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INTERNATIONAL AIRCRAFT LEASING: IMPACT ON INTERNATIONAL AIR LAW TREATIES

by

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ABSTRACT

Aircraft leasing is a method of fleet acquisition. It was known to none at the outset of the air traffic era; as a result, international air law treaties were not formulated upon the concept that realized the practices as such. The moment international aircraft leasing materialized, many regimes of international air law became unsuited to the situation.

On the one hand, public international air law treaties have faced the problems ranging from safety oversight responsibilities and aircraft accident investigation to airport charges and criminal jurisdiction.

On the other hand, private international air law treaties have faced the problems ranging from applicability of the 1952 Rome Convention and preferential rights under the 1948 Geneva Convention to aircraft engine leasing and the idiosyncrasy of leasing transactions.

This study is not aimed at scrutinizing leasing transactions but at examining the aforementioned difficulties, especially the issues of public international air law.

RÉSUMÉ

La location des avions est une des méthodes pour acquérir des avions. C'est une méthode rarement connue dans cette nouvelle air de l'aviation. Par conséquent, les lois internationales concernant les traités du traffic aérien n'ont pas été formulées de manière réalisée pour répondre à un tel pratique. Une fois que les traités de location des avions séa adoptés, les lois internationales du traité aérien ne conviendroncnt plus dans certaines régions.

D' un côté, la loi publique internationale du traité aérien doit faire face aux problèmes suivants; la sécurité qui surpasse la responsabilité, l'investigation concernant les accidents aériens, le tarif aérien ainsi que la juridiction criminelle.

D' un autre côté, la loi privée internationale du traité aérien doit faire face aux problèmes tel que le droit préférentiel qui a été introduit en 1948 pendant la convention au Genève et que celania été applicable qu'en 1952 durant la convention à Rome pour un traité des moteurs aviations et une idéosyncrasie de la transaction du traité.

Cette étude ne vise pas seulement sur la location des avions mais aussi, comme metionné ci-haut, faire ressortir les difficultés du côté de la loi publique internationale de l'aviation.

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INTRODUCTION

Aircraft are a *sine qua non* for every entity wanting to be called "airline". At the dawn of the air traffic era, straightforward purchasing was the norm for aircraft acquisition due mainly to the State-owned character of airlines and the accessible price of aircraft.

However, the advent of liberalization and privatization gradually isolated airlines from the States' financial support. Also, the breakthrough of aircraft technology boosted the price of modern aircraft higher than ever. Furthermore, the deliveries of 910 aircraft were estimated for the total value of US$ 65.5 billions during 1995 and 1996.[1]

By force of these circumstances, airlines are unable to afford a fleet of aircraft by conventional financing; consequently, other means of aircraft acquisition and other sources of capital were introduced into the aviation industry. One of them is leasing, a practice that became an integral part of aviation business in the 1960's attributing to the tax and account incentives.

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[1] See S.M. Walton, "Review of Important Funding Sources" in B.J.H. Crans, ed., *Aircraft Finance: Recent Development and Prospects* (the Netherlands: Kluwer Law International, 1995) 23 at 23.

The omnipresent use of aircraft leasing has affected many areas of international air law - both public and private - since international air law was developed without cognizance of such an activity. Under the rubric of public international air law, first of all, the concept of nationality of aircraft and the concept of nationality of airlines have jointly produced a paradoxical situation whereby the State of Registry legally retains safety responsibilities but possesses no actual control of leased aircraft. Additionally, there is no provision in the Chicago Convention recognizing the rights of the State of the Operator to participate in the investigation of leased aircraft accident. Moreover, several theoretical problems remain unresolved, namely Article 5: right of non-scheduled flight, Article 15: airport and similar charges, Article 24: customs duty and Article 25: aircraft in distress. Even though the problems are of theoretical nature, no one should underestimate the domestic arbitrariness of States involved. Finally, it is doubtful whether the State of the Operator should establish its jurisdiction over criminal acts on board leased aircraft. This criminal jurisdiction was not recognized by the 1963 Tokyo Convention but already took root in the 1970 Hague Convention and the 1971 Montreal Convention. However, due to the narrow scope of the latter two Conventions, the difficulty faced by the 1963 Tokyo Convention still survives.

According to the treaties dealing with private international air law, there is the applicability problem of the 1952 Rome Convention

because the Convention disregards the significance of the State of the Operator. Moreover, the 1948 Geneva Convention recognizes all kinds of security rights in aircraft; it can overcome the problem of the 'true sale' situation. The Convention also enumerates priority among the recognized rights, the creditors and the lessors of the same priority need to clarify that which one will take priority.

Furthermore, the 1948 Geneva Convention does not realize the modular nature of aircraft; thus, the aircraft engines are deemed as component parts of aircraft. Once the engines are switched to another aircraft or replaced the new ones, the engine lessor become financially unsecured.

Finally, UNIDROIT has attempted to incorporate the *sui generis* leasing concept into international legal acceptance by adopting the Convention on the issue. The UNIDROIT Convention profoundly recognizes the tripartite feature of such transactions and establishes the legal direct links with less relying on the concept of privity of contract.

The purpose of this study is to examine the principles of international air law affected by the use of international aircraft leasing. Chapter One will briefly describe the methods of aircraft acquisition and the features of aircraft leasing. Charter Two and Three will scrutinize public international air law and private international air law in relation to international aircraft leasing, respectively.

CHAPTER I EMERGENCE OF AIRCRAFT LEASING

Until 1960's, airlines were normally dependent on the conventional financing, but the introduction of expensive jet aircraft has forced airlines to seek other methods of fleet acquisition. One of them is leasing. Although various types of aircraft leasing have been devised to satisfy the needs of the concerned parties; the concepts of operating leases and capital leases, however, may cover all.

Besides, as long as the lessor and the lessee are the entities belonging to the different States, the transaction is of the international nature. This has incessantly caused the aviation community some legal confusion that is necessary to be settled.

SECTION I - AIRCRAFT ACQUISITION

To provide international air services in the low-demand routes, airlines need not acquire a fleet of aircraft. By dint of code-sharing, airlines can enter a new market without actual acquisition of aircraft.

However, when airlines consider the fleet acquisition necessary, many financial techniques are available, ranking from self-financing and equity financing to countertrade and security-

based financing. Alternatively, the uniqueness of aircraft leasing attracts parties concerned to rely on it.

1.1 Invisible Capital: Code-Sharing

If the main purpose of aircraft acquisition is to service air traffic routes, airlines in so doing do not always need their own aircraft. They may enter into code-sharing arrangements, which means that one airline uses its two-letter designator code on flights operated by another carrier. In other words, code-sharing is the use of a single air carrier designator code by two or more air carriers.[1] Notwithstanding the various different definitions of code-sharing, IATA attempts to define the practice as follows:

> "Shared Airline Designator (code-sharing) means a designator used when an airline holds out, by means of an airline designator code published in industry accepted methods such as printed airline guides and/or SCIP/SSIM transmittals, that it is providing transportation and such transportation is provided by another carrier."[2]

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[1] J.E.C. de Groot, "Code-Sharing: United States' Policies and the Lessons for Europe" (1994) 19:2 Air & Sp. L. 62 at 62.

[2] IATA, Res. PSC1(10)766, effective 1 April 1989.

However, the term code-sharing is a misnomer as it is not the code that is shared but rather the flight, i.e. the aircraft capacity.[3] In this regard, code-sharing can increase new routes for air carriers who are unable or unwilling to invest their money in new aircraft.[4] Unbelievably, airlines, without their own aircraft, can 'enter new market, expand their systems and obtain additional flow of traffic to support their other operations.'[5] This indicates that code-sharing not only allows small airlines to compete effectively with mega-carriers, but also prevents over-capacity from the international aviation business generally.[6]

In a nutshell, code-sharing helps airlines acquire the aircraft capacity without spending millions of dollars on a new fleet of aircraft.

1.2 Self-Financing

A common method for airlines to seek capital is the so-called 'internal financing' indicating that airlines can generate

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[3] de Groot, *supra* note 2 at 62-63.

[4] See S.D. Liyanage, *International Airline Code-Sharing* (LL.M. Thesis, McGill University, 1996) at 19.

[5] US International Aviation Policy Statement (1 November 1994) docket #49844. See 60 FR 21841, 3 May 1995, at 5.

[6] See Liyanage, *supra* note 5 at 22-23.

funds within themselves. Since the company is not forced to distribute its earnings or profits as dividends to its shareholders, such retained earnings could be set aside for the purpose of financing-including aircraft acquisition.

Besides, internal funds could be generated from the conversion of existing assets, namely (1) outright sale of equipment, (2) sale and leaseback or (3) sale of residuals.[7]

Self-financing is clearly cheaper than borrowing[8] due to the absence of interest. However, the advent of deregulation and the introduction of expensive wide-bodied aircraft have forced airlines to look to other sources of capital for their fleet acquisition.[9]

1.3 Equity Financing

Airlines may acquire funds by issuing new investors with common shares. In general, common shareholders are considered as the company's owners, who have voting rights and

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[7] See D.H. Bunker, *The Law of Aerospace Finance in Canada* (Quebec: Institute and Centre of Air and Space Law, McGill University, 1988) at 608.

[8] *Ibid.* at 7.

[9] See R. Margo, "Aircraft Leasing: The Airline's Objectives" (1996) 21:4/5 Air & Sp. L. 166 at 167.

take part in the profits or loss.[10] Hence, the advent of the new investors could diminish the legal status of the existing common shareholders,[11] proportionate to the number of the newcomers' common shares.

However, in comparison with loans, equity financing imposes on the airlines no obligation to pay interest cost, but it just offers them the option to pay dividends.[12] In addition, equity capital not only increases the airlines' solvency (measured by debt-to-equity ratio) but also provide additional comfort according to the likelihood of economic downturns.[13]

Together with the issue of common shares, a variety of preferred shares are another equity capital available to airlines, even though they are sometimes subsumed within the scope of debt financing. Preferred shares have some kinds of rights more special than those of common shares, for example the right to receive a

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[10] R.K. Rosales, *Legal Aspects of Asset Based Aircraft Financing* (LL.M. Thesis, McGill University, 1990) at 33.

[11] See D.I. Johnston, *Legal Aspects of Aircraft Finance* (LL.M. Thesis, McGill University, 1961) at 9.

[12] See P. Deighton, "Sources of Finance" in S. Hall, ed., *Aircraft Financing*, 2nd ed., (Great Britain: Euromoney Books, 1993) 15 at 15.

[13] See J.M. Jackson, "Selecting the Appropriate Structure: The Decision-Making Process" in S. Hall, ed., *Aircraft Financing*, 2nd ed., (Great Britain: Euromoney Books, 1993) 29 at 33-34.

preference over other classes of shares as to the payment of dividends, the right to receive cumulative dividends or the right to convert the shares into common shares.[14]

Nonetheless, the preference shareholder possesses the legal status between 'that of a full equity shareholder and that of a creditor who becomes entitled to repayment of any capital prior to any shareholder of any class.'[15]

1.4 Countertrade

There are various types of countertrade – for example classical barter, closed end barter, clearing account barter, counterpurchase, compensation trading, offsets and co-operation agreement[16] - but the OECD sets forth three forms of countertrade as follows:

> "(i) barter, counterpurchases and their variants, which add up to the total of the so-called commercial compensation; (ii) buy-back agreements and arrangements for the reciprocal exchange of goods under industrial co-operation agreements; and (iii)

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[14] See Bunker, *supra* note 8 at 11-15.

[15] *Ibid.* at 10.

[16] See Huszagh, "International Barter and Countertrade" (1986) 3:2 Int'l Marketing Rew.10 at 10..

switch operations and those linked to sales of military equipment."[17]

Although international countertrade might be considered as a pernicious influence undermining the competitive world economy,[18] it can be helpful in a period of economic downturns. In fact, the motivations behind countertrade can be ascribed to many reasons, namely the high cost of imported energy, increasing external debt burdens, reduced market power, exchange regulations and non-convertibility of currencies, political instability and a need for technology.[19]

Manufacturers who recognize these situations may use countertrade as a financial tool.[20] Even the exchange between rice and aircraft is possible as happened between Thailand and Indonesia.

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[17] OECD, *Competition and Trade Policies: Their Interaction* (OECD Publications, 1984) at 63.

[18] See P.W. Liesch, "International Countertrade" in K.C.D.M. Wilde, ed., *International Transactions: Trade and Investment, Law and Finance* (Sydney: The Law Book Company Limited, 1993) 172 at 172.

[19] Bunker, *supra* note 8 at 68.

[20] *Ibid.* 69.

1.5 Debt Financing

The availability of debt financing is experienced by most airlines.[21] Clearly, straightforward loans that epitomize the simplest form of debt[22] rely primarily on the basis of the creditworthiness of airlines.[23] While debt financing appears relatively less attractive due to scheduled (fixed or floating) interest payments;[24] it can be used in parallel with other method of financing to satisfy the airlines' need.

In airline finance, unsecured loans are practically unknown;[25] thus, lenders always require that airlines provide security such as a fixed mortgage and charge on aircraft as its secondary source of comfort. Under this circumstance, the issues of priority, liens and enforcement are quintessential. The parties concerned should take into account not only the law of the State in which aircraft are registered but also the law of the State on which

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[21] See Deighton, *supra* note 13 at 22.

[22] See D.H. Bunker, *Aerospace Finance* (unpublished paper, McGill University, 1991) at 37.

[23] M.K. Feldman, "Legal Opinions in Secured Aircraft Financing Transactions" (1990-1991) 6 Banking & Finance L. Rew.127 at 129.

[24] See Jackson, *supra* note 14 at 34.

[25] Johnston, *supra* note 12 at 12.

aircraft are based because such local laws could affect the existence of the proposed form of mortgage. To a certain extent, the 1948 Geneva Convention might be helpful in this regard;[26] thus, the selection of finance structure occasionally depends on the laws of the States concerned.

1.6 Title-Based Financing

Title-based financing in a broadest sense includes conditional sales, hire purchasing and leasing. However, one of the best-known title-based structures is leasing.

Leasing is defined differently from jurisdiction to jurisdiction throughout the world. Some countries recognize the term 'finance lease' such as the United Kingdom, whereas others recognize the concept but not the term, such as the United States.[27] Also, some countries deem leasing and hire purchasing to be the same thing, while the others treat them differently indeed.[28]

Succinctly, the very nature of leasing may be referred to as a contract that a lessee hires an asset from a lessor. While the

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[26] See generally Chapter 3 *infra* note 20-55.

[27] Holloway, *Aircraft Acquisition Finance* (Great Britain: Pitman, 1992) at 141-142.

[28] See A. Hornbrook, ed., "Introduction to leasing" (1986) W. Leasing Y.B. at 17.

lessee enjoys use and possession of the asset, the lessor retains ownership thereof and gains rental payments over an agreed period. As well, the lessor may offer the lessee an option to buy the leased asset for an estimated fair market price at the end of the lease.

The retention of aircraft's ownership and residual value can be used as a financial device. While lessor financiers can keep the aircraft's title as a better security position than that of ordinary means of security,[29] lessee airlines can transfer the risk of long-term asset value to lessors.[30]

In addition, lessors can gain the tax and account benefits of ownership, namely 'depreciation' and 'off-balance sheet' respectively.[31] Owing to the benefit of tax allowance, airlines would be charged lower rental payments.

Moreover, large front-end deposits are rarely required in leasing; hence, some airlines with limited resources are permitted

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[29] See Holloway, *supra* note 28 at 140.

[30] See Holloway, *ibid.* at 146. In this sense, the leased aircraft economically belong to airlines.

[31] However, these advantages are less attractive for financial leases because many States not only call a halt to such tax benefits but require lessees to capitalize leased assets in their balance sheets as well. See M.D. Rice, "Current Issues in Aircraft Finance" (1991) 56:4 J. Air L. & Com. 1027 at 1032-1034; and see also Hornbrook, ed., "The Capitalisation Debate" (1986) W. Leasing Y.B. at 27-30.

to obtain needed aircraft.[32] By the same token, other airlines may use available capital for other projects.[33]

SECTION II - CATEGORIES OF AIRCRAFT LEASING

The multifarious names of leases can make the wisest man humble at first glance. Dr. Bunker sets out sixty-five types of leases that are frequently used in Canada and elsewhere.[34] A plethora of different leasing products attributes not simply to the different perspectives of the parties involved[35] but also the parameters of different countries' commercial, tax and accounting laws.[36] However, lease contracts can be divided into two basic categories by purpose,[37] namely capital leases and operating leases, from which all other types of leases are derived.[38]

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[32] See W.W. Eyer, "The Sale, Leasing and Financing of Aircraft" (1979) 45:1 J. Air L. & Com. 217 at 231.

[33] Hornbrook, *supra* note 29 at 17. For an exhaustive list of leasing advantages, see Bunker, *supra* note 8 at 58-61.

[34] See Bunker, *ibid.* at 33-57.

[35] See *ibid.* at 24.

[36] Holloway, *supra* note 28 at 140-141.

[37] R. Gritta & P. Lynagh, "Aircraft Leasing-Panacea or Problem?" (1973) 5 Transportation L.J. 9 at 10.

[38] Bunker, *supra* note 8 at 25.

2.1 Capital Leases

Capital leases are leases that are used for a financial purpose and sometimes they are called 'financial leases'. Their general features will be enumerated below. Afterwards, the development of these practices will be briefly described.

(a) Characteristics of Capital Leases

The main characteristics of capital leases can be enumerated as follows.[39]

(1) The core of the lease rests on financial considerations. Leasing is nothing other than an alternative source of capital tantamount to secured loan financing. Thus, the lessor's role is financial.[40]

(2) The lessee will specify the equipment needed and act as the lessor's agent in the matters of ordering it, inspecting it and maintaining it.[41]

(3) During the initial term, the lease is normally non-cancellable except with severe penalty.

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[39] See Gritta & Lynagh, *supra* note 38 at 10-11.

[40] See Hornbrook, *supra* note 29 at 17.

(4) The length of the initial term of the lease is often greater than the aircraft's life.

(5) Aggregate rentals amount to the total cost of the aircraft plus a reture on the lessor's funds.

(6) There is usually an option to purchase the leased aircraft at less than fair market value.

(7) Under the 'net' lease principle, the lessee assumes all the expenses and risks associated with ownership. Basically, they are a triple net of taxes, maintenance and insurance.

(b)Growth of Capital leases

Prior to 1955 airlines acquired a fleet of aircraft by conventional means of financing, such as self-financing, equity financing or short-term bank loans.[42] No sooner were expensive jet aircraft introduced in early 1956 than airlines had to rely on long-term debt, in conjunction with convertible subordinated debentures, syndicated loans and mortgage indentures on flight equipment.[43]

In 1962 the investment tax credit and tax depreciation were allowed to encourage acquisition of expensive capital

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[41] *Ibid.*

[42] See Johnston, *supra* note 12 at 20.

equipment such as aircraft.[44] Due to unsatisfactory earnings, airlines by themselves could not take advantage of such tax benefits.

Under these circumstances, airlines allow financiers to possess the aircraft's ownership, but they still have the rights to use virtually all the title's benefits in the leased aircraft. By owning such aircraft, any lessor with a positive tax liability would become the beneficiary of those incentives, and simultaneously a portion of the benefits would be passed on to lessee airlines in form of lower rental payments.[45] This situation enhances the opportunity of airlines to acquire a fleet of aircraft and protects the interests of investors. As a result, this scenario has generated the ubiquity of capital aircraft leasing since the 1960's.[46]

2.2 Operating Leases

Operating leases are often viewed as true leases be cause they do not have other purposes, such as financial, behind the transactions. The general features and the growth of operating leases will be set forth below.

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[43] See Eyer, *supra* note 33 at 226.

[44] See Rosales, *supra* note 11 at 37.

[45] See Rosales, *ibid.* 11 at 37.

[46] See Eyer, *supra* note 33 at 227.

(a) Characteristics of Operating Leases

The term 'operating leases' are used frequently by manufacturers of equipment, but rarely by financiers in the leasing business. The general characteristics of operating leases can be described as follows.

Firstly, owing to a relatively short term of the lease contract, no full payout on the leased equipment is required and the lessor is able to rent them several times in sequence.

Secondly, the capital cost of the leased assets is not wholly amortized over the lease term and the lessor's profit is not necessarily derived from rentals during a single term.[47] As a result of this, the operating lessor must generally re-market (i.e. sell or re-lease) its aircraft in order to amortize and earn a return on the cost of the assets.[48]

Thirdly, residual values are of crucial importance for operating lessors because these lessors are actual owners of leased assets and their business rely upon present and forecast aircraft values.[49]

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[47] Bunker, *supra* note 8 at 25.

[48] Holloway, *supra* note 28 at 146.

[49] *Ibid.* at 141, 144-145.

Fourthly, operating leases generally include provisions of specific services by the lessor – such as insurance, installation and maintenance – that can be itemized as separate charges.

Finally, unlike financial lessors, operating lessors are really aircraft investors and traders managing a portfolio of assets.[50] They are in the business because their specialized skills in evaluating residual values of aircraft and in re-leasing effectively. Operating lessors can earn higher returns than they could obtain by lending their capital, accordingly.[51]

(b) Growth of Operating Leases

Why operating leases gradually became the emerging trend toward the airlines' acquisition of aircraft can be attributed to many factors.

Firstly, since 1976 many States have attempted to restrict the account and tax benefits of financial leases.[52] This means that only operating lessees are able to keep financing off their (and their countries')[53] balance sheets without duties to

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[50] *Ibid.* at 151.

[51] *Ibid.*

[52] See Bunker, *supra* note 8 at 25-33.

[53] See M. Ghonaim, *The Legal Aspects of Aviation Finance in Developing Countries* (LL.M. Thesis, McGill University, 1991) at 83.

capitalize leased assets. Also, only operating lessors are still entitled to apply the accelerated depreciation or capital cost allowance with respect to leased assets.

Secondly, the air traffic boom forced airlines to make excessive aircraft orders that aircraft manufacturers could not deliver in reasonable time. Unavoidably, this resulted in delivery backlogs[54] at the end of 1990, of which 25 per cent was imputed to the mega-lessors.[55] As a result, some airlines have no other choices except operating leasing.[56]

Thirdly, the cyclical nature of aviation business,[57] which was experienced by all the airlines, led them to seek a more flexible method of aircraft acquisition. In this connection, short-term operating leases may assist airlines in overcoming the uncertain world economy. Airlines are untrammeled to re-adapt their fleet in response not only to competitive pressures, but also to unpredictable situations, such as system congestion and noise emission restrictions.[58]

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[54] Rosales, *supra* note 11 at 47 and n.24. "For some aircraft types, such as the Airbus A320, the wait can be as long as 5 years."

[55] Holloway, *supra* note 28 at 147.

[56] See Rosales, *supra* note 11 at 48.

[57] *Ibid.* at 35-43.

[58] *Ibid.* at 50-51.

Last, but not least, some States, such as Brazil, encourage the growth of operating leases by offering the operating leased aircraft favorable treatment in regard to import duties.[59]

The aforementioned advantages of operating leases make airlines turn to rely on the practices more and more. In Asia-Pacific region, operating leases accounted for 6.05 per cent of the total region jet fleet by 1990 and doubled to 12.42 per cent by 1994.[60] Moreover, operating leases accounted for 25 per cent of the total world jet fleet by 1995.[61] This demonstrates that operating leases will become a significant means of aircraft acquisition sooner or later.

2.3 International Leasing

Both operating leases and capital leases can be used internationally because 'airlines will seek to access financing in whichever location provides the finest terms.'[62] Tax-oriented leases, in particular, can generate cross-border leases dealing with the

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[59] See Holloway, *supra* note 28 at 147.

[60] See Margo, *supra* note 10 at 167.

[61] See R.S. Sowter & B. Rek, "Balance Shifts in Airlines Financing" (1990) 45:2 Interavia Aerospace Rew. 133 at 134.

double-dip situation. Since capital leasing can be considered as a lease in the lessor's country and a secured loan in the lessee's country, the lessor and the lessee would each be treated as the owner of the leased asset in its respective home countries. In this regard, each of them is entitled to the tax benefits of ownership-a "double dip" of tax benefits.[63]

However, for the purpose of this study, international leasing includes any kinds of leases that have the cross-border elements - whether they are operating leases or financial leases. As long as the lessee's place of business and the lessor's place of business are in different States; and/or the place of aircraft registration and the operator's place of business are in different States, such leasing transactions will be considered as international leasing in this study.

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[62] A.J. Bernstein, The Lessee's Guide to Structuring the Cross-border Aircraft Lease" in S. Hall, ed., *Aircraft Financing*, 2nd ed., (Great Britain: Euromoney Books, 1993) 159 at 159.

[63] Rice, *supra* note 32 at 1034.

CHAPTER 2 INTERNATIONAL AIRCRAFT LEASING: IMPACT ON PUBLIC INTERNATIONAL AIR LAW TREATIES

The aircraft leasing phenomenon has affected many areas of public international air law. It was known to none in the early aviation era; international air law, consequently, was developed without cognizance of such activities. The concept of nationality of aircraft and the concept of nationality of airlines have evolved separately but jointly produced an illogical situation, which the State of Registry retains safety responsibilities but possesses no actual control of leased aircraft. As a result, Article 83bis was adopted to overcome the difficulty. Fortunately, it has entered into force since 20 June 1997 thank to the ninety-eighth instrument of ratification deposited by the Republic of Moldova.

In addition, Article 26 has raised a question relevant to the investigation of leased aircraft accidents. Nothing in this provision recognizes the rights of the State of the Operator to participate in the investigation thereof. Although the ICAO Council has attempted to tackle the problem by adopting Annex 13, the

Annex has no solid legal status and binding force, which demonstrates the necessity of tightening a loophole in Article 26.

Moreover, there remain several theoretical problems necessary to be considered, namely Article 5: right of non-scheduled flight, Article 15: airport and similar charges, Article 24: customs duty and Article 25: aircraft in distress. Even though the problems are of theoretical nature, no one should underestimate the domestic arbitrariness of States involved.

Finally, it is doubtful whether the State of the Operator should establish its jurisdiction over criminal acts on board leased aircraft. This criminal jurisdiction was not recognized by the 1963 Tokyo Convention but already took root in the 1970 Hague Convention and the 1971 Montreal Convention. However, due to the narrow scope of the latter two Conventions, the difficulty faced by the 1963 Tokyo Convention still survives.

SECTION I - THE CONCEPT OF NATIONALITY

Viewed broadly, the legal relationship between subjects and objects, of international law begets the notion of nationality which imposes certain rights and duties upon both sides. In addition, the concept is applied not only to persons and ships but also to aircraft and airlines.

International law primarily concerns two things - the subjects of international law and the objects of international law. The former are entities, such as 'States', 'condominia', 'intergovernmental organizations', and 'units of self-determination'[1] capable of bearing and maintaining international rights and obligations. The latter are anything incapable of possessing such rights and obligations, such as 'territories', 'persons' or other animate or inanimate objects, including aircraft.

In this connection, international law plays a pivotal role in allocating the objects of international law among the subjects of international law and demarcating the power of the subjects of international law over objects of international law.[2] This scenario produces, *inter alia*, the notion of nationality in which a State consigns nationality to objects of international law.[3]

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[1] I. Brownlie, "General Course on Public International Law" (1995) 255 Rec. des Cous 9 at 51.

[2] See B. Cheng, "Nationality for Spacecraft"," in T.L. Masson-Zwaan & P.M.J. Mendes de Leon, eds., *Air and Space Law: De Lege Ferenda* (the Netherlands: Kluwer Academic Publishers, 1992) 203 at 203.

[3] Compare C. Parry, *Nationality and Citizenship Laws of the Commonwealth and of the Republic of Ireland* (London: Stevens & Sons Limited, 1957) at 3-4. Prof. Parry opines that the concept of nationality was developed originally within the sphere of municipal law and was first to be found in post-revolutionary France. Nothing but the introduction of

Nationality was first imprinted on nationals and then extended to ships and aircraft. Under the rubric of international law, the word 'nationality' denotes the 'rights and duties' relationship between a State and a person.[4] The moment those objects of international law are conferred on the nationality, they receive legal protection from the State[5] and the State retains its personal or quasi-territorial jurisdiction over the objects. As well, the State is responsible to other countries for the performance of those objects. In other words, the State is the protector, guarantor and controller of the above objects simultaneously.[6]

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compulsory military services and national political rights necessitated nationality law. See also L. Oppenheim, *International Law: A Treatise*, vol.1: *Peace*, ed. by H. Lauterpacht (London: Longmans, Green & Co., 1948) at 586-587. Although each State determines, under its own law, who will be conferred on nationality, such law must be recognized by other States as to whether it is consistent with international law.

[4] See M. Milde, "Nationality and Registration of Aircraft Operated by Joint Air Transport Operating Organizations or International Operating Agencies", (1985) 10 Ann. Air & Sp. L. 133 at 140. [hereinafter Milde, "Nationality ..."]

[5] In the words of Prof. Parry, the nationality is the legal tie entitling the State to protect individuals, rather than entitling individuals to the State's protection. See Parry, *supra* note 3 at 11.

[6] J.C. Cooper, "A Study on the Legal Status of Aircraft" in *Explorations in Aerospace Law* edited by I.A. Vlasic (McGill University Press, 1968) 204 at 207.

Due to the fact that ships or aircraft for international transport carry passengers or cargo through many sovereign States, as well as the high seas, there might be more than one legal system applicable to the situation or there may be no law at all when those craft are on the high seas. The concept of nationality eases the problems by permitting the State of nationality to exercise its jurisdiction over not merely such craft but persons and things on board as well.[7]

1.1 Nationality of Aircraft

The idea of nationality of aircraft was first introduced into the aviation world by a French jurist and then was universally accepted by prominent lawyers, international conventions and State practices. The doctrine had clearly already been developed into customary international law before concluding the 1944 Chicago Convention.

Not until 1901 was the notion of aircraft nationality proposed for the first time by Paul Fauchille,[8] even though balloon

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[7] See Cheng, *supra* note 2 at 205-206.

[8] See P. Fauchille, *Le Domaine aérien et le le régime juridique des aérostate* (Paris: A. Pedone, 1901) cited by Cooper, *supra* note 6 at 217.

flights had been launched since 1783.[9] His proposal brought to public attention the idea that, among others, the air is free on condition that States have the right of 'self-preservation' which encompasses the prevention of reconnaissance, customs policy, sanitation and the necessities of defense. In tandem with this, all aircraft must have nationality pertaining to the State of Registry; the registration of aircraft should be based on the nationality of the owner, the commander, and three-quarters of the crew.[10]

Whether or not Fauchille's initiatives were entirely suitable, at least his concept of nationality of aircraft gained ubiquitous endorsements. From 1903 to 1909, a large number of jurists[11] gave credence to this doctrine. In 1910, it was recognized by the first formal diplomatic conference on air navigation and then by some national legislation, for example the British Aerial

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[9] See Cooper, *supra* note 6 at 216-217.

[10] See *ibid.* at 218.

[11] See *ibid.* at 218-220 citing Alexandre G.J.A. Mérignhac, *Les Lois et coutumes de la guerre sur terre* (Paris: A. Chevalier-Marescq, 1903) at 196; K. Hilty, "*Die völkerrechtlichen Gebräuche in der atmosphärischen Zone*" (1905) 19 *Archiv für öffentliches Recht* at 87-94; F. von Grote, *Beiträge zum Recht der Luftschiffahrt* (Bornaleipzig: R. Noske, 1907) at 22-23; A.K. Kuhn, "Aerial Navigation in its Relation to International Law" (1908) Proc. Am. Pol. Sci. Ass'n 5th Annual Meeting, at 85; and E. Zitelmann, "*Luftschiffahrtrecht*" (1909) 19 *Zeitschriff für internationales private und öffentliches Recht*" at 458-496.

Navigation Act of 1911 and the French decree on November 21, 1911.[12]

In addition, the confirmation of the concept was reproduced in an Exchange of Notes on July 16, 1913 between France and Germany. Also, throughout the first World War, many States deemed that aircraft had a type of national character.[13] Moreover, all the important international aviation agreements - the 1919 Paris Convention, the 1926 Madrid Convention, and the 1928 Havana Convention - formally accepted the principle of nationality of aircraft.

Finally, during the second World War, the nationality of aircraft proved to be a fully recognized fact, even for aircraft belonging to countries that were not Parties to the aforementioned conventions.[14] Thus, one can say that the concept of nationality of aircraft was already crystallized into customary international law;[15]

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[12] See *ibid.* at 223 and 226-227.

[13] E.g. the Netherlands, Sweden, Switzerland and the United States; see *ibid.* at 229.

[14] I.H.Ph. Diederiks-Verschoor, *An Introduction to Air Law* (the Netherlands: Kluwer Law and Taxation Publishers, 1985) at 8.

[15] See Cooper, *supra* note 6 at 237.

however, the registration of aircraft is not a source but a proof of the nationality of aircraft.[16]

1.2 Chicago Convention and Nationality of Aircraft

Since all the States have complete and exclusive sovereignty over the airspace above their territories,[17] the Chicago Convention recognizes such sovereignty and stipulates that aircraft, in order to fly internationally, must be imprinted with appropriate nationality and registration marks.[18] Aircraft, however, cannot be registered in more than one State[19] and their nationality will adhere to the State where they are registered.[20] Besides, each State is entitled to establish the rules and regulations of the aircraft

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[16] See Cooper, "The Chicago Convention-After Twenty Years", in *Explorations in Aerospace Law* edited by I.A. Vlasic (McGill University Press, 1968) 438 at 443.

[17] *Convention on International Civil Aviation*, signed at Chicago, on 7 December 1944. ICAO Doc. 7300/6 (1980) [hereinafter *Chicago Convention*]. Article 1 of the Chicago Convention recognizes this airspace sovereignty as a prior existing rule or, in legal parlance, customary international law. See Cooper, "Roman Law and the Maxim '*Cujus est solum*' in International Law" reprinted in *ibid.* at 54.

[18] Article 20 of the Chicago Convention, *ibid.*

[19] Article 18 of the Chicago Convention, *ibid.*

[20] Article 17 of the Chicago Convention, *ibid.*

registration by itself.[21] The State of Registry must provide ICAO with information concerning the registration and ownership of the aircraft.[22]

The registration of aircraft imposes responsibilities on the State of Registry; this State must ensure that flights are safely operated and the rules of maneuver are followed.[23] Additionally, in accordance with Articles 30, 31 and 32 of the Chicago Convention, it is the obligation of the State of Registry to provide a radio-operator license, a certificate of airworthiness, and a crew license, respectively.

1.3 Nationality of Airlines

The concept of nationality of airlines arose because the State-owned airlines were the norm at the time. It was used as a prerequisite for nationality of aircraft. as found in Article 7 of the 1919 Paris Convention,[24] any incorporated company was able to have its aircraft registered if it satisfied the requirement that its president

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[21] Article 19 of the Chicago Convention, *ibid.*

[22] Article 21 of the Chicago Convention, *ibid.*

[23] Article 12 of the Chicago Convention, *ibid.*

[24] *The Convention Relating to the Regulation of Aerial Navigation*, sighed at Paris, on 13 October 1919, 11 L.N.T.S. 173 [hereinafter *Paris Convention*] was the first multilateral treaty on air law.

and two-thirds of its directors held nationality of the State of Registry. Clearly, this Article was the combination between the concept of nationality of aircraft and the concept of nationality of airlines.

A watershed happened when the Paris Convention was amended in 1929.[25] The amendment not only terminated the 'ownership and control' clause, but also imparted the contracting States the rights to stipulate their own conditions upon the aircraft registration. However, the amendment left the nationality granted by the State of Registry untouched.

Under this circumstance, the concept of nationality of airlines was untied from the concept of nationality of aircraft. It was developed outside the realm of international law but unfortunately under the power of each State. As a result, the criteria of nationality of airlines could not be set in unison; in fact, they would vary from one State to another.[26]

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[25] *Protocol Concerning Amendment to Article 3, 5, 7, 15, 34, 37, 41, 42 and to the Final Provision of the Convention Relating to the Regulation of Aerial Navigation*, 15 June 1929, 138 L.N.T.S. 418.

[26] Article 19 led to the situation that some States lean towards the nationality of the owner as a requirement for the registration of aircraft, while others towards the domicile of the owner. See F.V. Escalada, "Nationality of Aircraft: A Vision of the Future" in T.L. Masson-Zwaan & P.M.J. Mendes de Leon, eds., *Air and Space Law: De*

1.4 Chicago Convention and Nationality of Airlines

In the 1944 Chicago conference, the US delegation proposed, among others, that so long as a foreign airline was not owned and controlled by nationals of the authorized State, any State was entitled to withhold the airline in question from flying through its territory.[27] This is based on the hostile feelings arising from the second World War[28] and on the belief that rights to fly are a part of friendly relations between States.[29] In other words, it was unacceptable for most, if not all, States to let their air space be utilized by third States, particularly the enemy States.

Nonetheless, the El Salvador delegation, who believed that small countries needed external capital and foreign technicians to operate airlines, opposed the US proposal.[30] Afterwards, the

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Lege Ferenda (the Netherlands: Kluwer Academic Publishers, 1992) 71 at 75.

[27] See United States Department of State, *Proceedings of the International Civil Aviation Conference*, vol. 1 (Washington, D.C.: US Government Printing Office, 1948) at 556.

[28] Prof. Haanappel notes that "only 'allied' and neutral States were invited to the Chicago Conference" P.P.C. Haanappel, "Multilateralism and Economic Bloc Forming in International Air Transport" (1994) 19:1 Ann. Air & Sp. L. 279 at 289 n.24.

[29] See *supra* note 27 vol. 2, at 1283.

[30] See *ibid.* vol. 1 at 595.

Chicago Conference did not mention the principle of nationality of airlines in the Convention, but in fact included it in two other agreements instead. As an illustration, Article I section 5 of the Transit Agreement[31] and Article I Section 6 of the Transport Agreement[32] similarly stated that:

> "Each contracting State reserves the right to withhold or revoke a certificate or permit to an air transport enterprise of another State in any case where it is not satisfied that substantial ownership and effective control are vested in national of a contraction State, ..."

Besides, owing to the failure of the Chicago Convention to establish the basic principles upon the multilateral exchange of air traffic rights, States were inevitably coerced into the domain of bilateralism.[33] In respect of nationality of airlines, a great number of

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[31] *International Air Services Transit Agreement*, signed at Chicago, on 7 December 1944, ICAO Doc. 7500.

[32] *International Air Transport Agreement*, signed at Chicago, on 7 December 1944, U.S. Dept. of State Publication 2282.

[33] The first bilateral agreement of major importance was the so-called 'the Bermuda Agreement I', signed at Bermuda, 11 February 1946, between the United Kingdom and the United States. Afterwards, it became a prototype for some 3,000 bilateral agreements. See Haanappel, *supra* note 28 at 291. For the final act of such an agreement, see B. Cheng,

bilateral agreements included the aforementioned Article, albeit not in verbatim vocabulary.

According to the 'ownership and control' clause at issue, it could be interpreted that a State which will determine the nationality of an airline is not a State which confers its nationality on the airline. Instead, any State who permits such an airline to operate aircraft across its territory is entitled to decide the proportion of the ownership and control.[34] This discretionary power not only prevents flags of convenience from international air

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The Law of International Air Transport, 3rd impression (Great Britain: Oceana Publication Inc., 1984) at 554-573.

[34] For instance, the United States determined that a Panamanian airline did not belong to Panamanians, thereby rescinding its air traffic permit. See E.V. Rocha, "Toward a New International Civil Aviation Convention?" (1994) 19:1 Ann. Air & Space L. 477 at 485.

transport[35] but also hampers the cooperation of the international aviation business in the globalization era.[36]

Finally, unlike nationality of aircraft which is concerned with political control - in particular safety aspects, nationality of airlines deals with economic control[37] which is closely linked to the operation of international air services.[38] This is why States need the rights to withhold or revoke air permission when the 'nationals' criteria are not satisfied. There is no State wanting third parties gain benefit without reciprocal exchanges.[39]

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[35] See Cheng, *supra* note 33 at 128 and 375. Additionally, there are some other reasons why the flag-of-convenience situation is irrelevant to the aviation world, namely the few hours airborne nature of air flight, the high professional status of pilot, the unnecessary risk for investors, the strict control by governments. For more details, see B. von Erlach, *Public Law Aspects of Lease, Charter and Interchange of Aircraft in International Operations* (LL.M. Thesis, McGill University, 1990) at 99-100.

[36] See generally H.A. Wassenbergh, *Principles and Practices in Air Transport Regulation* (Paris: Institut du Transport Aérien, 1993) c. 12 at 155-177.

[37] See J.G. Gazdik, "Nationality of Aircraft and nationality of Airlines as Means of Control in International Air Transportation" (1958) 25:1 J. Air L. & Com. 1 at 7.

[38] See Z.J. Gertler, "Nationality of Airlines: A Hidden Force in the International Air Regulation Equation" (1982) 48 J. Air L. & Com. 51 at 80.

[39] See *ibid.* at 79.

1.5 Two Concepts as a Source of Problems

By the very nature of leasing, aircraft could be the property of one legal entity and be operated by another simultaneously. As soon as an airline acquires a fleet of aircraft by dint of international leasing, the concept of nationality of aircraft and the concept of nationality of airlines hardly dovetail. As well, two States concerned are forced into an illogical situation.

On the one hand, although a lessee airline actually operates the leased aircraft, the State of such an airline do not possess a legal oversight of those planes; thus, it is not responsible to other States. On the other hand, the State of Registry, whose nationality is grafted onto such aircraft, still retains legal control of the craft and responsibility to other State - although its airline does not operate those aircraft.

This paradox once raised a question of the genuine link in the F. OABV Case before the Commission Internationale d'Enquète de Conciliation 1957-1958.[40] The aircraft in the case

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[40] The point of contention was whether the re-routing of the aircraft F.OABV by France, which was carrying the Algerian revolutionary leader Ben Bella, from its original destination, was contrary to international law. For more details, see D. Renton, *The Genuine Link*

belonged to a Moroccan company but was registered in France. According to Article 17 of the Chicago Convention, the aircraft must have the French nationality.

In an opposite belief, the Moroccan government insisted that the real and effective Moroccan nationality supersede the seeming French nationality inasmuch as the aircraft was owned by a Moroccan company and based in Morocco - namely the genuine link. Eventually, the Commission made no decision on the issue because the Moroccan government withdrew the case from the Commission.

Interestingly enough, Mr. Devid Renton propounds the academic views shedding light on the issue. Initially, by applying the concept of the genuine link in the Nottebohm case[41] to the nationality of aircraft, it requires the substantial or social connection between the registering State and the registered aircraft. Accordingly, the ownership of the aircraft by the nationals of the registering State is a prerequisite for the international recognition of aircraft nationality.

However, since the Nottebohm case 'stressed the physical nature of nationality and the family, social and political

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Concept and the Nationality of Physical and Legal Persons, Ships and Aircraft (Doctoral Dissertation, University of Köln, 1975) at 146-154.

[41] *The Nottebohm Case*, I.C.J. Rep. (1955).

ties,'[42] it is inappropriate to apply Nottebohm case analogously to the case of inanimate objects.[43] As well, the 'ownership' criterion is of a temporary link which the owner of the aircraft could be changed at any time, thereby clouding the issue.[44]

In the second approach, the absence of the genuine link does not terminate the bestowal of nationality by the State of Registry but put the State of Registry in breach of international responsibility instead.

Consequently, the F.OABV case would be decided that the aircraft held French nationality by virtue of registration and therefore France was entitled to diplomatic protection. Even if the genuine link did not exist between France and F.OABV, Morocco had no right to challenge French jurisdiction over F.OABV on the basis of a better claim to nationality. However, the fact that France lacked effective control over the aircraft, put France in breach of international responsibility.[45]

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[42] See D.W. Greig, *International Law* (London: Butterworths 1976) at 392-394; and see also R. Jennings, "General Course on Principles of International Law" (1967) 121:2 Rec. des Cours 327 at 463.

[43] See M.S. McDougal, W.T. Burke & J.A. Vlasic, "The Maintenance of Public Order at Sea and the Nationality of Ships" (1960) 54: Am. J. Int'l L. 25 at 39.

[44] See Renton, *supra* note 40 at 151.

[45] *Ibid.* at 152.

Together with the aforementioned case, the paradox has provoked some other legal issues, such as 'safety control', 'aircraft accident investigation', 'criminal jurisdiction' and other related problems which will be discussed below.

SECTION II - SAFETY CONTROL RESPONSIBILITIES

The State of Registry has certain duties, pursuant to the Chicago Convention, to ensure other States that aircraft bearing its insignia will conform to the flight regulations of any State wherever they fly. It is also in charge of overseeing the airworthiness of aircraft, the competence of flight crews and the operation of aircraft radio equipment. When aircraft are leased to an airline of another State, the State of Registry has only legal control of such aircraft. The actual control thereof goes into the hands of the State of the Operator. The Chicago Convention could not handle this situation efficiently; thus, Article 83bis was adopted by ICAO in order to ensure that the safety standards at issue would be implemented practically.

2.1 Article 12 - Rules of the Air

According to the concept of nationality of aircraft, the State of Registry is considered to be a guarantor[46] accountable to the international community for the performance of its aircraft. Article 12 of the Chicago Convention is the epitome of this belief. It essentially confirms that the State of Registry is obliged to insure other countries that aircraft carrying its nationality mark will abide by the rules of flight and maneuver. If the aircraft in question violate those rules, the State of Registry will be internationally responsible for that infringement.

Turning to the leasing respect, it is almost impossible for the State of Registry to enforce the foregoing Article[47] since the actual control of leased aircraft is not in the hands of this State[48] but instead belongs to the State of the Operator.

Practically, the two States could mitigate the situation by concluding a bilateral agreement transferring the duty from the

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[46] See Cooper, *supra* note 6 at 240.

[47] See I.E. Howie & R. van Dam, "Facilitating the Lease, Charter and Interchange of Civil Aircraft" (1989) 44:2 ICAO Bulletin 9 at 9.

[48] See G.F. FitzGerald, "The Lease, Charter and Interchange of Aircraft in International Operations: Amendments to the Chicago and Rome Conventions" (1977) 2 Ann. Air & Sp. L. 103 at 115.

State of Registry to the State of the Operator. However, in line with the maxim '*pacta tertiis nec necent nec prosunt*'[49], Article 34 of the Vienna Convention[50] stipulates that 'a treaty does not create either obligations or rights for a third State without its consent'; therefore, such a bilateral agreement has no legal impact on any other States. Inevitably, the State of Registry remains responsible to other contracting States and cannot release itself from the obligation under Article 12 of the Chicago Convention even though the State of the Operator performs that obligation in lieu.

2.2 Article 30 - Aircraft Radio Equipment

The principles established in Article 30 could be set forth as follows:[51]

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[49] Agreement have no effect on third parties.

[50] *Vienna Convention on the Law of Treaties* 23 May 1969, UN Doc. A/CONF 39/27, reprinted in (1969) 8 I.L.M. 679 at 693 [hereinafter *Vienna Convention*].

[51] See M. Milde, "Legal Aspects of the Global Air-Ground Communication" in G.R. Baccelli ed., *Liber Amicorum Honouring Nicolas Matteesco Matte* (Canada: De Daro Publishing, 1989) at 215 at 219-220.

(1) the State of Registry has jurisdiction to issue licenses for the installation and operation of the radio transmitting apparatus;

(2) the actual use of the transmitter must be in accordance with the regulations prescribed by the Overflown State; and

(3) only flight crew members licensed by the State of Registry can use the radio transmitting apparatus.

This provision does not empower the State of the Operator to provide such licenses in relation to leased aircraft, but nothing in the Convention prohibits that State from doing so. However any license issued by the State of the Operator will be recognized internationally only if the State of Registry renders them valid pursuant to Article 33.

Additionally, Article 23 of the 1959 Radio Regulation enacted by the International Telecommunication Union (ITU) lays down that:

> "[t]he service of every aircraft radio telegraph station shall be performed by a radio operator holding a

certificate issued or recognized by the Government to which the radio station is subject."[52]

This reaffirms that the State of the Operator's licenses will gain recognition worldwide provided that they are rendered valid by 'the Government to which the radio station is subject' - namely the State of Registry in this case.

2.3 Article 31 - Certificates of Airworthiness

In accordance with Article 31, the State of Registry is the sole authority entitled to issue or renew certificates of airworthiness to aircraft bearing its nationality insignia and flying internationally. For leased aircraft, there exists no problem concerning the initial issuance of those certificates because it ought to be done during the time of the registration of aircraft.

There are two possible difficulties. It is impracticable that, firstly, the continual maintenance of aircraft will be overseen by the State of Registry. Secondly, the renewal of those certificates, if inevitable, during the period of the lease could be problematic.[53]

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[52] For the text of the 1959 Radio Regulation, see (1965) U.N. Juridicial Y.B. 173; see N.M. Matte, *Aerospace Law: Telecommunications Sattellites* (Canada: Butterworths, 1982) at 94.

[53] See FitzGerald, *supra* note 48 at 117.

2.4 Article 32 - Licenses of Personnel

Again, on the authority of Article 32, nobody except the State of Registry shall provide the pilot and crew engaged in international navigation with certificates of competency. By the same token as the problems emanating from Article 31, controversy will arise when leased aircraft are flown by the pilot and crew licensed by the State of the Operator.

Nevertheless the difficulties under Article 30, 31 and 33 could be minimized by the State of Registry's recognition or by a bilateral approach. Firstly, in the light of Article 12, the State of Registry is empowered 'to adopt measures' so that its aircraft shall conform to the rules of flight that are in force worldwide. Of equal importance, Article 33 permits that if the State of Registry 'renders valid' the certificates of airworthiness or the certificates of competency issued by the State of the Operator, these certificates shall be recognized as valid by the other contracting States.

In simpler terms, for leased aircraft, the licenses of radio operation, the certificates of airworthiness and the certificates of competency could be issued by the State of the Operator, and then they are rendered valid by the State of Registry. As a result, every contracting State will consider such certificates valid accordingly.

Secondly, without rendering valid those certificates by the State of Registry, the State of the Operator is able to conclude bilateral agreements with other States whose territories are overflown by the leased aircraft. The bilateral agreements must contain a statement that the certificates in question issued by one contracting party shall be recognized as valid by the other contracting party.[54]

Still, although both solutions are workable under the existing international law, the State of Registry unavoidably remains fully responsible to other parties of the Chicago Convention. Hence, a better alternative might be found in some other places - viz. Article 83bis.

2.5 Article 83bis - Transfer of Certain Functions and Duties

Article 83bis is the first substantive amendment to the Chicago Convention[55] and fills a great need that was unforeseen at the time the Chicago Convention was drafted[56] which reflects the adaptability of the Convention to the development and reality of the

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[54] See Gazdik, *supra* note 37 at 5-6.

[55] M. Milde, "The Chicago Convention - After Forty Years" (1984) 9 Ann. Air & Sp. L. 124 at 125.

aviation business.[57] By and large, the Article reaffirms the rights of the State of Registry and the State of the Operator to conclude an agreement transferring responsibilities in relation to the safety of leased aircraft. Another interesting point is that it also lays down the procedure in order for the transfer agreement to be recognized by the other contracting States. In this section, the textual clarification will be presented below.

As mentioned earlier, the real problem of Articles 12, 30, 31 and 32(a) *vis-a-vis* the cross-border lease is the acceptance of third parties in transferring responsibilities from the State of Registry to the State of the Operator. To tackle the problem, many approaches were proffered to ICAO, that is to say, a series of bilateral agreements, a separate multilateral agreement, an annex to the Chicago Convention, and an amendment of the Chicago Convention.[58] Eventually, a solution was reached in the amendment of the Convention, materializing later to us as Article 83bis.

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[56] M.B. Jennison, "The Chicago Convention and Safety after Fifty Years" (1995) 20:1 Ann. Air & Sp. L. 283 at 289.

[57] R.D. van Dam, "Lease, Charter and Interchange of Aircraft and the Chicago Convention-Some Observations" (1994) 19:3 Air & Sp. L. 124 at 124.

[58] See ICAO, Panel of Experts on Lease, Charter and Interchange, Montreal, 11-19 October 1976, PE/CHA WD-1 (Report of

For the sake of analysis, Article 83bis will be reproduced as follows:

> **"Article 83bis**
>
> **Transfer of certain functions and duties**
>
> (a) Notwithstanding the provisions of Articles 12, 30, 31 and 32 (a), when an aircraft registered in a contracting State is operated pursuant to and agreement for the lease, charter or interchange of the aircraft or any similar arrangement by an operator who has his principal place of business or, if he has no such place of business, his permanent residence in another contracting State, the State of Registry may, by agreement with such other State, transfer to it all or part of its functions and duties as State of Registry in respect of that aircraft under Articles 12, 30, 31 and 32 (a). The State of Registry shall be relieved of responsibility in respect of the functions and duties transferred.
>
> (b) The transfer shall not have effect in respect of other contracting States before either the agreement between States in which it is embodied has been registered with the Council and made public pursuant to Article 83 or the existence and scope of the agreement have been

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Subcommittee on Resolution B of the Guadalajara Conference, March 1963) at 5-8 [hereinafter *ICAO Panel Expert*].

directly communicated to the authorities of the other contracting State or States concerned by State party to the agreement.

(c) The provisions of paragraphs (a) and (b) above shall also be applicable to cases covered by Article 77."[59]

(a) The Essence of Article 83bis

To put it simply, the substantive elements of Article 83bis are the following:

(1) there must be an agreement of lease, charter, or interchange of aircraft or any similar arrangement;

(2) aircraft must be registered in a contracting State;

(3) the State of the Operator must be a contracting State other than the State of Registry; and

(4) there must be an agreement between the two State transferring responsibilities under Articles 12, 30, 31 and 32(a).

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[59] *Protocol relating to an amendment to Convention on International Civil Aviation*, signed at Montreal on 6 October 1980, ICAO Doc.9318 [hereinafter *Article 83bis Protocol*].

The result, if the above elements are fulfilled, is that the State of Registry shall be relieved of those transferred responsibilities.

(b) Absence of Definitions

Obviously, there is no definition of the words 'lease'[60],'charter'[61] or 'interchange'[62] in Article 83bis but this does

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[60] See definitions of lease in Chapter 1. However, even though one author believes that a wet lease changes no operator, the other opines that such "a wet lease may often entail the transfer of the custody and control over the aircraft by way of its (temporary) inclusion on the Air Operator's Certificate of the Lessee. Consequently, a number of the supervisory functions of the State of the Lessor regarding such an aircraft may be transferred to the State of the Lessee (the Operator)." van Dam, *supra* note 57 at 127; and see A. Kean, "Interchange of aircraft" in A. Kean, ed., *Essays in Air Law* (the Netherlands: Martinus Nijhoff Publishers,1982) 111 at 111.

[61] Although 'charter' is not exactly the same as 'charter-flight (non-scheduled air service), both may share the common character of hire, rent or lease for a temporary use. See Erlach, *supra* note 35 at 71.

[62] In the words of Mr. Kean the term 'interchange' denotes a situation whereby "an aircraft is handed over by one operator to be operated by another for a period of time. The new operator takes possession of the aircraft and supplies his own crew and fuel. For that reason the Americans speak of a dry lease ... Influenced by maritime phraseology, we ... call it a barehull charter ... So far, neither the lawyers

not mean bad drafting. In the 23rd Session of the Legal Committee, some delegations asked for those terms to be defined. Others opined that all the words - 'lease', 'charter' and 'interchange' - should be omitted,[63] if the Article contained a notion that aircraft registered in one State were operated by another State.

However, since different States have different definitions of the terms, attempting to find a single acceptable definition is unproductive and impossible to gain acceptance worldwide. In addition, the provision lies in the scope of public international law, namely the transfer of duties from the State of Registry to the State of the Operator. Defining those terms is considered to be a task of private international law; therefore, it is safe to leave the terms undefined in the context of Article 83bis.[64]

Last, but not least, the phrase 'any similar arrangement' that is intended to avoid all kind of limitations,[65] denotes that the words 'lease', 'charter' and 'interchange' are only examples and not

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nor anyone else has been able to agree on the best name, but ICAO ... tends to make use of the American term Interchange." A. Kean, "Interchange" (1963) 67 J. Royal Aeronautical Soc.514 at 514.

[63] ICAO Doc. 9238-LC/180-182.

[64] G.F. FitzGerald, "The Lease, Charter and Interchange of Aircraft in International Operation-Article 83bis of the Chicago Convention on International Civil Aviation" (1981) 6 Ann. Air & Sp. L. 49 at 52.

a definitive list.[66] Accordingly, as long as the nature of the contract is that aircraft registered in one State are operated by the operator belonging to another State, the contract must be, for the safety purpose, subsumed within the phrase 'any similar arrangement', and Article 83bis is applicable to the situation.

(c) State of Registry

In compliance with Article 18, aircraft must be registered in only one State. The Article makes no reference whether or not that State is a contracting State. However, Article 83bis does specify the phrase 'an aircraft registered in a contracting State' which causes confusion about the meaning of 'a contracting State'.

It is probably sufficient to understand the term as a State being a contracting party to the 1944 Chicago convention only, excluding the amendment. Conversely, pursuant to Article 94(a), amendments come into effect upon States that have ratified them. This means that nothing in Article 83bis affects the contracting States of the Chicago Convention without their consent to be bound. Consequently, the phrase 'a contracting State', in the context of

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[65] Escalada, *supra* note 26 at 74.

[66] See Erlach, *supra* note 35 at 73.

Article 83bis, cannot but mean the contracting State of the Chicago Convention which has already ratified the amendment.

(d) State of the Operator

In order to know where the State of the Operator is, Article 83bis indicates that the operator must have its principal place of business or permanent place of residence in a contracting State other than the State of Registry. To elucidate, the State of the Operator is the State (1) which is the Party to the Chicago Convention; (2) which has already ratified Article 83bis, (3) which is not the State of Registry, and (4) in which the operator has its principal place of business, if not, then the permanent place of residence.

Nonetheless, there are three issues necessary to be clarified, namely the meanings of 'the operator', 'the principal place of business', and 'the permanent place of residence'.

Firstly, the operator in question is spiritually, if not literally, considered to be an airline. Although it could be understood as a business entity operating aircraft and designating

commander, employees and crew,[67] in practice the operator is always the airline.

Secondly, the principal place of business should be broadly interpreted as a place where the main part of the managerial and administrative work is undertaken.[68] Simply put, such an organ is accredited to the policy/decision-making power. In reality, it could be either the headquarters or any other offices of the airline provided that the foregoing criterion is satisfied.

Lastly, if there is no such place of business,[69] the application of the phrase "the permanent place of residence" will fill the gap. As a matter of fact, different countries construe the term differently. By analogy with Article 28(1) of the 1929 Warsaw Convention, the French word 'domicile' was translated into the concept of 'ordinary residence' by the United Kingdom Carriage by Air Act 1961. The 'ordinary residence' is viewed as a place where

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[67] *Ibid.* at 78.

[68] See *Dunning v. Pan Am*, U.S. Aviation Rep. 70 (1954).

[69] FitzGerald notes that "[a]lthought one delegation suggested that, in the English text, the words 'who has his principal place of business or, if he has no such place of business' was awkward and that, in any event, the words 'of business' could be deleted, no changed was made since this language reproduced the text of the Hague and Montreal Conventions." See FitzGerald, *supra* note 64 at 56.

the central management and control of the carrier reside.[70] Although this concept is commensurate with the concept of domicile,[71] the differences can be maintained. The domicile of the airline in the USA is its place of incorporation,[72] but in France is its '*siege social*' which is a location statutorily required to be named.[73]

Theoretically, there could be interpretative conflict on the term among the countries. Each of those countries might deem that a given airline has the place of residence in its own territory at the same time. The first country might apply the concept of 'incorporation', the second '*siege social*', and the last 'the center of management and administration'.

(e) Agreement Transferring Functions and Duties

Even though Article 83bis entered into force, the State of Registry and the State of the Operator, who have already ratified

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[70] L.B. Goldhirsch, *The Warsaw Convention Annotated: A Legal Handbook* (Boston: Martinus Nijhoff, 1988) at 144.

[71] See N.M. Matte, *Treatise on Air-Aeronautical Law* (Toronto: The Carswell Co. Ltd., 1981) at 426.

[72] *Ibid.*, citing *Smith v. Canadian Pacific Airways Ltd.* 452 F.2d 798 (2d. 1971).

[73] *Ibid.*; see also A.H. Robbins, "Jurisdiction under Article 28 of the Warsaw Convention" (1963) 9:4 McGill L.J. 355.

it, are not obliged to partake in an agreement transferring the functions and duties in accordance with Articles 12, 30, 31 and 32(a). Since Article 83bis only stipulates that the aforesaid responsibilities could be transferred partially or wholly, 'States are completely free to decide'[74] whether or not the situation necessitates the introduction of the agreement as such, or which functions and duties should be transferred.

This latitude in practice offers the State of Registry - especially the highly developed countries - the opportunity to evaluate the safety standards regulated by the State of the Operator - especially the less-developed countries. If the anticipated safety standards are unsatisfactory, the State of Registry is unlikely to conclude the agreement in question.[75]

Succinctly, the optional nature of Article 83bis provides the State of Registry with the discretion to decide whether those responsibilities should be transferred to the State of the Operator or should be maintained by the State of Registry itself.

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[74] See van Dam, *supra* note 57 at 127.

[75] See Erlach, *supra* note 35 at 101.

(f) Transfer Effect on The Third Contracting States

Substantively speaking, as soon as the elements laid down in Article 83bis(a) are satisfied, the State of Registry will be relieved of responsibilities transferred. Yet, the State of Registry remains fully responsible to the third party States if the procedural requirements are not complete.

In principle, to have any arrangement recognized by third parties, the existence of such an arrangement should be imparted to and acknowledged by them.[76] In respect of Article 83bis(b), there are two alternative formalities to make the transfer of responsibilities effective to the third contracting States.

Firstly, as a normal procedure subject to Article 83, every time contracting States conclude any arrangement not inconsistent with the Chicago Convention, they must have it registered with the Council, and the Council makes it public afterwards. However, this time-consuming process may be useless for short term leases which possibly expire before the end of such a lengthy formality.[77] This indicates that the objective of Article 83bis is hardly achieved as far as short term leases are concerned.

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[76] See FitzGerald, *supra* note 64 at 56.

[77] See LC, 9th Meeting, para. 9-10 at 54-55.

To fill the gap, the second procedure is expected to be an alternative. The States parties to the transfer agreement could by themselves bring it into effect upon the third party States by directly notifying them of the existence and scope of such an agreement. As a result, the State of Registry will not be responsible to the notified States.

Whereas Article 83bis(b) could solve the problem concerning the deliberate procedure of registration and publication, its terminology raises an interpretative question as to whether the 'registration' is compulsory in the second option. To clarify, the legal term relevant to the issue is extracted below:

> "... **either** the agreement ... has been registered with the Council and made public **or** the existence and scope of the agreement have been directly communicated to the authorities of the other contracting State ..."[78] [emphasis added].

In grammatical parlance, there are two choices between the '**registration/publication**' and the '**direct communication**'. To put it differently, the 'registration' of the transfer agreement is required in the first choice only, but not required if the States

[78] The Article 83bis Protocol, *supra* note 59.

parties to such an agreement 'directly communicate' with the other third party States.

Nevertheless, the other approach contends that the '**publication**' and the '**direct communication**' are optional, but the 'registration' of the transfer agreement is mandatory in both cases.[79] This is because the legal interpretation takes into account not merely the given terms in Articles 83bis but also its surrounding context[80] and its drafting history.[81]

According to Article 83 in tandem with Article 83bis, it is always the obligation of the contracting States to have any arrangement, not inconsistent with the Chicago Convention, registered with the Council. Moreover, in drafting negotiation of Article 83bis, several delegations confirmed that the States parties

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[79] See Erlach, *supra* note 35 at 81.

[80] See *supra* note 50 at 691-692, Article 31 of the Vienna Convention stipulates that treaty "shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of their object and purpose." This connotes that no rules of the treaty interpretation can be one and only. On the contrary, it is not simply the ordinary meaning and its context but also the *bona fide* doctrine and the intentional approach that ought to be considered all together. See also, Genoa Ships Case (1883) 4 CRob 388; Ambatielos Case (1952) ICJ Rep. 28; and Golder Case 57 ILR 200.

to the transfer agreement were obliged to register the agreement with the Council, irrespective of the fact that the 'direct communication' was already thoroughgoing.[82]

To sum up, the transfer of responsibilities from the State of Registry to the State of the Operator would be recognized by the other contracting States when (1) the transfer agreement is registered with the Council and (2) the transfer agreement is either made public by the Council or directly notified the other contracting States by the States parties to such an agreement.

(g) *mutatis mutandis* application of Article 83bis

The principles of Article 83bis are also be applied to both joint air transport operating organizations and international operating agencies under Article 77.

The nationality and registration problems dealing with such entities were foreseen but left unsolved at the Chicago Conference of 1944.[83] Nonetheless, the Conference imposed on the

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[81] See *ibid.* at 692. Article 32 of the Vienna Convention permits the use of *travaux preparatoires* as the supplementary means of interpretation.

[82] See LC, 9th Meeting, para.19 at 56-57 (Canada); LC, 10th Meeting, para. 5 at 60 (France).

[83] See Milde, "Nationality ..." *supra* note 4 at 137.

Council the duty to determine in what manner the provisions of the Convention relating to nationality of aircraft shall apply to aircraft operated by international operating agencies.[84] Simply put, the ICAO Council is empowered to 'decide' on the issue, binding on all contracting States. Moreover, the power of the Council covers not exclusively Articles 17 to 21, but also all the Articles of the Convention which refer-explicitly or implicitly- to nationality of aircraft.[85]

Given Article 83bis, its *mutatis mutandis* application shall not affect the authority of the Council, and the Council is empowered to decide in what manner Article 83bis should apply in situation foreseen in Article 77.[86]

(h) Entry into Force

Even though Article 83bis 'constitutes a positive step which solves a problem of legal security and is of unquestionable practical significance,'[87] the international aviation community had to await the ninety-eighth instrument of ratification to bring Article

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[84] Article 77 of the Chicago Convention, *supra* note 17.

[85] See Milde, "Nationality ..." *supra* note 4 at 145.

[86] LC, &th Meeting, paras. 3 and 7 at 9, Belgium and Senegal.

83bis into effect. Fortunately, insofar as the Republic of Moldova deposited such an instrument with ICAO, the principles set forth in Article 83bis became a legal reality.

Under the authority of Article 94(a), the ICAO Assembly specifies that at least ninety-eight instruments of ratification are required to bring Article 83bis into force. Due to the fact that this Article 'was approved by the legal Committee of ICAO without any negative votes and with only two abstentions, and was subsequently unanimously adopted by the ICAO Assembly,'[88] Dr. FitzGerald hoped that 'it had good prospects of wide ratification.'[89] Unbelievably, the amendment for the global safety aviation had to await the ninety-eighth instrument of ratification more than fifteen years.

There are no legitimate reasons for the slowness of ratification[90] because Article 83bis is of an enabling character and not of an obligatory one.[91] A ratifying State is completely free to

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[87] Escalada, *supra* note 26 at 74.

[88] van Dam, *supra* note 57 at 128.

[89] FitzGerald, *supra* note 49 at 64.

[90] See J. Ducrest, "Legislative and Quasi-Legislative Functions of ICAO: Towards Improved Efficiency" (1995) 20:1 Ann. Air & Sp. L. 343 at 343.

[91] See Erlach, *supra* note 35 at 56 citing IATA Memorandum 19/10/88, Discussion paper attached to Memorandum at 5.

decide if the transfer of responsibilities is necessary. However, there are certain explanations to this situation: States may give low priorities to ratification such an amendment; States may have more urgent problems competing for the Parliamentary priorities; States are not interested in aircraft leasing; or States do not have skilled personnel to present the issue more favorably to the respective governmental agencies.[92]

By virtue of such slowness, a workshop for a speedy ratification was established at the initiative of the Netherlands and the United States. In January 1988, the first meeting was held in the Hague.[93] Workshop participants have professional experience with the processes involved in ratification in their governments, which include several types of legal systems, and they stand ready to share their knowledge.[94] Participants have attempted to communicate with their colleagues from other contracting States for the need to bring Article 83bis into force.

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[92] *Ibid.* at 51.

[93] See Howie & van Dam, *supra* note 47 at 10.

[94] M.B. Jennison, "Bilateral Transfers of Safety Oversight will Prove Beneficial to all States" (1993) 48:4 ICAO J. 16 at 16.

Finally, on 20 June 1997, Article 83bis entered into force, the instant the Republic of Moldova deposited the ninety-eighth instruments of ratification with ICAO.[95]

Nevertheless, on the authority of Article 94 of the Chicago Convention, Article 83bis would be applicable exclusively to contracting States that already ratified it. Other contracting States cannot but deem that the State of Registry still retains the safety oversight responsibilities. As a practical matter, civil aircraft registered in the States that have already ratified Article 83bis account for more than ninety five per cent of international commercial air transport;[96] therefore, the difficulty as such is unlikely to happen.[97]

SECTION III - AIRCRAFT ACCIDENT INVESTIGATION

Under the rules of international law, the aircraft accident investigation is governed by Article 26 of the Chicago

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[95] See Attachment to State Letter LE 3/2-97/72, 8 August 1997, at 19. Paragraph 3(d) of the Article 83bis Protocol stated that "the Protocol shall come into force in respect of the States which have ratified it on the date on which the ninety-eighth instrument of ratification is so deposited." See *supra* note 59.

[96] See van Dam, *supra* note 57 at 130.

[97] See Erlach, *supra* note 35 at 77.

Convention alone. If this Article aims to improve air safety, it fails since all the potential viewpoints and interests - including the State of the Operator in relation to leased aircraft - are not present during the investigation. In order to mitigate the problems, Annex 13 was adopted by the ICAO Council; nevertheless, its legal status and binding force are questionable. Hence, the amendment of Article 26 remains necessary.

3.1 Article 26 - Investigation of Accidents

Until 1944, there was no even customary international law governing the investigation of aircraft accidents. The first international concern of such an investigation originated in the 1925 meeting of ICAN,[98] and then was incorporated into a body of international law in Article 26 of the 1944 Chicago Convention.

The ideal objective of the investigation is, not to implicate anyone, but to provide the aviation community with scientifically valid data arising from accidents and then to prevent the repetition of the possible similar accidents.[99] Insofar as airlines,

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[98] International Commission for Air Navigation (ICAN) was created by the Paris Convention. See *supra* note 24.

[99] H. Caplan, "The Investigation of Aircraft Accidents and Incidents", (1955) 59 J. Royal Aeronautical Soc'y 45 at 45.

albeit different in management, nationalities or cultures, always use the same or closely comparable type of aircraft,[100] any technical failure found in one aircraft accident could be an invaluable lesson for the overall aviation community. Clearly, this could result in improving airworthiness of aircraft and enhancing the air safety standards worldwide.

However, Article 26 hitherto has yet to achieve the aforesaid objective. In order to realize its drawbacks, the essential elements of Article 26 are presented below:

(1) an aircraft accident occurs in a contracting State;
(2) the hapless aircraft bears the nationality of a contracting State other than that of the State of Occurrence;
(3) the State of Occurrence is obliged unconditionally to institute an inquiry into the accident;

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[100] In addition, Annex 1 of the Chicago Convention (Personnel Licensing) and the ICAO training manuals induce the contracting States to establish the same procedure for the training and licensing of the flight personnel. Moreover, the uniform technology of Air Traffic Control in the aviation world is the fact. See M. Milde, "The Chicago Convention-Are Major Amendments Necessary or Desirable 50 Years Later?" 9(1) Ann. Air & Sp. L. 401 at 424 (1994) [hereinafter Milde, "The Chicago Convention ..."].

(4) so far as its law permits, the State of Occurrence should conduct the inquiry in accordance with the procedures recommended by ICAO;

(5) the State of Registry is entitled to appoint observers to be present at the inquiry; and

(6) the State of Occurrence is obliged to impart the report and findings to the State of Registry.

Since Article 26 is the sole provision of international law on the aircraft accident investigation, it is out of the question for one article to encapsulate all the aspects thereof.

Apart from the superiority of domestic law to the global safety needs,[101] there are a variety of puzzles necessary to be unraveled. What is the meaning of the accident? What is the relation between the aircraft accident investigation and other police or judicial investigations? What are the rights and duties of the observers? What is the legal status of the report and finding?[102] What are the rights and duties of the State of the Victims, the State

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[101] See Milde, "The Chicago Convention ..." *ibid.*, at 424-425.

[102] See M. Milde, "Aircraft Accident Investigation in International Law" (1984) 9:1 Air L. 61 at 62 [hereinafter Milde, "Aircraft Accident ..."].

of the Operator, the State of Manufacture, the State of Design and the State of the Experts?[103]

As far as aircraft leasing is concerned, Article 26 is silent on at least two problems - first the rights of the State of the Operator to participate in the inquiry and second the domestic investigation of aircraft accidents when the State of Registry is also the State of Occurrence.

Firstly, as mentioned earlier, the leased aircraft may be registered in one State but operated by another State. The operator or airline is directly responsible to ensure the safety of the operation of its aircraft and is of the group most intimately affected by the aircraft accident.[104] Under this circumstance, the State of the Operator should have the rights to participate in the inquiry. Unfortunately, aircraft leasing was not yet common practices at the time when the Chicago Convention was drafted; as a result, Article 26 made no mention of the State of the Operator's rights and duties as such.

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[103] See D.M. Fiorita, "The International Framework of Aircraft Accident Investigation-Contemporary Issue"(1994) 19:1 Ann. Air & Sp. L. 161 at 171-172. The above problems will be discussed only in relation to aircraft leasing.

[104] See R.A. Noel, *A Survey of Accident Investigation in International Air Law* (LL.M. Thesis, McGill University, 1967) at 12.

Secondly, supposing the leased aircraft accident occurs in the State of Registry, as a matter of fact, this State is also the State of Occurrence. Typically, the situation will be considered to be a domestic matter, even though such aircraft are operated by an airline belonging to another State.

3.2 Annex 13 - Aircraft Accident Investigation

To tighten the aforementioned loopholes, on 11 April 1951, ICAO first designated Standards and Recommended Practices[105] for Aircraft Accident Inquiries as Annex 13 to the

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[105] See Annex 13 to the Convention on international Civil Aviation (8th ed. July 1994) at (ix). Standards and recommended Practices are defined as follows:

> *Standard*: Any specification for physical characteristics, configuration, materiel, performance, personnel or procedure, the uniform application of which is recognized as **necessary** for the safety or regularity of international air navigation and to which Contracting States will **conform** in accordance with the Convention; **in the event of impossibility of compliance, notification to the Council is compulsory under Article 38.**
>
> *Recommended Practice*: Any specification for physical characteristics, configuration, materiel, performance, personnel or procedure, the uniform application of which is recognizes as **desirable** in the interests of safety, regularity or efficiency of international air navigation, and to which Contracting States will **endeavour to conform** in accordance with the Convention [emphasis added].

Chicago Convention.[106] With regard to aircraft leasing, the problem concerning the rights of the State of the Operator, to some extent, is minimized. According to Chapter 2 Specification 2.2, the principles of Annex 13 will be applicable to the State of the Operator on the conditions that:[107]

> (1) aircraft are leased, chartered or interchanged;
>
> (2) the State of the Operator is not the State of Registry; and
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> (3) the State of the Operator discharges, in part or in whole, the functions and obligations of the State of Registry.

Accordingly, the State of the Operator is entitled to appoint not only an accredited representative to participate in the investigation but also one or more advisors nominated by the operator to assist its accredited representative.[108] If the accredited representative is not appointed, the State conducting the investigation should invite the operator to participate.[109]

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[106] See *ibid.* at (vii) Foreword: Historical Background.

[107] See *ibid.*, Specification 2.2, at 3.

[108] *Ibid.*, Specification 5.18 & 5.19, at 10.

[109] *Ibid.*, Specification 5.19.1 Recommendation at 10.

In respect of the domestic investigation, namely when the State of Occurrence and the State of Registry is the same State, Chapter 2 Specification 2.1 of Annex 13 stipulates that:

> "[u]nless otherwise stated, the specifications in this Annex apply to activities following **accidents** and incidents **wherever they occurred**"[110] [emphasis added].

Compared with the former edition,[111] Annex 13 (8th ed.) does not require international elements *vis-à-vis* the investigation of domestic accidents. The term 'wherever accidents occurred' demonstrates that the scope of Annex 13 also embraces domestic accidents. Concerned States could be participants in those domestic investigation depending on the conditions established in the Annex.

By the same token, the State of the Operator might be entitled to participate in the accident investigation involving its

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[110] *Ibid.*, Specification 2.1, at 3.

[111] See Annex 13 (7th ed. May 1988) ICAO Doc. 6/88 E/PI/6000., c. 2, Specification 2.1 stated that "[u]nless otherwise stated, the specifications in this Annex apply to activities following **accidents** and incidents **occurring in the territory of a Contracting State to aircraft registered in another Contracting State.**" [emphasis added]. Clearly, this old version required the international element in the applicability of the Annex. See also Fiorita, *supra* note 103 at 177.

leased aircraft, although the State of Occurrence which is also the State of Registry deems the accident to be the domestic one.

However, there remain certain problems as to whether the adoption of Annex 13 is under the power of the ICAO Council, and whether Annex 13 is devoid of any legal significance. This will be discussed below.

3.3 *intra vires* of the ICAO Council

On the authority of Article 37(k) and its last phrase, the ICAO Council is empowered to adopt Standards and Recommended Practices governing the 'investigation of accidents' as well as 'other matters concerned with the safety, regularity and efficiency of air navigation as may from time to time appear appropriate'[112]. This evinces 'a unique feature among all organizations of the United Nations system that the Council of ICAO possesses quasi-legislative power.'[113]

Article 37 is sufficient authority for the Council to adopt Standards and Recommended Practices at issue because any

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[112] Article 37 of the Chicago Convention, *supra* note 17.

[113] M. Milde, "Enforcement of Aviation Safety Standards-Problems of Safety Oversight" (1996) 45:1 Z.L.W. 3 at 4 [hereinafter Milde, "Enforcement ..."].

aviation safety information, arising from a domestic accident notwithstanding, is beneficial to the international community at large. While Article 26 disregards the State of the Operator's rights and duties, the adoption of Annex 13 is not *ultra* but *intra vires* for the ICAO Council. [114]

3.4 Weak Legal Nature of Annex 13

According to the question pertaining to the legal status of Annex 13, Article 37 paragraph 1 states that

> "[e]ach contracting State undertakes to collaborate in securing the highest practicable degree of uniformity in regulations, standards, procedures, and organization in relation to aircraft, personnel, airways and auxiliary services in all matters in which such uniformity will facilitate and improve air navigation."[115]

This seems that each contracting State is obliged to observe Annexes adopted by the council of ICAO. However, pursuant to Article 54(l), the Council shall designate the Standards as Annexes to the Convention only for the sake of convenience;

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[114] See Fiorita, *supra* note 103 at 185-186.

[115] Article 37 of the Chicago Convention, *supra* note 17.

consequently, the legal status of Annexes does not amount to that of the Convention.

The separation of Annexes from the Chicago Convention stemmed from the idea intended to break through the constitutional obstacle faced by the Paris Convention. Any Annex to the Paris Convention was an indivisible part of the Convention, thereby having intrinsically the same legal value. In this regard, annexation at any time could change the rules and principles laid down in the Paris Convention. Many States - especially the United States - could not accept such uncertainty and did not join the Paris Convention.

By virtue of this historical lesson, the Chicago Convention subsequently debarred Annexes from being an integral part of the Convention and from having the same legal effect as that of the Convention.[116] Designating the Standards as Annexes is permitted only for convenience.

Of equal importance, Article 38 also weakens the legal significance of those Annexes by providing States with a possibility to ignore the rules laid down in Annexes. If States find it impracticable to comply in all aspects with Annexes, they have a choice to opt out by immediately notifying ICAO of different practices. This situation could lead to a patchwork of international

law[117] and make all the Annexes, including Annex 13, insignificant.[118]

Pursuant to Article 90(a), the adoption of Annexes might be a vain attempt, when a majority of the contracting States register their disapproval with the Council. This recapitulates that Annex 13 does not have a solid legal status. However, throughout the history of ICAO, no Annex was ever 'disapproved' by a majority of States;[119] even now Article 90(a) has no practical impact on any Annex.

Last, but not least, despite its weak legal nature, the procedures under Annex 13, in practice, are closely adhered to by the signatory countries when engaged in an Article 26

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[116] See Milde "Enforcement of ..." *supra* note 113 at 5.

[117] See D.C. Jennifer, *Aircraft Accident Investigation: The Need for a Stronger International Regime* (LL.M. Thesis, McGill University, 1993) at 28.

[118] Compare T. Buergenthal, *Law-Making in the International Civil Aviation Organization* (Syracuse, New York: Syracuse University Press, 1969) at 57. Mr. Buergenthal believes that although the machinery of Annexation does not meet the optimum demand of the aeronautically advanced States, it improves worldwide air navigation standards, thereby benefiting international aviation generally.

[119] See Milde, "Enforcement of ..." *supra* note 113 at 6.

investigation.[120] In this connection, Annexes are 'frequently compared to the law of gravity' denoting that if States ignore the aviation Standards, risky and costly consequences will ensue. Possibly, such ignorance could result in precluding those States from any meaningful participation in the international aviation community.[121]

In conclusion, Article 26 was oblivious to the accident investigation involving leased aircraft; thus, the ICAO Council has attempted to tackle the problems by adopting Annex 13. However, such Annex lacks the firm legal status and binding force; hence, Article 26 remains 'a prime candidate for a review in the near future.'[122]

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[120] See T. Lenhart, "A Modest Proposal to Encourage Wider Participation in Investigations" (1984) 9:1 Air L. 50 at 51-52.

[121] See Milde, "Aircraft Accident ..." *supra* note 102 at 62; and "Enforcement of ..." *supra* note 113 at 6 & n. 14. Prof. Milde notes that "the former USSR meticulously observed most ICAO Standards ... long before it joined ICAO in 1969; without such compliance their aircraft and personnel could not operate over or into the territory of ICAO States and their aviation products would not be saleable abroad."

[122] Milde, "The Chicago Convention ..." *supra* note 100 at 425.

SECTION IV - OTHER RELATED PROBLEMS IN THE CHICAGO CONVENTION

The Chicago Convention was drafted without the awareness of aircraft leasing. As soon as such practice became the norm, the wording of the Convention, to some extent, was incongruous and caused certain questions as appeared in Articles 5, 15, 24 and 25.

4.1 Article 5 - Right of Non-Scheduled Flight

According to Article 5, each contracting State agrees that all aircraft of the other contraction States not engaged in scheduled international air service shall have the right to make flights into or in transit non-stop across its territory and to make stops for non-traffic purpose without the necessity of obtaining prior permission. This is known as 'transit right' which is the most important and direct recognition of aircraft as being legal entities[123].

The expression 'all aircraft of the other contracting States' refers to aircraft bearing nationality of the other contracting States, whether such aircraft are owned by private individuals or the

State[124]. Predictably, the State of Registry might consider leased aircraft bearing its nationality as its national aircraft; therefore, such aircraft do not have the right under this provision but under the municipal law of the State of Registry instead.

While Article 5 paragraph 1 governs the navigational matter, Article 5 paragraph 2 deals with the economic matter.[125] If such aircraft engaged in the carriage of passengers, cargo or mail for remuneration, they also have the privilege of taking on or discharging passengers, cargo or mail, subject to the conditions imposed by the State where such embarkation or disembarkation takes place. This indicates that the overflown State is entitled to imposed limitation as it may consider desirable. However, bilateral agreements can be concluded for this purpose.

If the State of registry is also the overflown State, it will deem leased aircraft to be its national aircraft, which do not have the right under this provision. Nevertheless, the economic matter always needs the exchange of benefit; hence, the focal point lies in the negotiation between the States concerned. There is no need to review Article 5.

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[123] Cooper, *supra* note 6 at 240.

[124] Cheng, *supra* note 2 at 194.

4.2 Article 15 - Airport and Similar Charges

On the matter of airport and air navigation facilities, Article 15,[126] imposes upon contracting States the following non-discriminatory obligations: [127]

(1) uniform condition shall be applied to the use of airport and air navigation facilities;

(2) any charges for the use thereof by the other contracting States shall not be higher than those paid by its national aircraft; and

(3) no fees shall be levied upon other contracting States in respect solely of the right of transit, entry or exist.

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[125] See P.M. de Leon, "Air Transport as a Service under the Chicago Convention: The Origins of Cabotage" (1994) 19:2 Ann. Air & Sp. L. 523 at 536.

[126] Article 15 of the Chicago Convention, *supra* note 17.

[127] See generally E.O. Bailey, "Article 15 of the Chicago Convention and the Duty of States to Avoid Discriminatory User Charges: The US-UK London Heathrow Airport User Charges Arbitration" (1994) 19:2 Ann. Air & Sp. L. 81.

In relation to leased aircraft at issue, there could be questions arising from (2) and (3) since the State of Registry considers such aircraft as its national one. Since Article 15 does not prohibit discrimination by a State against aircraft on its register,[128] this State can impose charges or fees discriminatorily upon leased aircraft in question.

As long as the State of Registry is also the State of the airport, it is entitled to impose charges on such aircraft higher than those paid by its truly national aircraft. It goes without saying that such a State can impose fees on those aircraft in respect solely of the right of transit, entry or exist.

The problems are outside the regime established by Article 15, which focuses on the term 'the aircraft of any other contracting States' or 'any aircraft of a contracting State'. However, they are considered to be theoretical;[129] thus, no attempt has been made to solve the problems so far.

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[128] FitzGerald, *supra* note 48 at 113 n.29.

[129] ICAO, Panel of Experts, *supra* note 58, para.18 at 6.

4.3 Article 24 – Customs Duty

Although the Taxation of international air transport is not the cardinal concern of the Chicago Convention,[130] Article 24 simply frames the following principles:

(1) aircraft on a flight to, from or across the territory of another contracting State shall be free of duty;

(2) fuel, lubricating oils, spare parts, regular equipment and aircraft stores shall be exempt from customs duty, inspection fees or local duties and charges if they are on board an aircraft of one State, on arrival in the territory of another State and retained on board on leaving the territory thereof; and

(3) Spare parts and equipment imported into the territory of a contracting State shall be free of duty if they are for incorporation in or use on an aircraft of another contracting State engaged in international navigation.

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[130] See R.I.R. Abeyratne, "The Economic Relevance of the Chicago Convention - A Retrospective Study" (1994) 19:2 Ann. Air & Sp. L. 3 at 39.

The provision does not forbid the State of Registry to impose such fees, duties or charges upon aircraft bearing its nationality and operated by another State. The State of Registry can abuse such encumbrances on the discriminatory basis which might hamper the operation of such aircraft. However, whereas certain States construe Article 24 inapplicable to leased aircraft at issue, the problem is considered to be theoretical and the Article is left untouched eventually.[131]

4.4 Article 25 – Aircraft in Distress

Pursuant to Article 25, each contracting State shall provide assistance to aircraft in distress in its territory. It also permits the State of Registry to provide assistance.

With regard to leased aircraft in distress, the Article does not make any reference to the State of the Operator for providing those measures of assistance. According to Panel of Experts, the difficulty would be resolved in Annex 12 (Search and Rescue).[132]

To summarize, although many problems relevant to aircraft leasing *vis-à-vis* the Chicago Convention seem hypothetical

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[131] See FitzGerald, *supra* note 48 at 113.

[132] ICAO, Panel of Expert, *supra* note 58, para.20 at 7.

and insignificant, the international aviation community should not be unaware of them. The problems are really of an international matter but slip into a domain of domestic law. Any deviation from the uniform benchmarks established in the Chicago Convention is likely to happen at any time, depending upon the arbitrariness of each State.

SECTION V - AVIATION SECURITY CONVENTIONS

The criminal jurisdiction of the State of the Operator in relation to leased aircraft was not recognized in the first aviation security Convention – viz. the Tokyo Convention. Nevertheless, since the increasing number of aircraft hijacking forced the international aviation community to improve the security regime, the criminal jurisdiction thereof, *inter alia*, was established in the subsequent Conventions – viz. the Hague Convention and the Montreal Convention.

Some thirty years ago, the international aviation community lacked the legal mechanism to prevent or suppress unlawful acts against aircraft, airport or air navigation facilities, despite the vulnerable nature of aviation. Subsequently, the emergence of criminal acts - such as the hijacking of aircraft, the holding of hostages on aircraft and the sabotage of aircraft and air

navigation facilities - necessitated the international solution. Under the framework of ICAO, the following aviation security Conventions were adopted:

(1) the Convention on Offences and Certain Other Acts Committed on Board Aircraft signed on 14 September 1963 at Tokyo[133] [hereinafter 1963 Tokyo Convention];

(2) the Convention for the Suppression of Unlawful Seizure of Aircraft signed on 16 December 1970 at the Hague[134] [hereinafter 1970 Hague Convention];

(3) the Convention for Suppression of Unlawful acts against the Safety of Civil Aviation signed on 23 September 1971 at Montreal[135] [hereinafter 1971 Montreal Convention];

(4) the Protocol for the Suppression of Unlawful Acts of Violence at Airport Serving International Civil Aviation, Supplementary to the Convention for Suppression of Unlawful acts against the Safety of

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[133] ICAO Doc. 8364.

[134] ICAO Doc. 8920.

[135] ICAO Doc. 8966.

Civil Aviation, signed on 24 February 1988 at Montreal;[136]

(5) the Convention on the Marking of Plastic Explosives for the Purpose of Detection signed on 1 March 1991 at Montreal.[137]

However, only Conventions in (1), (2) and (3) are, to some extent, relevant to aircraft leasing issue and therefore will be examined here on the subject of criminal jurisdiction.

5.1 Overview of the Three Conventions

Due to the fact that aircraft in international transport fly rapidly through many sovereign States and over the High Seas, it is difficult to pinpoint exactly where criminal acts on board aircraft are committed. The concurrence of jurisdiction may happen, or some States may evade their responsibility to establish the criminal jurisdiction over the case.

To illustrate, in the United States of America v. Cordova case,[138] the court released the defendants on the ground that

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[136] ICAO Doc. 9518.

[137] ICAO Doc. 9571.

[138] See U.S. Aviation Rep. 1 (1950).

there was no US law governing unlawful acts committed on board aircraft above the High Seas. As well, Belgium did not extend its jurisdiction to cover unlawful acts committed on board foreign aircraft, unless the victim was a Belgian citizen or the aircraft lands in Belgium after commission of an offence.[139]

To settle the problems, the 1963 Tokyo Convention took the first and valuable step towards the establishment of the State of Registry's jurisdiction over offences committed on board aircraft while aircraft are in flight, over the high seas or outside the territory of any State.[140]

The Convention also provided the powers of aircraft commander to restrain and deliver the alleged offender to the competent authorities of any contracting State[141] because only having such jurisdiction does not guarantee that the alleged offender would be in custody.

However, the 1963 Tokyo Convention was outdated almost instantly after its adoption because it governs unlawful acts committed only on board aircraft and has no definition of the term 'unlawful act'. Moreover, only the State of Registry, with certain

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[139] Matte, *supra* note 71 at 328 n.10.

[140] Article 3 of the 1963 Tokyo Convention, *supra* note 133.

[141] Article 5 – 10 of the 1963 Tokyo Convention, *ibid.*

exceptions, is competent to establish the criminal jurisdiction over such an offence.

The dramatically increasing number of aircraft hijacking in the 1970s proved the inadequacy of the 1963 Tokyo Convention to handle the situation of aviation security. Consequently, the 1970 Hague Convention was adopted to minimize the problems. This Convention defined the unlawful seizure of aircraft as an offence punishable by severe penalties,[142] extended criminal jurisdiction to other concerned States tantamount to universal jurisdiction[143] and obliged contracting States the duty either to extradite or to prosecute the alleged offender.[144]

Nevertheless, since the 1970 Hague Convention focused on aircraft in flight only and disregarded other security chains, ICAO, in order to widen the aviation security regime, adopted the 1971 Montreal Convention.

The 1971 Montreal Convention defined acts of interference with civil aviation as follows: violence against persons on board aircraft in flight; sabotage or destruction of aircraft in service; damage of air navigation facilities; placing of dangerous

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[142] Articles 1-2 of the 1970 Hague Convention, *supra* note 134.

[143] Article 4 of the 1970 Hague Convention, *ibid.*

[144] Article 7 of the 1970 Hague Convention, *ibid.*

substances on board aircraft; and communication of information known to be false in order to endanger the safety of aircraft in flight.[145] In the matters of jurisdiction, applicability and extradition, the 1971 Montreal convention is almost a verbatim quotation of the 1970 Hague Convention.

5.2 Criminal Jurisdiction

According to Article 3 of the Tokyo Convention, the State of Registry is competent to exercise jurisdiction over offences or acts committed on board aircraft. Other contracting States may not interfere with aircraft in flight in order to exercise their jurisdiction except in the following cases:[146]

(a) the offence has effect on their territories;

(b) their nationals or permanent residents have committed the offence;

(c) their security is affected by the offence;

(d) their flight rules are violated by the offence; or

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[145] Article 1 of the 1971 Montreal Convention, *supra* note 135.

[146] Article 4 of the 1963 Tokyo Convention, *supra* note 133.

(e) the exercise of jurisdiction is necessary to ensure their observance of international obligations

Although the State of the Operator possesses the actual control of leased aircraft, the provision would not be applied to it. The Convention is not helpful in the present situation whereby most of the aircraft are registered in one State but operated by another. Furthermore, since criminal acts are undefined and the Convention does not create an obligation with respect to extradition of offenders,[147] the State of Registry is not obliged to exercise its jurisdiction.

In retrospect, there was a proposal to insert the following draft Article into the 1963 Tokyo Convention:

> "An aircraft chartered on a bare-hull basis to an operator who is a national of a State other than the State of Registration shall be treated for the purposes of this Convention as if throughout the period of the charter it was registered in that other State."

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[147] See M. Milde, "The International Fight against Terrorism in the Air" in C.-J. Cheng, ed., *the Use of Airspace and Outer Space for All Mankind in the 21st Century* (the Netherlands: Kluwer Law International, 1995) 141 at 147.

This draft permitted the State of the Operator to establish its jurisdiction in lieu of the State of Registry. Unfortunately, the ICAO Legal Committee considered it inappropriate to intertwine criminal jurisdiction with a private-law transaction.[148] Additionally, a more recent attempt to amend and reach a final decision on the subject was considered to be premature by the Special Subcommittee on Lease, Charter and Interchange of Aircraft in International Operations (Montreal, March 23-April 5, 1977). Therefore, the Subcommittee decided merely to report to the Legal Committee the discussion.[149] In the consideration of the matter, the Legal Committee could not unite the different opinions and no conclusion was reached eventually.[150]

Nonetheless, the 1970 Hague Convention and the 1971 Montreal Convention eliminated such a shortcoming and created the system of multiple jurisdiction. As a result, The State of the

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[148] ICAO Doc. 8582-LC/153-2 Legal Committee, 15th Session, Montreal, 1-19 September 1964, vol. II, Document 134-143.

[149] See FitzGerald, *supre* note 48 at 132-135.

[150] ICAO Doc. 9238-LC/180-1, Legal Committee, 23rd Session, Minutes, 17th Meeting, Montreal, 21 February 1978, para. 17 at 92.

Operator, among other States,[151] is competent to establish its jurisdiction over the offence 'when the offence is committed (against or) on board an aircraft leased without crew to a lessee who has his principal place of business or, if the lessee has no such place of business, his permanent residence, in that State.'[152]

The jurisdictional priority between the State of the Operator and the other competent States could be questioned. The two Conventions do not establish priority among the competent jurisdiction since one of their aims is to enlarge the aviation security regime so that the perpetrators can not escape sanctions by virtue of a conflict of jurisdiction.[153] This means that any competent State is empowered to establish its jurisdiction over the offence.

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[151] Roughly speaking, the competent States in the 1970 Hague Convention are (1) the State of Registry (2) the State of Landing (3) the State of the Operator and (4) the State where the offender is found. In the 1971 Montreal Convention, the competent States are not only the same as those of the 1970 Hague Convention but also the State in whose territory the offence is committed.

[152] Article 4(c) of the 1970 Hague Convention, *supra* note 134; and Article 5(d) of the 1971 Montreal Convention, *supra* note 135. The different wording of the two Articles-'on board' and 'against or on board' respectively attributes to the different scopes of the two Conventions. The former deals specifically with aircraft hijacking whereas the latter covers various acts against the safety of civil aviation.

[153] See Matte, *supra* note 71 at 355.

Notwithstanding the absence of the principle *ne bis in idem*[154] in the two Conventions, the majority of States implicitly acknowledge the principle,[155] thereby recognizing that although the offence could be under the jurisdiction of any competent State, including the State of the Operator, the offender shall not be punished twice or more for committing one unlawful act.

Last, but not least, there remains a missing link between the 1963 Tokyo Convention and the other two Conventions. While the former deals primarily with general criminal acts on board aircraft, the latter deal with specific offences. In this regard, the broader scope of criminal jurisdiction in the latter two Conventions may not cover criminal acts pursuant to the 1963 Tokyo Convention. This means that, for example, the sexual offence is committed on board a leased aircraft, registered in the USA but operated by Thailand, during the flight from Bangkok to London. According to the 1963 Tokyo Convention, only the USA as the State of Registry is competent to establish its jurisdiction over the offence.

However, it is likely on the arrival at the UK airport that police refuse to take the alleged offender into custody because the aircraft was not registered in the UK and the offence was not

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[154] Nobody should be prosecuted for the same act twice.

[155] See Matte, *supra* note 71 at 359.

committed in the UK airspace; as a result, the English court does not have jurisdiction and has to free the accused.[156]

Sooner or later, the 1963 Tokyo Convention should be amended to cover criminal jurisdiction relevant to crimes not found in the 1970 Hague or 1971 Montreal Conventions.[157]

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[156] See D.M. Fiorita, "Aviation Security: Have All the Questions Been Answered?" (1995) 20:2 Ann. Air & Sp. L. 69 at 83-84.

[157] See *ibid* at 89-90.

CHAPTER 3 INTERNATIONAL AIRCRAFT LEASING: IMPACT ON PRIVATE INTERNATIONAL AIR LAW TREATIES

The 1952 Rome Convention and the 1948 Geneva Convention have faced problems concerning the widespread use of international aircraft leasing. In addition, the international community after experiencing such a phenomenon for some times has endeavored to develop the *sui generis* Convention to govern the situation in general.

First of all, the advent of international aircraft leasing pinpoints the loophole in the 1952 Rome Convention in relation to its applicability. Since the Convention disregards the significance of the State of the Operator, international-oriented problems may be viewed as domestic matters. However, the difficulties are resolved in the 1978 Montreal Protocol by recognizing the State of the Operator's rights and duties.

Secondly, since the 1948 Geneva Convention recognizes all kinds of security rights in aircraft, it can overcome a 'true sale' situation. Although the Convention attempted to enumerate priority among the recognized rights (in a quite

perplexing manner), the creditors and the lessors of the same priority need to clarify that which one will take priority.

Moreover, the 1948 Geneva Convention did not realize the modular nature of aircraft; thus, the aircraft engines are deemed as component parts of aircraft. As far as leasing is concerned the commotion can happen among the concerned parties if the engines as such are switched to another aircraft or replaced the new engines that are leased from another lessor.

Finally, since many States do not welcome the unique feature of international financial leasing – including aircraft leasing – UNIDROIT created the *sui generis* Convention on the subject. The UNIDROIT Convention profoundly recognizes the tripartite feature of such transactions, bypasses the apparent independent agreements and establishes the legal direct links without relying on the concept of privity of contract.

SECTION I - 1952 ROME CONVENTION AND THE 1978 MONTREAL PROTOCOL

This section will examine the general principles of the 1952 Rome Convention and the 1978 Montreal Protocol and then discuss problems concerning leased aircraft.

1.1 Overview of the Two Treaties

The 1952 Rome Convention[1] deals with liability of aircraft owners and operators for damage caused to persons or property on the surface. Among other things, the fundamental principles of the Convention are to be mentioned here.

Firstly, the applicability of the Convention is on the condition that: an aircraft registered in one contracting State causes damage to third parties on the surface in the territory of another contracting State.[2]

Secondly, in accordance with the concept of risk, innocent third parties on the surface are incapable of preventing the overflight of aircraft above their domains.[3] As a result, the regime of strict liability was established but limited to a sum proportionate to the aircraft weight 'in order not to hinder the development of international civil air transport.'[4] In addition, since the risk of accidents is the result of the operation - not the ownership - of the

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[1] *Convention on Damage Caused by Foreign Aircraft to Third Parties on the Surface*, signed at Rome, on 7 October 1952, ICAO Doc. 7364 [hereinafter 1952 *Rome Convention*].

[2] Article 23(1) of the 1952 Rome Convention, *ibid.*

[3] See N.M. Matte, *Treatise on Air-Aeronautical Law* (Toronto: The Carswell Co. Ltd., 1981) at 504.

[4] The Preamble of the 1952 Rome Convention, *supra* note 1.

aircraft, the operator - not the owner - should be liable for any damage therefrom.[5]

Lastly, actions could be brought before the court of the contracting State where the damage was occurred or, by agreements between claimants and defendants, before the court or arbitration of any State.[6]

Because the 1952 Rome Convention did not gain wide acceptance, ICAO endeavored to improve the system by adopting the 1978 Montreal Protocol[7]. The Protocol brought certain changes to the 1952 Rome Convention, including the introduction of the Special Drawing Right (SDR),[8] the increase of liability limitation and the definition of the State of the Operator.

However, the proposal aimed at applying the Protocol to damage caused by noise and sonic boom was rejected; the liability limitation was not based on the economic data. The 1978

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[5] See Matte, *supra* note 3 at 504.

[6] Article 20 of the 1952 Rome Convention, *supra* note 1.

[7] *Protocol to Amend the Convention on Damage Caused by Foreign Aircraft to Third Parties on the Surface Signed at Rome on 7 October 1952*, signed at Montreal on 23 September 1978, ICAO Doc, 9257.

[8] See generally A. Tobolewski, "The Special Drawing Right in Liability Convention: An Acceptable Solution?" (1979) Lloyd's Maritime & Com. L.Q. 169.

Montreal Protocol 'shows once more the serious difficulties faced by those who attempt to revise existing liability conventions.'[9]

1.2 Issues Related to Leased Aircraft

As far as leased aircraft are concerned, three relevant issues come to the scene. First, the operator is a principal person liable to third parties. Second, the State of the Operator is not governed by the 1952 Rome Convention. Lastly, the Overflown State may require the guarantee for the operator's liability.

(a) Liability of the Operator

Since the Rome Convention imposes liability on the operator of aircraft, it deals properly with the situation whereby leased aircraft cause damage to third parties on the surface. The operator is defined as the person who is making use of aircraft at the time of damage for its own interest either directly or through his employees or agents.[10] The operator is liable as long as their

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[9] See G.H. FitzGerald, "The Protocol to Amend the Convention on Damage Caused by Foreign Aircraft to Third Parties on the Surface (Rome, 1952) Signed at Montreal, September 23, 1978" (1979) 4 Ann. Air & Sp. L. 29 at 73.

[10] Article 2(2a) of the 1952 Rome Convention, *supra* note 1.

employees or agents use aircraft in the course of their employment regardless of the scope of their authority.[11]

Additionally, in order to ensure the third parties' rights to compensation, the registered owner is presumed to be the operator liable for damage unless it proves the contrary during the legal proceedings and makes the real operator become a party in the proceedings.[12] Any financier lending money to airlines under the title-based financing should be aware of liability it is presumed.

(b) Applicability of the 1952 Rome Convention and the 1978 Montreal Protocol

There are various cases that demonstrate the possible application of the two treaties; however, two cases will be focused on here. The first case lies outside the scope of the 1952 Rome Convention attributing to the absence of an international link, and the second case owing to the inappropriate criteria of the Convention that emphasizes mainly on the State of Registry. As a result, the 1978 Montreal Protocol was adopted to overcome, *inter alia*, these difficulties.

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[11] Article 2(2b) of the 1952 Rome Convention, *ibid.*

[12] Article 2(3) of the 1952 Rome Convention, *ibid.*

TABLE I

	THE LEGAL STATUS OF			*THE APPLICATION OF*	
	THE STATE OF OCCURRENCE	*THE STATE OF REGISTRY*	*THE STATE OF THE OPERATOR*	*The 1952 Rome Convention*	*The 1978 Montreal Protocol*
1	Party	Party	Party	Yes	Yes
2	Party	Party	Non-Party	Yes	Yes
3	Party	Non-Party	Non-Party	No	No
4	**Party**	**Non-Party**	**Party**	**No**	**Yes**

- The State of Occurrence, the State of Registry and the State of the Operator are different States.

If the 1952 Rome Convention is based on the hypothesis that the occurrence of damage results from the operation, not the ownership, of aircraft,[13] the State of the Operator should have been a condition for the Convention's application. However, the 1952 Rome Convention is inconsistent with such hypothesis because Article 23 lays down that:

Article 23 of the 1952 Rome Convention

"1. This Convention applies to damage contemplated in Article 1 caused in the territory of a Contracting

[13] See Matte, *supra* note 3 at 504.

State by an aircraft registered in the territory of another Contracting State."[14]

Consequently, the Convention will be applied only to the case that both the State of Occurrence and the State of Registry are the Parties to the Convention, without regard to the State of the Operator. This is why the 1952 Rome Convention can not applied to Case no.4, which the State of the Operator who has actual control of aircraft is the Party State but the State of Registry is not the Party State.

Nonetheless, the 1978 Montreal Protocol changed the above condition by providing an alternative focussing on the State of the Operator.[15] Article 12 stipulates that:

Article 12 of the 1978 Montreal Protocol

"1. This Convention applies to damage contemplated in Article 1 caused in the territory of a Contracting State by an aircraft registered in another Contracting State or by an aircraft, **whatever its registration may be**, the operator of which has his principal place of business or, if he has no such place of business, his

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[14] *Supra* note 1.

[15] Pursuant to Article 17 of the 1978 Montreal Protocol, the State of the Operator means "any Contracting State other than the State of registry on whose territory the operator has his principal place of business or, if he has no such place of business, his permanent residence." *Supra* note 7.

permanent residence in another Contracting State"[16] [emphasis added].

The clause 'whatever registration of aircraft may be' indicates that the Convention no longer relies on the State of Registry. Given Case no.4, although the State of Registry is not the Party State, the Protocol is applicable if the State of the Operator is the State Party to the Protocol.

TABLE II

	THE LEGAL STATUS OF			*THE APPLICATION OF*	
	THE STATE OF OCCURRENCE	*THE STATE OF REGISTRY*	*THE STATE OF THE OPERATOR*	*The 1952 Rome Convention*	*The 1978 Montreal Protocol*
5	**Party**		**Party**	**No**	**Yes**
6	Party		Non-Party	No	No

- The State of occurrence and the State of Registry are the same State.

According to Case no.5, there is the classical example clarified by Dean P. Chauveau as follows:

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[16] *Ibid.*

> "SABENA is operating a flight from Brussels to Paris with an aircraft belonging to Air France. While flying over a French city, the aircraft crashes into a Gas Works, which explodes and lays waste a whole district. ... SABENA will not be able to avail itself of its provisions since the Convention (Article 23 Rome Convention) applies to damage arising on the territory of one contracting State and caused by aircraft registered in the territory of another contracting State."[17]

However, Article 12 of the 1978 Montreal Protocol sheds light on this problem provided that the State of the Operator is the State Party to the Protocol, irrespective of 'whatever registration of aircraft may be.' Therefore, even though leased aircraft are registered in the State of Occurrence, the Protocol remains applicable to the situation.

(c) Guarantee for the Operator's Liability

On the authority of Article 15 of the 1952 Rome Convention, any contracting State may require that the operator of an aircraft registered in another contracting State shall be secured

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[17] ICAO Doc.7921-LC/143-2, Legal Committee, 11th Session, Tokyo, 12-25 September 1957, para.24 at 19.

by means of insurance,[18] a cash deposit, a bank guarantee, or a State guarantee.[19] In addition, if the Overflown State has reasonable grounds for doubting such guarantees, it may request additional evidence of financial responsibility.[20]

Nevertheless, the 1978 Montreal Protocol widens the scope by permitting the Overflown State to request those guarantees from the operator who has its principal place of business or, if not, its permanent residence in another contracting State.

Moreover, the Overflown State may require consultation with the State of Registry or the State of the Operator provided that such guarantees do not financially satisfy the obligations under the Convention.[21] Hence, this could minimize the difficulties concerning leased aircraft.

SECTION II - 1948 GENEVA CONVENTION

This section will first describe the basic principles of the 1948 Geneva Convention and then will examine issues related to international aircraft leasing.

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[18] Article 15(1) of the 1952 Rome Convention, *supra* note 1.

[19] Article 15(4) of the 1952 Rome Convention, *ibid.*

[20] Article 15(7) of the 1952 Rome Convention, *ibid.*

[21] Article 6 of the 1978 Montreal Protocol, *supra* note 7.

2.1 Overview of the 1948 Geneva Convention

As soon as the acquisition of aircraft is based on cross-border transactions, the legal uncertainty and financial risk arrive. By and large, to protect the interest of creditors, security rights are contained in every contract of that kind. However, since aircraft at issue are operated internationally, they inevitably deal with various legal approaches.

Each State creates its own system of security rights in order to balance the domestic financial interest among parties concerned, namely banks, industry and consumers. The system consists of a 'closed' limited set of property rights having *erga omnes* effect,[22] thereby denying any different secured right in the visiting foreign aircraft.

Without an international treaty governing the situation, third parties, such as suppliers of goods or services and tax authorities, having special priority rights under rules of national law, may arrest the aircraft, leaving the mortgagee in uncertainty.[23]

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[22] See M.V. Polak, "Conflict of Laws in the Air: Some Legal Issues of International Aircraft Financing and Leasing" (1992) 17:2 Air & Sp. L. 78 at 80-81.

[23] See B.J.H. Crans, "Selected Pitfalls and Booby-Traps in Aircraft Finance" in B.J.H. Crans, ed., *Aircraft Finance* (the Netherlands: Kluwer Law International, 1995) 1 at 3.

This could make a hundred-page contract meaningless and hamper the development of aviation financing.

These circumstances were taken into account by CITEJA.[24] Unfortunately, the draft Convention in 1931 was largely theoretical, and thus not proceeded with before the Second World War. However, after the War, the USA urged the international community to find a solution on the subject. In addition, due to the growth of international aviation and the expansion of the export trade in aircraft coerced States into concluding the treaty on security rights. Even though ICAO attempted to devise an internationally acceptable standard form of charges on aircraft, it was unsuccessful because of the divergence in national conceptions.[25]

While the USA had a highly developed technique of airline finance, evolved by practice and analogy from railroad finance, others had different approaches, and the rest had yet to formulate their own domestic laws on the subject.[26] This scenario

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[24] Comité International d'Experts Juridiques Aeriens (CITEJA) see generally J.J. Ide, "The History and Accomplishments of the International Technical Committee of Aerial Legal Experts (C.I.T.E.J.A.)" (1932) 3:1 J. Air L. & Com. 27.

[25] See R.O. Wilberforce, "The International Recognition of Rights in Aircraft" (1948) 2 Int'l L.Q. 421 at 422-423.

[26] See *ibid.* at 423.

changed the theme of the Convention from unification to recognition of security rights.

As a consequence, in June 1948, ICAO approved the Convention on International Recognition of Rights in Aircraft.[27] Since it is a recognition treaty, individual States are free to maintain or create their own legal concepts and laws regarding charges on aircraft without prejudice to the Convention.[28] However, the fundamental principles of the Convention are, *inter alia*, examined below.

Firstly, the persons involved in aircraft financial transactions are, to some extent, protected. The Convention recognizes a set of specific rights, in spite of giving no definition to them. Those rights will be accepted internationally provided that they are legally constituted and regularly recorded in the State of Registry. The recognized rights are enumerated as follows.[29]

(1) Rights of property in aircraft cover outright ownership of the aircraft where legal and beneficial

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[27] *Convention on the International Recognition of Rights in Aircraft*, signed at Geneva, 19 June 1948, ICAO Doc.7620 [hereinafter *1948 Geneva Convention*].

[28] T. Conlon, "The Aircraft Mortgages Convention: The United Kingdom Moves Toward Ratification" (1977) 43 J. Air L. & Com. 731 at 746.

ownership is a combination.[30] The term also refers to the one who is destined to become the owner, whether it is a matter of a conditional sale, lease or hire purchase contract.[31]

(2) Rights to acquire aircraft by purchase coupled with possession of the aircraft are devised to protect the option rights of a purchaser under a hire-purchase agreement or equipment trust to have the property in the aircraft transferred to him in accordance with the terms of his agreement.[32]

(3) Rights to use an aircraft under a lease of six months are recognized in order to protect a sub-lessor as against the original lessor.[33]

(4) Mortgages, hypotheques and similar rights in aircraft include security rights of all kinds, irrespective of their names provided that they are

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[29] Article 1 of the 1948 Geneva Convention, *supra* note 27.

[30] Subcommittee of the Air Coordinating Committee, "Annotated Text of Convention on International Recognition of Rights in Aircraft" (1970) 16:1 J. Air L. & Com. 69 at 69.

[31] See Matte, *supra* note 3 at 567.

[32] Subcommittee, *supra* note 30.

[33] *Ibid.* at 71.

contractually created as security for payment of a debt.[34]

Secondly, third parties are protected from hidden security rights. They are entitled to receive certified copies or extracts of the particulars recorded. However, such documents constitute only *prima facie* evidence of the contents of the record;[35] thus, if the documents are proved inaccurate, they will lose such legal status without affecting the record thereof. Individuals damaged by inaccurate copies have to bring their claims for compensation under the national law.[36]

Thirdly, although the extension of the creditors' secured rights over spare parts is considered to be a monstrosity,[37] 'spare parts' are subsumed within the scope of the convention provided that:

(1) the law of the State of Registry permits;

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[34] See *ibid.*

[35] Article 3 of the 1948 Geneva Convention, *supra* note 27.

[36] Conlon, *supra* note 28 at 737.

[37] See J.W.F. Sundberg, "Rights in Aircraft: A Nordic Lawyer Look at Security in Aircraft" (1983) 8 Ann. Air & Sp. L. 233 at 237.

(2) spare parts are stored in specified places; and

(3) an appropriate notice is exhibited at the place where the spare parts are located so as to give due notice to third parties that such spare parts are encumbered.[38]

Fourthly, pursuant to the Convention, the judicial sale is the sole method of enforcement of rights in aircraft. The proceedings of aircraft in execution shall be determined by the law of the State where the sale takes place. However, although the Convention does not attempt to establish a uniform procedure at issue, it requires certain minimum standards as follows:

(1) the date and place of the sale shall be fixed at least six weeks in advance; and

(2) the executing creditor shall (a) supply the Court an extract of the recordings concerning the aircraft; (b) give public notice of the sale at the State of Registry at least one month before the fixed date; and (c) notify by registered letter the recorded

[38] Article 10 of the 1948 Geneva Convention, *supra* note 27.

owner and the holders of recorded rights in the aircraft.[39]

Last, but not least, according to the foregoing judicial sale, the transfer of aircraft shall be free from all rights, which are not assumed by the purchaser. This follows the doctrine of '*la purge*' that upon sale of a secured chattel, a clear title will be vested in the purchaser at the sale, free and clear of all preexisting liens.[40]

2.2 Issues Related to Aircraft Leasing

Even though the Convention does not deal directly with aircraft leasing issues, there are certain points worth discussing here, namely a 'true sale' situation, priority of the recognized rights and an aircraft engine leasing issue.

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[39] Article 7 of the 1948 Geneva Convention, *ibid.*

[40] G.N. Calkins, Jr., "Creation and International Recognition of Title and Security Rights in Aircraft" (1949) 15 J. Air L. & Com. 156 at 172.

(a) 'True Sale' Situation

The Convention recognizes not merely a lessor's title as owner but also a lessee's rights to possess leased aircraft provided that the requirements under Article 1 are satisfied. Without the Convention, a local jurisdiction may not recognize a lease agreement as giving the airline a mere possessory interest and, therefore, may give effect to it as if ownership had in fact passed to the airline.[41]

The financier who possesses the ownership of aircraft as financial security will lose his security in relation to that jurisdiction. Obviously, the 'true sale' situation could undermine a title-based structure of aircraft financing and curtail airlines' opportunity to acquire a fleet of aircraft.

(b) Priority of the Recognized Rights

Since there are a variety of rights to be claimed over aircraft, the Convention attempts to establish the following order of priority:[42]

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[41] A. Littlejohns, "Legal Issues in Aircraft Finance" in S. Hall, ed., *Aircraft Financing*, 2nd ed. (Great Britain: Euromoney Books, 1993) 281 at 282.

[42] See Crans, *supra* note 23 at 3-5.

(1) claims based on Article 12 stipulating that 'nothing in this Convention shall prejudice the right of any Contracting State to enforce against an aircraft its national laws relating to immigration. customs or air navigation';[43]

(2) claims based on Article 7, paragraph 6 stipulating that costs of sale in execution 'shall be paid out of the proceeds of sale before any claims, including those given preference by Article 4';[44]

(3) claims based on Article 10 concerning spare parts, which 'the competent authority may limit the amount payable to holders of prior rights to two-thirds of such proceeds of sale after payment of the costs referred to in Article 7, paragraph 6';[45]

(4) (4.1) claims based on Article 4 stipulating that salvage and preservation costs 'shall take priority over all other rights in the aircraft';[46] (4.2) claims based on Article 7, paragraph 5(b) stipulating that 'any right referred to in Article 1 may not be set up

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[43] Article 12 of the 1948 Geneva Convention, *supra* note 27.

[44] Article 7 of the 1948 Geneva Convention, *ibid.*

[45] Article 10 of the 1948 Geneva Convention, *ibid.*

[46] Article 4 of the 1948 Geneva Convention, *ibid.*

against' injured persons on the surface in excess of an amount equal to eighty per cent of the sale price;[47] and (4.3) claims based on Article 1, such as purchase options, lease rights and mortgage rights,[48] over which contracting States shall not admit any right as taking priority.

The Convention leaves claims under (1), (2) and (3) in the realm of national law of the State where the sale in execution takes place. Whether these claims are to be placed ahead of the rights of lessees, mortgagees or purchasers depends on the arbitrariness of such State.

However, since lessees, mortgagees and purchasers are of equal positions, they should have an agreement specifying that who takes priority. If it is unavoidable, for commercial or tax reasons, to record such rights in the State of Registry, the clarification is required that who should be subsequent to whom.[49]

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[47] Article 7 of the 1948 Geneva Convention, *ibid.*

[48] Article 1 of the 1948 Geneva Convention, *ibid.*

[49] See Crans, *supra* note 23 at 4.

(c) Engine Leasing[50]

Aircraft are modular by nature - that is, there are many separate components of an aircraft that are readily replaceable by other components. The most important of these are aircraft engines.[51] Pursuant to Article 16 of the 1948 Geneva Convention, the term 'aircraft' shall include, *inter alia*, the engines whether installed therein or temporarily separated therefrom.

This appears acceptable to all legal systems. Since engines are essential to the very nature and existence of aircraft, they are often considered as component parts thereof. As a rule, the owner of aircraft has the ownership in its component parts; hence, engines, when installed on aircraft, lose its independent title.

However, there is no definition of the term 'temporarily separated'. In practice, engines are interchangeable and may be detached, not just temporarily, from aircraft and subsequently attached to someone else's aircraft.[52] The ownership of such engines is at once transferred accordingly.

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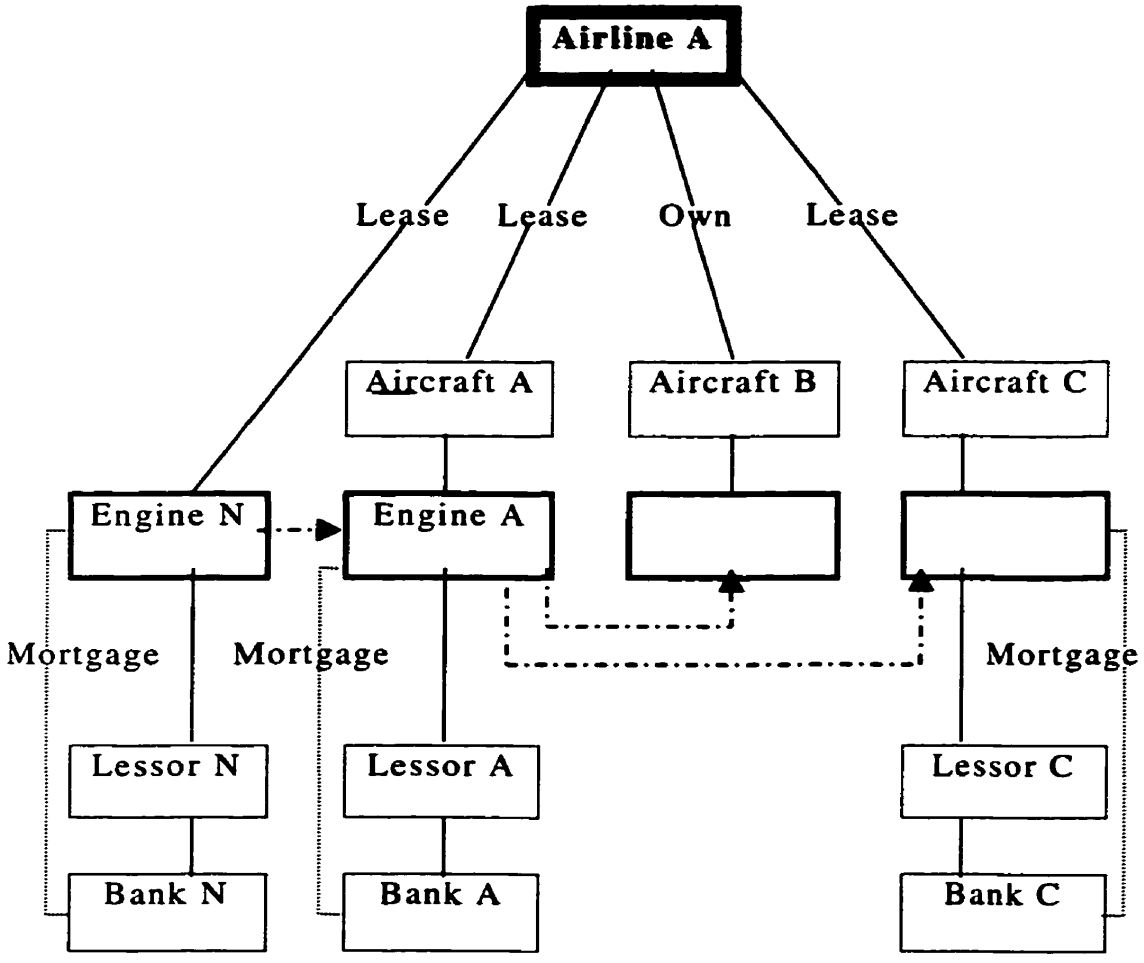
[50] See *ibid.* at 5-7; and see also H. Lind, "Engine Covenants: An Insoluble Problem?" (October 1990) Int'l Financial L. Rew. 25.

[51] M.K. Feldman, "Legal Opinions in Secured Aircraft financing Transactions" (1990-1991) Banking and Finance L. Rew.127 at 131-132.

[52] Crans, *supra* note 23 at 5.

By force of this circumstance, not only the parties financing the aircraft but also the third parties financing the engines could fall in the midst of chaos.[53] The following chart will show the aforementioned problem.

CHART[54]



[53] See Feldman, *supra* note 51 at 132.

- Aircraft A is leased from Lessor A and mortgaged in favor of Bank A.
- Aircraft B is owned by Airline A.
- Aircraft C is leased from Lessor C and mortgaged in favor of Bank C.

Since engines are interchangeable, Aircraft A's Engine may be removed and installed on Aircraft B or Aircraft C. If the engine is considered as a component part of aircraft, the results are that:

(1) Engine A's title is immediately transferred from Lessor A to Airline A or to Lessor C;
(2) the value of Bank A's Security is reduced substantially.

- A new engine(Engine N) is leased from Lessor N and mortgaged in favor of Bank N.

As soon as Engine N is installed on Aircraft A in place of the old one, Lessor N loses the Engine N's title to Lessor A and the Bank N's security in such engine disappears. However, since Lessor A, without legal ground, gains the value of Engine N higher

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[54] See Crans, *supra* note 23 at 6.

than that of Engine A, a claim of undue enrichment might be filed to neutralize the surplus.

As long as the term aircraft encompasses the engines, the aforesaid difficulties remain possible in reality. However, alternatives could be that (1) Airline A's total debt should be provided by one syndicate of banks; or (2) a separate agreement between parties involved should be inserted a settlement-mechanism. In the event engines are switched, excess value compensation should be calculated by reference to engine hours and maintenance reserves received.[55]

Last, but not least, any future amendment to the 1948 Geneva Convention should take into account the situation above and should establish the principles that recognize the modular nature of aircraft and engines.

SECTION III – UNIDROIT Leasing Convention

Without capital, no business can be run. The mission of financiers is to provide the business community with such an indispensable factor. In order to make loans and get them repaid, financiers are always conservative and impressed by certainty,

[55] See *ibid.* at 7.

stability and predictability.[56] Although international leasing is utilized as title-based security for financiers, its implementation is uncertain, unstable and unpredictable attributing to the nebulousness and fragmentary nature of different domestic laws on leasing. Various attempts to force leasing into the existing legal classifications have invariable failed, as each jurisdiction has naturally tended to pursue the internal logic of its own legal system.[57]

To overcome the difficulty, UNIDROIT[58] had drafted the Convention on International Financial Leasing[59] since February 1974; subsequently, the draft Convention was approved by the Ottawa Diplomatic Conference in May 1988.

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[56] J.R. Lientz, "Capital Formation for Airline Industry: Are the Banks Going to be There?" (1979) 7:3 Int'l Bus. Law. 159 at 159-160.

[57] See A. Hornbrook, ed., "Introduction to leasing-UNIDROIT" (1986) W. Leasing Y.B. 41 at 41.

[58] The International Institute for the Unification of Private Law (UNIDROIT) is an independent organization, formerly associated with the League of Nations. In 15 March 1940, UNIDROIT was re-established by the UNIDROIT Charter. Its functions are to examine ways of harmonizing and coordinating the private law of States and group of States, and to prepare gradually for the adoption by various States of uniform legislation in the field of private law (Article 1).15 U.S.T. 2495, T.I.A.S. no. 5743. U.K.T.S.1965 no.54.

The UNIDROIT Leasing Convention is expected to establish uniform commercial laws governing the triangular nature of international financial leasing. If successful, it not merely facilitates financial activities but also promotes international business in general.[60]

3.1 Scope of the UNIDROIT Leasing Convention

Generally speaking, lessees want to acquire the right to use equipment, lessors want the nominal title of such equipment to secure their interests, and suppliers want to sell the equipment to whoever is able to buy. Under this circumstance, international financial leasing could satisfy the need of all the parties concerned.

In such an activity, there are at least two independent contracts. The first one is a purchase contract between a supplier and a lessor and the other one is a lease contract between a lessor and a lessee. The UNIDROIT Leasing Convention penetrates the illusion of the two independent contracts and perceives them as a single transaction of triangular relationship.

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[59] *The UNIDROIT Convention on International Financial Leasing*, 20 May 1988, (1988) 27 I.L.M. 931 [hereinafter *UNIDROIT Leasing Convention*]

[60] See O. Nagano, "Cross-border Leasing-its Current Status and Tasks Ahead""(1988) W. Leasing Y.B. 20 at 20.

The new concept is called '*sui generis* equipment financial lease', replacing neither the English hire-purchase or the ancient pledge nor a modification of bailment or mortgage law. Its very objective is to enable an independent financier in one country to make available for use by the lessee in another country equipment that the lessee could not immediately pay for in full but periodic rent payments.[61]

As a result, Article 1(1) frames the scope of the Convention that, under the tripartite transaction, there are two agreements involved. First, on the specification of the lessee, the lessor enters into the supply agreement with the supplier. Second, the lessor enters into the lease agreement with the lessee granting the right to use equipment in return for the rentals.

The scope of this provision encompasses all kinds of equipment, excluding equipment that is to be used for the lessee's personal, family or household purpose.[62] Additionally, the drafters were not concerned with accounting or tax aspects of leasing; instead, they attempted to avoid the problem, so troublesome in American law, of distinguishing between a lease and a security

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[61] See P.F. Coogan, "Is There a Difference between a Long-Term Lease and an Installment Sale of Personal Property?" (1981) N.Y.U.L. Rew.1036 at 1039.

[62] Article 1(4) of the UNIDROIT Leasing Convention, *supra* note 59.

interest.[63] By reference to commercial and civil law aspects of financial leasing in its preamble, the Convention does not encroach on the domain of the fiscal and the accounting authorities in relation to this transaction.[64] As long as transactions meet the requirement of Article 1, they are covered by the Convention whether or not the lessee has the option to buy the equipment or to hold it for a further period, and whether or not for nominal price or rental.[65]

Moreover, the Convention specifies the tripartite character of financial leasing, which excludes operating leases from its scope. Operating leases should be properly treated among the general body of bailment contracts.[66]

Furthermore, the Convention was devised uniquely to govern sub-leasing transactions.[67] Any person who supplies the first financial lessor is always considered as the supplier to all the sub-lessees no matter how many sub-leasing transactions are in the

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[63] M.D. Rice, "Current Issues in Aircraft Finance" (1991) 56:4 J. Air L. & Com. 1027 at 1058.

[64] Hornbrook, *supra* note 57 at 43.

[65] Article 1(3) of the UNIDROIT Leasing Convention, *supra* note 59.

[66] D.H. Bunker, *The Law of Aerospace Finance in Canada* (Quebec: Institute and Centre of Air and Space Law, 1988) at 62.

[67] Article 1(3) of the UNIDROIT Leasing Convention, *supra* note 59.

chain. In this regard, the financial lessor is not treated as the supplier in relation to sub-lessees.[68]

3.2 Applicability of the Convention

The UNIDROIT Leasing Convention is not binding a State unless adopted and leasing transactions are not covered by the Convention unless:

(1) the lessor and the lessee have their places of business in different States;
(2) those States and the State in which the supplier has its place of business are contracting States; and
(3) the transactions are governed by the law of a contracting State.[69]

However, the drafter felt that a legislative vacuum of leasing law in many jurisdictions would encourage courts in those States to look to the Convention for guidance.[70]

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[68] See R.M. Goode, "Conclusion of the Leasing and Factoring Convention-I" (July 1988) J. Bus. L. 347 at 350.

[69] Article 2(1) of the UNIDROIT Leasing Convention, *supra* note 59.

[70] Rice, *supra* note 63 at 1057-1058.

3.3 Rights and Duties of the Three Parties

As mentioned earlier, the Convention perceives the triangular transactions of international financing as a single event, thus attempting to rearrange rights and duties of the parties concerned. Basically, the lessor financier is exonerated from liability and a nexus of direct rights and duties is created between the supplier and the lessee.

(a) Lessor

To safeguard the lessor's title on the lessee's insolvency, the Convention recognizes the validity of the lessor's title in the equipment against the lessee's trustee in bankruptcy and creditors, including creditors who have obtained an attachment or execution.[71] However, the lessor's title shall not affect the priority of any creditor who has:

(1) a consensual or non-consensual lien or security interest in the equipment arising otherwise than by virtue of an attachment or execution; or

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[71] Article 7(1) of the UNIDROIT Leasing Convention, *supra* note 59.

(2) any right of arrest, detention or disposition conferred specifically in relation to ships or aircraft under the law applicable by virtue of the rules of private international law.[72]

Besides, due to the fact that the lessee's role in the transactions is dynamic and that the lessor's role is purely financial,[73] any liability arising from the equipment should not be imposed on the lessor except the following situations.

Initially, where the lessor plays a non-purely financial role by influencing the selection of the supplier or the specification of the equipment, it should be liable to the extent of its intervention.[74]

Secondly, although the lessor, in its capacity of lessor, is not liable to third parties for death, personal injury or property damage caused by the equipment,[75] its liability in any other capacity, such as owner, remains unaffected.[76]

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[72] Article 7(5) of the UNIDROIT Leasing Convention, *ibid.*

[73] See Hornbrook, *supra* note 57 at 45.

[74] Article 8(1)(a) of the UNIDROIT Leasing Convention, *supra* note 59; see Hornbrook, supra note 57 at 45.

[75] Article 8(1)(b) of the UNIDROIT Leasing Convention, *supra* note 59.

[76] Article 8(1)(c) of the UNIDROIT Leasing Convention, *ibid.*

Finally, the UNIDROIT Leasing Convention limits itself not to prevail over any other existing or future treaty.[77] As a result, pursuant to Article 2(3) of the 1952 Rome Convention, the lessor is presumed liable for any damage caused by aircraft to third parties on the surface.[78]

(b) Lessee

According to Article 8(2), the lessee's right of quiet possession is warranted by the lessor from any disturbance resulting from a person having a superior title or right, or a person claiming a superior title or right[79] and acting on the authority of a court. However, the lessor is exculpated from such disturbance if the right or claim of the third party derives from (1) an act or omission of the lessee or (2) an intentional or grossly negligent act or omission of the lessor.

Additionally, the lessee normally has duties to take proper care of the equipment, to use it in a reasonable manner and to keep it in the condition in which it was delivered, subject to wear

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[77] Article 17 of the UNIDROIT Leasing Convention, *ibid.*

[78] See, *supra* note 1; see also Goode, *supra* note 68 at 349.

[79] For example, when the lessor does not have the right to dispose of the equipment or when the third party initiates the case of the patent or trademark's infringement. See Hornbrook, *supra* note 57 at 45.

and tear as well as its agreed modification.[80] Furthermore, the lessee shall return the equipment when the leasing agreement comes to an end and the lessee does not exercise the right to buy or to hold the equipment.[81]

(c) Supplier

One of the unique characters of the UNIDROIT Leasing Convention lies in the concept that the supplier's duties under the supply agreement is owed to the lessee as if it were a party to that agreement and as if the equipment were to be supplied directly to the lessee.[82]

By the very nature of leasing, the lessee in many ways appears as the purchaser of the equipment. The supplier's infringements of the supply agreement could affect the lessee's trading income; hence, it is logical to make the lessee a third party beneficiary, despite the absence of privity of contract between the lessee and the supplier.[83] The 'direct right' concept denotes that the

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[80] Article 9(1) of the UNIDROIT Leasing Convention, *supra* note 59.

[81] Article 9(2) of the UNIDROIT Leasing Convention, *ibid.*

[82] Article 10(1) of the UNIDROIT Leasing Convention, *ibid.*

[83] See Hornbrook, *supra* note 57 at 45.

lessee's rights amount to those of the lessor in respect of the supply agreement.

However, the lessee is not entitled to terminate or rescind the supply agreement without the consent of the lessor 'since otherwise title to the equipment would revest in the supplier and the lessor would be deprived of an essential element of its investment.'[84] Finally, like the maxim *ne bis in idem*, the supplier is not liable to both the lessee and the lessor for the same damage.[85]

(d) Non-Performance by the Supplier

As explained earlier, due to the fact that the lessor's role is financial and the lessee on its own selects the supplier as well as the equipment, any responsibility for non-delivery, delay in delivery or delivery of non-conforming equipment should rest primarily on the supplier,[86] not on the lessor.[87] Therefore, pursuant to Article 12(5) coupled with Article 8, the lessor is not liable to the lessee for a claim as such unless the failure in performance regularly from its act or omission.

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[84] *Ibid.*

[85] *Ibid.*

[86] *Ibid.*

[87] Goode, *supra* note 68 at 347.

However, while the lessor is given the right to remedy the supplier's failure to tender the equipment under the supply agreement,[88] the lessee has the right to withhold rentals payable under the leasing agreement until the lessor has remedied such failure.[89] Furthermore, the lessee has the right as against the lessor to terminate the leasing agreement.[90] As soon as the lessee exercises this right, it is also entitled to recover any rentals or other sums paid in advance.[91]

(e) Event of Default

Nothing in the Convention limits the parties' freedom to stipulate a liquidated-damages clause of their own in the leasing agreement. Instead, the Convention attempts to constitute the elements of a liquidated-damages clause that should not be cut down under local law.[92] In the event of default by the lessee, the

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[88] Article 12(1)(b) of the UNIDROIT Leasing Convention, *supra* note 59.

[89] Article 12(3) of the UNIDROIT Leasing Convention, *ibid.*

[90] Article 12(1)(a) of the UNIDROIT Leasing Convention, *ibid.*

[91] Article 12(4) of the UNIDROIT Leasing Convention, *ibid.*

[92] See Hornbrook, *supra* note 57 at 46.

lessor may recover accrued unpaid rentals, together with interest and damages.[93]

When the default as such is substantial, the lessor may require accelerated payment of the value of the future rentals. As well, if the leasing agreement so provided, the lessor may terminate the leasing agreement.

In so doing, it may recover possession of the equipment and damages as will place the lessor in the position in which it would have been if the lessee had performed the leasing agreement in accordance with the term.[94]

However, as a normal rule, the duty to minimize damage is of the lessor. The lessor is not entitled to recover damages to the extent that it has failed to take all reasonable steps to mitigate its loss.[95]

(f) Transfer of Rights

That the Convention allows the lessor to transfer any of its rights under the leasing agreement is based on the following concept.

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[93] Article 13(1) of the UNIDROIT Leasing Convention, *supra* note 59.

[94] Article 13(2) of the UNIDROIT Leasing Convention, *ibid.*

[95] Article 13(6) of the UNIDROIT Leasing Convention, *ibid.*

> "In leveraged leases, whereas legal title to the equipment - and hence entitlement to the tax indemnification benefits associated with ownership – vests in the lessor, the latter will, by reason of the huge amounts of money involved, put up only a part of the capital cost represented by the purchase of the equipment. For the rest of the cost it will have recourse to one or more lenders who will assure their position by requiring an assignment to themselves of the stream of rentals provided for under the leasing agreement."[96]

Nevertheless, the transfer of the lessor's rights shall not be prejudice to its duties under the leasing agreement or alter either the nature of the leasing agreement or its legal treatment as provided in this Convention. This denotes that the transfer as such cannot be abused as a means of circumventing the application of the Convention.[97]

Also, pursuant to Article 14(2), the lessee is entitled to transfer its right to use the equipment but such a transfer must be subject to the consent of the lessor and the rights of third parties.[98] Clearly, this provision conditionally permits the lessee to sublease the equipment.

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[96] Hornbrook, *supra* note 57 at 46.

[97] *Ibid.*

[98] Article 14(2) of the UNIDROIT Leasing Convention, *supra* note 59.

CONCLUSION

Aircraft leasing is an arrangement whereby a lessee airline leases an aircraft from an owner lessor. While the lessor retains the aircraft's ownership, the lessee possesses the rights to use such an aircraft. Due to various advantages, aircraft leasing can be used for both operating and financial purposes. Once aircraft leasing was ushered into the international aviation community, many regimes of international air law appeared insufficient, fragmentary and even anachronistic. This study examines the following issues.

- Given safety oversight responsibilities, the concerned States encounter the paradox between legal control and actual control of aircraft. Nonetheless, Article 83bis offers a solution which the transferred responsibilities from the State of Registry to the State of the Operator shall be recognized as valid by all other contracting States.

- Since air safety standards are international in nature, the ICAO Council designated Standards and Recommended Practices as Annex 13 to govern aircraft accident investigations. This provides the State of the Operator with an opportunity to participate in the investigation related to leased aircraft. However,

the legal status of Annex 13 is problematic; therefore, the revision of Article 26 of the Chicago Convention, a source of Annex 13, is still necessary.

- As far as leased aircraft are concerned, some Articles of the Chicago Convention are not applicable – namely Article 5: Right of Non-Scheduled Flight, Article 15: Airport and Similar Charges, Article 2: Customs Duty, and Article 25: Aircraft in Distress. The problems are considered to be theoretical; hence, no effort has been made so far to overcome the obsolete principles.

- According to the 1963 Tokyo Convention, the State of Registry is the sole criminal jurisdiction. This is insufficient and inappropriate when offences take place on board leased aircraft. Although the State of the Operator's criminal jurisdiction is already recognized in the 1970 Hague Convention and the 1971 Montreal Convention, less serious crimes under the 1963 Tokyo Convention remain outside the power of the State of the Operator. The amendment of the 1963 Tokyo Convention is still necessary.

- Although the 1948 Geneva Convention recognizes the real rights in aircraft, it is silence on determining priority among the purchaser, the mortgagee and the lessor. If possible, the parties concerned should clarify among themselves that which one will take the benefit of priority.

- Considering the aircraft engines as component parts of the aircraft might be suitable for the period of straightforward purchase transactions. When leasing transactions became the norm, the above principle can be polemical because the engine lessor will lose the engine's title to the aircraft lessor. Thus, the international aviation community should establish the independent legal status of aircraft engines.

- Due to the fact that international financial leasing are used worldwide, albeit the absence of fundamental legal principles on the subject, UNIDROIT has attempted to invent the new *sui generis* Convention based on the triangular nature of such leasing. The Convention perceives the independent agreements among the parties as the single transaction and rearranges the parties' rights and duties pursuant to the concept of the direct link. Up to now, the Convention has yet to enter into force.

The aviation community has benefited from the use of aircraft leasing, but international law governing the practice is outdated, fragmentary and insufficient. It is worth the effort to modernize and systematize the rules of international air law at issue.

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