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LEGAL DIFFICULTIES IN SECURED AIRLINE EQUIPMENT FINANCING

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HISTORY

SECURED financing traditionally has been used in connection with the purchase of equipment for the nation's carriers. The railroad equipment trust is of course the classic example. In spite of early legal vicissitudes, the equipment trust has become almost the exclusive method of financing the purchase of rolling stock. This form of security enjoys a standing among investors and banking institutions attained by no other form of corporate security. The basic reason for the strength of equipment trusts is simply that payment of the obligation is made more rapidly than the equipment declines in value.¹ In the case of aircraft, for example, such obligations might have a life of five years, while the equipment would, according to present experience, have substantial value at the end of that period. The period recognized for tax depreciation as well as for book depreciation varies from four to seven years for transport aircraft. If the period used were five years, payment of the obligations would not disturb the balance sheet. Thus the obligations might be fully paid without the airline having earned a cent of profit.

Examples of secured financing of airline equipment are fairly numerous although a complete history has yet to be written. Between 1936 and 1942, nine airlines entered into twelve arrangements for secured financing, nine involving chattel mortgages, one involving a lease-purchase agreement, and two involving equipment trusts.² Dewing remarks upon the extension of equipment obligations to other industries and states:

“... Recently the equipment trust agreement has been used by air transportation lines for financing large and expensive planes. Subject to carefully drawn provisions for insurance, this forms a new


and admirably adapted use for equipment obligations, since a modern well-built high-power plane can be readily sold to American or foreign air lines. . . .”

Dewing cites two examples: An American Airlines financing with Reconstruction Finance Corporation in 1936 and a Pan American Airways financing of $2,500,000 with The New York Trust Company in 1939. However, the former transaction involved a chattel mortgage, not an equipment trust. The certificates in the latter transaction, which ultimately involved $3,500,000, were sold privately to two banks and two insurance companies. The trust was based upon a lease-purchase agreement (the so-called Philadelphia plan). A second case of equipment trust financing occurred in 1940, when Mid-Continent Airlines, Inc. made a conditional sale contract the basis for a trust with Guaranty Trust Company (the so-called New York plan). This loan was refinanced in 1941 under a chattel mortgage.

The more recent trend, it is true, has been toward term loans based upon the general credit and earning power of the airline fortified by negative covenants which forbid encumbering equipment or other property of the airline. This has been part of the general use of term loans in the “easy money” era. The sharp decline of the stock market in September 1946 followed by a continuing severe decline in airline securities has made not only equity financing but general financing much more difficult. The debentures issued by airlines have not stood up well marketwise and have on occasion proved an obstacle to further financing. The manufacturers are in no position to finance sales of aircraft in substantial quantities. The largest pool of private capital which might be tapped for financing aircraft equipment (outside the commercial banks which have been largely used already) appears to lie in financial institutions such as insurance companies. Obviously, once airline equipment trust certificates and mortgage bonds become “legals,” a broader investment field opens and attractive interest rates become available. But such results can be achieved only with obligations backed by definite security. When it is realized that almost one-half of the net worth of the airlines is made up of operating equipment, the wide scope of the field of secured financing begins

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4 An example is the TWA-Equitable Life financing, under a complex and restrictive trust indenture dated Dec. 1, 1945 providing for issuance of thirty million dollars in 3% sinking fund debentures. The document is 114 pages long; the definitions alone occupy fourteen pages. American Airlines and Pennsylvania Central Airlines have issued debentures. The more usual type of term loan has been represented by a relatively simple bank loan agreement, such as those of Pan American Airways and The New York Trust Co. and other banks; Northwest Airlines and Bankers Trust Co. and others; Eastern Air Lines and The Chase National Bank of the City of New York and others; United Air Lines and the National City Bank of New York and others; Braniff Airways and Bankers Trust Co. and others; and National Airlines and The Chase National Bank of the City of New York and others.

to be seen. It therefore appears almost certain that the use of secured financing will shortly be resumed, especially for carriers of marginal financial strength.

It is appropriate therefore to reexamine the legal basis for secured airline financing and to ascertain what legal obstacles may exist to impair the availability of such financing. A legal committee of the Aircraft Industries Association, a national association of aircraft manufacturers, has been studying this matter and has prepared proposed legislation for the purpose of remedying most of the difficulties discussed in this article. The text of the proposed amendments, which will be referred to in greater detail hereinafter, is set forth in the appendix following this article. The airlines constitute a young and vigorous industry, presently hampered by financial growing pains. Their importance in national defense as well as in public service throughout the world certainly justifies special consideration for financial legislation of the type proposed.

**Owner’s Liability**

The first difficulty arises with respect to possible liability of the security title or lien holder as “owner” of the aircraft. Section 5 of the Uniform State Law for Aeronautics provides that the “owner” of aircraft operated over lands or waters of the state is absolutely liable for injuries to persons or property on the land or water beneath, caused by the ascent, descent or flight of the aircraft or the dropping or falling of any object therefrom, subject only to contributory negligence on the part of the injured party. If the aircraft is leased, both owner and lessee are made liable. A lien is granted the injured party to the extent of the damage. It seems clear from the terms of Section 5 that liability to passengers is not involved.

It is obvious that the term “owner” in connection with an equipment trust might be construed to include the trustee who under the New York plan has legal title as conditional seller and under the Philadelphia plan is lessor of the equipment. As a matter of fact, both the conditional seller and the equipment trust trustee claim to be owners—the registration certificate of the aircraft will name the manufacturer or bank which is his assignee as “owner and vendor” or “owner and assignee of vendor” or the bank acting as trustee under an equipment trust agreement.

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6 In the following discussion the writer is greatly indebted to a pioneering study entitled *Airline Finance* published in 1945 by Bankers Trust Co., The Mutual Life Insurance Co. of New York, The Chase National Bank of the City of New York and The New York Trust Company, and to its principal authors, Gordon D. Brown and H. A. Watkins, vice presidents, Bankers Trust Co., and Alfred Heuston, of White & Case. This study also suggested statutory amendments similar in purpose to those set forth in the Appendix.

7 11 U.L.A. 159.

trust as "trustee, owner and lessor." The ownership of the aircraft will be registered with the CAA in the same manner and if the plane is "plated" notice will be given to all the world that the manufacturer or the bank in question is the "owner and vendor" or the "trustee, owner and lessor." A chattel mortgage appears less likely to be held the owner, even in jurisdictions where such a mortgagee has title rather than a lien. Decisions may be found to support almost any view as to the status of such persons as "owners," but the decisions holding conditional sellers and mortgagees of automobiles not liable as owners are persuasive against this similar statutory liability. Whether the lien given by the statute would take priority over pre-existing security interests has not been determined, but this is of less moment to financing institutions than the matter of possible liability.

A number of factors tend to mitigate the risk to the financing agency. First, Section 5 of the Uniform Law has not been too widely adopted. Although twenty-one states and Hawaii adopted the Law, in only thirteen states and Hawaii is Section 5 in effect in such form as to affect adversely holders of security interests. These latter states do not include New York, Virginia (Washington National Airport), Illinois or California, where aviation travel centers are located. It appears likely that the number of states where Section 5 is in force will decrease rather than increase. The Conference of the Commissioners on Uniform Laws withdrew promulgation of the Uniform Law in 1943 and in 1947 recommended that Section 5 be amended to exclude liability on the part of a chattel mortgagee, conditional vendor or trustee under an equipment trust not in possession of the aircraft. Such an amendment has been adopted in three states. Second, in five of the thirteen states, limitations upon recovery for wrongful death provide some protection against excessive liability. Third, insurance is available at a reasonable rate to cover excess legal liability of the security title holder. The airline normally will carry from five to seven million dollars liability insurance. From five to ten million dollars additional insurance is available, to the financing agency, according to recent quotations, making a total coverage of ten to seventeen million dollars. The Texas City disaster on April 16, 1947 involved liability of almost forty million dollars, but this was possibly the greatest disaster in our history, from a liability point of view. The Cleveland gas explosion and fire on October 20, 1944 resulted in a loss of only seven million dollars, although it occurred in a thickly-built residential area. Therefore, insurance would appear to serve as protection against all but the greatest catastrophies. Fourth, the pro-

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11 Ark., N.J., S.C., R.I. imposes liability upon the registered owner.
12 Ind., $10,000; Minn., $10,000; N.C., Pecuniary injury; S.D., $10,000; Wis., $12,500 plus $2,500 for loss of society.
vision has been strictly construed against liability. In the only reported decision under Section 5, the section was held inapplicable where injury to a bystander occurred during an authorized landing at an airport, since no trespass on the rights of a landowner was involved.\footnote{State, to Use of Birkhead v. Sammon, 171 Md. 178, 189 Atl. 265 (1936).} Fifth, it appears unlikely that a court would hold a security title holder to be the “owner” of the aircraft for purposes of Section 5.

In spite of these mitigating factors, financing institutions hesitate to incur any possible risk of a liability which might be very substantial. Their fees for acting as assignee of the manufacturer under a conditional sales agreement, or trustee under an equipment trust are small and cannot be said to include any substantial amount of compensation to the financing institution for assuming any risk of the great liabilities which might be imposed on them. Legislative action to remove this difficulty therefore appears necessary. Amendment of the state laws is desirable but probably cannot be accomplished in all of the states affected within a reasonable time. Amendment of the Civil Aeronautics Act of 1938 has also been proposed as a solution. H.R. 4912, 79th Congress, 1st Session, introduced by Mr. O’Hara on December 6, 1945 covered not only the liability of air carriers for surface injury or damage but excluded from liability persons having a security interest, unless in possession or control of the aircraft.\footnote{See also H.R. 532, 79th Cong. 1st Sess. (1945) dealing with carrier’s liability only. This bill also was not reported out of committee.} The bill was not reported out of committee. As a matter of fact, it would seem that the time has come to relieve scheduled aircraft carriers of the medieval encumbrance of absolute liability — to remove them from the class of reservoirs and of tigers and other wild animals — in the same way that the steam boiler, locomotives, and automobiles which in many jurisdictions were originally made subject to absolute liability, have now been freed therefrom. However, an amendment directed solely and specifically to protection of security title holders would be less controversial and might have greater chances of success, and the addition of a new Section 504 to the Act has been proposed to achieve this end. This amendment would also protect a lessor of airline equipment. Such protection appears necessary and desirable in view of the possibility of equipment leases and pools, used either as financing media or otherwise. The text as prepared by the Aircraft Industries Association is set forth in Part A of the Appendix.

Although federal authority has not yet been exercised with respect to aviation tort liability,\footnote{See Comment, 14 JOURNAL OF AIR LAW AND COMMERCE 395, 398 (1947).} there appears every reason to believe that such an amendment to the Civil Aeronautics Act would be valid and
effective. The Act itself has been upheld under the commerce power. If federal legislation is extended to cover tort liability, it would be paramount over conflicting state statutes.

**Repossession in Bankruptcy**

One of the strongest features of railroad equipment trusts has been their status in reorganization or receivership. This has been due, without doubt, to the right of immediate repossession upon default. The receiver or trustee has continued to pay upon these obligations rather than to lose essential operating equipment, and actual repossession has almost never occurred. This right of repossession of railroad equipment is specifically recognized in the Bankruptcy Act. There is, however, no comparable provision in Chapter X of the Act dealing with corporate reorganizations generally.

Whether a court in reorganization proceedings would have jurisdiction over airline equipment would depend upon whether the equipment were the "property" of the debtor. It has been held that a conditional seller is entitled to repossess, since the article in question is not the property of the debtor, but immediate repossession has not always been permitted. Bank counsel are not, however, convinced that these decisions are sound or would be followed by the Supreme Court, on the ground that the conditional buyer is in substance the owner and that the mortgage situation cannot be properly distinguished. In the case of a chattel mortgage there is no doubt but that the court has jurisdiction and may stay foreclosure. There would

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18 Employees' liability cases: Second Employer's Liability Cases, Mondou v. N.Y., N.H. & H.R. Co. 223 U.S. 1, 56 L.Ed. 327, 32 S. Ct. 169 (1912); Copley v. Industrial Accident Commission, 19 Cal. (2d) 284, 120 P. (2d) 880 (1942).

Safety regulations under the Civil Aeronautics Act have been upheld. See Elwell, Enforcement of Air Safety Regulations, 14 Journal of Air Law and Commerce 318, 320 (1947).
19 DEWING, op. cit. supra note 1, at 212, 214-217.
21 In re Lake's Laundry, supra note 21, was criticized on similar grounds in 35 Col. L. Rev. 1305 (1935); 49 Harv. L. Rev. 328 (1935); and 34 Mich. L. Rev. 579 (1936).
22 In re Lake's Laundry, supra note 21, was criticized on similar grounds in 35 Col. L. Rev. 1305 (1935); 49 Harv. L. Rev. 328 (1935); and 34 Mich. L. Rev. 579 (1936).
23 Sections 113, 116(4), 148, 11 USCA 513, 516(4), 548. See also In re Lake's Laundry, supra note 21.
appear to be an economic if not legal distinction between conditional sales and chattel mortgages, in that a conditional sale transaction may exist only in connection with a purchase while a chattel mortgage may secure a pre-existing debt.\textsuperscript{24} The conditional seller who furnishes the article in question may hence be justified in expecting and in being accorded the additional security afforded by repossession in bankruptcy. However, the same is true of the holder of equipment trust certificates who furnishes most of the funds making possible the acquisition of new equipment. Chattel mortgages have frequently been used to provide funds for the acquisition of new flying equipment, and have an advantage as to owner's liability referred to above. In order to remove doubt and to equalize the position of the various security devices in this respect, an appropriate amendment of Chapter X has been suggested. The chief argument in opposition to this proposal is that, since the largest single debt of an airline may consist of equipment obligations, reorganization proceedings could not be effective in holding together the property used by the debtor. On the other hand, equipment financing would be facilitated for the carriers if lenders could be assured that in case of trouble they would not face court control of indefinite duration under a trustee of unknown ability who, under the prohibitions of the Bankruptcy Act, can have had no connection with the carrier prior to the commencement of the reorganization proceedings. Since aircraft have a comparatively short life and deteriorate rapidly if not constantly attended and protected, a financing agency would be hesitant to rely upon such equipment as security unless the right of immediate repossession were assured. One solution would be to permit such repossession only when expressly provided for in the lease, mortgage or conditional sale contract. This would presumably be done chiefly in purchase money transactions, or when the equipment was not a major portion of the airline's assets. The text of a proposed amendment to the Bankruptcy Act along these lines prepared by the Aircraft Industries Association is set forth in Part B of the Appendix.

\textbf{Security Interests in Spare Parts}

At the time new aircraft are purchased, it is necessary for the airline also to purchase spare engines, propellers, accessories and airframe parts which may cost as much as 25\% of the purchase price of the aircraft. If an airline is pressed for funds, it will not be able to make the minimum down payment (generally 20\%) on the price of the aircraft plus the total price of the spares, or a total of 36\% of the entire price of planes and spares. Since aircraft without spare parts are not operative, an effective lien upon parts greatly strengthens the security afforded when both aircraft and parts are financed as a whole. Thus the lack of a lien on parts has in the past lessened the value of any lien obtained

\textsuperscript{24} Hines, Rights and Remedies under California Conditional Sales, 23 Calif. L. Rev. 557, 588 (1935). See also VOLD, SALES (1931), 283-284, 309-312.
upon the aircraft alone, and prevented some airlines from obtaining much-needed new equipment.

The use of spare parts as security has so far been impracticable. Local recording is not satisfactory in many states for articles which may move among widely scattered repair bases. Furthermore, many spare parts are not individually identifiable, and the only practicable description for a stock of airframe parts may be, for example, “all spare parts for Model X aircraft (excluding engines and propellers) located at the repair depots of A airline at Los Angeles, California and Chicago, Illinois.” In some states formal requirements would not be met by such “basket” description. 25 The Civil Aeronautics Act provides for recording as to aircraft only, not as to parts. 26

An attempt to provide for national recording of interests in spare parts was made in H.R. 5502, 79th Congress, 2d Session, introduced by Mr. Bulwinke on February 18, 1946. The extent to which recording would be permitted was, however; left up to the Administrator of the Civil Aeronautics Authority. An identifying description of each item was required. The bill was not reported out of committee.

One reason for opposition to such a provision lies in the mechanical difficulties encountered in recording documents affecting thousands of different kinds of accessories and spare parts and, perhaps, ten thousand and more individual engines and propellers. Aircraft engines are individually identifiable by permanent serial numbers, and the larger engines used in airline planes have substantial value. Also a considerable number of spare engines is required. In view of these circumstances, one solution suggested is as follows: to permit recording as to individual engines used by air carriers (this would exclude the more numerous small engines used in non-airline planes and limit the volume of recordings); and to permit recording by general description and situs (the “basket” type referred to above) for all unattached spare parts, including engines. While this scheme would theoretically permit interests in spare airline engines to be recorded either by specific description or by basket reference or both (and hence would require the statute to make some provision with respect to the relative priority between two such recordings covering the same engine), it is believed that as a practical matter interests in all engines involved in security transactions would be recorded by specific description. As will be seen from later discussion, it is necessary to provide for basket recording as to spare engines as well as other spare parts in order to assure proper recognition of international recording of interests in spare parts under the proposed international convention concerning the recognition of rights in aircraft. Thus the holder of a security interest in all engines

25 Most states appear to recognize such description as adequate. See 1 JONES, CHATTTEL MORTGAGES AND CONDITIONAL SALES (Bower's ed. 1933), par. 65, 70; 2 Id. par. 409 (b). For an example, see COLLEED v. TULLY, 77 N.J. Eq. 439, 77 Atl. 1079 (1910), aff'd 78 N.J. Eq. 557, 80 Atl. 491, Ann. Cas. 1912 c. 78.

26 §503 (a). In Calif., state recording requirements as to aircraft are assimilated to CAA requirements. See CAL. CIV. CODE §§2958 (a), 2971.
of a certain type used by a particular airline engaged in international
operations would record in both fashions, the basket recording design-
ating and being chiefly useful for locations outside of the United
States. In any event, "basket" recording appears to be essential if
spare parts other than engines and perhaps propellers are to be readily
available as security.

If spare parts are used as security, problems of priority arise when
such parts are attached to an aircraft itself subject to a lien or security
title. Here an analogy might be made to the similar situation arising
as to vessels under the Ship Mortgage Act of 1920. The lien upon a
replacement part installed in a ship has been held inferior to the re-
corded lien upon the ship itself. It appears desirable that any amend-
ment extending the recording system to include "basket" recording for
spare parts should also make it clear that recorded interests in aircraft
to which such parts may be attached will have priority over the inter-
ests (recorded or otherwise) in the parts, excepting only airline en-
gines recorded by specific description. This result may be achieved,
it is believed, by providing that the basket lien is effective only while
the parts are at the designated location. In order to assure proper
recognition under the proposed international convention of rights in
airline engines when and as they are integral parts of an aircraft, it
also appears advisable to restate in the Civil Aeronautics Act what is
believed to be the general law on the subject: that title to or a lien
upon the aircraft extends to engines thereafter installed therein, but
must yield in priority to title to or a lien upon the engines recorded
by specific description prior to the time of such installation.

The recording provision would be of value in enabling the financ-
ing agency upon default to repossess or foreclose upon the parts in the
possession of the debtor, even though the debtor might have been able
in effect to subordinate the first lien by means of a wrongful transfer
followed by attachment to planes of the transferee subject to a differ-
ent lien. The text of proposed amendments to the Civil Aeronautics
Act designed to carry out the scheme of recording outlined above and
prepared by the Aircraft Industries Association is set forth in Part C
of the Appendix. These amendments would not constitute a federal
mortgage act or preempt the field of substantive law which traditionally
is controlled by the states, but would provide the necessary mechanics
for central recording of interests in aircraft spare parts. Possibly a
federal aircraft mortgage act would be desirable to eliminate the many
varying and sometimes unsuitable provisions of state laws as to chattel
mortgages.

27 46 USCA §§911-984, c. 25. See generally, Lord and Glenn, The Foreign
28 The Eastern Shore, 31 F.S. 964 (D.C. Md. 1940). This decision appears
to be consistent with the purpose of the Act as expressed in Detroit Trust Co.,
Trustee v. The Thomas Barlum, 293 U.S. 21, 79 L.Ed. 176, 55 S. Ct. 31 (1934);
The Favorite, 34 F.S. 324 (D.C. N.Y. 1940), aff'd 120 F. (2d) 899 (C.C.A. 2,
1941).
Public Issue

It is anticipated that the purchase of equipment by the airlines will continue for the present to be financed by banks and other private or government financial institutions rather than by public issue of securities such as secured bonds or equipment trust certificates. With the continued growth and increased stability of air carriers, however, public issue may not only occur but may become a commonplace, as with railroad equipment trusts. In such an event, certain problems may arise under the terms of the Trust Indenture Act of 1939. This Act seems to be primarily intended for the conventional types of debenture and bond issues, and it may be difficult to adapt equipment trust documents and procedure so as to conform to it. Also the Act requires an unqualified opinion of counsel as to the effective recording of the indenture. The present provisions of the Civil Aeronautics Act as to recording are without doubt effective with respect to aircraft in the United States used in interstate or foreign commerce. However, in the absence of legislation providing for national recording of interests in spare parts and an international convention providing for recording of interests in aircraft and spare parts, it would be impossible to obtain such an opinion with respect to spare parts in the United States or with respect to aircraft or spare parts in foreign countries.

It should be noted that the railroads have not had to contend with the terms of the Trust Indenture Act with respect to issuance of equipment trust certificates, since such issues are subject to control by the Interstate Commerce Commission and are therefore exempted from this Act as well as from the Securities Act of 1933. It has been suggested that the Civil Aeronautics Board be given similar control over the financial organization of air carriers, but the question is at present in a controversial stage. Certainly this atomic bomb is not required to dispose of this small spider. If the recording problem is solved, other matters may be solved by means of appropriate amendments to the Act.

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29 15 USCA §77 (aaa), et seq.; Sub. c. III of c. 2A.
30 §14, 15 USCA §77 (nnn) (b).
31 The Act is probably effective without regard to such use. Cf. notes 16 and 17 supra. But one lower court decision has held recording under the Civil Aeronautics Act ineffective as to a small plane used intrastate. Aviation Credit Corp. v. Gardner 22 N.Y.S. (2) 37 (1940).
32 The existence of difficulties is pointed out in the Report of the Committee on Trust Indenture Act, Proceedings of the Section on Corporation, Banking and Mercantile Law, American Bar Association, 1946 Annual Meeting, p. 103. The Chairman of the Committee, W. Hugh Peal, has been kind enough to supplement this report with a more detailed statement of his own views in correspondence.
33 See §4(a) (4) of the Trust Indenture Act of 1939, 15 USCA §77 (ddd) (a) (4), exempting from that Act securities exempted from the Securities Act of 1933; §2(4) of the Securities Act of 1933, 15 USCA §77 (b) (4), defining “issuer” of equipment trust certificates to mean the user of the equipment; §3(a) (6) of the Securities Act of 1933, 15 USCA §77 (c) (a) (6), exempting from that Act any security issued by a common carrier subject to 49 USCA §20 (a); §20 (a) of the Interstate Commerce Act, 49 USCA §20 (a), subjecting securities issued by a common carrier to the control of the Interstate Commerce Commission; 1 P.-H. Sec. Reg. Ser., (3rd ed.) pars. 1697, 1921-1925.
INTERNATIONAL PROBLEMS

There is at the present time no international treaty or convention dealing with the recognition and recording of titles to aircraft or of security interests therein. Most foreign countries either do not recognize or protect mortgage interests in aircraft or afford inadequate recognition or protection of such interests. Without such a convention, financial institutions have been extremely reluctant to lend money upon, or finance the purchase of, aircraft intended to be used on foreign flights, and funds for new equipment have been difficult to obtain. The matter of foreign protection becomes of even greater importance when it is realized that instead of a single large international carrier and a few small ones under the American flag, as before the war, there are now many American carriers flying beyond the borders of the United States. The situation has thus been reversed and a majority of the so-called domestic carriers have become international. Such a convention is likewise necessary if the purchase of American aircraft by foreign airlines is to be financed in this country.

Initial drafts of a proposed convention were prepared as long ago as 1931, but it is only recently that intense efforts have been made to secure agreement upon the terms of such a convention and its adoption by most countries. Although serious disagreements and other obstacles have existed, it is hoped that through the International Civil Aviation Organization (ICAO) agreement upon such a draft in form satisfactory for the development of American financing will soon be reached. The most recent draft, prepared by a legal committee of ICAO at Brussels in September 1947, does eliminate many of the disagreements and represents a major achievement on the part of the United States delegation. Thus it provides for recognition of equipment trusts and conditional sales, as well as mortgages (Article 1 (1)); it recognizes with a minor limitation the principle of fleet mortgages (according to which each plane is security for the entire debt) (Article V (5)); it provides for recording of interests in spare parts, though limiting the effectiveness of the security by an apportionment provision under which the obligation is protected only to two-thirds of the value of the parts and only two-thirds of the net proceeds of.

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34 In addition to Pan Am. and Panagra, the following carriers are operating or have been certificated to operate foreign routes: American, American Overseas, Braniff, Chicago and Southern, Colonial, Eastern, National, Northeast, Northwest, TWA, United, and Western.

35 Reference to the history and background of these efforts will be found in the following recent sources: Report of the Standing Committee on Aeronautical Law, Advance Program, 70th Annual Meeting, American Bar Association, Sept. 1947, pp. 43-46, 14 JOURNAL OF AIR LAW AND COMMERCE 483-484 (1947); Comment, 14 JOURNAL OF AIR LAW AND COMMERCE 378, 382 (1947); Warner, PICAo and the Development of Air Law, 14 JOURNAL OF AIR LAW AND COMMERCE 1, 7-8 (1947); Lord and Glenn, The Foreign Ship Mortgage, 56 Yale L.J., 923, 925-926 (1947).

36 The text of this draft, together with the report and commentary of the ICAO Legal Committee are found in 14 JOURNAL OF AIR LAW AND COMMERCE 500 (1947). An excellent analysis of this draft appears in the same issue. Comment by Moore, at page 591.
judicial sale are applied to the obligation (Article VIII); it restricts charges which have priority over recorded interests (Article III (1)).

The draft still recognizes the principle of the “purge” under which all prior liens are wiped out by judicial sale, so long as the charges having priority are assumed by the purchaser at such sale (Articles V (4) and VI). Some financial agencies feel that the latter procedure would be ruinous because the holder of the security interest would have to be ready to protect his interest by making bids in foreign countries in local currency on short notice. (Six weeks' notice is required by the present draft.) If the bid is successful, and he becomes entitled to the proceeds of his own bid to the extent of his lien (any excess being paid to the foreign creditor), then it may be impossible to reconvert the foreign funds to dollars because of various foreign exchange control restrictions, unless some procedure is worked out so that to the extent of the obligation secured no cash payment is required but an offset occurs. In the case of a fleet mortgage, however, no foreign creditor-purchaser would be likely to assume the entire debt. That he would be obligated to do so appears fairly clear under the terms of the convention although greater clarity might be desirable. (See Articles I (1) (d), IV, V (4), and VI.) Even so, such assumption would presumably be in the foreign currency and might otherwise be difficult of enforcement.

An attempt has been made in preparing the proposed recording amendments to the Civil Aeronautics Act (Appendix Part C) to cover all requirements necessary to assure full recognition of international recording of interests in aircraft and in spare parts under the Brussels draft. Article VIII of the draft recognizes basket recording of spare parts if such recognition is in conformity with the law of the state of registration of the aircraft. Since the term “spare parts” is defined to include engines, it appears necessary that basket recording of engines be provided for in the national law. Otherwise not merely would recording of engines be without international effect, but all basket recording for spare parts might fail under adverse interpretation by a foreign court, on the ground that the national law failed to provide such recording for all spare parts. Since basket recording cannot apply to engines while installed in aircraft and since specific recording of engines is not provided for in the Brussels draft, it appears desirable to state as part of the national law that title to or a lien upon aircraft shall extend to the engines, subject only to any prior interest recorded by specific description. Otherwise engines, interests in which were recorded by specific description, might be held free and open for claims of foreign creditors, even though the aircraft itself were subject to a lien given international recognition.

CONCLUSIONS

The legal obstacles which hinder the development of secured financing of airline equipment may be summarized as follows:
(1) Possible liability of the holder of the security interest for ground damage to persons and property. Although such liability is by no means sure and certain, nor would it exist in most states, nevertheless some risk may be involved. Insurance should prove a stop-gap remedy. Amendment of the Civil Aeronautics Act appears desirable and such amendment would be legally effective.

(2) Doubt as to the right of immediate repossession in bankruptcy. Due to the nature of the articles involved, and in order to assure payment of the claim in full, a secured lender must be given the right of immediate repossession upon default, in event of bankruptcy. An amendment to Chapter X of the Bankruptcy Act similar to the provision now found in the Act with respect to railroad equipment appears necessary.

(3) Lack of effective recording of interests in spare parts. Adequate financing requires the use of spare parts as security, and the Civil Aeronautics Act should be amended to provide for recording of interests in such parts.

(4) Certain difficulties under the Trust Indenture Act of 1939, in the event of public issue of securities backed by airline equipment. One difficulty will be eliminated if adequate provision for recording occurs, pursuant to paragraph (3) above and paragraph (5) below, and other difficulties may be remedied by amendment.

(5) Lack of international recognition or recording of interests in aircraft. Adoption by countries having air transport of an adequate international convention is necessary. Progress is being made to this end through ICAO.

Note: Since this article was written the President's Air Policy Commission has rendered its Report dated January 1, 1948. The Report at page 69 infra recommends the removal of the legal obstacles referred to in paragraphs (1), (2), (3) and (5) above.

Appendix

Part A. Liability of Holders of Security Interests in Aircraft

Proposed New Section 504 to Civil Aeronautics Act

Section 504. No person having a security interest in any civil aircraft under a conditional sale contract, equipment trust, chattel or corporate mortgage or other instrument of similar nature, whether or not such person shall be the owner of the legal title to said aircraft nor any person leasing any such aircraft to any air carrier or foreign air carrier, shall be liable by reason of such security interest or ownership or by reason of such interest as lessor under such lease or of ownership of the aircraft so leased, to any person or persons, for injuries to, or death of, persons or damage to, or loss of, property, caused by, or attributable to, such aircraft, or by or to the ascent, descent, or flight of such aircraft or the dropping or falling of any object therefrom, unless such person was in actual possession of such aircraft at the time and place of such injury, death, damage or loss.
PART B. REPOSESSION IN BANKRUPTCY

PROPOSED AMENDMENT TO CHAPTER X OF THE BANKRUPTCY ACT

The title of any owner, whether as trustee or otherwise, to, and the interest of any chattel mortgagee in, any aircraft equipment, leased or conditionally sold to the debtor, or upon which a chattel mortgage has been given for any purpose in good faith and for a valuable consideration, and any right of such owner or mortgagee to take possession of such property in compliance with the provisions of any such lease, conditional sale contract, or chattel mortgage, or in compliance with any provision of law relating to such lease, conditional sale contract, or chattel mortgage, or the right of any purchaser upon foreclosure to possession of such property, shall not be affected or abridged by the provisions of this Chapter in any case where such lease, conditional sale contract or chattel mortgage so provides. The term “aircraft equipment” shall include: (a) aircraft, meaning any contrivance now known or hereafter invented, used, or designed for navigation of or flight in the air; (b) aircraft engines, meaning engines used, or intended to be used, for propulsion of aircraft, including all parts, appurtenances and accessories thereof other than propellers; (c) propellers, including all parts, appurtenances and accessories thereof; (d) appliances, meaning instruments, equipment, apparatus, parts, appurtenances or accessories, of whatever description, which are used, or intended to be used, in the navigation, operation or control of aircraft in flight (including parachutes and including communication equipment and any other mechanism or mechanisms installed in or attached to aircraft during flight), and which are not a part or parts of aircraft, aircraft engines, or propellers; and (e) spare parts, meaning parts, appurtenances and accessories of aircraft (other than aircraft engines and propellers), of aircraft engines (other than propellers), and of propellers, and of appliances, maintained for installation or use in an aircraft, aircraft engine, propeller or appliance but which at the time are not installed therein or attached thereto.

PART C. RECORDING OF INTERESTS IN ENGINES AND SPARE PARTS

PROPOSED AMENDMENTS TO SECTIONS 1 AND 503 OF THE CIVIL AERONAUTICS ACT

Section 1. Section 1 of the Civil Aeronautics Act of 1938, as amended, is amended to change the numbering of paragraph (31) to (32), and to include a new paragraph (31), reading as follows:

“(31) ‘Spare parts’ means parts, appurtenances and accessories of aircraft (other than aircraft engines and propellers), of aircraft engines (other than propellers), of propellers and of appliances, maintained for installation or use in an aircraft, aircraft engine, propeller or appliance, but which at the time are not installed therein or attached thereto.”

Section 2. Paragraph (17) of Section 1 of such Act is amended to read as follows:

“(17) ‘Conditional sale’ means (a) any contract for the sale of an aircraft, aircraft engine, propeller, appliance or spare part under which possession is delivered to the buyer and the property is to vest in the buyer at a subsequent time, upon the payment of part or all of the price, or upon the performance of any other condition or the happening of any contingency; or (b) any contract for the bailment or leasing of an aircraft, aircraft engine, propeller, appliance or spare part, by which the bailee or lessee contracts to pay as compensation a sum substan-
SECURED AIRLINE EQUIPMENT FINANCING

Similarly equivalent to the value thereof, and by which it is agreed that the bailee or lessee is bound to become, or has the option of becoming, the owner thereof upon full compliance with the terms of the contract. The buyer, bailee, or lessee shall be deemed to be the person by whom any such contract is made or given.”

Section 3. Section 503 of such Act is amended to read as follows:

"SECTION 503. (a) The Administrator shall establish and maintain a system for the recording of all conveyances which affect the title to, or any interest in, any or all of the following: (i) any civil aircraft of the United States, (ii) any aircraft engine used or intended to be used by an air carrier, (iii) any aircraft engines, propellers and appliances, maintained for installation or use in aircraft, aircraft engines or propellers, and any spare parts, which conveyance need only describe generally by types the engines, propellers, appliances or spare parts covered thereby and designate the location or locations thereof.

(b) No conveyance made on or after the effective date of this section, which affects the title to, or any interest in, any civil aircraft of the United States shall be valid in respect of such aircraft against any person other than the person by whom the conveyance is made or given, his heir or devisee, and any person having actual notice thereof, until such conveyance is filed for recordation in the office of the Administrator; and, for the purposes of this paragraph (b), such conveyance shall take effect from the time and date of its filing for recordation and not from the time and date of its execution.

(c) Each conveyance recorded by means of or under the system provided for in paragraph (a) of this section shall from the time of its filing for recordation be valid as to all persons without further or other recordation, except that a conveyance recorded pursuant to clause (iii) of said paragraph (a) shall be effective only with respect to those of such items as may from time to time be situated at the designated location or locations and only while so situated; provided, however, that a conveyance affecting title to, or any interest in, an aircraft engine, if it be acknowledged on a date when such engine is not at a location designated in a conveyance then filed for recordation or recorded in the office of the Administrator pursuant to clause (iii) of said paragraph (a), and if within five (5) days of the date of acknowledgment it be received in the office of the Administrator for recordation pursuant to clause (ii) of said paragraph (a), shall not be affected by any conveyance recorded pursuant to clause (iii) of said paragraph (a).

(d) Notwithstanding any other provision of this section or of any law of the United States or of any State, if any aircraft engine is installed in or attached to a civil aircraft of the United States which is used or intended to be used by an air carrier and which, at the time such aircraft engine is so installed or attached, is subject to a mortgage, lease or contract of conditional sale theretofore duly filed for recordation in the office of the Administrator and theretofore or thereafter duly recorded, then whether or not title to such aircraft engine was retained by or vested in a mortgagee, vendor or lessor thereof, the title to or interest in such aircraft engine shall, while the same is installed in or attached to such aircraft, be subject to the rights and title of the mortgagee, lessor or conditional sale vendor of such aircraft, as the case may be, under the recorded conveyance above mentioned, as fully as if such aircraft engine had been a part of such aircraft at the date of the recording of such mortgage, lease or contract of conditional sale; provided, however, that if at the time of the installation of the aircraft engine in, or its attachment to, such a civil aircraft of the United States,
there shall have been filed for recordation in the office of the Administrator, and theretofore or thereafter duly recorded pursuant to clause (ii) of paragraph (a) of this section, a mortgage, lease or contract of conditional sale of such aircraft engine, then the rights and title of the mortgagee, lessor or conditional sale vendor of such aircraft in and to such aircraft engine shall be subject to the prior rights and title of the aforesaid mortgagee, lessor or conditional sale vendor of such aircraft engine.

"(e) No conveyance shall be recorded unless it shall have been acknowledged before a notary public or other officer authorized by the law of the United States, or of a State, Territory, or possession thereof, or the District of Columbia, to take acknowledgment of deeds.

"(f) The Administrator shall record conveyances filed with him in the order of their reception, in files to be kept for that purpose, and indexed according to—

"(1) The identifying description of the aircraft or aircraft engine, or in the case of a conveyance referred to in clause (iii) of paragraph (a) of this section the location or locations specified therein; and

"(2) The names of the parties to the conveyance.

"The Administrator shall keep a record of the time and date of the filing of conveyances with him and of the time and date of recordation thereof.

"(g) The Administrator is authorized to provide by regulation for the endorsement upon certificates of registration, or aircraft certificates, of information with respect to the ownership of the aircraft for which each certificate is issued, the recording of discharges and satisfactions of recorded instruments, and other transactions affecting title to or interest in aircraft, aircraft engines, propellers, appliances or parts, and for such other records, proceedings and details as may be necessary to facilitate the determination of the rights of parties dealing with civil aircraft of the United States, aircraft engines, propellers, appliances or parts.

"(h) The person applying for the issuance or renewal of an airworthiness certificate for an aircraft with respect to which there has been no recordation of ownership as provided in this section shall present with his application such information with respect to the ownership of the aircraft as the Administrator shall deem necessary to show the persons who are holders of property interests in such aircraft and the nature and extent of such interests."