

1. De-registration Request. The present text of the Aircraft Protocol contains some ambiguity as to two questions:

First, is a national aircraft registry required to honor a request for de-registration and export under Article XIII of the Protocol upon proper submission of a request by an authorised party (subject, of course, to applicable aviation safety laws and regulations)? Second, and related, must the national registry honor a request in the absence of consent or satisfaction of the holders of registered international interests that are junior to the interest of the holder on whose behalf the request for de-registration is made? We believe that the answers to these questions are not clear under the Protocol and we propose revisions that would provide clear answers.

Article IX(2) of the Aircraft Protocol provides:

2. B The creditor shall not exercise the remedies specified in paragraph 1 [i.e., de-registration and export remedies] without the prior consent in writing of the holder of any registered interest *ranking in priority to that of the creditor*. (emphasis added)

Note that this provision contains no directions to a national registry. Arguably that obligation can be implied from its duty to cooperate and assist under Article XIII(3) of the Protocol. Or, that obligation might arise pursuant to a national registry's "confirmation" made pursuant to paragraph (ii) of the form set out in the Annex referred to in Article XIII(1). But neither of these conclusions is required from the text of the Protocol itself. Our proposed revision would clearly impose this obligation on national registries.

Another ambiguity concerns the relationship of the Convention and the Protocol to the *Convention on the International Recognition of Rights in Aircraft*, opened for signature in Geneva on 19 June 1948 ("Geneva Convention"). Article IX of the Geneva Convention provides:

Except in the case of a sale in execution in conformity with the provisions of Article VII, no transfer of an aircraft from the nationality register or the record of a Contracting State to that of another Contracting State shall be made, unless *all holders of recorded rights* have been satisfied or consent to the transfer. (emphasis added)

Inasmuch as junior interests may be registered in the international registry, their validity and priority would not be prejudiced by a de-registration of the aircraft in the national registry. Under Article XXII of the Protocol the Geneva Convention is superseded, but only "with respect to matters not covered or affected by" the Convention. Because the duty of a national registry to honor a request for de-registration is not clearly spelled out in the Protocol, arguably that is not a "matter covered or affected" and Geneva would not be superseded in this context. Unless the Protocol clearly directs a national registry to honor a proper request for de-registration in the absence of consent or satisfaction of interests junior to the holder of the interest on whose behalf the request is made, a registry might insist on the consent or satisfaction of junior interests as a condition precedent to de-registration. That result would be unacceptable.

In view of the foregoing, we propose the addition of a new Article IX(4) to the Protocol to read as follows:

4. The registry authority in Contracting States shall, subject to applicable aviation safety laws and regulations, honour a request for de-registration and export if:

(a) the request is properly submitted by the authorised party under a recorded irrevocable de-registration and export request authorisation; and

(b) the authorised party certifies to the registry authority that all holders of registered interests ranking in priority to that of the creditor in whose favour the authorisation has been issued have been satisfied or consent to the de-registration and export.

2. Assignments: Convention Chapter IX and Protocol Article XV. We have reviewed a revised version of Chapter IX of the Convention prepared by the Rapporteur to the Joint Sessions, Sir Royston M. Goode. See Convention, footnote 2. The revised version is attached to this paper as Annex I. We believe that the revised Chapter IX is a substantial improvement and support its inclusion in the Convention. (References to Articles of Chapter IX below are to Articles of the *revised* version.) We have the following additional specific comments and proposals.

a. Article 32(3). We propose that the words “preceding paragraph” be replaced by the words “this article.” The relationship between paragraphs 1 and 2 suggests that it would be prudent to refer to the entire article.

b. Article 31. In general we agree with an informal proposal by the Government of Canada to add a new paragraph 2 to Article 31. We propose that the new paragraph should read as follows:

2. - An assignment of an international interest created pursuant to a security agreement is not valid unless some or all related associated rights also are assigned.

c. Definition of “associated rights”; Article 1(c). In order to achieve the result intended by the words “associated rights relate to” in Article 35, we propose the deletion of the reference to “and the reasonable costs under 7(5).” We also propose to redefine “associated rights” as follows:

(c) “associated rights” means all rights to payment or other performance by a debtor under an agreement which are secured by or associated with the object ~~or the transaction, including finance charges, indemnification obligations, fees or other charges, and any reasonable costs incurred in the exercise of a remedy relating to the agreement, the object, or the transaction;~~

This approach would eliminate the possibility that a court might erroneously limit the priority to the “principal” of a loan or the price or rentals for an object. The change to the definition would make the reference to costs under 7(5) unnecessary inasmuch as those costs would be picked up as associated rights.

d. Article 35 Limitation of Priority; Protocol Article XV. Article 35 is intended to limit the otherwise applicable priority afforded to assignments of associated rights. For a few years square brackets have appeared around Article XV(2) of the Protocol.¹ That provision, if retained, would eliminate the priority-limiting language of Article 35. We believe that Article XV(2) should be removed from the Protocol.

¹Article XV(2) of the Protocol provides:

[2. – Article 35 of the Convention applies as if the words following the phrase “not held with an international interest” were omitted.]

Resolving the policy question whether to retain the Article 35 limitation on priority for the Protocol depends, at least in part, on the answer to an empirical question. Would affording full priority to assignments of associated rights secured by, but otherwise unrelated to, an international interest in an aircraft object unreasonably impair general receivables financings and securitization transactions? We believe that a rule adopting full priority would unreasonably impair these financings and that Article 35 should be retained.

While we believe that the priority should be limited along the lines of Article 35, we also believe that Article 35 may be too limiting. We propose to expand the priority beyond the current limitation. We propose the revision of Article 35 to read as follows:

Where the assignment of an international interest in an object has been registered, the assignee shall, in relation to the associated rights transferred in connection with the assignment, have priority under Article 28 only to the extent that the associated rights relate to:

- (a) a sum advanced and utilised for the purchase of the object;
- (b) a sum advanced and utilised for the purchase of another object in which the assignor held another international interest if:
 - (i) the assignor assigned the international interest to the assignee; and
 - (ii) the assignment has been registered.;
- (c) the price payable for the object; or
- (~~e~~) (d) the rentals payable in respect of the object;

~~and the reasonable costs referred to in Article 7(5).~~

This formulation enhances the potential for cross-collateralization among registered “purchase-money” international interests held by the same assignee. But it also ensures that any potential assignee of associated rights will be made aware, from the “purchase-money” character of those rights, that an aircraft object is involved and that the international registry must be consulted. Note that it may be necessary for the drafting group to clarify in more explicit language the circumstances under which associated rights “relate to” the itemized obligations.

Finally, some who have read Article 35 have misunderstood its implications for so-called “cross-collateralization” of international interests. However, under the Convention a debtor and creditor are free to agree that an object will secure not only obligations relating to the debtor’s acquisition of, or use of, an object but also any other obligations of the debtor to the creditor. See Article 6(d). And if the international interest in the object is registered, it obtains full priority with respect all of the obligations secured. Consequently, if a debtor and creditor enter into a series of transactions, they may provide in each transaction that the relevant object secures obligations that have arisen or that will arise under the other transactions. Article 35, on the other hand, simply takes account of the situation of a creditor that assigns its various international interests and related associated rights to multiple assignees. Under Article 35, as revised, the assignee achieves priority in each set of associated rights with respect to the related international interest assigned to it and all other registered international interests assigned by the same creditor to that assignee. It avoids the unacceptable dilemma of the prospective assignee of associated rights that are unrelated to the acquisition of the object. Such an assignee would have no means of knowing that under an unrelated transaction an object secured the rights to be assigned.

3. Prospective International Interests and Prospective Assignments. Article 15(1) provides for the registration of “prospective international interests” and “prospective assignments.” We believe that the Convention and the Protocol should provide clearly that if an international interest is purportedly registered before the interest actually exists, the registration is effective, even though the registration does not indicate that it is a prospective international interest, upon the international interest coming into existence.

A simple example will illustrate this principle:

A Co. enters into a security agreement with Bank covering an aircraft already owned by A Co. The interest to be created by the security agreement is registered under the Convention and the Protocol. When Bank is satisfied with the registration and obtains a search indicating that no conflicting interest is of record, Bank loans funds to A Co. Immediately before the loan is made, no international interest actually exists because there are no obligations that can be secured. Before the loan is made, Bank has a “prospective international interest.” It does not choose to have the information submitted in connection with the registration to so indicate, however. Bank worries that there might be a subsequent step (e.g., another registration step) that must be taken after it makes the loan. If for any reason that step were not made (e.g., intervening court order, bankruptcy, etc.), it fears its interest may be compromised. If the registration system is going to be functional, the registration of Bank’s international interest must be effective, without any further step, immediately upon making the loan.

In order to effectuate this principle, we propose the addition of a new second sentence to Article 18(3). But the new sentence, alone, may not be sufficient. If a prospective international interest is identified as such, the question remains whether some sort of follow-up step may be implicitly required. Consequently, we propose the revision of Article 18(3) as follows:

3. - If an interest ~~first~~ registered as a prospective international interest becomes an international interest, that international interest shall, without any further action by any person, be treated as registered a registered international interest from the time of registration of the prospective international interest. A prospective international interest may be registered whether or not the registration information submitted to the international registry indicates that the interest to be registered is prospective.

4. Participation by Intergovernmental Bodies as Parties to the Convention. The United States would consider a proposal for participation by intergovernmental organizations as parties to the Convention and the Protocol. However, our favorable consideration would require that participation be open to all similarly situated organizations and not solely to particular bodies. Satisfaction of three other conditions also would be necessary.

First, any such proposal must ensure that implementation of the Convention and the Protocol would not be affected. For example, generally a state that ratifies a convention assumes an obligation to implement its provisions. It must be clear that an intergovernmental organization that becomes a party to the Convention on behalf of its member states would assume the same obligation and would not interpose additional rules or requirements or otherwise impede its implementation.

Second, ratification by an intergovernmental organization must be effective to bind its member states or to bind specified member states. But this approach to ratification should be utilized only if it would not unduly delay the effectiveness of the Convention in the member states. That delay would undermine the purposes of the Convention and reduce its value.

Third, organizations that provide specialized services on behalf of, but which are not empowered to ratify a treaty for, their member states would require special scrutiny. Their rights derived from becoming a party to the Convention could be realized only to the extent that the organization would exercise those rights on behalf of a member state that also was a party to the Convention. Otherwise, rights would be conferred on states that were not otherwise bound to the Convention and which would not be obligated to recognize international interests and other rights arising out of the Convention. That would be an unacceptable result.

5. Designated Entry Points. We are very interested in issues that may arise in the implementation of the international registry concerning entry points in Contracting States designated under Protocol Article XVIII. This is especially so in the context of an entry point that also is a Contracting State's national aircraft registry. During the course of the diplomatic conference members of our delegation would benefit from meeting with members of other delegations to discuss these issues of implementation.

6. Post-Diplomatic Conference Matters. There are three important post-Diplomatic Conference matters that we believe the conference should address.

a. Official Commentary. We support a resolution or other action at the diplomatic conference to mandate the issuance of official comments to the text of the Convention and the Protocol. The commentary should be sponsored jointly by ICAO and UNIDROIT. In preparing the commentary, it is essential that the two secretariats enlist the assistance of legal and aviation industry experts. States and legal and industry experts also must have a reasonable period of time to provide input on the proposed commentary before it is finalized.

b. Review Board. We also support the creation of a Review Board pursuant to Article XXXII of the Protocol. However, we believe that a membership of five would be an inadequate number of members. We support establishment of the board soon after the diplomatic conference has completed its work. As with the commentary, it is essential that the review board work closely with legal and aviation industry experts. One matter that the board should consider is the feasibility of accommodating, in a future additional protocol or in appropriate revisions to the Protocol, certain types of smaller aircraft and certain state-owned aircraft.

c. International Registry. We believe it essential that the diplomatic conference establish a date certain for the creation and operation of the international registry. We also believe that in considering an appropriate initial Registrar, or an interim Registrar if necessary to avoid unnecessary delay, a wide scope of eligibility must be observed. Any entity demonstrating the required capabilities should be considered. In a hi-tech, electronic registry the discretion that the Registrar can exercise will be negligible. Consequently, conflicts of interest on the part of potential candidates for Registrar which are associated with the aviation industry do not present an issue of any practical importance.

7. Aviation Working Group ("AWG")/International Air Transport Association ("IATA") Comments. We have taken note of the joint comments dated 31 August 2001 submitted by the AWG and IATA ("Joint Comments"). In general, we support their major proposals, some of which relate to points we have mentioned above.

In particular, we support the proposal for a single "opt-in" Annex to permit a Contracting States to adopt only those "optional" provisions that it chooses by its affirmative act (Joint Comments, Appendix 1-A). This approach is essential to ensure maximum flexibility for Contracting States.

The additional debtor-protection provisions (Joint Comments, Appendix 1-B) are less central than the "opt-in" Annex approach. They may even address matters not covered by the Convention. However,

so long as the proposed language in Appendix 1-B is not modified in ways that would undermine the utility of the convention in promoting asset-based financing, we could support the proposal.

We also generally support the limited technical comments submitted by the AWG and IATA. Some of these are particularly important.

Article 17(5) (new): 5.- A Contracting State making a declaration permitted by the preceding paragraph and the Protocol may specify the requirements, if any, to be satisfied prior to transmission of such information through its designated entity.

Although the proposal would clarify what is implicit in the current text, we believe that this point is of sufficient importance to be made explicit in the text. A designated entity must be free to specify the means, manner, and conditions for its transmission of information in the registration process.

Article 27: “except for losses attributable to acts or circumstances arising prior to receipt of registration information at the International Registry.”

We support this proposal for very limited exceptions to the liability of the Registry. The proposal is consistent with existing technology. Limitations on liability should be confined to very narrow concepts of *force majeure* in order to retain the confidence of the aviation industry.

Article 39: “...which under that State's law would have priority without filing or other publication over an interest in an object equivalent...”

It has been the intention and understanding throughout the process of formulating the Convention that the superpriority afforded certain non-consensual interests would relate only to non-consensual interests that have priority under national laws in the absence of filing or other public notice.

Article 55: Transition. We also support the policy underlying Alternative A. It would not be feasible and would be enormously costly to apply the Convention to pre-existing transactions and interests. We question, however, whether the current text of Article 55 is adequate. The time the Convention enters into force (i.e., when it has been ratified by 3 or 5 states) cannot be the relevant time for determining whether an interest is pre-existing. For example, following entry into force of the Convention it nonetheless should not apply to transactions entered into by debtors situated in states that have not yet become Contracting States. For this purpose it may be necessary to specify a single state in which a debtor is situated; the approach taken in Article 4 may be too broad. We intend to formulate an alternative text during the course of the diplomatic conference.

Protocol Article XVIII(2)(a): “international interests or prospective international interests in, assignments of international interests or prospective assignments in, or sales or prospective sales of, helicopters....”

We support this expansion of the role of designated entry points in the international registry system. The current text would exclude many, if not most, transmissions of information for registration.

8. Continued Industry Participation. The purpose of the Convention and the Protocol is to promote private sector financing for the air transportation industry in all regions. The success of the Convention and the Protocol will depend on the continued cooperation and acceptance of the aviation industry. Consequently, we believe it important that aviation industry associations and representatives be consulted and involved not only at the diplomatic conference but in all stages of implementation of the Convention and the Protocol.

APPENDIX

**PROPOSAL FOR REVISED TEXT OF CHAPTER IX OF THE
DRAFT CONVENTION**

CHAPTER IX

**ASSIGNMENTS OF ASSOCIATED RIGHTS, INTERNATIONAL INTERESTS
AND RIGHTS OF SUBROGATION**

Article 30

Effects of assignment

1. – An assignment of associated rights or of the related international interest made in conformity with Article 31 also transfers to the assignee, to the extent agreed by the parties to the assignment:

- (a) in the case of an assignment of associated rights, the related international interest;
- (b) in the case of an assignment of an international interest, the associated rights; and
- (c) all the interests and priorities of the assignor under this Convention.

2. – Subject to paragraph 3, the applicable law shall determine the defences and rights of set-off available to the debtor against the assignee.

3. – The debtor may at any time by agreement in writing waive all or any of the defences and rights of set-off referred to in the preceding paragraph, but the debtor may not waive defences arising from fraudulent acts on the part of the assignee.

4. – In the case of an assignment by way of security, the assigned rights revert in the assignor, to the extent that they are still subsisting, when the obligations secured have been discharged.

Article 31

Formal requirements of assignment

1. – An assignment of an international interest or of associated rights is valid only if it:
- (a) is in writing;
 - (b) enables the associated rights, the related international interest and the object to which it relates to be identified; and,
 - (c) in the case of an assignment by way of security, enables the obligations secured by the assignment to be determined in accordance with the Protocol but without the need to state a sum or maximum sum secured.

Article 32

No. 28

Debtor's duty to assignee

1. – To the extent that associated rights and the related international interest have been transferred in accordance with Articles 30 and 31, the debtor in relation to those rights and that interest is bound by the assignment and has a duty to make payment or give other performance to the assignee, if but only if:

(a) the debtor has been given notice of the assignment in writing by or with the authority of the assignor;

(b) the notice identifies the associated rights and the international interest [; and

(c) the debtor [consents in writing to the assignment, whether or not the consent is given in advance of the assignment or identifies the assignee] [has not been given prior notice in writing of an assignment in favour of another person].

2. – Irrespective of any other ground on which payment or performance by the debtor discharges the latter from liability, payment or performance shall be effective for this purpose if made in accordance with the preceding paragraph.

3. – Nothing in the preceding paragraph shall affect the priority of competing assignments.

Article 33

Default remedies in respect of assignment by way of security

In the event of default by the assignor under the assignment of associated rights and the related international interest made by way of security, Articles 7, 8 and 10 to 13 apply in the relations between the assignor and the assignee (and, in relation to associated rights, apply in so far as those provisions are capable of application to intangible property) as if references:

(a) to the secured obligation and the security interest were references to the obligation secured by the assignment of the international interest and the security interest created by that assignment;

(b) to the chargee and chargor were references to the assignee and assignor;

(c) to the holder of the international interest were references to the holder of the assignment; and

(d) to the object were references to the assigned rights and the international interest related to the object.

Article 34

Priority of competing assignments

Where there are competing assignments of associated rights and related international interests and at least one of the assignments is registered, the provisions of Article 28 apply as if the references to an international interest were references to an assignment of the associated rights and the related international interest.

Article 35

No. 28

Assignee's priority with respect to associated rights

Where the assignment of an international interest has been registered, the assignee shall, in relation to the associated rights transferred in connection with the assignment, have priority under Article 28 only to the extent that the associated rights relate to:

- (a) a sum advanced and utilised for the purchase of the object;
- (b) the price payable for the object; or
- (c) the rentals payable in respect of the object,

and the reasonable costs referred to in Article 7(5).

Article 36

Effects of assignor's insolvency

The provisions of Article 29 apply to insolvency proceedings against the assignor as if references to the debtor were references to the assignor.

Article 37

Subrogation

1. – Subject to paragraph 2, nothing in this Convention affects the acquisition of associated rights and the related international interest by legal or contractual subrogation under the applicable law.

2. – The priority between any interest within the preceding paragraph and a competing interest may be varied by agreement in writing between the holders of the respective interests.

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