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Evolution of Aircraft Finance Law
Considerations of the UNIDROIT Reform
Project Relating to Aircraft Equipment

By

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A thesis submitted to the Faculty of Graduate Studies and Research in partial fulfillment
of the requirements of the degree of Master of Laws (LL.M.).

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ABSTRACT

After more than ten years from its initiation by the Canadian delegation in 1988, the UNIDROIT's legal reform in the area of international security and leasing interests in mobile equipment reached its final stage of discussion at the international level. A *Preliminary Draft UNIDROIT Convention on International Interests in Mobile Equipment* ("Convention") and a *Preliminary Draft Protocol on Matters Specific to Aircraft Equipment* ("Protocol") present an evolution of the international security law and the aircraft finance law in particular. The "Convention", as applied through the "Protocol", particularly aims at economic benefits for the aviation industry, which has to cope with considerable financing difficulties due to the uncoordinated national security laws. This thesis addresses legal and economic issues behind the UNIDROIT proposal.

Following a brief review of the aircraft financing market and existing aircraft financing instruments, this thesis will introduce security laws of selected common law and civil law jurisdictions with respect to movable property, particularly aircraft equipment. It will also present the *Geneva Convention on the International Recognition of Rights in Aircraft*, which is the only convention on conflict of laws in the area of aircraft finance law. This thesis will focus on the UNIDROIT proposal, especially provisions relating to the uniform substantive security laws. Finally, an analysis of Chinese law and an examination of China's reaction to the UNIDROIT proposal will complete this thesis.

The success of an international uniform law depends on its acceptability by ICAO member states. The "Convention" and the "Protocol" constitute a substantive reform in the area of security law. The desired economic benefits behind the UNIDROIT proposal will only be realized after the ICAO member states accept to amend their domestic laws. Thus, what laws have to be amended and to what extent are states willing to amend laws become the relevant issues. Indeed, besides the economic considerations political factors are also involved. This thesis supports the legal reform at the international level and discusses the impact brought by this reform. It also addresses the crucial issue of the legislative process.

The texts of the "Convention" and the "Protocol" as reviewed by the Drafting Committee of the First Joint Session (Rome, 1-12 February 1999), are attached in the Appendix. The method of referencing follows the *Canadian Guide to Uniform Legal Citation*, 4th ed. (Scarborough, Ont.: Carswell, 1998).

RÉSUMÉ

Plus de dix ans après l'initiative de la délégation canadienne en 1988, la réforme par UNIDROIT dans le domaine des sûretés internationales et des biens sur des équipements mobiles a atteint son dernier stade dans les négociations internationales. *L'avant-projet de Convention d'UNIDROIT relative aux garanties internationales portant sur des matériels d'équipements mobiles* (la «*Convention*») et *l'avant-projet de Protocole portant sur les questions spécifiques relatives aux matériels d'équipement aéronautiques* (le «*Protocole*») représentent une évolution dans le domaine du droit des sûretés internationales et plus particulièrement dans le domaine du financement des avions. La «*Convention*», telle quelle est appliquée par le «*Protocole*», a surtout pour but d'avantager économiquement l'industrie aéronautique qui est constamment confrontée aux problèmes financiers importants dus à l'absence de coordination dans les lois nationales dans le domaine des sûretés. Cette mémoire a pour but de voir au-delà des enjeux juridiques et économiques du projet de UNIDROIT.

Après une brève révision du marché du financement en aviation et des instruments de financement utilisés dans l'industrie, ce mémoire présente une introduction à la législation dans certaines juridictions de droit civil et de «*Common Law*» sur les sûretés pour les biens mobiliers, dont les équipements d'aviation. Les prochaines ligues présentent également la *Convention de Genève relative à la Reconnaissance Internationale des Droits sur Aéronef* qui est la seule convention sur les conflits de lois dans le domaine du droit du financement en aviation. Une attention particulière est portée au projet de UNIDROIT et aux dispositions sur le droit substantif et uniforme en matière de sûretés. Finalement, une analyse du droit chinois et une étude de la réaction de la Chine au projet de UNIDROIT compléteront ce mémoire.

Le succès d'un projet de droit uniforme dépend de l'acceptabilité du projet au pris des états membres de OACI. La «*Convention*» et le «*Protocole*» représentent une réforme majeure dans le domaine du droit des sûretés. Mais les avantages économiques désirés et qui sont à la base du projet de UNIDROIT ne pourront être réalisés qu'à partir du moment où les états membres de OACI de changer leurs lois nationales. Les questions pertinentes deviennent alors quelles lois devront être amendées et dans quelle mesure les états voudront-ils amender leurs lois. En effet, il ne faut pas minimiser les effets des facteurs économiques et politiques. Ainsi, cette thèse a pour objet de soutenir la réforme au niveau international et voir les conséquences de cette réforme dans des systèmes internes. On attachera de même beaucoup d'importance au processus législatif.

Les textes de la «*Convention*» et le «*Protocole*», revu par le Comité de la Première Session Conjointe (Rome, 1-12 février 1999) sont reproduits dans les annexes. Le mode de référence est celui adopté par le Manuel Canadien de la Référence Juridique dans sa quatrième édition (Scarborough, Ont.: Carswell, 1998).

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Introduction

It has been increasingly recognized, in recent years, that appropriate legal reforms can enhance the development and growth of financial markets. The result is a positive effect on economic growth by lowering the cost and increasing the availability of finance as well as promoting economic restructuring.¹ This effect is greater for those industries, which for technology-related reasons² largely rely on external financing instead of retained earnings.³ The commercial air transport sector is an excellent example of this kind of industry. As a result of the commercial airline industry being heavily dependent on external financing, any constraints on the availability of external financing and/or the high cost of external financing will have a greater adverse impact on this industry than most other sectors of the economy.⁴

Prior to World War II aircraft equipment financing was practically unknown. Limited earnings were largely reinvested and supplemented from time to time by equity financing and short-term loans. With the end of the war, many of the aircraft that served during the war were used for civil aviation and the commercial airlines soon emerged. Prior to 1955 new equipment had been purchased out of retained earnings, equity financing, cash from accelerated depreciation through tax amortization certificates and short-term bank loans, but the high cost of the “big jets” made a completely new method of long-term financing arrangements necessary.

Ever since the emergence of jet aircraft, airlines have been facing increasing challenges in financing the equipment, both airframes and engines. The technological

¹ See A. Saunders & I. Walter, *Proposed Unidroit Convention on International Interests in Mobile Equipments Applicable to Aircraft Equipment through the Aircraft Equipment Protocol - Economic Impact Assessment*, (A Study prepared under the Auspices of INSEAD and the New York University Salomon Center, September 1998)] (1998) 23:6 Air & Space Law 339-416, at i [hereinafter *Economic Impact Assessment*].

² These industries are normally characterized according to their project size, cyclicity, engineering complexity and infrastructure.

³ There are two broad ways in which any company can finance its investment. The first is internal finance, such as net cash flows or net profits from operations. The second is external finance, such as raising funds in the debt, leasing and equity markets or government funding. See *Economic Impact Assessment*, *supra* note 1 at 2.

⁴ *Ibid.* at 3.

advancement in the aircraft industry has created a new wave of heavy capital investment in aircraft. Responding to the high capital requirements, the financiers developed the asset-based financing devices, i.e. the title reservation agreement and the leasing agreement, to supplement the traditional security-based financing device in the aircraft transactions.

An improved framework for secured transactions represents an essential step in improving access to credit and increasing credit for financing equipment.⁵ The problems with the framework in secured transactions have their roots entirely in the laws and legal institutions of the countries concerned, regardless of the civil law or the common law jurisdictions.

The security provisions generally attach “real rights” on the aircraft that can only be created under specific national law. Secured creditors face enforcement problems in a foreign jurisdiction especially whose laws of real rights are incompatible with their domestic laws. This situation brings high risks for aircraft financiers, which leads to a higher cost of individual aircraft. In order to solve the conflict of laws, international legal instruments are the best approach.

The current solution for conflict of laws in aviation matters has been provided by the conflict of laws rules in the *Geneva Convention on the International Recognition of Rights in Aircraft*⁶. Drafted in 1940’s, the *Geneva Convention* provided the basis for today’s laws. Commercial interests in facilitating credit and lowering interest costs have recently led to a higher level of conflict solution, which consists in harmonizing the substantive law of securing personal property. Its purpose is to eliminate the subsisting inefficiencies that are produced by legal systems, particularly in aircraft financing. The International Institute for the Unification of Private Law (UNIDROIT),⁷ the aircraft

⁵ The importance of this framework rests on two economic facts: first, private lenders and credit sellers depend on collateral; second, producers and financiers depend on movable property. The commercial aircraft transaction falls into the second category. See Nuria de la Peña, “Reforming the Legal Framework for Security Interests in Mobile Property” (1999) 2 Unif. L. Rev. at 347.

⁶ See *Convention on the International Recognition of Rights in Aircraft*, 19 June 1948, ICAO Doc. 7620; [1953] 4 U.S.T. 1830; T.I.A.S. 2847, 310 U.N.T.S. 151 [hereinafter *Geneva Convention*].

⁷ UNIDROIT was founded in 1926 as an auxiliary organ of the League of Nations and reestablished in 1940 under the so-called UNIDROIT Charter. The Charter is adopted currently by 58 States, including China, France, Germany, Italy, India, Japan, the Russian Federation, the United Kingdom and the United

industry, the International Civil Aviation Organization (ICAO) and the International Air Transport Association (IATA) are currently in the process of drafting a *Convention on International Interests in Mobile Equipment*⁸ and a *Protocol on Matters Specific to Aircraft Equipment*.⁹

In line with the worldwide tendency in harmonization of the law of secured transactions,¹⁰ the UNIDROIT project, particularly the Aircraft Equipment Protocol under the *Draft Convention* represents a significant evolution in the aircraft financing law. It unified important substantive laws consisting in the aircraft transactions, i.e. the creation of international interests, the priority rule of competing security rights, the enforcement of the secured interests and the insolvency policy. Originally requested by the airline industry, these legal reforms will enhance the development and growth of financial markets and promote the aircraft financing on the right trail.

Following a brief description of the aircraft financing market, Chapter One of this thesis will introduce the currently used aircraft financing instruments, both the traditional security-based financing and the asset-based financing. The security rights will be discussed in detail, as they constitute the core of each financing agreement.

The airline industry is highly global by nature and the economic globalization that the world has recently experienced tends to strengthen this feature. In providing or supplying external financing, a key concern of a lender/investor/lessor is the risk-adjusted return.¹¹ How can they get the secured rights and guarantee the repossession or reemployment of the aircraft in case of the default? The civil and common law systems with respect to movable property law and the securitisation each have their own principles.

States. See *Charter of the International Institute for the Unification of Private Law*, 15 March 1940, 15 U.S.T. 2494, T.I.A.S. 5743, 1965 U.K.T.S. 54. For its organization and activities, see A. Djojonegoro, "The UNIDROIT Proposal for a Uniform Air Law - A New Aircraft Mortgage Convention?" (1998) 22:2 Ann. Air & Sp. L. 53 at 55ff. For its activities in security law, see N.B. Cohen, "Harmonizing the Law Governing Secured Credit: The Next Frontier" (1998) 33 Texas Int'l L.J. 173 at 181ff.

⁸ See *Convention on International Interests in Mobile Equipment*, UNIDROIT 1998 Study, LXXII - Doc. 42 [hereinafter *Draft Convention*].

⁹ See *Protocol on Matters Specific to Aircraft Equipment*, UNIDROIT 1998 Study, LXXIID - Doc. 3 [hereinafter *Draft Aircraft Protocol*].

¹⁰ See below, Chapter Two, Part III.

¹¹ See *Economic Impact Assessment*, *supra* note 1 at 4.

Chapter Two will focus on the conflict of laws in the securitisation and recommend an approach for resolving these conflicts.

In the area of aircraft financing, the *Geneva Convention* provides to a large extent a better solution than the domestic conflict of law rules. Chapter Three will summarize its mechanisms and shortcomings.

The core of this thesis will discuss recent initiatives by the private international law society. The UNIDROIT proposed Convention and Aircraft Equipment Protocol will provide an economically updated solution mechanism and supersede domestic substantive and conflict of laws. It will also supersede the *Geneva Convention* so far as inconsistencies exist. The substantive law embodied in the UNIDROIT draft texts is the core of Chapter Four.

As one of the major aircraft importing States, China plays an important role in processing of the UNIDROIT project. Chapter Five will introduce China's domestic laws with respect to aircraft financing transactions. The author will analyze the possible conflicts between Chinese law and the proposed Convention and Protocol, summarize China's attitude to these international legal instruments and finally put forward the suggested solutions.

The topic of the thesis is vast and complex and the following text attempts to highlight the important issues.

Chapter One The Financial Challenges to Aircraft Financing

The airline industry is one of the most important industries in every national economy. It, along with other transport devices, constitutes the fundamental industry sector-transportation. A large increase in travel will require a larger aircraft fleet, the expansion of the infrastructure and the training of personnel etc. Undoubtedly, fleet cost and financing are the key factors among all these inputs.

1. Financial challenges to airline industry

A. A need for high performance aircraft

The demand for new aircraft is a combination of traffic growth and the need to replace older aircraft coming to the end of their economic lives. Traffic growth is, in turn, primarily driven by economic growth, and is further linked to the real cost of air travel.¹²

The fast development of civil and commercial air transportation after World War II stimulated the aircraft manufacturing industry to a great extent. In turn, the development of aircraft manufacturing, combined with the evolution of technology, provided the airline industry with more and more efficient airplanes to meet the market demands. The jet aircraft in the late 1950s resulted in a rapid expansion of the airline industry.

The significant change from the traditional propeller engine to the jet engine led to an unprecedented demand for aircraft financing. During the 1960's, the airline industry invested approximately \$9 billion primarily to finance the transition from propeller aircraft to the first generation of jets.¹³ In the following decades, aircraft must be acquired for both replacement and air traffic growth.

¹² K.J. Holden, "Jet Aircraft Requirements to 2000 and beyond" in S.A.D. Hall, ed., *Aircraft Financing*, 2nd ed. (London: Euromoney, 1993) at 3 [hereinafter *Aircraft Financing*, 2nd ed.].

¹³ See R.W. Mandell, *Financing the capital requirements of the US airline industry in the 1980s* (Lexington, Massachusetts: D.C. Heath and Company, 1979).

In the past, a large proportion of traffic growth has been absorbed by increases in airline productivity, aircraft utilization and load factors. Over the last two decades, the steadily increasing world population, the augmenting mobility of international business, tourist travel and, more recently, the increasing use of air transport that accompanied the economic development in the Eastern European and Asian markets fueled the demand for bigger, faster and affordable aircraft.¹⁴

The world economy in 1998 showed some deviation from economists' predictions. The Asian fiscal crisis is the best reason because it hindered the increase of air transport and made growth lower than predicted is.¹⁵ However, despite the near term impact of the Asian economic recession and the increasing maturity of several major air travel markets, Airbus Industrie's latest Global Market Forecast (GMF) still predicts that over the next twenty years civil air transport will remain one of the world's greatest growth industries.

The 1999 Current Market Outlook by the Boeing Corporation and the 1999 Global Market Forecast by Airbus Industrie have anticipated a large demand for new jetliners delivery in the following two decades. It is estimated that "To provide the required capacity and to renew their fleets, the airlines and cargo operators will take delivery of some 15,500 new aircraft worth approximately \$1.29 trillion (1999 prices)".¹⁶

Government noise and air pollution regulations will further cause airlines to buy new models. New models also tend to be more fuel-efficient.

¹⁴ See J.A. Krupski, *Conflict of Laws in Aircraft securitisation: Jurisdictional and Material Aspects of the 1998 Unidroit Reform Project Relating to Aircraft Equipment* (LL.M. Thesis, McGill University, 1998) at 1 [unpublished].

¹⁵ "Economic problems have reduced growth forecasts. Before the crises of 1998, Asia was expected to grow at 4.1% a year for five years. Now the estimates are for only 0.7% a year. This represents almost a 16% lower forecast for GDP in 2002. Although the forecast is for growth to return for the remaining 15 years of the 20-year forecast, the new projected aggregate GDP for Asia at the end of the period remains 16% lower than forecasted in 1997." Boeing Corporation, Current Market Outlook 1999, online: Boeing Corporation <<http://www.boeing.com/commercial/cmo/index.html>> (date accessed: 26 October , 1999). See also Airbus Industrie, 1999 Global Market Forecast (1999-2018), online: Airbus Industrie <http://www.airbus.com/news_forecast.html> (date accessed: 26 October , 1999).

¹⁶ The Boeing Corporation made a prediction of 1.38 trillion, which is larger than that of Airbus Industrie, for the same period. See *ibid.*.

B. The economic nature of airline industry

In 1976, a survey was conducted to determine consumer ratings of twenty industries in the United States. Airlines received the highest ranking, and airline travel reflected the most dramatic technical accomplishments of twentieth century civilization. At the same time the airline industry was in financial trouble.¹⁷ This phenomenon can be explained by the economic nature of the airline sector.

1. Cyclicalities

The airlines will go through several years of financial problems as they receive earlier ordered aircraft. The increase in traffic normally can not match the capacity offered by the new equipment.¹⁸ This inherent character is called the cyclicalities, which is normal for the airline industry. Most capital- intensive industries that have a high fixed-cost base are very sensitive to revenue performance.¹⁹

In practice, cyclicalities has had a far greater impact on aircraft demand and aircraft value than variations in long-term forecasts of supply and demand.²⁰ On one hand, the airlines need to order the new aircraft in advance to satisfy the market demand in the near future. On the other hand, the financial deficiency resulting from the previous order renders the airlines little capital for the new orders.

2. Effect of cyclicalities

During the jet era of the past three decades, rapid revenue growth was accompanied by continuous high capital expenditures and declining profit margins.²¹ The ratio of capital expenditures to revenues has averaged 12 per cent, while the net profit

¹⁷ See Mandell, *supra* note 13 at xv.

¹⁸ See W.E. O'Connor, *An Introduction to Airline Economics*, 2nd ed. (New York: Praeger, 1982) at 9.

¹⁹ See P. Deighton, "Sources of Finance" in A. Littlejohns & S. McGairl eds., *Aircraft Financing*, 3rd ed. (London: Euromoney, 1998) at 17 [hereinafter *Aircraft Financing*, 3rd ed.]. See also V. DuBose, "Sources of Finance" in *Aircraft Financing*, 2nd ed., *supra* note 12 at 11.

²⁰ There are three complete cycles behind us by 1997 since the jet era, beginning in 1958 when the Boeing 707 first entered service. See K.J. Holden, "Industry Financing Requirements Approaching the 21st Century" in *Aircraft Financing*, 3rd ed., *ibid.* at 5.

²¹ *Ibid.* at 7.

margins have declined from 3.3 per cent in the 1960s to 1.0 per cent in the 1980s.²² During the 1990s, revenues have doubled again, capital expenditures have increased even faster to account for 16 per cent of revenues and the profit margin has shrunk to around 0.5 per cent or less.²³

During the 1990s, the fund from depreciation was not as effective for capital expenditure as in the past decades. The less conservative depreciation policies,²⁴ together with the annual rise of the aircraft price, make the depreciation charges far from enough to replace the aircraft cost.²⁵ Additional off-balance sheet financing is a major method for airlines to fulfil their capital requirements. This amounted to US\$90 billion in 1990s.

C. External financial market as major source for aircraft financing

A modern airliner is extremely expensive. The new 767 will sell for \$40 million and the total fleet of the US scheduled airline industry in 1980 was valued approximately \$20 billion. The carrying cost of these assets is the third largest cost (after fuel and labor), which, together with interest payments, exceeds \$2 billion a year.²⁶

When combining the large appetite for capital with the industry's cyclical and cash flow volatility, it is not a surprise that access to capital is a key concern currently confronting many airlines.²⁷ The airlines can obtain the necessary capital through the following markets: the equity market, the debt market, the leasing market and the merger market. In addition, aircraft manufacturers also offer financing in order to promote the sale of their products.²⁸ Among all these options, the debt and the leasing markets are the most important.

²² See *ibid.* at 6 [Exhibit 1.5: Worldwide Airline Revenues and Expenditure, 1960-89].

²³ See *ibid.* at 7 [Exhibit 1.6: World Airline Revenues and Expenditure in the 1990s].

²⁴ See Holden, *supra* note 20.

²⁵ See O'Connor, *supra* note 18.

²⁶ See O'Connor, *ibid.* at 71.

²⁷ See DuBose, *supra* note 19.

²⁸ See *ibid.* at 11ff.

Lenders however tend to be apprehensive about deepening their role in aircraft financing. As a result, capital availability is the single largest hurdle to be overcome if the industry is to continue to offer a high level of service.²⁹

II. Providing collateral in aircraft financing

As it has been shown and demonstrated, the airlines must look for substantial funding from outside sources to finance their projects. However, everyone who is involved in the aircraft transaction, whether the financial institutions, the lease companies or the manufacturers, seeks collateral to lessen the high risks in the commercial deed. The existing aircraft provide the required collateral. In addition, the practitioners have also developed asset-based equivalencies.

Asset-based financing is defined as a “technique of providing financing for an aircraft acquisition using the value of the aircraft itself as the principle security”.³⁰ The principal asset of an airline is undoubtedly its fleet of aircraft. They are expensive units of equipment that have retained a high resale value. Combined with the cyclical nature of airline earnings and decreasing reliance on export credit support, these factors have made real rights in aircraft, whether by ownership or through collateral security, the surest form of protection a financier can obtain for his sizable investment. Through secured methods of financing, the ability of the airline to repay becomes less of a concern.³¹

A. Sources of security law

The security law under both civil law and common law, can be traced back to Roman law, under which the essence of the security transaction was to give the creditor some rights, basically the rights *in rem*, over property by way of security for the debt. The law in force today regarding security interests in aircraft as collateral still adheres to the basic principles of Roman law.

²⁹ See Mandell, *supra* note 13.

³⁰ R.K. Rosales, *Legal Aspects of Asset Based Aircraft Financing* (LL.M. Thesis, McGill University, 1990) at 41 [unpublished].

The classical Roman law developed three types of security in chattels: the early *fiducia cum creditore* and later the *pignus* and the *hypotheca*.³² The *pignus* was construed as based on a real contract, meaning that only transfer of the chattel into the creditor's possession can perfect the contract. The debtor was protected from wrongful sales by the creditor, which is different from the *fiducia*, but this security deprived him of possession of the property. The *hypotheca*, on the other hand, means a simple lien on real and personal property. The possessory rights were vested in the creditor but the security remained in the debtor. Contrary to the above two, the *fiducia* brought into play the title that was transferred for security, which means the ownership of the property was transferred to the creditor who has to reconvey the property when the debt had been duly paid. Thus, the debtor was deprived of the use of the property though it could be left in his possession.

Civil law and common law systems underwent different methods to develop their own security law from the Roman law principles. The civil law system disregarded the title shattering *fiducia* and gave preference to the dualism of nonpossessory *pignus* for chattels and the possessory *hypotheca* for real property.³³ French civil law absorbed the institutions of *pignus* and *hypotheca*, which were applied as *pledge* and *hypothec* respectively, with certain exceptions, to the movable and the immovable. On the other hand, the common law developed the Roman law institutions of *pignus* and *fiducia cum creditore* into security devices of *pledge* and *chattel mortgage* in order to secure the creditor's interest in moveable property.

Security in movable property is one of the major concerns in the matter of aircraft property. The civil law countries faced the difficulties because they do not have the possessory security interest in chattels available. However, the aircraft operator, normally the debtor under the security agreement, can not put the secured aircraft in proper use if it is confined to the custody of the financier, the creditor. In order to keep pace with the economic development, the existing laws relating to the chattel instrument to aircraft

³¹ See *ibid.* at 43.

³² See S.A. Bayitch, *Aircraft Mortgage in the Americas* (Coral Gables, Florida: University of Miami, 1960) at 13.

³³ See Bayitch, *ibid.*

equipment, along with agricultural and industry equipment, underwent a fundamental change. Some countries reclassified the aircraft as an immovable property so that the laws of real property can be applied.³⁴ Some other countries classified aircraft as a special type of movable property.³⁵ A considerable number of civil law jurisdictions, although did not state explicitly, considered the aircraft as an immovable property for mortgage purposes.³⁶

Entering the aviation era, the common law countries were not confronted with the same difficulties that plagued civil law jurisdictions. The chattel mortgage and the floating charge laws were both developed by the common law system, which are still widely used in aircraft financing.

B. Financial instruments used for aircraft financing

Regardless of how complex the transaction looks like, we can always divide the currently used aircraft financing instruments into two categories, the typical security agreements and their functional equivalencies in title-based aircraft financing. The creditor of the title-based transaction has the fullest proprietary interest, absolute title, which is treated as security for payment of the debt owned by the purchaser.³⁷

1. Typical security-based aircraft financing instruments

a. Chattel mortgage

The chattel mortgage is one of the most commonly used security instruments in aircraft financing. The chattel mortgage in the common law system is considered “an

³⁴ “Codigo Civil art. 812 (Peru 1936) providing: ‘Immovables are 1. land, mines and public water courses...4. ships and aircraft.’” (10) REVISTA JURIDICA DE LA FACULTAD DE DERECHO (Caracas) 65, 70 (1957), cited by Bayitch, *supra* note 32 at 15, footnote 14.

³⁵ See Ley de aviation civil art. 62 (Venezuela 1955), cited by Bayitch, *ibid.* at 16, footnote 18.

³⁶ This stipulation happened in most of the French law influenced jurisdictions, see *supra* note 26 at 16. “[Some] [c]ountries allow non-possessory chattel mortgages, invariably registrable, over the list of chattels specified in the statute, notably identified industrial machinery, plant and equipment, which must often be kept at a named location”, see P.R. Wood, *Comparative Law of Security and Guarantees* (London: Sweet & Maxwell, 1995) at 29. Most of them are civil law jurisdictions, such as Latin American countries, Denmark, the Philippines, China and Taiwan. For China’s case, see Chapter Five, below.

³⁷ See C. Thaine, “Security Interests in Aircraft and Spare Parts I: England and Wales” (1987) 4 IBL 167 at 170.

agreement vesting in the creditor the title to the chattel, defeasible by performance on the part of the debtor, of the obligation for which title to the chattel is conveyed as security.”³⁸

The outstanding characteristic of the chattel mortgage is its flexibility. It may be used for either property presently owned by the debtor, or property to be purchased, particularly spare and replacement parts. A chattel mortgage also includes any property described and identified at its source or location that may become attached to or incorporated in a mortgaged aircraft.

The availability of the nonpossessory chattel mortgages shows great division between jurisdictions,³⁹ so for now applicability is confined mainly within national boundaries. The mortgage legally established in one state may be compromised in the absence of similar provision in a foreign jurisdiction.

b. Floating charge

English law has developed a form of security known as a floating charge.⁴⁰ It allows the debtor to create an equitable charge over the complete business enterprise as a security. A floating charge can be given over assets which are repeatedly dealt with by the company, so the corporation effectively pledges all its assets as security for payment of the bonds while at the same time retaining the right to continue to deal with such assets in the normal course of business. It floats like a cloud over the assets of the borrower generally prior to default and the enforcement, which makes it, fixed.⁴¹ The debtor uses the entire fleet or the enterprise as the subject of the security, and does not need to specify which aircraft is covered by the security.

The advantage of the floating charge to an airline is the flexibility in its dealings. The airline must have the greatest possible freedom of acquisition and disposition in

³⁸ Bayitch, *supra* note 32 at 19.

³⁹ Generally speaking, the common law jurisdictions have liberal attitudes to corporate chattel mortgages, usually registrable. The Germanic “fiduciary transfer” countries, such as Germany, the Netherlands, and some other civil law countries also have similar provisions. But France and some French influenced jurisdictions, for example, Austria, Egypt, Lebanon etc, have no non-possessory chattel mortgages. See Wood, *supra* note 36.

⁴⁰ See Thaine, *supra* note 38 at 169. Floating charge is also available in Canada, see D.I. Johnston, *Legal Aspects of Aircraft Finance* (LL.M. Thesis, McGill University, 1956) at 149 [unpublished].

respect of its fleet and the spare parts until an event occurs which entitles the chargee to intervene and assert its security rights. In other words, a floating charge is “incomplete” and “dormant” until it crystallizes whereupon the charge becomes fixed.⁴²

c. Trust Deeds

Many investors have funds available to lend under suitable conditions and with suitable security, but they prefer to spread their risk by lending these funds to many borrowers in relatively small amounts to each. Trust deed is a device designed to avoid the trouble and difficulties of dealing separately with each lender.⁴³

Under the typical tripartite agreement of the trust deed, individual investors lend their funds to the corporation that issues debentures in the appropriate amount. The corporation enters into a trust deed with a trustee for the debenture holders. The trustee agrees to act on behalf of the debenture holders, supervising the execution of the trust deed and, if necessary, applying the sanctions for which it provides.⁴⁴

The trust deed is by nature still the best means for a corporation to get a long-term loan from lenders, since no airlines can afford the new aircraft only by their own capital. Under the trust deed, the security of the debenture holders usually consists of a fixed or specific charge. It may also consist of a floating charge over the whole undertaking of the borrower.⁴⁵ It is basically a traditional security-based financing device.

2. Functional equivalencies in title-based aircraft financing transactions

a. Conditional sale agreements

A conditional sale of a chattel is a sale in which the transfer of title to the thing sold, or the purchaser's right to retain the thing sold, is made dependent upon the performance of a condition. According to the mutual agreement, the title of the goods sold

⁴¹ D. Bunker, *The Law of Aerospace Finance in Canada* (Montreal: McGill University Institute and Center for Air and Space Law, 1988) at 145.

⁴² Thaine, *supra* note 37 at 170.

⁴³ See Bunker, *supra* note 41 at 144.

⁴⁴ See Bunker, *ibid.* See also D. Bunker, *Aerospace Finance* (notes of the lecture presented to McGill University Institute and Center of Air and Space Law, 1998) [unpublished].

⁴⁵ See Bunker, *supra* note 41 at 145ff.

shall not be vested in the purchaser but shall remain in the vendor until the entire amount of the price is paid.

There exists distinction between the conditional sale and the chattel mortgage.⁴⁶ The formality of the conditional sale contract can be different from one jurisdiction to the other. In English law, it is not registrable under the Companies Act. While in Canadian common law legislation, the conditional sale agreements should be registered in the same manner as a chattel mortgage.⁴⁷

Under the conditional sale transaction, the purchaser will operate, control and maintain the aircraft and spare parts within or without the territorial limits. The vendor will have the right to inspect the aircraft and spare parts. The rights and obligations of the parties to the transaction are similar to the rights and obligations of the security.⁴⁸

b. Equipment trust certificates

The equipment trust originated from the railroad equipment financing in the United States and Canada during 1800's when railroads were unable to secure conventional financing and provide a first mortgage as debt security. It is easier to obtain the equipment by postponing the acquisition of the title until the purchase obligation was performed.

The first form of equipment trust is known as the "New York Plan". It is based, in fact, on the conditional sale agreement to protect the holder of the title against claims from other parties. The second form of equipment trust is the so-called "Philadelphia Plan". The laws of Pennsylvania do not recognize the conditional sale contract, thus this plan introduces the trustee as the intermediate for the purchase and the lease. Under the

⁴⁶ Conditional sales agreements shall not be used in any situation where a loan is to be secured by property owned by the borrower at the time of the making of the loan, because in this situation a chattel mortgage should be set. See Bunker, *ibid.* at 139.

⁴⁷ See *ibid.* at 138.

⁴⁸ English law, Canadian law and the US law have the conditional sales contracts. In Canadian legal system, both the common law provinces and the Quebec province recognize the conditional sales contract. All the common law provinces except Manitoba adopted a Conditional Sales Act. The Quebec Civil Code was amended in 1910 with respect to installment sales (conditional sales), but these provisions were repealed in 1970 with the result of no statutory provisions in Quebec dealing with commercial conditional sales or the registration thereof. See Johnston, *supra* note 40, Chapter VI, 2 (ii); see also J.-M. Fortier, *Real*

"Philadelphia Plan", the equipment trust certificates are guaranteed by the railroad company as lessee with respect to the payment of principal and interest.⁴⁹

In the early 1970s, when it became increasingly difficult to obtain long-term loans from institutional participants, the airlines adopted this financial instrument. Many air carriers were able to meet their needs by obtaining the debt component leveraged leases through public issues of equipment trust certificates.⁵⁰

Under an equipment trust, a trustee purchases an aircraft with the proceeds of a public issue or private placement of equipment trust certificates, representing up to 80 per cent of the aircraft cost, with the airline advancing the balance of the price. The trustee leases the aircraft to the carrier at a rental sufficient to amortize principal, interest and expenses and at the end of the lease, transfers the title to the carrier.⁵¹

The principal advantage of the equipment trust is the facility of financing where participation is divisible into as many parts as there are holders of trust certificates so as to spread the financial risk.⁵²

c. Leasing

Among the various methods available for an airline to finance its fleet, equipment leasing remains the most important. Traditionally, leasing has been a means of achieving "off balance sheet financing" and "tax benefit transfers" which enables the lessees to finance equipment essential for an efficient operation with the costs below those of conventional borrowings.

Equipment leasing has been defined by various laws and regulations throughout the world.⁵³ In the simplest term, it is essentially a commercial arrangement whereby an

Rights in Aircraft, (LL.M. Thesis, McGill University, 1980), Chapter IV, 7 [unpublished]; see also Bunker, *ibid.* at 138ff.

⁴⁹ See Fortier, *ibid.* Chapter IV, 3. See also Bunker, *ibid.* at 149.

⁵⁰ See Bunker, *ibid.* at 148ff.

⁵¹ See Bunker, *ibid.*

⁵² See Bunker, *supra* note 41.

⁵³ The Equipment Leasing Association in the United Kingdom defined "[A] lease is a contract between lessor and lessee for the hire of a specific asset selected from a manufacturer or vendor of such assets by the lessee. The lessor retains ownership of the asset. The lessee has possession and use of the asset on payment of specified rentals over a period", see R.S. Sowter "Lease Finance for Airlines" (1979) 4:1 Air Law 11 at 15. See also *Quebec Civil Code*, art. 1601: "[t]he lease or hire of things is a contract by which

equipment owner (lessor) conveys to the user (lessee) the right to use the equipment for payment of specified rentals over an agreed period of time (term). This simple concept of leasing has acquired a wide range of descriptions and definitions arising from the classification of leases for different purposes.⁵⁴ However, there are two basic categories of leases: operating lease and financial lease.

Operating lease is no more than a rent contract, carrying no purpose of obtaining the title of the object at the end of the term. A financial lease is essentially a kind of financing device, whereby the lessee can possess and use the equipment while obtaining the financing. Although the lessee still needs to pay the rent as the operating lessee does, the final option for acquisition reflects the financial nature of this commercial arrangement.

Financial leasing⁵⁵ serves also as an excellent security device in that title to the leased equipment remains in the lessor during the financing term, thereby facilitating repossession in the event of default.⁵⁶

III. The core of the aircraft finance law

Risk and interest are the key factors in a successful transaction between borrowers and lenders. These two factors are interdependent: the higher the risk, the higher the interest should be.⁵⁷ The quality of the collateral with which the security is issued is critical in the security market, because the lender is always looking for safe collateral and by which to set the interest for the loan. From the view of the borrower, however, high

one of the parties, called the lessor, grants to the other, called the lessee, the enjoyment of a thing, during a certain time, for a rent or price which the latter obliges himself to pay", cited by Bunker, *supra* note 41 at 23. See also *Contract Law of the People's Republic of China* [hereinafter *PRC Contract Law*], promulgated on 15 March 1999 and effective as of 1 October 1999, art. 212: "A lease contract is a contract by which a lessor agrees to deliver a thing to a lessee for him to use or collect fruits from, and the lessee agrees to pay rent therefor".

⁵⁴ See Bunker, *supra* note 41 at 24ff.

⁵⁵ Financial Leasing was defined in the international convention as: the lessor "on the specifications of another party (the lessee), enters into an agreement (the supply agreement) with a third party (the supplier) under which the lessor acquires plant, capital goods or other equipment (the equipment) on terms approved by the lessee so far as they concern its interests"; and "enters into an agreement (the leasing agreement) with the lessee the right to use the equipment in return for the payment of rentals". See UNIDROIT *Convention on International Financial Leasing*, 28 May 1988, art. 1 [hereinafter *Financial Leasing Convention*].

⁵⁶ See Bunker, *supra* note 45.

interest rates are neither usual nor desirable, because they represent a major annual cost for the borrower.

Unfortunately, aircraft is not a good chattel to secure the loan. First of all, aircraft, a moveable property, is nonpossessory in the secured transaction. It brings the risk that the chargee is reluctant to take. Secondly, aircraft incorporate the most advanced aviation technologies, so it has a high unit value. Thirdly, aircraft are by nature the most mobile object among the moveable properties. It is designed to overcome long distances within a short time and regardless of territorial boundaries.

An aircraft en route in an international flight can involve in any of the following activities: charges are incurred each day in different countries and continents when the airplane is fueled, repaired, overhauled, its engines changed, its radar set replaced and so forth; the aircraft or its spare parts may be mortgaged, charged or even sold in a foreign country in an hour from the departure, or made subject to a seizure in a foreign jurisdiction.⁵⁸ It can incur lot of risks. Hence, the creditors in aircraft financing transactions are more cautious about the quality of the aircraft collateral.

Aircraft have a comparatively short life and deteriorate rapidly if not constantly attended and protected. The value of an aircraft is entirely dependent on the ability of the financier to repossess and re-market the asset in the event of a loan or lease default or on termination of a lease.⁵⁹ So, a financing agency would be hesitant to rely upon such equipment as security unless the right of immediate repossession was expressly provided in the lease, mortgage or conditional sale contract.⁶⁰ If the aircraft is registered in the defaulting airline's state it will certainly have to be de registered to permit global re marketing. The assurance of the repossession can lower the risks that the seller or lessor might face and will reduce the cost of the transaction, therefore makes aircraft collateral more acceptable for financiers.

⁵⁷ See Bunker, *supra* note 41.

⁵⁸ See Johnston, *supra* note 40 at 42.

⁵⁹ See S. Holloway, *Aircraft Acquisition Finance* (London: Pitman, 1992) at 231.

⁶⁰ See F.E. Hines, "Legal Difficulties in Secured Airline Equipment Financing" (1948) 5 J. Air L. & Com. 11 at 17.

Responding to the feature of aircraft equipment as the chattel in the security agreement, special laws and regulations are created by individual jurisdictions.⁶¹ The security law is the substantive law in each sovereign state and the diversity of legal traditions and policy considerations makes it very different from country to country. This brings upon us the task to solve the conflict of security laws.

Basically, three matters should be identified in the conflict of laws field. Firstly, how to create the security rights? Secondly, how can the creditor be guaranteed priority order among the competing rights on the secured aircraft in the case of insolvency? Thirdly, in case of the debtor's default, how can the creditors exercise their entitled remedies promptly?

⁶¹ The special law with respect to aircraft chattel is established in most of the industrialized countries. For some undeveloped states, this legal system is still premature.

Chapter Two Conflict of Security Laws on Movable Property

1. Diversity of law and conflicts of laws

“Credit enhancement” is designed to reduce the risk and enable a mutually profitable transaction.⁶² Collateral is used to fulfill the requirement of credit enhancement by granting to the creditor a “security interest” in specified assets of the debtor.⁶³ Security interest reduces the creditor’s risk of loss and allows the creditor to enter into the transaction at an interest rate low enough to be profitable for the debtor. So, the security interest facilitates the transaction.

The differences between secured credit regimes are quite significant in different jurisdictions. Substantively, the regime differs depending upon the type of property⁶⁴ in which a security interest may be granted and whether the transaction that is security instrument in substance but not in form⁶⁵ are governed by the rule of security interests.⁶⁶ Mostly they differ with the rules concerning priority of the secured party as against other claimants of the collateral.⁶⁷

The existence of different legal regimes that may govern an international secured transaction places burdens on such transactions in that the uncertainty about which law governs has an impact on the value of transactions.⁶⁸ When the collateral is “movable

⁶² The risk of debtor insolvency is a major determinant of whether a credit transaction will be seen as profitable for the creditor. Nonpayment would not only make the transaction unprofitable, but would also offset gains from many other transactions in which the debtor fully pay their debts. The goal of credit enhancement is to minimize the creditor’s risk of loss due to nonperformance while nonetheless allowing the transaction to be profitable for the debtor. See Cohen, *supra* note 7 at 174ff. See also Chapter One, Part II, C., above.

⁶³ Credit enhancement devices work normally by applying the following ideas: (1) making more assets reachable by the creditor to satisfy the claim; and (2) increasing the creditor’s priority with respect to assets available to it. The first idea is usually accomplished by arranging for a surety, guarantor, or other secondary obligor to agree to liability with respect to the debtor’s obligation. See Cohen, *ibid.*

⁶⁴ See Chapter One, above.

⁶⁵ The title based financing falls into this category. See Chapter One, above.

⁶⁶ See Chapter One, above.

⁶⁷ See Part II, A., below.

⁶⁸ These additional costs may include increased attorney’s fees as well as other internal costs of time and effort. See Cohen, *supra* note 7 at 177.

property”, things are even more complex because it may be impossible to predict where the property might be at any particular time and, accordingly, to predict which country’s law is applicable.

The cost of disharmony in the law of secured credit generally and national insolvency laws more specifically, would be such that credit transactions are discouraged due to high financial risks for creditors in the case of a failed transaction. Even without failure, a financier can not count on direct⁶⁹ or indirect⁷⁰ profits flowing from his advancement of funds because the cost of the transaction is higher than the profits generated by the expected return on investment.

II. Conflicts of laws on the secured moveable property

The private international law of security interests is infinitely more complicated than the ordinary contractual conflicts which seem elementary by comparison. Any attempt to summarize is futile and all one can do is to identify a few of the key issues.⁷¹

Aircraft is a special kind of movable property. So, the discussion will focus on the conflict of laws on movable property and specific issues related to aircraft object will be pointed out.

A. The priority of the security rights on movable property

1. The *lex situs* rule

It took long time to establish the rule for movable property in conflict of laws. As early as 1200s in Italy, the *lex situs* rule was used to solve the conflict of laws with respect to immovable property. The civil law countries applied “*mobilia personam sequuntur*” or “*movilia ossibus inhaerent*” to movable property; the responding legal usage in common law countries is “*personality has no locality*”. With the development of

⁶⁹ Direct profit derives from interest charges in excess of the creditor’s time value of the money. See Cohen *ibid.*, at 174.

⁷⁰ Indirect profits occur when the credit finances profitable sales of the creditor’s products or services to buyers. See Cohen, *ibid.*

⁷¹ See Wood, *supra* note 36 at 178.

the world economy and the international business, the amount of the transaction object is bigger and the location of the movable property is more complex than before. The *lex situs* rule was adopted at the end of 1800s in order to enlarge the jurisdiction of national law and facilitate the application of national law to the movable property located in the territory.

It is the *lex situs* that determines not only the nature of a thing, i.e. the immovable or a chattel,⁷² but also the rights, obligations, or documents connected with it.⁷³ Chattels are situated in a given country at the relevant time with the exceptions of commercial ships and civil aircraft, because they are moving across countries all the time. To ascribe them a permanent *situs* in the country where it is registered would avoid difficulties that could arise in the case of an aircraft in flight over the high seas or a *territorium nullius*.⁷⁴ This paramount importance was stipulated in international conventions dealing with rights of property in aircraft and also reflected in the national law respectively.⁷⁵

2. The disunity of formal requirements

⁷² "The only law which can effectively determine whether things shall be treated as movable or immovable is the law of the country which has control of the thing, that is, if the thing is tangible, the law of the country where it is situated". See Dicey A.V. & Morris, J.H.C., *The Conflict of Laws*, vol. 2, 12th ed. by Collins, L. et al. (London: Sweet & Maxwell, 1993) at 915.

⁷³ See *ibid.* See also Depei Han et al., *Guo Ji Si Fa*, rev. ed. (Wuhan: Wuhan University, 1989) at 131 ff [in Chinese].

⁷⁴ This exception of the *lex situs* rule can be found in most conflict of law rules, e.g. in the United Kingdom, a civil aircraft may at some times be deemed to be situated in its country of registration, see Dicey & Morris, *supra* note 72 at 936; in the United States, see *Restatement (second) of the Law of Conflict of Laws* (1971).

⁷⁵ See *Convention on International Civil Aviation*, art 17-19[hereinafter *Chicago Convention*]. See also *Geneva Convention*, art 1 "...recognize...rights in aircraft...which has been constituted in accordance with the law of the Contracting State in which the aircraft was registered as to nationality at the time of their constitution". National law has similar provision in the relevant regulations too, e.g., *Civil Aviation Law of the People's Republic of China*, adopted at the 16th Meeting of the Standing Committee of the Eighth National People's Congress on October 30, 1995, promulgated by Order No. 56 of the President of the People's Republic of China on October 30, 1995 and effective as of March 1, 1996. Online: <<http://www.qis.net/chinalaw/prclaw89.htm>> (date accessed: 10 April, 1999), art. 14, 16 [hereinafter *PRC Civil Aviation Law*]. Canada is not a signatory of the *Geneva Convention*, because it has not set up a central registry that is required under the *Geneva Convention*, i.e., security rights will only be respected in member states when such rights have been duly recorded in a central register maintained in the given state, see Bunker, *supra* note 41 at 766ff. The United Kingdom did not sign the *Geneva Convention* because of the domestic law with respect to lien rights. This point will be discussed in detail in this Chapter, see below.

The classical paradigm with respect to the transfer of title of personal property in many civil law jurisdictions is effectuated *solo consensu* and therefore has effect only *inter partes*.⁷⁶

Similarly, the creation of proprietary rights (absolute or by way of security) in common law jurisdictions is effective *inter partes* only after the fulfillment of necessary attachment.⁷⁷ However, the safe transaction order require certain protection for a third party who is in good faith when obtaining an interest in the asset. So security rights need to be perfected by ways of possession, registration and notice to the debtor or fundholder.⁷⁸ Perfection by registration (public notice) is almost universally accepted to give *erga omnes* efficacy to those real interests established on such chattel as commercial ships or civil aircraft.⁷⁹ Perfection does not guarantee priority over subsequent encumbrances, while it gives maximum efficacy to the security interest. In other words, an unperfected security interest will usually be invalid against subsequent encumbrances

⁷⁶ See Krupski, *supra* note 14 at 40. For the case of China, see Chapter Five, below.

⁷⁷ The ingredients of attachment include (1) security transfer or agreement; (2) identifiability of the subject matter; (3) debtor's interest or power to dispose; (4) obligation to be secured; and (5) fulfillment of contractual conditions for attachment. See R.M. Goode, *Legal Problems of Credit and Security*, 2nd ed. (London: Sweet & Maxwell, 1988) at 27ff; see also the attachment requirements in *Personal Property Security Act*, S.O. 1989 c. 16, R.S.O. 1990, c. P-10 as. am., s. 11 (2): identification, value, right; U.C.C. 9-201 (1994); Draft U.C.C. (July 1998), online: University of Pennsylvania <<http://www.law.upenn.edu/library/ulc/ucc9/ucc9txt1.htm>> (date accessed: January 11, 2000).

“9-201 - General Effectiveness of Security Agreement. (a) Except as otherwise provided in [the Uniform Commercial Code], a security agreement is effective according to its terms between the parties, against purchasers of the collateral, and against creditor[s].”
and Draft U.C.C., *ibid.*

9-203 - Attachment and Enforceability of Security Interest; Proceeds; Supporting Obligations; Formal Requisites. (a) A security interest attaches to collateral when it becomes enforceable against the debtor with respect to the collateral, unless an agreement expressly postpones the time of attachment. (b) Except as otherwise provided in subsections (c) through (l), a security interests enforceable against the debtor and third parties with respect to the collateral only if: (1) value has been given; (2) the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party; and [(3)].

As to registration of the security rights on aircraft, where it is recorded or not under section 503 of the Civil Aeronautics Act, the security transaction instrument binds the purchaser or borrower and persons with actual notice of the transaction. And the failure to record does not void a conveyance as between buyer and seller. See M. Scott, “Liens in Aircraft: Priorities” (1958) 25 J. Air L. & Com. 193 at 204, footnote 55, 56.

⁷⁸ See Goode, *ibid.* at 38.

⁷⁹ *Ibid.*

regardless of any other priority rule; a perfected security interest will bind subsequent encumbrances unless displaced by a particular priority rule.

The requirement of registration applied to international aircraft transactions is not just a simple publication that was criticized as time consuming, unreliable as to the legal value of the title and as provoking an immobilization of aircraft.⁸⁰ It also carries the objective to override the “false wealth” problem,⁸¹ which exists both in civil law and common law jurisdictions. The false wealth principle requires a security interest to be published either by a possessory pledge or by registration or filing in a public bureau⁸² in order to make the mortgage effective in case of bankruptcy of the owner. When the actual possession is impossible in the case of nonpossessory security, such as security on aircraft, the service of such notice is the nearest equivalence to possession. In addition, the notice by registration constitutes an overt act which would help to establish the existence of the assignment and preclude collusion between the assignor and assignee in fabricating an instrument of assignment and giving it a false date.⁸³

The attention should be drawn on some equivalent security instruments⁸⁴ regarding the registration matter. In many jurisdictions, particularly the common law jurisdictions, the attitude towards security is quite liberal. For example, in North America, the title retention agreement is equal to the security device. However elsewhere, in the common law as well as the civil law system, a sharp distinction is drawn between the grant of security on an asset that a debtor owner currently owns and an agreement between a seller and a buyer, which normally does not allow the passing of title to the

⁸⁰ See Krupski, *supra* note 14 at 42.

⁸¹ False wealth is also called ostensible credit-worthiness. It arises when a debtor has many possessions but few assets, because he has mortgaged them, thereby allegedly encouraging false credit. See Wood, *supra* note 36 at 4.

⁸² Perfection by registration is sometimes complicated by the need to perfect in more than one register. E.g. in the United Kingdom, any charge by company over a ship or aircraft must be registered both in the Company Registry and the ship's port of registry or the Registry of Aircraft Mortgages. See Thaine, *supra* note 37 at 171. See also Wood, *supra* note 36 at 209.

⁸³ See R. Goode, “The Protection of Interests in Movables in Transnational Commercial Law” (1998) 2/3 Unif. L. Rev. 453 at 457.

⁸⁴ The equivalent security instruments refer to the title reservation agreement and leasing agreement. They are not security agreements by nature, but they play important role in the aircraft financing transaction and have the economic function as security. See Chapter One, above.

buyer until completion of payment.⁸⁵ Hence, the notification requirements for the reservation of title may depend on varying degrees of formalities, such as stipulation, public notification or registration.⁸⁶

Examples of problematic securities are not only the above mentioned conditional sale and the hire-purchase, but also the fiduciary transfer of title to a movable property by the debtor of the main obligation as a means of security notably in Germany and the Netherlands, the *hypothèque mobilière sans dépossession* in Quebec and the leasing, because they all side step the pledge with delivery (dispossession).⁸⁷ The diversity of the security and title retention device brings out the matter of recognition of real rights while the transnational factor is involved. This problem is largely solved by the *Geneva Convention*, which will be discussed in detail in next chapter.

3. Priorities of competing security interests

Priority is closely associated with the public notice formality. Duly perfected secured creditors⁸⁸ are super-priority creditors⁸⁹ on insolvency. The main concern of the creditor is whether the perfected security rights can be protected in the bankruptcy, so the priority was established in order to determine the outside effects.

Although the international tendency is to encourage security, there are no uniform laws, for example, the priority might be qualified or limited by insolvency rescue proceedings in different jurisdictions. The certainty and predictability of the creditor's

⁸⁵ See R. Goode, "Transcending the Boundaries of Earth and Space: the Preliminary Draft UNIDROIT Convention on International Interests in Mobile Equipment" (1998) 1 Unif. L. Rev. 52 at 62. The United States and Canada recognize the conditional sales. While outside North America, even common law jurisdictions do not recognize this title reservation agreement as security, e.g. the United Kingdom.

⁸⁶ See Krupski, *supra* note 14 at 43, footnote 181.

⁸⁷ Krupski, *ibid.* at 44.

⁸⁸ Security effective only between the agreement parties is futile in insolvency. The perfection normally can be accomplished either by possession or by public notice.

⁸⁹ Super-priority creditors are those who are paid in full or up to the amount of their asset. Secured creditors and title finance creditors are specified in this class. The hierarchy of payment in the bankruptcy internationally can be concluded as follows: 1. super-priority creditors; 2. priority creditors; 3. *pari passu* creditors; 4. deferred creditors; 5. equity shareholders; and 6. expropriated creditors. See P.R. Wood, *Principles of International Insolvency* (London: Sweet & Maxwell, 1995) at 11.

priority over competing interests can be severely affected by, e.g., the liens attaching to the given assets.⁹⁰

a. General rule -- first to file, or first to create

Generally ship and aircraft registration statutes establish a system of priorities which depend upon the order of registration rather than confusing unpredictable doctrines of reputed ownership, actual or constructive notice of prior interests and the like.

The general rule of priority for registered mortgages ranks according to the date of registration as opposed to the date upon which the mortgage is created.⁹¹ Therefore, between two mortgages that are executed subsequently but the latter one was registered prior to the earlier one, the second mortgage takes priority over the first mortgage.⁹² One difference concerns the ranking of mortgages created on the same day. Many states prescribe that the order of time of registration governs for aircraft, e.g., England and many English-influenced states. But in some jurisdictions, mortgages registered on the same day have equal priority, e.g., France, Finland and Greece, etc.

b. Aircraft lien

Considerable uncertainties and risks lying in the creditor or owner/lessor of an aircraft arise from the possession to lessees/mortgagees because many claims may be enforced against the aircraft in priority to the ownership rights.⁹³ The same as the maritime liens, which can surface after the ship has been sold and mortgaged to a mortgagee unaware of the lien because of lack of registration and the secret nature of the

⁹⁰ Lien is the most important factor in case of ships and aircraft. For other affecting factors generally, see Wood, *ibid.* at 13.

⁹¹ For priority of security rights on ships, Denmark, Liberia, the United States, Italy, Norway, Sweden and Britain apply the order of registration. See Wood, *supra* note 36 at 217. Japan is the same, that is, the priority between more than one mortgage is determined by the order in which applications for the registration of those mortgages are filed. See G.M. White, "Security Interests in Aircraft and Spare Parts III: Japan, Korea, Singapore and Hong Kong" (1987) 5 IBL 215 at 217. But for the example of China, the priority is classified according to the function of registration, and applies different orders respectively. See Chapter Five, below.

⁹² Japanese law is one of the examples for this situation, which is stated in the Aircraft Hypothecation Law, art. 10. See White, *ibid.*

⁹³ See N.B.A. Hughes, "Eurocontrol and Airport Liens and some other Rights of Detention/Forfeiture of Aircraft" (1992) 17:3 Air & Space Law at 137.

liens,⁹⁴ the major problem for the aircraft owner/lessor is that the rights giving rise to the claims are generally beyond his control, and there is no standard method of recording/registering either.⁹⁵

a.a. Lien on Aircraft

Basically the liens are classified into two categories: the contractual liens and the statutory liens.⁹⁶ The contractual liens arise from the relevant agreement between the creditor and the debtor, such as repairman's liens and storage liens.⁹⁷ Whereas the statutory liens can include a variety of types according to domestic law,⁹⁸ such as government tax liens, government penalty liens and liens for wages.⁹⁹

⁹⁴ See Wood, *supra* note 36 at 218.

⁹⁵ See Hughes, *supra* note 93.

⁹⁶ This classification is based on the model of English Law. See Thaine, *supra* note 37.

⁹⁷ Repairmen's liens are the typical non-statutory lien both in common law authority and in civil law code. However, the storage lien, which is drawn by analogy from the common law bailee's lien and the maritime warfare lien, has been recognized slowly by common law court in US. In United States, "[A] bundant state legislation is found providing the private or municipal aircraft repairmen with a lien for the contract price or reasonable value of his services", see Scott, *supra* note 77 at 198, footnote 27. In United Kingdom, repairer's lien is the main type of non-statutory lien which is likely to be claimed against an aircraft, see *ibid.* In Chinese legal system, which was influenced mainly by civil law tradition, a lien is defined as a contractual agreement between the debtor and creditor giving the creditor possession of the debtor's moveable property. The possessing lien is similar with the repairmen's liens; the storage lien is stipulated; and transportation contract is included too. See the *Guaranty Law of the People's Republic of China*, adopted at the 14th Meeting of the Standing Committee of the Eighth National People's Congress, promulgated by Order No. 50 of the President of the People's Republic of China on June 30, 1995, and effective as of October 1, 1995 [hereinafter *PRC Guaranty Law*], art. 82:

"'Lien' as used in this Law means that the creditor shall possess the debtor's movables according to the terms of the contract as provided by Article 84 of this Law. If the debtor defaults on his debt, the creditor shall be entitled to retain the property...and to the priority of having the debt paid with the money converted from the property or proceeds from sale or auction of the property."

see also art. 84:

"In the event of any costs arising from a storage, transportation or processing contract, if the debtor defaults, the creditor shall have the right to retain the property."

However, the special law with respect to aircraft confines the liens only to the rescue and the custody related to rescue. See also *PRC Civil Aviation Law*, art. 19.

⁹⁸ In the United Kingdom, the Civil Aviation Act 1982 provided the statutory lien affecting aircraft located in the UK territory. Airport authority is empowered under section 88 of aforementioned Act to detain an aircraft that has accrued unpaid airport charges and any other aircraft of the defaulting operator. See Thaine, *supra* note 37; see also Hughes, *supra* note 93 at 138. In Japan, the lien can arise from taxation, social security, airport charges and other public dues and imposts. See White, *supra* note 91. In the United States, the violation of certain provisions of the Civil Aeronautics Act regarding registration of aircraft, safety certification, postal regulations and navigation regulations will subject the aircraft to government penalty liens; a lien for unpaid taxes shall arise under sections 3670-3672 of the Internal

The law on aircraft liens takes its inspiration from maritime liens, but these liens are in practice less important than maritime liens for two reasons. The first is that the creditors of airlines tend to rely more on the credit of the airline than the aircraft itself, such an inconvenient asset. Secondly, the 1948 *Geneva Convention* severely limits the liens that can rank ahead of a mortgage. The *Geneva Convention* broadly limits the applicable liens to the enforcement costs, salvage and preservation expenses and tort liability for injury or damage to persons or property on the surface caused by the aircraft.¹⁰⁰

Unlike the relatively settled subject of priority among maritime liens, the seniority of liens and other security interests in aircraft is uncertain. In England, there is no *in rem* right to proceed against the aircraft in the same way as maritime liens, except for minor exceptions, e.g., the salvage of aircraft. However, the possessory liens of repairers and statutory rights of detention have priority over aircraft mortgages.¹⁰¹ Most English-based countries rank these liens ahead of the mortgagee.¹⁰² Some countries rank the possessory repairers' lien after the mortgagee, e.g. Germany, Norway and Sweden. From the US case law, we can conclude that the registered mortgage is prior to the lien arising from the repair.¹⁰³ Some countries rank liens and the registered security rights together by the order of occurrence.¹⁰⁴

Revenue Code; the "ground damage" legislation providing lien in favor of a party injured by an aircraft or objects falling therefrom. See Scott, *supra* note 77 at 197.

⁹⁹ See Scott, *ibid.* at 196-99.

¹⁰⁰ See *Geneva Convention*, art. IV. See Chapter Three, below.

¹⁰¹ Under Paragraph 14(5) of the Mortgaging of Aircraft Order 1972, the registration of a mortgage confers no priority "over any possessory lien in respect of work done on the aircraft (whether before or after the creation or registration of a mortgage) on the express or implied authority of any person lawfully entitled to possession of the aircraft under any Act of Parliament". See Thaine, *supra* note 37 at 172.

¹⁰² E.g., Singapore and Hong Kong apply the same priority rule. See White, *supra* note 91 at 220-24.

¹⁰³ With the competing claims of a mortgagee whose lien had been federally recorded, and a subsequent lienor for repairs upon an intrastate aircraft, the lien of the mortgagee was senior, see *In re Veteran's Air Express Co.*, (D.C.N.J. 1948) 76 F. Supp. 684. In case the repairman was preferred, not because the court found him prior in right to the recording mortgagee, but because the mortgage itself was no basis upon which to assert a valid lien, see *United States v. United Aircraft Corp.*, (D.C. Conn. 1948) 80 F. Supp. 52. See Scott, *supra* note 77 at 200ff.

¹⁰⁴ E.g. the case of Japan. The priority is determined according to the order of the due dates specified in the law of the public dues, imposts and taxes as compared with the date of registration of the mortgage. The public dues can take priority over the registered mortgage when the due date for public dues is earlier than the date of registration. See White, *supra* note 91.

We should pay attention to the strict liens priority in English-based countries, particularly the United Kingdom. The big divergence between the domestic law and the relevant international convention drove the United Kingdom out of 1948 *Geneva Convention*. It was a big failure of the *Geneva Convention* considering the UK is a big force in world airline industry. The lien priority in the UK is in conflict with Article 1(2) of the *Geneva Convention* that prohibits the subordination of mortgages and charges by non-contractual security interests, such as common law liens and statutory detention rights.¹⁰⁵ The UK government proposed to impose a bonding requirement to guard against non-payment of airport and air navigation charges so as to remove the priority of liens. However, the bonding might cause discrimination against foreign operators and would not be a solution with regard to the supply of air navigation services through Eurocontrol.¹⁰⁶ The loss of those detention powers under the *Geneva Convention* would deprive Eurocontrol and the UK of a means of recovering en route charges from bad payers. The particular situation resulted in the failure of the UK's joining in the *Geneva Convention*.¹⁰⁷

b.b. Transnational problem with the Eurocontrol fee

Issues came out from the Eurocontrol¹⁰⁸ air navigation fee exercised by the UK detention rights. The Eurocontrol's activities related to the collection of en-route service charges were stated in the Multilateral Agreement relating to Route Charges signed on 8 September 1970. The Contracting States¹⁰⁹ agreed to adopt a common policy in respect of charges for en route air navigation facilities and services in the airspace falling within their respective jurisdictions.

¹⁰⁵ See *Geneva Convention*, art 1.

¹⁰⁶ See "Transnational problem with the Eurocontrol fee", below.

¹⁰⁷ This problem does not occur in other common law countries, e.g., in the United States, the costs of the airport and air navigation services are not charged to airlines but are largely met from a tax on airline tickets. See Thaine, *supra* note 37 at 173.

¹⁰⁸ Eurocontrol was established as under the *Eurocontrol International Convention relating to Cooperation for the Safety of Air Navigation* 1960 as amended in 1981. It stands for the European Organization for the Safety of Air Navigation and has independent legal personality and regulatory powers relating to air traffic control in the upper airspace of the Contracting States. By 1992, 11 States signed the 1981 amended Convention. See T. Christopherson & J.H. Bax, "Eurocontrol: UK Detention Rights" (1992) 17:1 Air Law 2. See also Hughes, *supra* note 93 at 142.

¹⁰⁹ Contracting States were Belgium, France, German Federal Public, Ireland, Luxembourg, the Netherlands and the United Kingdom. See Christopherson & Bax, *ibid.*, footnote 1, 7.

Upon regulating Eurocontrol's status in Section 24 and Schedule 4 of the *Civil Aviation Act 1982*, English law provides the local authority to exercise the detention rights on aircraft in respect of air navigation services occurred from Eurocontrol¹¹⁰, the same as from the Civil Aviation Authority. Thus, Eurocontrol may require the Civil Aviation Authority to act on its behalf to detain either the aircraft on which the charges were made or any other aircraft of which the person in default is the operator.¹¹¹

The detention right provided by the UK legislation is beyond its equivalent powers in Germany, France, Belgium or the Netherlands. It goes beyond the regulation under the Multilateral Agreement and merely reflects the Civil Aviation Authority's existing detention powers. Considering the UK is not a Contracting State of 1933 *Arrest Convention*¹¹² which protects certain categories of aircraft from precautionary arrest, the aircraft is more vulnerable to detention in the UK than in the other jurisdictions.

The owner or lessor of the aircraft may have to pay for services provided to a previous operator, because the charges can follow an aircraft irrespective of ownership or the identity of the operator.¹¹³ Moreover, the detention can be exercised with the requirement of court order under the UK law. Hence, the creditor, owner or lessor of the commercial aircraft encounters significant uncertainty in this particular jurisdiction.

B. The default and the enforcement of security on movable properties

1. Remedies

The motive behind the establishment of the priority is to protect the rights of the creditor in the situation of the debtor's insolvency. Domestic laws provide a variety of remedies for creditors in the situation of the debtor's default.

¹¹⁰ The relevant regulations authorize the Secretary of State for Transport to: (1) require the payment of charges to the Civil Aviation Authority or Eurocontrol in respect of air navigation services; (2) authorize detention of aircraft in case of default in the payment of any relevant charge payable by an operator; (3) in cases of further specified delay, authorize the sale of the detained aircraft. See Christopherson & Bax, *ibid.* at 3ff.

¹¹¹ See Christopherson & Bax, *ibid.* at 4.

¹¹² For detailed discussion of this convention, see Part III, C. 1., below.

¹¹³ This detention happened in practice, see Christopherson & Bax, *supra* note 108 at 5-8.

In English-based jurisdictions, an exceptionally flexible array of enforcement remedies¹¹⁴, which are called the “self help” and applied in the common law jurisdictions of the United States also, is available to the secured creditor under a properly drafted security document. By contrast, however, in most other jurisdictions, the secured creditor is generally limited to public auction, usually only after obtaining a court order.¹¹⁵ These jurisdictions from the beginning have given priority to the protection of the debtor by insisting on judicial monitoring of enforcement and by a public sale designed to prevent a collusive sale by the mortgagee. Hence, it is judicial protectionism.

a. Foreclosure

Foreclosure is an absolute transfer of the mortgaged property to the mortgagee.¹¹⁶ Since there is no test of value and a possible temptation to the creditor, thus this remedy is universally controlled or even prohibited. In those jurisdictions where the foreclosure is permitted, the court order is normally required.¹¹⁷

b. Possessory management

English-based jurisdictions generally permit a mortgagee to take possession of the secured asset and to collect the income from the asset. When the secured debt is repaid, the creditor surrenders possession. This temporary possession¹¹⁸ is an important remedy in practice for ships and aircraft, because it provides the mortgagee the right to operate the

¹¹⁴ These remedies include private sale, taking possession temporarily to collect the income, and taking possession through a receiver to operate the asset or the business covered by a floating charge. See Wood, *supra* note 36 at 138. For example, in the United Kingdom, an owner or mortgagee may retake possession of a leased or mortgaged aircraft following an operator default without applying to court and operate the aircraft to discharge the debt due, see S. Roche & Temperley eds., *Repossession of Aircraft and Insolvency in EC Countries* (London: Lloyd's, 1993) at 140.

¹¹⁵ These countries include most of the European continental countries, such as France, Germany, Italy etc.; most of Latin America countries, such as Argentina, Brazil etc.; Finland and Sweden in Scandinavia and some other jurisdictions, China is in this line too. See Wood, *ibid.*

¹¹⁶ See Wood, *ibid.* at 138, 243.

¹¹⁷ E.g., in England, foreclosures require a court order and this happens rarely, because the court usually orders a sale. Exception exists in the case of receivables because the proceeds are already money and the creditor cannot take more. See Wood, *ibid.* at 139.

¹¹⁸ This type of possessory management is distinguished from a custodial possession by the creditor to take over the title. See Wood, *ibid.* at 139, 246.

vessel or the aircraft so as to complete a voyage, and to move the asset to a favorable enforcement jurisdiction where there are less obstacles, e.g., in the form of prior liens.¹¹⁹

From the date when the mortgagee takes possession, he is liable for all the expenses incurred and entitled to all the earnings.¹²⁰ The risks might arise accompanying the possession, since the mortgagee is operating the vessel, he incurs the liabilities of an owner to third parties.¹²¹ The creditor is also liable to the debtor for negligent losses and damages resulting from wrongful or premature possession.¹²² In case of ships, aircraft and other assets whose operations must be officially licensed, the mortgagee needs to obtain the necessary certificates to operate the asset or conduct the business.¹²³

The possessory management is a peculiar English remedy that can be found in English-influenced jurisdictions¹²⁴ including most states in the United States. The civil code countries do not permit it generally.¹²⁵ Put it in another way, the “self help” remedies are not available for those countries. One exception is Greece,¹²⁶ which enacted the Decree¹²⁷ with the desire to promote the foreign financing of its merchant fleet and flag aircraft. In this Decree, the mortgagee was offered a duly additional power of possessory management and sale without court order provided so stated in the mortgage agreement.¹²⁸

c. Sale

¹¹⁹ See Wood, *ibid.* For aircraft lien, see above.

¹²⁰ In English law, this right arises at law regardless of any express provision in the agreement.

¹²¹ This kind of liability incurs when the chattel causes pollution or damage to third parties. See Wood, *supra* note 36 at 140.

¹²² One international Convention was set up to solve this kind of problems with respect to commercial aircraft. Under the 1933 *Arrest Convention*, the prejudgment arrests are not permitted on some conditions with the purpose to prevent the aircraft from serious interfere. See *Arrest Convention*, art. 2(1); see also Wood, *ibid.* at 257.

¹²³ For the aircraft, only one nationality can be carried by each aircraft and only with the necessary certificates can it be used in the business. See *Chicago Convention*, c. V.

¹²⁴ E.g., Singapore follows the English model, the available remedies for secured creditor will be possession, sale, foreclosure and the appointment of a receiver. See White, *supra* note 91 at 222.

¹²⁵ This remedy is rarely available in civil code countries or in Scandinavia, including countries otherwise sympathetic to security, e.g. Germany, Japan and Sweden. See Wood, *supra* note 36 at 141.

¹²⁶ Panama is the same case since 1984, which is specified by Panama Commercial Code, art 1527A. See Wood, *ibid.* at 248.

¹²⁷ See Greek Legislative Decree No 3899/58.

¹²⁸ Strict conditions were added in this regulation. The mortgage has to be duly notarized, or the court order will still be required. See Roche & Temperley, *supra* note 114 at 61.

Most of the jurisdictions require the judicial order prior to the possession and the sale of the chattel. There are two ways to enforce the security rights after obtaining the court order, either through the judicial public auction or through the private sale.

a.a. Public auction

A public auction under judicial supervision is intended to protect the debtor. The delays in public auctions can “run to years and the cost can be astronomical”,¹²⁹ but it gives a clear title, free of all prior claims, which will be internationally recognized.

The judicial protectionism is evidenced by the requirements for aircraft mortgage. Numbers of countries require a court order for realization or public auction or both in this case.¹³⁰

bb. Private sale

A private sale permits a rapid disposal of the asset without delays or court costs. Besides the English-based states, some other jurisdictions allow the private sale under some conditions.¹³¹

However, the mortgagee may have the risk of no protection on the price. The main problem accompanying the private sale is its validity, because other jurisdictions might not recognize it at all. If the flag registry state does not recognize a forced private sale, the

¹²⁹ See Wood, *supra* note 36 at 245.

¹³⁰ In Denmark, without the consent of the mortgagor, a mortgagee cannot sell the aircraft other than through judicial proceedings involving a sale. A public auction can be held regarding the request of the mortgagee and following the required notice. See Roche & Temperley, *supra* note 114 at 31. In France, a mortgagee cannot take possession of nor sell the aircraft upon the occurrence of an event of default without judicial intervention. See Roche & Temperley, *ibid.* at 40. See also J.T. Brown, “Security Interests in Aircraft and Spare Parts V: France” (1987) 6 IBL 262 at 265. In China, the mortgagee may, through agreement with the mortgagor, be paid out the proceeds from the conversion of the mortgaged property or from the auction or sale of the mortgaged property. When they fail to reach an agreement and bring suit in court, the court supervised public auction is exercised. See *PRC Guaranty Law*, *supra* note 97, art. 53.

¹³¹ A “commercially reasonable” test is required in the Uniform Commercial Code in US, see Wood, *supra* note 36 at 143. The mutual agreement between the mortgagor and the mortgagee is required in the *PRC Guaranty Law*. In Germany, unless the debtor resists, the fiduciary transfer allows a private sale, see J.T. Brown & U. Mannsfeldt, “Security Interests in Aircraft and Spare Parts IV: Germany” (1987) 5 IBL 224 at 225, see also Roche & Temperley, *supra* note 114 at 50. Japan and Switzerland are the “fiduciary transfer” countries too and have the same regulation as Germany, see White, *supra* note 91 at 218, see also Wood, *supra* note 36 at 143.

purchaser of the chattel, say ship or aircraft, can not obtain a certificate necessary for de-registration from that state.¹³² Moreover, the aircraft liens occurred before the sale will not be overridden by the sale and the creditor might be liable under the sale agreement to the purchaser.

d. Grace periods of enforcement rights

Before the enforcement, a grace period is normally granted to the debtors to fulfill the contract. The grace period can be reached mutually by the creditor and the debtor by way of mutual agreement in advance, which is the situation in the UK.

Outside English-based countries, the grace periods on enforcement are common.

C. Insolvency

Few, if any, areas of the commercial law are more policy-laden than the insolvency law.¹³³ This paper can not discuss more details on this topic due to limited scope of the thesis.

Based on the purpose of protecting the creditor's priority rights in the insolvency, the relevant insolvency proceedings will be discussed. The author will pay more attention to the US insolvency model (focus on aircraft) as it was adopted by the UNIDROIT *Draft Convention* and *Draft Aircraft Protocol*.

1. Problems related to the Hierarchy of Insolvency

Similar to the secured right, the priority in one jurisdiction is not necessarily the same as that in another legal regime.¹³⁴ For example, an English court will characterize

¹³² See Wood, *ibid.* at 142, 245.

¹³³ See T.M. Gaa, "Harmonization of International Bankruptcy Law and Practice: Is it necessary?" (1993) 27 *International Law* 893-96, cited by J. Wool, "The Next Generation of International Aviation Finance Law: An Overview of the Proposed Unidroit Convention on International Interests in Mobile Equipment as Applied to aircraft Equipment" (1998) 23:6 *Air & Space Law* 243 at 260.

¹³⁴ See Krupski, *supra* note 14 at 53.

the German fiduciary transfer as a floating charge and rank it after the rights of preferential creditors although it is ahead of them in Germany.¹³⁵

The private international law has to intervene and provide a solution to this conflict of opposability, which is relevant for the enforcement of the security against the defaulting buyer, lessee or lienee. In case of aircraft the shifting *lex suite* is not practical to determine the applicable law. Rather, due to the close connection to seizure in execution and the likely application of different laws to competing securities on the same movable property, most courts that are competent in the insolvency will decide the *lex fori* as the single order of priority.

2. Special treatment to secured creditors on aircraft property

Even as the super priority creditors, the rights of the secured creditors are severely limited on the insolvency proceedings. The modern insolvency law adopts the corporate rescue proceedings, the corporate rehabilitation,¹³⁶ which is designed to resuscitate the debtor companies in distress. The statute generally imposes a freeze on enforcement of the security, under which a secured party normally cannot repossess or foreclose on its collateral, despite the contrary terms of a security agreement between the debtor and the creditor.¹³⁷ So it significantly impinges on creditor rights.¹³⁸ The rationale behind is the intention to preserve what remains of the debtor's estate in order to provide a systematic and equitable procedure for all creditors (including secured creditors) to pursue their claims, and to protect the debtor from defending a multitude of claims in different and sometimes distant courts.¹³⁹

¹³⁵ See Wood, *supra* note 36 at 195. In English law the floating charge has less priority than a fixed charge or other subsequent purchasers and mortgagees. See Wood, *ibid.* at 75ff.

¹³⁶ The impetus of the rescue has come from an economic recession that has led to political pressure to rescue economic enterprise and to succor those who were the victims. See Wood, *supra* note 89 at 175

¹³⁷ See L.B. Goldman, M.J. Album & M.S. Ward, "Repossessing the Spirit of St. Louis: Expanding the Protection of Sections 1110 and 1168 of the Bankruptcy Code" (1985) 41 Business Lawyer 29 at 33.

¹³⁸ See Wood, *supra* note 89 at 13, 182.

¹³⁹ See Goldman, Album & Ward, *supra* note 137. See also Wood, *ibid.*

Although it is said the creditor's rights are only delayed until the success of the rehabilitation, there is very low rate¹⁴⁰ of the success. Meanwhile, the secured rights, as a kind of volatile asset, are in high risk.

The traditional bankruptcy law confers special treatment on certain secured creditors by granting them relief of the stay under certain circumstances. In addition, some jurisdictions afford special treatment to certain lenders for targeted transportation industries, e.g., the United States. Starting with the railroads and moving to airlines and water carriers, the US bankruptcy laws have exempted equipment financiers in these industries from the automatic stay prescribed in the bankruptcy laws. The current provisions of Section 1110 of the Code¹⁴¹ in effect create a category of "super lenders" to the transportation industry.

¹⁴⁰ The rate is only as low as 10%. See Wood, *supra* note 89 at 74.

¹⁴¹ Section 1110 provides in full that:

(a) The right of a secured party with a purchase-money equipment security interest in, or of a lessor or conditional vendor of, whether as trustee or otherwise, aircraft, aircraft engines, propellers, appliances, or spare parts, as defined in section 101 of the Federal Aviation Act of 1958 (49 U.S.C. 1301), or vessels of the United States, as defined in subsection B(4) of the Ship Mortgage Act, 1920 (46 U.S.C. 911(4)), that are subject to a purchase-money equipment security granted by, leased to, or conditionally sold to, a debtor that is an air carrier operating under a certificate of convenience and necessity issued by the Civil Aeronautics Board, or a water carrier that holds a certificate of public convenience and necessity or permit issued by the Interstate Commerce Commission, as the case may be, to take possession of such equipment in compliance with the provisions of a purchase-money equipment security agreement, lease, or conditional sale contract, as the case may be, is not affected by section 362 or 363 of this title or by any power of the court to enjoin such taking of possession, unless-

(1) before 60 days after the date of the order for relief under this chapter, the trustee, subject to the court's approval, agrees to perform all obligations of the debtor that become due on or after such date under such security agreement, lease, or conditional sale contract, as the case may be; and

(2) any default, other than a default of a kind specified in section 365(b)(2) of this title, under such security agreement, lease, or conditional sale contract, as the case may be-

(A) that occurred before such date is cured before the expiration of such 60 period; and

(B) that occurs after such date is cured before the later of-

(i) 30 days after the date of such default; and

(ii) the expiration of such 60-day period.

(b) The trustee and the secured party, lessor, or conditional vendor, as the case may be, whose right to take possession is protected under subsection (a) of this section may agree, subject to the court's approval, to extend the 60-day period specified in subsection (a)(1).

Under this Chapter, certain secured parties are exempted from the automatic stay imposed on creditors.¹⁴² Their rights of repossession are unaffected by the automatic stay and are, for the most part, independent of any bankruptcy court action.¹⁴³

The Section 1110 is not contrary to the philosophy of the whole spirit of the Bankruptcy Law.¹⁴⁴ It was designed to prevent bankruptcy from arising in the first place by encouraging loans to the railroad, airline, and water carrier industries. It encourages the financing necessary to capitalize and equip industries deemed vital to the nation's growth and survival.¹⁴⁵

This kind of special treatment is only found in the US bankruptcy law, which embodies the spirit to promote the airline industry by giving more protection to the secured creditors involving in aircraft transactions. In practice, the legislation accomplished its purpose.

¹⁴² Under section 362 of this Code, an automatic stay will be put upon the creditors after the filing of the bankruptcy, so any act "to obtain possession of property of the estate or property from the estate" or "to enforce any lien against property of the estate" is not allowed. See section 362:

(a)...a petition filed under section 301, 302, or 303 of this title...operates as a stay, applicable to all entities, of-

...

(2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;

(3) any act to obtain possession of property of the estate or of property from the estate;

(4) any act to create, perfect, or enforce any lien against property of the estate;

...

¹⁴³ See Goldman, Album & Ward, *supra* note 137.

¹⁴⁴ The philosophy of the Bankruptcy Code is intended to protect the debtor instead of the creditor. The protection afforded to a limited class of financiers of aircraft and vessels is "intended to be narrowly construed to prevent secured parties or lessors from gaining the protection of the section unless the interest of such lessor or secured party is explicitly enumerated therein". See R.A. Greenspon, "Airline Reorganizations in the US and Their Impact on the Interests of Aircraft Lessors and Secured Creditors" (1986) 4 IBL 100.

¹⁴⁵ See Goldman, Album & Ward, *supra* note 137 at 30.

III. Approaches to establish the harmony

A. Approaches to solve conflict of laws

Classically, national law deals with the conflict of laws by stipulating relevant principles so as to choose the applicable law.¹⁴⁶ However, even the modern approach, the national conflict of laws and international conflict conventions, is not satisfying. The method applied to a particular problem in the private international law depends on the conceptual compatibility of relevant domestic laws.¹⁴⁷ This purpose can only be met by an uniform substantive law, which entirely redesigns national law and smoothens the friction between diametrically opposed traditional legal concepts.

B. Undertakings to harmonize security law

The study of harmonization of international transaction with respect to security law was launched as early as 1977,¹⁴⁸ initiated by the United Nations Commission on International Trade Law (UNCITRAL). At that time, it is premature to obtain sufficient government support for an international conference dealing with the relatively technical topic of security interests.¹⁴⁹

After more than twenty years of the UNCITRAL first report, the international secured transactions landscape has changed dramatically. Particularly within the last decade, initiatives for the reform of both international and domestic laws governing secured transactions have been launched. The purpose of modernization and harmonization is no longer far from realizing.

¹⁴⁶ The national efforts to solving this legal problem were classified as four approaches: single concept or principles; multiple numbered rules; general texts, commentaries, and essays; and national legislation and international conventions. See W. Tetley, *International Conflict of Laws: Common, Civil and Maritime* (Montreal: International Shipping, 1994), Part One.

¹⁴⁷ See Krupski, *supra* note 14 at 32. See also Tetley, *ibid.* at 37.

¹⁴⁸ Professor Ulrich Drobnig of the Max-Planck-Institute for Foreign Private and Private International Law was designed to “make a study of the law of security interests in principle legal systems”. A study was published in 1977 to assess the need and prospects for accomplishing harmonization in this area of law. See Cohen, *supra* note 7 at 178, footnote 18.

¹⁴⁹ Two proposals for the harmonization of secured credit law at the time of the study had been addressed. Neither of them had succeeded or appeared likely to have significant influence. See Cohen, *ibid.* at 179.

1. The reform at international level

UNIDROIT and UNCITRAL undertook the responsibility of reforms at international level.

UNIDROIT had worked out the *Financial Leasing Convention*¹⁵⁰ and the Convention on International Factoring¹⁵¹ concluded in Ottawa on 28 May 1988. Another matter on the UNIDROIT agenda is a convention concerning security interests on immovable goods. This project is based on an initiative of the Canadian government and desires as a starting point to facilitate international recognition of financial lessors' rights in collateral against bankruptcy trustees and creditors.¹⁵² The *Draft Convention*, with the *Draft Aircraft Protocol*, had been discussed intensively by the government experts through two Joint Sessions¹⁵³ and now in the last stage before submitting to the Diplomatic Conference.

UNCITRAL is concentrating on the development of a convention since 1995, which would govern international receivable financing¹⁵⁴. This Convention, partly concerning with transactions within the scope of the *Factoring Convention* but going much further, "would govern virtually any international assignment of a receivable and any assignment (domestic or international) of an international receivable."¹⁵⁵

2. The undertakings by individual state

¹⁵⁰ See Chapter One, above.

¹⁵¹ "Factoring is a common method of commercial finance in which a merchant who sells goods or services on credit can transform its rights to receive money from its customers in the future to cash in the present by selling those rights to a financier, or "factor", who will undertake to collect from the customers", see Cohen, *supra* note 7 at 181. See also UNIDROIT *Convention on International Factoring*, 28 May 1988 [hereinafter *Factoring Convention*].

¹⁵² See Diojonegoro, *supra* note 7 at 54 referring to M.J. Stanford, "Taking Security over Movables - Moving Towards an Universal System of Registration" (Address, Firenze, 3 September 1997) [unpublished].

¹⁵³ The Sessions were jointly held by UNIDROIT and ICAO in Rome, February 1999 and in Montreal, August-September 1999 respectively.

¹⁵⁴ The *Convention on Assignments in Receivables Financing*. See Working Group on International Contract Principles, UNCITRAL, Revised Articles on the Draft Convention on Assignment in Receivables Financing (Apr. 23, 1997) U.N. Doc. A/CN.9/WG.II/WP.93, online: <<http://www.un.or.at/uncitral>> [hereinafter *Receivables Project*](date accessed: 10 January, 2000).

¹⁵⁵ See *Receivables Project*, *ibid.*, art. 1.

Currently, many nations throughout the world are taking efforts to reform domestic secured transaction law. A significant project under the auspices of the World Bank is to carry out the reform in former Soviet republics, Soviet-dominated states, and other developing economies.¹⁵⁶ This project is carried out by the European Bank for Reconstruction and Development (EBRD),¹⁵⁷ the American bar Association (ABA)¹⁵⁸ and the University of Maryland¹⁵⁹ to serve as the basis for enactment of modern national laws on secured transactions in Central and Eastern Europe and former Soviet Republics. The World Bank sponsored certain Central and South American developing economies for the reform too.¹⁶⁰ The NAFTA harmonization activities, which focus on the impact in Mexico, are encouraged by the National Law Center for Inter-American Free Trade at the University of Arizona.¹⁶¹

The reform of secured transaction in China was brought into line with the long-term legal reform. The most outstanding achievement was the enactment of the *PRC Guaranty Law* in 1995.¹⁶²

¹⁵⁶ See Cohen, *supra* note 7 at 183.

¹⁵⁷ See European Bank for Reconstruction and Development (EBRD), *Model Law on Secured Transactions*, 1994, online: European Bank for Reconstruction and Development <<http://www.ebrd.com/new/misc/modlaw0.htm>> (date accessed: 10 January, 2000); see also Cohen, *ibid.* at 183ff.

¹⁵⁸ See American Bar Association, Central and East European Law Initiative (CEELI), *Concept Paper on Secured Transactions Law* of 24 March 1997, online: American Bar Association <<http://www.abanet.org/ceeli/papers/sec.html>> (date accessed: 10 January, 2000); see also J. Key, "Old Countries, New Rights" (1994) 80 American Bar Association Journal 68; see also Cohen, *ibid.* at 184.

¹⁵⁹ See University of Maryland, *Institute Reform and the Informal Sector (IRIS) Project - History and Goals*, online: University of Maryland, <<http://www.inform.umd.edu/EdRes/Colleges/BSOS/Depts/IRIS/present.html>> (date accessed: 10 January, 2000) and University of Maryland, *Collateral Law Projects Survey*, online: University of Maryland <<http://www.inform.umd.edu/EdRes/Colleges/BSOS/Depts/IRIS/present.html>> (date accessed: 10 January, 2000); see also W.E. Kovacic, "The Competition Policy Entrepreneur and Law Reform in Formerly Communist and Socialist Countries" (1996) 11 American University Journal of International Law and Policy 214; see also Cohen, *supra* note 7 at 184.

¹⁶⁰ See J.W. Head, "Evolution of the Governing Law for Loan Agreements of the World Bank and Other Multilateral Development Banks" (1996) 90 AJIL 214; see also Cohen, *ibid.* at 185.

¹⁶¹ See T.C. Nelson & R.C.C. Cuming, *Harmonization of the Secured Financing Laws of the NAFTA Partners: Focus on Mexico* 1, 4 (1995), cited in Cohen, *ibid.* at 185, footnote 50; see also R.C.C. Cuming, "Harmonization of the Secured Financing Laws of NAFTA Partners" (1995) 39 St. Louis Law Journal 809.

¹⁶² The detailed discussion of the security legal structure of China will be addressed in Chapter Five, below.

C. The role of aircraft finance law reform in the legal regime

Both UNIDROIT and UNCITRAL initiatives deal with a specific type of secured transaction rather than general secured transactions. Focusing on a specific area is an easy way to gain the widespread ratification or enactment from the States. The adoption of these rules in those countries with no modern secured transaction laws will provide an opening into the legal cultures of those countries and lead to the general reform in the future.¹⁶³

When the given area of reforms involves great economic self interest, the countries will pay more attention to the project that might result in the desirable reform in national law. As a good example, the UNIDROIT Draft Convention on Mobile Equipment, particularly its Aircraft Equipment Protocol, is attracting attention not only from all the big air fare countries but from all over the world.

There are two international legal instruments that are relevant to the law of aircraft securitisation. These are the *Rome Convention on the Unification of Certain Rules Relating to the precautionary Arrest of Aircraft*¹⁶⁴ and the *Geneva Convention*. The UNIDROIT Draft Convention/Protocol is expected to take a few more years to come into effect. However, it is the most important international instrument ever in the area of aviation securitisation law.

1. 1933 Rome Convention

The *Arrest Convention* came into force on 12 January 1937, more than 16 years before the *Geneva Convention*, which entered into force on 17 September 1953.

The *Arrest Convention* is an instrument of relevance for private and public aeronautical laws, which outlaws the attachment of aircraft without immediately enforceable judgement or right of seizure where this would interfere with state services or disrupt commercial traffic.¹⁶⁵ Thus it regulates and limits the ability of a creditor, owner or other person entitled to a right *in rem* to arrest an aircraft in pursuance of a private

¹⁶³ See Cohen, *supra* note 7.

¹⁶⁴ See *Convention on the Unification of Certain Rules Relating to the Precautionary Arrest of Aircraft*, 29 May 1933, 129 L.N.T.S. 289 [hereinafter *Arrest Convention*].

¹⁶⁵ See *Arrest Convention*, *ibid.* art. 2(1).

interest.¹⁶⁶ The exceptions are the cases of bankruptcy, certain offences and unlawful dispossession.¹⁶⁷ The effect therefore is to restrict prejudgment arrests and not post-judgment execution. When an aircraft is not exempt from arrest, immediate release from or avoidance of arrest can be obtained by providing sufficient security.¹⁶⁸

However, the importance of the *Arrest Convention* in respect to its protection function should not be over estimated. Under this Convention, the protection provided for the aircraft operator as an investor in air transportation falls only incidental in the whole purpose that the navigation had to be protected against risks emanating from seizure, when the aircraft is ready to take off.¹⁶⁹ At that time, the air transportation was still at its early stage and from the political situation all the necessary protection should be afforded in order to promote the development of this novel industry. Notwithstanding, a fundamental development during that period was the germination of an official discussion about the establishment of such a transnational aviation network as a means of economic cooperation. Such a system was not decided upon at a governmental level until the end of World War II.¹⁷⁰

To date, only 22 states,¹⁷¹ such as Germany, the Netherlands and some African and Scandinavian countries have ratified or adhered to the Convention, but no main air faring nations.¹⁷² In all, the *Arrest Convention* does not carry the task to solve the conflict of security laws at the international level.

2. 1948 Geneva Convention

¹⁶⁶ See Roche & Temperley, *supra* note 114 at 6.

¹⁶⁷ See *ibid.*, art. 7 (breach of customs, penal or police regulations) and art. 3(2) (arrest undertaken by an owner who has been unlawfully dispossessed of his aircraft).

¹⁶⁸ See *ibid.*, art. 4.

¹⁶⁹ See *ibid.*, art. 3.

¹⁷⁰ See J.C. Cooper, "The Internationalization of Air Transport", in I.A. Vlasic, ed., *Explorations in Aerospace Law - Selected Essay by John Cobb Cooper 1946-1966* (Montreal: McGill University Press, 1968) at 395.

¹⁷¹ Among these states, six EC members are included. See Roche & Temperley, *supra* note 114 at 7. See also Wood, *supra* note 36 at 257. But another book said the parties of the *Arrest Convention* are 28 countries, see S. McGairl, "International Conventions Affecting Aircraft Financing Transactions" in Littlejohns & McGairl, *Aircraft Financing*, 3rd ed. 367 at 368.

¹⁷² The former includes Algeria, Mali, Neger, etc. The latter include Finland and Sweden. See Wood, *ibid.*

The *Convention on the International Recognition of Rights in Aircraft* signed in Geneva in 1948 was promoted in order to give as much security as possible to lessors and lenders financing these expensive pieces of equipment.¹⁷³ It was designed to protect parties' interests in aircraft that have been duly registered in and according to the laws of the state of registration of the aircraft in question.¹⁷⁴

Contrary to the 1933 *Arrest Convention*, the 1948 *Geneva Convention* serves the interests of investors in aircraft, addresses legal issues that are abstract from issues of the public international law. So it is the fundamental conventional framework for aircraft securitisation law.

3. UNIDROIT Convention as applied to Aircraft Equipment

The latest and most extensive harmonization of security law in respect to mobile equipment is the UNIDROIT *Draft Convention*. Among the applicable mobile equipment¹⁷⁵ that are designed to be regulated by responding Protocol under the Convention/Protocol system¹⁷⁶, a *Draft Aircraft Protocol* takes the lead in coming into to the written instrument.

Although the Aircraft Equipment Protocol is mainly supported by the leasing and financing community and certain interests groups,¹⁷⁷ it is by nature a great act in the security law area aiming to establish uniform substantive laws, which was not achieved in the *Geneva Convention*.

The economic motive is highly favored by the Aviation Working Group¹⁷⁸ during the whole drafting and discussing processing. Thus the primary purpose of the

¹⁷³ See Wood, *supra* note 36 at 263.

¹⁷⁴ See Roche & Temperley, *supra* note 166.

¹⁷⁵ The following categories fall into the scope of the *Draft Convention*: (a) airframes; (b) aircraft engines; (c) helicopters; (d) [registered ships;] (e) oil rigs; (f) containers; (g) railway rolling stock; (h) space property; (i) other categories of uniquely identifiable object. See UNIDROIT *Draft Convention*, art. 3.

¹⁷⁶ This Convention creates a unique structure for international conventions. That is, the Convention and Protocol structure.

¹⁷⁷ See B.J.H. Crans, "The Unidroit Convention on International Interests in Mobile Equipment and the Aircraft Equipment protocol: Some Critical Observations" (1998) 23:6 Air & Space Law 277.

¹⁷⁸ The Aviation Working Group was formed in 1994 at the invitation of the Unidroit study group at work on the UNIDROIT *Draft Convention* with respect to aircraft equipment. The *AWG* currently has 16 members, including 7 manufacturers and 9 leasing companies and lenders. Airbus Industrie and the Boeing Company are the organizers. See D. Clancy & G. Voss, "Facilitating Asset-Based Financing and

Convention as applied by the Aircraft Equipment Protocol is summarized as “to facilitate the extension and reduce the cost of aviation credit”.¹⁷⁹ However, only by providing sufficient legal system, the economic purpose can be obtained.

Leasing of Aircraft Equipment Through The Proposed Unidroit Convention” (1998) 23:6 Air & Space Law 287[hereinafter *AWG*]. For the members of the *AWG*, see D. Clancy & G. Voss, *ibid.*, footnote 2, 3; see also S.A. Espinola, “Asset-based Financing Would Be Facilitated by International Convention Currently in Development” (1997) 52:8 ICAO Journal 9.

¹⁷⁹ See *Draft Aircraft Protocol*, Preamble.

Chapter Three The Landmark - 1948 GENEVA Convention

The conflict of security laws basically aims to solve two problems: the creation of the mortgage, the recognition and enforcement. The former is primarily a matter of determining, under the specific facts of each case, what law is to be applied and whether the transaction is valid under such law.¹⁸⁰ The latter is one that will be resolved primarily as a matter of public policy of the State in which the determination is to be made.¹⁸¹

When the place of basing and the domicile of the owner were in different jurisdictions, neither the *mobilia sequuntur personam*¹⁸² nor the logical justification of *lex rei situs* applies.¹⁸³ If an aircraft is attached abroad, or is locally subjected to a lien or other encumbrance in foreign territory, it is obvious that it should be subject to the complete dominion of that jurisdiction. Under such circumstances the aircraft loses its exclusivity from other chattel.¹⁸⁴

Generally speaking, a foreign right in a foreign chattel will be recognized and enforced only to the extent that such a right is not contrary to the public policy of the forum. That's why the international effort is necessary to reach the agreement. A major step and also the first try towards a workable "extra-territorial" effect of security rights in aircraft was taken with the adoption of the *Geneva Convention* of 1948.¹⁸⁵

I. Background of the Geneva Convention

From the beginning of international air transport activities, the problems involved in connection with rights in aircraft which fly abroad were realized. The airline industry was still at its very early stage and the public international air law was not established yet.

¹⁸⁰ For the creation of secured rights, see Chapter Two, above.

¹⁸¹ See G.N. Calkins, Jr., "Creation and International Recognition of Title and Security Rights in Aircraft" (1948) J. of Air L. & Com. 156 at 157.

¹⁸² This is the first rule in respect to movable property. See Chapter Two, above.

¹⁸³ The *lex rei situs* rule simply means the registration place of the aircraft.

¹⁸⁴ The movable character of aircraft determines the place of registration is the *situs*, which is different from the normal chattels. See Calkins, *supra* note 181 at 160.

¹⁸⁵ See M.V. Polak, "Conflict of Laws in the Air" (1992) 17:2 Air & Space Law 78 at 81.

In 1926 CITEJA¹⁸⁶ was created as a result of the International Conference on Air Law held in Paris in the Autumn of 1925 and was specifically charged by that Conference with drawing up of draft conventions on aeronautical registers, aircraft ownership, rights *in rem*, and mortgages. In the year 1931 the CITEJA produced two separate drafts conventions, one relating to an aeronautical property record and the other to mortgages and secured interests, but they were never submitted to a diplomatic conference.

When World War II was over, the world aviation situation changed. The United States emerged as the leading manufacturing and financing nation in the field, followed at a distance by The Great Britain. The Americans wanted to expand the “export trade in aircraft” and were willing to participate in the financing of such exports. Promoted by the leading aviation forces, the drafts were brought onto the table again.

Shortly before the end of World War II, the International Civil Aviation Conference meeting in Chicago recommended the adoption of an instrument based on the two earlier texts. After further discussion and study held by PICAQ,¹⁸⁷ the last draft modified by the ICAO Legal Commission was presented during the second Assembly of ICAO in June 1948. Subject to the reservations of a few states the text was approved on 18 June 1948.¹⁸⁸

The significance of the *Geneva Convention* can not be under estimated in the aviation law family, particularly considering it is one of the forerunners in harmonizing the conflicts in the area of private international law. However, the solution embedded in the *Geneva Convention* was from the beginning merely conceived as a temporary stage in the development of an effective system for the protection of security rights on aircraft.¹⁸⁹ It is a conflict of laws system, reached by conciliating both the American system and

¹⁸⁶ Comité international technique d'experts juridiques aériens.

¹⁸⁷ Provisional International Civil Aviation Organization.

¹⁸⁸ For a more detailed presentation of the history of the Convention, see N.M. Matte, *Treaties on Air-Aeronautical Law* (Toronto: Carswell, 1981) at 543ff. See also Calkins, *supra* note 181 at 162ff. See also Bayitch, *supra* note 32 at 69, footnote 346.

¹⁸⁹ See R.O. Wilberforce, “The International Recognition of Rights in Aircraft” (1948) 2 *International Law Quarterly* 421 at 435.

Latin group.¹⁹⁰ It did not even propose to establish the uniform substantive law principles that are the requirements of the modern methodology applied in conflict of laws.¹⁹¹

II. A recognition Convention

The *Geneva Convention* is a recognition convention. It addresses the problems of transposition and adoption through unification of conflict of law rules and international civil procedure for purposes of standardized recognition.¹⁹²

Four classes of rights¹⁹³ are recognized by each Contracting State, defining broadly both the title type and the lien type in the secured rights class. The Convention does not validate any right. The national law applied to the creation of the secured transaction will be respected regardless of the existence of the specific type of right in that jurisdiction.¹⁹⁴ The basic rule remained that every country was free to refuse recognition of the foreign type of security that did not fit into the local categories, provided that they did not prohibit the recording of a right which could validly be constituted according to the national law.¹⁹⁵

The *Geneva Convention* goes further than the typical conflict law convention since it addressed something about the enforcement of the security rights, which is not included in the modern conflict of law doctrine. An enforcement of the security in foreign courts on the debtor's default through sale in execution or foreclosure¹⁹⁶ has to be deemed to produce the same effects as an execution in the State of registration. Therefore, it leads *de facto* to a form of "official co-operation".¹⁹⁷

¹⁹⁰ See J.W.F. Sundberg, "Rights in Aircraft: A Nordic Lawyer Looks at Security in Aircraft" (1983) 8 Ann. Air & Sp. L. 233 at 237. See also C.S. Doskow, "Transitory Chattels and Stationary Law: A Proposal to Facilitate Secured Financing of Aircraft Employed in International Flight" (1959) 26 J. Air L. & Com. 36 at 47.

¹⁹¹ The international conflict convention, as classified as the fourth approach to conflict of laws, is not a complete answer. See Tetley, *supra* note 146 at 37.

¹⁹² See Krupski, *supra* note 14 at 64.

¹⁹³ These rights are (a) rights of property; (b) rights to acquire aircraft by purchase coupled with possession of the aircraft; (c) rights to possession of aircraft under leases; and (d) mortgages, hypothèques and similar rights in aircraft. See *Geneva Convention*, art. I.

¹⁹⁴ See *Geneva Convention* art. I.1(d)(i)(ii).

¹⁹⁵ See *Geneva Convention* art. I.1.

¹⁹⁶ See *Geneva Convention*, art. VII.

¹⁹⁷ See Krupski, *supra* note 14 at 65.

Nevertheless the *Geneva Convention* by nature does not override the conflict convention, it solves partly the conflict of security laws relying on the international recognition of domestically established rights while leaving still a lot of substantive problems unsettled.

A. Rights protected

The scope of the real rights applicable in the *Geneva Convention* is very broad. It applies to the right of ownership, conditional sale, long-term leases and equipment trust arrangements as well as to “mortgages, hypothèques and similar rights in aircraft”.¹⁹⁸ It follows that both the pledge and the title type of security interests¹⁹⁹ in aircraft qualify for recognition. As to the security arrangements, they must be “contractually created”²⁰⁰ so as to qualify for international recognition. Hence, it excludes statutory, common law or judicial liens.

The *Geneva Convention* not only covers the title reservation agreement, the long term leases, but intended to cover all possibility for financing aircraft which is in the nature of a mortgage. This is a good attempt to bring all the security arrangements applicable for aircraft financing under one international convention, which lays a foundation for the further legal undertakings in this field.

The rights related to the acquisition of new aircraft that are common in aircraft financing are not included in the Convention. Because of the “indebtedness” requirement, such case as an aircraft manufacturer effectuating a direct secured aircraft sale for purpose of export, i.e. an initial sale or acquisition of a new aircraft, is not eligible to be recognized under the *Geneva Convention*.²⁰¹ Traditionally this does not constitute the great number of cases in aircraft financing. While the highly demand for new generation aircraft is pushing this matter on the stage now.²⁰²

¹⁹⁸ See *Geneva Convention*, art. I.1(d).

¹⁹⁹ See Chapter Two, above.

²⁰⁰ See *Geneva Convention*, art. I.1(d), art. VII(5)(b) and art. X(1).

²⁰¹ See Krupski, *supra* note 14 at 66.

²⁰² See Chapter One, above.

B. Formality requirements

To qualify for international recognition the security interests must not only be substantively valid but also properly recorded. In other words, to obtain application of domestic securities law in another State will compel to an attachment in line with the substantive and formal rules of the parties.²⁰³ The requirements for recording of the property interest attack the creation of hidden security interests since the Contracting States will not recognize unrecorded rights as ranking prior to recorded interests.²⁰⁴

All the rights relating to a given aircraft must appear on the same record, no matter this record coincides with the nationality register or is distinct from the general asset register, so it is not open to a Contracting State to permit recording of one right in one record and a second right in another.²⁰⁵ Moreover, the record maintained by the Contracting States must be public record that is open to public.²⁰⁶

As to the formality of the registration, the *Geneva Convention* leaves it for the national law.²⁰⁷ However, in the majority of States the registration in a record does not have constituent function for a real right in mobile equipment. Instead, it merely achieves such of perfection²⁰⁸ and is therefore negligible. Regardless of the manner of creation according to the different national laws,²⁰⁹ the *Geneva Convention* requires filing to a public record for extraterritorial application of the national security interest in order to effectively safeguard the lessor's real right.

Although *the Geneva Convention* postulates registration, it does not require a compulsory registration system but merely makes such registration a prerequisite for international recognition under the convention. Consequently, the transfer of a real right

²⁰³ See Krupski, *supra* note 201.

²⁰⁴ This formality requirement is to overcome the "false wealth" problem in the area of security law. See Wood, *supra* note 36 at 4, 266.

²⁰⁵ See *Geneva Convention*, art. II.1.

²⁰⁶ See *ibid.*

²⁰⁷ See *Geneva Convention*, art. I.1:

"The regularity of successive recordings in different Contracting States shall be determined in accordance with the law of the State where the aircraft was registered as to nationality at the time of each recording".

²⁰⁸ See Chapter Two, above.

²⁰⁹ The Contracting States ought to recognize the flag state's view as to formalities, e.g. notarizations, deed, legalization, degree of identification of the debtor, creditor and aircraft, and execution by one or both parties. See Wood, *supra* note 36 at 267.

in an aircraft that is not registered as to nationality can not be completed within the *Geneva* mechanism.²¹⁰ In this sense, the Convention deviates from the formalities otherwise required *lege rei sitae*. It introduces a constituent registration requirement for international validity in Art. I (1) (I) and simultaneously rejects the recordation nexus in Art. I (1)(ii).²¹¹

C. Priority rules

The *Geneva Convention* bears a strong resemblance to the *Brussels Convention* of 1926.²¹² The law of the state of creation governs the recognition of secured interests,²¹³ but the priority is provided for in term by the Convention.²¹⁴ However, there is no such a wholly elaborated priority system in the *Geneva Convention*. Although it confines some claims to take preference over those secured rights enumerated in Art. I, it does not solve the priority problem among the competing secured rights duly established domestically. Therefore, even after recognizing the foreign secured right, how the exporting State determines the priority is still uncertain. It is not safe for a super prior creditor in one State to gain the same protection in the defaulting State when the priority rule is different.²¹⁵ From this point of view, the *Geneva Convention* is very national.

The only priority rule in the *Geneva Convention* is that some privileged claims can rank ahead of the rights prescribed in Art. I. These privileged claims are severely limited to the certain legal and administrative expenses incurred in the common interest in the course of execution proceedings leading to a sale,²¹⁶ the salvage claims, the “extraordinary

²¹⁰ Both the title rights and security rights are recognized provided they are duly “recorded in a public record of the Contracting State in which the aircraft is registered as to nationality”. See *Geneva Convention*, art. I.1(b)(ii).

²¹¹ See Krupski, *supra* note 14 at 67, footnote 307.

²¹² See *International Convention for the Unification of Certain Rules Relating to Maritime Liens and Mortgages*, April 10, 1926, Brussels [hereinafter *Brussels Convention*].

²¹³ See *Brussels Convention*, *ibid.* sec. 1, cited by Daskow, *supra* note 190 at 48, footnote 69.

²¹⁴ See *Brussels Convention*, *ibid.*, sec. 2, cited by Daskow, *ibid.* footnote 70.

²¹⁵ For example, a German created priority might not be listed in the same order in England. See Chapter Two, above.

²¹⁶ See *Geneva Convention*, art. VII.6.

expenses indispensable for the preservation of the aircraft”,²¹⁷ the tort liability²¹⁸ and the violation of local law.²¹⁹ Following the classical maritime lien theory, the *Geneva Convention* replaces the golden first-to-file rule, stipulating the opposite rule of ranking according to inverse time sequence²²⁰ with respect to the claims of aircraft salvage and the preservation.²²¹

The *Geneva Convention* confines the prior rights strictly. The sacred lien for crews wages and the profane lien for taxes are not privileged; aircraft liens are restricted to only two categories: the salvage and the preservation, thus the possessory repairers liens are subordinated.²²² All other rights permitted by the national law of a contracting state are subordinated to the above privileged rights and to the recorded rights. It is these limits that hindered the ratification of the convention by some States since their domestic laws provide²²³ other aircraft liens the preference rights.

D. Enforcement

Strictly speaking, the *Geneva Convention* is not an enforcement convention. It defines the priority of the secured rights, but how to realize these rights is not guaranteed. However, the Convention is more than just “recognition” and contains one method of

²¹⁷ The *Geneva Convention* does not create these privileges since that is left to local law. The privileges rank in inverse order of time. The salvage and preservation privileges expire within three months unless noted on the register and unless certain other steps are taken. Hence the prior claims can remain unrecorded and secret by only temporary. See *Geneva Convention*, *ibid.* art. IV.1.

²¹⁸ The mortgagee’s priority may be reduced by liability for injury or damage to persons or property on the surface in the Contracting States where the sale of a mortgaged aircraft takes place. See *Geneva Convention*, *ibid.* art VII.5.

²¹⁹ See *Geneva Convention*, *ibid.* art. XII. A contracting state can only impose a first lien on an aircraft for violation of its smuggling rules and its air traffic rules. Some possessory liens constituted under the national law are sacred. See Wood, *supra* note 36 at 273. See also Chapter Two, above.

²²⁰ The maritime liens rank in the inverse order of their creation. The so-called “beneficial service theory” is that the later lienor preserves the value of the vessel for all earlier liens and so should have first bite. The other “proprietary interest theory” holds that a prior lienor who does not immediately arrest the vessel has become fictionally a part-owner and implies consent to the creation of subsequent liens. See Wood, *supra* note 36 at 276.

²²¹ See *Geneva Convention*, art. IV.2.

²²² See *Geneva Convention*, *ibid.*

²²³ This is the main objection of the United Kingdom and other English-based jurisdictions. The other example is the Mexico, which ratified the *Geneva Convention* with the reservation on the priority of fiscal claims and certain crew claims.

enforcing a right in an aircraft, the judicial sale.²²⁴ The judicial sale of the aircraft confers clear title to the third party.²²⁵

Detailed minimum standards are set out for the notification and publication of the sale. The date and place of the sale must be fixed at least six weeks in advance and the executing creditor must give at least one month's prior public notice of the sale²²⁶ where the aircraft is registered as to nationality and concurrently notify the recorded owner and the holders of recorded rights in the aircraft. Hence there are compulsory grace periods.

III. An intermediary solution for the uniformity of substantive security law

In the *Geneva Convention* there was no intention or attempt to achieve the unification of air law that is inherent in other Conventions. Since the subject dealt with was too complex, it was only required to establish certain principles concerning the recognition of rights in aircraft, and to refer frequently to the variety of national laws to resolve the numerous problems concerning details which might arise in this respect at that time. Thus, the Convention was confined to binding member States only with regard to certain rules that constituted an urgent response, since complete codification of financing on an international basis would have been premature.

The financing of aircraft purchases has not been proven as difficult as was forecast by the experts and the need for the international recognition of rights in aircraft has not become urgent throughout the world.²²⁷ International air carriers are financially much stronger than what was anticipated and some of them are nationally owned and operated. The number of Contracting States for the *Geneva Convention* is nevertheless limited.²²⁸

²²⁴ The "proceedings" means that the sale of an aircraft in execution is a judicial sale. See *Geneva Convention*, art. VII.

²²⁵ See *Geneva Convention*, *ibid.* art. VIII.

²²⁶ See *Geneva Convention*, *ibid.* art. VII(2).

²²⁷ See Johnston, *supra* note 40 at 133.

²²⁸ So far, many English-influenced States, a few States hostile to security generally and some States without a developed commercial and insolvency law did not ratify the Convention. See Wood, *supra* note 36 at 264. It has so far been ratified by 81 States, see L. Weber & A. Espínola, "The Development of a New Convention Relating to International Interests in Mobile Equipment, in Particular Aircraft Equipment: A Joint ICAO-UNIDROIT Project" (1992) 2 Unif. L. Rev. 463 at 464.

The Convention never became the safe and sure legal framework for worldwide aircraft finance that was originally intended.²²⁹

A nation is surrendering very little when it agrees to a uniform set of safety rules, or rules to facilitate customs inspection and embarkation and disembarkation from international aircraft. But property rights and rights of commerce and transit are not to be so easily surrendered to a multilateral agreement.²³⁰ The lack of ratification may be partly due to the hesitation of many governments to surrender property rights in the field of private law to a multilateral agreement.²³¹ It was premature at that time to convince the States to give effect to property rights, particularly security interests, of a type that could not exist under their own legal system.

Looking through the *Geneva Convention*, we can find easily that, as an intermediary convention, it presents some limitations that also lead to some States' refusal of ratification.

A. Limitations

1. The scope of the protected rights

The *Geneva Convention* does not purport to establish a "treaty mortgage". It does not try to protect international credit as such in all aircraft either. The scope of the Convention is limited to the recognition, enforcement and protection of valid secured interests in foreign aircraft only. No uniform nature and formality of any rights are stipulated in the Convention, the diversity of security rights in different jurisdictions is left untouched. The States do not need to amend their national law while signing the Convention, but they might be obliged to recognize those rights that do not exist in their legal systems and exercise them too. It is still a considerable step and even more complex.

In addition, the *Geneva Convention* does not cover the secured rights related to initial transfer of the ownership of new aircraft from the manufacturer. Over the past decades, aircraft financing practice demonstrates that the acquisition of new aircraft is

²²⁹ See Johnston, *supra* note 40 at 132.

²³⁰ See Daskow, *supra* note 190 at 47.

²³¹ See Daskow, *ibid.*

becoming the tendency instead of the second hand aircraft transaction.²³² Therefore, it is desired to regulate this kind of secured right at the international level.

2. Registration

In the *Geneva Convention*, a private law for aeronautical registration was not created, since the main aim was to arrive at the international recognition of real rights. The context of the convention is strongly in favor of the creation of such a register, an example of which was provided by the United States through the system of recordation.²³³ The convention neither succeeded in unifying the system of preferred claims, nor was the transfer of ownership achieved. The only real accomplishment in this domain was the obligation to publicize guaranteed debts, privileges and changes of ownership.²³⁴

Accompanying problem arises from the federal States where provinces are granted autonomy in matters of private law without a central asset-registration system. In this case, it is necessary to determine which law is applicable upon the validity of the charge. Canada is an example.²³⁵ While the field of aeronautics is of primary federal competence,²³⁶ the right to enact laws pertaining to security on moveable property is principally a provincial matter.²³⁷ Although the federal government has the constitutional competencies to oblige its federated entities to recognize validly constituted foreign rights in an imported aircraft according to the *Geneva Convention*, some provinces may retain the power to enact legislation governing the recognition. This constitutional difficulty hindered the attempts to establish a uniform central registry in Canada. It is also the major concern for which Canada never becomes the signatory of the Geneva Convention.

²³² For the detailed information on the world aircraft financing market. See Chapter One, above.

²³³ In the United States, the *Federal Aviation Act* stipulates the registration and filing.

²³⁴ See *Geneva Convention*, art. II.

²³⁵ The necessity and the desirability of a central registry in Canada are discussed in several theses and papers. For detailed analysis of the constitutional difficulties and the legislative attempts proposed in Canada, see Johnston, *supra* note 40, title IV, Legislation for Canada, c. XIII, establishment of Canadian registry for rights in Aircraft. See also J.M. Fortier, *supra* note 48, c. VIII, 3, Canada's need for a central aircraft registry; Rosales, *supra* note 30, c. III, Part B, a Canadian registry for rights in aircraft; Bunker, *supra* note 41, c. III, D, 3.

²³⁶ No specific designation on this subject in the Constitution, but the courts have declared unequivocally that legislative authority over the field of aeronautics is vested in Parliament. See Rosales, *ibid.* at 163.

²³⁷ See *Constitution Act*, 1867, 30 & 31 Victoria, c. 3, an Act of the Parliament of the United Kingdom, (formerly *British North America Act*, 1867), S. 92(13), in Rosales, *ibid.*, note 109, 111.

The *Geneva Convention* does not desire to venture a mandatory requirement on Contracting States to maintain a record or system of registration. However, such a registration is a requirement for recognition under the convention. The security rights will only be respected in member States when such rights have been duly recorded in a central register.

3. Priority

The nationality plays the major role in deciding the priority under the *Geneva Convention*. Whether the secured right will be given priority depends upon the law *lex fori*. The *Geneva Convention* does not even mention the general priority rule except adopting the reverse order for some special claims.²³⁸

Surveying the property law of both civil law and common law systems, the “first-to-file” is the golden rule in deciding the priority of the secured rights.²³⁹ To clarify this rule in the international convention is not only a confirmation but also will wipe out any possible ambiguity in this matter.

The narrow definition of the applicable aircraft liens is the direct reason why the United Kingdom did not ratify the Convention.²⁴⁰ They would have to accept rules of priority of security interests that significantly limit the rights of government agencies to attach aircraft for unpaid taxes, landing charges and such like.²⁴¹ In view of the limited number of ratification, it is seen that the protection afforded by the convention is limited and certainly is in no sense an embarkation on a new era in international aircraft financing as was intended.²⁴²

Privileged liens are common all over the world because every jurisdiction has its authority to protect some national interest under certain conditions. In other words, it is impossible to eliminate these liens, or put them in the same line in one single Convention.

²³⁸ These claims are related to the salvage of aircraft so strictly speaking, they should be characterized as “special”.

²³⁹ See Chapter Two, above.

²⁴⁰ Two types of liens, one is the common law lien, the other is the statutory lien, under the English law are omitted by the *Geneva Convention*. See Chapter Two, above.

²⁴¹ See Chapter Two, above.

²⁴² See Johnston, *supra* note 40 at 132.

The Geneva Convention tried to regulate the aircraft liens by limiting the applicable scope. Consequently a lot of important liens are not covered. When the omitted liens are really indispensable for some States, e.g. the United Kingdom, they will, therefore, choose to keep the integrity of their national law and give up the international convention.

4. Enforcement

The major shortcoming of the *Geneva Convention* is that it does not solve the enforcement problems. In the absence of efficient enforcement rules, the very purpose of creation of security to protect creditors in case of the debtor's default or insolvency gets defeated.

Under the *Geneva Convention*, the contracting states are given freedom to choose their own enforcement mechanism. Any exercise of enforcement is deemed to be the national judicial proceedings and will be duly recognized.

5. Assignment

Assignment and receivable financing are sophisticated securitisation instruments in a modern security law. At that time when the *Geneva Convention* was figured and discussed, these security methods were not on the agenda of problems for which urgent action had to be taken. Hence, it is not appropriate for us to characterize it as the shortcoming of the *Geneva Convention*. We can only conclude that the development of the aircraft financing demands a more advanced international mechanism.

B. Unification of the substantive law

As a significant but intermediary solution, the *Geneva Convention's* advantages have to be discounted because of its recognition concept merit to be explained from the prospect of substantive uniformity.²⁴³

What was sought through the Convention was a worldwide system whereby each nation would be bound to recognize valid interests created in other nations. However, "we

²⁴³ See Krupski, *supra* note 14 at 74.

presented with a fine house in which no one wants to live".²⁴⁴ Because merely a unification of conflict rules is incapable of providing a solution due to the substantive incompatibility of cross-border securities with the territorially strictly confined and precisely defined domestic creditor system.²⁴⁵

Unification of substantive law appears to be the only remedy. It is the modern tool of avoiding conflict of laws problems as compared to a recognition convention based on comity and reciprocity or unified conflict rules.²⁴⁶ It tries to ideally overrule the incompatibility existing in domestic laws by constructing a complete and smooth universal standard.

1. Uniform law aspects in the *Geneva Convention*

To a minor extent, the *Geneva Convention* contains substantive uniform law. The Contracting States need to standardize their domestic laws so as to fulfill the recordation requirements²⁴⁷ and the execution procedures.²⁴⁸ These are the improvements compared with the *Arrest Convention*, which does not include any standard procedural rules. The only remedy provided in the *Geneva Convention* is the judicial sale in agreement with the *lex fori executionis*, which is in lieu with the civil law jurisdictions.²⁴⁹ Apart from the private sale,²⁵⁰ the *Geneva Convention* compromised the conflict of those two legal systems while ensuring the protection of debtors and higher-ranking creditors in execution.²⁵¹

While leaving the priority matter for the domestic laws, the *Geneva Convention* did provide the priority rule for the aircraft liens in Art. IV and VII. This attempt, in fact,

²⁴⁴ Doscow, *supra* note 190 at 47.

²⁴⁵ See Krupski, *supra* note 14 at 74, footnote 353.

²⁴⁶ See Chapter Two, above.

²⁴⁷ See *Geneva Convention*, art. II, III, IV and IX for the recordation; see art. VII and VIII for certain substantive standards in execution procedure.

²⁴⁸ See *Geneva Convention*, art. VII and VIII for certain substantive standards in execution procedure.

²⁴⁹ See Chapter Two, above.

²⁵⁰ Private sale is widely used in common law jurisdictions. See Chapter Two, above.

²⁵¹ The elaborated civil law mechanisms are introduced in the *Geneva Convention*. This choice for a stricter execution mechanism shows the concern of the common law jurisdictions for the recognition of creditor's rights in the civil law jurisdictions. See Krupski, *supra* note 14 at 76. For the comparison on the remedies in civil and common law jurisdictions, see Chapter Two, above.

severely limited the application of the Convention.²⁵² However, the intention to uniform the substantive law, i.e. priority of the creditors and the lienors, should be approved considering the background of its enacting.

2. Unifying the aircraft financing law

The number of ratification so far represents a considerable degree of acceptance for the *Geneva Convention*.²⁵³ However it failed to create uniform real rights in aircraft. It confined itself in recognizing them, to providing some publicity for registration of real rights and changes of aircraft ownership and to establishing a preferential order among the different claims and the international conditions of sale in execution of the aircraft. Therefore, the ability of the *Geneva Convention* to protect a creditor's security interest in an asset is limited and may not serve the industry fully satisfactorily²⁵⁴ in an aircraft financing market where new trends and commercial practices are developed over years.²⁵⁵ Only commercial necessities and pressures would favor the ratification of the Geneva instruments and, in the long run, lead to a standardization of uniform legal system. It is time to build up a new plane for the legal reform.

²⁵² See Part III, A.3, above.

²⁵³ See Weber & Espinola, *supra* note 228.

²⁵⁴ See *ibid.*

²⁵⁵ See Chapter One, above.

Chapter Four UNDROIT Draft Convention - An International Uniform Law

The new generation of the aircraft financing law is the *Draft Convention* with the *Draft Aircraft Protocol* processed currently by UNDROIT, the aircraft industry,²⁵⁶ ICAO and IATA.

There are both economic and legal issues behind the UNDROIT initiative,²⁵⁷ which reflects considerable financial improvements for the aviation finance industry and government budgets. The economic gains “will be widely shared among airlines and manufacturers, their employees, suppliers, shareholders, and national economies in which they bare located”.²⁵⁸ The substantive private law unification is developed based upon three fundamental principles, namely, the “transparent priority principle”, which determines and assures the creditor or lessor’s proprietary interest in a financed or leased asset is superior among competing property interests, the “prompt enforcement principle”, which, will be able to promptly realize the value of the asset and/or redeploy that asset for generating proceeds or revenues upon default and the “bankruptcy law enforcement principle”, which will uphold the above rights granted to the creditor or lessor in the context of bankruptcy or insolvency.²⁵⁹

Compared to the *Geneva Convention* that is conceived only to ensure a minimum protection of creditor rights, the *Draft Convention* is proposed primarily for the economic and commercial objectives, which are attainable under an international legal instrument.

²⁵⁶ The aircraft industry is represented by the *AWG*, see *supra* note 178. Besides Airbus Industrie and the Boeing Co./Douglas Aircraft, the following companies are in this group too: GE Capital Aviation Services, General Electric Aircraft Engines, International Lease Finance Corp., Rolls-Royce plc., Snecma and United Technologies Pratt & Whitney. See Espinola, *supra* note 178.

²⁵⁷ See Espinola, *ibid.* at 9.

²⁵⁸ See *Economic Impact Assessment*, *supra* note 1 at i.

²⁵⁹ See *Economic Impact Assessment*, *ibid.* at ii, 11ff, para. 3.1.

I. The inception of the UNIDROIT Convention

The unification of substantive law regarding mobile equipment can be traced back to 1944 when the *Geneva Convention* was on the agenda of aviation lawyers. The CITEJA and subsequently ICAO are handling the work to improve the temporary Geneva solution under their authority on matters of aviation.²⁶⁰

It is UNIDROIT that started to study on international security and leasing interests in mobile equipment on a broader level in 1988. Shortly after the conclusion of the *Leasing Convention* in Ottawa, the representative of the Canadian government to the UNIDROIT Governing Council requested this organization to commence working on the unification of laws on the regulation of rights in mobile equipment, which was inspired by a desire to amplify international recognition under the *Leasing Convention* of a financial lessor's real rights against bankruptcy trustees and creditors,²⁶¹ thereby covering the broader issues surrounding the enforcement of security rights.²⁶² In 1994, an *ad hoc* Aviation Working Group was set up through the encouragement of Airbus Industrie and Boeing to formulate, explain and promote the interests of the aviation finance under the support of aircraft manufacturers, leasing companies and lending institutions.²⁶³ Later, AWG was joined by the IATA in 1996, representing its member airlines' interests. They agreed to co-operate by providing co-ordinated comments on the draft instruments and to promote completion of the project vis-a-vis governments, international organizations and the aviation industry. Early in 1997, ICAO was invited by UNIDROIT to establish an institutional co-operation mechanism.²⁶⁴ ICAO's involvement could prove to be a valuable contribution, which resulted from the already existing co-operation between

²⁶⁰ See CITEJA and ICAO Charter; see also *Chicago Convention*.

²⁶¹ See *Financial Leasing Convention*, *supra* note 56, art. 7(a).

²⁶² See Stanford, *supra* note 152.

²⁶³ Among the members of the *AWG* at the beginning, the manufacturers are Bombardier, General Electric Aircraft Engines, Pratt & Whitney, Rolls-Royce, SNECMA, the financiers are International Lease Finance Corporation, Chase Manhattan Bank, CIBC Wood Gundy, Credit Agricole Indosuez, Kreditanstalt für Wiederaufbau, Deutsche Verkehrsbank, Singapore Aircraft Leasing Enterprise, GE Capital Aviation Services, the Long Term Credit Bank of Japan and Boullioun Aviation Services. See Krupski, *supra* note 14 at 9; see also Espinola, *supra* note 256.

²⁶⁴ ICAO is a Specialized Agency of the United Nations system with 185 member States and the UNIDROIT is an intergovernmental organization independent of the United Nations system with 57 member States (56 of which are also members of ICAO). So their co-operation is "institutional". See Weber & Espinola, *supra* note 228 at 463.

UNIDROIT and representatives of aviation industry, can be particularly fruitful in dealing with security rights in aircraft because of the organization's aviation expertise. More importantly, ICAO's consultation process will provide the ground for developing a legal instrument that could find broad acceptance among States. ICAO took part in the efforts of AWG and IATA to draft an Aircraft Equipment Protocol within the Aircraft Protocol Group (APG), which was formed in 1997. The APG completed its work in January 1998 and will be co-sponsoring the intergovernmental negotiations together with UNIDROIT.

ICAO activated its law-making process regarding this project pursuant to its objectives established by its statutory principles.²⁶⁵ The Council of ICAO decided in December 1997 to include this subject in the General Work Program of the Legal Committee as Item No. 6 under the designation of "*international interests in mobile equipment (aircraft equipment)*". The Assembly of ICAO in its 32nd session recommended ICAO and UNIDROIT Secretariats for their joint efforts and major contribution towards the development and promotion of the proposed new treaty law. It urged the ICAO Legal Committee to work further jointly with UNIDROIT and in consultation with the AWG and IATA, to finalize the draft texts with a view to their submission to a diplomatic conference, or "international conference on air law" at the earliest possible date. A Sub-Committee was established under the ICAO Legal Committee focusing on further study.

The *Draft Convention* and the *Draft Aircraft Protocol* have been revised in June 1998 by a Steering and Revision Committee (SRC) formed in February 1998 as per the decision taken by the UNIDROIT Governing Council at its 77th session, held in Rome from 16 to 20 February 1998. Basing on these preliminary texts,²⁶⁶ a sub-committee of

²⁶⁵ One of the functions of the Committee is "to study problems relating to private air law affecting international civil aviation, to prepare drafts of international air law Conventions and to submit reports and recommendations thereon". See *Chicago Convention*, art. 44; see also the *Constitution of Legal Committee*.

²⁶⁶ *Preliminary Draft UNIDROIT Convention on International Interests in mobile Equipment*, established by the UNIDROIT Study Group and revised by a Steering and Revisions Committee in Rome from 27 to 29 June 1998 (1998) 23 Ann. Air & Sp. L. 397-414 [hereinafter *Preliminary Draft Convention*]; *Preliminary Draft Protocol to the preliminary Draft UNIDROIT Convention on International Interests in mobile Equipment on Matters Specific to Aircraft Equipment*, established by the UNIDROIT Study Group and revised by a Steering and Revisions Committee in Rome from 27 to 29 June 1998 (1998) 23 Ann. Air & Sp. L. 415-434 [hereinafter *Preliminary Draft Aircraft Protocol*].

ICAO Legal Committee, jointly with a committee of governmental experts of UNIDROIT had held two sessions to discuss thoroughly this project and express the concerns from each jurisdiction. The first Joint Session²⁶⁷ was held in Rome from 1 to 12 February 1999 and was attended by representatives of 34 States, five intergovernmental Organizations and nine international non-governmental Organizations.²⁶⁸ And the latest second Joint Session²⁶⁹ was held in Montreal from 24 August to 3 September 1999. The third Joint Session is on the agenda of early 2000. Considering the comprehension of this project, three working groups have been set up regarding the registration,²⁷⁰ insolvency²⁷¹ and jurisdiction²⁷² respectively. Now it is time to pass this matter from the Sub-Committee level to the ICAO Legal Committee, a permanent body open to all ICAO member States. Once the Legal Committee finishes its review, the drafts will be submitted to a diplomatic conference for adoption.

²⁶⁷ The first joint session of the UNIDROIT Committee of governmental experts for the preparation of a draft Convention on International Interests in Mobile Equipment and a draft Protocol thereto on Matters specific to Aircraft Equipment and the Sub-Committee of the ICAO Legal Committee on the study of international interests in mobile equipment (aircraft equipment) [hereinafter *First Joint Session*].

²⁶⁸ Major legal systems are present in the joint session. *AWG* and *IATA* attended the session as the members of the international non-governmental Organizations group. See First Joint Session Report (Rome, 1-12 February 1999), Unidroit CGE/Int.Int./Report, ICAO Ref. LSC/ME-Report, Attachment A [hereinafter *First Joint Session Report*].

²⁶⁹ The second joint session of the UNIDROIT Committee of governmental experts for the preparation of a draft Convention on International Interests in Mobile Equipment and a draft Protocol thereto on Matters specific to Aircraft Equipment and the Sub-Committee of the ICAO Legal Committee on the study of international interests in mobile equipment (aircraft equipment) [hereinafter *Second Joint Session*].

²⁷⁰ The Registration Working Group was set up by the first joint session on 5 February 1999 and met during the *Second Joint Session* on 25 and 26 August 1999. Ten members and two observers, *AWG* and *IATA* attended the meeting. Its business was to consider the provisions of the *Draft Convention* and *Draft Aircraft Protocol* concerned with the international registration system, modalities of registration and liabilities, immunities of the international registry and the specific registration of international interests in aircraft objects. See *First Joint Session Report*, Attachment C; see also Second Joint Session (Montreal, 24 August - 3 September 1999) Report (by the Registration Working Group (RWG)), ICAO Ref. LSC/ME/2-WP/17, UNIDROIT CGE/Int.Int./2-WP/17, 26/8/99.

²⁷¹ The Informal Insolvency Working Group was convened in the *First Joint Session*. Its purpose is to consider the insolvency-related provisions of the *Draft Convention* and the *Draft Aircraft Protocol* from the angle of their relationship with existing international instruments on insolvency and insolvency assistance and national law rules pertaining to transnational insolvency. See Second Joint Session (Montreal, 24 August - 3 September 1999), Informal Insolvency Working Group (Rome, 1/2 July 1999) Report, ICAO Ref. LSC/ME/2-WP/10, UNIDROIT CGE/Int.Int./2-WP/10, 18/8/99.

²⁷² The Jurisdiction Working Group was set up during the *Second Joint Session*. Ten States attended the discussion as members and *AWG* attended as observer and adviser. See Second Joint Session (Montreal, 24 August - 3 September 1999), Jurisdiction Working Group Report, ICAO Ref. LSC/ME/2-WP/27, UNIDROIT CGE/Int.Int./2-WP/27, 1/9/99.

However, after two joint sessions, it seems that there may be a long way to go before the draft texts are ready to be submitted to a diplomatic conference. Most of the civil law countries are concerned about the considerable changes which will have to be made in the national law to accommodate the proposed international legal system. And only very few States appeared to have no difficulties to adopt them.²⁷³

The major reference texts of this thesis will be the *Preliminary Draft Convention* and the *Preliminary Draft Aircraft Protocol* revised after the *First Joint Session*,²⁷⁴ the texts amended after the *Second Joint Session*²⁷⁵ will be pointed out.

II. Structure and scope of the Draft Convention

A. Convention and Protocol structure

Apart from the significant character that it unifies the substantive national law, the *Draft Convention* system is innovative in terms of treaty law and rests upon the partnership between public and private sectors in establishing industry-specific international regimes.²⁷⁶

The proposed project has a twofold structure, that the instruments comprise a base Convention that provides for the “constitution and effects of an international interest in

²⁷³ See Weber & Espinola, *supra* note 228.

²⁷⁴ Text of the Preliminary Draft UNIDROIT Convention on International Interests in Mobile Equipment as Reviewed by the Drafting Committee, see *First Joint Session Report*, Attachment D, Appendix I [hereinafter *Preliminary Draft Convention as reviewed by the First Joint Session*]. Text of the Preliminary Draft Protocol to the Preliminary Draft UNIDROIT Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment as Reviewed by the Drafting Committee, see *ibid.*, Appendix II [hereinafter *Preliminary Draft Aircraft Protocol as reviewed by the First Joint Session*]. For these texts, see also Unif. L. Rev., 1999-2, Appendix I, II; online: <<http://www.unidroit.org/english/news/pdconv-99-02.htm>> (date accessed: 12 December, 1999).

²⁷⁵ Text of the [Preliminary] Draft [UNIDROIT] Convention on International Interests in Mobile Equipment as reviewed by the Drafting Committee in the light of the Joint Session's second reading thereof [hereinafter *Preliminary Draft Convention as reviewed by the Second Joint Session*], see Second Joint Session Drafting Committee Report, ICAO Ref. LSC/ME/2-WP/24, UNIDROIT CGE/Int.Int./2-WP/24, 1/9/99, Appendix I. Text of the [Preliminary] Draft Protocol to the [Preliminary] Draft [UNIDROIT] Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment as reviewed by the Drafting Committee in the light of the Joint Session's second reading thereof, see *ibid.*, Appendix II [hereinafter *Preliminary Draft Aircraft Protocol as reviewed by the Second Joint Session*].

²⁷⁶ See C. Chikin & C. Kessedjian, “The Legal Relationship between the Proposed UNIDROIT Convention and Its Equipment-Specific Protocols” (1999) 2 Unif. L. Rev. 323.

mobile equipment”²⁷⁷ and equipment-specific Protocols designing “an uniquely identifiable object of a category”²⁷⁸ each for the Convention, which will only come into force in respect of the particular category²⁷⁹ when the corresponding protocol is adopted.

The only Protocol being elaborated so far is the *Draft Aircraft Protocol*. It covers the security regime for airframes, aircraft engines and helicopters.²⁸⁰ There will, however, be a separate registration system for engines.

It is not foreseen that the base Convention will stand by itself so as to apply in general to all the equipment apart from that specifically regulated by a Protocol. It shall be “read and interpreted as a single instrument”²⁸¹ with each relevant protocol. As for the aircraft protocol, the base Convention and the Protocol “shall be known as the UNDROIT Convention on International Interests in Mobile Equipment as applied to aircraft objects.”²⁸² The legal consequences of the Convention-Protocol structure, however, require careful and explicit consideration. Since the reading and understanding of Protocols may be difficult,²⁸³ each equipment-specific Protocol will be controlling because not only the application of the Convention’s provisions depend on whether they are contained within a protocol, but also the Protocols can amend or modify the base Convention where the specific characteristics of the relevant sector make this necessary;²⁸⁴ the base Convention can only be applicable among the Parties to the relevant Protocol, consequently States’ obligations under the base Convention will vary dramatically.²⁸⁵ These difficulties may be overcome by a “series of stand-alone

²⁷⁷ See *Preliminary Draft Convention as reviewed by the First Joint Session*, *supra* note 274, art 2.1.

²⁷⁸ See *ibid.* art. 2. 2.

²⁷⁹ The *Preliminary Draft Convention* is envisaged as applying to a range of Categories of “uniquely identifiable objects”: airframes, aircraft engines, helicopters, [registered ships,] oil rigs, containers, railway rolling stock and space property. See *Preliminary Draft Convention*, *supra* note 266, art. 3. This list of categories was deleted from the text according the suggestion raised in the *First Joint Session*. See *First Joint Session Report*, *supra* note 268, at 7.

²⁸⁰ See *Preliminary Draft Aircraft Protocol as reviewed by the First Joint Session*, *supra* note 274, art.I.2.

²⁸¹ See *Preliminary Draft Convention as reviewed by the First Joint Session*, *supra* note 275, art. U.2.

²⁸² See *Preliminary Draft Aircraft Protocol as reviewed by the First Joint Session*, *supra* note 274, art. II.2.

²⁸³ See Department of Justice Canada, *Questionnaire for the Attention of Canadian Authorities and Industries on a Draft Convention on International Interests in Mobile Equipment and a Draft Protocol on Matters Specific to Aircraft Equipment*, 28 September 1998 [unpublished, hereinafter *Questionnaire*], Comment on question 2 at 2, cited by Krupski, *supra* note 14 at 10.

²⁸⁴ See Chikin & Kessedjian, *supra* note 276 at 324.

²⁸⁵ See *ibid.*

Conventions, each confined to a particular type of mobile equipment”.²⁸⁶ However, the legislative procedure for stand-alone Conventions will be time consuming because they involve a lengthy process of diplomatic conferences which are avoided in the existing Convention/Protocol system that lead to the formation of a fast track procedure for the making of additional Protocols after the conclusion of the Convention. In addition, it avoids the risk of inconsistency between the general provisions of the different Conventions.

So far, the Convention/Protocol structure is favored by most of the States. The challenge posed by this structure is to ensure sufficient flexibility within the Convention to accommodate the needs of different sectors within the relevant Protocols, while ensuring the essential structural coherence.²⁸⁷ Therefore, careful drafting should be done and the future adoption and amendments should be carefully figured out.

B. Scope of the project

The *Preliminary Draft Aircraft Protocol* Art. III (1) in conjunction with the *Preliminary Draft Convention* Art. 3 defines the scope of application of the Convention to aircraft equipment.²⁸⁸ The location of the obligor and the registration of an aircraft in a national register²⁸⁹ determine the application of the Convention to aircraft.

III. The substantive unification in the Convention

The necessity for an international conflict of laws instrument is inherent in the features of the cross-border asset-based financing. The problem of recognizing the foreign created nonpossessory security interests is addressed in the *Geneva Convention*.²⁹⁰

²⁸⁶ See *Questionnaire*, *supra* note 284, question 2) (c) at 2.

²⁸⁷ See Chikin & Kessedjian, *supra* note 276 at 324ff.

²⁸⁸ See *Preliminary Draft Convention as reviewed by the First Joint Session*, *supra* note 274, art. 3; see *Preliminary Draft Aircraft Protocol as reviewed by the First Joint Session*, *ibid.* art. III (1).

²⁸⁹ To register an aircraft in a national register is the specified “connection”. The *First Joint Session* decided not to extend the scope of application of the article too much, so we can conclude the location of the obligor and the duly registration are the exclusive conditions for determining the application. See *First Joint Session Report*, *supra* note 268 at 7.

²⁹⁰ See Chapter Three, above.

However, this Convention is far from enough to provide protection for the transaction because it does not resolve the critical enforcement matter. In practice, certain national legal rules inequitably favor domestic parties over foreign parties, particularly in the context of priority disputes.²⁹¹ From the economic scenario, asset-based financing and leasing are efficient forms of credit extension in which prompt recourse to the value of underlying assets is a central feature in the analysis of overall risk in transactions. National legal rules that are inconsistent with the general principles underlying these transaction types impose costs, financing becomes comparatively more expensive or, where excessive risk is present, unavailable.

Whether a legal system or legal reform initiative embodies asset-based financing principles, and is correspondingly economically valuable, depends crucially on three key factors: (I) the quality and transparency of the registry of property interests; (ii) the speed with which legal enforcement is available; and (iii) the ability to enforce contractual rights when a borrower or lessee is bankrupt or insolvent.²⁹²

The objective of the UNIDROIT project is to facilitate asset-based financing and leasing of aircraft equipment, increasing its availability and/or reducing its cost. This objective is embedded in individual provisions of the *Draft Convention* and the *Draft Aircraft Protocol*. Given the diversity of individual national law with respect to the asset-based financing, it is reasonable that some provisions raise fundamental policy questions for certain countries whose domestic law is different, such as the insolvency rules, the timetables applicable to legal proceedings, the self-remedy rules, and the use of an international sanctioned form to facilitate nationality deregistration.

A. The transparent priority principle - the creation of an international interest

Draft Convention and *Draft Aircraft Protocol* go further than the *Geneva Convention* with respect to the real rights on aircraft through the establishment of an international registry system. All secured interests and leasing interests in and transfers of aircraft equipment must be registered in order to ensure their priority against third parties.

²⁹¹ See *Economic Impact Assessment*, *supra* note 1 at 12.

Such priority will be determined on a first-in-time basis, except the “preferred nonconsensual creditors”.

1. General rule for the priority

a. The registrable rights

Art. 7 of the *Preliminary Draft Convention* as reviewed by the *First Joint Session* sets out the formal requirements for the creation of an international interest, which would be independent from various categories of similar national interests but coexist with them.²⁹³ The applicable international interests include those which are granted by the charger under a security agreement, vested to the conditional seller under a title reservation agreement and vested to the lessor under a leasing agreement.²⁹⁴ An agreement creating an international interest under the Convention must: (1) be in writing; (2) relate to an objective over which the creditor, seller, or lessor can enter into an agreement; (3) properly identify the object; and (4) identify the secured obligation.²⁹⁵

An international interest does not need recognition as addressed in the *Geneva Convention*,²⁹⁶ because under a worldwide secured transaction law, or at least law binding among a large number of Contracting States, there exists no different laws which would have to recognize that interest. This is the elementary purpose upon which the economic objective can launch.

b. Nature of the international registration

Registration can be termed in different meanings in English, only by examining the context within which it is used, we can determine its particular meaning.²⁹⁷ In contrast to the notion of security rights in most civil law States, where the registration is required to give effect to an interest,²⁹⁸ here, the registration only serves to give public notice of an

²⁹² See *Economic Impact Assessment*, *supra* note 1 at ii.

²⁹³ See Krupski, *supra* note 14 at 87.

²⁹⁴ See *Preliminary Draft Convention as reviewed by the First Joint Session*, *supra* note 274, art. 2.

²⁹⁵ See *Preliminary Draft Convention as reviewed by the First Joint Session*, *supra* note 274, art. 7.

²⁹⁶ See Chapter Three, above.

²⁹⁷ See R.C.C. Cuming, “Considerations in the Design of an International Registry for Interests in Mobile Equipment” (1999) 2 Unif. L. Rev. 276.

²⁹⁸ See Chapter Two, above.

existing interest to third parties and is not required to give effect to one's rights. In other words, the international interests under the *Preliminary Draft Convention* and *Preliminary Draft Aircraft Protocol* are not created through registration, but to one that already exists or has potential existence.²⁹⁹ The effect of this provision is to apply the principle *qui prior est tempore potior in jure* to registration of competing interests rather than to their creation.³⁰⁰

More than encompassed in the termination aforementioned, registration in an international registry under the *Preliminary Draft Convention* and *Preliminary Draft Aircraft Protocol* system is not a public record of the existence of such an interest; it is a record of the potential existence of such an interest or of a potential contract that affects an existing property right.³⁰¹ Hence, for priority purpose, the interest is deemed to have been created or affected at the date of registration, not ahead of the registration in the common sense.

c. First-to-file principle

Deeply influenced by the common law tradition, the first-to-file principle is accepted.³⁰² A registered interest has priority over any other interest subsequently registered and over an unregistered interest.³⁰³ No matter what state of knowledge of the holder of a competing interest would be, the registration focuses on the fact under the *prior tempore* rule.³⁰⁴ This mechanism is designed to achieve commercial predictability by reducing any ambiguity and uncertainty while deciding the priority of the competing rights.

2. Treatment of nonconsensual rights and interests

²⁹⁹ See *Preliminary Draft Convention as reviewed by the First Joint Session*, *supra* note 274, art

³⁰⁰ See Cuming, *supra* note 297 at 277.

³⁰¹ See *ibid.*

³⁰² See Chapter Two, A.3.a, above.

³⁰³ See *Preliminary Draft Convention*, *supra* note 266, art 27(1).

³⁰⁴ See *Preliminary Draft Convention*, *ibid.*, art 27(2), (3)

As an exception of the first-to-file principle, the “nonconsensual rights and interests” provisions³⁰⁵ are designed to enhance the flexibility of the Convention, coupled by the reservation mechanism.

Here the “nonconsensual rights and interests” refer to those rights and interests rising as a matter of law. In some common law States, these rights can prevail over the consensual rights, e.g. the common law lien and the statutory lien under the UK domestic laws.³⁰⁶ The main type of non-statutory lien is a repairer’s lien against an aircraft, engine or spare parts. The statutory lien can be exercised by the airport authority to detain an aircraft against the unpaid airport charges including the air navigation fees.³⁰⁷

At the early stage, two options are offered with respect to the “nonconsensual rights and interests”. The first one allows the Contracting States to set out categories of nonconsensual rights and interests that shall be registrable in the system as if the right or interest was an international interest and be regulated accordingly.³⁰⁸ So, the declared rights and interests would be treated fairly by participating the first-to-file regime, which means they can prevail over subsequent, but not preexisting, consensual interests. The other option provides the Contracting States to retain the full preference of the nonconsensual rights and interests despite nonregistration. It limits only to the rights and interests which have priority over a registered interest of the same type as the international interest without any act of publication under the domestic law.³⁰⁹ Again it should be made by a declaration in a ratification instrument.³¹⁰

As proposed by the aircraft protocol group, the inclusion of the nonconsensual rights and interests will enhance the utility of the international registry,³¹¹ which is the very commercial objective that the proposed system is seeking for. The potential policy

³⁰⁵ See *Preliminary Draft Convention as reviewed by the First Joint Session*, *supra* note 274, art. 37, 38.

³⁰⁶ See Chapter Two, above.

³⁰⁷ The author cites only the aircraft liens in the UK, in this case it is outstanding in respect to the discussion on the “nonconsensual rights”. The actual scope of aircraft liens is broader than what we referred here. See Chapter Two, above.

³⁰⁸ See *Preliminary Draft Convention as reviewed by the First Joint Session*, *supra* note 274, art. 37.

³⁰⁹ See *Preliminary Draft Convention as reviewed by the First Joint Session*, *supra* note 274, art. 38.1(b).

³¹⁰ See *Preliminary Draft Convention as reviewed by the First Joint Session*, *ibid.* art. 38.1(a).

³¹¹ See J. Wool, “The Next Generation of International Aviation Finance Law: An Overview of the Proposed Unidroit Convention on International Interests in Mobile Equipment as Applied to Aircraft Equipment” (1998) 23:6 Air & Space Law at 261.

concerns of Contracting States, however, are not avoidable because of the sensitivity of domestic laws.

The provisions, especially the second option builds in the possibility of preferred secret liens, thus lessening overall transparency.³¹² While the declaration of wide preferences will have adverse economic implications. Common law States have more concerns on these provisions. The delegates of the UK even proposed not to include the “nonconsensual rights” in this Convention considering that various countries have different understanding about this concept. By declaring the “nonconsensual rights”, the Convention can be overturned (for the same reason, UK did not ratify the *Geneva Convention*).³¹³ While the *AWG* insists on its commercial initiative embodied by these provisions because the States can make their own decision on the priority according to respective domestic law. Maximum flexibility was given to States on how to treat this right, which will encourage the ratification of this Convention and also serve to the great extent the commercial objective.³¹⁴

The basic opinion of the Draft Committee during the *Second Joint Session* is to retain the two kinds of options. The second option, however, will be restricted to such rights and interests that involve a right to payment or such obligations that could result in the deprivation of the proprietary interest of an obligee.³¹⁵ At the same time, it provides that the Contracting States can modify the declaration from time to time in order to respond to the policy concerns.³¹⁶ Thereby a balance between commercial and policy issues can be reached.

One issue that has been raised, but not yet been addressed, is the question of supra national nonconsensual liens, such as those in favor of the Eurocontrol. In practice, only the UK, among the Eurocontrol members, provides the local authority the detention rights on aircraft in favor of Eurocontrol fee, the same as the fee occurred from local authority.

³¹² The “false wealth” theory can explain this problem. See Chapter Two, above.

³¹³ Notes taken by the author from the *Second Joint Session*.

³¹⁴ See *ibid.*

³¹⁵ See *Preliminary Draft Convention as reviewed by the Second Joint Session*, *supra* note 275, at 23, 24, notes 27, 32.

³¹⁶ See *Preliminary Draft Convention as reviewed by the Second Joint Session*, *ibid.*, art. 38(2).

Since the domestic law specifies this right,³¹⁷ we can regard it as the national regulation even though this right by nature occurred supranationally. Therefore, it can be classified as one of the nonconsensual rights under the proposed legal system.

3. Insolvency rules

The priority rule is also applied under the situation of insolvency. Except when nonconsensual rights and interests are deposited by ratification, no rights or interests shall have priority over registered interests.³¹⁸ This stipulation supplements the priority rule and makes it a complete system.

B. The prompt enforcement principle - applicable remedies and speedy judicial relief

As the core of the asset-based financing transaction, the unification of enforcement of secured rights in case of debtors' default is the most significant improvement in this proposed project. The proposed instrument provides financiers and lessors a right to take possession and sell or redeploy aircraft equipment. These remedies are essential to maximize the potential financing-related benefits of the legal instruments in a given country, particularly to countries where the risk of material enforcement delays is currently a key factor in risk/return assessments.

1. The remedies available upon default

Based on the autonomy principle, the *Preliminary Draft Convention* and *Preliminary Draft Aircraft Protocol* stipulate that the transaction parties are at liberty to agree by mutual understanding with what kind of event constitutes default.³¹⁹ In the event of no definition about the default in the agreement, a highly unlikely circumstance in the

³¹⁷ See Chapter Two, above.

³¹⁸ See *Preliminary Draft Aircraft Protocol as reviewed by the First Joint Session*, supra note 274, art. XI [Alternative A], 7; see also Second Joint Session Insolvency Working Group Report, ICAO Ref. LSC/ME/2-WP/19, UNIDROIT CGE/Int.Int/2-WP/19, 26/8/99, Appendix I, art. XI [Option A], 11.

³¹⁹ See *Preliminary Draft Convention as reviewed by the First Joint Session*, supra note 274, art. 11(1).

context of aircraft financing,³²⁰ a “substantive default” is required to give rise to the remedies.³²¹

2. Substantive default remedies

According to the distinguished nature of the security instruments,³²² the remedies are divided into two categories: one is for a chargee under a security agreement;³²³ the other is for a conditional seller of lessor under a title reservation or leasing contract.³²⁴ Some modifications were made with respect to aircraft equipment.

A chargee under a security agreement may exercise one or more of the following remedies in the event of default. Firstly, the chargee may take possession or control of any object charged to it.³²⁵ Secondly, the chargee may sell or grant a lease of any such object.³²⁶ Thirdly, the chargee may collect or receive any income or profits arising from the management or use of any such object.³²⁷ Fourthly, the chargee may deregister an aircraft from the relevant *Chicago Convention* nationality register.³²⁸ Fifthly, the chargee may export and physically transfer the aircraft object from the territory in which it is situated.³²⁹

A conditional seller under a title reservation agreement or a lessor under a leasing agreement may, in the event of default by the conditional buyer or lessee, respectively, terminate the agreement and take possession or control of any object to which the agreement relates.³³⁰ They may also apply for a court order authorizing or directing either

³²⁰ In aircraft financing transaction, the default provision is normally mandatory in the contract. See generally Yan Wang, *Fei Ji Rong Zi Zu Lin De Ruo Gan Fa Lu Wen Ti* (LL.B. Paper, Peking University, 1997) [unpublished].

³²¹ See *Preliminary Draft Convention as reviewed by the First Joint Session*, *supra* note 274, art. 11(2).

³²² See Chapter One, above.

³²³ See *Preliminary Draft Convention as reviewed by the First Joint Session*, *supra* note 274, art. 8.

³²⁴ See *Preliminary Draft Convention as reviewed by the First Joint Session*, *ibid.* art. 10.

³²⁵ See *Preliminary Draft Convention as reviewed by the First Joint Session*, *ibid.* art. 8.1(a).

³²⁶ See *Preliminary Draft Convention as Reviewed by the First Joint Session*, *ibid.* art. 8.1(b), but see art. Y(1), which permits a declaration that prevents a chargee from granting a lease.

³²⁷ See *Preliminary Draft Convention as reviewed by the First Joint Session*, *ibid.*, art. 8.1(c).

³²⁸ See *Preliminary Draft Aircraft Protocol as reviewed by the First Joint Session*, *ibid.* art. IX.1(a); see also *Chicago Convention*.

³²⁹ See *Preliminary Draft Aircraft Protocol as reviewed by the First Joint Session*, *ibid.*, art. IX.1(b).

³³⁰ See *Preliminary Draft Convention as reviewed by the First Joint Session*, *supra* note 274, art. 10(a).

of these acts.³³¹ The aforementioned last two remedies especially applicable for aircraft equipment are also available for the seller and the lessor.

These substantive remedies are not exhaustive.³³² They do not prevent the additional remedies permitted by applicable law as long as they are compatible with the proposed Convention/Protocol system.

3. The model of execution of remedies

The *Preliminary Draft Convention* and *Preliminary Draft Aircraft Protocol* provide financiers and lessors a legal right to take possession and sell or redeploy aircraft equipment in case of default under the basic convention rules.³³³ The ability to exercise the remedies which is contained in the optional convention rules, is of two kinds:³³⁴ a. the Contracting States can choose to exercise the remedies by leaving of the court or without, the latter non-judicial remedy is so called “self-help”,³³⁵ b. the Contracting States may prosecute judicial proceedings relating to the asset on a “speedy” basis or, alternatively, within a maximum timetable.³³⁶

The applicability of one or both of these sets of optional convention rules is essential to maximizing the potential financing-related benefits of the legal instruments in a given country, particularly to countries in which the risk of material enforcement delays is currently a key factor in risk/return lending assessments.

a. The “self-help” option

The *Preliminary Draft Convention* and *Preliminary Draft Aircraft Protocol* made clear that any remedy available to an obligee might be exercised either by judicial way or by self-help. These provisions in general, are meant to signal the usefulness of non-judicial remedies in sophisticated secured transactions and in leasing involving high-value

³³¹ See *Preliminary Draft Convention as reviewed by the First Joint Session*, *ibid.* art. 10(b).

³³² See *Preliminary Draft Convention as reviewed by the First Joint Session*, *ibid.*, art. 13.

³³³ See *Economic Impact Assessment*, *supra* note 1 at 12.

³³⁴ See *Preliminary Draft Convention as reviewed by the First Joint Session*, *supra* note 274, art. 12(2). See also *Preliminary Draft Convention as reviewed by the Second Joint Session*, *supra* note 275, art. 12 [Alternative A], (2)2.

³³⁵ See *ibid.* See also Chapter Two, above.

³³⁶ See *Preliminary Draft Aircraft Protocol as reviewed by the First Joint Session*, *supra* note 274, art. X.

mobile equipment such as aircraft.³³⁷ In practice, even though such unilateral creditor action is permitted by a particular country, it may be restricted to the extent such action violates public order or breaches the peace.³³⁸

In fact, only some common law States have the tradition of such self remedies, while most of the civil law systems prevent or severely curtail the exercise of non-judicial remedies.³³⁹ The drafters of the proposed project have not underestimated the friction. To accommodate the interests of civil law jurisdictions, an optional provision has been inserted according to which such public interference through leave of the court may be required by the Contracting State where the remedy is to be exercised provided that State has declared a reservation. Hence, the reservation mechanism plays the role again in order to let these Contracting States opt-out.³⁴⁰

b. *Sui generis* expedited remedies

The second option is the potentially effective one and it also embodies the creativity of the proposed legal regime.

One major impediment to true asset-based financing is the risk, following default, of prolonged litigation or protracted court proceedings. The delay in exercising the contractual remedies leads to great loss for the financier or lessor. In the case of aircraft equipment, because the requirements for the replacement of old equipment with more efficient equipment, the aircraft generations shift in relatively short-term cycle.³⁴¹ It means the financier or lessor will lose money if they can not physically possess the mortgaged object and put it in the market in time. The high capital feature of aircraft equipment makes the situation even worse.

This makes the expedited remedies under the *Draft Convention* and *Draft Aircraft Protocol* system a novelty when compared with the previous aircraft finance law. An obligee is entitled to the “speedy judicial relief” in the form of a variety of court orders

³³⁷ See Wool, *supra* note 311 at 258.

³³⁸ See Cuming, *supra* note 297.

³³⁹ See Wood, *supra* note 36 at 138ff.

³⁴⁰ See *Preliminary Draft Convention as reviewed by the First Joint Session*, *supra* note 274, art. Y(2).

³⁴¹ The aircraft equipment type changed every decade. See Chapter One, above.

relating to remedies against the aircraft object,³⁴² by adducing *prima facie* evidence of default by an obligor.³⁴³ The relief is available pending final determination of its claim on the merits.³⁴⁴

a.a. The traditional interim remedies

The interim remedies are not unusual in the treaty law and national laws. The *Brussels/Lugano Conventions* provide a similar regulation. Such national prototypes are the *Mareva* Injunction in English Common law,³⁴⁵ or the conservatory arrest in Quebec, France, the Netherlands or Germany. Both can be obtained to prevent the aircraft from leaving the jurisdiction prior to judgement.³⁴⁶ Jurisdiction to determine the case on the merits in this case has to be determined independently according to the general principles of the *Brussels/Lugano Convention*, but may also guide, as in domestic law, the jurisdiction for expedited relief.³⁴⁷

b.b. The innovation of the “speedy judicial relief”

Of outmost importance, the standard for speedy judicial relief is *sui generis*. It is an international norm created by virtue of the *Preliminary Draft Convention* and *Preliminary Draft Aircraft Protocol*, and is not depended upon, derived from or to be interpreted in light of national interim relief rules.

The purpose of the expedited relief rule in the *Preliminary Draft Convention*, as interpreted by the aircraft protocol group, is different in kind from that of national injunctive relief. The availability of national provisional or injunctive relief is generally a matter to be decided by the courts, which are given wide discretion. Fairness, rather than

³⁴² The obligee obtains speedy judicial relief in the form of “(a) preservation of the object and its value; (b) possession, control or custody of the object; (c) immobilisation of the object; (d) sale, lease or management of the object; (e) application of the proceeds or income of the object”. See *Preliminary Draft Convention as reviewed by the First Joint Session*, *supra* note 274, art. 14(1).

³⁴³ See *ibid.*.

³⁴⁴ See *Preliminary Draft Convention as reviewed by the First Joint Session*, *ibid.* art. 14(2).

³⁴⁵ See *Mareva Compania Naviera S.A. v. Int. Buld Carriers S.A.*, [1975] 2 Lloyd’s L.R. 509 (C.A.). Today, see Supreme Court Act 1981 (U.K.), 1981, c. 54, s. 36(3). Cited by Krupski, *supra* note 14 at 94, footnote 465.

³⁴⁶ See Krupski, *supra* note 14 at 94.

³⁴⁷ See Krupski, *ibid.*.

commercial predictability, is sought. The expedited relief rule serves the purpose of commercial predictability by setting out objective standard (*prima facie* proof of default) triggering remedies against the aircraft objects.

The interim relief if granted “pending final determination” of its claim, i.e. it does not restrict the right to prosecute ongoing litigation on the merits. The *Preliminary Draft Aircraft Protocol* defines “speedy judicial relief” as a period not exceeding a to-be-specified number of “calendar days from the date on which the instrument initiating the proceedings is lodged with the court or its administrative office.”³⁴⁸

To the extent economic issues are a primary consideration, that article should be reformulated to ensure that any and all specified default remedies are promptly available.

C. The bankruptcy law enforcement principle

Whether the *Preliminary Draft Convention* achieves its objective of promoting the asset-backed aircraft financing or not depends on the applicability of the enforcement principle, either the non-bankruptcy enforcement, so called “specific expedited relief”, or the bankruptcy enforcement.

Few, if any, areas of commercial law are more policy-laden than insolvency law. Questions of incentives and disincentives to commercial enterprises, employment policy and equity are directly implicated.³⁴⁹ Insolvency laws that prevent or modify security-type and leasing rights result in greater risk to financial institutions that, in turn, pass on this risk to borrowers in the form of higher interest and leasing rates.

1. Priority rules on insolvency

An international interest is valid against the equipment user’s trustee, liquidator or syndic in bankruptcy³⁵⁰ of the obligor if, prior to the commencement of the bankruptcy, that interest was registered in conformity with the Convention and Protocol system.³⁵¹

³⁴⁸ See *Preliminary Draft Aircraft Protocol* as reviewed by the First Joint Session, *supra* note 274, art. X.

³⁴⁹ See J. Wool, “The Case for a Commercial Orientation to the Proposed UNIDROIT Convention as Applied to Aircraft Equipment” (1999) 2 Unif. L. Rev. 289 at 298.

³⁵⁰ See *Preliminary Draft Convention* as reviewed by the First Joint Session, *supra* note 274, art. 28(3).

³⁵¹ See *ibid.*, art. 28(1).

This provision, developed from similar wording in the *Leasing Convention*,³⁵² is the very core function of preferences and priorities that was undisputed under *the Geneva Convention* too. It seeks to ensure that the proprietary nature of the international interest represented by a registration will neither be set aside because its form would not otherwise be recognized in insolvency proceedings in a Contracting State nor subordinated in such proceedings on account of a failure or comply with otherwise applicable national “perfection” requirements.

Nothing on bankruptcy standardization is included in the proposed project. Both the *European Convention on Certain International Aspects of Bankruptcy*³⁵³ and the *European Union Convention on Insolvency Proceedings*³⁵⁴ determine international jurisdiction for a primary bankruptcy according to the center of the debtor’s main interests³⁵⁵ and a second bankruptcy in any other State where the debtor has an establishment. The applicable law, as a matter of procedure generally, follows the *lex fori*. The Draft Convention only achieves a minimum protection for secured aircraft financiers, since in most cases of bankruptcy only the domestic secured creditors are taken into consideration as it finds them on the date of opening of proceedings or petition date respectively.

2. Transplant of US Chapter 11- remedies on insolvency

A “hard” bankruptcy rule is provided by art. XI of *the Preliminary Draft Aircraft Protocol as reviewed by the First Joint Session*. It requires an obligor to cure all defaults or give possession of the aircraft object³⁵⁶ to an obligee within a to be specified period from the defined insolvency date. It also provides that no exercise of remedies that the Convention and Protocol allow may be prevented or delayed in the context of insolvency

³⁵² See *Financing Leasing Convention*, *supra* note 56, art. 7(1).

³⁵³ See *Council of Europe - European Convention on Certain International Aspects of Bankruptcy*, 5 June 1990, (1991) 30 I.L.M. 165 [hereinafter *Istanbul Convention*].

³⁵⁴ See *European Union - Convention on Insolvency Proceedings*, 23 November 1995, (1996) 35 I.L.M. 1223 [hereinafter *Insolvency Convention*].

³⁵⁵ See *Istanbul Convention*, *supra* note 356 art. 4 and *Insolvency Convention*, *ibid.* art. 3.

³⁵⁶ See *Preliminary Draft Aircraft Protocol as reviewed by the First Joint Session*, *supra* note 274, art. XI(3).

proceedings after the to-be-specified period.³⁵⁷ In addition, the provision would prevent obligations of an obligor relating to an international interest from being modified in the insolvency proceedings without the consent of an obligee.³⁵⁸ Finally, it specifies the priority of the international interest in an insolvency proceeding.³⁵⁹

This provision, according to which the equipment user must both cure all defaults under the transaction document and agree to perform all its future obligations or return the aircraft equipment to the financier/lessor subject to a short time period, is modeled after Chapter 1110 of the U.S. Bankruptcy Code.³⁶⁰ The US statute has demonstrably contributed to the historically and comparatively low funding costs of aircraft financing transactions and led to a considerable increase in value of the airline stock.³⁶¹ However, the implementation of the *Draft Aircraft Protocol* in this respect will heavily depend on policy decisions taken by the government.

It was proposed to formulate a more flexible insolvency opinion³⁶² during the *Second Joint Session*. The alternative choice will be fixed waiting period, something similar to the reconciliation period in modern insolvency law. However, this option has not been added formally into the *Draft Aircraft Protocol* yet. If the options are offered in the draft, some countries that do not want to be bound by the US model can opt out.³⁶³

Many jurisdictions have debtor protection legislation of one form or another. Where and to the extent that the rules of particular legal systems are unclear or open-ended on these issues. These issues need to be considered in detail in any financing at the outset. The end result may well be a conclusion that debtor protection is a risk of doing

³⁵⁷ See *ibid.*, art. XI(5).

³⁵⁸ See *ibid.*, art. XI(6).

³⁵⁹ See *ibid.*, art. XI(7).

³⁶⁰ See Chapter Two, above.

³⁶¹ See Saunders & Walter, *Economic Impact Assessment*, *supra* note 1 at 16. See P.A. Baggaley, "Criteria for Rating Enhanced Equipment Trust Certificates", Standard and Poor's Global Sector Review, Transportation (August 1998), cited by Wool, *supra* note 352.

³⁶² See Second Joint Session Insolvency Working Group Report, ICAO Ref. LSC/ME/2-WP/19, UNIDROIT CGE/Int.Int./2-WP/19, 26/8/99, APPENDIX I, II, III.

³⁶³ See *ibid.* APPENDIX I, Option A. 1.

business with that particular jurisdiction, but that element of risk should be reflected in the structure and pricing of the deal.³⁶⁴

³⁶⁴ See A. Littlejohns, "Legal Issues in Aircraft Finance" in S.A.D. Hall ed. *Aircraft Financing*, 2nd ed., *supra* note 12 at 300.

Chapter Five Considerations of UNIDROIT Convention - China's Perspective

China, as a new power in the Asia-Pacific economic rim has achieved a great deal of development in the aviation industry over the past 20 years. The annual average growth rate of China's air traffic is approximately double that of the national economy, triple that of the domestic transportation and four times that of the world air transport industry. Its ranking rose from the 37th place in the world in 1978 to the present 10th place.³⁶⁵ The fleet of transports has also increased dramatically. In 1978, Chinese civil aviation industry had 80 transport aircraft including only 42 transport aircraft each with over 100 seats, while in 1997 the fleet went up to 485 transport aircraft including 397 transport aircraft each with over 100 seats.³⁶⁶ This drastic increase in fleet brings China, a developing country, into a situation where there is always a shortage of funds for investing in new generation aircraft.

China signed the *Geneva Convention* but never ratified it. So far no international instruments with respect to aircraft financing are applicable in China. In order to finance new aircraft purchases, China is relying mainly on western capital markets. Aircraft from the United States and France comprise the majority of the fleet of Chinese airlines. Therefore, the aircraft transactions that China is involved in are almost all cross-border transactions and an international instrument is imperative for China.

Undoubtedly, the proposed UNIDROIT Convention and Aircraft Protocol system will promote the cross-border aircraft transaction and benefit the importing States like China. However, adjusting the existing domestic legal system to the emerging international conventions is an imperative task for both scholars and practitioners.

³⁶⁵ See CAAC, 1998 Annual Report, at 19.

³⁶⁶ *Ibid.* at 24.

I. General legal framework of China's aircraft finance law

A. General introduction on Movable property security rights

Influenced by the civil law theory, China distinguishes the moveable and immovable property. The regulation on movable property is more flexible than that on the immovable. Firstly, the restrictions on movable property with respect to the contents and rights are less than that on the immovable. Secondly, the movable property can be acquired through either transfer or original acquisition, while the immovable property can only be acquired by transfer. Thirdly, the registration is necessary for immovable property, as a consequence of the State's interference.³⁶⁷

As one of the civil law states, China has recently established a fairly completed guaranty legal system based on the civil law theory, the *PRC Guaranty Law*. Before this law came in to existence, financiers had to look at a patchwork of regional and national legislation in order to determine what type of security was available and how such security could be registered and subsequently enforced.³⁶⁸ A handful of provisions of the *General Principles of the Civil Law of the People's Republic of China*³⁶⁹ deal with the "creditors' rights",³⁷⁰ which formed the basis for the Guaranty Law.

The *PRC Guaranty Law* fills several major gaps in existing legislation and offers the creditors sufficient protection. It provides for five types of security: a guarantee by a third party;³⁷¹ a mortgage over the debtor's or a third party's assets;³⁷² a pledge over the

³⁶⁷ See Huixing Liang, Yifei Long & Huabin Chen, *Zhong Guo Cai Chan Fa* (Beijing: Fa Lu Chu Ban She, 1998) at 13ff [in Chinese].

³⁶⁸ See N. Johnston & L. Barale, "China's New Security Law" (1996) 1 JIBL 31 at 32.

³⁶⁹ See *General Principles of the Civil Law of the People's Republic of China*, adopted at the Fourth Session of the Sixth National People's Congress, promulgated by Order No. 37 of the President of the People's Republic of China on April 12, 1986, and effective as of January 1, 1987. Online: <<http://www.fqis.net/chinalaw/prclaw27.htm>> (date accessed: 10 April, 1999) [hereinafter *PRC Civil Law*].

³⁷⁰ The performance of a debt can be guaranteed by a specific property offered by the debtor or a third party as a pledge. If the debtor defaults, the creditor shall be entitled to keep the pledge to offset the debt or have priority in satisfying his claim out of the proceeds from the sale of the pledge pursuant to relevant legal provisions, see *PRC Civil Law*, *ibid.* art. 89(2). Also, a possessor shall have a lien on the other party's property and may keep the retained property to offset the debt or have priority in satisfying his claim out of the proceeds from the sale of the property if the other party violates the contract by failing to pay a required sum of money within the specified time limit, see *ibid.* art. 89(4).

³⁷¹ See *PRC Guaranty Law*, *supra* note 97, c. II, art. 6.

³⁷² See *PRC Guaranty Law*, *ibid.*, c. III, art. 33.

debtor's or a third party's assets (movable property and certain documentary intangibles) involving the transfer of possession;³⁷³ an advance deposit by the debtor (applicable in the case of commercial contracts such as equipment purchase contracts rather than loan agreements);³⁷⁴ and a lien over the debtor's assets (that is, a right for the lien holder to retain the debtor's assets until the debt is paid).³⁷⁵

There is no chattel mortgage in Chinese law. The security type for movable property is pledge, under which the debtor or a third party need to transfer the possession of his movable or intellectual property rights. In order to meet the demands of the economic development, the attitude of the law towards the chattel instrument to aircraft equipment, together with other agricultural and industry equipment, underwent a fundamental change. Although Chinese law does not state explicitly that this equipment are immovable properties, as some civil law jurisdictions did,³⁷⁶ it directly indicates that the mortgage is applicable for these movable equipment.³⁷⁷

Floating charge is not available in the *PRC Guaranty Law*. The only sub-mortgage is the *Mortgage of Maximum Amount*, which means that the mortgaged property shall be used to secure the creditor's claims that occur successively during a given period of time and to the extent of the total amount of the claims.³⁷⁸ Similar to the laws of the civil law countries,³⁷⁹ Chinese law requires the contracting parties to specify the total amount of the claims by a mutual agreement. In practice, once the actual claims exceed or equal to the agreed claims, the actual occurred claims prevail; once they are less than the agreed claims, the agreed ones prevail.³⁸⁰ After the amount is specified, it

³⁷³ See *PRC Guaranty Law*, *ibid.*, c. IV, art. 63.

³⁷⁴ See *PRC Guaranty Law*, *ibid.*, c. V, art. 82.

³⁷⁵ See *PRC Guaranty Law*, *ibid.*, c. VI, art. 89.

³⁷⁶ See Chapter One, above.

³⁷⁷ See *PRC Guaranty Law*, *supra* note 97, art. 33, "Mortgage...means that the debtor or a third party secured the creditor's rights with property...without transference of its possession"; art. 34, "The following property may be mortgaged:... (2) machines, means of transport and other property owned by the mortgagor". These equipment include machines, means of transport and other property. Aircraft, ships and vehicles are specified as the means of transport. See *PRC Guaranty Law*, *ibid.* art. 34(2), (4), 42(4).

³⁷⁸ See *PRC Guaranty Law*, *ibid.* art. 59.

³⁷⁹ The English-based countries, e.g., Australia, New Zealand, do not require to specify the amount of the claims. However, Germany, France and other France influenced countries require it. See Wood, *supra* note 36, at 100.

³⁸⁰ See Hairong Zhang, "Xian Xing Wo Guo Dan Bao Zhi Du Cun Zai De Ji Ge Wen Ti" (1997) *Si Fa Shi*

becomes the common mortgage. However, under Chinese law the creditors right to the principal contract may not be transferred,³⁸¹ which contradicts the general provisions relevant to principal contract secured by the mortgage.³⁸² The reason to deny the transfer of principal contract is to prevent the chaos resulting from the uncertainty of the mortgages established within the claimed amount.³⁸³

The mortgage of maximum amount may be transferred in certain civil law countries. According to German and Japanese Civil Code, it will be transferred together with the principal contract after the claimed amount is specified; if the claimed security is not specified, the principal contract can be transferred separating from the mortgages and the transferred debt becomes a common debt without mortgage.³⁸⁴ Hence, mortgage of maximum amount is independent from the principal contract and it does not transfer together with the principal contract necessarily. On the other hand, the creditor can transfer the debt to the third party without the debtor's agreement. No matter there is mortgage on the principal contract or not, the contracting parties' free will is decisive. In this sense, the limitation on transfer of the maximum mortgaged amount breaches the spirit of civil law and detriments the creditor's right. Therefore, in order to conform to the trend of international practice, Chinese law should lessen the limitation on debt transfer by separating the principal debt and the mortgage thereon so as to keep the integrity of the mortgage.³⁸⁵

Title reservation contract, such as conditional sale and financial leasing, is recognized in China. The contracting parties may agree to attach conditions to the effectiveness of the contract, which becomes effective upon fulfillment of those

Jian 34 at 35 [in Chinese].

³⁸¹ See *PRC Guaranty Law*, *supra* note 97, art. 61.

³⁸² As a principle, the right of mortgage may not be separated from the creditor's rights and transferred singly, see *PRC Guaranty Law*, *ibid.* art. 50. However, the mandatory provision of non-transfer of the principal contract secured by the mortgage of maximum amount completely denies the possibility of transfer, which is necessary and beneficial for the commercial practice.

³⁸³ See Xiangjun Kong *et al.*, *Dan Bao Fa Li Jie Yu Shi Yong* (Beijing: Ren Min Fa Yuan Chu Ban She, 1996) at 421ff [in Chinese].

³⁸⁴ See Yaming Mao, *Dan Bao Fa Lun*, 1st ed. (Beijing: Fa Lu Chu Ban She, 1997) at 136, cited by Xuean Zhang, "Guo Ji Rong Zi Zhong De Di Ya Yu Zhong Guo Xiang Guan Fa Lu Wen Ti Bi Jiao Yu Tan Tao" (1998) 5 *Xian Dai Fa Xue* 61 at 63ff [in Chinese]. See also Xiangjun Kong, *ibid.* at 422.

³⁸⁵ See Xiangjun Kong, *ibid.*

conditions.³⁸⁶ Civil aircraft conditional sale agreements fall into this category. Lease-finance contract is defined as "a contract by which a lessor, based on a lessee's selections in respect of the seller and the leased thing, agrees to purchase a thing from the seller and makes it available to the lessee for his use, and the lessee agrees to pay rent therefor".³⁸⁷ In practice, commercial aircraft occupies an important position in China's financial leasing industry. In the early 1980's, the first financial leasing transaction held by the China Trust and Investment Company is to lease the first Boeing 747 aircraft for the General Administration of Civil Aviation of China (CAAC).

B. Specific laws and regulations

China signed the *Geneva Convention* but never became one of the Contracting States of this international aircraft financing law instrument. However, it does not mean there is a vacuum in the field of regulating aircraft financing in China. After the decentralization of Chinese aviation industry in early 1980's,³⁸⁸ CAAC became solely and exclusively a government regulatory agency and airlines gained the autonomous status in management. Since then, China has been establishing the fundamental aircraft financing law framework step by step.

The *PRC Civil Aviation Law* is the milestone in the history of China's civil aviation industry. For the first time, it comprehensively regulated the civil aviation activities in China. Two regulations were enacted soon afterwards to supplement the *PRC Civil Aviation Law*: the *Regulations of the People's Republic of China For Registration of*

³⁸⁶ See *PRC Contract Law*, *supra* note 53, art. 45.

³⁸⁷ See *PRC Contract Law*, *ibid.* art. 237.

³⁸⁸ Before 1979 the aviation industry in China was part of the Chinese Air Force operated under the tight control of the CAAC, which was a government regulatory agency on the one hand and the national flag carrier on the other. After March 15, 1980, Chinese civil aviation industry was separated from Air Force completely. The following administrative measures, such as 1984 *Airline Industry Reform Report* and 1986 *Civil Aviation Management Reform Project and Program Report*, served to modernize and liberalize the aviation industry. The far reaching 32nd Order (CCAR - 279LR) "*The Rules on Transfer of Management System of State-owned Civil Aviation Enterprises*" promoted the airlines to establish modern enterprise system that is in line with the whole industry enterprise reform in China. See Chia-Jui Cheng, "Recent Developments in the Aviation Industry of the People's Republic of China" (1995) 20:2 Air & Space Law 68. For the CCAR - 279LR, see online: <<http://www.qis.net/Chinalaw/lawtran1.htm>> (date accessed: 15 February, 1999).

*Rights in Civil Aircraft*³⁸⁹ and the *Regulations of the People's Republic of China For Registration of Nationality in Civil aircraft*.³⁹⁰

With general laws, supplemented by the specific laws and regulations in aviation area, China has provided the essential protection to creditors involved in aircraft financing transactions.

1. Registrable rights on aircraft

Rights on aircraft is specified in Chapter III of the *PRC Civil Aviation Law*, which supplements the *PRC Guaranty Law* with respect to mortgage on special movable property as previously discussed. The mortgage of a civil aircraft shall be established by registering with the competent authority and may act against a third party.³⁹¹ The ownership and possession on civil aircraft are also registrable³⁹² responding to the title reservation agreement and lease contracts as a security device.

Following the *Geneva Convention*, civil aircraft liens were limited to the remuneration for rescuing and necessary expenses incurred for the custody of the civil aircraft only.³⁹³ Aircraft lien shall have priority over the mortgage of a civil aircraft.³⁹⁴

2. Formal requirements for registration

To effect a registration of the mortgage in a civil aircraft, the holder of such right shall have to fill in an application form and submit the following relevant documents to the competent civil aviation authority under the State Council:³⁹⁵ (1) the certificate of nationality registration of the civil aircraft according to the *PRC Aircraft Nationality*

³⁸⁹ See the *Regulations of the People's Republic of China for Registration of Rights in Civil Aircraft*, promulgated by Decree of the State Council of the People's Republic of China No. 233 by Premier Li Peng, October 21, 1997. Online: <<http://www.qis.net/chinalaw/prclaw69.htm>> (date accessed: 10 April, 1999) [hereinafter *PRC Aircraft Rights Registration Regulations*].

³⁹⁰ See the *Regulations of the People's Republic of China For Registration of Nationality in Civil aircraft*, promulgated by Decree of the State Council of the People's Republic of China No. 232 by Premier Li Peng, October 21, 1997. Online: <<http://www.qis.net/chinalaw/>> (date accessed: April 10, 1999) [hereinafter *PRC Aircraft Nationality Registration Regulations*].

³⁹¹ See *PRC Civil Aviation Law*, *supra* note 75, art. 16.

³⁹² See *PRC Civil Aviation Law*, *ibid.* art. 11(1), (2).

³⁹³ See *PRC Civil Aviation Law*, *ibid.* art. 19.

³⁹⁴ See *ibid.* art. 22.

³⁹⁵ See *PRC Aircraft Rights Registration Regulations*, *supra* note 389, art. 4, 7.

*Registration Regulations*³⁹⁶; (2) the ownership registration certificate or the relevant document(s) proving the acquisition of the ownership therein; (3) the civil aircraft mortgage contract; and (4) other necessary document(s) required by the competent authority.

The possession of a civil aircraft can also be registered under the *PRC Aircraft Rights Registration Regulations*.³⁹⁷ The civil aircraft sale contract or the lease contract can be effectively registered with the same competent authority after submitting the necessary documents.³⁹⁸

Modeled after the *Geneva Convention*, aircraft liens need to be registered within three months commencing from the date of the end of rescue or custody,³⁹⁹ or the aircraft lien will expire after the short period. This provision aims to make all the security rights and liens on a given aircraft public so as to eliminate any secret rights and protect subsequent buyers and creditors.

Chinese law does not exclusively comply with the golden rule of "first to file, first to create" in determining the priority of competing mortgages on the same property.⁴⁰⁰ The type of property determines the legal implications of registration. Registration is regulated in order to place in effect a mortgage agreement on some property;⁴⁰¹ on others,

³⁹⁶ For the detailed requirements of documents for nationality registration, see *PRC Aircraft Nationality Registration Regulations*, *supra* note 390, art. 7.

³⁹⁷ See *PRC Aircraft Rights Registration Regulations*, *supra* note 389, art. 4.

³⁹⁸ Except the certificates of nationality registration and the ownership registration of the civil aircraft, to effect a registration of the possession of a civil aircraft, the possessor shall submit the civil aircraft sale contract or the lease contract in conformity with the *PRC Civil Aviation Law*. See *PRC Aircraft Rights Registration Regulations*, *ibid.* art. 6.

³⁹⁹ See *PRC Civil Aviation Law*, *supra* note 75, art. 20.

⁴⁰⁰ See *PRC Guaranty Law*, *supra* note 97, art. 54:

"Where the same property is mortgaged to two or more creditors, the proceeds from the auction or sale of the mortgaged property shall be used for liquidation according to the following provisions: (1) [w]here a mortgage contract takes effect with its registration, the liquidation shall be made in the order of the time of registration of the mortgaged property; if the registration is in the same order, the liquidation shall be made according to the respective proportions of the claims; (2) [w]here a mortgage contract takes effect on the date of its execution and the mortgaged property is registered, the liquidation shall be made in the order of the effective dates of the contracts; if the order of the effective dates is the same, the liquidation shall be made according to the respective proportions of the claims. The claim secured by registered mortgage shall be satisfied prior to the claim secured by unregistered mortgage."

⁴⁰¹ These property include aircraft equipment, ships, vehicles and the land-use right, see *PRC Guaranty Law*, *supra* note 97, art. 42. See Zhang, *supra* note 384 at 62.

it is only the prerequisite to act against the third party. In the case of aircraft equipment, the *PRC Civil Aviation Law* overrides the general stipulation in the *PRC Guaranty Law*.⁴⁰² In other words, the mortgage agreement on civil aircraft is still effective between the contracting parties even if there was no registration. A mortgage may not act against a third party unless registered.⁴⁰³ Hence, among the registered security rights on aircraft, the effective date of the contract is the decisive factor of the priority instead of the registration date; while comparing the registered security rights and the unregistered security rights, the secured one prevails.⁴⁰⁴

3. Enforcement of the security

Security enforcement under Chinese law is more liberal than in most of the civil law jurisdictions, which are judicial protectionism and historically give priority to the protection of the debtor by insisting on judicial monitoring of enforcement and by a public sale designed to prevent a collusive sale by the mortgagee. The mortgagee, who is not paid at the maturity of the obligation, may, through agreement with the mortgagor, be paid out of the proceeds from the conversion of the mortgaged property or from the auction or sale of the mortgaged property. If they fail to reach an agreement, the mortgagee may bring a lawsuit in a People's Court.⁴⁰⁵ The three ways to exercise the mortgaged property can be determined either by mutual agreement or by judicial decision. Hence, the private sale, the conversion of the mortgaged property expressed in Chinese law, and the auction are all available. The commercial rational embedded here is that the price through conversion or sale shall be fixed with reference to the market price.⁴⁰⁶

⁴⁰² There is a principle in Chinese law that once any conflict arises between the general law and the special law, the special law prevails. See *PRC Guaranty Law*, *ibid.* art. 95. Although the *PRC Guaranty Law* classifies the aircraft as one of the properties that can not be effectively created unless duly registration, the *PRC Civil Aviation Law* overrides this stipulation and the registration becomes only the "perfection" of security rights. See *PRC Guaranty Law*, *ibid.* art 41, 42 (4); see also *PRC Civil Aviation Law*, *supra* note 75, art. 16.

⁴⁰³ See *PRC Civil Aviation Law*, *supra* note 75, art. 16.

⁴⁰⁴ See Zhang, *supra* note 401.

⁴⁰⁵ See *PRC Guaranty Law*, *supra* note 97, art. 53.

⁴⁰⁶ See *PRC Guaranty Law*, *ibid.* art. 94.

On the other hand, Chinese law does not permit the self-help remedies. Only after reaching agreement with the mortgagor or judicial decisions, the mortgagee can undertake any action on the mortgaged property. In this sense, Chinese law follows the classical civil law traditions that are more restricted than the English-based jurisdictions.

As one of the properties specified in the *PRC Guaranty Law*, the aircraft equipment with security shall be enforced along the same procedure.

II. Critical provisions in the Draft Convention

The UNIDROIT *Preliminary Draft Convention* and *Draft Aircraft Protocol* touch the substantive aspects of security law. In order to determine if China's aircraft financing law can be adjusted to this project it is necessary to analyze the domestic law carefully.

A. International interests

China has one central register for both the aircraft nationality and rights registration. This register is maintained by the CAAC, the competent civil aviation authority under the State Council.⁴⁰⁷ This authority shall maintain the Register of Nationality in Civil Aircraft and the Register of Rights in Civil Aircraft, which shall be the unitary record of the registered matters thereof.⁴⁰⁸

The function of registration in Chinese law is exactly the same as that of proposed international interests registration. The registration of an international interest in the international registry is the necessary "perfection". In the worst case, parties might feel obliged to make dual filings out of caution.⁴⁰⁹ There is nothing to prevent the Chinese civil aircraft registration system from applying the international registration. China has set up the central registry on a national basis and as a result the required documents and

⁴⁰⁷ See *PRC Civil Aviation Law*, *supra* note 75, art. 6, 12. See also *PRC Aircraft Rights Registration Regulations*, *supra* note 389, art. 3; see also *PRC Aircraft Nationality Registration Regulations*, *supra* note 390, art. 5.

⁴⁰⁸ See *ibid.*

⁴⁰⁹ See C.W. Mooney, "Relationship between the Prospective UNIDROIT International Registry, Revised Uniform Commercial Code Article 9 and National Civil Aviation Registries" (1999) 2 *Unif. L. Rev.* 335 at 343.

procedures are compatible with the proposed international registry. This government-run domestic registry can well serve the international interests established by the proposed project.

In addition, Chinese law includes the title reservation agreements and financial lease agreements in the same national register which is also compatible with the international system. Certain countries, e.g., the United Kingdom, maintain different registers for the security rights and the title reservation security.⁴¹⁰ In comparison with a dual register system, Chinese law is quite advanced in this aspect.

B. Jurisdiction

Article 3 of the *Preliminary Draft Convention* provides a broader scope for application that as long as the obligor is situated in a Contracting State or the object is situated in a Contracting State, this proposal applies. The fact that the obligee is situated in a non-Contracting State does not affect the applicability. The obligor is situated in the Contracting State if it: is incorporated; has its registered office; has its center of control; or has its place of business in that State.⁴¹¹

As a major aircraft importing State, China is concerned that this stipulation is too broad and might detriment the debtor's rights. The main objective of the proposed project is to provide protection for financial institutions, such as creditors or lessors, thus they can always gain the greatest protection as long as the debtor or the lessee is situated in a Contracting State. However Chinese law favors the obligor, the same as the "speedy relief remedy", but there are no judicial remedies available to protect the obligee. Therefore, conflicts between the national law and the proposed international instruments might arise when Chinese law is applicable. In this sense, the Chinese delegation to the Second Joint Session suggested that both the obligor and the obligee should be located in the Contracting State.

⁴¹⁰ In English law, the security law provides the register only for security rights. The other title-backed securities should be registered according to the company law, see Chapter Two, above.

⁴¹¹ See *Preliminary Draft Convention as reviewed by the First Joint Session*, *supra* note 274, art. 4.

The aircraft manufacturers and lessors, represented by the United States, think that the broader application is the commercial objective of the proposed project. They insist on leaving the provisions untouched. However, China's consideration for national integrity of national might lead to the refusal of the international instruments and will in turn affect the broad acceptance of the project.

For aircraft financial lease contracts, the Supreme People's Court issued an explanation for the jurisdiction matter.⁴¹² The contracting parties can choose the applicable law with free will; if not, the law where the obligor is located will apply.⁴¹³ Although there is no conflict with Chinese law in determining the location of the obligor, the *Preliminary Draft Convention* allows also the location of the project to take the jurisdiction, which is much broader than China's existing national law.

The existing law can effectively limit the jurisdiction of Chinese courts except when the contracting parties mutually select another jurisdiction in advance. Assuming the proposed jurisdiction provisions are adopted, China can no longer domain the jurisdiction as an obligor in aircraft financing transactions. Any Contracting States where the aircraft object is located while in default can file a lawsuit. The movable feature of aircraft leads to the situation that we can not predict the Jurisdiction State.

C. Self-help remedies

Although Chinese law is more liberal than most of the civil law countries, the self-help remedies are still not permitted. The self-help remedies can affect the commercial air transportation. China is not a Contracting State of the 1933 Arrest Convention and there is no effective protection for public order in case of the abuse of this kind of private remedy. Once the Draft Convention and Aircraft Protocol are enacted, the Arrest Convention will be superseded if no particular declaration.⁴¹⁴ China may declare reservation on this remedy⁴¹⁵ and choose the other option.⁴¹⁶

⁴¹² See *Notice on the Matters of Jurisdiction of Financial Lease Contract*, issued by the Supreme People's Court of China No. 19, May 27, 1996 [in Chinese].

⁴¹³ See *ibid.* art. 4.

⁴¹⁴ See *Preliminary Draft Aircraft Protocol as reviewed by the First Joint Session*, *supra* note 274, art.

D. Insolvency provisions

Similar to other modern insolvency law, the *PRC Insolvency Law*⁴¹⁷ adopted the corporate rehabilitation.⁴¹⁸ The reconciliation agreement⁴¹⁹ between the default enterprise and the creditors shall be effective through judicial procedure.⁴²⁰ After the court's announcement, the reconciliation imposes a freeze on enforcement of the security for up to two years, under which a secured party normally cannot repossess or foreclose on its collateral. Hence, this insolvency law is basically debtor protected.

The proposed project offers special protection to the aircraft financiers.⁴²¹ Modeled after the US bankruptcy laws, it in effect creates a category of "superlenders" to the transportation industry. Currently the *Insolvency Working Group* is still working on a more flexible formulation of the insolvency remedy.⁴²² Although this option may allow the applicability of the existing Chinese law by opting out the US model through the reservation mechanism, there might be some problems for China to adjust the domestic law to the proposed project.

The current *PRC Insolvency Law* is still on trial implementation and only applies for the state enterprises. There is still a long way to go to work out a mature and complete insolvency legal system. Since the United States is one of the major aircraft exporting

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⁴¹⁵ The Contracting State can make a declaration under Article Y to opt out the self-help remedies. See *Preliminary Draft Convention as reviewed by the First Joint Session*, *ibid.* art. Y, art. 12(2).

⁴¹⁶ The remedies provided shall be exercised in conformity with the procedure prescribed by the law of the place where the remedy is to be exercised. See *Preliminary Draft Convention as reviewed by the Second Joint Session*, *supra* note 275, art. 12 [Alternative B].

⁴¹⁷ *The State Enterprise Insolvency Law of People's Republic of China (Trial)*, adopted at the 18th Meeting of the Standing Committee of the 6th National People's Congress on December 2, 1986 [hereinafter *PRC Enterprise Insolvency Law*].

⁴¹⁸ The reconciliation and reorganization deal with the staying of insolvency proceedings in order to give the petitioned debtor an opportunity to reorganize his enterprise and pay his debts. See the *PRC Enterprise Insolvency Law*, *ibid.* c. IV.

⁴¹⁹ The enterprise can not put the reconciliation unilaterally. It should apply the reconciliation to the creditors and an agreement should be reached mutually. See *PRC Enterprise Insolvency Law*, *ibid.* art. 18.

⁴²⁰ See *PRC Enterprise Insolvency Law*, *ibid.* art. 19.

⁴²¹ See Chapter Two, above.

⁴²² See *Second Joint Session Insolvency Working Group Report*, ICAO Ref. LSC/ME/2-WP/19, UNIDROIT CGE/Int.Int./2-WP/19, APPENDIX II, APPENDIX III.

states for China, China's attitude to the relevant insolvency provisions will affect the American manufacturers and financiers' interests greatly. In turn, if China insists on protecting the national debtors and chooses to opt out of the US model, American financiers can always claim that their interests are not fully protected in China, which might hinder the future aircraft transactions with the United States. Considering there are no more regulations on insolvency matter, China may consider proposing some insolvency rules applicable especially for the airline industry so as to coexist with the international instrument.

III. China's attitude towards the Convention/Protocol and the future legal reforms

China has been carrying out economic reform over the past twenty years and the airline industry is one of the basic industries in this reform. Capital shortages are more and more intense while market competition demands new generation aircraft. The aircraft financing instrument is becoming more and more important for the Chinese airline industry. Hence, China shows great interest in the recently launched international instrument and actively participated in the study of the UNIDROIT project. At the same time, the Chinese government is promoting the ratification of the *Geneva Convention*.

Under the proposed project Chinese airlines have better access to secured loans and leases on a commercial basis, and will enhance the prospects of their access to international capital markets.⁴²³ The economic benefits⁴²⁴ are specified in the *Economic Impact Assessment* sponsored by the AWG and mainly reflect the developed countries' interests. As one of the main aircraft importing states, China's interests are different from the AWG. So far there is no precise statistical data to indicate the economic impact after

⁴²³ See *Economic Impact Assessment*, *supra* note 1 at 14.

⁴²⁴ This project will obtain both the microeconomic and macroeconomic gains. Estimates of available funds and cost saving, global airline financing cost savings, estimates of pass-through, transactions cost and fleet planning benefits. The macroeconomic gains include aggregate output and income, trade, investment and multiplier-effects, employment effects, public-sector revenues, fiscal balance and privatization and potential growth effects. See *Economic Impact Assessment*, *ibid.* 14-31.

China joins in the proposed legal system. The issue of how the project will benefit China's civil aviation industry will need further economic study.

It is definite that the proposed project will have a great impact on China's civil aviation industry. The project can be implemented as long as three States ratify it. So far the developed countries such as the United States and some European countries have showed great interest in this Convention and may ratify it. Since they are the major aircraft manufacturers and exporting States with which China is doing business, if China is excluded from the Convention, the future importing and aviation industry will be negatively influenced.

However, the proposed Convention/Protocol system reflects the developed countries' interests, in which most of the aircraft manufacturers and financial institutions are located. As an aircraft importing State, China should pay more attention to the debtor protection measures and consider the financing practice carefully so as to promote the desired aircraft financing transactions and airline industry development.

Inspired by the Uniform Commercial Code, the North American Law of secured transactions domains the *Draft Convention* and *Draft Aircraft Protocol*.⁴²⁵ This includes not only the language used in the instruments but also some unique legal concepts of common law jurisdictions.⁴²⁶ Civil law jurisdictions face the difficulty of accepting these concepts and applying them to their national law. If these international instruments become effective, according to the general principle "international treaty would override the national law",⁴²⁷ they would have the character of a code in China and directly modify the existing civil code. Therefore, there is a need to study the relevant provisions intensively. China should also be prepared to modify the domestic law with respect to security rights on movable property.

⁴²⁵ See Krupski, *supra* note 14 at 111.

⁴²⁶ E.g., the concept of "self-help" remedies. See Chapter Two, above.

⁴²⁷ This is the basic conflict of laws rule dealing with the conflicts of international treaty and national law. See *PRC Civil Law*, *supra* note 369, art. 142.

Conclusion

UNIDROIT *Draft Convention* and *Draft Aircraft Protocol* present a great evolution in the area of aircraft finance law lately. The following economic benefits are significant after the adoption of these instruments.

After careful observation of the whole progress of the legislation at an international level, it seems that although the airline industry wants a quick adoption and implementation of the proposed new instrument, there is a need for consultation within inter governmental agencies and international groups. It is not sufficient for only the private sector to present a draft text to a group of selected states interested in a particular field of international commerce and ask to have an international legal instrument made out of it, even though its core objective is to facilitate commercial transactions among industry partners.⁴²⁸ International law making is a formal concerted process among sovereign nations whose agreement or consensus is not always easy to reach but indispensable.⁴²⁹ An international treaty should not only be commercially oriented to be acceptable to the industry, but also politically acceptable to the States on which its adoption depends.

The UNIDROIT proposed instruments are not only responsible for the evolution of aircraft financing law, but also for a significant reform in the uniform private law field. The optimistic economic effect has been addressed as early as 1980's, and all the Contracting States of ICAO realized the great benefit. However, there still exists intense divergence between both the civil law and common law systems and the industrialized and the developing countries. The progress of negotiations is very slow.

This Convention embodies primarily the convention of the common law system and requires high established domestic security law. It is ambitious to prescribe rules of enforcement and priority that would override relevant national laws. As substantial laws of national legal system, security law, property law and relevant insolvency law are the

⁴²⁸ See Weber & Espinola, *supra* note 228 at 468.

⁴²⁹ *Ibid.*

most complicated ones and can incur a lot of policy related considerations. The expectation is that this substantive reform would be acceptable because of the extremely narrow scope of the convention.⁴³⁰ Special enforcement and priority rules that only applied to aircraft and certain other high-value equipment would not mean that a contracting state's laws were fundamentally undermined.⁴³¹

In order to reach an agreement, some substantial issues must be addressed in a proper way, or the desired economic profits can never be fulfilled. The reservation mechanism and the set of optional provisions offered the Contracting States a high level of freedom to choose, but at the same time, it can also result in the deviation from the original intention.

The draft texts put forward the modern security law principles. Although some States refuse to accept them subject to the present national laws, they were offered the opportunity to consider the security law system again. If the proposed instruments can be enacted, the adjustment of the national law to the modern securitisation law will be a great legal reform worldwide. The proposed project will promote the reforms in the area of security laws, particularly in those countries that do not have established security legal system.

China shows great interest in this legal reform and already gave positive response through participation in the international conference and by organizing study domestically. Undoubtedly the economic development is the motive behind the legal reform. Although China aspires to be a member of the international instrument, the national interest and sovereignty should not be sacrificed. Some disagreements between Chinese domestic law and the proposed legal instruments, the jurisdiction and the insolvency provisions for example, are quite severe. Therefore, harmonization of conflicting laws and at the same time maximize the benefits brought by the instrument is the major task in the area of aircraft finance law for China in the future.

⁴³⁰ As indicated in the title of the instrument, the Convention will be applied to only high value mobile equipment, which is quite narrow considering the whole movable property family.

⁴³¹ See S. McGairl, "International Conventions Affecting Aircraft Financing Transactions" in A. Littlejohns & S. McGairl eds., *Aircraft Financing*, 3rd ed. 367 at 374.

APPENDIX

**TEXT OF THE PRELIMINARY DRAFT UNIDROIT CONVENTION ON
INTERNATIONAL INTERESTS IN MOBILE EQUIPMENT**

**AS REVIEWED BY THE DRAFTING COMMITTEE DURING THE
FIRST JOINT SESSION OF THE UNIDROIT COMMITTEE OF
GOVERNMENTAL EXPERTS FOR THE PREPARATION OF A DRAFT
CONVENTION ON INTERNATIONAL INTERESTS IN MOBILE
EQUIPMENT AND A DRAFT PROTOCOL THERETO ON MATTERS
SPECIFIC TO AIRCRAFT EQUIPMENT AND THE SUB-COMMITTEE
OF THE ICAO LEGAL COMMITTEE ON THE STUDY OF
INTERNATIONAL INTERESTS IN MOBILE EQUIPMENT (AIRCRAFT
EQUIPMENT) © (Unidroit 1999)**

(Rome, 1 - 12 February 1999)

**(The Drafting Committee did not have the time to complete its giving of
headings to each Article of the preliminary draft Convention; in this text
headings are accordingly only given up to and including Article 26.)**

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

[PREAMBLE

THE STATES PARTIES TO THIS CONVENTION,

AWARE of the need to acquire and use high-value mobile equipment and to facilitate the financing of the acquisition and use of such equipment in an efficient manner,

RECOGNISING the advantages of asset-based financing and leasing for this purpose and desiring to facilitate these types of transaction by establishing clear rules to govern them,

DESIRING to provide broad economic benefits for all interested parties,

BELIEVING that such rules must reflect the principles underlying asset-based financing and leasing and promote the autonomy of the parties necessary in these transactions,

CONSCIOUS of the need to establish an international registration system as one of the essential features of the legal framework applicable to international interests in high-value mobile equipment,

HAVE AGREED upon the following provisions:]

CHAPTER I

SPHERE OF APPLICATION AND GENERAL PROVISIONS

Article I Definitions

In this Convention the following words are employed with the meanings set out below:

"agreement" means a security agreement, a title reservation agreement or a leasing agreement;

"assignment" means a consensual transfer, whether by way of security or otherwise, which confers on the assignee rights in the international interest;

"associated rights" means all rights to payment or other performance by the obligor under an agreement or a contract of sale secured by or associated with the object;

"buyer" means a buyer under a contract of sale;

"chargee" means the grantee of an interest in an object under a security agreement;

"chargor" means the grantor of an interest in an object under a security agreement;

"conditional buyer" means the buyer under a title reservation agreement;

"conditional seller" means the seller under a title reservation agreement;

"contract of sale" means a contract for the sale of an object which is not an agreement;

"court" means a court of law or an administrative or arbitral tribunal established by a Contracting State;

"Intergovernmental Regulator" means, in respect of any Protocol, the intergovernmental regulator referred to in Article 16(1);

"international interest" means an interest to which Article 2 applies and which is constituted in conformity with Article 7;

"International Registry" means the international registry referred to in Article 15(3);

"leasing agreement" means an agreement by which one person ("the lessor") grants a right to possession or control of an object (with or without an option to purchase) to another person ("the lessee") in return for a rental or other payment;

"object" means an object of a category to which Article 2 applies;

"obligee" means the chargee under a security agreement, the conditional seller under a title reservation agreement or the lessor under a leasing agreement;

"obligor" means the chargor under a security agreement, the conditional buyer under a title reservation agreement, the lessee under a leasing agreement [or the person whose interest in an object is burdened by a registrable non-consensual right or interest];

"prospective assignment" means an assignment that is intended to be made in the future, upon the occurrence of a stated event, whether or not the occurrence of the event is certain;

"prospective international interest" means an interest that is intended to be created or provided for as an

international interest in the future, upon the occurrence of a stated event (which may include the obligor's acquisition of an interest in the object), whether or not the occurrence of the event is certain;

"prospective sale" means a sale which is intended to be made in the future, upon the occurrence of a stated event, whether or not the occurrence of the event is certain;

"Protocol" means, in respect of any category of object and associated rights to which this Convention applies, the Protocol in respect of that category of object and associated rights;

["qualified proceeds" means proceeds of an object payable by reason of the loss or physical destruction of the object or payable by a Government or State entity in respect of the confiscation, condemnation or requisition of the object;] I

"registered" means registered in the International Registry pursuant to Chapter V;

"registered interest" means an international interest [or a registrable non-consensual right or interest] registered pursuant to Chapter V;

["registrable non-consensual right or interest" means a right or interest registrable pursuant to an instrument deposited under Article 37;]

"Registrar" means, in respect of any category of object and associated rights to which this Convention applies, the person designated under Article 16(3);

"regulations" means regulations made, pursuant to the Protocol, by the Intergovernmental Regulator under Article 16(4);

"sale" means a transfer of ownership of an object pursuant to a contract of sale;

"secured obligation" means an obligation secured by a security interest;

"security agreement" means an agreement by which a chargor grants or agrees to grant to a chargee an interest (including an ownership interest) in or over an object to secure the performance of any existing or future obligation of the chargor or a third person;

"security interest" means an interest created by a security agreement;

"title reservation agreement" means an agreement for the sale of an object on terms that ownership does not pass until fulfilment of the condition or conditions stated in the agreement;

"unregistered interest" means a consensual interest or non-consensual right or interest [(other than an interest to which Article 38 applies)] which has not been registered, whether or not it is registrable under this Convention[; and

"writing" means a record of information (including information [sent][obtained] by teletransmission) which is in tangible form or is capable of being reproduced in tangible form and which [identifies][indicates] by reasonable means the person sending the record and that person's approval of it].

Article 2

The international interest

1. - This Convention provides for the constitution and effects of an international interest in mobile equipment and associated rights.

2. - For the purposes of this Convention, an international interest in mobile equipment is an interest, constituted under Article 7, in an uniquely identifiable object of a category of such objects designated in a Protocol:

- (a) granted by the chargor under a security agreement;
- (b) vested in a person who is the conditional seller under a title reservation agreement; or
- (c) vested in a person who is the lessor under a leasing agreement.

An interest falling within sub-paragraph (a) does not also fall within sub-paragraph (b) or (c).

3. - This Convention does not determine whether an interest to which the preceding paragraph applies falls within sub-paragraph (a), (b) or (c) of that paragraph.

[4. - This Convention governs only:

- (a) the constitution of an international interest, its effects, its assignment and rights of subrogation;
- (b) matters relating to the international registration system and the modalities of registration;
- (c) questions of jurisdiction,

as provided for in Articles 2 to 41.]

[5. - An international interest in an object extends to [qualified proceeds] of that object.]

Article 3
Sphere of application

[1. -] This Convention shall apply when at the time of the conclusion of the agreement creating or providing for the international interest:

- (a) the obligor is situated in a Contracting State; or
- (b) the object to which the international interest relates has a connection, as specified in the Protocol, with a Contracting State.

[2. - The fact that the obligee is situated in a non-Contracting State does not affect the applicability of this Convention.]

Article 4
Where obligor is situated

[1. -] For the purposes of this Convention [other than the provisions of Article 40], the obligor is situated in any Contracting State where it:

- (a) is incorporated;
- (b) has its registered office;
- (c) has its centre of control; or
- (d) has its place of business

in that State.

[2. - A reference in this Convention to the obligor's place of business shall, if it has more than one place of business, mean its principal place of business or, if it has no place of business, its habitual residence.]

Article 5
Derogation

In their relations with each other, the parties may, by agreement in writing, derogate from or vary the effect of any of the provisions of Chapter III, except as stated in Articles 8(2)-(6), 9 (3) and (4), 12(1) and 13.

Article 6
Interpretation and applicable law

1. - In the interpretation of this Convention, regard is to be had to its purposes as set forth in the preamble, to its international character and to the need to promote uniformity and predictability in its application.

2. - Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the applicable law.

3. - References to the applicable law are (, except as provided in Articles ..., (to the law applicable by virtue of the rules of private international law of the forum State.

4. - Where a State comprises several territorial units, each of which has its own rules of law in respect of the matter to be decided, and where there is no indication of the relevant territorial unit, the law of that State decides which is the territorial unit whose rules shall govern. In the absence of any such rule, the law of the territorial unit with which the case is most closely connected shall apply.

CHAPTER II

CONSTITUTION OF AN INTERNATIONAL INTEREST

Article 7
Formal requirements

An interest is constituted as an international interest under this Convention where the agreement creating or providing for the interest:

- (a) is in writing;
- (b) relates to an object of which the chargor, conditional seller or lessor has power to dispose;
- (c) enables the object to be identified in conformity with the Protocol; and
- (d) in the case of a security agreement, enables the secured obligations to be determined, but without the need to state a sum or maximum sum secured.

CHAPTER III

DEFAULT REMEDIES

Article 8

Remedies of chargee

1. - In the event of default as provided in Article 11, the chargee may, to the extent that the chargor has so agreed, exercise any one or more of the following remedies:

- (a) take possession or control of any object charged to it;
- (b) sell or grant a lease of any such object;
- (c) collect or receive any income or profits arising from the management or use of any such object,

or apply for a court order authorising or directing any of the above acts.

2. - Any remedy given by sub-paragraph (a), (b) or (c) of the preceding paragraph shall be exercised in a commercially reasonable manner [and by lawful means]. A remedy shall be deemed to be exercised in a commercially

reasonable manner where it is exercised in conformity with a provision of the security agreement except where such a provision is manifestly unreasonable.

3. - A chargee proposing to sell or grant a lease of an object under paragraph 1 otherwise than pursuant to a court order shall give reasonable prior notice in writing of the proposed sale or lease to:

- (a) interested persons specified in paragraph 6 (a) and (b); and
- (b) interested persons specified in paragraph 6 (c) who have given notice of their rights to the chargee within a reasonable time prior to the sale or lease.

4. - Any sum collected or received by the chargee as a result of exercise of any of the remedies set out under paragraph 1 shall be applied towards discharge of the amount of the secured obligations.

5. - Where the sums collected or received by the chargee as a result of the exercise of any remedy given in paragraph 1 exceed the amount secured by the security interest and any reasonable costs incurred in the exercise of any such remedy, then unless otherwise ordered by the court the chargee shall pay the excess to the holder of the international interest registered immediately after its own or, if there is none, to the chargor.

6. - In this Article and in Article 9 "interested persons" means:

- (a) the chargor;
- (b) any person who, for the purpose of assuring performance of any of the obligations in favour of the chargee, gives or issues a suretyship or demand guarantee or a standby letter of credit or any other form of credit insurance;
- (c) any other person having rights subordinate to those of the chargee in or over the object.

Article 9

Vesting of object in satisfaction; redemption

1. - At any time after default as provided in Article 11, the chargee and all the interested persons may agree that ownership of (or any other interest of the chargor in) any object covered by the security interest shall vest in the chargee in or towards satisfaction of the secured obligations.

2. - The court may on the application of the chargee order that ownership of (or any other interest of the chargor in) any object covered by the security interest shall vest in the chargee in or towards satisfaction of the secured obligations.

3. - The court shall grant an application under the preceding paragraph only if the amount of the secured obligations to be satisfied by such vesting is reasonably commensurate with the value of the object after taking account of any payment to be made by the chargee to any of the interested persons.

4. - At any time after default as provided in Article 11 and before sale of the charged object or the making of an order under paragraph 1, the chargor or any interested person may discharge the security interest by paying in full the amount secured, subject to any lease granted by the chargee under Article 8(1). Where, after such default, the payment of the amount secured is made in full by an interested person, that person is subrogated to the rights of the chargee.

5. - Ownership or any other interest of the chargor passing on a sale under Article 8(1) or passing under paragraph 1 of this Article is free from any other interest over which the chargee's security interest has priority under the provisions of Article 27.

Article 10

Remedies of conditional seller or lessor

In the event of default under a title reservation agreement or under a leasing agreement as provided in Article 11, the conditional seller or the lessor, as the case may be, may:

(a) terminate the agreement and take possession or control of any object to which the agreement relates; or

(b) apply for a court order authorising or directing either of these acts.

Article 11

Meaning of default

1. - The obligor and obligee may agree as to the events that constitute a default or otherwise give rise to the rights and remedies specified in Articles 8 to 10 and 14.

2. - In the absence of such an agreement, "default" for the purposes of Articles 8 to 10 and 14 means a substantial default.

Article 12

Procedural requirements

1. - Subject to paragraph 2, any remedy provided by this Chapter shall be exercised in conformity with the procedure prescribed by the law of the place where the remedy is to be exercised.

2. - Any remedy available to the obligee under Articles 8 to 10 which is not there expressed to require application to the court may be exercised without leave of the court except to the extent that the Contracting State where the remedy is to be exercised has made a declaration under Article Y or in the Protocol.

Article 13

Additional remedies

Any additional remedies permitted by the applicable law, including any remedies agreed upon by the parties, may be exercised to the extent that they are not inconsistent with the mandatory provisions of this Chapter as set out in Article 5.

Article 14

Relief pending final determination

1. - A Contracting State shall ensure that an obligee who adduces prima facie evidence of default by the obligor may, pending final determination of its claim and to the extent that the obligor has 2 so agreed, obtain speedy judicial relief in the form of [such] one or more of the following orders [as the obligee requests]:

- (a) preservation of the object and its value;
- (b) possession, control or custody of the object;
- (c) immobilisation of the object; 3
- (d) sale, lease or management of the object;
- (e) application of the proceeds or income of the object.

[2. - In making any order under sub-paragraphs (d) or (e) of the preceding paragraph, the court may impose such terms as it considers necessary to protect the obligor in the event that the obligee:

- (a) in implementing any order granting such relief, fails to perform any of its obligations to the obligor under this Convention; or
- (b) fails to establish its claim, wholly or in part, on the final determination of that claim.]

[3.] - Ownership or any other interest of the obligor passing on a sale under the preceding paragraph is free from any other interest over which the obligee's international interest has priority under the provisions of Article 27.

[4.] - Nothing in this Article limits the availability of forms of interim judicial relief other than those set out in paragraph 1.

[CHAPTER IV 4

THE INTERNATIONAL REGISTRATION SYSTEM

Article 15

The International Registry

1. - An International Registry shall be established for registrations of:

- (a) international interests, prospective international interests [and registrable non-consensual rights and interests];
- (b) assignments and prospective assignments of international interests; and
- (c) subordinations of interests referred to in sub-paragraph (a) of this paragraph.

[2. - The International Registry shall have international legal personality and such legal capacity as may be necessary for the exercise of its functions and the fulfilment of its purposes under this Convention.]

[3.] - Different registries may be established for different categories of object and associated rights. For the purposes of this Convention, "International Registry" means the relevant international registry.

[4.] - For the purposes of this Chapter and Chapter V, the term "registration" includes, where appropriate, an amendment, extension or discharge of a registration.

[Article 16

The Intergovernmental Regulator and the Registrar

1. - The Protocol shall designate an Intergovernmental Regulator 5 to exercise the functions assigned to it by this Chapter, Chapter V and the Protocol.

2. - The Protocol may provide for Contracting States to designate operators of registration facilities in their respective territories. Such operators shall be transmitters of the information required for registration and, in such capacity, shall constitute an integral part of the registration system of this Convention. The Protocol may specify the extent to which the designation of such an operator shall preclude alternative access to the International Registry.

3. - The Intergovernmental Regulator shall establish the International Registry, designate the Registrar and oversee the International Registry and the operation and administration thereof. 6

4. - The manner in which such oversight is conducted, the responsibilities of the Registrar and operators of registration facilities and the fees to be paid by users of the international registration system shall be prescribed in the Protocol and/or from time to time in the regulations.

5. - The Registrar shall:

- (a) operate the International Registry efficiently and responsibly;
- (b) perform the functions assigned to it under this Convention, the Protocol and the regulations;
- (c) report to the Intergovernmental Regulator on its performance of these functions and otherwise comply with the oversight requirements specified by the Intergovernmental Regulator;
- (d) maintain financial records relating to its functions in a form specified by the Intergovernmental Regulator; and
- (e) insure against liability for its acts and omissions in a manner acceptable to the Intergovernmental Regulator.

6. - The Intergovernmental Regulator shall have power to require acts and omissions which are in contravention of this Convention, the Protocol or the regulations to be rectified.

7. - The Protocol and/or the regulations may prescribe the procedures pursuant to which the Registrar and operators of registration facilities may request advice from the Intergovernmental Regulator regarding the exercise of their respective functions under this Convention, the Protocol and the regulations.]]

[CHAPTER V 7

MODALITIES OF REGISTRATION

Article 17

Registration requirements

The Protocol and regulations may contain conditions and requirements, including the criterion or criteria for the identification of the object, which must be fulfilled in order:

- (a) to effect a registration; or
- (b) to convert the registration of a prospective international interest or a prospective assignment of an international interest into registration of an international interest or of an assignment of an international interest.

Article 18

Transmission of information

The information required for a registration shall be transmitted, by any medium prescribed by the Protocol or regulations, to the International Registry or registration facility prescribed therein.

Article 19

When registration takes effect

1. - A registration shall take effect upon entry of the required information into the International Registry data base so as to be searchable.

2. - A registration shall be searchable for the purposes of the preceding paragraph at any time when:

(a) the International Registry has assigned to it a sequentially ordered file number; and

(b) the registration, including the file number, may be accessed at the International Registry and at each registration facility in which searches may be made at that time.

3. - If an interest first registered as a prospective international interest becomes an international interest, the international interest shall be treated as registered from the time of registration of the prospective international interest.

4. - The preceding paragraph applies with necessary modifications to the registration of a prospective assignment of an international interest.

5. - The International Registry shall record the date and time a registration takes effect.

6. - A registration shall be searchable in the International Registry data base according to the criteria prescribed by the Protocol.

Article 20

Who may register

[1. - An international interest which is a security interest, a prospective international interest or an assignment or prospective assignment of an

international interest may be registered by or with the consent in writing of the chargor or assignor or intending chargor or assignor, as the case may be. Any other type of international interest may be registered by the holder of that interest.] 8

[2.] - The subordination of an international interest to another international interest may be registered by or with the written consent of the person whose interest has been subordinated.

[3.] - A registration may be amended, extended prior to its expiry or discharged by or with the consent in writing of the party in whose favour it was made.

[4. - A registrable non-consensual right or interest may be registered by the holder thereof].

Article 21

Duration of registration

Registration of an international interest remains effective for the period of time [specified in the Protocol or the regulations as extended in conformity with Article 20(3)] [agreed between the parties in writing].

Article 22

Searches

1. - A person may, in the manner prescribed by the Protocol and regulations, make or request a search of the International Registry concerning interests registered therein.

2. - Upon receipt of a request therefor, the Registrar, in the manner prescribed by the Protocol and regulations, shall issue a registry search certificate with respect to any object:

- (a) stating all registered information relating thereto, together with a statement indicating the date and time of registration of such information; or
- (b) stating that there is no information in the International Registry relating thereto.

[Article 23

List of declared non-consensual rights or interests

The Registrar shall maintain a list of the categories of non-consensual right or interest declared by Contracting States in conformity with Article 38 and the date of each such declaration. Such list shall be recorded and searchable in the name of the declaring State and shall be made available as provided in the Protocol and regulations to any person requesting it.]

Article 24

Evidentiary value of certificates

A document in the form prescribed by the regulations which purports to be a certificate issued by the International Registry is prima facie proof:

- (a) that it has been so issued; and
- (b) of the facts recited in it, including the date and time of a registration under Article 20.

Article 25

Removal of registration

1. - When the obligations secured by a security interest [or the obligations giving rise to a registrable non-consensual right or interest] have been discharged or the conditions of transfer of title under a title reservation agreement have been fulfilled, the obligor may, by written demand delivered to the holder of such a registered interest, require the holder to remove the registration relating to the interest.

2. - Where a prospective international interest or a prospective assignment of an international interest has been registered, the intending grantor or assignor may by notice in writing, delivered to the intended grantee or assignee at any time before the latter has given value or incurred a commitment to give value, require the relevant registration to be removed.]

[CHAPTER VI 9

LIABILITIES AND IMMUNITIES OF THE INTERNATIONAL REGISTRY

Article 26

Indemnity and immunity

- 1. - Any person suffering loss by reason of any error or system malfunction in the International Registry shall be entitled to an indemnity in respect of such loss. The measure of liability shall be compensatory damages for loss incurred as the result of the act or omission.
- 2. - The courts [of the Contracting State[s] in which the Registrar or the operators of registration facilities, as the case may be, [is] [are] situated] shall have jurisdiction to resolve any disputes arising under this Article.
- 3. - Subject to paragraph 1, the International Registry, the Registrar and staff of the International Registry, the Intergovernmental Regulator and the operators of registration facilities and the staff thereof shall, in the exercise of their functions, enjoy immunity from legal process except:
 - (a) to the extent that the International Registry expressly waives such immunity; or
 - (b) as otherwise provided by agreement with a State in which the International Registry is situated.

4. - The assets, documents and archives of the International Registry shall be inviolable and immune from seizure or legal process except to the extent that the International Registry expressly waives such immunity.]

CHAPTER [VII]

EFFECTS OF AN INTERNATIONAL INTEREST AS AGAINST THIRD PARTIES

Article 27

1. - A registered interest has priority over any other interest subsequently registered and over an unregistered interest.

2. - The priority of the first-mentioned interest under the preceding paragraph applies:

(a) even if the first-mentioned interest was acquired or registered with actual knowledge of the other interest; and

(b) even as regards value given by the holder of the first-mentioned interest with such knowledge.

3. - The buyer of an object acquires its interest in it:

(a) subject to an interest registered at the time of its acquisition of that interest; and

(b) free from an unregistered interest even if it has actual knowledge of such an interest.

4. - The priority of competing interests under this Article may be varied by agreement between the holders of those interests, but an assignee of a subordinated interest is not bound by an agreement to subordinate that interest unless at the time of the assignment a subordination had been registered relating to that agreement.

5. - Any priority given by this Article to an interest in an object extends to [qualified proceeds].

[6.- For a registrable non-consensual right or interest to maintain its priority, the holder thereof must provide notice in writing, within ... days of the registration thereof, to all parties with registered interests in the same object.] 11 12

[Article 28 13

1. - An international interest is valid against the trustee in bankruptcy and creditors of the obligor if prior to the commencement of the bankruptcy 14 that interest was registered in conformity with this Convention. 15

2. - For the purposes of this Article and Article 35:

(a) "bankruptcy" includes a liquidation, administration or other insolvency proceeding involving the administration of the estate or affairs of the obligor for the benefit of the general body of the obligor's creditors;

(b) "trustee in bankruptcy" includes a liquidator, administrator or other person appointed to administer the estate or affairs of the obligor for the benefit of the general body of creditors.

3. - Nothing in this Article affects the validity of an international interest against the trustee in bankruptcy where that interest is valid against the trustee in bankruptcy under the applicable law.]

CHAPTER [VIII]

ASSIGNMENTS OF INTERNATIONAL INTERESTS AND RIGHTS OF SUBROGATION

Article 29

1. - The holder of an international interest ("the assignor") may make an assignment of it to another person ("the assignee") wholly or in part.

2. - An assignment of an international interest shall be valid only if it:

- (a) is in writing;
- (b) enables the international interest and the object to which it relates to be identified;
- (c) in the case of an assignment by way of security, enables the obligations secured by the assignment to be determined in accordance with the Protocol [but without the need to state a sum or maximum sum secured].

Article 30

1. - An assignment of an international interest in an object made in conformity with the preceding Article transfers to the assignee, to the extent agreed by the parties to the assignment:

- (a) all the interests and priorities of the assignor under this Convention; and
- (b) all associated rights.

2. - Subject to paragraph 3, an assignment made in conformity with the preceding paragraph shall take effect subject to:

- (a) all defences of which the obligor could have availed itself against the assignor;
- (b) any rights of set-off in respect of claims existing against the assignor and available to the obligor; and
- (c) any restrictions on assignment contained in the agreement.

3. - The obligor may by agreement in writing waive all or any of the defences and rights of set-off referred to in the preceding paragraph.

4. - In the case of an assignment by way of security, the assigned rights revert in the assignor, to the extent that they are still subsisting, when the security interest has been discharged.

Article 31

1. - To the extent that an international interest has been assigned in accordance with the provisions of this Chapter, the obligor in relation to that interest is bound by the assignment, and, in the case of an assignment within Article 30(1)(b), has a duty to make payment or give other performance to the assignee, if but only if:

- (a) the obligor has been given notice of the assignment in writing by or with the authority of the assignor;
- (b) the notice identifies the international interest [; and
- (c) the obligor does not have [actual] knowledge of any other person's superior right to payment or other performance].

2. - Irrespective of any other ground on which payment or performance by the obligor discharges the latter from liability, payment or performance shall be effective for this purpose if made in accordance with the preceding paragraph.

3. - Nothing in the preceding paragraph shall affect the priority of competing assignments.

Article 32

In the event of default by the assignor under the assignment of an international interest made by way of security, Articles 8, 9 and 11 to 14 apply (and, in relation to associated rights, apply in so far as they are capable of application to intangible property) as if references:

(a) to the secured obligation and the security interest were references to the obligation secured by the assignment of the international interest and the security interest created by that assignment;

(b) to the chargee and chargor were references to the assignee and assignor of the international interest;

(c) to the holder of the international interest were references to the holder of the assignment; and

(d) to the object included references to the assigned rights relating to the object.

Article 33

Where there are competing assignments of international interests and at least one of the assignments is registered, the provisions of Article 27 apply as if the references to an international interest were references to an assignment of an international interest.

Article 34

Where the assignment of an international interest has been registered, the assignee shall, in relation to the associated rights transferred by virtue of the assignment, have priority over the holder of associated rights not held with an international interest to the extent that the first-mentioned associated rights relate to:

(a) a sum advanced and utilised for the purchase of the object;

(b) the price payable for the object; or

(c) the rentals payable in respect of the object,

and the reasonable costs referred to in Article 8(5).

Article 35

1. - An assignment of an international interest is valid against the trustee in bankruptcy of the assignor if prior to the commencement of the bankruptcy that assignment was registered in conformity with this Convention.

2. - Nothing in this Article affects the validity of an assignment of an international interest against the trustee in bankruptcy where that interest is valid against the trustee in bankruptcy under the applicable law.

[Article 36]

1. - Subject to paragraph 2, nothing in this Convention affects rights or interests arising in favour of any person by operation of principles of legal subrogation under the applicable law.

2. - The priority between any interest within the preceding paragraph and a competing interest may be varied by agreement in writing between the holders of the respective interests.]

[CHAPTER [IX]

NON-CONSENSUAL RIGHTS AND INTERESTS

Article 37

A Contracting State may at any time in an instrument deposited with the depositary of the Protocol list the categories of non-consensual right or interest which shall be registrable under this Convention as regards any category of object as if the right or interest were an international interest and be regulated accordingly.

Article 38

[1.-] A non-consensual right or interest (other than a registrable non-consensual right or interest) which under the law of a Contracting State would have priority over an interest in the object equivalent to that held by the holder of the international interest (whether in or outside the insolvency of the obligor) has priority over the international interest to the extent, and only to the extent that:

- (a) such priority is specified by that State in a declaration; and 17
- (b) the non-consensual right or interest would, under the domestic law of that State, have priority over a registered interest of the same type as the international interest without any act of publication.

[2. - The non-consensual interest has priority only over an international interest registered after the declaration takes effect.] 18

[CHAPTER [X]

APPLICATION OF THE CONVENTION TO SALES

Article 39

The Protocol may provide for the application of this Convention, wholly or in part and with such modifications as may be necessary, to the sale or prospective sale of an object.]

[CHAPTER [XI]

JURISDICTION

Article 40

1. - A court of a Contracting State has jurisdiction to grant judicial relief under Article 14(1) where:

- (a) the object is within [or is physically controlled from] the territory of that State;
- (b) the defendant is situated within that territory; or
- (c) the parties have agreed to submit to the jurisdiction of that court.

2. - A court may exercise jurisdiction under the preceding paragraph even if the trial of the claim referred to in Article 14(1) will or may take place in a court of another State or in an arbitral tribunal.

[Article 41

A court of a Contracting State to which Article 40(1) applies has jurisdiction in all proceedings relating to this Convention, but no court may make orders or give judgments or rulings against or purporting to bind the International Registry.]]

[CHAPTER [XII]

RELATIONSHIP WITH OTHER CONVENTIONS] 20 21

CHAPTER [XIII]

[OTHER] FINAL PROVISIONS

Article U

1. - This Convention enters into force on the first day of the month following the expiration of six months after the date of deposit of the ...

instrument of ratification, acceptance, approval or accession but only applies as regards any category of object listed in Article 3 23:

- (a) as from the time of entry into force of the Protocol;
- (b) subject to the terms of that Protocol; and
- (c) as between Contracting States Parties to that Protocol.

2. - This Convention and the Protocol shall be read and interpreted as a single instrument.

Article V

A Contracting State may declare at the time of signature, ratification, acceptance, approval of, or accession to the Protocol that it will not apply this Convention in relation to [a purely domestic transaction]. 24 Such a declaration shall be respected by the courts of all other Contracting States.

Article W

[Insert provision for accelerated procedure to finalise further Protocols]

[Article X

A Contracting State shall declare at the time of ratification, acceptance, approval of, or accession to the Protocol the relevant "court" or "courts" for the purposes of Article 1 of this Convention.]

Article Y

1. - A Contracting State may declare at the time of signature, ratification, acceptance, approval of, or accession to the Protocol that while the charged

object is situated within, or controlled from its territory the chargee shall not grant a lease of the object in that territory.

2. - A Contracting State may declare at the time of signature, ratification, acceptance, approval of, or accession to the Protocol that any remedy available to the obligee under Articles 8 to 10 which is not there expressed to require application to the court may only be exercised with leave of the court.

Article Z

A Contracting State may declare at the time of signature, ratification, acceptance, approval of, or accession to the Protocol that it will not apply the provisions of Article 14, wholly or in part.

[Remaining Final Provisions to be prepared by the Diplomatic Conference]

1 Consideration should be given to an optional provision for compensation in respect of such governmental acts to be paid before they are performed in order to reduce political risk.

2 The question remains to be considered whether the words "at any time" need to be added.

3 It was proposed that the comment by a delegation seeking to ensure that Article 14(1)(c) should not run counter to any other international instrument on the subject should be dealt with at the appropriate time in the Final Provisions.

4 The provisions of this Chapter are presented in square brackets in that they were not the subject of consideration by the Drafting Committee pending the outcome of their consideration by the Registration Working

Group. It should be noted that the Registration Working Group has proposed considerable amendments to the provisions of this Chapter.

5 The present text assumes that the Intergovernmental Regulator and the operators of the International Registry will be different bodies. However, as indicated in the preliminary draft Protocol on Matters specific to Aircraft Equipment, an alternative to be considered is an unitary International Registry Authority which would act as both operator and regulator (cf. Article XVI(1) of that text which provides as follows:

ALTERNATIVE A

[1. - [The International Registry shall be regulated and operated by the International Registry Authority.] [The International Registry shall be regulated by the International Regulator and operated by the Registrar.]] .

6 It was noted by the Aircraft Protocol Group that Article 16(3) is an example of the type of provision which was envisaged as being within Article U(b) and which may therefore find itself modified by the terms of a Protocol.

7 The provisions of this Chapter are presented in square brackets in that, with the exception of Article 20(1) and (2), they were not the subject of consideration by the Drafting Committee pending the outcome of their consideration by the Registration Working Group. It should be noted that the Registration Working Group has proposed considerable amendments to the provisions of this Chapter.

8 Consideration should be given to whether the written consent of obligors under leasing and title reservation agreements should also be required for the registration of international interests.

9 The provisions of this Chapter are presented in square brackets in that they were not the subject of consideration by the Drafting Committee pending the outcome of their consideration by the Registration Working Group. It should be noted that the Registration Working Group has proposed considerable amendments to the provisions of this Chapter.

10 It was proposed by the Committee that the question of registration by the trustee in bankruptcy of the date of commencement of the bankruptcy raised by one delegation be considered in the context of the general review of the insolvency-related provisions of the two instruments. The Committee did not believe itself to be in a position to deal with the question of non-consensual rights and interests, in the absence of adequate instructions from the Joint Session.

11 The question was left open as to whether the more appropriate place for this provision would be Article 27(6) or Article 37.

12 It is for consideration whether the Registrar should be required to provide the notice referred to in this paragraph.

13 This Article will be revised in the light of a general review of the insolvency provisions of the preliminary draft Aircraft Protocol and consideration of the transfer of some or all of those provisions to the preliminary draft Convention itself. The Committee moreover proposed that, on the occasion of the general review of the insolvency-related provisions, the definition of "bankruptcy" be extended to cover reorganisation and that consideration possibly be given to the definitions appearing in the Uncitral Model Law on Cross-Border Insolvency.

14 Consideration should be given to the ability of an obligee to determine the commencement of bankruptcy proceedings.

15 This paragraph is intended to state the substantive rights of the holder of the international interest but not to displace special rules of bankruptcy law restricting the exercise of remedies or avoiding unfair preferences.

16 A question to be considered is whether these provisions should be left to the Protocol, which might in turn refer to the applicable law.

17 This sub-paragraph will need to be reviewed in the context of the Final Provisions, so as to state that such a declaration could be made at any time.

18 This paragraph will need to be reviewed in the context of the Final Provisions.

19 Article 40 will be amended in order to make it clear that it is intended to operate independently of Article 14(1). This Article and Article 41 will be comprehensively reviewed in the light of advice from the Hague Conference on Private International Law and the remarks made by some delegations.

20 It is thought that the only existing Conventions needing to be dealt with in Chapter XII are the UNIDROIT Convention on International Financial Leasing and, possibly, the UNIDROIT Convention on International Factoring. It is thought that relations between this Convention and other equipment-specific Conventions should be left to each Protocol.

21 This Chapter was not reviewed by the Drafting Committee in line with the decision taken by the Joint Session not to consider this Chapter at this stage.

22 *Idem*.

23 Note by the Secretariat:

This reference to the former Article 3 will need to be reviewed in the light of the decision to delete that Article at the first Joint Session.

24 To be defined by taking account of the location of the object and the parties.

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

**AS REVIEWED BY THE DRAFTING COMMITTEE DURING THE
FIRST JOINT SESSION OF THE UNIDROIT COMMITTEE OF
GOVERNMENTAL EXPERTS FOR THE PREPARATION OF A DRAFT
CONVENTION ON INTERNATIONAL INTERESTS IN MOBILE
EQUIPMENT AND A DRAFT PROTOCOL THERETO ON MATTERS
SPECIFIC TO AIRCRAFT EQUIPMENT AND THE SUB-COMMITTEE
OF THE ICAO LEGAL COMMITTEE ON THE STUDY OF
INTERNATIONAL INTERESTS IN MOBILE EQUIPMENT (AIRCRAFT
EQUIPMENT) © (Unidroit 1999)**

(Rome, 1 - 12 February 1999)

**PRELIMINARY DRAFT PROTOCOL TO THE PRELIMINARY DRAFT
UNIDROIT CONVENTION ON INTERNATIONAL INTERESTS IN
MOBILE EQUIPMENT ON MATTERS SPECIFIC TO AIRCRAFT
EQUIPMENT © (Unidroit 1999)**

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

PREAMBLE

THE CONTRACTING STATES TO THIS PROTOCOL,

MINDFUL of the demand for, and utility of aircraft equipment and the need to finance the acquisition and use thereof as efficiently as possible,

RECOGNISING the advantages of asset-based financing and leasing for this purpose and desiring to facilitate these transactions by establishing clear rules to govern them,

BELIEVING that such rules must (i) reflect the principles underlying asset-based financing and leasing of aircraft objects and (ii) provide transaction parties with autonomy to allocate risks and benefits to the extent consistent with the policy decisions made by Contracting States in this Protocol,

CONSCIOUS of the need for an international registration system as an essential feature of the legal framework applicable to international interests in aircraft equipment,

CONSIDERING it necessary to implement the UNIDROIT Convention on International Interests in Mobile Equipment so as to meet the requirements of aircraft finance and the purposes described above,

HAVE AGREED upon the following provisions relating to aircraft equipment:

CHAPTER I

SPHERE OF APPLICATION AND GENERAL PROVISIONS

Article I Defined terms

1. - Terms used in this Protocol and defined in Article I of the Convention are employed herein with the meanings there stated.

2. - In this Protocol the following terms are employed with the meanings set out below:

"aircraft" means airframes with aircraft engines installed thereon or helicopters;

"aircraft engines" means aircraft engines [(other than those used in military, customs or police services)] powered by jet propulsion or turbine or piston technology and:

(a) in the case of jet propulsion aircraft engines, have at least 1750 lbs of thrust or its equivalent; and

(b) in the case of turbine-powered or piston-powered aircraft engines, have at least 550 rated take-off shaft horsepower or its equivalent,

together with all modules and other installed, incorporated or attached accessories, parts and equipment and all data, manuals and records relating thereto;

"aircraft objects" means airframes, aircraft engines and helicopters;

"airframes" means airframes [(other than those used in military, customs and police services)] that, when appropriate aircraft engines are installed thereon, are type certified by the competent aviation authority to transport:

(a) at least eight (8) persons including crew; or

(b) goods in excess of 2750 kilograms,

together with all installed, incorporated or attached accessories, parts and equipment (other than aircraft engines), and all data, manuals and records relating thereto;

"authorised party" means the party referred to in Article XIII(2);

"Chicago Convention" means the Convention on International Civil Aviation, signed at Chicago on 7 December 1944, as amended;

"common mark registering authority" means the authority maintaining the non-national register in which an aircraft of an international operating

agency is registered in accordance with Article 77 of the Chicago Convention;

"de-register the aircraft" means delete the registration of an aircraft from a national aircraft register;

"Geneva Convention" means the Convention on the International Recognition of Rights in Aircraft, signed at Geneva on 19 June 1948;

"guarantee contract" means a contract entered into by a person as guarantor;

"guarantor" means a person who, for the purpose of assuring performance of any obligations in favour of an obligee secured by a security agreement or under an agreement, gives or issues a suretyship or demand guarantee or a standby letter of credit or any other form of credit insurance;

"helicopters" means heavier-than-air machines [(other than those used in military, customs or police services)] supported in flight chiefly by the reactions of the air on one or more power-driven rotors on substantially vertical axes and which are type certified by the competent aviation authority to transport:

(a) at least five (5) persons including crew; or

(b) goods in excess of 450 kilograms,

together with all installed, incorporated or attached accessories, parts and equipment (including rotors), and all data, manuals and records relating thereto;

"insolvency date" means the date referred to in Article XI(1);

["International Registry Authority" means the permanent international body designated as the International Registry Authority under this Protocol;]

["International Regulator" means [the permanent international body designated as the International Regulator under this Protocol] [the entity designated as the International Regulator in Article XVI(1)];]

"national aircraft register" means the national register in which an aircraft is registered pursuant to the Chicago Convention;

"national registry authority" means the national authority, or the common mark registering authority in a Contracting State which is the State of registry responsible for the registration and de-registration of an aircraft in accordance with the Chicago Convention;

"primary insolvency jurisdiction" means the insolvency jurisdiction of the State in which the centre of the obligor's main interests is situated;

"prospective sale" means a sale that is intended to take effect on the conclusion of a contract of sale in the future;

["Registrar" means [the entity designated as the Registrar under this Protocol] [the entity initially designated or subsequently appointed or re-appointed as the Registrar, as the case may be, as specified in Article XVI];] and

"State of registry" means in respect of an aircraft the State, or a State member of a common mark registering authority, on whose national aircraft register an aircraft is entered under the Chicago Convention.

Article II

Implementation of Convention as regards aircraft objects

1. - The Convention shall apply in relation to aircraft objects as implemented by the terms of this Protocol.

2. - The Convention and this Protocol shall be read and interpreted together as one single instrument and shall be known as the UNIDROIT Convention on International Interests in Mobile Equipment as applied to aircraft objects.

Article III 2

Sphere of application

1. - The connection with a Contracting State under Article 3(b) of the Convention is satisfied with respect to this Protocol if an [aircraft object] is registered in a national aircraft register of a Contracting State [or if the agreement provides that the aircraft object shall be registered, and the aircraft object becomes so registered, in a Contracting State].

[2. - Notwithstanding the provisions of Article V of the Convention, this Protocol shall apply to [a purely domestic transaction].]

[3.] - In their relations with each other, the parties may not derogate from or vary the provisions of this Protocol, except, by agreement in writing, Articles IX(1), X or XI(1) - (6).

Article IV

Application of Convention to sales

The following provisions of the Convention apply *mutatis mutandis* in relation to a sale and a prospective sale as they apply in relation to an international interest and a prospective international interest:

Article 15(1) other than sub-paragraph (c);

Articles 17 - 19;

Article 22;

Articles 24 and 26;

Chapter VII; and

Article 38.

Article V

Formalities and effects of contract of sale

1. - For the purposes of this Protocol, a contract of sale is one which:

- (a) is in writing;
- (b) relates to an aircraft object of which the transferor has power to dispose; and
- (c) identifies the aircraft object.

2. - A contract of sale transfers the interest of the transferor in the aircraft object to the transferee according to its terms.

3. - A sale may be registered by either party to the contract of sale in the International Registry by or with the consent in writing of the other party.

Article VI

Representative capacities

A party to an agreement or a contract of sale may enter into an agreement, or register a related interest in an aircraft object in an agency, trust or other representative capacity. In such case, that party is entitled to assert rights and interests under the Convention to the exclusion of the party or parties represented.

Article VII

Description of aircraft objects

A description of an aircraft object that contains its manufacturer's serial number, the name of the manufacturer and its model designation is sufficient to identify the object for the purposes of Article 7(c) of the Convention and Article V(1)(c) of this Protocol.

Article VIII

Choice of law

1. - The parties to an agreement or a contract of sale or a related guarantee contract or subordination agreement may agree on the law which is to govern their rights and obligations under the Convention, wholly or in part.

2. - Unless otherwise agreed, the reference in the preceding paragraph to the law chosen by the parties is to the rules of law in force in the designated State or political subdivision of a State other than its rules of private international law.

CHAPTER II

DEFAULT REMEDIES, PRIORITIES AND ASSIGNMENTS

Article IX

Modification of default remedies provisions

1. - In addition to the remedies specified in the provisions of Articles 8(1), 10 and 14(1) of the Convention, the obligee may, to the extent that the obligor has at any time so agreed and in the circumstances specified in such provisions:

- (a) de-register the aircraft; and
- (b) export and physically transfer the aircraft object from the territory in which it is situated.

2. - The obligee may not exercise the remedies specified in the preceding paragraph without the prior consent in writing of the holder of any registered interest ranking in priority to that of the obligee. 3

3. - (a) Article 8(2) of the Convention shall not apply to aircraft objects.

(b) A new Article 13bis shall be inserted after Article 13 of the Convention, to read as follows:

"1. - Any remedy given by this Convention shall be exercised in a commercially reasonable manner.

2. - An agreement between an obligor and an obligee as to what is commercially reasonable shall, subject to paragraph 3, be conclusive.

3. - An obligee may not take possession or control of an aircraft object otherwise than by lawful means. For these purposes, the removal of the aircraft object from service shall not in itself be deemed unlawful."

4. - A chargee giving ten or more working days' prior written notice of a proposed sale or lease to interested persons is deemed to satisfy the requirement of providing "reasonable prior notice" specified in Article 8(3) of the Convention. The foregoing shall not prevent a chargee and a chargor or a guarantor from agreeing to a longer prior notice period.

Article X

Definition of speedy judicial relief

[1. -- For the purposes of Article 14(1) of the Convention, "speedy" in the context of obtaining judicial relief means a period not exceeding [...] calendar days from the date on which the instrument initiating the proceedings is lodged with the court or its administrative office.]

[2.- The obligor may at any time agree that Article 14(2) of the Convention shall not apply.]

[3.- The remedies specified in Article IX(1) shall be made available by the national registry authority and other administrative authorities, as applicable, in a Contracting State no later than [...] working days after the judicial relief specified in the preceding paragraph is authorised or, in the case of judicial relief authorised by a foreign court, approved by courts of that Contracting State.

[4.] - Judicial relief under Article 14(1) of the Convention may be granted in a Contracting State notwithstanding the commencement of insolvency proceedings 4 in another [Contracting] State unless its application would contravene an international instrument binding on that Contracting State.

Article XI

Remedies on insolvency

[Alternative A]

1. - For the purposes of this Article, "insolvency date" means the earliest date on which one of the events specified in paragraph 2 shall have occurred.

2. - This Article applies where:

(a) any insolvency proceedings⁵ against the obligor have been commenced by the obligor or another person in a Contracting State which is the primary insolvency jurisdiction of the obligor; or

(b) the obligor is located in a Contracting State and has declared its intention to suspend, or has actually suspended payment to creditors generally.

3. - Within a period not exceeding [. . .] 6 days from the insolvency date the obligor shall:

(a) cure all defaults and agree to perform all future obligations under the agreement and related transaction documents; or

(b) give possession of the aircraft object to the obligee [in accordance with, and in the condition specified in the agreement and related transaction documents].

4. - Where possession has been given to the obligee pursuant to the preceding paragraph, the remedies specified in Article IX(1) shall be made available by the national registry authority and other administrative

authorities, as applicable, no later than [. . .]7 working days after the date on which the aircraft object is returned.

5. - No exercise of remedies permitted by the Convention may be prevented or delayed after the period specified in paragraph 3.

6. - No obligations of the obligor under the agreement and related transactions may be modified [in the insolvency proceedings] without the consent of the obligee.

7. - No rights or interests, except for preferred non-consensual rights or interests listed in an instrument deposited under Article 38 of the Convention, shall have priority in the insolvency over registered interests.

[Alternative B] 8
Article XII
Insolvency assistance

The courts of a Contracting State in which an aircraft object is situated shall, in accordance with the law of the Contracting State, co-operate to the maximum extent possible with foreign courts or other foreign authorities administering the insolvency proceedings referred to in Article XI in carrying out the provisions of that Article.

Article XIII
De-registration and export authorisation

1. - Where the obligor has issued an irrevocable de-registration and export request authorisation substantially in the form annexed to this Protocol and has submitted such authorisation for recordation to the national registry authority, that authorisation shall be so recorded.

2. - The person in whose favour the authorisation has been issued (the "authorised party") or its certified designee shall be the sole person entitled

to exercise the remedies specified in Article IX(1) and may do so only in accordance with the authorisation and any applicable airworthiness or safety laws or regulations. Such authorisation may not be revoked by the obligor without the consent in writing of the authorised party. The national registry authority shall remove an authorisation from the registry at the request of the authorised party.

3. - The national registry authority and other administrative authorities in Contracting States shall expeditiously co-operate with and assist the authorised party in the exercise of the remedies specified in Article IX.

Article XIV
Modification of priority provisions

Article 27 of the Convention applies with the omission of paragraph 4.

Article XV
Modification of assignment provisions

1. - Article 29(2) of the Convention applies with the following being added immediately after sub-paragraph (c):

"(d) is consented to in writing by the obligor, whether or not the consent is given in advance of the assignment or specifically identifies the assignee."

[2. - Article 31(1) of the Convention applies with the omission of sub-paragraph (c).]

[3. - Article 34 of the Convention applies with the omission of the words following the phrase "not held with an international interest".]9

[CHAPTER III

REGISTRY PROVISIONS RELATING TO INTERNATIONAL INTERESTS IN AIRCRAFT OBJECTS

Article XVI Regulation and operation of Registry

Alternative A

[1. - [The International Registry shall be regulated and operated by the International Registry Authority.] [The International Registry shall be regulated by the International Regulator 11 and operated by the Registrar.]]
12

Alternative B

[1. - The International Registry shall be regulated by the Council of the International Civil Aviation Organization or such other permanent body designated by it to be the International Regulator.

2. - The initial Registrar hereby designated to operate the International Registry shall be a newly created, independent special purpose affiliate of the International Air Transport Association.

3. - The initial Registrar shall be organised in consultation with the International Regulator. Its constitutive documents shall contain provisions that:

- (a) restrict it to acting as Registrar and performing ancillary functions; and
- (b) ensure that it has no greater duties (fiduciary or otherwise) to members of the International Air Transport Association than to any person or entity in the performance of its functions as Registrar.

4. - The initial Registrar shall operate the International Registry for a period of five years from the date of entry into force of this Protocol. Thereafter, the Registrar shall be appointed or re-appointed at regular five-year intervals by the [Contracting States] [International Regulator].]

[2./5. - Article 16(1) and (3) of the Convention apply as modified by the preceding paragraphs of this Article.]

Article XVII Basic regulatory responsibilities

1. - The [International Registry Authority] [International Regulator] shall act in a non-adjudicative capacity. This shall not prevent the [International Registry Authority] [International Regulator] from undertaking the functions specified in Article 16(6) and (7) of the Convention.

2. - The [International Registry Authority] [International Regulator] shall [be responsible to the Contracting States and shall report thereto on its regulatory [and oversight] functions. Such reports shall be made on a yearly basis or more frequently as the [International Registry Authority] [International Regulator] deems appropriate.]

[3. - The initial regulations shall be promulgated by the [International Registry Authority] [International Regulator] on entry into force of this Protocol.]

Article XVIII Registration facilities

1. - At the time of ratification, acceptance, approval of, or accession to this Protocol, a Contracting State may, subject to paragraph 2:

- (a) designate its operators of registration facilities as specified in Article 16(2) of the Convention; and

(b) declare the extent to which any such designation shall preclude alternative access to the International Registry.

2. - A Contracting State may only designate registration facilities as points of access to the International Registry in relation to:

(a) helicopters or airframes pertaining to aircraft for which it is the State of registry; and

(b) registrable non-consensual rights or interests created under its domestic law.

Article XIX

Additional modifications to Registry provisions

1. - For the purposes of Article 19(6) of the Convention, the search criterion for an aircraft object shall be its manufacturer's serial number, supplemented as necessary to ensure uniqueness. Such supplementary information shall be specified in the regulations.

2. - For the purposes of Article 25(2) of the Convention and in the circumstances there described, the holder of a registered prospective international interest or a registered prospective assignment of an international interest shall take such steps as are within its power to effect a removal thereof no later than five working days after the receipt of the demand described in such paragraph.

3. - The fees referred to in Article 16(4) of the Convention shall be determined so as to recover the reasonable costs of operating the International Registry and the registration facilities and, in the case of the initial fees, of designing and implementing the international registration system.

4. - The centralised functions of the International Registry shall be operated and administered by the [International Registry Authority] [Registrar] on a

twenty-four hour basis. The various registration facilities shall be operated and administered during working hours in their respective territories.

5. - The regulations shall prescribe the manner in which the following provisions of the Convention shall apply:

Article 16(6) and (7);
Article 17;
Article 18;
Article 21;
Article 22(1) and (2);
Article 23; and
Article 24.]

CHAPTER IV

JURISDICTION

Article XX

Modification of jurisdiction provisions

For the purposes of Articles 40 and 41 of the Convention, a court of a Contracting State also has jurisdiction where that State is the State of registry.

Article XXI

Waivers of sovereign immunity

1. - Subject to paragraph 2, a waiver of sovereign immunity from jurisdiction of the courts specified in Article 41 of the Convention or relating to enforcement of rights and interests relating to an aircraft object under the Convention shall be binding and, if the other conditions to such

jurisdiction or enforcement have been satisfied, shall be effective to confer jurisdiction and permit enforcement, as the case may be.

2. - A waiver under the preceding paragraph must be in a[n authenticated] writing that contains a description of the aircraft.

CHAPTER V

RELATIONSHIP WITH OTHER CONVENTIONS

Article XXII

Relationship with 1948 Convention on the International Recognition of Rights in Aircraft

1. - Where a Contracting State is a party to the Geneva Convention:

(a) the reference to the "law" of such Contracting State for the purposes of Article I (1)(d)(i) of the Geneva Convention should be to such law after giving effect to the Convention;

(b) for the purposes of the Geneva Convention, the term "aircraft" as defined in Article XVI of that Convention shall be deleted and replaced by the terms "airframes," "aircraft engines" and "helicopters" as defined in this Protocol; and

(c) registrations in the International Registry shall be deemed to be regular recordations "in a public record of the Contracting State" for the purposes of Article I (1)(ii) of the Geneva Convention.

2. - Subject to paragraph 3, the Convention shall, for the Contracting States referred to in the preceding paragraph, supersede the Geneva Convention to the extent, after giving effect to the preceding paragraph, of inconsistency between the two Conventions.

3. - The provisions of the preceding paragraph shall not apply to Articles VII and VIII of the Geneva Convention where an obligee elects to exercise

remedies against an obligor in accordance with those Articles [and provides the court with written evidence of that election].

Article XXIII

Relationship with 1933 Convention for the Unification of Certain Rules Relating to the Precautionary Arrest of Aircraft

The Convention shall, for Contracting States that do not make a declaration under Article Y(2) of the Convention, supersede the 1933 Convention for the Unification of Certain Rules Relating to the Precautionary Arrest of Aircraft.

Article XXIV

Relationship with 1988 UNIDROIT Convention on International Financial Leasing

The Convention shall supersede the 1988 UNIDROIT Convention on International Financial Leasing as it relates to aircraft objects.

CHAPTER VI

[OTHER] FINAL PROVISIONS 14

ADDENDUM

CHAPTER VI

[OTHER] FINAL PROVISIONS

Article XXV

Adoption of Protocol

1. - This Protocol is open for signature at the concluding meeting of the Diplomatic Conference for the Adoption of the Draft Protocol to the UNIDROIT Convention on International Interests in Mobile Equipment on Matters specific to Aircraft Equipment and will remain open for signature by all Contracting States at [...] until [...].
2. - This Protocol is subject to ratification, acceptance or approval of Contracting States which have signed it.
3. - This Protocol is open for accession by all States which are not signatory Contracting States as from the date it is open for signature.
4. - Ratification, acceptance, approval or accession is effected by the deposit of a formal instrument to that effect with the depositary.

Article XXVI Entry into force

1. - This Protocol enters into force on the first day of the month following the expiration of [three] months after the date of deposit of the [third] instrument of ratification, acceptance, approval or accession.
2. - For each Contracting State that ratifies, accepts, approves or accedes to this Protocol after the deposit of the [third] instrument of ratification, acceptance, approval or accession, this Protocol enters into force in respect of that Contracting State on the first day of the month following the expiration of [three] months after the date of the deposit of its instrument of ratification, acceptance, approval or accession.

Article XXVII Territorial units

1. - If a Contracting State has two or more territorial units in which different systems of law are applicable in relation to the matters dealt with in this Protocol, it may, at the time of ratification, acceptance, approval or accession, declare that this Protocol is to extend to all its territorial units or only to one or more of them and may substitute its declaration by another declaration at any time.

2. - These declarations are to be notified to the depositary and are to state expressly the territorial units to which this Protocol extends.

3. - If a Contracting State makes no declaration under paragraph 1, this Protocol is to extend to all territorial units of that Contracting State.

Article XXVIII Temporal application

This Protocol applies in a Contracting State to rights and interests in aircraft objects created or arising on or after the date on which this Protocol enters into force in that Contracting State.

Article XXIX Declarations and reservations

No declarations or reservations are permitted except those expressly authorised in this Protocol.

Article XXX Declarations disapplying certain provisions

A Contracting State, at the time of ratification, acceptance, approval of, or accession to this Protocol[([.])]:

(a)] may declare that it will not apply any one or more of the provisions of Articles VIII and X to XIII of this Protocol[;

(b) to the extent that it has not made a declaration under sub-paragraph (a), must declare that it will apply time-periods as specified in its declaration for the purposes of Articles X and XII; and

(c) may declare that it will impose other conditions on the application of Articles VIII [, IX(1)] and X to XII as specified in its declaration].

Article XXXI

Subsequent declarations

1. - A Contracting State may make a subsequent declaration at any time after the date on which it enters into force for that Contracting State, by the deposit of an instrument to that effect with the depositary.

2. - Any such subsequent declaration shall take effect on the first day of the month following the expiration of [twelve] months after the date of deposit of the instrument in which such declaration is made with the depositary. Where a longer period for that declaration to take effect is specified in the instrument in which such declaration is made, it shall take effect upon the expiration of such longer period after its deposit with the depositary.

3. - Notwithstanding the previous paragraphs, this Protocol shall continue to apply, as if no such subsequent declaration had been made, in respect of all rights and interests arising prior to the effective date of that subsequent declaration.

Article XXXII

Withdrawal of declarations and reservations

Any Contracting State which makes a declaration under, or a reservation to this Protocol may withdraw it at any time by a formal notification in writing addressed to the depositary. Such withdrawal is to take effect on the first

day of the month following the expiration of [three] months after the date of the receipt of the notification by the depositary.

Article XXXIII

Denunciations

1. - This Protocol may be denounced by any Contracting State at any time after the date on which it enters into force for that Contracting State, by the deposit of an instrument to that effect with the depositary.

2. - Any such denunciation shall take effect on the first day of the month following the expiration of [twelve] months after the date of deposit of the instrument of denunciation with the depositary. Where a longer period for that denunciation to take effect is specified in the instrument of denunciation, it shall take effect upon the expiration of such longer period after its deposit with the depositary.

3. - Notwithstanding the previous paragraphs, this Protocol shall continue to apply, as if no such denunciation had been made, in respect of all rights and interests arising prior to the effective date of that denunciation.

Article XXXIV

Establishment and responsibilities of Review Board

1. - A five-member Review Board shall promptly be appointed to prepare yearly reports for the Contracting States addressing the matters specified in sub-paragraphs (a)-(d) of paragraph 2. [The composition, organisation and administration of the Review Board shall be determined, in consultation with other aviation interests, jointly by the International Institute for the Unification of Private Law and the International Civil Aviation Organization.]

2. - At the request of not less than twenty-five per cent of the Contracting States, conferences of the Contracting States shall be convened from time to time to consider:

(a) the practical operation of this Protocol and its effectiveness in facilitating the asset-based financing and leasing of aircraft objects;

(b) the judicial interpretation given to the terms of the Convention, this Protocol and the regulations;

(c) the functioning of the international registration system and the performance of the [International Registry Authority] [Registrar and its oversight by the Intergovernmental Regulator]; and

(d) whether any modifications to this Protocol or the arrangements relating to the International Registry are desirable.

Article XXXV

Depositary arrangements

1. - This Protocol shall be deposited with the [....].

2. - The [....] shall:

(a) inform all Contracting States which have signed or acceded to this Protocol and [....] of:

(i) each new signature or deposit of an instrument of ratification, acceptance, approval or accession, together with the date thereof;

(ii) each declaration made in accordance with this Protocol;

(iii) the withdrawal of any declaration;

(iv) the date of entry into force of this Protocol; and

(v) the deposit of an instrument of denunciation of this Protocol together with the date of its deposit and the date on which it takes effect;

(b) transmit certified true copies of this Protocol to all signatory Contracting States, to all Contracting States acceding to the Protocol and to [....];

(c) provide the [International Registry Authority] [Registrar] with the contents of each instrument of ratification, acceptance, approval or accession so that the information contained therein may be made publicly accessible; and

(d) perform such other functions customary for depositaries.

appendix

FORM OF IRREVOCABLE DE-REGISTRATION AND EXPORT REQUEST AUTHORISATION

[Insert Date]

To: [Insert Name of National Registry Authority]

Re: Irrevocable De-Registration and Export Request Authorisation

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

This instrument is an irrevocable de-registration and export request authorisation issued by the undersigned in favour of [insert name of obligee] ("the authorised party") under the authority of Article XIII of the Protocol to the UNIDROIT Convention on International Interests in Mobile Equipment on Matters specific to Aircraft Equipment. In accordance with that Article, the undersigned hereby requests:

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

(a) obtain de-registration of the aircraft from the [insert name of national aviation registry] maintained by the [insert name of aviation authority] for the purposes of Chapter III of the Chicago Convention of 1944 on International Civil Aviation; and

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

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

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

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

[insert name of operator/owner]

By: [insert name of signatory]
Its: [insert title of signatory]

Agreed to and lodged this [insert date]

[insert relevant notational details]

1 Consider the position of propellers.

2 Add a paragraph inserting as a connecting factor the situation of the transferor under a contract of sale.

3 Further consideration is to be given to the situation of holders of other interests that are protected under Article IX of the Geneva Convention.

4 The phrase "insolvency proceedings" should be defined and brought into line with the terminology of the Convention.

5 A Contracting State may find it appropriate or necessary to adjust its relevant domestic laws or regulations in order to give full effect to this Article and Article XII.

6 See Article XXX.

7 See Article XXX.

8 It was suggested that an alternative, more flexible formulation of the remedies on insolvency should be prepared. A proposed text does not yet exist, however.

9 Article 34 of the preliminary draft Convention, as may be modified by this preliminary draft Protocol, will have important implications for the competing rights of a receivables financier and an asset-based financier. Consideration should be given to the appropriate rule in the context of aviation financing as well as to its effects on general receivables financing.

10 The provisions of this Chapter are presented in square brackets in that they were not the subject of consideration by the Drafting Committee pending the outcome of their consideration by the Registration Working Group.

11 Further consideration needs to be given as to whether the appropriate term is International Regulator or Intergovernmental Regulator.

12 The two bracketed provisions in this Alternative A are mutually exclusive, so that if the decision is to have an International Registry Authority references in other Articles to the International Regulator and the Registrar will be deleted, whilst if the latter are adopted references to the International Registry Authority will be deleted.

13 With the exception of Article XXX, the meeting of governmental experts did not discuss Chapters V and VI, leaving consideration of those Chapters to a time nearer to a diplomatic Conference.

14 It is envisaged that, in line with practice, draft Final Provisions will be prepared for the Diplomatic Conference at such time as governmental experts have completed their preparation of the draft Protocol. The proposals for draft Final Provisions set out in the Addendum to this preliminary draft Protocol below are in no way intended to prejudge that process but simply to indicate the suggestions of the Aircraft Protocol Group on this matter. Particular attention is drawn to Articles XXXI(3) and XXXIII(3) (limiting the effect of any future declaration or reservation and denunciation respectively as regards established rights) and Article XXXIV (establishing a Review Board and contemplating review and revision of this Protocol). The proposals for draft Final Provisions set out in the Addendum to this preliminary draft Protocol below are in no way intended to prejudge that process but simply to indicate the suggestions of the Aircraft Protocol Group on this matter. Particular attention is drawn to Articles XXXI(3) and XXXIII(3) (limiting the effect of any future declaration or reservation and denunciation respectively as regards established rights) and Article XXXIV (establishing a Review Board and contemplating review and revision of this Protocol).

15 It is recommended that a resolution be adopted at, and contained in the Final Acts and Proceedings of, the Diplomatic Conference, contemplating

the use by Contracting States of a model ratification instrument that would standardise, inter alia, the format for the making and/or withdrawal of declarations and reservations.

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

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