

# Draft the Convention as ‘Rules’: Effective Devices in Drafting the Cape Town Convention<sup>1</sup>

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## Abstract

This paper focuses on the drafting process of the 2001 Cape Town Convention. The Convention aims to establish an international legal framework for the protection of creditors, which is essential to facilitate the aircraft financing in an efficient manner. The UNIDROIT, an intergovernmental organization which mainly took charge of drafting the Convention, was on the horns of a dilemma between two needs as to what the legal order should be. To realize the cost-effective aircraft financing, it is indispensable to establish a legal order which excludes the discretion of countries in case of a default of debtor (airline) and thereby ensures a smooth enforcement of security interests even in the countries with political risk. However, pursuing such an ideal too much may, on the other hand, lead to the situation that a drafted convention is not acceptable to many countries. Lacking of consideration for this point means the failure of project because the difference in stance on the non-possessory security interest is so wide among jurisdictions. To solve the trade-off between these two needs, the UNIDROIT took various devices in the drafting process.

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## **1 Introduction**

The entrepreneur can be financed easily by offering the creditor a collateral. He can use his means of production as a collateral if he is allowed to offer only their titles and to continue using them under the law. He also has the choice of using a lease or conditional sale if the goal of financing is equipment investment.

However, the asset-backed financing and leasing of aircraft are sensitive to local conditions of the host country in which the entrepreneur (airline) is located. The reason is that these conditions affect the acts of state authorities in case of a default by the airline. This tends to intensify in developing countries. If the creditor can't repossess the aircraft rapidly and sell or lease it smoothly at case of a default, the creditor can't finance the airline enough by getting the aircraft as collateral. Therefore, in those countries, the airline is suffered from high costs in financing and in the worst case it can't even access the international financing market.

One of means to solve that problem is to restrict the discretion of state authorities by a convention. The convention has a potentiality to make state authorities of its contracting state act in accordance with its duties. On this occasion, as the duties of convention are drafted clearly, the discretion of state authorities becomes more restrictive. As a result, the creditor can enjoy the predictability on financing in contracting states.

In this paper, we discuss the Cape Town Convention, whose main purpose is to facilitate the financing for acquisition and use of high value mobile equipments in an efficient manner.<sup>1</sup> For this purpose, the Convention aims to establish a stable international legal framework for the protection of creditors in asset-based financing and leasing of certain categories of mobile equipment including aircrafts.

To facilitate the aircraft financing, as mentioned above, it is necessary that the creditor can predict the smooth enforcement of security interest in a host country, and for a convention to create the predictability, it is necessary that the duties of the convention is drafted clearly. The same arguments can be found in terms of the Cape Town Convention. For example, the preamble of the Convention says that it facilitates the asset-based financing and leasing "by establishing clear rules to govern them." This point is considered to show that the drafters of the Convention sufficiently appreciated the significance of drafting its duties clearly.

One of instances showing the drafters' efforts are successful in this point is found at the

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<sup>1</sup> The preamble of the Convention.

discount offered by the EXIM since 2003. The bank has offered a one-third reduction of its exposure fee on the asset-backed financing of new US-manufactured large commercial aircraft for airlines in contracting states of the Convention. The exposure fee is the risk premium which the bank charges for the export financing. Behind the discount, there is the fact that the bank has an expectation that the Convention significantly reduces the legal risk associated with aircraft financing. Through the discount, many airlines located in the developing countries have enjoyed more favorable financings.<sup>2</sup> This implies that the Convention is clear enough to give creditors the predictability on aircraft financing.

On the other hand, the number of contracting states is another important factor influencing whether a convention is successful or not. One of purposes of this type of conventions is to harmonize or unify the private law between countries and thereby to reduce transaction costs for transnational parties. In particular, as far as the Convention is concerned, the mobility of the equipments covered by it makes this factor more important because it is impossible to establish a stable international legal framework for the protection of creditors without supports by many countries. For this reason, it is considered that the drafters were also necessary to draft the Convention acceptable to many countries. Table 1 shows that the drafters' efforts are successful in this point.

However, as described later, countries may have a different preference from business in clarity of a convention. In such a case, it isn't easy for drafters of a convention to satisfy both needs from business and countries. For this reason, the international organization which played a primary role in drafting the Convention, UNIDROIT, had to create various devices to satisfy these two needs. As the result, the Convention is very unique in some points. We analyze that these needs strongly effect the contents, the structures and the drafting processes of the Convention in terms of economic analysis of law.

The rest of this paper is organized as follows. In the next section, we develop our basic model and, through that means, evolve a hypothesis about the preferences of business and countries in clarity of the convention covering aircraft financing. In Section 3, we analyze the significance of some devices created by the UNIDROIT to satisfy these two preferences. Section 4 concludes and notes some policy implications.

## **2 Basic Model**

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<sup>2</sup> <<http://www.exim.gov/pressrelease.cfm/A45E77EE-DF56-CE48-084A25574AAEA175/>>.

In this section, we develop a simple model and analyze that how the clarity of convention effects the acts of creditor and debtor and how much clarity is required to acquire many approvals from countries and thereby consider the preference of business and countries in the clarity of convention. We discuss a convention covering the asset-based financing and leasing of aircraft.

Our basic model consists of the decision-making of three actors; a drafting organization, states and business. Each role of these actors and all stages of the game are organized as follows.

1. A drafting organization drafts a draft convention.
2. States make a convention based on the draft convention and adopt it in a diplomatic conference.
3. A creditor concludes a loan agreement with a debtor (airline) for the purchase of aircraft.
4. In case of a default of the airline, the creditor excises his security interest in the state in which the aircraft is located.

Each stage is explained more concretely below. Firstly, a drafting organization drafts a draft convention covering asset-base financing and leasing of aircraft. In doing so, the drafting organization is free to decide whether it drafts the draft convention as ‘rules’ or as ‘standards’ and if it decides to do as ‘rules,’ it is also free to decide the strength of security interests. This paper adopts such a definition in accordance with Kaplow (1992), in which the only distinction between ‘rules’ and ‘standards’ is the extent to which efforts to give content to the law are undertaken before or after individuals act.<sup>3</sup> Therefore, if the drafting organization decides to draft the draft convention as ‘rules,’ the law is given content by the organization. On the other hand, if it decides to draft the draft convention as ‘standards,’ the law is given content by the state authorities and courts of contracting states, which apply or enforce the convention in their own jurisdictions.

Secondly, the government delegates of each State make a convention based on the draft convention and adopt it in a diplomatic conference. If the convention is not acceptable to many states, it is not adopted. Each state decides whether it ratifies the convention adapted in the diplomatic conference. If ratifications reach the number provided in the convention, the convention enters into force.

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<sup>3</sup> Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 Duke L. J. 557 (1992).

Thirdly, under the convention entering into force, a creditor concludes a loan agreement with an airline for the purchase of aircraft. In a contract, they agree to a financed amount and interest while they agree that the creditor has the security interest on aircraft to secure payments of the principal and interest. If the business of airline is good, the airline will pay the principal and interest back to the creditor in accordance with the contract. On the other hand, when the business is bad, the airline will make a default.

In case of a default of the airline, fourthly, the creditor exercises his security interest on aircraft in a contracting state in which the aircraft is located. But he can not always do that smoothly. The reason is that the state authorities and courts of contracting states may reject enforcement, repossession, deregistration or exportation of the aircraft by the creditor. On this occasion, if the convention which the contracting state ratified is a rule-like convention, the state authorities and courts have duties to act in accordance with the clear wording of the convention. On the other hand, if the convention is a standard-like convention, the state authorities and courts would have discretion within the ambiguous wording of the convention.

Hereinafter, we develop the analysis of this game in a contrary order. The rest of this section is as follows. We analyze the fourth stage in Subsection 2.1, the third stage in Subsection 2.2, the second stage in Subsection 2.3 and the first stage in Section 3.

## **2.1 Enforcement of the Security Interest on Aircraft in the Host Country**

If a convention is rule-like one, the state authorities and courts of contracting states act in accordance with the clear duties of the convention. If a convention is standard-like one, on the other hand, the state authorities and courts are given the discretion. In this subsection, we analyze the acts of state authorities and courts when a convention is standard-like one.

In this occasion, the state authorities of the host country can use the discretion to give priority not to the secured creditor but to another interested party. Moreover, a standard-like convention leads the complicated weighing of various interests when the courts interpret the text of the convention. As a result, it may be occurred that the interest of secured creditor is subordinated to the interest of another interested party. These acts of state authorities and courts are represented as following.

$$\max_{\sigma} W^{S:post} = (1 - \sigma)s$$

$\sigma$  represents the degree of protection of creditor's interest,  $W^{S:post}$  does the benefit of host country and  $s$  does the value of collateral.  $\sigma \in [0,1]$  can be considered to be a rate of the

value of collateral discounted by the degree of protection of creditor's interest.  $1 - \sigma$ , therefore, means the degree of protection of interests other than the creditor's one. As a result of the exercise of security interest, the secured creditor actually obtains the value of collateral  $\sigma s$  and the other interested parties obtains its rest  $(1 - \sigma)s$ . These are the factors of which the state authorities and courts consider when they wield the discretion or weigh the interests.

In this occasion, the decision of authorities and courts is  $\sigma^* = 0$ .<sup>4</sup> That is to say, the authorities and courts do not protect the creditor's interest. This means that a secured creditor has to be prepared for the case that he can not exercise his security interest smoothly in the host country in case of a default of the airline if the convention is standard-like one. The reason is that the possibility is not denied completely, that the state authorities and courts give priority to another interested party other than the secured creditor based on the protection of the weak.

## 2.2 Asset-based Financing and Leasing of Aircraft between Creditor and Debtor

In this subsection, we consider a loan agreement to purchase an aircraft between a creditor and a debtor (airline). We assume that the both parties are risk neutral. The creditor loans a funds  $I$  to the debtor to obtain an aircraft. The airline acquires an aircraft by using the funds and runs air transport business. The airline needs a cost  $\psi$  to do that business. The business is successful with probability  $p$  and yields a benefit  $b(> I + \psi)$ . Following the loan agreement, the airline transfers the lender  $t$  as principal and interest. The business is not successful with probability  $1 - p$  and leads to default of the airline. Then, the lender exercises his security interest on the aircraft and acquires the collateral  $s$ . In this regard, the lender practically gets a real collateral value  $\sigma s$ , which is discounted by the protection level of security interests in the host country. Figure 1 shows that relationship between the lender and the airline.

In brief, the lender gets  $t - I$  with probability  $p$  and acquires  $\sigma s - I$  with probability  $1 - p$ . The airline, on the other hand, receives  $b - t - \psi$  with probability  $p$  and obtains  $-\psi$  with probability  $1 - p$ . With that in mind, the lender and the airline enter into a loan agreement to purchase an aircraft. We suppose that the agreement is characterized by  $t^*(p, b, \sigma, s, I, \psi)$  and the contents of the agreement are determined by the Nash bargaining solution. We solve the following problem and get the solution:

$$\max_t [p(b - t) - \psi] \times [pt + (1 - p)\sigma s - I]$$

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<sup>4</sup> The variables with superscript \* indicates ones each actors choose.

$$t^* = [pb - (1 - p)\sigma s + I - \psi]/2p$$

From this equation, we can find that the amount of repayment for the lender  $t^*$  increases as the protection level of security interests  $\sigma$  in the host country is smaller. This means that if the value of the aircraft as collateral may be depreciated by the judicial inefficiency of the host country, the lender takes such risks into consideration of the contract. The equilibrium transfer  $t^*$  by determined the Nash bargaining, as be well known, divides the benefit of the parties into equal parts. Therefore, each profit of the lender and the airline is

$$[pb + (1 - p)\sigma s - I - \psi]/2 \quad (1).$$

The lender finances the airline only when this formula is positive. The protection level of security interests in the host country  $\sigma$  which makes the formula (1) positive is

$$\sigma > \frac{I + \psi - pb}{(1 - p)s} \quad .^5$$

We define the right side of this formula as  $\hat{\sigma}$ . Other things being equal, the lender finances the airline only in the scope of  $\sigma > \hat{\sigma}$ , and doesn't in that of  $\sigma \leq \hat{\sigma}$  (see Figure 2). This means that if the protection level of security interests in the host country is not sufficiently large, the lender doesn't finance the airline, and vice versa. This is credit rationing, which results from an insufficient protection of foreign lenders' security interests in the host country.

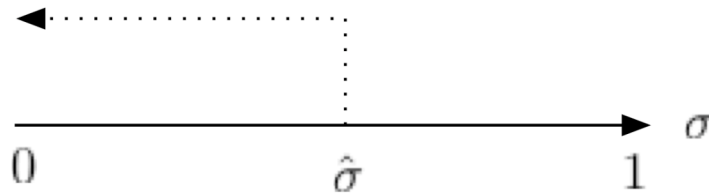


Figure 2 Range of  $\sigma$  in which the lender doesn't finance the airline (i.e. in which the credit rationing occurs)

Simple comparative statics on  $\hat{\sigma}$  obtains  $\partial\hat{\sigma}/\partial p < 0$ . This represents that  $\hat{\sigma}$  becomes bigger as the probability  $p$ , with which the air transport business is successful, is smaller. Therefore, the range of  $\sigma$  in which the lender finances the airline becomes narrower. In other hand, a host country must protect security interests of foreign lenders more strongly when an

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<sup>5</sup> To make things interesting, we will assume that  $I + \psi - pb > 0$ . The value of  $\hat{\sigma}$  is nonnegative. This indicates that on the equilibrium with  $\sigma = 0$  investment to the business is not financed.

airline in the country is less credible. For above reasons, as regards the preference of business for the clarity of conventions, we can suppose that business likes a rule-like convention.

### 2.3 Ratification of the Convention by States

In this subsection, we analyze the decision-making by states of making and adapting of a convention in a diplomatic conference and the decision-making by states whether they ratify the convention which was adapted. The former decision-making and the latter decision-making are based on different policies. But these two decision-makings are common in being effected by the clarification of convention.

As regards the preference of states, we suppose that the convention could not be acceptable to many states if the draft convention or the convention are drafted as ‘rules.’ The reason is that the increasing number of states which participates the global community and the diversified interests of states. For this reason, in the stage of adaptation of convention, if a draft convention was drafted as ‘rules,’ it is difficult for such a draft convention to reach an international consensus on adaptation. For similar reasons, in the stage of ratification of convention, if a convention is a rule-like one, a few countries would ratify the convention and the convention does not reach to the critical mass. Therefore, the convention could not catch the potential contracting states which ratify the convention expecting the network effects of the convention. In brief, whether in the stage of adaptation or ratification, there is not so much difference between these two stages in difficulty of getting many approvals from states when a draft convention or a convention are a rule-like one. This makes it possible that we develop our basic model, especially focusing the decision-making by states in the stage of ratification.

We use  $W^S$  to represent the benefit of contracting states if a convention is standard-like one and use  $W^R$  to represent the benefit of contracting states if a convention is rule-like one. Based on the hypothesis,  $W^S$  means the benefit of states which is obtained through adjusting the interests ex ante and  $W^R$  means the benefit of airlines which is obtained through ratifying a rule-like convention. If the convention is standard-like one,  $\sigma = 0$  is established in equilibrium because the state authorities and courts have discretion. Based on the hypothesis, in the occasion, the credit rationing occurs and no profit is yielded from the business. Consequently,  $W^S$  and  $W^R$  are respectively as follows.

$$W^S = y$$

$$W^R = [pb + (1 - p)\sigma s - I - \psi]/2$$

$y$  means the benefit of states which is obtained through avoiding to ratify the rule-like

convention. This is considered to be a relative benefit of states which is obtained by keeping a room to make discretion for state authorities. In other words, it can be also considered that  $y$  means an opportunity cost, which is occurred when a state ratifies a rule-like convention and thereby abandons discretion.  $y \in [0, \infty)$  is presupposed to follow the distribution of  $f(y)$ . This means the benefit of states which is obtained by keeping the state authorities and courts discretion varies between states.

Considering in that way, when the benefit of states which is obtained not by ratifying the rule-like convention is larger than that which is obtained by it, that is  $W^S \leq (>)W^R$  is established, the state ratifies the rule-like convention. In other words, when

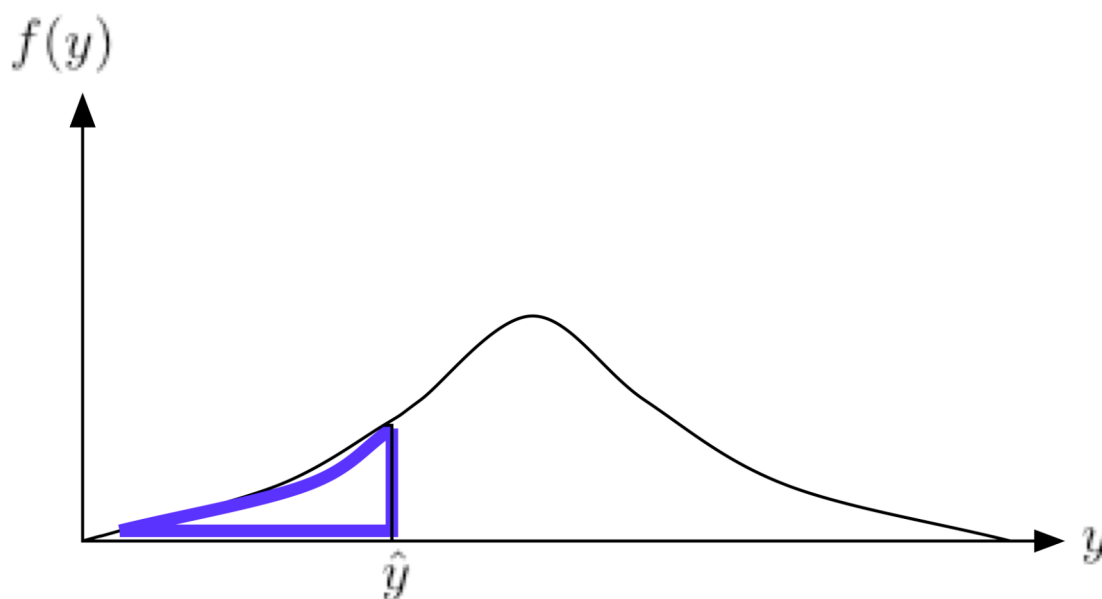
$$y \leq [pb + (1-p)\sigma s - I - \psi]/2$$

the state ratifies a rule-like convention.  $\hat{y}$  represents the right side of this formula. In Figure 3, the left part of  $\hat{y}$  shows the proportion of states which ratify a convention if the convention is rule-like one. The right part of  $\hat{y}$ , on the other hand, shows the proportion of states which do not ratify a convention if the convention is rule-like one. Therefore,  $\hat{y}$  is the threshold whether each state ratifies a rule-like convention. how many countries ratify a rule-like convention is depends on the form of  $f(y)$  and the size of  $\hat{y}$ . We examine the form of  $f(y)$  and the size of  $\hat{y}$ . It is considered to be practical that the form of  $f(y)$  is widen toward the end and the size of  $\hat{y}$  is small. When the value of  $\hat{y}$  is small, the right part of  $\hat{y}$  is larger than its left part. As the result, we can presuppose that a number of states do not like the rule-like convention as the preference of states.

Comparing the result of this subsection with the result of Subsection 2.1 and 2.2, we can conclude that states have a different preference from business in the clarity of convention. This means that even if a drafting organization prepares a draft convention as rules to satisfy the needs from business, such a draft convention is not very acceptable to the potential contracting states. As the result, such a rule-like draft convention would become a standard-like convention in a diplomatic conference. And even if a rule-like convention is made based on such a rule-like draft convention, the convention could not get many ratifications from the potential contracting states and could not reach to the critical mass. In other words, as regards drafting a draft convention as rules, the relation between the needs of business (“draft it as rules!”) and the needs of potential states parties (“don’t draft it as rules!”) is trade-off. Our model presents that it is possible for a drafting organization not to satisfy the needs from potential states parties if it satisfies the needs from business. The important thing is that UNIDROIT was required to satisfy

these incompatible two needs in drafting the Cape Town Convention.

In this section, as can be seen, we analyze that what a drafting organization needs to consider in drafting a convention which establishes an international regimen of secured transactions of aircrafts, by analyzing this game in the contrary order. Our arguments in this section lead a hypothesis that the needs of business may be incompatible with the needs of potential states parties. In the next section, given this situation, we analyze some devices created by UNIDROIT in drafting the Cape Town Convention to satisfy these two needs.



### 3 Devices in Drafting the Convention

#### 3.1 Participation of Industrial Groups in the Drafting Process

As the devices to satisfy the needs of business, firstly, we regard the participation of industrial groups in the drafting process. The Aviation Working Group (AWG) and the International Air Transport Association (IATA) participated in the drafting process of the Convention. The AWG is composed of airframe manufacturers, aircraft engine manufacturer, leasing companies and banks and its members play the role of creditor in aircraft financing. On the other hand, the IATA is an industrial group of airlines. As discussed in Section 2.2, these two industrial groups could directly benefit from entering into force of a convention facilitating the aircraft financing in an efficient manner. These two industrial groups provided information throughout the drafting process by presenting some reports to the Study Group and by participating the Aircraft Protocol Group whose purpose was preparing the draft aircraft protocol.

It is necessary to collect information in a drafting process to draft a convention as rules.

And it is important to distill the needs of business from such information and to reflect it to a convention. Some defects in this process would spoil the advantage of rules for which it is possible to design the best acts for each actor to be taken, before each actor acts, from the perspective on facilitating aircraft financing in an efficient manner. It is considered that the participation of these two industrial groups in the drafting process was an effective way to correctly distill the needs of business to reflect to the Convention. The device stated in the next subsection, the dual structure approach, is a device to reflect the needs of business distilled in that way to the Convention, maintaining the clarity of the needs.

### **3.2 Dual Structure Approach**

The second device to satisfy the needs of business is the dual structure approach. The Convention consists of the convention and the protocols of each equipment. All articles applied to all categories of equipments are on the convention, while all articles applied to a specific category of equipments are on each protocol (see Figure 4). In this paper, we call such an approach the dual structure approach.

Adapting this approach made it possible for the drafters to consider each equipment separately from other equipments and to set up the group to prepare each draft protocol by equipment. Therefore, even if solutions to a problem is controversial between the equipments, the drafters can draft the best solution for each equipment on each protocol without making compromises and then drafting ambiguous wording.<sup>6</sup> This means that the structure makes surroundings to reflect the needs of business to the Convention, keeping the clarity of the needs distilled by the participation of the industrial groups. Moreover, it is expected that the structure creates an interest of related organizations to the project and encourages their participation in drafting process.

The relationship between the convention and the protocols is as follows. Firstly, the convention enters into force only as regards a category of objects to which a Protocol applies: (a) as from the time of entry into force of that Protocol; (b) subject to the terms of that Protocol; and (c) as between States Parties to this Convention and that Protocol (Art. 49). And secondly, to the extent of any inconsistency between this Convention and the Protocol, the Protocol shall prevail (Art. 6-2). The relationship is also very important to ensure the rule-like nature of the

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<sup>6</sup> Mark J. Sundahl, *The "Cape Town Approach": A New Method of Making International Law*, 44 COLUM. J. TRANSNAT'L L. 339, 362 (2006) [hereinafter Sundahl 2006].

Convention.

In addition, the dual structure approach made it possible to integrate the common matters among all equipments into the convention. This means that the approach isn't suffered from a problem which would have happened if UNIDROIT had adapted the stand-alone approach, namely the problem that even common matters among all equipments could be provided differently in each convention. As the result, the courts of contracting states interpret a common matter among all equipments in a same manner based on a same provision in the convention.<sup>7</sup> The dual structure approach is expected to promote the quicker establishment of case laws about these common matters than stand-alone approach. Because the establishment of case laws supplies predictability to business, the approach also has the merit to shift the convention to more rule-like one quickly.

### **3.3 Removal of Good Faith from the Interpretation Tool**

The third device to meet the requirement of business is removing the good faith from the interpretation tools of the Convention. Although it was intend to give more contents to the convention in the stage of drafting, the Convention includes some matters which could not resolve or which were considered that doing so was not desirable in the stage of drafting. It is the courts in contracting states that resolve these matters. Therefore, the key to reduce uncertainty incident to these matters depends on whether interpretations of these matters by the national courts are unified.

Art. 5.1 of the convention provides for interpretation tools which the national courts can use. The provision says that "in the interpretation of this Convention, regard is to be had to its purposes as set forth in the preamble, to its international character and to the need to promote uniformity and predictability in its application." It is an instruction to national courts to avoid national concepts in interpreting the texts.<sup>8</sup> But it is questionable for the provision to facilitate unified interpretations of these matters by national courts, considering the degree that the legal concepts of national laws effect national judges.

But it is important to exclude the good faith from the interpretation tools of the convention intentionally. When the study group discussed whether this legal conception was adapted, AWG

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<sup>7</sup> See Roy Goode, Official Commentary on the Convention on International Interests in Mobile Equipment and the Protocol thereto on Matters Specific to Aircraft Equipment (2002, Unidroit) at 7 [hereinafter Official Commentary].

<sup>8</sup> *Id.*, at 63.

and IATA asked that the good faith was excluded from the interpretation tools because of uncertainty. They said that “the absence of a good faith standard in a number of jurisdictions, as well as the varying treatment of this concept in others, will result in uncertainty as to the meaning of the provision,” and concluded that “[i]t is, in sum, a potentially litigious provision which we view as inappropriate in a convention designed to provide clear, useful rules supporting international asset financing.”<sup>9</sup>

Here again considering Art. 5.1 of the convention on a basis of the discussion developed in the drafting process, the meaning of the provision is to stop giving the courts of contracting states a legal conception which may supply uncertainty. Art. 5.1 of the convention stops the courts of contracting states diminishing the business needs reflected in the convention when they apply it.

### **3.4 Application of the Party Autonomy**

The forth device to meet the requirement of business is to apply the party autonomy to supply open-textured provisions with contents. At the beginning, as regards the manner in which remedies are exercised, the drafting group drafted that any remedy giving to chargee “shall be exercised in a commercially reasonable manner. In determining what is reasonable the court shall have regard to any terms of the security agreement relating to the manner of exercise of such remedies.”<sup>10</sup> In response, AWG and IATA took issue with this provision and, in particular, with the open-textured concept of a commercially reasonable manner of exercising remedies. They did so on the grounds “that its interpretation ( i ) would be unclear, ( ii ) would vary quite widely between jurisdictions, ( iii ) would invite litigation, and ( iv ) could be used as inappropriate justification in support of decisions by courts to prefer their nationals in the context of international litigation.”<sup>11</sup> In brief, they had misgivings about uncertainty resulted from such an open-textured provision.

Following the statement, AWG and IATA suggested that “very fundamental questions relating to the manner in which remedies are exercised should not be left to national courts without adequate guidance” and that “transaction parties should be able to negotiate this matter with minimal, if any, policing” and recommended that “the remedies giving to chargee would

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<sup>9</sup> See UNIDROIT 1997 Study LXXII – Doc. 32 Add. 2 at 8 [hereinafter AWG/IATA Memo].

<sup>10</sup> UNIDROIT 1996 Study LXXII – Doc. 30 at 11.

<sup>11</sup> AWG/IATA Memo, *supra* note 9, at 9.

be exercisable to the extent and on the terms set forth in the relevant agreement.”<sup>12</sup> In brief, they insisted that it was the transaction parties rather than the courts of contracting states that should supply substantial and specific contents to the open-textured concept of a commercially reasonable manner of exercising remedies. Ultimately, the manner in which remedies are exercised is provided along the two industrial groups’ recommendation: any remedy “shall be exercised in a commercially reasonable manner. A remedy shall be deemed to be exercised in a commercially reasonable manner where it is exercised in conformity agreement except where such a provision is manifestly unreasonable.”<sup>13</sup> And, as regards aircraft equipments, this concept of a commercially reasonable manner of exercising remedies is extended to all remedies given by the convention and the aircraft protocol.<sup>14</sup> Such provisions extend the area which business can control when they transact.

As stated above, these five devices individually play important roles to draft a rule-like draft convention. We will explain the effects of them, based on our model. As the result that these devices strengthen the rule-like character of the Treaty, firstly, related authorities and courts in contracting states are bound to the clear text of the Treaty. This improves the protection level of security interests  $\sigma$  in Subsection 2.2 and, thereby, makes it possible for lenders to predict the smooth exercise of their security interests in the contracting state in case of the default of the airlines. That is to say, these devices help to create an attractive legal environment in contracting states for foreign lenders (this results from a decrease in the range of  $\sigma$ , in which a credit rationing occurs, in Figure 2).

Secondly, the reduction of legal risk resulting from improvement of the protection-level of security interests is reflected the country risk premium, and is expected to make  $t^*$ , the transfer from the borrower to the lender, smaller ( $\frac{\partial t^*}{\partial \sigma} < 0$ ). The reaction of the EXIM is typical of such decrease of country risk premium.

Thirdly, the reduction of  $t^*$  results in increase of profits of the domestic airlines. From the presumption, this means increase of  $W^R$  in Subsection 2.3, that is to say, right shift of the threshold  $\hat{y}$  (see Figure 5). As the result, the shaded region increases and the model shows that the proportion of countries ratifying the rule-like treaty increases.<sup>15</sup>

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<sup>12</sup> *Id.*, at 10.

<sup>13</sup> Art. 8-3 of the convention.

<sup>14</sup> Art. IX-3 of the aircraft protocol.

<sup>15</sup> See Anthony Saunders & Ingo Walter, *Proposed UNIDROIT Convention on International Interests in*

### **3.5 Limitation of Equipments Covered by the Convention**

On the other hand, as the devices to satisfy the needs of potential contracting states, firstly, we regard limitation of the types of personal properties covered by the convention to some high-value mobile equipments.

### **3.6 System of Declarations**

The second device to meet the requirement of potential contracting states is introducing the system of declarations. These options are prepared for even such provisions as Art. 54-2 and Art. XI, which are important to facilitate asset-based financing and leasing in an efficient manner. But there is no option which damages the rules of priority among creditors and the international registration system. From this points, the meaning of the system of declarations is that the each contracting state can do decision-makings about important matters as far as the essential business needs reflected into the convention and the logical consistency in the convention are protected.

Uniformity and clarity of a convention are two important factors to supply predictability to international commercial transactions. On one hand, it is obvious that introduce of the system of declarations reduces international uniformity of the Convention. But on the other hand, it is also obvious that clarity of the Convention would not be maintained in a level which business required if the system of declarations was not introduced into the convention, because differences between national property laws are too big to adjust national laws to clear texts of the convention. For the following two reasons, it is relevant that the drafters give priority to clarity rather than uniformity. Firstly, to facilitate aircraft financing in an efficient manner around the world, it is important for creditors to exercise their security interests rapidly and surely at default of airlines. To realize it, it is needed to restrict contracting states to the clear text of the convention. Secondly, we can point out that the parties concerned with the type of transactions covered by the Convention can ask legal advices easily. Considering these two reasons, the problem that the system of declarations complicates the convention is not serious. On the contrary, considering that the industrial groups of the potential users of the convention participated in the drafting process of the convention, it results from their decision-making that

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*Mobile Equipment as Applicable to Aircraft Equipment Through the Aircraft Equipment Protocol: Economic Impact Assessment*, XXIII AIR & SPACE L. 339, 346 (1998).

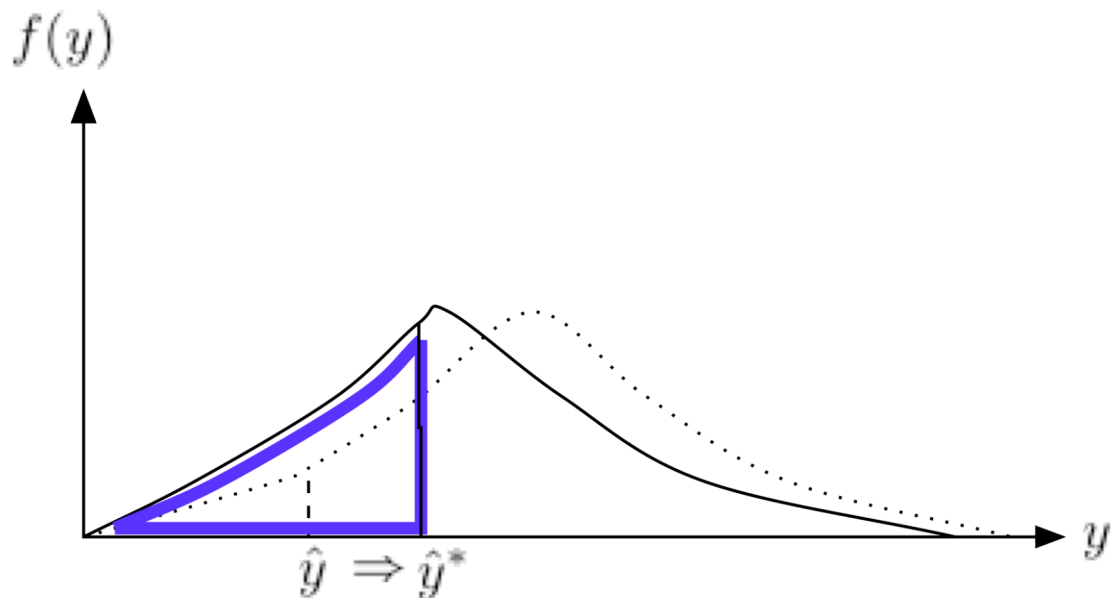
the complicated rules are more desirable than the simple standards in facilitating aircraft financing. The parties who plan to enter into aircraft financing can easily get information about all contents of declarations which each contracting state do by seeing the UNIDROIT's website.<sup>16</sup>

As stated above, these two devices individually play important roles to make the Treaty acceptable to many states. We will explain the effects of them, based on our model. Firstly, as the result that the drafters limited the types of personal properties covered by the Treaty to some high-value mobile equipments and introduced the system of declarations, it becomes possible to give potential contracting states the opportunity of ratifying the Treaty by each equipment. This is expected to have the effect to present an essence for policy-making to potential contracting states and presses them to make a choice between two policies. That is to say, one policy is to ratify the Treaty and, thereby, to facilitate acquisition and use of aircrafts in their own country. The other is to continue to adjust interests of all interested parties ex post as in past decades. In other words, it has the effect to make potential states parties aware of the  $\hat{y}$ .

Moreover, introducing of the system of declarations made it possible that the each contracting state makes a decision on some important matters, as far as the essential business needs reflected into the Treaty and the logical consistency in the Treaty are protected. This makes  $W^S$  (the benefit a state obtains if it does not ratify the rule-like convention), and  $y$  (the opportunity cost a state bears if it ratifies the rule-like convention), smaller. Figure 5 indicates that the distribution of  $y$  moves in the left direction in our model. In Figure 5, the dot line means the previous distribution and the solid line do the new distribution. When the distribution of the potential contracting states'  $y$  changes as described above (the whole benefits  $y$  tend to decrease), we can see in the Figure that the number of contracting states increases even if the threat value  $\hat{y}$ , at which a state ratifies rule-like conventions, doesn't change. The limitation of equipments covered by the Convention and the introduction of the system of declarations are considered to change the preference of countries in the clarity of rule-like convention and thereby the Convention more applicable one. Therefore, it is concluded that these two devices have the effect to loosen the participation restrictions to the Convention.

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<sup>16</sup> <<http://www.unidroit.org/english/implement/i-2001-convention.pdf>>, <<http://www.unidroit.org/english/implement/i-2001-aircraftprotocol.pdf>>.



#### 4 Concluding Remarks

This paper explores why the Cape Town Convention is successful today. The word of 'successful' has two means in this context. The Convention is, on one hand, successful in offering business the predictability enough to facilitate the aircraft financing in an efficient manner. The Convention is, on the other hand, successful in obtaining a number of contracting states. As sated above, as regards drafting the duties of convention clear, it is always not easy to satisfy the two needs between business and countries. The UNIDROIT made it possible to satisfy these two needs by creating various devices in the drafting process.

The convention has the potentiality to realize a policy over borders. When, to realize a policy, it is required for a convention to offer the predictability and thereof to be drafted as 'rulers' rather than 'standards,' the drafting process of the Convention will present some suggestions. Firstly, it is important for the drafters to understand the preferences of related actors and then to decide which actors should be allowed to participate in the drafting process. Secondly, it is important to bring an appropriate order to the drafting process for the allowed actors to fulfill their expected roles. In the drafting process of the Convention, the dual structure and the system of declarations function as such orders. Thirdly, it is important to prescribe each role of actors required to realize a transnational policy clearly in a convention. For example, which actor can fill ambiguous provisions of convention with meanings? Is it the courts of contracting states or the parties of transactions? Finally, it is important to create the devices for many countries to accept a convention. It should not be forgotten that the realization of a policy

over borders is based on pulling out the cooperation of many countries.