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

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

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COMMENTS

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

GENERAL OBSERVATIONS AND APPROVAL OF THE PURPOSES OF THE CONVENTION

1. The path forward

Many States, including the U.S., believe that sufficient progress should be made at the Third Joint Session so that the basic Convention text and the first equipment Protocol (aircraft) can be submitted to the participating international bodies for authorisation to proceed to a diplomatic Conference for final negotiation and approval. It is important that this should be accomplished without delay, bearing in mind the significant economic benefits that can be achieved, especially for developing States and countries which have growing requirements for upgrading their transportation systems and services in the next decades.

2. Continued importance of a multi-equipment Convention

We believe it is very important for States to continue our collective focus on a new Convention system that can open doors to increased credit from capital markets for a number of important types of equipment, integral to developing the infrastructure of many countries. This should be a forefront position in support of developing States and States in transition, who benefit both from increased infrastructure funding, and from moving that funding away from sovereign debt, utilising private capital markets under the Convention instead. Given the progress already made, this can be accomplished without any delay in completing the Aircraft Protocol and Convention.

Work on a Protocol for railroad equipment, for example, has advanced substantially. Comparable issues are also under review with respect to space equipment, where availability of commercial finance under the Convention can affect the acquisition of satellite services in all

States. Initial consideration of special protocol issues for other types of equipment are also expected in the near future. Completion of the basic Convention system still leaves fully optional for each State whether to adopt any or all Protocols, and thus control of the extent to which the Convention applies to transactions in that State.

The United States is prepared to support the completion of this Convention and the Protocol system available for a range of equipment requirements, and to continue to support the role of international bodies, which are expected to change for each separate Protocol, that undertake that same commitment.

3. Fundamental provisions for modern commercial finance

The preliminary draft Convention and the preliminary draft Aircraft Protocol texts have been premised on the requirements of modern commercial and equipment finance, and support of these basic provisions is key to achieving financial benefits through the Convention. Core articles, such as Articles 27 and 28, are based on modern asset-based financing, in which laws provide for the creation and recognition of secured financing rights in mobile property. Consensus should be made clear at this third meeting on these fundamental points which underlie the entire project.

4. Special optional financing provisions

Optional provisions available by way of declarations under the Convention and Aircraft Protocol were designed to facilitate credit for developing States. These are in each case standard factors taken into account by capital markets in international transactions, including adjustment of insolvency provisions, rights of repossession, assurances of speedy resolution of matters requiring judicial or administrative intervention, etc. These provisions have substantial effect on credit availability, especially in under served markets, but by remaining fully optional, they allow all States to make appropriate economic decisions.

The actual effect of such provisions however should be understood in the context of existing capital market arrangements. Credit availability on high value but mobile secured equipment depends upon an *ex ante* assessment, that is, prior to the extension of credits, of how risks are managed in particular countries. Rights of repossession, for example, while very important signals for credit ratings, are only infrequently employed with regard to such equipment in actual cases.

The assurance for the capital markets provided by selecting these options, i.e. that refinancing negotiations are likely to take place immediately rather than at the end of substantial delays due to judicial or other administrative processes, in turn has a very significant effect on the availability and the cost of equipment credit. Changes in the draft provisions now also make it clear that special remedies involve consent, so that an overall balance of rights, including balanced debtor protection, is achieved consistent with the standards that need to be met in order to draw from capital markets.

5. International registry and priority rights

Enhanced asset-based equipment financing also requires a publicly accessible notice filing registry system, in which prior interests arising from equipment finance are known to other parties, and the terms of on-going finance arrangements are adjusted on that basis. This is particularly

important for expanding markets in developing States, where a common registry system will allow capital financing from a variety of sources with assurances that Convention rights have an international basis for recognition.

COMMENTS ON SELECT PROVISIONS: BASIC CONVENTION

Re Article 1 (gg)

Insert "or as otherwise provided for" after the terms "Supervisory Authority". The manner of issuance of regulations for the operation of each registry will likely be determined by each Protocol, although as a default standard, the Authority would be authorised under this provision to perform that function.

Article 6 (3)

The treaty language or commentary should clarify the import of the term "domestic" law, i.e. that the reference is to substantive law of the jurisdiction, and that reference is first made to that law determined applicable by the Convention's rules, and then as necessary to the law determined applicable by conflicts rules.

Article 12

We support the compromise reached on the basis of deliberations at the Second Joint Session, by removing the presumptions in favour of these remedies, making them subject to the law of the place where the remedy is to be exercised, and further subject to the right of any State to require such remedies to be exercised by leave of a court. At the same time, this approach retains the key optional provisions, whereby States may make appropriate economic decisions on remedies and the extent that they wish to provide assurances to credit extenders.

Article 14

We support the approach now taken in Article 14(1)and corresponding provisions of the Aircraft Protocol (Article X(1)), which require agreement by the debtor to certain remedies, which can be given at any stage for the exercise of certain interim relief measures. We believe that the approach taken by these provisions balances protections for debtor interests, but in a manner so as to facilitate the extension of credit.

Convention Article 14(2) and the corresponding Protocol Article X(2), together with Article 14(3) have however become unnecessarily complex and will raise difficult issues of interpretation. Article 14(2) instead might be restated to ensure that nothing in Article 14(1) prejudices any of the debtor's rights against the creditor, which is the purpose of that provision.

Re Chapter IV

In order for the Convention's benefits to be fully realised, the registry system for aircraft interests must be a notice filing not a transaction document filing system, computer-based, in which filers obtain priority upon proper posting of their information and where few discretionary functions

are involved, thus significantly reducing both the risks and costs involved. Such a system would be insurable and can spread start-up costs so that early participants do not bear an inappropriate share.

Re Article 17, footnote 11

It is important to note that for an international registry significantly to limit both costs and the extent of administrative functions required, separation is needed between national registration entities which provide input or otherwise set conditions for the input of data from their respective territories, on the one hand, and the operation of the International Registry, which should begin from the point of receipt of that input in proper form and which is based on searchability of data in the international system.

National authorities can thus decide, for example, what input services are permitted from their territories, allow their parties to utilise the services of other States, or simply leave such activity to the parties directly involved. Local national law would resolve questions of liability of nationally-based registries, but would not have jurisdiction over the International Registry. The Convention therefore should not deal with liability relating to the operation of national registries.

Re Articles 17(2) and 19(3)

We are concerned that the effort hereto draft provisions on prospective filings has become complicated and thus may not be consistent with the certainty of priorities otherwise provided. Footnotes 10 and 12 we believe illustrate this difficulty. The debtor's rights may be protected better by a system for removing registrations, rather than a system to accommodate registration of prospective interests.

Re Article 20(1)

This provision should be aligned with Article31(1)(c). As to aircraft transactions, the substance of Alternative B will be the appropriate choice in any event for Protocol Article XV.

Re Chapter VI

Persons or organisations acting on behalf of the Supervisory Authority or Registrar should receive only functional immunities and privileges. Since it is anticipated that the Supervisory Authority will in any event be composed of ratifying States and such other States or international bodies as are agreed upon, the question of privileges and immunities will likely have been resolved as to such persons. The focus of these provisions therefore should be on the Registrar, including technical experts or others who act on behalf thereof.

Re Article 26

This matter should be dealt with by the Convention and/or each Protocol, subject to agreement by a host State, but cannot be the exclusive concern of that State, as suggested by footnote 16 of Article 26. The extent and type of immunities or jurisdictional protections granted the Registrar has a direct and substantial effect on the costs of operation and the level of exposure to risk, and thus must be dealt with by the Convention system.

Re Article 26 (3)

The Convention should provide, as a general standard, exemption from taxes and other appropriate privileges. These factors should then be taken into account with respect to any proposals received for performance of registry functions.

Re Article 26bis (1)

Assuming that the Authority is composed of diplomatic representatives or operates through an international body, it is unlikely that it would accept liability for damages directly. Compensatory redress will need to be through actions against the Registry or otherwise as provided for, backed up by appropriate security, which may include, but should not be limited to insurance.

Alternative A of Article 26bis should be the default standard for the Convention, subject to modification by a Protocol. This is a matter of systemic risk, and the default assumption should be strict liability for actual damage, rather than requiring a dispute in law and fact as to the appropriate level of due care under the circumstances of any particular case, which would substantially raise uncertainty for parties in reliance on the registry's function.

Re Articles 27 and 28

As noted in our general comments, these provisions are the core of the Convention, in so far as they form the bottom-line basis for extension of credit through capital markets. The Convention cannot achieve benefits through increased credit, especially for developing and other emerging States, without these core provisions.

Re Article 28 (3)

Paragraph (3) performs a useful function and should be retained; the bracketed language however should be deleted. Its inclusion could well render a critical provision very uncertain and require considerable additional drafting.

Re Articles 40-41

We support the overall approach and compromise reached on matters of jurisdiction and believe it will contribute to efficient functioning of the Convention with appropriate avenues for redress.

It remains necessary to provide for adjustments to take into account rules in some States that permit courts to decline jurisdiction in certain cases. The reference to applicable law can also be restated so as to clarify its inclusion of the law of the forum State.

Re Article V

We support the compromise reached, subject to retaining the language bracketed in this Article, except that the term “may” in the ultimate sentence should be “shall”, so that financing parties will be on notice as to the probable application of the Convention.

COMMENTS ON SELECT PROVISIONS - PRELIMINARY DRAFT PROTOCOL:

Re Article I(2)(b)

Based on consultations since the conclusion of the Second Joint Session, we now support *optional* limited coverage by the Convention of aircraft and engines used in military, customs or police services, subject to the express right of both selling and acquiring States to condition those rights under the Convention and the Protocol as necessary.

There has been an increasing market for commercial finance in the acquisition of such aircraft. Consideration therefore should be given to keeping the Convention open to these transactions, where that is the desire of the parties and with the approval of the respective States. As to drafting, were commend that the term "State aircraft" be avoided, given its special uses in other air transportation contexts.

Re Article I(2)(p)

We join with others in seeking to assure that this provision results in commercial certainty, which in turn affects credit cost. As a result, we seriously question making the presumption rebuttable, since *ex ante* predictability is important. We therefore recommend deletion of the "unless" clause.

In the search for terminology that avoids particular country usages, the term "statutory seat" as a substitute term should be further tested in the context of business entity practices, as well as its application in cross-border insolvency and other matters in various legal systems. Clear commentary language or possibly additional treaty language may be necessary to ensure that business entities in differing jurisdictions are covered by whatever terminology is finally adopted.

Re Article III

The compromise reached at the Second Joint Session for the Convention's Article V permits each Protocol to consider the appropriateness of a declaration allowing exclusion of a purely domestic transaction, which we believe is the most acceptable approach.

We believe such a declaration may be workable for some types of equipment, such as certain railway rolling stock. We recommend however that this not be adopted in this Protocol on aircraft. The rapid mobility of aircraft precludes the ability to draft a meaningful concept of a domestic transaction, wherein the equipment could not be anticipated to cross borders. Since *ex ante* certainty of what rules would apply is critical for extension of credit, such a provision would significantly undercut that purpose and the benefits of the Convention as to a country making such a declaration.

Re Article IX (2)

The proposed limitation as to which parties' prior consent must be obtained was designed to make more effective the use of modern commercial finance, since the earlier Geneva Convention system, which required consent from junior interests, readily lent itself to transaction blocking by parties without corresponding rights in the financing. This is an appropriate updating of finance methods which have changed markedly since the late 1940's.

Re Article X

See discussion above on Convention Article 14. Convention Article 14(1) and Protocol Article X(1) are often very important in assessing risk factors for the extension of credit for presently underserved markets. Delay in rapid resolution of rights and the recovery of interests is one of the most significant obstacles to the extension of credit in such markets. These optional provisions allow a Contracting State to streamline its procedures, limited to the specific equipment covered, in order to obtain enhanced credit, and should be within that State's option at any point under the Convention.

This optional provision of the Protocol should however best be limited to paragraphs 1 and 3 of Article X, which accomplish the purpose of the provision without undue complexity. As noted in our earlier comments, we believe that little is gained by the current paragraph X(2) or by its counterpart in the Convention's Article 14(2), which together lead to much unneeded complexity. However, if paragraph 2 of the Convention's Article 14 is retained, then the corresponding Protocol Article X(2) will also need to be retained.

Re Article XI

It has been understood at the Insolvency Working Group and at the plenary that the two versions, Alternatives A and B, should be stated as options to be selected by declaration of Contracting States (plus another option which we now believe should be available, as set forth below).

As with Article X, this is a critical provision with respect to the ability of the Convention to have a significant effect on availability of credit. Uncertainty as to settlement of competing rights and the extent of protection for parties that have provided the equipment has been shown in actual market practice to be a very substantial factor in limiting credit or raising the rates for placement of aircraft. It is therefore important for options to be available, and for Alternative A to remain fully consistent with today's capital markets.

Taking into account issues raised in the formulation of the two Alternatives, we believe that additional flexibility may be necessary either by (a) allowing States to adopt neither Alternative (thus applying their national law), and/or (b) by allowing a declaration by which States could select their national law with regard to specified issues that fall within this Article's coverage.

Re Article XIX

Alternatives A and B and paragraph 6: decisions on fee structure and related matters should be deferred until receipt of proposals by prospective registrar entities.

Re Chapter V

We support the approach in Protocol Articles XXII -XXIV, subject to modification of specific paragraphs as necessary. Each of the referenced Conventions that are currently in force were concluded at early stages of the development of air transportation and well before the development of modern finance methods for aircraft.

States that wish to select this new Convention should therefore be understood to grant primacy to it, since the capital markets, especially when funding high value mobile equipment, require a significant degree of commercial certainty as to the application of rules which must be determined prior to, not after, the extension of credit. It is not feasible from a finance point of view to allow both the existing Conventions and this new Convention potentially to apply to the same transaction in a given State, because to do so would create uncertainty that would undermine the purpose and value of the new Convention.

That said, we agree with recommendations by other States that examination of the provisions of the Geneva Convention, the Chicago Convention, the Rome Convention of 1933 and the UNIDROIT Convention on International Financial Leasing should continue to be undertaken, in order to identify any provisions of each which should be preserved in order to facilitate the extension of credit, and which are not inconsistent with the new Convention or incompatible with modern aircraft finance. Furthermore, as recommended by some States, the utility of expanding definitions in the Convention and Protocol should be examined as to whether they should take account of Article 77 of the Chicago Convention, and the possible application either to multi-party or to international registration and operation of aircraft.

The examination should also be continued as to the relationship to the draft UNCITRAL Convention on Assignment in Receivables Financing, which is expected to be finalised this year, in order to determine whether full exclusion of that Convention, with regard to transactions covered by this new Convention, is appropriate in the UNIDROIT Convention, or whether a selective exclusion would be beneficial, such as separating those transactions in which passenger and freight receivables are in fact separate from the transfer of, and security in the aircraft.

An appropriate exclusion clause should also be included covering the draft UNCITRAL Receivables Financing Convention in connection with space equipment and services. It would appear that such an exclusion is not required for railway rolling stock.

Re Article XXXII

It is recommended that the period of time be not less than six months.

Re Article XXXIV

We support the establishment of a Review Board and believe this will be a progressive development under this treaty system. Decisions as to participating organisations however should not be made at this stage, until the role of bodies such as ICAO is in fact determined.

Re transition provisions

A revised report on transition provisions based on discussions at the December meeting of the Public International Law Working Group is expected to be available at the Joint Session. These provisions, which are required for Articles 27 and 38 of the Convention and such other Articles as may be necessary, are very important to ensure certainty, and to resolve the status of prior existing interests.

This will need to take into account both financing practices and costs for filers of a large number of existing interests, should filing of prior interests be permitted or required. Another

approach may be to permit at no cost or very low cost the optional filing of prior interests for credit information purposes only, which would not effect pre-existing priority status.

Re Appendix: deregistration and export authorisation

Inclusion of this form to be employed in appropriate cases is, as stated at prior Joint Sessions, a very important factor in reducing uncertainties as to remedies and thus can significantly enhance credit. It is important to note that it does not however derogate from air safety and navigation functions otherwise vested in civil aviation authorities.

Additional comments will be submitted at the Third Joint Session