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DIPLOMATIC CONFERENCE TO ADOPT A MOBILE EQUIPMENT CONVENTION AND AN AIRCRAFT PROTOCOL

(Cape Town, 29 October to 16 November 2001)

COMMENTS ON DRAFT CONVENTION AND DRAFT PROTOCOL

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

The International Air Transport Association (“**IATA**”) and the Aviation Working Group (“**AWG**”) respectfully submit these joint comments to the above-identified Conference.

The AWG will also be representing the International Coordinating Committee of Aerospace Industries Associations (“**ICCAIA**”) at the Conference.

IATA, AWG and ICCAIA members consist of users, buyers, sellers, manufacturers, lessors, lessees and financiers of commercial aircraft equipment. One or more members of IATA, AWG and/or ICCAIA are involved in **over 90% of the commercial aircraft equipment transactions** falling within the scope of the Convention/Protocol.

Accordingly, the comments made in this letter derive from the collective experience and the **coordinated perspective of the principal participants in the commercial aircraft sector, including debtors and creditors.**

Based on our–

- (a) active participation in the development of the draft texts,
- (b) study of their potential economic benefits,
- (c) analysis of the relevant legal issues, and
- (d) assessment of the ability of the Convention and Protocol to attract ratifications and otherwise achieve political and industry acceptance –

we comment as follows:

1 Criteria for Support of the Final Texts: Substance and Entry Into Force

1.1 Substantive Criteria. The current draft texts, embodying, as they do, the fundamental principles underlying asset-based financing and leasing of aircraft equipment, will increase the availability and reduce the cost of aviation credit.

The positive effect of the texts on the financing of aviation transactions has always been, and remains, the basic substantive criterion for our support of the Convention/Protocol.

We will support the final texts if, and only if, they are not amended in a manner adverse to the substantive criterion.

1.2 Entry Into Force Criteria. Many treaties, including select air law treaties, duly adopted at diplomatic conferences, have either not come into force (e.g., *Guatemala City Protocol to Warsaw System*) or have come into force after an excessive time period (e.g., *Protocol to Convention of International Civil Aviation Article 83 bis*). This was due, to a large extent, to the “entry into force” standard agreed to at their diplomatic conferences.

We strongly support the current draft text, which requires three to five ratifications for entry into force, for the following reasons:

- (i) The Convention/Protocol are of significant economic value, but that value only accrues when and where they are in force.
- (ii) Significantly, the realisation of this economic value does not require a large number of ratifications.
- (iii) The Convention/Protocol will provide maximum benefits to States and airlines taking deliveries of aircraft equipment in the near term *only if* the Convention/Protocol are in effect in those States at the time of such deliveries. Accordingly, a protracted entry into force period is prejudicial to governments and those airlines with current aircraft acquisition requirements, and, thus, is inequitable.

For these reasons, as well as the others discussed in a recently published law review article (*see* Vol. 66, No. 4 *Journal of Air Law & Commerce* (Fall, 2001)), the basic procedural criterion against which the final work of the Conference will be assessed by the aircraft industry relates to prompt entry into force.

The entry into force standard reflected in the draft text is in line with the approach taken in the Geneva Convention of 1948, the air law instrument most relevant to the Convention/Protocol. Geneva required a small number of ratifications (two) for a “transactional air law” instrument (in contrast with “public international law” or “non-transactional air law instruments”). This entry into force standard, despite the passage of time since adoption of the Geneva instrument, is also consistent with the current private international law treaty practice, as advanced by its leading sponsors, UNIDROIT, UNCITRAL, and the Hague Conference on Private International Law.

Some have questioned whether the creation of the International Registry contemplated by the Convention/Protocol might warrant a larger number of ratifications, so that a larger pool of user fees is available to cover its operational costs. ***We believe that the question is inapposite and should not affect the appropriate number of minimum ratifications for the following reasons:*** First, three States comprise in excess of 60% of transaction volume, whereas some 120 States comprise less than 10% of such volume. Consequently, there is no necessary connection between the *number* of ratifying States and actual *transaction volume*. Secondly, regardless of the transactional volume, there will be an initial funding gap

since the International Registry must be financed prior to the first transaction. The appropriate way to address the funding gap, therefore, is with an appropriate funding mechanism, not with a higher number of required ratifications. As the anticipated costs of Registry-creation are relatively modest, this mechanism should not be problematic. Thirdly, the creation of the International Registry, while an important element of the new regime, should not be permitted to delay the economic benefits that flow from other aspects of the Convention/Protocol.

2 Economic Benefits Plus Other Policies: Opt-in Annex Plus Debtor Provision

The texts attempt to balance the dual objectives of producing economic benefits while respecting (i.e., not pre-empting) other policies, where applicable. As study has shown, special care is required in this regard since general or “soft” provisions (i.e., vague standards rather than predictable rules) are inconsistent with the requirements of advanced asset-based financing and leasing and will not lead to economic benefit.

After wide-ranging consultations, we believe that the balancing of those dual objectives would be furthered pursuant to two changes to the texts.

2.1 Opt-in Annex. A number of delicate, and highly negotiated, provisions are presented as “options,” in the sense that a State **(i)** may opt out of a provision (which would be applicable *unless* the State declares otherwise) or **(ii)** must opt into a provision (which would be applicable *only if* the State affirmatively so declares). (In Vienna Treaty terms, either approach amounts to a permitted “reservation.”)

However, these provisions, as well as the elective mechanisms, are at times difficult to locate in the texts and therefore, to fully comprehend.

In order to *clarify these options*, and, moreover, to ensure that they *only apply by affirmative declaration*, we strongly recommend (as we did, with considerable support, at the 31st Session of the ICAO Legal Committee) that a simple “opt-in annex” be annexed to the Protocol (and proposed nonlegally binding Consolidated text).

Pursuant to a final clause in the Protocol, this annex would apply, wholly or in part, only by affirmative declaration of a Government.

Annexed as **Appendix 1-A** to this comment letter is a draft of that final clause in the Protocol and an opt-in annex (**Annex I - Supplemental asset-based financing and leasing provisions**). (We are also sending an electronic version of these drafts, which are technical but do not have changes in substance, to the two Secretariats.)

Please note that this suggested approach leaves unaffected the more technical, permitted declarations for **(i)** non-consensual rights and interests (Convention Articles 38 and 39), **(ii)** use of entry points to the International Registry (Protocol Article XVIII) and **(iii)** internal transactions (Convention Article 48).

2.2 Debtor Provision. In the course of our consultations, it has become evident that an additional provision, which carefully addresses two debtor items, is desirable. This provision would –

- (i) ensure that a debtor is entitled, under the Convention/Protocol, to *quiet possession* of aircraft equipment *absent* (a) a default, or (b) a contrary agreement between the transaction parties (which may form a key element of the relevant contract); and
- (ii) expressly retain a creditor's liability for breach of its contract, as determined and quantified under applicable law.

Annexed as **Appendix 1-B** is a draft of that debtor provision.

3 Creation of the International Registry and Maximum User Fees

In furtherance of the above comments in support of a prompt entry into force, it is imperative that the Diplomatic Conference agree on *specific procedures* and a *date certain* for the *creation* of the International Registry. In this regard, consideration should be given to use of an interim registry.

As a matter of policy, and with a view toward avoiding potential ratification delays, it is important that an acceptable *maximum fee schedule* for use of the International Registry be agreed to at the Diplomatic Conference.

It is unreasonable to ask industry to agree to pay unspecified user fees. Any procedure that, in effect, does so will raise concerns and dampen enthusiasm for the Convention and Protocol.

As the International Registry is wholly electronic in nature, we believe it should be possible for scheduled fees to be modest.

4 Status of Consolidation

Without altering the basic legal structure of the texts, the multi-equipment approach generally, or the ratifiability of the Convention and Protocol as such, there is a need for an *official or sanctioned working purpose Consolidated text of the Convention and Protocol*.

That non legally-binding Consolidation ideally would be agreed to at the Conference and should be attached to the Aircraft Protocol.

If that is not practical, an acceptable process must be agreed to. The most appropriate candidate, in our view, would be joint post-Conference finalisation by UNIDROIT and ICAO, with assistance from interested governments and industry.

5 Limited Technical Comments

We have limited technical comments on the texts. They are set out – in the form of precise drafting suggestions coupled with their rationale in **Appendix 2**. We will be prepared to further elaborate on these technical comments at the Conference.

6 Post-Conference Matters: Commentary and Review

The Conference should reach specific agreement on two post-Conference items that are material to transaction parties. The first is the preparation of an official *Commentary* on the texts. The materials prepared by the Rapporteur to Joint Sessions, submitted by the Secretariats as DCME-IP/2, are excellent

starting points. Second, the *Review Board* is an important feature of the Convention/Protocol, and one that will assist in keeping the system responsive to the evolving needs of the air transport sector. Industry representatives should be involved in both of these user-driven features.

Appendix 1-A: (Opt-in) Annex I Supplemental asset-based financing and leasing provisions

Appendix 1-B: Debtor Provision

Appendix 2: Limited Technical Comments

**FORM OF IRREVOCABLE DE-REGISTRATION
AND EXPORT REQUEST AUTHORISATION**

Annex Referred to in Article 24(1)

[Insert Date]

To: [Insert Name of Registry Authority]

Re: Irrevocable De-Registration and Export Request Authorisation

The undersigned is the registered [operator] [owner]* of the [insert the airframe/helicopter manufacturer name and model number] bearing manufacturer's serial number [insert manufacturer's serial number] and registration [number] [mark] [insert registration number/mark] (together with all installed, incorporated or attached accessories, parts and equipment, the aircraft).

This instrument is an irrevocable de-registration and export request authorisation issued by the undersigned in favour of [insert name of creditor] (as the authorised party) under the authority of Article 24 of the Convention on International Interests in Aircraft Equipment. In accordance with that Article, the undersigned hereby requests:

(i) recognition that the authorised party or the person it certifies as its designee is the sole person entitled to:

(a) procure the de-registration of the aircraft from the [insert name of aircraft register] maintained by the [insert name of registry authority] for the purposes of Chapter III of the *Convention on International Civil Aviation*, signed at Chicago, on 7 December 1944; and

(b) procure the export and physical transfer of the aircraft from [insert name of country]; and

(ii) confirmation that the authorised party or the person it certifies as its designee may take the action specified in clause (i) above on written demand without the consent of the undersigned and that, upon such demand, the authorities in [insert name of country] shall co-operate with the authorised party with a view to the speedy completion of such action.

The rights in favour of the authorised party established by this instrument may not be revoked by the undersigned without the written consent of the authorised party.

Please acknowledge your agreement to this request and its terms by appropriate notation in the space provided below and lodging this instrument in [insert name of registry authority].

[insert name of operator/owner]

Agreed to and lodged this

By: [insert name of signatory]

[insert date]

Its: [insert title of signatory]

_____ [insert relevant notational details]

* Select the term that reflects the relevant nationality registration criterion.

Appendix 1-B

Debtor Provision

Article 14 bis
Debtor Provision

1. - Unless otherwise agreed to by the debtor, absent a default as specified in Article 10, a debtor shall be entitled to the quiet possession and use of an aircraft object subject to, and in accordance with, the terms of the agreement.

2. - Nothing in the Convention shall affect any liability of a creditor under applicable law for damages caused by its breach of an agreement, as determined under applicable law. References in the preceding sentence to law are to that specified in Article VIII of this Protocol, if applicable, or, if not, in Article 5(3) of the Convention.

Appendix 2

Limited Technical Comments

Convention

Table of Contents is needed to assist readers.

Third Recital – desiring to provide “broad and mutual economic and other benefits ...”

rationale: The economic impact assessment has established the mutuality of economic benefits associated with the Convention/Protocol. Others have identified several non-economic benefits (e.g., acquisition of modern, safe aircraft equipment) connected with Convention/Protocol.

Article 1(l) (definition of insolvency proceeding) – means “collective judicial, administrative or other procedures, including interim and non-judicial proceedings, in which the assets and affairs of the debtor are subject to control or supervision by a court or are otherwise statutorily regulated for the purpose of reorganisation or liquidation”.

rationale: Several legal systems have insolvency-type arrangements that may not be covered by the current wording in this clause.

Article 12(d) – “lease or management (other than as contemplated by (a) –(c))...”

rationale: Some observers have expressed concern that the term “management”, without qualification, could be read to overlap with the other remedies of preservation, possession and immobilisation. As the jurisdictional rules are different, *see* Convention Article 42, clarification is desirable.

Article 15(d) – “subordination of interests referred to in sub-paragraphs (a) and (e)...”

rationale: National interests could be the subject of subordinations.

Article 17(2) – this provision should be modified if reported developmental work of the International Registry Task Force confirms our view that *requiring two electronic consents* to registration is feasible.

rationale: The purpose of the current clause is to ensure an efficient notice-based electronic registry system, which, in particular, does not contemplate manual review of consents to registration. That objective is not compromised by requiring *electronic consents*, which, if feasible, would (i) enhance the accuracy of the data on the registry and (ii) guarantee debtor involvement in what is entered into the system.

Article 17(5) (NEW TEXT) – “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.”

rationale: See similar recommendation contained in Second Report of the International Registry Task Force, Attachment 1 at footnote 8 – noting the importance of setting this matter out expressly, rather than relying on inference. As this point is intended, and such was confirmed at the ICAO Legal Committee meeting, we believe that the proposed clause is clarifying in nature.

Article 19 – as noted in connection with Article 17(2), if two-party electronic consents are feasible, then, with two exceptions, all registrations may be made by one party with the consent of the other. Amendments are needed to Articles 19(2), (4) (as regarding contractual subrogation), and (6). The two exceptions are those specified in Article 19(3) (discharges - made by the holder of the interest) and Article 19(5) (registrable non-consensual interests - registered by the holder thereof).

rationale: As noted above, if the two-party electronic consent approach is feasible, the policies underlying its use apply equally to subordinations, contractual subrogation and national interests.

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

rationale: After appropriate risk-minimising techniques are employed (*e.g.*, back-up servers to manage “acts of god” risk), and placing aside problems associated with acts or omissions by “unauthorised users” (which are not “errors or omissions” of the Registrar or system malfunction), the sole legitimate exclusion from the Registrar’s liability, in our view, relates to acts or circumstances *prior to receipt of information at the International Registry*. In other words, the Registrar does not take “telecommunications risk”. This exception is not troubling to users since they can self-protect, in particular by searching for their own registrations (which may well be “prospective registrations”) prior to transferring money and/or other property.

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

rationale: We believe that the policy underlying this provision – superpriority (priority of unfiled subsequent interests) of declared nonconsensual interests – is predicated on that interest having priority over a consensual interest under national law *without filing or registration*. Otherwise, a State could expand, rather than retain, this special priority. The former was never intended.

Article 46 – given the refusal of the UNCITRAL working group to exclude receivables associated with mobile equipment covered by the Convention/Protocol, an approach we find regrettable, this Article must be retained.

rationale: We fully concur with the generally accepted view that, absent an exclusion from the UNCITRAL Convention for receivables linked to mobile equipment, this treaty-override provision is essential, and will avoid (i) duplicative legal requirements, (ii) added transaction costs, and (iii) application of inappropriate “receivables-financing” rules in the “equipment-financing” context. Moreover, the UNCITRAL working group refused UNIDROIT/ICAO request for that exclusion, in part, relying on the subject clause.

Article 52(1) – while we continue to question the appropriateness of this clause in the aviation-finance context, believing it is at odds with both debtor and creditor interests, we appreciate its correspondence to certain legal systems and note its optional character.

Article 55 – we support Alternative A on grounds of fairness (no in effect retroactivity) and cost avoidance (no need to review prior transactions and incurring refiling and associated legal costs).

Protocol

Table of Contents is needed to assist readers.

Article I(p) (definition of State of Registry) – “...the State on the national register of which the aircraft is entered or to be entered or the State of the common mark registering authority maintaining or to maintain the aircraft register.”

rationale: Absent this technical change, Article IV(1)(b) (sphere of application), and its connection with Article XX (jurisdiction), lacks appropriate force. The change is also required to permit use of a designated entry point (at the Contracting State's option) for prospective interests. *See* Article XVIII.

Article II(3)(NEW TEXT) – “3. – An authentic version of a working purpose, non-legally binding 'Consolidation of the "Convention on International Interests in Mobile Equipment as applied to aircraft objects' -

alternative A [is attached as Annex X hereto].

alternative B [shall be finalised jointly by the Secretary Generals of UNIDROIT and the ICAO, with assistance from interested States and industry, no later than ninety days from the adoption of the Convention and Protocol].”

rationale: *See* point 4 of the main comment letter.

Article IV(3) – “...derogate from or vary the effect of any of the provisions of Chapter II except Articles IX(2)-(4) and XII-XV.”

rationale: The scope for derogation is too wide, since the Protocol, other than Chapter II, deals with public law or third party matters. Limiting the power of derogation to Chapter II, and further excluding the mandatory provisions of Articles IX(2)-(4) and XII-XV, is appropriate.

Article XV(2) – we support removal of the brackets, and retention of the text.

rationale: The retention of the texts would provide for a simple and comprehensive priority rule in respect of assigned associated rights, that is, contractual rights under agreements covered by the Convention/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....”

rationale: The basic logic of, and policies underlying, the current wording in the clause applies equally to (i) assignments and (ii) prospective interests (of international interests, sales and assignments).

Article XVIII(2)(d) (NEW) – “(d) international interests or prospective international interests in, assignments of international interests or prospective assignments in, or sales or prospective sales of, engines, that they may be so transmitted.”

rationale: While no particular state can be the *exclusive* point of entry for interests in engines, as engines have no inherent nationality under the Chicago Convention (and thus do not fall within the State of Registry concept), nothing should prohibit a State from *permitting* use of its designated entry point of

input for such interests. Doing so may, depending on facts and circumstances, provide transactional efficiencies.

Article XIX(1) – “...the search criterion for the aircraft object shall be its manufacturer's serial number, the name of the manufacturer and its model designation.”

rationale: The current text, which looks to the regulations to supplement the manufacturer's serial number (MSN) to “ensure uniqueness,” is unnecessary *if* the legal search criteria (which, in turn, ties into Convention Article 18 in respect of the criteria for a valid registration) adds (to the MSN) the name of the manufacturer and the model designation. This change, therefore, would simplify use of the International Registry.

Article XXII – while the current negotiated wording (agreed to by a special working party) is acceptable, the final sentence underscores the need for sanctioned or official *commentary*, for example, to note the intended wide reach of the words “covered or affected”. There should be no scope for arguing, for example, that Article IX of the Geneva Convention is retained in light of Article IX(2) (and, if applicable, Article XIII) of the Protocol.

Article XXXII(1) – “a Review Board shall be promptly appointedThe Review Board shall be jointly administered by UNIDROIT and ICAO. All Contracting States may designate a representative to serve on the Review Board, which shall also include representatives of industry.”

rationale: The Review Board is an important aspect of the new system, providing it with an internal capacity to address legal and practical developments. To be effective, appropriate representation is required.

– END –