



Sub-Committee of the ICAO Legal
Committee on the study of
international interests in mobile
equipment (aircraft equipment)

UNIDROIT Committee of governmental
experts for the preparation of a draft
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in Mobile Equipment and a draft
Protocol thereto on Matters specific
to Aircraft Equipment

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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:

MEMORANDUM ON THE IMPORTANCE FOR AIRCRAFT EQUIPMENT OF THE INCLUSION OF ASSOCIATED RIGHTS WITHIN THE SPHERE OF APPLICATION OF THE PROPOSED INSTRUMENTS (*)

(prepared by Mr J. Wool, co-ordinator of the Aviation Working Group)

The aviation sector has assumed that associated rights, that is, contract rights under an agreement secured by or associated with aircraft objects, would be included in the legal regime contemplated by the preliminary draft UNIDROIT Convention on International Interests in Mobile Equipment and the preliminary draft Aircraft Equipment Protocol thereto (**Convention/Aircraft Protocol**). Beyond correspondence to the current draft texts, this assumption has been made given the *inextricable link* in aircraft financing structures between the aircraft object and associated rights.

In simplest terms, associated rights constitute an integral part of the overall security granted in aircraft financings. Prompt access to their value, together with the anticipated future value of the connected aircraft object, are what limit risk to a financier or lessor, and thus justify cost reductions to the world's airlines.

(*) This memorandum has been written by Mr Wool's personal capacity, and, accordingly, should not be read as a statement of the position of any entity or group, including the Aviation Working Group.

Importantly, it can be empirically established that, in the context of aircraft financing, associated rights are *not separated from* the aircraft object and further assigned and/or pooled as stand-alone payment streams. Two examples may suffice: standard secured bank financing and secured capital market debt financing.

In bank financing transactions, the typical security package prominently includes a mortgage over the aircraft *and* a security-type assignment of the payment obligations of the airline under an agreement. Any credit decision would consist of a detailed assessment of the value of such payment obligations. The role of associated rights is, if anything, even more important in capital market transactions - where third-party credit assessors (*i.e.*, credit rating agencies) must quantify and categorise the level of risk present. This assessment is done with reference, *inter alia*, to the anticipated value of payment rights and the aircraft object.

While the definition of associated rights in the Convention/Aircraft Protocol will be narrow, covering direct payment obligations, it will also include *performance obligations* of an airline under the relevant agreement. These obligations, most notably insurance and maintenance undertakings, are also directly linked to the aircraft object and are specifically designed to maximise its value. It is difficult, even as a conceptual matter, to imagine “de-linking” such associated rights from the aircraft object itself.

Moving from financing structures to matters of law, it is desirable to subject these two elements of an integrated financing - aircraft objects and associated rights - to a common legal regime. Anything else would inevitably lead to highly complex conflict of laws issues and increased transaction costs.

Finally, the particulars of the legal rules relating to associated rights are of concern to the aviation sector. The proposed rules under the Convention/Aircraft Protocol, having been developed with aviation sector input, are satisfactory in this context. Essential matters addressed in the Convention/Aircraft Protocol include (i) the creation of an *asset-specific international registry* in which priority-establishing registration covering security-type rights may be made, (ii) the requirement that airline “consents” be obtained, (iii) the establishment of rules relating to the treatment of associated rights in the context of insolvency, and (iv) the coverage of governmentally guaranteed associated rights. These rules may be viewed as wholly or partially inappropriate in the context of a treaty or other law covering pure receivables financing.