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“Hot Issues” in the Development of the (Draft) Convention on International Interests in Mobile Equipment and the (Draft) Aircraft Equipment Protocol

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I. Background

The project to develop a convention providing for an international regime of law to regulate interests in high value mobile equipment of a kind that is ordinarily used in more than one jurisdiction or that, for some other reason, is not subject to a single national law originated in a proposal¹ presented in 1988 to the UNIDROIT² Governing Council by the Canadian member of the Council. Following the preparation of a background report³ and a follow-up questionnaire sent to equipment suppliers, equipment buyers, equipment financiers, and government agencies in several countries, working groups and a study group were established to develop a draft convention dealing with international creation.

Thereafter, three UNIDROIT-ICAO⁴ co-sponsored meetings of governmental experts and members of an ICAO Legal Subcommittee were held in 1999 and 2000, where the

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1. The author of this paper was the originator of the proposal for the draft Convention and, from the inception of work on it, has acted as a member of the Study Group, a member of the Canadian Delegation to the three joint UNIDROIT-ICAO sessions of governmental experts and members of an ICAO Legal Subcommittee, chairperson of the Registration Working Group established at the first joint sessions, a member of the Canadian Delegation to the meeting of the ICAO Legal Committee on the proposed Convention and Aircraft Protocol, and a member of the Registry Task Force established at the second joint session.

2. International Institute for the Unification of Private Law, Rome, Italy.

3. See UNIDROIT 1989 Study: LXXII—Doc. 1, *International Regulation of Aspects of Security Interests in Mobile Equipment: Study* (Cuming report), reprinted in Ronald C.C. Cuming, *International Regulation of Aspects of Security Interests in Mobile Equipment*, UNIF. L. REV. 63 (1990).

4. International Civil Aviation Organization, Montreal, Canada.

proposals of the Study Group were refined.⁵ Further refinement occurred at the recent meeting of the ICAO Legal Committee that was attended by many of the same delegates who attended the joint sessions.⁶ The expectations are that a diplomatic conference will be held in 2001.⁷

While it was assumed from the beginning that the draft Convention would apply to interests in different types of mobile equipment, it was recognized early on that the Convention would play a central role in international secured financing and leasing of commercial aircraft. Consequently, an Aviation Working Group was formed by representatives from a wide range of organizations involved in the sale, financing, and use of commercial aircraft with a mandate to work with the Study Group in the preparation of the draft Convention. Later, the ICAO became involved through a subcommittee of the ICAO Legal Committee.⁸

Midway through the process of preparing the draft Convention, the Study Group reached the conclusion that it would be unrealistic to attempt to create a legal regime and a registry system that applied uniformly to all types of mobile equipment that might fall within its scope. At the same time, the Aviation Working Group made it clear to the Study Group

5. See UNIDROIT Committee on 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/Subcommittee of the ICAO Legal Committee on the study of international interests in mobile equipment (aircraft equipment). First Joint Session (Rome, 1–12 Feb. 1999), UNIDROIT CGE/Int. Int./Report ICAO Ref. LSC/ME-Report; Second Joint Session (Montreal, 24 Aug.–3 Sept. 1999), UNIDROIT CGE/Int. Int./2-Report ICAO Ref. LSC/ME/2-Report; Third Joint Session (Rome, 20–31 Mar. 2000), UNIDROIT CGE/Int. Int./3-Report ICAO Ref. LSC/ME/3-Report [hereinafter Report of the Third Session].

6. The report of the proceedings of the ICAO Legal Committee meeting held in Montreal, Canada, during the period August 28 to September 8, 2000, was not available at the time this paper was prepared. However, the author was a member of the Canadian Delegation to the meeting.

7. The concepts and various drafts of the proposed Convention and Aircraft Protocol have generated a considerable amount of academic literature. The following is a sampling. D. Clancy & G. Voss, *Facilitating Asset-Based Financing and Leasing of Aircraft Equipment Through the Proposed UNIDROIT Convention: Manufacturers' Perspective*, (1998) XXIII AIR & SPACE L. 286; Lorne Clark & Jeffrey Wool, *A Report on the Development of the Proposed UNIDROIT Convention on International Interests in Mobile Equipment as Applied to Aircraft Equipment*, 31 U.C.C. L.J. 389 (1999); Berend J. H. Crans, *Analyzing the Merits of the Proposed UNIDROIT Convention on International Interests in Mobile Equipment and the Aircraft Equipment Protocol on the Basis of a Fictional Scenario*, XXV AIR & SPACE L. 51 (2000); Ronald C.C. Cuming, *Considerations in the Design of an International Registry for Interests in Mobile Equipment*, 1999–2 UNIF. L. REV. 275 (1999); T. Gallagher, *Assessment of the Anticipated Economic Benefits of the UNIDROIT Convention*, XXIII AIR & SPACE L. 294 (1998); Roy 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 (1998); A. Harimathy, *The Regulation of Secured Transactions under the Future UNIDROIT Convention: A Hungarian Point of View*, 1999–2 UNIF. L. REV. 433 (1999); Paul B. Larsen & Juergen A. Heilbock, *UNIDROIT Project on Security Interests: How the Project Affects Space Objects*, 64 J. AIR L. & COM. 703 (1999); Howard Rosen, *Creating an International Security Structure for Railway Rolling Stock: An Idea Ahead of Its Time?* 1999–2 UNIF. L. REV. 313 (1999); Martin J. Stanford, *A Broader or Narrower Band of Beneficiaries for the Proposed New International Regime? Some Reflections on the Merits of the Convention/Protocol Structure in Facilitating the Former*, 1999–2 UNIF. L. REV. 242 (1999); Jean Stoufflet, *L'avant-projet de Convention d'UNIDROIT: Reflexions sur son Insertion dans le Système Juridique Français*, 1999–2 UNIF. L. REV. 361 (1999); Ludwig Weber & Silvério Expinola, *The Development of a New Convention Relating to International Interests in Mobile Equipment, in Particular Aircraft Equipment: A Joint ICAO-UNIDROIT Project*, 1999–2 UNIF. L. REV. 463 (1999).

8. The Council of ICAO will make the final determination in December 2000 as to the extent ICAO will become further involved in the project.

that it would be requesting special features be included in the Convention that have particular significance in the context of international aircraft financing and leasing. The Study Group concluded that the only practical way, apart from having a separate convention for each type of equipment, to accommodate the special needs of the interests to which the draft Convention would apply was to provide a separate protocol for each type of equipment. All of the following joint sessions proceeded on the basis of this structure; however, as noted later in this paper, the structure of the draft Convention remains one of the "hot issues" to be settled at the diplomatic conference.

II. A Brief Overview of the Proposed Convention and Aircraft Protocol⁹

A. THE RAISON D'ÊTRE OF THE CONVENTION

The underlying problem, stated in very simple terms, that the draft Convention and associated protocols would address is the lack of recognition, priority, or enforcement in one state of a security interest in mobile equipment created under the laws of another state.¹⁰ The goal of the draft Convention's designers was to develop a body of international substantive law¹¹ that would displace otherwise applicable national law and address the key elements of the secured financing of high value mobile equipment: creation of interests, priority of interests, public disclosure of interests, and enforcement following default.

B. TRANSACTIONS COVERED

The draft Convention, in part, adopts function rather than form as the basis for identifying the transactions that create international security interests. Article 2(2)(a) provides that the Convention applies to a "security agreement" that is defined in article 1(nn)¹² in generic terms.¹³ However, this approach was not applied universally. Article 2(2) of the draft Convention provides that it applies to two additional types of agreements: a conditional sale agreement and a leasing agreement.¹⁴ In addition, articles 31 and 32 would extend the

9. Hereafter, a reference to the "Protocol" is to the Draft Protocol to the Draft Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment.

Article 2(3) of the draft Convention lists three categories of equipment to which it would apply: aircraft objects (airframes, aircraft engines, and helicopters), railways rolling stock, and space property. Article T of the draft Convention prescribes a system allowing for the adoption of protocols dealing with railway rolling stock and space property without the need for a formal diplomatic conference. Article U provides for the development and adoption of protocols dealing with other types of high-value mobile equipment.

10. See generally Cuming, *supra* note 3, at 77-89; and Theodor J. R. Shilling, *Some European Decisions on Non-Possessory Security Rights in Private International Law*, 34 INT'L & COMP. L.Q. 87 (1985).

11. The proposed Convention and Aircraft Protocol are revolutionary in that, unlike the Aviation Convention on the International Recognition of Rights in Aircraft, June 19, 1948, T.I.A.S. No. 2,847, they would prescribe a body of substantive law. While the applicable law provides background to the instrument, the central features of modern secured financing transactions are addressed in the proposed Convention and Protocol.

12. References in this paper to specific articles of the draft Convention are to the articles of the draft prepared by the UNIDROIT-ICAO Third Joint Session, *supra* note 5.

13. "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 an existing or future obligation of the chargor or third person." *Id.* art. 2(2)

14. Article 2(5) provides that an international interest in an object extends to proceeds of that interest. In article 1(bb), "proceeds" are defined as money or nonmoney proceeds arising from the total or partial loss or physical destruction or expropriation of an item of equipment. *Id.*

scope of the draft Convention to encompass assignments of international interests and "associated rights."¹⁵

The distinctions between the types of transactions to which the draft Convention would apply are, for most purposes, not significant for two reasons. First, article 2(4) explicitly leaves to the applicable law the issue of characterization of agreements as being in one or another of the three categories. Accordingly, should the issue of characterization of a transaction in the form of a lease or conditional sales contract come before the court of a state of the United States or a common law province of Canada, the court could decide that under the Convention the transaction is a security agreement since, in substance, its function is to secure performance of an existing or future obligation. Second, the rules dealing with creation, registration, and priorities apply equally to all three types of agreements. The distinctions are, however, relevant in the context of default by a lessee or buyer. Where a lease or conditional sale agreement is involved, the remedy of the lessor or seller is to recover possession of the equipment.¹⁶ Where a security agreement is involved, the debtor's interest in the property is recognized through an obligation of the secured party to sell or lease the equipment or take it in satisfaction of all or part of the obligation secured and a right given to the debtor to redeem it before disposition by the secured party.¹⁷

The Aircraft Protocol would extend the application of the Convention's priority and registration provisions to sales of aircraft and aircraft engines.¹⁸ While this feature does not provide a title registration system, it would have a similar effect with respect to aircraft and engines purchased from manufacturers after the Convention and Protocol came into effect. A potential buyer would be able to search the "chain of ownership" from the manufacturer to the seller. A person who buys on the strength of this information would take free from an intervening transfer of ownership that has not been registered.

The draft Convention also provides for the extension of the registration and priority rules to a "non-consensual right or interest," such as repairers' or suppliers' liens, tax liens, and wage liens, which a contracting state, in its declaration, elects to treat as consensual international interest.¹⁹

C. THE CONNECTING FACTORS

As a result of article 3, the draft Convention would apply when, at the time of execution of the agreement creating or providing for an international interest, the debtor, lessor, or buyer is located in a contracting state, even though all factors relating to the agreement and the equipment are located in a single state.²⁰ Although any state that becomes party to

15. This term is defined in article 1(c) as all rights to payments or other performance by a debtor under an agreement that are secured by or associated with the object.

16. Report of the Third Session, *supra* note 5, art. 9.

17. *Id.* arts. 7-8.

18. Protocol, art. III.

19. Report of the Third Session, *supra* note 5, art. 38. The term "non-consensual interest" is defined in article 1(v) as a right or interest conferred by law to secure the performance of an obligation, including an obligation to a state or state agency. *Id.* art. 1(v). Article 39 provides for the recognition of the priority of non-consensual interests under national laws that are declared by a contracting state. The list of such interests will be kept on record at the International Registry. *Id.* art. 22.

20. *Id.* Article S would allow a contracting state to declare that the Convention does not apply to an "internal transaction" as defined in article 1(q). The significance of this possible declaration is examined later in this paper.

the Convention would be entitled to declare that the Convention will not apply to “a purely domestic transaction,”²¹ the all-important registration and priority rules of the Convention would apply to the rights of the creditor under such transaction. Article III of the Protocol provides, however, that the Convention will apply to a transaction involving an aircraft if the aircraft is registered in a contracting state or an agreement exists that the aircraft will be registered in a contracting state.²²

D. CREATION OF AN INTERNATIONAL INTEREST

Article 6 sets out the requirements for the creation of an international interest. All that would be necessary is an agreement in writing containing a description under which the equipment can be identified. This need not be a specific item description so long as there is a formula in the agreement under which the object can be identified. What constitutes an adequate description will be specified in the applicable protocol.²³ There is no requirement that the debtor own or have an in rem interest in equipment at the date of execution of the agreement.

E. POST-DEFAULT REMEDIES AND PROTECTIVE MEASURES

Articles 8–14 of the draft Convention provide a regime of post-default in rem rights and remedies of secured parties that bears close resemblance to secured transactions laws of most North American jurisdictions. However, the articles contain qualifications designed to accommodate approaches to enforcement employed elsewhere in the world and to address what are perceived to be special needs. Article 14 provides that the parties may agree in writing to derogate from or vary most of the rights and obligations specified by the draft Convention in chapter III.²⁴ Article 11 provides that the parties may agree to additional remedies not inconsistent with the mandatory provisions of chapter III.

The remedies given to secured parties, lessors, and title retention sellers under the draft Convention must be read in the light of article 13, which makes it clear that the procedural laws of the place of exercise of the remedy must be followed. In addition, article *W* empowers a contracting state to declare that enforcement rights may be exercised only with leave of a court.²⁵

Of great practical significance is the controversial article XI of the Protocol, which addresses the issue of release of the secured party from the effect of reorganization proceedings of the debtor, conditional buyer, or lessee. This issue is addressed later in this paper.

F. THE INTERNATIONAL REGISTRY

The draft Convention sets out a priority structure for competing interests in equipment built around the concept of publication of interests or potential interests in a registry that

21. *Id.* art. V.

22. This article was renumbered as article IV at the ICAO Legal Committee meeting.

23. Article VII of the Protocol prescribes the description requirements for aircraft objects. Report of the Third Session, *supra* note 5, art. VII.

24. The article contains a list of mandatory articles. These are articles 7(2)–(5), 8(3) and (4), 12(2), and 13. Report of the Third Session, *supra* note 5.

25. The post-default remedy provisions of the draft Convention have been substantially modified and supplemented by the Protocol. *See id.* arts. IX, X, and XXVII.

is open to the public. While articles 15–27 of the draft Convention describe a skeletal structure for a registry for international interests and registerable nonconsensual interests, all registries that function in the context of the draft Convention would be established under protocols. The essential features of the type of registry system contemplated by the draft Convention are those that have been developed for Canadian provincial Personal Property Security Acts.²⁶

The draft Convention provides for an administrative structure for a registry. A supervisory authority, named in each protocol, would establish the registry and designate its operator. The details of the operation of the registry are to be set out in regulations promulgated by the supervisory authority.²⁷ Article 16(2)(bb) of the draft Convention provides that the registry is to be notice-based and electronic. Under this type of registry, a registration or a search can be effected from a remote computer terminal located anywhere in the world.

G. PRIORITIES

The priority rules of the Convention, for the most part, parallel those of North American personal property security law. Under article 28, competing interests registered under the draft Convention would rank in order of their registration and a registered interest would have priority over an unregistered interest. Knowledge of a prior unregistered interest would not affect the priority status of a holder of a registered interest. An international interest would be subordinate to a buyer's interest of a third party acquired in the property from the debtor, lessee, or buyer at a time when the international interest was not registered. This is so whether or not the buyer's interest was acquired with or without actual knowledge of the unregistered international interest.²⁸ A registered international interest would have priority over a trustee in bankruptcy and execution or attaching creditors. Furthermore, if under the applicable law an international interest were valid against a trustee in bankruptcy without registration, it would have the same status under the Convention. Accordingly, if an international interest arising under a true lease were valid against a trustee in bankruptcy under the applicable law without registration, there would be no requirement that it be registered under the Convention.²⁹

III. Some of the "Hot Issues"

A. INTRODUCTION

The project to develop a Convention on International Interests in Mobile Equipment is unprecedented and extremely ambitious. In order to reach the current advanced state of development, its proponents have had to address a significant number of difficult concep-

26. The following are characteristic of a modern, notice-based electronic registry system: pre-agreement registration that sets priority (art. 18(3)); variable life registration (registering party selects the period of registration, other than for registrations of sales) (art. 20); registration is effective when it is searchable (art. 18(1)); protection against error or omissions in the operation of the registry (art. 27); and open electronic access to the registry (art. 25). See generally Cuming, *supra* note 7.

27. Report of the Third Session, *supra* note 5, art. 16.

28. In this respect, the priority rules of the draft Convention differ from those of Canadian Personal Property Security Acts and Article 9 of the Uniform Commercial Code. Indeed, this feature was the source of considerable concern to a few of the participating states because it was thought that fraud would be sanctioned by it.

29. Report of the Third Session, *supra* note 5, art. 29.

tual, political, and logistical issues. In order to secure ultimate success, several additional obstacles must yet be surmounted. In the following paragraphs, the author will describe important issues that either have been resolved or that have yet to be addressed before or as part of implementation of the Convention. During the three sessions of the meetings of governmental experts and members of the ICAO Legal Subcommittee and the meeting of the ICAO Legal Committee, the representatives reached accommodations on some of the more contentious issues. Often the accommodation involved allowing contracting states to opt out of a provision of the draft Convention or Protocol, or to adopt one of two alternative provisions. Where accommodation was not possible, the matter was left to be settled at the diplomatic conference. In any event, nothing occurring at these meetings is binding on delegates to the diplomatic conference. It is most likely that many of the contentious issues that have arisen during the preparatory meetings will be raised and debated at the diplomatic conference.

B. THE CONCEPTUAL STRUCTURE

Since the draft Convention contemplates an international regime of substantive secured financing law, it must employ a unified conceptual structure that accommodates modern secured financing transactions. However, not all legal systems approach secured financing arrangements in the same way. Indeed, a significant number of countries have only the most rudimentary systems of secured financing law. The civil law has traditionally taken a hostile attitude to any form of nonpossessory security interest in movable property.

An initial goal of the participants in the project was to get agreement on the conceptual structure of the regime that the draft Convention would implement. While compromises were made on the periphery to accommodate varying views as to what this should be, ultimately the approach of the common law states, particularly those of North America, prevailed.³⁰ Of particular significance is the wholesale adoption of the priority and associated registry concepts contained in Canadian Personal Property Security Acts and Article 9 of the U.S. Uniform Commercial Code.³¹ One of the compromises was the recognition of conditional sales contracts and security leases as transactions generically different from security agreements, the enforcement of which involves little more than having the seller's or lessor's property returned to it.³² Another was the recognition of the supremacy of the procedural laws of the place where an enforcement remedy is being exercised, and that a contracting state may allow enforcement only pursuant to a court order.³³

30. While experts from Canada, the United States, and the United Kingdom initially proposed the use of the functional approach to characterization of all transactions falling within the draft Convention employed by modern North American secured financing systems, several members of the Study Group (principally, but not exclusively, those from civil law jurisdictions) objected to having included in the definition of security agreement title reservation agreements in the form of conditional sales contracts and leases even though, functionally, these transactions serve the same purpose as security agreements. To accommodate this position, article 2(2) of the Convention provides that it applies to three separate types of agreements: "a security agreement," "a title reservation agreement," and "a leasing agreement." All three terms are defined in article 1. Interests arising under these transactions are cumulatively referred to as "international interests" (art. 2(2)). However, as noted above, characterization of agreements as falling into one or the other of the three categories is left to the forum.

31. Report of the Third Session, *supra* note 5, art. 16.

32. *Id.* arts. 2(2) and 10.

33. *Id.* art. 13.

C. A SUPRANATIONAL BODY OF SUBSTANTIVE LAW

The draft Convention prescribes a body of substantive law that, for the most part, would displace other applicable national law. The internationality of a transaction that brings it within the scope of the Convention would be nothing more than that the debtor, lessee, or buyer is located in a contracting state,³⁴ and that the equipment that is the subject of the agreement is the type of property that falls within a protocol.³⁵ The location of the secured party, lessor, or seller would be of no significance.³⁶

Some of the participating states had a great deal of difficulty accepting that their national law may not totally apply to a transaction in which both parties to the agreement creating the interest and the subject of the transaction are located within their boundaries at the date of execution of the agreement. A modest, and largely cosmetic, compromise to deal with this concern has been included in the draft Convention. Under article S, a contracting state may declare that the Convention will not apply to a transaction where the center of the main interest of all of the parties to the transaction and the object of the transaction are all situated in that state at the time of conclusion of the transaction. However, such a reservation will have little practical significance except in a case where enforcement of the secured party's, lessor's, or seller's rights is to occur in that state.³⁷ The reservation would not have the effect of excluding the application of the Convention to priority issues, even though all of the competing claims are those of persons located in the state.³⁸ The practical effect of this provision would be that all transactions relating to property subject to a protocol to which the debtor's, lessee's, or buyer's state is a party would be registered in the International Registry. This is because a secured party, lessor, or seller cannot rely on any system of national law to guarantee invulnerability to defeat by competing international interests created under the Convention.

D. THE STRUCTURE OF THE INSTRUMENT

A matter that was the source of considerable debate in the meetings of governmental experts and members of the ICAO Legal Committee was the structure of the instrument. The issue was whether there should be separate stand-alone conventions for each type of equipment, or a base convention applicable to all types of equipment and a separate protocol for each type. The largest number of states favored retaining the bifurcated structure proposed by the UNIDROIT Study Group. Other states preferred a stand-alone aircraft convention that would be a composite of the proposed base convention and the protocol. Those favoring the bifurcated structure pointed to the long-term importance of having a base

34. *Id.* arts. 3 and 4.

35. An additional connecting factor is added by the Aircraft Protocol. See *supra* note 20 and text accompanying.

36. *Id.* art. 3(2).

37. Even in this context, the effects of the Convention cannot be totally excluded. Article S(2) provides that, notwithstanding a declaration by a contracting state that the Convention does not apply to an internal transaction in that state, article 7(3) (which requires reasonable notice of disposition of a sale or lease of collateral as part of the enforcement of a security interest), 8(1) (providing for informal foreclosure of the debtor's interest in collateral), chapter V (the international registry), article 28 (the priority rules), and "any provisions of this Convention relating to registered interests shall apply to an internal transaction." *Id.*

38. *Id.*

convention that could be adopted with separate protocols for different types of equipment. It would facilitate the extension of the system to other types of equipment without the necessity of having to develop a complete convention for each type of equipment. This approach would encourage the development of jurisprudence dealing with the interpretation and application of the base convention in the context of system-regulating international interests in several types of equipment.³⁹

Those favoring the unitary approach pointed to the complexity that the bifurcated approach entails. Under the unitary approach, the law applicable to the same transactions would be contained in a single instrument. This would make the law much simpler to comprehend and apply. Of particular concern is the fear that, because of this complexity, the draft Convention would not get the necessary support from the relevant persons and organizations. There are many complex matters addressed in the Convention and Protocol. A bifurcated instrument may make it much more difficult for persons, including government officials and persons involved in the manufacture, finance, and use of the equipment involved who have not been directly involved in the drafting of it, to develop a level of comfort with it necessary to gain their support.

At the third session of the meetings of governmental experts and members of the ICAO Legal Subcommittee and the meeting of the ICAO Legal Committee, it was generally agreed that the bifurcated structure would be retained. However, a working consolidation of the draft Convention and the Aircraft Protocol would be prepared. The ultimate form of the instrument will have to be decided at the diplomatic conference.

E. INSOLVENCY

An issue that resulted in sharply divided positions was the interface between national insolvency law (reorganization) and the rights of secured parties, lessors, or sellers in the event of default by debtors, lessees, or buyers. On the one side were states that wanted to have the Aircraft Protocol specify the right of a secured party, lessor, or seller to have an aircraft object surrendered by the debtor, lessee, seller, or insolvency administrator in possession within a very short period of time after default unless, within that time, the default has been remedied. Supplementary provisions ensuring priority of the registered secured party's, lessor's, or seller's interest in the insolvency proceedings would be required.

This concept, while well known in U.S. law,⁴⁰ is foreign to the insolvency systems of most other states. Nevertheless, there was general support for it in some form. The disagreement that developed was as to what form. One group of states argued for a "strict" rule under which a remedy would be available without court or administrative involvement that might result in delay. It would specify a period of time during which the remedy must be made available. The second group of states preferred a "soft" rule under which the secured party, lessor, or seller would be entitled to the possession remedy in accordance with the applicable law. The applicable law may permit a court to require the additional steps or guarantees as preconditions to an order requiring surrender of possession.

The conflict between the two positions was resolved by including in the draft Convention

39. See generally Stanford, *supra* note 7.

40. The strongest support for this position came from U.S. representatives who pointed to 11 U.S.C. (1994) as a central feature of secured aircraft financing in the United States.

a choice.⁴¹ Under article XXVIII(3), a contracting state⁴² may declare its intention to apply the “strict rule” alternative or the “soft rule” alternative. The declaration is to identify the types of insolvency proceedings to which the chosen alternative will apply.⁴³

F. INTERFACE WITH THE (DRAFT) UNCITRAL CONVENTION ON ASSIGNMENT
[IN RECEIVABLES FINANCING] [OF RECEIVABLES IN INTERNATIONAL TRADE]

The draft Convention would apply to assignments of international interests and “associated rights.”⁴⁴ Assignments would be subject to the registration and priority systems⁴⁵ of the draft Convention. Conceptually, this is a peculiar feature since it treats the right to the receivable arising from the financing of an object that is the subject of an international interest as accessory to the interest in the object. Under most legal systems, a security interest is accessory to the obligation. However, from a functional perspective, this feature of the draft Convention is not surprising; indeed, it is indispensable. Assignments of agreements providing for the lease or financing of the aircraft are very common. The commercial value of the draft Convention would be substantially diminished if it did not extend to assignments, financing and leasing contracts, and the streams of payment associated with these contracts.

The Working Group on International Contract Practices of the United Nations Commission on International Trade Law has prepared for the consideration of the UNCITRAL Commission a draft convention on assignments of receivables that would apply to assignments of international agreements and associated rights falling within the draft Convention on International Interests in Mobile Equipment. While at an early stage in the development of these draft conventions conflicting views as to which convention should govern these assignments existed, it now appears that the UNIDROIT Convention will prevail. Article 46 of the draft Convention provides that the Convention is to supersede the UNCITRAL Convention. Article 36 of the draft of the UNCITRAL Convention, presented to the Commission in June 2000, provides that the Assignments Convention would not prevail over an international agreement that may be entered into and that contains matters governed by the Convention.⁴⁶

41. Protocol, art. XI, Alternative A and B.

42. The declaration applies to the state that is the primary insolvency jurisdiction defined in article 2(n) as the center of the debtor's main interests, and unless the evidence indicates otherwise, this is the jurisdiction where the debtor, lessee, or buyer has its statutory seat, and if none, the place where it is incorporated or formed.

43. There is every reason to conclude that the costs of aircraft financing in a particular Contracting State will be affected by one of the two alternatives that is chosen by that state.

44. Report of the Third Session, *supra* note 5, art. 31. Associated rights are defined in article 1(c) as all rights to payment or other performance by a debtor under an agreement, which are secured by or associated with an object that is the subject matter of an international interest.

45. Article 35 provides that, when an international interest has been registered, the assignee shall, in relation to the associated rights, have priority to the extent that such associated rights relate to the sum advanced and utilized to purchase the object, the price of the object, the rentals payable in respect of the object, and reasonable costs of enforcement. *Id.*

46. Article 36 contains in brackets the following qualifier: “provided that the assignor is located in a State party to such agreement or, with respect to the provisions of this Convention that deal with the rights and obligations of the debtor, the debtor is located in a state party to such an agreement.” *Id.*

G. THE INTERNATIONAL REGISTRY

As noted above, the priority structure of the draft Convention assumes a single, modern registry for international interests. A unique feature of the registry system the draft Convention contemplates is its international character. All of the systems that can be looked to as models have national governmental infrastructures.⁴⁷ An equivalent for the International Registry had to be planned. The approach that was adopted is to have a Supervisory Authority appointed that would have powers and responsibilities paralleling those of a government department responsible for establishing and maintaining a registry.⁴⁸ However, unlike a government department, the Supervisory Authority would not operate the International Registry. It would contract this to a registrar.⁴⁹

A central issue associated with the International Registry to be established under the Aircraft Protocol is what organization will be the Supervisory Authority. It is conceivable that the Supervisory Authority would be a special purpose organization created by the contracting states at the diplomatic conference. However, there are significant unanswered questions associated with this approach. Would this be a body incorporated under the national laws of a contracting state? If so, could this body be given the necessary international personality and immunities? What mechanism would be established to provide for oversight of a Supervisory Authority in this form?

The alternative that has by far the largest amount of support among the states participating in the development of the proposed Convention and Protocol is to ask an existing international organization to be or to create the Supervisory Authority. The obvious candidates are the two sponsoring organizations: UNIDROIT and ICAO. It is quite possible that, with a change in its constitution and expansion of its infrastructure, UNIDROIT could become the Supervisory Authority for the Protocol. The balance of the advantage, however, would appear to favor ICAO. It is the arm of the United Nations with a mandate to regulate many aspects of civil aviation. While the operation of an international registry for interests in aircraft would involve an expansion of this mandate, ICAO has the capacity to discharge such an undertaking.

A feature of many modern registries of legal rights is protection against structural or operational deficiencies. Without this protection, a registry loses much of its value as a reliable source of information upon which to base risk assessment. It has been generally accepted that the credibility of the International Registry established under the draft Convention will depend upon the availability of user protection against deficiencies in the system. The amounts involved in aircraft financing are very large. Deficiencies in the system might be very costly to its users.

It is very unlikely that a Supervisory Authority or a registry company contracted to operate the International Registry would be prepared to assume liability for losses suffered by users of the system resulting from its failure. If the protection is to be made available, it must be through insurance. Since the International Registry must be financially self-

47. The principal models for the International Registry are the registry systems of the Canadian provinces that are the most advanced in the world.

48. *Id.* art. 16. The Supervisory Authority is to be appointed as provided in the protocol. *See* Protocol, art. XVI.

49. Report of the Third Session, *supra* note 5, art. 16(2)(b). Under article XVI of the Protocol, the contract would be for five years but would be renewable.

supporting,⁵⁰ the cost of this insurance must be recovered in the fees charged for registry services. Consequently, there will be a direct relationship between the level of user protection and the cost of registration.⁵¹

The draft Convention would give immunity to the Supervisory Authority, its officers, and employees.⁵² Since the registrar would operate the International Registry, it is appropriate that it be the agency through which to provide user protection against system failure. Article 27 provides that the registry shall be liable for compensatory damages for losses suffered by a person directly from an error or omission of the registrar and its officers and employees, or from a malfunction of the registry. This formulation indicated clearly that strict,⁵³ but not absolute, liability is contemplated. A working group of states was struck at the ICAO Legal Committee meeting to prepare recommendations as to what limitations should be placed on the scope of the registrar's liability. The scope of system failure is much smaller in the context of a modern, electronic system of the kind that will be employed by the International Registry than it is where registry personnel are involved in entering registry data in the database. The only types of system failure that could cause loss under such a system will result from hardware or software design defects that result in data corruption or interruption of the system operation as a result of an event such as a strike or interruption of electrical supply. While the matter has yet to be finalized, it is highly unlikely that the registrar will be required to guarantee against loss resulting from interruption in the operation of the registry.

H. TRANSITION

The issue as to the effect of the Convention and Protocol on interests that are in existence at the date the Convention comes into force was one that caused heated debate at the joint sessions. Article Z of the draft Convention, as it existed following the third session of governmental experts and members of the ICAO Legal Subcommittee, provided two alternatives. Under Alternative A, the Convention would not apply to a pre-existing right or interest. Any such right or interest would retain the priority it enjoyed before the Convention came into force. Alternative B would extend the Convention to prior interests to the extent of bringing them into the registry and priority structure after a specified grace period. The effect of Alternative B would be to require the holder of pre-Convention interest, which would be an international interest had it come into existence after the Convention came into force, to register the interest in the International Registry prior to the expiration of the grace period. If registration were effected, the interest would retain its pre-Convention priority. If it were not, the interest would be treated as an unregistered international interest under article 28.

The benefits of Alternative B are obvious. Without it, the registry and priority system of the Convention would be only partially efficacious. Anyone taking a security interest in an item of equipment of the kind referred to in article 2(2) would get risk protection only with respect to interests created after the Convention comes into effect. Under Alternative B, this problem would not be eliminated, but it would be limited in time.

50. Protocol, art. XIX(3).

51. Experience with the computerized Canadian registry systems is that the potential for liability is very small if the system is properly designed.

52. Report of the Third Session, *supra* note 5, art. 26.

53. At the Third Joint Session, it was agreed that negligence was not an appropriate basis for liability.

The supporters of Alternative A initially argued that the costs of having to identify and register all pre-existing interests would be prohibitive, particularly in the context of aircraft financing, which tends to be multitiered and complex. However, for reasons not publicly explained, this opposition softened at the meeting of the ICAO Legal Committee. The opponents of Alternative B decided to drop their insistence on the adoption of Alternative A so long as the grace period was substantial and the fees for registration of existing interest were not excessive. In the result, article Z now incorporates Alternative B. The suggested grace period is ten years.⁵⁴ A footnote to the article states, “[i]t is intended that the fees required for registration of pre-existing rights or interests will be nominal.”⁵⁵

IV. Summary

The progress of the project to develop a convention providing for an international substantive law regime dealing with the creation, enforcement, and priority status of interests involved in the financing of high-value, internationally mobile equipment has been impressive. While it has been twelve years since the project was first proposed, one could reasonably have expected that the complexity of the political, logistical, and legal issues involved would necessitate a much longer period of gestation for a convention of this kind. While there are several issues that remain outstanding, an impressive level of agreement has been reached among the participating states as to the key features of such a convention.

The next step is for the ICAO Legal Committee to report to the Council on the outcome of the joint sessions of governmental experts and members of the ICAO Legal Subcommittee and the meeting of the ICAO Legal Committee. Following that, a diplomatic conference will be held at which the final form of the instrument will be settled. The blossoming interest in and support of the project among states and manufacturers, financiers, and users of the types of equipment involved that has developed over the last few years is a good indication that, when confirmed at a diplomatic conference, the Convention will be ratified by a significant number of states.

54. The supporters of Alternative B may have a Pyrrhic victory. Most pre-Convention financing agreements do not extend much beyond ten years.

55. Report of the Third Session, *supra* note 5, art. 26.

