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INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW
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COMMITTEE OF GOVERNMENTAL EXPERTS FOR THE PREPARATION OF A DRAFT
CONVENTION ON INTERNATIONAL INTERESTS IN MOBILE EQUIPMENT AND
A DRAFT PROTOCOL ON MATTERS SPECIFIC TO AIRCRAFT EQUIPMENT

*PRELIMINARY DRAFT UNIDROIT CONVENTION
ON INTERNATIONAL INTERESTS IN MOBILE EQUIPMENT*

and

*PRELIMINARY DRAFT PROTOCOL TO THE PRELIMINARY DRAFT UNIDROIT
CONVENTION ON INTERNATIONAL INTERESTS IN MOBILE EQUIPMENT
ON MATTERS SPECIFIC TO AIRCRAFT EQUIPMENT:*

PRELIMINARY OBSERVATIONS

(submitted by the Government of the United States of America)

Rome, December 1998

INTRODUCTION
(by the Unidroit Secretariat)

On 10 August 1998 the Unidroit Secretariat communicated to Unidroit member Governments the texts of a preliminary draft Unidroit Convention on International Interests in Mobile Equipment, as established by an Unidroit Study Group and revised, in accordance with a decision taken by the Unidroit Governing Council at its 77th session, held in Rome from 16 to 20 February 1998, by a Steering and Revisions Committee, meeting in Rome from 27 to 29 June 1998, (Study LXXII – Doc. 42) and a preliminary draft Protocol thereto on Matters specific to Aircraft Equipment, as established by a special working group (the Aircraft Protocol Group), constituted under the authority of the President of Unidroit and the core members of which were the International Civil Aviation Organization (I.C.A.O.), the International Air Transport Association (I.A.T.A.) and an aviation working group (A.W.G.) organised jointly by Airbus Industrie and The Boeing Company, and subsequently revised pursuant to the aforementioned procedure decided upon by the Governing Council (Study LXXIID – Doc. 3). These texts were communicated to member Governments with a view to a first session of a committee of governmental experts for the preparation of a draft Convention on International Interests in Mobile Equipment and a draft Protocol on Matters specific to Aircraft Equipment, convened jointly by Unidroit and I.C.A.O., to take place in Rome from 1 to 12 February 1999. On that occasion the Unidroit Secretariat invited member Governments to formulate comments on the aforementioned texts with a view to the forthcoming session of governmental experts.

In December 1998 the Unidroit Secretariat received preliminary observations from the Government of the United States of America. These preliminary observations are set out hereunder.



**PRELIMINARY DRAFT UNIDROIT CONVENTION
ON INTERNATIONAL INTERESTS IN MOBILE EQUIPMENT**

and

**PRELIMINARY DRAFT PROTOCOL TO THE PRELIMINARY DRAFT
UNIDROIT CONVENTION ON INTERNATIONAL INTERESTS IN MOBILE
EQUIPMENT ON MATTERS SPECIFIC TO AIRCRAFT EQUIPMENT:**

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1. General Observations

Our review indicates that the preliminary draft Convention, together with the preliminary draft Protocol on Matters specific to Aircraft Equipment (hereinafter referred to as the preliminary draft Aircraft Protocol), and other future equipment protocols offer great potential for promoting international trade as well as transportation and other services. Access to high-value mobile equipment is one of the cornerstones of infrastructure development to-day. In the absence of modern commercial laws designed for asset-based finance, the availability of finance for such equipment is however often restricted in many markets and the credit costs significantly higher. These constitute economic burdens, limiting both infrastructure development and the ability of commercial entities within a country to develop, let alone compete in the international market place. This preliminary draft Convention in our view offers a modern alternative, and can have significant economic benefits. A shift to modern asset-based financing laws also permits a country markedly to reduce the level of sovereign guarantees or fixed property-based collateral, which are limited. In the longer term, the Convention can also encourage international harmonisation focussed on developments in transactional law.

As outlined below, we generally support the purposes and major policies of the preliminary draft Convention, and believe its proposed structure suitable to achieve those purposes.

2. Co-operation of international bodies

We welcome the co-operation of the international Organisations involved, each of which has important contributions to make. Unidroit has the necessary track-record on international commercial and finance law, and in particular on equipment finance, through prior Convention negotiations that have taken place under its auspices. I.C.A.O. has the important role of structuring international civil aviation and monitoring the effectiveness of existing treaty systems focussed on aviation infrastructure. I.A.T.A. represents airline and transportation users and their important role in almost all the participating States. The establishment of the Aviation Working Group and the Aircraft Protocol Group has ensured that industry and finance sector concerns are fully reflected, which in turn provides the assurance that the work undertaken at the intergovernmental stage can achieve practical results.

It is of course of great importance to have the participation of each group. It is also hoped that each recognise the need to adjust their efforts so as to accommodate the needs of the States involved to achieve a practical treaty regimen in the shortest feasible time. Such a result will permit the considerable benefits of this proposed treaty system to become an actuality, at a time when changes in world economic patterns may most require it.

3. Review of the preliminary draft Convention's basic purposes

It would be appropriate to review the preliminary draft Convention's basic assumptions and purposes at the outset of the intergovernmental meeting. In order to facilitate that discussion, a review first of current developments in commercial finance practices and laws and their relation to equipment transactions would be of benefit. That review could include a survey of the economic effects of the preliminary draft Convention as well as the preliminary draft Aircraft Protocol, which we believe should be the first of several Protocols to be negotiated. An explanation of the preliminary draft Convention by the Study Group could serve to relate the provisions it has recommended to the purposes sought to be achieved.

4. Major policies and provisions

Following is a summary of our view of the major policies and their related provisions we believe reflected by the preliminary draft Convention. For convenience, our references to the preliminary draft Convention also embrace the Protocols. We have used terms here generally as defined in the preliminary drafts.

(a) Foundational economic principles

We believe the preliminary draft Convention's principal purpose is the facilitation of asset-based financing at the international level, which can provide economic benefits to all regions and Governments, as well as users and distributors of equipment, infrastructure development, consumers and others. The preamble to the preliminary draft Aircraft Protocol outlines principles on which the preliminary draft Convention is based, and it is contemplated that a similar preamble should be added to the basic Convention. The potential economic benefits are further identified in the *Economic Impact Assessment* study (September 1998), prepared under the auspices of INSEAD and the New York University Salomon Center. To accomplish these ends, through existing and new sources of international credit, the preliminary draft Convention's provisions must be sufficiently specific as well as consonant with modern commercial finance.

(b) Structure of preliminary draft Convention

The preliminary draft Convention features a basic Convention containing a comprehensive regimen for the secured financing of equipment as well as provisions covering financings structured as leasing agreements and title reservation agreements. Protocols for each specific type of equipment would be needed to provide the necessary certainty as to scope of coverage, and to ensure that practices particular to each type of equipment are recognised. A Protocol may vary the terms of the basic Convention, thus providing through this structure the flexibility necessary to accommodate the variety of objects and specific practices that may become subject to the Convention.

(c) Scope

The preliminary draft Convention has a broad scope. Any type of equipment may be covered, so long as a Protocol is in force with respect to that type. The preliminary draft Convention would apply if the obligor is located (e.g., incorporated) in a Contracting State, if the object is registered in a nationality register in a Contracting State or if it is closely connected to a Contracting State as specified in a Protocol. The sphere of application does not contain a separate test of «internationality.» Since mobile equipment by its nature can at any time move across borders, but financing commitments need to be made with certainty, the preliminary draft Convention would fail to provide the necessary predictability of which transactions were covered if that could occur because of contingencies, such as later moves across borders.

In addition, the preliminary draft Convention is designed to apply to an international interest that secures an obligation, created by a chargor in favour of a chargee under a security agreement, as well as to an international interest held by a lessor under a leasing agreement or by a conditional seller under a title reservation agreement. Moreover, if provided in a Protocol, the preliminary draft Convention may apply to ownership interests acquired in sales of objects (the preliminary draft Aircraft Protocol takes this approach).

(d) Party autonomy

The preliminary draft Convention recognises the importance of party autonomy in business financing arrangements. It permits the parties, *inter se*, to derogate from, or vary the provisions of the Convention, with the exception of a handful of mandatory provisions concerning default remedies.

(e) Commentaries

The preliminary draft Convention contains a provision instructing that, in its interpretation, regard should be had to the commentary. Although this provision appears in square brackets, we support its inclusion. Explanatory commentaries are an important source of guidance to legislators as well as a means of promoting harmonisation in the implementation of the preliminary draft Convention.

(f) Default remedies

The preliminary draft Convention recognises that the essence of modern asset-based financing is the existence of certain effective remedies on default. It provides default remedies for chargees that hold international interests created under security agreements (i.e., interests that secure an obligation). It accommodates differences in national regimes by providing a more limited set of remedies for international interests created under leasing agreements and title reservation agreements. However, it provides the crucial remedy of taking possession and control of an object subject to any international interest. It also requires Contracting States to provide speedy judicial relief (although a Contracting State may take reservations for those requirements). Allowing reservations will permit States to measure the economic effects of such changes in their laws, limited to specific types of transaction.

(g) Registration of international interests

The preliminary draft Convention contemplates a system of registration of international financing interests that would provide accessible public notice, a key factor in attracting finance capital and in reducing its costs, especially in lesser-served markets. Absence of this type of system would significantly increase the costs of credit, and in many cases fail to create the new sources of credit that the preliminary draft Convention could otherwise attract. The Protocol approach permits, but does not require separate registries for different types of object.

While much technical work remains, the principle of registration of international financing interests is compatible with the fundamental principle of the preliminary draft Convention's priority rules, discussed below. The preliminary draft Convention contemplates the possibility of co-ordinating an international registry with national or private sector registries operated under the national laws of Contracting States. The preliminary draft Convention also provides, or would authorise issuance of standards for, requests to the International Registry to conduct a search and provide a report on its records concerning a particular object to be financed.

(h) Priority rules

The preliminary draft Convention provides a first-in-time priority rule based on the time that an international interest or prospective international interest is registered. A registered international interest in an object has priority over a later-registered or an unregistered interest and over a subsequent buyer of the object, with exceptions such as the right of participating States to except certain types of statutory lien.

(i) Optional protocol reservations

The Protocol approach provides great flexibility. For example, the preliminary draft Aircraft Protocol permits a Contracting State to take a reservation with respect to several of its provisions. This approach accommodates differing national laws and views. It allows a Contracting State to give more or less weight to economic considerations, such as decreasing financing costs and other non-economic considerations.

(j) Future review and modification

The preliminary draft Aircraft Protocol contains a useful provision for the creation of a Review Board. The Board would monitor the operation and administration of the preliminary draft Aircraft Protocol and make reports. The preliminary draft Aircraft Protocol also contains provisions for Contracting States to call for a conference to consider whether changes in the preliminary draft Aircraft Protocol are needed.

5. Matters needing further consideration

Some aspects of the preliminary draft Convention were subject to full discussion by the Study Group, including industry sectors, and are sufficiently set out in the preliminary draft

Convention so as to be ready for discussion at the February meeting. Others, including those referred to below, require considerable additional attention.

(a) Jurisdiction

The preliminary draft Convention addresses the jurisdiction of courts of a Contracting State with respect to remedies on default and other matters. While this approach has promise, in principle, additional refinements are needed.

(b) «Purely domestic» transactions

A provision, still in brackets, of the preliminary draft Convention permits a Contracting State to take a reservation that would make the preliminary draft Convention inapplicable to «[a purely domestic transaction].» (The preliminary draft Aircraft Protocol rejects this approach.) For the same reasons that the Study Group was unable to devise a test of internationality for the scope of the preliminary draft Convention, we doubt that a sufficiently certain and practical definition of «purely domestic transaction» is possible. We encourage those who believe that this basis for a reservation should be retained to propose a definition for the term, covering equipment that is inherently mobile, that at the same time permits financing transactions to proceed.

(c) International Registry

The provisions in the preliminary draft Convention and the preliminary draft Aircraft Protocol dealing with the International Registry are preliminary and warrant further technical discussion. We encourage communication concerning the International Registry among representatives of invited States and others both before and during the upcoming meeting in Rome.

(d) Other issues

Along with other States, observers and industry representatives, we expect to raise additional technical and drafting points during the upcoming meeting.

6. The path forward

An accelerated time schedule for completion would be important to achieve. This results from the rapidly growing importance of the market for mobile equipment for infrastructure development as well as the ability of many commercial sectors to expand, and the increasing shift amongst international lending agencies and others away from sovereign-backed guarantees and away from public-funded development programmes.

We believe this can be done by completing this work in several phases. The first phase should be completion of the basic Convention, together with the proposed Aircraft Protocol, which is the only category of equipment on which sufficient progress has been made to make negotiations possible at this time. This objective can be accomplished on a fast-track basis. We

recommend that a second intergovernmental meeting take place in the shortest possible period, so as to complete a full review of the preliminary draft provisions, and if feasible at that time a diplomatic Conference can be agreed to at which final provisions could be adopted.

At the same time, a schedule for follow-on intergovernmental meetings should be planned, which would follow the completion of the first phase, and which would then take up additional preliminary draft Protocols for other types of equipment. It is expected that work on several other categories of equipment will be initiated while meetings on the preliminary draft Convention and the preliminary draft Aircraft Protocol are in process, thus expanding the economic benefits of this Convention system for many States and regions.



We look forward to comments and recommendations by other participating States and Organisations, and would welcome the opportunity to exchange views prior to the scheduled February meeting.