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## **LEGAL ANALYSIS**

(Prepared by the UNIDROIT Secretariat)

### **Introduction**

1. The purpose of this document is to set out the legal and technical issues related to the preliminary draft Protocol to the Convention on International Interests on Mobile Equipment on Matters specific to Agricultural, Construction and Mining Equipment (hereinafter “the preliminary draft MAC Protocol”). The document provides research conducted by the Secretariat as well as deliberations and decisions of the Study Group across its four meetings (15 – 17 December 2014, 8 – 10 April 2015, 19 – 21 October 2015 and 7 – 9 March 2016).
2. This legal analysis document is similar in structure to the legal analyses documents considered during the Study Group meetings. The issues are group together under five thematic sections:
  - (1) Issues related to scope
  - (2) Issues related to association of MAC equipment with other assets
  - (3) Issues related to insolvency
  - (4) Issues related to registration
  - (5) Other issues
3. The appendices to this document contain research papers produced by the Secretariat and assisting organisations between 2014 – 2016 to provide further analysis on certain complex legal issues.
4. References in this document to the “preliminary draft MAC Protocol” are references to the UNIDROIT 2016 - Study 72K – CGE1 – Doc. 2. During the Study Group sessions, the Study Group developed six iterations of the draft text. Previous drafts of the text developed during the Study Group sessions are referred to in this paper as “Study Group draft”.

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## LEGAL ISSUES

### PART 1 - ISSUES RELATED TO SCOPE

#### A. Use of the Harmonized System

5. Throughout the development of the project, concerns were consistently raised regarding the scope of the preliminary draft MAC Protocol.<sup>1</sup> Specifically, the concern most often raised was that the scope of a preliminary draft MAC Protocol covering all agricultural, construction and mining equipment was simply too broad and uncertain. It had also been queried whether it was possible to limit the scope of a preliminary draft MAC Protocol to types of agricultural, construction and mining equipment which were inherently mobile and high-value, and whether it was appropriate to cover agricultural, construction and mining equipment in the same instrument. After considering a variety of different approaches to limiting the scope of the preliminary draft MAC Protocol, the Study Group identified one mechanism that could be used to ensure its scope would be clear, precise and appropriate.

6. The preliminary draft MAC Protocol uses the Harmonized Commodity Description and Coding System (HS System) to identify the types of agricultural, construction and mining equipment to be covered by its scope. The HS System is a global nomenclature system developed by the World Customs Organisation (WCO) to achieve uniform classification of commodities or merchandise in international trade. Countries also use it to monitor controlled goods, calculate and collect internal excise and sales taxes and compile transport statistics. The HS System is utilised by more than 200 countries and covers 98% of all international trade. The WCO was consulted in determining how the HS System could be utilised for determining the scope of the preliminary draft MAC Protocol, and a senior technical officer from the organisation attended the third Study Group meeting to provide expert explanations.

7. The Annexes to the preliminary draft MAC Protocol list the HS codes that cover the types of agricultural,<sup>2</sup> construction and mining equipment which fall within its scope (HS System codes for agricultural equipment are listed in Annex 1, construction equipment in Annex 2 and mining equipment in Annex 3). Use of the HS System to define the scope of the preliminary draft MAC Protocol ensures that the Protocol will apply to high value equipment used primarily in the agriculture, construction and mining industries. Further, the listing of the HS codes covering equipment from the different industries (agriculture, construction and mining) in different Annexes allows Contracting States to apply the preliminary draft MAC Protocol to equipment used in only one or two of the agriculture, construction and mining industries if they so wish.<sup>3</sup>

8. A detailed document on the operation of the Harmonized System, as completed by the National Law Centre for Inter-American Free Trade (NLCIFT) and presented to the Study Group at the second Study Group meeting is at Appendix I. Appendix I provides information on the organisation and structure of the HS System, amendment process, other international instruments that utilise the HS System to define their scope and alternative classification systems.

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<sup>1</sup> See [UNIDROIT 2006 - C.D. \(85\) 19](#), page 10; [UNIDROIT 2009 - C.D. \(88\) 17](#), paragraphs 143 - 147; [UNIDROIT 2010 - C.D. \(89\) 17](#); paragraphs 33 - 37; [UNIDROIT 2011 - C.D. \(90\) 18](#), paragraphs 68 - 70; [UNIDROIT 2012 - C.D. \(91\) 15](#), paragraphs 46 - 47; [UNIDROIT 2013 - C.D. \(92\) 17](#), paragraphs 44 - 48; [UNIDROIT 2014 - C.D. \(93\) 14](#), paragraphs 34 - 38.

<sup>2</sup> The Study Group decided that the definition of 'agriculture' for the preliminary draft Protocol should be consistent with the Food and Agriculture Organization of the United Nations (FAO) definition, which includes forestry and fisheries (to the extent that fisheries covers aquaculture equipment).

<sup>3</sup> For example, Contracting States are permitted to make a declaration under Article 2(3) of the preliminary draft Protocol to apply the Protocol to only agricultural equipment in Annex 1 and mining equipment in Annex 3, but not construction equipment in Annex 2.

*Consideration at previous meetings*

9. At the first meeting of the Study Group, it was agreed that the best likely method of delineating the scope of the preliminary draft MAC Protocol was by use of the HS System.<sup>4</sup> The issue was considered in more detail at the second Study Group meeting, based on research done by the NLCIFT.

10. During the second Study Group meeting, it was noted that the HS System is broken down into 5,205 6-digit codes, covering 98% of international trade. The amendment process which occurs every five years, addresses both clarifications and structural reorganisation of the HS System. The amendments are generally not radical changes to the system, and 72% of all HS codes have never been changed by any amendment. Over the last three amendment processes to the HS System which occurred in 2002, 2007 and 2012, only 6 of the 103 initially suggested HS codes for inclusion under the preliminary draft MAC Protocol were affected by the amendments, and these changes were structural rather than substantive. It was highlighted that while there were several other goods classifications that are utilised globally for a variety of purposes, the HS system remained the benchmark and most utilised of all other systems, and was the most appropriate system for establishing the scope of the preliminary draft MAC Protocol.

11. At the third Study Group meeting, Mr Ed de Jong, Senior Technical Officer from the WCO, delivered a detailed presentation on how the HS mechanism operates and how the system could be used by the preliminary draft MAC Protocol to delineate its scope. He noted that the current 2012 edition of the HS Code was in force and would be valid up to the end of 2016, given that the WCO had a review cycle of every five to six years. He suggested that the Study Group should take into account the 2017 edition as the basis for its deliberations on the scope.

12. Mr de Jong explained various aspects of the HS system, and noted that trade statistics on the global trade of goods under the HS system were monitored and kept by COMTRADE<sup>5</sup> (a part of the United Nations Statistics Division), contracting parties to the HS system were required to publish their statistics and that there were 154 contracting parties (at 12 May 2016). He also noted that amendments to the HS system were made due to changes in trade volume, problems in classification or emerging new technologies. Where a code was subject to deletion due to a lack of trade volume, a good traded under the deleted code would still be tradable under a residual six-digit code subheading. At the end of the third meeting the Study Group concluded that the HS system continued to be the best mechanism for delineating the scope of the preliminary draft MAC Protocol.

13. At the fourth Study Group meeting the Secretariat provided the Study Group with additional research on two other international instruments that utilised the Harmonized System to define aspects of their scope. The Secretariat conducted an additional study on both the Agreement on Trade in Civil Aircraft and the Energy Charter Treaty (ECT), in order to ascertain whether the approaches used in these instruments could be adopted by the preliminary draft MAC Protocol. It was noted that the approaches of the two instruments to utilisation of the HS System as a scoping mechanism were limited, as they both also had description-based scoping mechanisms in addition to the use of the HS codes.

It was explained that the potentially useful mechanism utilised by both instruments was the 'ex' designation placed before HS codes to indicate that not all items that fell under a certain HS code

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<sup>4</sup> [UNIDROIT 2015 - Study 72K - SG1 - Doc. 5](#), paragraphs 6-9.

<sup>5</sup> COMTRADE is the United Nations Commodity Trade Statistics Database. COMTRADE is the largest depository of international trade data, with 1.7 billion data records dating back to 1962. Over 170 reporter countries provide the United Nations Statistics Division with annual international trade statistics data detailed by commodities and partner countries.

were within the scope of the instrument. If it was decided to exclude certain items from the preliminary draft MAC Protocol, such as parts that were covered under an HS code listed in the Annex, then the 'ex' designation could be used to continue to apply the preliminary draft MAC Protocol to the completed equipment listed under an HS code, albeit excluding parts.

## **B. Preliminary List of HS Codes for inclusion under the MAC Protocol**

14. The Annexes to the preliminary draft MAC Protocol list the HS codes that cover the types of agricultural, construction and mining equipment which fall within its scope. The Annexes to the preliminary draft MAC Protocol contain 36 HS codes (20 in Annex 1, 28 in Annex 2 and 17 in Annex 3).<sup>6</sup>

15. The preliminary list of HS codes was produced in collaboration with the MAC Protocol Working Group. As at August 2016, the Working Group consists of 13 members<sup>7</sup> from six countries.<sup>8</sup> Included in the Working Group membership are many of the largest MAC equipment manufactures globally, as well as several trade associations, including the Association of Equipment Manufacturers (AEM), which has 917 members in the agriculture and construction industries, the Equipment Leasing and Finance Association (ELFA), which represents over 575 financial service companies, banks and manufacturers and the Verband Deutscher Maschinen und Anlagenbau (VDMA), which is one of the largest industrial associations in Europe representing 3,100 member companies in the engineering industry. The Working Group is led by Mr Phillip Durham, partner in the Structured Finance Group of law firm Holland and Knight in New York.

16. The HS codes in the preliminary list were initially selected by the Working Group and were subsequently scrutinised by the Study Group. The Study Group considered the following factors in deciding whether an HS code was appropriate for inclusion in the Annexes to the preliminary draft MAC Protocol:

- (a) Whether the HS code covered equipment used primarily in the agriculture, construction and mining industries. Where the equipment was commonly used outside these industries, it was deemed multiple purpose equipment and was excluded from the Annexes.
- (b) Whether the HS code covered equipment that was of high value. The Study Group noted that an HS code did not need to cover exclusively high value equipment to be included in the Annexes. Individual unit prices for new equipment covered by the HS codes listed in the Annexes to the preliminary draft MAC Protocol range from \$10,000 USD - \$7,000,000 USD, however most HS codes had a minimum individual unit value of at least \$100,000 USD.
- (c) Whether the HS code covered equipment that was individually financed under current industry practice. Where the equipment was not currently individually financed, the Study Group decided that it was inappropriate for it to be included under the scope of a preliminary draft MAC Protocol.

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<sup>6</sup> It should be noted that the same HS code may be listed in more than one Annex, because equipment covered by that HS code is used in more than one of the three relevant industries (for example, an HS code might cover excavators that are used in both construction and mining and thus would be listed in both Annexes 2 and 3 respectively).

<sup>7</sup> Association of Equipment Manufacturers (AEM), AGCO, Caterpillar, CNH Industrial, Equipment Leasing and Finance Association (ELFA), General Electric, Hitachi, Holland and Knight, John Deere, Komatsu, Pfaandbrief, Tafe, Verband Deutscher Maschinen- und Anlagenbau (VDMA) and Vermeer.

<sup>8</sup> Australia, Germany, India, Italy, Japan and the United States.

- (d) Whether the HS code covered equipment that had individual unique manufacturer-issued serial numbers. Individual serialisation is required for registration of an interest in the equipment in the International Registry.
- (e) Whether the HS code covered parts as well as equipment or only parts. The HS System explicitly provides that certain HS codes cover parts of equipment. The Study Group decided that HS codes explicitly covering parts should be excluded from the Annexes, as parts to the relevant types of equipment were generally not of sufficiently high individual value or individually financed in practice.
- (f) Whether the HS code covered significant amounts of international trade. The Study Group considered 2014 global export data for the HS codes identified for the inclusion in the Annexes to the preliminary draft MAC Protocol, which had been extracted from the COMTRADE platform. Certain HS codes were of particular importance to the private sector as they covered a large amount of global trade in agricultural, construction and mining equipment, which made their inclusion essential to the economic viability to the preliminary draft MAC Protocol (as long as they satisfied the other criteria for inclusion as listed in sub-points (a)-(e) above).

17. Using these criteria, the Study Group categorised the HS codes suggested by the Working Group into three tiers of suitable (Tier 1), possible (Tier 2) and unsuitable (Tier 3) codes. Tier 1 codes have been included in the Annexes to the preliminary draft MAC Protocol on the basis that they are suitable for inclusion under its scope. Tier 2 codes were considered to have some merit, however failed to satisfy one or two of the criteria (set out above) and required further evidence from the Working Group to demonstrate they did meet all relevant criteria for inclusion. Tier 3 codes failed to meet several key criteria and were excluded from consideration. The Tier 1 codes are further divided up into agricultural, construction and mining equipment. Of the 113 codes on the list, 38 were classified as Tier 1 (suitable) codes, 18 were classified as Tier 2 (possible codes) and 57 were classified as Tier 3 (unsuitable) codes. The Working Group continues to provide input for inclusion in the preliminary list to ensure that the information it contains is as accurate and detailed as possible.

#### *Consideration at previous meetings*

18. At the first Study Group meeting, the Study Group was provided with a list of 97 HS codes selected by the private industry during Consultations in Washington in 2013 and 2014.

19. At the second Study Group meeting, this list was expanded to include an additional six codes suggested by General Electric mining, and further detail on the nature of equipment was added to the list:

- (a) Examples of the typical equipment types covered by the applicable HS code, focusing primarily on their use. The examples and uses were based on the actual rulings of the U.S. Customs and Border Protection where exporters to the U.S. sought an HS classification of their products.
- (b) Images of the sample equipment covered by the applicable HS codes.
- (c) Statistical information on the volume of trade for certain countries that import and export the relevant types of equipment covered under the applicable HS code. The statistical information included was sourced from two databases which are both publicly accessible on the Internet and easily searchable. These two databases are compiled by the Government of Canada and the European Union.

20. In preparation for the third Study Group meeting, the UNIDROIT Secretariat further refined the preliminary list:

- (a) Where applicable, subheadings providing additional examples for HS codes with several sub-areas of equipment.

- (b) Expanded descriptions which provide more information about the various types of equipment included under the listed HS codes.
- (c) Additional comments taken from the official Explanatory Notes of the HS system.
- (d) Additional columns indicating whether each listed HS code covers equipment that could be considered an accession, is affixable to immovable property or could be commonly used outside the agricultural, construction and mining fields.
- (e) An additional column indicating whether each code falls within the agricultural, construction or mining fields, or whether they cover equipment which is used in more than one of the fields.

21. Consultations with German industry in August 2015 led to the addition of 7 new HS codes for consideration on the preliminary list (HS codes 841370, 843049, 847431, 847432, 847982, 870540, 871620).

22. Further codes were suggested by members of the Working Group in September 2015, bringing the total number of HS codes presented to the Study Group at its third meeting to 113. Following the conclusion of the third Study Group meeting, the codes were first categorised into three tiers of codes.

23. Further data was gathered by the Secretariat between the third and fourth Study Group meetings. This information included:

- (a) Global export and import data for the HS codes on the preliminary list has been extracted from the COMTRADE platform (maintained by the United Nations Statistics Division). This information gives a much more accurate measurement of global trade values for the equipment within the scope of the preliminary draft MAC Protocol, which previously was based upon statistical information extracted from databases maintained by the Government of Canada and the European Union.<sup>9</sup>
- (b) Information provided by the Working Group:
  - (i) Approximate range of unit prices for new equipment under each code (provided by a range of manufacturers and aggregated to be anonymous by the Working Group).
  - (ii) Whether the equipment under each code is currently separately financed or leased (provided by the financiers).
  - (iii) Practical information on whether the equipment under each code is affixed to movable property or installed on other equipment to function.
  - (iv) Whether the equipment under each code has single manufacturer serial numbers and whether the manufacturer serial numbers are recycled.
  - (v) Whether the equipment under each code has model designations.
  - (vi) The Working Group requested the addition of 5 previously unlisted HS codes to Tier 1 (HS codes 842959, 843031, 843049, 843340 and 843351).
  - (vii) The Working Group requested three HS codes be elevated from Tier 2 to Tier 1 (HS codes 847982, 843680 and 870190), and provided additional information to justify the requested change.

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<sup>9</sup> In international trade statistics, exports may not coincide with imports (called trade asymmetries) due various methodological reasons: a) time of recording, b) trade system [or territorial coverage], c) incorrect classification, d) imports include freight and insurance whereas exports not, etc. More information available at: <http://unstats.un.org/unsd/trade/events/2014/mexico/documents/session4/Asymmetries%20in%20official%20ITS%20and%20analysis%20of%20globalization%20-%20V%20Markhonko%20-%2018%20Sep%202014.pdf>

24. At the fourth Study Group meeting, the Working Group provided an additional four previously unlisted HS codes which they requested be added to Tier 1 (HS codes 843031, 843049, 843340 and 843351). The Study Group also considered additional input from Japanese manufactures. Of the 8 HS codes suggested by the Japanese manufacturers all of them were already on the list; 6 were already in Tier 1 and 2 were already listed in Tier 2. From the Japanese descriptions, the two Tier 2 codes (843149 and 843141) appeared to cover attachments/implements.

25. At its fourth meeting, the Study Group agreed to add HS codes 843031, 843049, 843340, 843351 to Tier 1, upgrade HS codes 847982, 870190 and 843680 from Tier 2 to Tier 1 and downgrade HS codes 842620 (Tower Cranes) from Tier 1 to Tier 3, bringing the total number of HS codes on the Tier 1 of the Preliminary List to 36 codes.

### **C. Use of Article 51(1) Criteria – high value, mobile, uniquely identifiable**

26. The natural starting point when considering the scope of the preliminary draft MAC Protocol is Article 51(1) of the Cape Town Convention itself, which provides:

*The Depositary may create working groups, in co-operation with such relevant non-governmental organisations as the Depositary considers appropriate, to assess the feasibility of extending the application of this Convention, through one or more Protocols, to objects of any category of high-value mobile equipment, other than a category referred to in Article 2(3), each member of which is uniquely identifiable, and associated rights relating to such objects.*

27. Article 51(1) sets out three clear elements that equipment must demonstrate to be capable of being the subject of a future Protocol: i) high-value, ii) mobile and iii) uniquely identifiable. In doing so, Article 51 naturally limits the scope of the Convention by ensuring it is not of general application in regulating international secured transactions.

#### *High Value criterion*

28. At the first meeting of the Study Group it was discussed whether a minimum unit value sales price threshold could be set in the preliminary draft MAC Protocol. There were significant concerns regarding this approach. Primarily, it would be a departure from the previous Protocols where no such mechanism exists. Secondly, setting such a price would be extremely difficult to apply to the sale of used equipment on the secondary market. Thirdly, it could lead to unanticipated and undesirable market distortions, such as manufacturers and other sellers increasing the price of certain types of MAC equipment to meet the minimum unit value sales price and as such enjoy the benefits of the Protocol.

29. Utilisation of the HS System allows the scope of the preliminary draft MAC Protocol to be restricted to certain types of MAC equipment, as identified by 6 digit HS codes (e.g. 841340 Concrete Pumps, or 842620 Tower Cranes). Each of these codes contain a range of equipment of a certain type. At the third Study Group meeting it was agreed that the high value criterion should be utilised to select relevant HS codes for inclusion in the Annexes to the preliminary draft MAC Protocol, but should not form an additional independent requirement under the Protocol itself.

30. It appears there is potential for the inclusion of limited amounts of low value MAC equipment (e.g. \$10,000 - \$20,000 equipment) under a HS code that covers mainly high value MAC equipment. However, the possibility of a limited amount of lower value types of equipment being covered should not strictly prevent the listing of a certain HS code. The possibility of the registration of low value equipment exists in the Luxembourg Rail Protocol. The Luxembourg Rail Protocol allows for the registration of any individually serialised railway rolling stock that meets the description in Article I(e). While vast majority of railway rolling stock objects that meet this definition will be larger and



high value, the description also covers older and smaller railway rolling stock objects, regardless of their value.

31. Further, an additional possible limitation excluding low value goods is the unique identifiability requirement. It is possible that many of the low value assets covered by the listed HS codes may not be individually serialised by their manufacturer and thus ineligible for registration in the International Registry.

32. The February 2016 preliminary list of HS codes included a range of aggregated unit prices as provided by the manufacturers on the Working Group. There remains significant diversity in unit prices (the lowest being \$10,000 and the highest \$7 million), however most machinery have values in the hundreds of thousands of dollars.

#### *Mobility criterion*

33. The Study Group decided at its first meeting<sup>10</sup> and reaffirmed at subsequent meetings that no specific definition of mobility was required in the preliminary draft MAC Protocol. It was also decided at subsequent meetings that MAC equipment that was not mobile in its operation should not be strictly excluded. The Study Group further concluded that mobility would be taken into account in the selection of the HS codes for inclusion in the Annexes to the preliminary draft MAC Protocol.

34. It was also noted at the first Study Group meeting that the definition of mobility also arose during the negotiation of the Luxembourg Rail Protocol and that a solution could not be identified. Majority of international interests registered under the International Registry for the Aircraft Protocol cover aircraft objects that actually service domestic rather than international routes. As such, it is clear that demonstrated routine international mobility for every type of equipment is not required for a Protocol to the Cape Town Convention to be successful.

35. At the third Study Group meeting, it was discussed whether equipment stationary in its operation should be included in the preliminary draft MAC Protocol. In considering the issue, various conceptions of mobility were discussed, including:

- (a) Mobility defined as goods that are internationally traded, and as such identified through the HS system.
- (b) Mobility defined as covering objects that are traded in a way where rights thereto could be subject to potential conflict of laws issues.
- (c) Mobility in terms of operation, which would cover equipment that was not physically attached to immovable property.
- (d) Whether a distinction between domestic and international mobility should be drawn.

36. It was ultimately concluded at the third Study Group meeting that focusing on definitions of high value or mobility during the selection phase of the HS codes for inclusion in the Annexes would suffice, and the future Official Commentary could provide additional detail on how these criteria were taken into account during the selection process.

#### *Unique identifiability criterion*

37. It was concluded at the third Study Group meeting that a manufacturer's serial number should be required to register an interest in MAC equipment in the International Registry, as consistent with the approach in the Aircraft Protocol.

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<sup>10</sup> [UNIDROIT 2015 - STUDY 72K – SG1 – DOC. 5](#), paragraphs 11-13.

38. 'Identification of agricultural, construction or mining equipment for registration purposes' (Article XVI in the preliminary draft MAC Protocol) provides that to register an interest in the International Registry, the name of the manufacturer and the manufacturer's serial number (as supplemented to ensure uniqueness) is required.

39. An additional benefit of adopting a strict approach based on Article VII of the Aircraft Protocol which prevents the registration of MAC equipment without a manufacturer's serial number is that it would also assist in preventing the registration of un-serialised low value commodity-like objects and parts covered by the listed HS codes. Low value goods are less likely to have individual unique serial numbers than high value goods.

#### *Consideration at previous meetings*

40. At the second Study Group meeting it was discussed whether the approach under Article XIV of the Luxembourg Rail Protocol should be followed, which allows for the creation and affixation of unique serial numbers, to allow the registration of international interests in objects that do not have a manufacturer's serial number. A compromise solution was found, under which the Regulations would provide that after a certain date, registrations may only be made over equipment with a unique manufacturer's serial number. The Study Group decided at its second meeting that the relevant provision of the preliminary draft MAC Protocol should be modelled on Article VII (Description of aircraft objects) of the Aircraft Protocol, under which a reference to the manufacturer's serial number is required. It was envisaged that a second paragraph be added under which it would be allowed – until a certain date – to make registrations also for equipment without a unique manufacturer's serial number, providing for a procedure under which a unique identification number would instead be issued by the Registrar.

41. At the third Study Group meeting, a preference for a strict manufacturer serial number mechanism based on Article VII of the Aircraft Protocol was adopted. In the absence of a demonstrated need for Registry-generated serial numbers, the manufacturer serial number approach would suffice for the registration of international interests in objects in the International Registry under the future MAC Protocol.

42. In consultations conducted between November 2015 and February 2016, the Working Group noted that the equipment under the HS codes in Tier 1 of the preliminary list all contained individual manufacturer serial numbers, except 842620 (Ships' derricks; cranes, including cable cranes; mobile lifting frames, straddle carriers and works trucks fitted with a crane – Tower Cranes) and 842919 (Self-propelled bulldozers, angledozers, graders, levellers, scrapers, mechanical shovels, excavators, shovel loaders, tamping machines and road rollers – Other – Straight blade, Semi-U Blade and U-Blade). The individual blades were indicated as the items under the HS code that may not have individual serial numbers. As a result of these findings, the Study Group decided at its fourth meeting (Rome, 7-9 March 2016) that HS code 842620 was to be downgraded from Tier 1 to Tier 2 and further research was requested on HS code 842919.

43. On the basis of the additional evidence presented by the Working Group that indicated that vast majority of equipment under the Tier 1 HS code list had unique individual manufacturer-issued serial numbers, it was decided at the fourth Study Group meeting that the additional provision allowing for the creation and affixation of unique serial numbers (based on the Luxembourg Rail Protocol approach) could be removed from the preliminary draft MAC Protocol.

#### **D. Interaction with previous Protocols to the Cape Town Convention**

44. At the first Study Group meeting it was noted that there could be an overlap between the preliminary draft MAC Protocol and the Luxembourg Rail Protocol, due to the broad definition of

railway rolling stock contained in the Luxembourg Rail Protocol.<sup>11</sup> There are two possible instances in which this could occur:

- (a) Where MAC equipment covered by an HS code listed in the Annexes to the preliminary draft MAC Protocol also meets the definition of 'railway rolling stock' in the Luxembourg Rail Protocol.
- (b) Where MAC equipment covered by an HS code listed in the Annexes to the preliminary draft MAC Protocol is subsequently attached to equipment which meets the definition of 'railway rolling stock' in the Luxembourg Protocol.

45. The first instance is not a likely scenario. The HS System covers "railway or tramway locomotives, rolling-stock and parts thereof; railway or tramway track fixtures and fittings and parts thereof; mechanical (including electro-mechanical) traffic signalling equipment of all kinds" under Chapter 86. As at August 2016, Tier 1 of the preliminary list of HS codes suggested for inclusion under the scope of the preliminary draft MAC Protocol does not include any item from Chapter 86.

46. At its fourth meeting, the Study Group concluded that the interaction between the preliminary draft MAC Protocol and previous Protocols to the Cape Town Convention should be dealt with as a matter of scope. The Study Group further concluded that the rule should be modelled on Article II of the Space Protocol.

47. Article 2 paragraph 4 of the preliminary draft MAC Protocol provides:

*This Protocol does not apply to objects falling within the definition of "aircraft objects" under the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment, "railway rolling stock" under the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Railway Rolling Stock or "space assets" under the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Space Assets.*<sup>12</sup>

48. The rationale behind this decision was to ensure clarity and legal certainty, and to avoid the prospect of competing international interests in the same piece of equipment under different Protocols to the Cape Town Convention. Competing international registrations under different Protocols in the same piece of equipment would be problematic, because it would require a party to search all international registries to assure themselves that a registration in the MAC registry would have priority, and it could mean that different insolvency alternatives could apply to the same object, depending on the declarations made by Contracting States in relation to each Protocol.

49. While the likelihood of objects under the Aircraft Protocol and Space Protocol also falling within the scope of the MAC Protocol remains extremely unlikely, expanding the rule beyond the Luxembourg Rail Protocol to cover all previous Protocols appears prudent, as it provides additional security to stakeholders to the previous Protocols that their interests will not be effected by the MAC Protocol.

#### *Consideration at previous meetings*

50. The first Study Group meeting suggested two alternative approaches for dealing with the overlap between the two Protocols: (i) limiting the scope of the preliminary draft MAC Protocol or (ii)

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<sup>11</sup> [UNIDROIT 2015 - Study 72K – SG1 – Doc. 5](#), paragraph 25.

<sup>12</sup> This is a newly drafted article based on the decision at the third Study Group meeting to completely carve out the scopes of the previous Protocols from the scope of the MAC Protocol, for the sake of clarity and legal certainty. In the fifth Study Group draft this provision was a standalone Article in Chapter V of the Protocol, however at the fourth Study Group meeting it was decided to move it to Article II. This provision, inserted into the current preliminary draft MAC Protocol, is modelled on Article II(3) of the Space Protocol, which dis-applies the Space Protocol to equipment falling under the definition of "aircraft objects" under the Aircraft Protocol.

inserting a priority rule into the preliminary draft MAC Protocol. It was noted that in limiting its scope by identifying specific types of equipment through the HS system, the preliminary draft MAC Protocol has a stricter approach to scope than the description-based approach of the Luxembourg Rail Protocol. It was further suggested that if the preliminary draft MAC Protocol adopted this stricter approach to scope, it should prevail over the Luxembourg Rail Protocol in the event of a conflict between the scopes of the two Protocols. At the second Study Group meeting several approaches to this issue were discussed.<sup>13</sup> Professor Mooney noted that given the scope of the Luxembourg Rail Protocol is more certain, it may be desirable for the preliminary draft MAC Protocol to defer to the Luxembourg Rail Protocol.

51. Professor de las Heras queried whether railway rolling stock could be carved out of the preliminary draft MAC Protocol scope, by making a specific reference in the Annexes to the preliminary draft MAC Protocol, which would provide 'Agricultural equipment means any types of equipment covered by the HS codes in this Annex, that is not "railway rolling stock."<sup>14</sup> Professor Mooney noted that under this approach, MAC equipment subsequently attached to other equipment that would allow it to operate on rail would be treated as an accession issue.

52. Mr Deschamps noted that Article 29(7) of the Cape Town Convention does not provide an effective solution for the potential overlap of the Luxembourg Rail Protocol and the preliminary draft MAC Protocol. Mr Deschamps noted that in applying Article 29(7) to the Luxembourg Rail Protocol, a crane being attached to railway rolling stock would be considered an item, whereas the railway rolling stock itself would be considered an object. Mr Böger noted that Article 29(7) may deal with the circumstance of subsequent attachment of MAC equipment to railway rolling stock.

53. The Study Group tentatively decided that the Annexes to the preliminary draft MAC Protocol should provide that it applies to the types of equipment contained in the HS codes in the Annexes, except where they are capable of being considered objects under the Luxembourg Rail Protocol and the Luxembourg Rail Protocol was already in force in the Contracting State. The Study Group further concluded that any conflict between subsequent attachment of MAC equipment to railway rolling stock would be dealt with by Article 29(7) of the Cape Town Convention.

54. At the third Study Group meeting it was decided that the preliminary draft MAC Protocol should contain an Article that explicitly provided that any object subject to an international interested registerable under the Aircraft, Space and Luxembourg Rail Protocols could not be registered under the MAC Protocol. The Study Group discussed other more limited carve-out rules, such as allowing registrations under the MAC Protocol if the Luxembourg Rail Protocol was not in force in the relevant Contracting State, however it was concluded that a complete deference to previous Protocols would be a simpler and more efficient solution.

55. A draft Article XXI was inserted in Chapter V (Relationship with other Conventions) of the fifth Study Group draft. The article provided: Interests registerable under the Protocol to the Convention on International Assets in Mobile Equipment on Matters Specific to Aircraft Equipment, the Protocol to the Convention on International Assets in Mobile Equipment on Matters Specific to Railway Rolling Stock or the Protocol to the Convention on International Assets in Mobile Equipment on Matters Specific to Space Assets may not be registered under this Convention.

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<sup>13</sup> [UNIDROIT 2015 - Study 72K - SG2 - Doc. 6](#), paragraphs 33-43.

<sup>14</sup> 'Railway rolling stock' having the same definition that it does under Article I(e) of the Luxembourg Rail Protocol: "railway rolling stock" means vehicles movable on a fixed railway track or directly on, above or below a guideway, together with traction systems, engines, brakes, axles, bogies, pantographs, accessories and other components, equipment and parts, in each case installed on or incorporated in the vehicles, and together with all data, manuals and records relating thereto.

56. This approach was altered at the fourth meeting, where the Study Group decided that the Article should prevent constitution of an interest under the preliminary draft MAC Protocol, rather than prevent the registration of such an interest. Further consideration may be required in relation to whether the Article needs to be amended to provide for the circumstance under which a piece of MAC equipment is subsequently affixed to railway rolling stock.<sup>15</sup>

### **E. Severability**

57. It had been suggested during consultations early in the development of the MAC Protocol project that it may be worth splitting the preliminary draft MAC Protocol into three protocols covering agriculture, construction and mining equipment separately. The basis for this view was that the three fields are very different from one another, with diverse groups of stakeholders and categories of equipment. Further, the national Questionnaire completed by different jurisdictions in 2008 revealed that certain States favoured the creation of a Protocol regulating secured transactions for one of the three areas, but not necessarily for the others.

58. At the first Study Group meeting it was concluded that the preliminary draft MAC Protocol should be maintained as a single Protocol, while allowing States to opt out of any of the three categories (agricultural, construction and mining) of equipment.<sup>16</sup> This opt out option for Contracting States is located in Article II paragraph 3 of the preliminary draft MAC Protocol.

59. At the second meeting, the Study Group noted that severance of one category of equipment from the preliminary draft MAC Protocol should only be contemplated if, later in the process, it becomes clear that one or more of the categories of equipment is radically different and it proves very difficult to deal with the categories together. While a possible divergence in the treatment of agricultural equipment in relation to insolvency has been identified (see Part 3, sections M and N), the divergence does not warrant severing agricultural equipment from the preliminary draft MAC Protocol.

### **F. Multiple purpose equipment**

60. At the first Study Group meeting it was concluded that, in principle, the preliminary draft MAC Protocol should not cover equipment that is general in nature.<sup>17</sup> In determining the purpose of equipment, it was suggested that the design rather than the use of the equipment should be considered. To a large extent, the use of the HS System resolves this issue, because equipment that is general in nature (for example, trucks) will not be listed under HS codes associated with the agriculture, construction and mining fields. As such, the use of the HS itself will serve as a filter to prevent the listing of general-purpose equipment under the preliminary draft MAC Protocol.

61. At the second Study Group meeting it was concluded that where a type of MAC equipment has the possibility to be listed under more than one of the classes (agriculture, construction and mining), then it should be listed under each class independently. The Study Group also confirmed that in the event that a Contracting State opts out of a particular Annex of equipment (agriculture, construction or mining), where a type of equipment is included on that Annex and another Annex,

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<sup>15</sup> One possible method of regulating this would be to preserve any existing international interest under the MAC Protocol in the equipment, providing that it was registered before the equipment was affixed to railway rolling stock. This way, it would comply with the rule that the MAC equipment was not railway rolling stock at the time the international interest was created under the MAC Protocol (and thus would be a valid registration). However, there would still be competing interests under the two Protocols, which is an undesirable circumstance. This matter could potentially be dealt with in the Official Commentary.

<sup>16</sup> [UNIDROIT 2015 - Study 72K – SG1 – Doc. 5](#), paragraph 19.

<sup>17</sup> [UNIDROIT 2015 - Study 72K – SG1 – Doc. 5](#), paragraphs 20-24.

the type of equipment would continue to be covered by the MAC Protocol in that Contracting State, regardless of its final use.

62. The Study Group concluded that a cautious approach should be taken to including types of MAC equipment which could be used in all three fields (agriculture, construction and mining) under the scope of the preliminary draft MAC Protocol. The provisional list of HS codes for coverage under the preliminary draft MAC Protocol contains a column indicating whether each code falls within the agricultural, construction or mining categories, as suggested by the Working Group in April 2016.

63. As at August 2016, of the 36 HS codes on Tier 1 of the provisional list of HS codes, nine codes are listed in Annexes 1, 2 and 3 (HS codes 842911, 842919, 842951, 842952, 842959, 843049, 843050, 870130 and 871620).

## **G. Inventory**

64. In principle, there is no problem with MAC equipment within the scope of the preliminary draft MAC Protocol being held as inventory and international interests covering such items being registered in the International Registry. However, the issue becomes slightly more complex when considering unfinished MAC equipment held by the manufacturer, which may also constitute inventory against which the manufacturer may seek secured financing.

65. At the first Study Group meeting, it was discussed whether the preliminary draft MAC Protocol should contain additional provisions dealing with the financing of equipment being held on inventory. It was suggested that the preliminary draft MAC Protocol should not create a distinction between inventory and equipment. For an interest in equipment to be registerable under the preliminary draft MAC Protocol the equipment itself must be uniquely identifiable. As such, unfinished inventory was unlikely to be uniquely identifiable and thus interests thereto could not be registered under the preliminary draft MAC Protocol. The piece of equipment would become registerable once it became uniquely identifiable by manufacturer serial number. The first Study Group meeting concluded that there was no need for the preliminary draft MAC Protocol to contain additional provisions covering inventory.

66. At the third Study Group meeting Mr Bazinas, Senior Legal Officer of the United Nations Commission for International Trade Law Secretariat (UNCITRAL) noted that inventory, even if individually serialised, was identified in bulk. It was normally not subject to a specialised registration system, and rather subject to a general registration system. He argued that the general criteria of high value, unique identifiability, as opposed to identifiability in bulk, as well as cross-border mobility should all be preserved in the assessment.

67. The Study Group noted that it was not feasible to have a regime which would apply to a specific type of asset in circumstances where the asset is held and used as equipment, whereas it would not apply to the same asset when it was held as inventory. It was reiterated that 'actual use' was not the point of the focus in the context of the preliminary draft MAC Protocol. If a crane was held for lease to contractors, it could be considered as inventory, yet if the same crane was purchased by a builder then it would become 'equipment' rather than inventory.

68. On a practical level, it was noted that as items of equipment come into inventory they had to be specifically identified by their make, model and serial number. As the equipment moved in and out of inventory, international interests would be required to be registered or de-registered for every single transaction, possibly prior to the transaction actually taking place. The third party would then be able to take title free and clear of that interest. The Study Group noted that certain issues could arise as to how this system would practically function.

## **H. Merged collateral**

69. An established practice in the financing industries is to provide financing to customers for new equipment in the form of a financial lease where the creditor takes a security interest over both the new equipment and other assets of the customer as additional collateral. The additional collateral is typically other machinery.

70. Where all equipment involved in the transaction (both the new equipment and the equipment being used as additional collateral) is MAC equipment within the scope of the preliminary draft MAC Protocol, the interests could all be internationally registered, which would have priority over any prior registered interests under national law. However, where the collateral equipment falls outside the scope of the preliminary draft MAC Protocol, there may be a burden on the creditor to comply with the requirements of two distinct regimes to perfect its interest in the entire package of assets (i.e. the creditors would have to register their international interest in the new MAC equipment in the International Registry, but the associated collateral equipment would require registration of a security interest and compliance with the domestic secured transactions laws.)

71. Ultimately, the first Study Group meeting concluded that merged collateral was not an issue unique to the financing of MAC equipment and there was no need to diverge from the approach of the previous Protocols.

## **I. Aquaculture equipment**

72. At its fourth meeting the Study Group discussed whether aquaculture equipment should be included within the scope of the preliminary draft MAC Protocol. To assist the Study Group in its deliberations, the Secretariat prepared a report on the matter. The report introduced the practice of aquaculture, discussed its economic significance and touched upon some of the legal issues associated with the operation of aquaculture equipment at sea. The report also set out some of the major manufacturers producing aquaculture equipment. The report is available at Appendix II to this document.

73. At the fourth meeting, it was specifically noted that from a policy perspective only the equipment in the cultivation phase, as opposed to the post cultivation phases (which would include processing equipment) would potentially be covered. The Study Group also noted potential complications in relation to enforcement and repossession of offshore aquaculture equipment.

74. The Study Group concluded that aquaculture could be included under the definition of agriculture for inclusion in the preliminary draft MAC Protocol, however further research on the relevant HS codes and further consultation with the aquaculture industry was required.

75. Further research will be conducted on this issue.

## PART 2 - ISSUES RELATED TO ASSOCIATION WITH OTHER ASSETS

### J. Association with immovable property<sup>18</sup>

76. Issues may arise where MAC equipment becomes so associated with immovable property that domestic law interests in the immovable property extend to the MAC equipment. There are sensitivities in relation to immovable-associated equipment, as States often regard the treatment of their territory as an issue of sovereignty, making it particularly difficult to harmonise immovable-related interests at an international level. Despite these sensitivities, this issue may need to be directly addressed in the preliminary draft MAC Protocol. No guidance can be drawn from the three previous protocols to the Cape Town Convention, as aircraft, railway rolling stock and space objects are not affixable to immovable property.

77. Initially, association with immovable property appeared to be a matter of limited significance, as it was originally understood that it would only be relevant for types of MAC equipment that were physically connected to immovable property (for example, certain types of cranes and drills). However, following a comparative law analysis conducted by the Secretariat, it became apparent that certain jurisdictions permitted interests in immovable property to extend to mobile equipment that was utilised for the economic exploitation of the immovable property, even where there was no physical connection between the equipment and the immovable property.<sup>19</sup>

78. The issue was considered at length during the third and fourth Study Group sessions, and was the subject to two out-of-session teleconferences in December 2015 and February 2016. In preparing a draft article to resolve the issue, the Study Group adopted the following principles:

- (a) Association with immovable property should be directly addressed by a standalone article in the preliminary draft MAC Protocol.
- (b) The article governing association with immovable property should be the object of a mandatory declaration, giving Contracting States flexibility in their approach to the issue, but also requiring States to make an active selection of the alternative they favour.
- (c) Due to the complex and sensitive nature of the issue, the preliminary draft MAC Protocol should provide an array of options on how to address the potential effect of international interests in MAC equipment on domestic interests arising under immovable property law.
- (d) The article and various options need to take into account all potential interests arising out of association with immovable property (i.e. interests arising out of physical connection between the equipment and the immovable property, referred to as 'fixtures' in some jurisdictions and interests arising out of the utilisation of mobile equipment for the economic exploitation of the immovable property, referred to as 'accessories' in some jurisdictions).
- (e) If possible, the article should avoid substantively defining the words 'fixture' and 'accessory'. If they are required to be defined, they should be defined with reference to the domestic law in which the equipment is located.
- (f) The article should apply the declaration made by the Contracting State in which the immovable property is located, as opposed to the declaration of the Contracting State there the debtor is situated (as is the traditional case for the application of the Cape Town Convention).

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<sup>18</sup> In early Study Group papers, this issue was considered under the heading of 'fixtures'.

<sup>19</sup> See research paper *Jurisdictional analysis on association with immovable property* at Appendix IV to this document.



79. Article VII of the preliminary draft MAC Protocol addresses the issue of association with immovable property. Article VII provides that a Contracting State must apply one of three alternative approaches in resolving the potential conflict between international interests in MAC equipment and domestic interests in the immovable property that the MAC equipment has become associated with:

Alternative A: An international interest in MAC equipment retains its priority as against any domestic interests in the immovable-associated equipment that exist as a result of the equipment's association with immovable property.

Alternative B: A distinction is made between MAC equipment that becomes so associated with immovable property that it loses its individual legal identity (under the domestic law of the country in which the equipment is located) and MAC equipment that retains its legal identity. International interests in MAC equipment that loses its individual legal identity are subordinated to domestic interests (where the domestic law provides for such a subordination), whereas international interests in MAC equipment that retains its individual legal identity lose their priority only where (i) the interest in the immovable property is registered under domestic law prior to the registration of the international interest and (ii) the equipment has become associated with the immovable property prior to the registration of the international interest in the equipment.

Alternative C: The domestic law of the Contracting State in which the equipment is located determines whether the international interest is subordinated to domestic interests that exist as a result of the equipment's association with immovable property.

80. Paragraph 1 of Article VII also provides that the domestic law determines whether the international interest is subordinated to domestic immovable property interests where the equipment is located in a non-Contracting State.

81. The Study Group considered that the policy and legal approaches of the three alternatives gave Contracting States sufficient flexibility in balancing the primacy of the international interests over domestic interests and the protection of immovable property interests, although further work on the exact language of Article VII might be required to ensure the desired policy outcomes were realised.

*Defining 'immovable-associated equipment' and whether the preliminary draft MAC Protocol should distinguish between different types of immovable-related equipment*

82. As discussed at length in the background legal analysis on this issue at Appendix III and the comparative jurisdictional analysis at Appendix IV, there is no universally accepted definition for the words 'fixture' and 'accession', which have very different meanings across the world. Further, the elements considered in different jurisdictions to determine whether an object has become associated with immovable property to the extent that an interest under the domestic law extends to the object also vary greatly.

83. In view of these complexities, the preliminary draft MAC Protocol attempts to provide a basic definition of only the term 'immovable-associated equipment'.

84. Article 1(2)(f) of the preliminary draft MAC Protocol provides that "immovable-associated equipment" means agricultural, construction or mining equipment that is so associated with immovable property that an interest in the immovable property extends to the equipment under the law of the state in which the immovable property is situated. The article does not provide any substantive legal definition of 'immovable-associated equipment', it simply refers to domestic law of the country in which the equipment is located to determine whether an interest related to immovable property law is created. The term "associated" is used because other similar terms such as "connected", "attached" and "affixed" all imply a degree of constant physical connection between the

equipment and the immovable property, which may not be necessary in some jurisdictions for an interest in the immovable to extend to the equipment (as noted above). Article 1(2)(f) also does not distinguish between different types of immovable property-related interests under the domestic law (i.e. it does not distinguish between fixtures and accessories).

85. However, Alternative B still attempts to make a distinction between different types of immovable-associated equipment. Alternative B is based upon a proposal from the German Ministry of Justice presented at the first teleconference in December 2015.<sup>20</sup> The benefit of Alternative B is that it distinguishes between different types of immovable-associated equipment without actually using the terms 'fixtures' and 'accessories', and in doing so it restricts the circumstances under which an international interest in an accessory will lose its priority as against an interest arising from its association with immovable property. The potential issue with this Alternative is that it is dependent upon the use of the criterion of the complete loss of individual legal identity, even though it does revert to the national law of the location of the immovable to determine the circumstances under which the loss of individual legal identity occurs. As such, Alternative B would only be ratified by countries whose domestic law allows for immovable property interests to extend to movable equipment that retains its individual legal identity.

#### *Application of rules to non-Contracting States*

86. Article VII(1) provides:

*this Protocol does not affect the application of any domestic laws that determine whether an international interest in immovable-associated equipment ceases to exist, is subordinated to any other rights or interests in the immovable-associated equipment or is otherwise affected by the association of the equipment with immovable property, where the immovable-associated equipment is situated in a non-Contracting State.*

87. During the second teleconference the Study Group discussed what would occur in relation to international interests in MAC equipment that became associated with immovable property in non-Contracting States. The prevailing view was that in the absence of an express provision stating otherwise, Article 29 of the Cape Town Convention would apply, and the international interest would take priority over any domestic interest arising out of the equipment's association with immovable property. This outcome would be broadly consistent with the prior Protocols to the Cape Town Convention in terms of maintaining the priority of the international interest over domestic interests. An added benefit would be that it would incentivise countries to becoming Contracting States in order to protect interests arising from their immovable property.

88. However, as Article 29 was not drafted to contemplate an international interest conflicting with an interest arising out of association with immovable property, the Study Group concluded that it would also be prudent to consider including a draft provision providing that international interests in MAC equipment did not interfere with immovable property-related interests in non-Contracting States. The drafting of the provision in the fifth Study Group draft was based on Article 29(7), but that approach has been changed in the current preliminary draft MAC Protocol.

89. At the second teleconference the Study Group also discussed an approach based on applying the priority rules of the Contracting State in which the debtor was located to non-Contracting States, in circumstances where the equipment has moved to the non-Contracting State and there is a conflict between immovable property-related interests and international interests under the preliminary draft MAC Protocol. However, this approach was not favoured as there is no real substantive policy rationale as to why the State where the debtor is situated should have the power to determine

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<sup>20</sup> The German Ministry of Justice proposal is in Appendix III.

whether the non-Contracting State's immovable property law or the rules of the preliminary draft MAC Protocol should prevail.

*Consideration at previous meetings*

90. Substantive legal background and earlier draft articles regarding association with immovable property considered by the Study Group are at Appendix III to this paper. A jurisdictional analysis of the operation on fixtures and accessories under domestic legal regimes prepared for the Study Group in advance of the third meeting is at Appendix IV.

**K. Accessions**

91. In Cape Town Convention parlance, 'accessions' are pieces of equipment that are not capable of being subject to an international interest (i.e. are not "objects") but may be installed/connected/affixed to an object subject to an international interest. The three existing Protocols employ differing approaches to accessions:

92. Article I(2) of the Luxembourg Rail Protocol provides: *(e) "railway rolling stock " means vehicles movable on a fixed railway track or directly on, above or below a guideway, together with traction systems, engines, brakes, axles, bogies, pantographs, accessories and other components, equipment and parts, in each case installed on or incorporated in the vehicles, and together with all data, manuals and records relating thereto.*

93. Article I(2) of the Space Protocol provides: *"space asset" means ... together with all installed, incorporated or attached accessories, parts and equipment and all data, manuals and records relating thereto.*

94. The Aircraft Protocol includes three separate definitions of aircraft engines, airframes, and helicopters, which can all constitute separate objects under the Protocol. Unlike the other Protocols, it treats engines as separate objects. Aircraft Protocol Article I(2) provides: *(b) aircraft engines means ... together with all modules and other installed, incorporated or attached accessories, parts and equipment and all data, manuals and records relating thereto; (e) airframes means ... together with all installed, incorporated or attached accessories, parts and equipment (other than aircraft engines), and all data, manuals and records relating thereto; (l) Helicopter means ... together with all installed, incorporated or attached accessories, parts and equipment (including rotors), and all data, manuals and records relating thereto.*

95. At the first Study Group meeting, it was noted that in negotiating the Luxembourg Rail Protocol, a decision was made not to allow the registration of discrete interests in railway engines. While there were circumstances where railway engines were removed and put into other trains, this practice was not widespread enough to warrant including a separate provision allowing for the registration of an interest in railway engines in the Luxembourg Rail Protocol. The first Study Group meeting distinguished this from the longstanding practice in the aviation industry of separate financing for aircraft engines.

96. There is no corresponding provision in the preliminary draft MAC Protocol describing what physically constitutes agricultural, construction and mining equipment, as the preliminary draft MAC Protocol uses the HS System to define agricultural, construction and mining equipment. As such, the treatment of accessions under the preliminary draft MAC Protocol is a question which may require further consideration by the Committee of Governmental Experts.

*Exclusion of HS codes explicitly covering accessions*

97. During the third Study Group meeting, WCO senior technical expert Mr de Jong explained that most parts were covered by explicit HS codes that expressly provide that they apply to parts. However, he noted that classification of parts was difficult, and it was possible that in certain circumstances parts of equipment could also be traded under codes associated with the entire completed pieces of equipment.

98. In determining the criteria for inclusion of HS codes in the preliminary list, the Study Group decided that all codes explicitly and exclusively covering parts should be excluded from Tier 1 (suitable codes), as they were unlikely to cover objects that were high value, separately financeable and uniquely identifiable. In initial consultations with the MAC Protocol Working Group following the categorisation, there did not appear to be significant opposition to the exclusion of the HS codes explicitly covering parts from Tier 1.

99. If it was to be determined in the future that there were certain HS codes covering high-value equipment that should be included in the preliminary draft MAC Protocol but also covered parts, an article could be inserted into the preliminary draft MAC Protocol providing for the exclusion of parts, and an 'ex' could be inserted in front of the relevant codes, as consistent with the practice in other international instruments using the HS System to define their scope. The 'ex' would signal that not the entirety of the particular HS code is covered by the Protocol, and any parts included under the code would not be eligible for individual registration in the International Registry.

*Inclusion of HS codes that cover accessions in part*

100. As at August 2016, Tier 1 of the preliminary list contains three HS codes that, based on input from the Working Group, purport to cover accessions in part:

820713: Interchangeable tools for hand tools, whether or not power-operated, or for machine tools (for example, for pressing, stamping, punching, tapping, threading, drilling, boring, broaching, milling, turning or screw driving), including dies for drawing or extruding metal, and rock drilling or earth boring tools -- Rock drilling or earth boring tools, and parts thereof --With working part of cermets

842641: Ships' derricks; cranes, including cable cranes; mobile lifting frames, straddle carriers and works trucks fitted with a crane - Other machinery, self-propelled -- On tires (for example, deck cranes and loader cranes)

842919: Self-propelled bulldozers, angledozers, graders, levelers, scrapers, mechanical shovels, excavators, shovel loaders, tamping machines and road rollers -- Bulldozers and angledozers -- Other (for example, Straight blade, Semi-U Blade and U-Blades for tractors)

101. The financing industry has indicated that types of complete equipment under HS codes 820713 and 842641 are separately financeable, whereas just the tractor blades under HS code 842919 are not separately financeable (tractor blades would likely be considered implements, see below section). At its fourth meeting, the Study Group decided that as long as the objects under these codes were individually financeable in practice, then they should continue to be covered by the preliminary draft MAC Protocol.

*Differentiation between accessions and implements*

102. Tier 1 contains five HS codes that cover discrete pieces of equipment that must be connected to other equipment to be used (in most cases pulled by tractors):

843210: Agricultural, horticultural or forestry machinery for soil preparation or cultivation; lawn or sports-ground rollers - Plows

843221: Agricultural, horticultural or forestry machinery for soil preparation or cultivation; lawn or sports-ground rollers - Harrows, scarifiers, cultivators, weeders and hoes – Disc harrows

843230: Agricultural, horticultural or forestry machinery for soil preparation or cultivation; lawn or sports-ground rollers - Seeders, planters and transplanters

843240: Agricultural, horticultural or forestry machinery for soil preparation or cultivation; lawn or sports-ground rollers – Manure Spreaders and fertilizer distributors

843340: Harvesting or Threshing Machinery, including Straw or Fodder Balers; Grass or Hay Mowers; Machines for Cleaning, Sorting or Grading Eggs, Fruit or other Agricultural Produce; Other than Machinery of Heading 8437 – Straw or Fodder Balers

103. It is understood that such equipment is not installed upon other equipment, and as such would not be considered as accessions in the same way as aircraft engines but rather as independent implements used in conjunction with other equipment. Their situation would be more analogous to railway rolling stock being connected together for use on a railway line, which would not affect interests in the separate pieces of rolling stock.

104. The second meeting the Study Group discussed whether a distinction should be made between accessions as objects installed as part of another object (such as an engine), and implements which are simply connected to other objects in a temporary and limited fashion, such as connecting a plough to a tractor. It was concluded that a distinction should be drawn between accessions and implements, as interests in implements should remain capable of being registered in the International Registry without the need for the insertion of special rules into the preliminary draft MAC Protocol.

*Accessions and installations under Article 29(7) of the Cape Town Convention*

105. Article 29 of the Convention deals with the priority of competing interests. Paragraph 7 of Article 29 provides:

*This Convention:*

(a) *does not affect the rights of a person in an item, other than an object, held prior to its installation on an object if under the applicable law those rights continue to exist after the installation; and*

(b) *does not prevent the creation of rights in an item, other than an object, which has previously been installed on an object where under the applicable law those rights are created.*

106. Paragraph 7(a) deals with the installation of an item which is not covered by the Convention (such as a computer or spare part) on an object which is covered by the Convention. It provides that installation or incorporation does not affect pre-existing rights, if they are preserved by applicable law. Alternatively, if the applicable law provides that the right to the installed or incorporated item passes under the doctrine of accession to the owner of the internationally registered object as the principal asset, then the pre-existing right will be extinguished.<sup>21</sup> Paragraph 7(b) States that where the applicable law so provides, rights in items which have previously been installed may be created in them after their removal from the object.

107. Article 29(7) defers to the applicable national law to determine how to treat installations on objects encumbered by an international interest under the Cape Town Convention. Under this Article, deferring to the applicable law for installations does not affect the priority of the international interest over the object itself.

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<sup>21</sup> Official Commentary to the Aircraft Protocol (3rd Edition), paragraph 4.197.

### PART 3 – ISSUES RELATED TO INSOLVENCY

#### L. Insolvency alternatives

108. Previous Protocols to the Cape Town Convention allow Contracting States to select the insolvency remedies to apply in relation to the enforcement of international interests under the Convention against a party which is insolvent. Alternative A (broadly considered to be the 'creditor friendly' option) allows expedited remedies for parties holding international interests. Alternative B (broadly considered to be the 'debtor friendly' option) allows for a more significant role for the court in the insolvency proceedings. All three previous Protocols to the Cape Town Convention contain Alternatives A and B. The Luxembourg Rail Protocol additionally includes Alternative C, which was added as an alternative that better reflects European insolvency law. Alternatively, Contracting States are permitted not to elect any of the alternatives, in which case their domestic insolvency law would apply.

109. At the first Study Group meeting it was tentatively agreed that Insolvency Alternatives A, B and C as reflected in the Luxembourg Rail Protocol should be kept in the preliminary draft MAC Protocol, pending further discussion. This decision was reaffirmed at the second, third and fourth Study Group meetings.

110. Given that Alternatives A and B are included in all three previous Protocols, it would be reasonable for them to be included in the preliminary draft MAC Protocol as well. The first Study Group meeting was supportive of also including Alternative C, on the basis that it takes into account the Continental European approach to insolvency.

111. Alternative C features only in the Luxembourg Rail Protocol, and was designed as a compromise between Alternatives A and B. As in Alternative A, the obligation of the insolvency administrator under Alternative C is triggered by the occurrence of an insolvency-related event (i.e. with no need for a request from the creditor). As consistent with Alternative B, Alternative C requires the administrator to either cure all defaults or provide the creditor with the 'opportunity' to take possession 'in accordance with the applicable law' within a specified period. However, the administrator can defer the obligation for such time as the court orders (but no later than when the underlying agreement would have expired), provided that sums accruing to the creditor during the suspension period are paid, and the rolling stock and its value are maintained.<sup>22</sup>

112. After the expiration of the cure or the further suspension period, where ordered, the exercise of the default remedies available to the creditor under the Convention and Protocols can no longer be prevented or delayed, as consistent with Alternative A. This provision requires the displacement (from the end of the cure period or further suspension period) of procedural restrictions, such as a stay, that could otherwise bar the exercise of default remedies in insolvency. As such, the core difference between Alternative A and Alternative C is the possibility of delays in the exercise of default remedies under Alternative C where a suspension order is made.<sup>23</sup>

113. As a matter of policy, there is also benefit in giving Contracting States the widest variety of options in selecting insolvency remedies, as long as they remain consistent with the approaches in the previous Protocols. As such, the Study Group recommended that the preliminary draft MAC Protocol include Alternatives A, B and C, as consistent with the approach in the Luxembourg Rail Protocol. This approach is set out in Article X of the preliminary draft MAC Protocol.

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<sup>22</sup> Kristin Van Zwieten, 'The Insolvency Provisions of the Cape Town Convention and Protocols: Historical and Economic Perspectives', *Cape Town Convention Journal* (2012) Volume 1, page 69.

<sup>23</sup> Kristin Van Zwieten, 'The Insolvency Provisions of the Cape Town Convention and Protocols: Historical and Economic Perspectives', *Cape Town Convention Journal* (2012) Volume 1, page 69.

114. Due to the relative similarity in the nature of aircraft and space objects, the Space Protocol Study Group adopted the policy approach that the provisions in the Aircraft Protocol should be followed (as opposed to those in the Luxembourg Rail Protocol), unless there was a demonstrably strong rationale for deviating from the Aircraft Protocol.

*Consideration at previous meetings*

115. At the third Study Group meeting it was decided to allow Contracting States to apply different insolvency alternatives to different Annexes to the preliminary draft MAC Protocol. The rationale behind giving States this additional flexibility arose out of the consideration of special insolvency regimes for agriculture (see the analysis on Special Insolvency Regimes affecting farmers and agricultural enterprises and restrictions on the enforcement of security interests in farming equipment at Appendix V to this paper). As such, the fifth Study Group draft allowed Contracting States to apply an insolvency alternative to construction and mining equipment, however not apply a declaration and thus apply domestic insolvency law to agricultural equipment.

116. The draft Article (Article X - Remedies on Insolvency, paragraph 3) in the fifth Study Group draft provided that where a Contracting State declared the application of different Alternatives to different Annexes, a Contracting State had to also declare which Alternative applied to HS codes contained in more than one Annex. This mandatory requirement aimed at removing any potential uncertainty in relation to which insolvency regime applied to a certain piece of MAC equipment.

117. Upon further discussion at the fourth Study Group meeting, it was decided to drop the provision allowing Contracting States to apply different insolvency regimes to different Annexes to the preliminary draft MAC Protocol. It was considered to be an unnecessary complexity and should only be included if there was strong support from it from negotiating States or if its inclusion would allow additional Contracting States to become parties to the Protocol without sacrificing their local agricultural insolvency laws.

**M. Special insolvency regimes affecting farmers and agricultural enterprises**

118. During its first meeting, the Study Group requested further research on special insolvency regimes for farmers or other enterprises that are likely to own MAC equipment focusing primarily on agricultural machinery.

119. At its third meeting, the NLCIFT reported back on the issue (a detailed analysis on the issue is at Appendix V). The research revealed that there were certain specialised insolvency regimes that could apply to farmers. Domestic laws generally tended to give farmers certain rights as opposed to other insolvent debtors. In some jurisdictions certain agricultural machinery could be exempted from repossession, certain assets could be protected as part of the protection of the farmers' ownership in the land itself, and certain actions taken by creditors could be suspended, and under some regimes farmers also have access to special funds to restructure their business. Most legal mechanisms protecting farmers and agricultural enterprises primarily targeted individual and family farmers, which would exclude economically high value equipment as small scale farmers wouldn't generally be in a position to possess such equipment. The report concluded that there wouldn't be any need for additional alternatives as the transactions covered by the special domestic insolvency regimes would simply be outside the scope of the preliminary draft MAC Protocol in the first place.

120. The third meeting also discussed whether an additional Article based on either Article 25 (the public service railway exemption) of the Luxembourg Rail Protocol or Article 40 (registerable non-consensual rights or interests) of the Cape Town Convention could be drafted in this respect. It would operate to the effect that where there was a conflict between the existing national law and insolvency remedies under the preliminary draft MAC Protocol, then the State could declare that they uphold their current domestic legislation. Under the Article 40 approach, States would be required to

specifically provide information about how their declaration would affect rights under the Convention and preliminary draft MAC Protocol. It was noted that while the drafting of Article 25 of the Luxembourg Rail Protocol might be a useful model, it would be important to distinguish that issue from the public service provision in the Luxembourg Rail Protocol, as the inclusion of such an article could cause significant controversy.

121. Ultimately the Study Group concurred with Professor Mooney, who took the view that the current options under the preliminary draft MAC Protocol should be left as they were and any exclusive exceptions for the agricultural sector should not be included. He explained that the strong version of the insolvency provisions mimicked in many ways section 1110 of the U.S. Bankruptcy Code which was limited to transportation equipment. The theory behind section 1110 was that the protected firms had an extraordinarily high portion of their assets tied up in very expensive equipment when compared to most kinds of businesses. For that reason, a special protection in favour of lessors and lenders was needed in order to be able to provide financing. Such a strong version of protection for the agricultural sector seemed to be unnecessary.

#### **N. Restrictions on the enforcement of security interests in farming equipment**

122. At the third Study Group meeting, the NLCIFT presented a comparative analysis regarding restrictions that exist in various jurisdictions in relation to the enforcement of security interests in farming equipment (the comparative analysis is at Appendix VI).

123. The report noted that laws which imposed certain limitations on enforcement rights were typically found in pieces of legislation separate from the secured transactions regimes, such as in Australia, Canada and the USA. Some secured transactions laws, such as in Kenya and Nigeria, explicitly included such limitations. However in the context of latter two countries, it was noted that their secured transaction regimes were subject to current IFC secured transaction reform projects, and it was anticipated that such laws in Kenya and Nigeria would no longer be applicable. It was further elaborated that certain States and Provinces in Australia, Canada and the USA had adopted laws which required mediation of farmer debts which would essentially delay the enforcement of secured creditors' rights. The farmer had the right to initiate mediation in order to attempt to settle a debt whereby the enforcement process was suspended, typically for a period of thirty days. If the mediation was then unsuccessful, the creditor's rights could then be enforced under the relevant law. Mexico had a unique approach. Typically, exemption laws would protect assets only against judgement creditors.<sup>24</sup> Yet in Mexico, there was a peculiar situation, namely estate exemption, which allows a family farmer to exempt certain farming machinery even against secured creditors. For that exemption to take effect, however, public registration was a pre-requisite. Therefore, a creditor essentially knew beforehand that a certain asset might not be subject to enforcement.

124. The Study also considered the 11 submissions received from a number of UNIDROIT Correspondents. Most jurisdictions did not have any specific protection for farmers and agricultural equipment, except for Hungary, Japan and Turkey. In Hungary there was a closed list of farmer definitions whereby based on eligibility criteria, an individual would be exempt from enforcement measures of secured creditors. Excluding agri-businesses and large scale agricultural enterprises, the Turkish legislation provided for special legal protection for farmers, provided that such equipment was deemed essential for the sustenance of the debtor farmer and his family. The Japanese approach, on the other hand, provided for exemption from seizure for 'indispensable equipment' for the agricultural sector subject to certain conditions. Under the Japanese protections, agricultural equipment was only protected against actual seizure, whereas transfer of such equipment was not

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<sup>24</sup> A judgment creditor is a party to which a debt is owed that has proved the debt in a legal proceeding and that is entitled to use judicial process to collect the debt.



prohibited. As a result, security by way of assignment was legally effective and enforceable against agricultural equipment.

125. It was noted by the IFC at the third meeting that in emerging markets where the IFC had been working to reform secured transactions law, no opposition from the agricultural sector had been encountered thus far in relation to the application of insolvency or enforcement regimes to agricultural equipment. Further, the representative from the IFC reiterated that in the case of small scale individual farmers as well as family farmers which governments were aiming to protect, it would be unlikely that any type of high-value machinery would be involved.

126. Ultimately, the Study Group concluded that there was no need for the inclusion of a specific article in the preliminary draft MAC Protocol in relation to restrictions on the enforcement of international interests in agricultural equipment.

## **PART 4 – ISSUES RELATED TO REGISTRATION**

### **O. Interaction with domestic secured transaction regimes**

127. Assets covered by the Cape Town Convention and its three existing Protocols are typically excluded from general domestic secured transaction regimes, as consistent with Recommendation 4 of the UNCITRAL Legislative Guide on Secured Transactions. However, when such assets are covered by a domestic regime that provides for the creation and registration of domestic interests in that equipment, there is a potential overlap between such domestic interests under the national laws and an international interest under the Cape Town system. In this situation, Article 29 of the Cape Town Convention provides that the international interest takes priority.

128. At its first meeting, the Study Group affirmed that interests registered under the preliminary draft MAC Protocol should be expected to have priority over those interests made effective under national laws, as consistent with the previous Protocols.

### **P. Registration and titling of MAC equipment**

129. At the second Study Group meeting it was requested that Secretariat prepare research on whether MAC equipment was generally registerable under different kinds of domestic registries, and as such whether a de-registration and export request authorisation Article was required, as consistent with Article XIII of the Aircraft Protocol.

130. At the third Study Group meeting, a paper prepared by the NLCIFT was presented to the Study Group (the research paper is at Appendix VII). The report noted that the registration of MAC equipment in national registries was possible in several jurisdictions, however only in limited circumstances. Typically the laws that govern the registration of ownership had different scopes of application whereby such scope would depend on the definition of the asset in question. It explained that the definition of 'motor vehicle' was important for this purpose. Other than motor vehicles, some States also included a category of 'specialised vehicles' in their laws. The NLCIFT paper also noted that in the USA, for instance in Arizona and Texas, the registering authorities were given the power to issue serial numbers.

131. In presenting the report at the third Study Group meeting, Mr Dubovec noted that some States' secured transactions laws did have a specific provision for a 'transfer statement' through which the secured creditor would be empowered to submit a statement to the department of motor vehicles, transferring ownership of the vehicle to the transferee or the buyer who bought it at a foreclosure sale. Therefore he foresaw some need for the preliminary draft MAC Protocol to address those situations, under certain circumstances for these States, but not in the form of a full-blown Immediate Deregistration and Export Request Authorisation (IDERA) provision as set forth in Article XIII of the Aircraft Protocol.

132. It was also noted at the third Study Group meeting that unlike in the case of the Aircraft Protocol, the safety regulations for the export of MAC equipment were less relevant. The Study Group supported the inclusion of a straightforward and simple obligation for Contracting States to cooperate with creditors when they realised their enforcement rights in the form of a cooperation provision, instead of trying to come up with a precise obligation. It was agreed that Article VII paragraph 5 of the Luxembourg Rail Protocol would be sufficient in this context for adoption in the preliminary draft MAC Protocol.

133. Ultimately, the Study Group affirmed that the preliminary draft MAC Protocol should continue to include a provision modelled on Article VII(5) of the Luxembourg Rail Protocol (modification of default remedy provisions). This approach is reflected Article VIII paragraph 5 of the preliminary draft MAC Protocol.

**Q. De-registration and export request authorisation**

134. The first Study Group meeting discussed whether it was necessary to include an Article in the preliminary draft MAC Protocol on 'de-registration and export request authorisation', as consistent with Article XIII of the Aircraft Protocol. It was noted that the two separate de-registration and export powers are two of the most powerful remedies in the Aircraft Protocol. It was further noted that a similar export power exists in Articles VII(5) and IX(8) of the Luxembourg Rail Protocol which provide that subject to any applicable safety laws are regulations, a Contracting State shall ensure that the relevant administrative authorities shall expeditiously co-operate with and assist a creditor in procuring the export and physical transfer of equipment from the territory in which it is situated where the debtor has defaulted on their obligations or has become insolvent.

135. The first Study Group meeting noted that there seemed to be no need for an explicit de-registration provision for the preliminary draft MAC Protocol, as countries did not have title registries for MAC equipment in the same way they do for aircraft, nor was there a clear 'relevant administrative authority' for MAC equipment from which a party might require assistance. Page 405 of the Luxembourg Rail Protocol Official Commentary provides that the reference to 'relevant administrative authority' did not intend to affect or refer to export/customs rules. The first Study Group meeting reaffirmed that this approach was correct.

136. The first Study Group meeting considered that while a single relevant administrative authority could not be identified, assistance from authorities other than export/customs authorities might be required in moving certain types of equipment within a territory. It was concluded that the approach in Article VII of the Luxembourg Rail Protocol should be retained for the preliminary draft MAC Protocol, however more detail on the meaning of 'relevant administrative authority' should be provided in the future Official Commentary to the MAC Protocol. This approach is reflected in Article VIII(5) of the preliminary draft MAC Protocol.

## PART 5 – OTHER ISSUES

### R. Application to sales

137. The previous Protocols to the Cape Town Convention differ in their treatment of sales of the types of equipment they cover. The Aircraft Protocol and Space Protocol apply to sales and allow a sale to be registered in the International Registry, as this reflected existing commercial practices in these industries. The Luxembourg Rail Protocol allows only for the registration of notices of sale in the International Registry, which have no substantive legal effect under the Protocol itself, but may affect interests under domestic law.

138. The Official Commentary to the Luxembourg Rail Protocol provides the following analysis of Article XVII of the Luxembourg Rail Protocol governing notices of sale:

*5.70: ...Article XVII of the Luxembourg Protocol, allowing registration of notices of sale, provides that any such registration and any search made or certificate issued is to be for information purposes only and is not to have effects under the Convention or Protocol. The sole purpose of the registration facility is to give notice of the sale transaction with a view to securing a priority under national law. It is, of course, for the applicable law to determine whether a voluntary registration in the International Registry has any significance in the application of its priority rules.*

139. At its third meeting the Study Group requested that the Secretariat conduct further research on the effect of notices of sale under domestic law regimes, using practical examples to illustrate. A research report on the effect of registration of notices of sale under domestic law prepared by the NLCIFT is at Appendix VIII to this paper.

140. The report provides that there are two limited circumstances under which the registration of a notice of sale may affect the rights of parties, both relating to the conflict between a first buyer and a subsequent buyer. The report then considers the possible legal effects of the registration of a notice of sale in seven different countries. Generally, the notice of sale is likely to have effect on the rights of the parties in legal regimes which require the secondary buyer to act in good faith. The report concludes that the registration of a notice of sale would not affect the rights of parties in Colombia, but might affect their rights in France, Germany, Mexico, Spain, the United Kingdom and the United States.

141. At its fourth meeting, the Study Group decided that the preliminary draft MAC Protocol should adopt the Luxembourg Rail Protocol approach of allowing the registration of notices of sale. In making this decision, the Study Group noted that not inserting such an article would constitute a further deviation from the previous Protocols (which either allowed the registration of notices of sales without any substantive effect, or require such registrations for the purposes of applying the priority rules).

142. Article XVIII (notices of sale) of the preliminary draft MAC Protocol reflects the approach of the Luxembourg Rail Protocol.

#### *Consideration at previous meetings*

143. The first Study Group meeting discussed whether the preliminary draft MAC Protocol should extend to sales, in conformity with the approaches in the Aircraft and Space Protocols. It was noted that the Aircraft Protocol was extended to sales because of the existing practice in the industry of registering sales on the title registry. It was further noted that registration of sales was also important in the aircraft industry because of the very high value of aircraft and that payment was often made to a seller before the sale.

144. The first Study Group meeting examined the approach taken in Article XVII of the Luxembourg Rail Protocol in relation to notices of sale. Article XVII of the Luxembourg Rail Protocol allows for the registration in the International Registry of notices of sale covering railway rolling stock. However, such registration of a notice of sale is for information purposes only and does not have any legal effect under the Convention or Protocol. The first Study Group meeting noted that the benefits of this approach were that it allowed for more accessible information on the sales of equipment, and it generated additional fees for the International Registry.

145. At the second Study Group meeting, Professor Mooney noted that while knowledge of a prior interest may be relevant for domestic regimes outside the Cape Town Convention, allowing for the registration of notices of sale with no legal effect would provide useful information to markets, and unless it can be demonstrated that the Luxembourg Rail Protocol approach would cause harm, it should be followed.

146. The counterargument articulated by Mr Deschamps at the first Study Group meeting is that the purpose of the preliminary draft MAC Protocol is to implement the Convention for a certain type of equipment, not assist domestic law rules. Professor Mooney also noted at the first meeting that the policy logic behind the International Registry system set out in the Cape Town Convention was that knowledge of an earlier interest was an irrelevant consideration in determining priority, and allowing the registration of a notice of sale that could affect domestic priority rules based on knowledge encouraged a countervailing legal policy.

147. The third Study Group meeting debated whether a “harm minimisation” or a “demonstrated benefit” approach should be adopted, ultimately deciding to retain the Luxembourg Rail Protocol approach and deferring the issue to the Committee of Governmental Experts.

148. With the possible entry into force of the Luxembourg Rail Protocol in the near future, it may be instructive to witness how many registrations of notices of sale are completed under the Rail Registry, whether such registrations are necessary to assure the economic viability of the Registry, and whether those registrations are found to have any effect under domestic legal regimes.

### **S. Interaction between Article 29(3)(b) and the preliminary draft MAC Protocol**

149. At the second Study Group meeting, during discussions regarding whether the MAC Protocol should apply to sales, Mr Deschamps queried how the registration of a notice of sale interacts with Article 29(3) of the Cape Town Convention.

150. Article 29 (priority of competing interests) provides the following:

3. *The buyer of an object acquires an interest in it:*

(a) *subject to an interest registered at the time of its acquisition of that interest; and*

(b) *free from an unregistered interest even if it has actual knowledge of such an interest.'*

151. At the second Study Group meeting, Professor von Bodungen noted that there was no conflict between Article XVII (notices of sale) of the Luxembourg Rail Protocol and Article 29(3) of the Cape Town Convention, as the buyer’s position is not protected under the Luxembourg Rail Protocol, and Article XVII of the Luxembourg Rail Protocol was not meant to prevail or otherwise interact with Article 29(3).

152. Professor Mooney noted that when a notice of sale is entered into the registry, regardless of whether the buyer may or may not have an interest in the object, such an interest would be an

unregistered interest. Professor Mooney recommended that if the Luxembourg Rail Protocol approach is adopted in the preliminary draft MAC Protocol, then it should also clarify that national law that allows certain buyers to take free of or subject to an interest should prevail, otherwise secondary buyers could rely on 29(3) to take free of an interest even if they would not qualify for such priority under the domestic law.

153. The Official Commentary to the Luxembourg Rail Protocol provides the following explanation of Article 29(3):

*4.186. Paragraph 3 introduces the first of two exceptions to the general rule that even an unregistrable interest is displaced by a subsequent registered interest. The case of purchase by an outright buyer is considered so common and important as to justify a special rule giving the buyer's interest priority over an interest not registered until after the time of the buyer's acquisition of the object. However, it is an implicit condition of the application of Article 29(3) that the seller had a power to dispose of the object. Where the buyer acquires priority under this rule, the effect is to extinguish any unregistered security interest in the object, and where the international interest was in respect of a conditional sale or leasing agreement, any title of the conditional seller or lessor whose interest was unregistered, since its displaced interest is not as conditional seller or lessor but simply whatever interest it had at the time it had at the time of entering into the conditional sale or leasing agreement.*

154. This paragraph is illustrated at page 309 of the Official Commentary in the following way:

*O, the owner of a locomotive, leases it to L. Before O has registered its interest, L wrongfully sells the locomotive to B. B displaces O as the owner, and this is so even if B knew of O's international interest.*

155. In the above illustration, it is understood that O's 'international interest' is an internationally registrable interest that has not been registered.

156. As the Aircraft and Space Protocols allow for the registration of the interest of an outright buyer, Article 29(3) of the Convention is replaced by Article XIV(1) and (2) of the Aircraft Protocol and Article XXIII of the Space Protocol, which provide:

*Modification of priority provisions*

*1. The buyer of an [aircraft object/space asset] under a registered sale acquires its interest in that asset free from an interest subsequently registered and from an unregistered interest, even if the buyer has actual knowledge of the unregistered interest.*

*2. The buyer of an [aircraft object/space asset] under a registered sale acquires its interest in that asset subject to an interest previously registered.*

157. This issue was discussed at length at the third Study Group meeting. It was decided that Article 29(3) did not intend to deal with the situation of competing buyers, and that it should not be read to infer that a secondary buyer should acquire an interest free from a previously unregistered interest of a first buyer. The Study Group decided that there was no need to insert an Article in the preliminary draft MAC Protocol on this issue, however the future Official Commentary to the MAC Protocol should expressly provide that Article 29(3) would not apply to situations involving competing buyers.

## **T. Modification of assignment provisions**

158. The first Study Group meeting discussed whether it was necessary for the preliminary draft MAC Protocol to modify the assignment provisions in the Cape Town Convention, as consistent with Article XV of the Aircraft Protocol and Article XXIV of the Space Protocol. It was noted that Article XV

of the Aircraft Protocol modified Article 33 of the Cape Town Convention, by adding the additional requirement of obtaining a debtor's consent in writing before an assignee may enforce the debtor's duty to make payment or perform other obligation. It was further noted that this additional requirement was included in the Aircraft Protocol because it reflected the established practice in aircraft financing and that the airline industry did not want to have it removed. The Luxembourg Rail Protocol did not follow this approach as such a practice was not followed in the rail industry.

159. The first Study Group meeting concluded that the precedent in the Luxembourg Rail Protocol was to be followed and there was no need for the preliminary draft MAC Protocol to modify the original assignment provisions in the Cape Town Convention.

#### **U. Public service exception**

160. Article XXV of the Luxembourg Rail Protocol and Article XXVII of the Space Protocol provide an exemption to the operation of certain aspects of the Cape Town Convention and the relevant Protocols in relation to the provision of public services. While the approach to this issue in the two Protocols is materially different, the underlying policy is the same: the State has a natural interest in ensuring that a creditor exercising its rights under the Convention/Protocol does not cause the abrupt termination of a service of public importance.<sup>25</sup>

161. Article XXV of the Luxembourg Rail Protocol provides that a Contracting State may, at any time, enter a declaration that it will continue to apply its domestic law in force at the time of the declaration that precludes, suspends or governs the exercise by the creditor of any remedies under the Convention/Protocol in relation to public service railway rolling stock. Article XXV applies to both passenger vehicles and freight vehicles that must be habitually providing a service of public importance (i.e. a passenger vehicle habitually carrying a substantial number of passengers on a main line would ordinarily be considered to provide a service of public importance).<sup>26</sup> If the public service is exercised by the Contracting State, it has duties to preserve and maintain the asset and pay to the creditor compensation under either the national law or the market lease rental within 10 calendar days of taking possession of the asset (and thereafter on the first day of each successive month). There is no time limit on the period the Contracting State can prevent the creditor from exercising a remedy in relation to public service rolling stock.

162. Under Article XXVII of the Space Protocol, a debtor who enters into a contract providing the use of a space asset for public services can agree with other parties to the contract for the provision of the public service and the Contracting State to register a public service notice under the Protocol. Technically, it does not require the creditor's consent, as the creditor is not a party to the contract for the provision of public services. However, the creditor can impose contractual restraints on the debtor's consent to registration of a public service notice at the time of the creation of the international interest, and therefore in practice is likely to be a part of the negotiations.<sup>27</sup> Subject to certain exceptions, a creditor may not exercise any Convention/Protocol remedies in the event of a debtor default on an asset that is subject of a public service notice. The period that a creditor cannot exercise its remedial rights is limited to 3-6 months. During the suspension period, the creditor, debtor and public service provider are required to cooperate in good faith with a view to find a commercially reasonable solution permitting the continuation of the public service. The approach in Article XXVII appears to be more complex than the approach in the Luxembourg Rail Protocol.

163. The types of important public services relating to rail transport (carriage of persons and goods) and space assets (national security, transport safety, communications) are obvious.

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<sup>25</sup> Space Protocol Official Commentary, page 194.

<sup>26</sup> Luxembourg Rail Protocol Official Commentary, page 181.

<sup>27</sup> Space Protocol Official Commentary, page 196.

Conversely, the agriculture, construction and mining sectors do not provide public services. Rather, they simply operate in fields of significant public interest.

164. The first Study Group meeting agreed to adopt a cautious approach to this issue, given the difficulty involved in its negotiation in the previous Protocols. The first Study Group meeting highlighted the important distinction between objects that actually provide a public service covered under the Luxembourg Rail and Space Protocols, and objects that are used in performing functions that are of significant public interest. For example, construction equipment may be used in the building of important infrastructure projects that are central to the public interests of a country; however the construction equipment itself is not providing a continuous public service. It was further noted that the most common types of MAC industry-related projects of national importance would have a degree of public financing and as such would be unlikely to be financed by private financing agreements covered by the Cape Town Convention.

165. The Study Group agreed that it was not necessary to include a public service exception article in the preliminary draft MAC Protocol, on the basis that MAC industries do not provide continuous public services.

## **V. Amendment procedures**

166. Due to the usage of the Harmonized System to define the scope of the preliminary draft MAC Protocol, the preliminary draft MAC Protocol will have to adopt a different approach to amendment as compared to the previous Protocols to the Cape Town Convention. This is due to the fact that the list of HS codes included in the Annexes may need to be periodically amended to realign with changes to the HS system itself, and may also need to be updated to accommodate the development of new technologies or to respond to changes in the agricultural, construction and mining sectors or patterns in world trade.

167. The amendment provision has been consistently drafted across all three previous Protocols (Article XXXVI of the Aircraft Protocol, Article XXXIII of the Luxembourg Rail Protocol and Article XLVII of the Space Protocol). Article XXXII of the preliminary draft MAC Protocol provides:

1. *The Depositary, in consultation with the Supervisory Authority, shall prepare reports yearly, or at such other time as the circumstances may require, for the States Parties as to the manner in which the international regime established in the Convention as amended by the Protocol has operated in practice. In preparing such reports, the Depositary shall take into account the reports of the Supervisory Authority concerning the functioning of the international registration system.*

2. *At the request of not less than twenty-five per cent of the States Parties, Review Conferences of the States Parties shall be convened from time to time by the Depositary, in consultation with the Supervisory Authority, to consider:*

- (a) the practical operation of the Convention as amended by this Protocol and its effectiveness in facilitating the asset-based financing and leasing of the objects covered by its terms;*
- (b) the judicial interpretation given to, and the application made of the terms of this Protocol and the regulations;*
- (c) the functioning of the international registration system, the performance of the Registrar and its oversight by the Supervisory Authority, taking into account the reports of the Supervisory Authority;*
- (d) whether any modifications to this Protocol or the arrangements relating to the International Registry are desirable; and*



- (e) *whether any changes to the Harmonized System have affected the Harmonized System codes listed in the Annexes, or whether new codes have emerged under the Harmonized System that may warrant inclusion in the Annexes.*

3. *Any amendment to this Protocol other than the Annexes shall be approved by at least a two-thirds majority of States Parties participating in the Conference referred to in the preceding paragraph and shall then enter into force in respect of States Parties which have ratified, accepted or approved such amendment when it has been ratified, accepted or approved by five States Parties in accordance with the provisions of Article XXIII relating to its entry into force.*

4. *If the report referenced in paragraph 1 identifies additional agricultural, construction or mining equipment that is materially similar to equipment that falls under existing Harmonised System codes contained in the Annexes, the Depositary may add or retain the Harmonised System codes covering such additional equipment to the Annexes. The Depositary shall notify States Parties of a revision to the Annexes under this paragraph. Any such revision shall become effective six months after its notification to the States Parties. If within three months after its notification to the States Parties a majority of the States Parties notify the Depositary of their objection, the revision shall not become effective. The Depositary shall immediately notify all States Parties of the date that a revision pursuant to this paragraph enters into force.*

5. *If the report referred to in paragraph 1 concludes that technical changes to the Harmonized System have affected the numbering of the Harmonized System codes listed in the Annexes without expanding their scope, the Depositary may revise the Harmonized System codes contained in the Annexes to ensure conformity with the Harmonized System. The Depositary shall specify the date as of which such a revision shall apply. The Depositary shall notify States Parties of a revision to the Annexes and the date at which the revision shall become effective.*

6. *Any revision to the Annexes shall not affect rights and interests arising prior to the date the revision becomes effective or applicable.*

168. To assist the Study Group in considering this issue, the Secretariat conducted additional research on the amendment procedures in other relevant international instruments, which is at Appendix IX to this paper.

169. The research paper considered the Agreement on Trade in Civil Aircraft, the Energy Charter Agreement and the Convention for the Unification of Certain Rules for International Carriage by Air (The Montreal Convention). It found that the first two instruments did not contain any particularly useful mechanisms that could be adopted by the preliminary draft MAC Protocol. However, Article 24 paragraph 2 of the Montreal Convention provides a mechanism under which the Depositary can unilaterally revise the limits of liability under the Convention, where it determines (during a five yearly review) that the inflation factor has exceeded a certain amount. Such a revision has automatic effect unless a majority of States Parties register their disapproval. The research paper suggested that such an approach could be adopted in relation to changes to the Annexes to the preliminary draft MAC Protocol that simply realign the codes in the Annexes to reflect revisions to the Harmonized System, but do not intend to expand the scope of the preliminary draft MAC Protocol to new types of MAC equipment.

#### *Draft Provision*

170. At its fourth meeting, the Study Group agreed that the preliminary draft MAC Protocol should contain a three-tiered amendment procedure. Firstly, a substantive amendment to the preliminary

draft MAC Protocol would require the usual amendment procedure reflect in the previous three Protocols to the Cape Town Convention, and thus require a fully-fledged Review Conference.

171. Secondly, where additional HS codes introduced in the new HS System edition contain equipment 'materially similar' to the equipment contained in the Annexes to the MAC Protocol, the Depositary may add the 'materially similar codes'. Such a revision would become effective in six months, unless a majority of States Parties register their objection. This procedure would allow emerging new technologies to be reflected in the MAC Protocol without the need for a full amendment process. During the fourth Study Group meeting, the hypothetical example that was considered was a mining machine that utilised lasers. As it was used for mine digging and there is no principled reason not to include the laser-based mining machine in the MAC Protocol, then adding an HS code covering such equipment would not be a material expansion and thus would not be an expansion of the scope of the MAC Protocol.

172. Thirdly, where a new nomenclature is adopted by the WCO (as occurs periodically approximately every five years), the Depositary will consult with the WCO. Once the Depositary has been advised by the WCO that the numbering in the Annexes could be amended to retain consistency with the updated nomenclature without extending the scope of the Protocol, the Annexes could be amended by the Depositary without intervention by Contracting States.

173. Article XXXII of the preliminary draft MAC Protocol reflects this three-tiered approach (paragraph 3 applies to substantive changes to the preliminary draft MAC Protocol, paragraph 4 applies to the addition of 'materially similar' codes and paragraph 5 allows for the realignment of the Annexes to correspond to changes to the Harmonized System without approval from Contracting States).

#### *Consideration at previous meetings*

174. At the third Study Group meeting in October 2015, the Study Group expressed a preference for placing the procedural aspects of the amendment procedure for the Annexes in the body of the preliminary draft MAC Protocol itself.

#### **W. Supervisory Authority**

175. There is some difficulty in identifying a Supervisory Authority for the MAC Protocol, due to the diverse nature of the three categories of equipment (agriculture, construction and mining). In contrast to the approach adopted by the Luxembourg Rail Protocol, it was agreed that it was undesirable to attempt to create a new international body to act as Supervisory Authority. The Study Group raised the possibility of either the World Customs Organisation or the International Finance Corporation (IFC) being the Supervisory Authority.

176. At the third Study Group meeting, the representative of the IFC noted that the Supervisory Authority issue would be discussed internally at the IFC, to determine whether it was feasible for the IFC to perform such a role. In January 2016, the UNIDROIT Secretariat provided additional information to the IFC in relation to the nature of the Supervisory Authority role to assist with their discussions.

177. At the fourth Study Group meeting the representative of the IFC noted that the IFC was working with UNIDROIT in exploring the possibility of the IFC acting as the Supervisory Authority to the Protocol. He mentioned a number of considerations, namely whether such a role would fall within the sphere of activity of the IFC and its articles of agreement, given that IFC's exclusive focus was on investment in the private sector. However, he noted that parts of the IFC's mandate was to promote the development of the private sector, which could possibly be read to allow for a slightly broader range of activities.

178. He also noted that from a practical perspective, if the IFC was to perform the role of Supervisory Authority, actions would have to be taken to avoid possible conflicts of interest, as the IFC would be both a user of the International Registry and its Supervisory Authority.

## APPENDICES

### Appendix I – Research on the Harmonized System

1. The following section contains an analysis of the HS system conducted by the NLCIFT and provided to the Study Group at its second meeting in April 2015.

#### *Organisation of the HS System*

2. The HS System is divided into 21 Sections which contain a total of 97 Chapters. The Chapters are further sub-divided into 1,224 headings identified by 4-digit codes. Most headings are further subdivided into 5 and 6-digit subheadings. The 2012 version, currently in effect, is divided into 5,205 groups identifiable by a 6-digit code. The previous 2007 version contained 5,051 groups.

3. The four digits that identify a heading have a particular significance – the first two digits identify the Chapter in which the heading appears and the latter two indicate the position of the heading within the Chapter. If a heading has not been subdivided, it is identified as follows: 0707.00 – with the fifth and sixth digits indicating that there is no subheading. For headings that are further subdivided, the sequence of digits may read as follows: (heading) 20.08 Fruits and nuts; (sub-heading) 2008.30 Citrus fruit. The Preliminary List of HS Codes for Inclusion under the MAC Protocol (List) includes only 6-digit subheadings in which the last two digits are not separated by a full stop.

4. According to Article 3 of the Convention, countries are allowed to create subdivisions based on their needs. As a result, it may be the case that a country's 6-digit HS codes may have been further subdivided. In the European Union, the Combined Nomenclature of the EU integrated the HS System but also included additional 8-digit subheadings to address its own needs. In the United States' implementation of the HS System, 8424.81 (Other Appliances: Agricultural and Horticultural) is subdivided into 8424.81.10 (Sprayers) and 8424.81.90 (Others). The subdivision 8424.81.90 is further subdivided into 8424.81.90.10 (Self-propelled, center pivot), 8424.81.90.20 (Other), 8424.81.90.40 (Sprayers, self-contained having a capacity not over 20 liters) and 8424.81.90.90 (Other). Since the 8424.81 code has been included in the List, it is assumed that any items identified by countries in their 8 or 10-digit subheadings would be automatically included within the scope of the MAC Protocol. Since the codes for 8 and 10-digit subheadings may vary country-by-country, the 6-digit classification which is prescribed by the Convention itself should remain the basis for the MAC Protocol.

5. Chapter 77 is reserved for possible future use. Chapters 98 and 99 are not part of the HS at all, but they may be used by member countries. Only a handful of countries utilise Chapters 98 and 99 for special purposes, including Canada, the EU, India and the United States.

6. Chapters are organized according to the degree of manufacture, starting with raw products, then unprocessed products and semi-finished goods, and ultimately finished products. For instance, live animals belong under Chapter 1, animal skins under Chapter 41, and leather footwear under Chapter 64.

#### *Structure of the HS System*

7. The HS system is composed of:

- (i) General Rules for the Interpretation of the System
- (ii) Section and Chapter Notes, including Subheading Notes
- (iii) A list of headings

8. The General Rules contain 6 guidelines that apply hierarchically i.e., Rule 1 takes precedence over Rule 2. For instance, Rule 3 provides classification guidelines applying to goods that seemingly fall under more than one heading. According to Rule 3(a), goods should be classified in the heading giving them the most specific description. Rule 4 applies to goods that have not been previously classified because, for

instance, they are new on the world market. This Rule dictates that such goods be classified under the heading appropriate to the goods to which they are most akin. From the perspective of the MAC Protocol, if a new item of equipment enters the market and has not been previously classified under an HS code, applying this interpretation rule, it may fall under the scope of the MAC Protocol if it is classified under a code that already falls under the scope of the MAC Protocol. Accordingly, the scope of the MAC Protocol may be expanded through this mechanism even before a new edition of the HS System enters into force.

9. The main function of the Notes is to delineate the scope and limits of each heading and subheading. Contracting States may include additional (national) notes for their domestic use. The EU has done so and included a number of legal notes in its HS nomenclature.

#### *Amendment Process and the Harmonized System Committee*

10. The current 5<sup>th</sup> edition of the HS System became effective January 1, 2012. It replaced the 2007 version, incorporating 234 amendments which reflected primarily social and environmental issues. The majority of amendments were included based on the recommendations of the Food and Agriculture Organisation of the United Nations (FAO). For instance, FAO suggested revisions with respect to the codes relating to fish and fishery products in order to enhance their monitoring for food security purposes. Some amendments also resulted from changes in international trade patterns (e.g., the separate headings 69.07 for unglazed ceramic products and 69.08 for glazed ceramic products in the 2007 version were merged into a single heading in the 2012 version).

11. In order to facilitate the implementation of the HS amendments and to ensure common interpretations, the WCO Secretariat publishes correlation tables for each HS amendment that are to be used as a guide to facilitate the implementation of new editions of the HS System<sup>28</sup> In some circumstances, rather than amending the Convention and, thus the entire HS System, merely the Explanatory Notes are modified.

12. The WCO Council, at its 123<sup>rd</sup>/124<sup>th</sup> Sessions in June 2014, adopted a Recommendation that includes a list of proposed amendments to the 2012 HS nomenclature. This Recommendation was issued under Article 16 of the Convention that regulates the amendment process. At its March 11-20, 2015 meeting, the Harmonized System Committee (HS Committee) considered the scope for the 6<sup>th</sup> edition and adopted a draft Article 16 Recommendation relating to the 2017 edition.

13. The HS Committee is responsible for amending and updating the HS System. Established pursuant to Article 6 of the Convention, the Committee includes a representative from every member country. The Committee is vested with the power to continuously update the HS System reflecting the changes in and emergence of new technologies as well as new patterns of international trade. The HS Committee has established the HS Review Sub-Committee to systematically and regularly review the HS System.

14. Amendments to the Convention, including the HS System, may be adopted pursuant to Article 16 of the Convention upon recommendation of the WCO Council. First, the Council will make the amendment available for public comment. Second, member countries will be given a period of six months within which they may file objections. If, at the end of the six-month period, no objections have been filed, the amendment will deem to be adopted. After an amendment has become effective, no country may accede to the Convention without adhering to the amendment. However, because of the changes that countries will need to implement to reflect the amendment, amendments enter into full force about two years after their adoption. Accordingly, the entire procedure to amend the HS System takes at least two and a half years from the moment the Council adopts an amendment Recommendation.

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<sup>28</sup> See [http://www.wcoomd.org/en/topics/nomenclature/instrument-and-tools/hs\\_nomenclature\\_2012/correlations-tables.aspx](http://www.wcoomd.org/en/topics/nomenclature/instrument-and-tools/hs_nomenclature_2012/correlations-tables.aspx).

15. In general, the nature of the amendments reflected in the previous editions was two-fold: i) clarifications and ii) structural reorganisation. For instance, different codes for similar goods that are not traded heavily on a cross-border basis have been merged or when an asset gains importance, the relevant code has been split. The product categories related to each amendment vary. The HS 1996 amendments included some major structural changes to food, tropical woods, steel and electronic products; the HS 2002 amendments were mainly related to wood, paper, waste of chemicals and pharmaceuticals, and metals; and the HS 2007 amendments focused on information technology and communication products. In addition to the clarifying and structural changes, amendments typically include a number of less significant changes, such as the deleting of subheadings that cover products with low trade volumes and the correcting of errors in previous HS editions. Of all subheadings, 72 percent have never been changed by any amendment.

#### *Value of Exports*

16. Information on the values of individual types of MAC equipment considered for inclusion under the MAC Protocol is not publicly available. Such prices, including the lows, medians and highs, may be obtained only by contacting manufacturers and dealers. However, a few databases exist that compile the aggregate values for particular HS codes.

17. One such database has been built by the World Bank. It is known as the Exporter Dynamics Database and it uses datasets based on six main variables including: i) year of exports; ii) HS 6-digit code; and iii) value of exports in \$USD.<sup>29</sup> The data contained in the database was provided by customs agencies from 38 developing and 7 developed countries. An update of the Database should be issued in 2015.

18. Other publicly available sources of information also do not include the individual values of equipment. The trade data in the 2013 International Trade Statistics Yearbook, published by the UNSD's Department of Economic and Social Affairs, includes the aggregate export/import values for many kinds of equipment from the Private Sector Recommendations but is calculated on a global basis. For instance:

- For **SITC Code 713** Internal combustion piston engines and parts thereof, that corresponds to the **8407 HS Code**, the four subheadings of which were included in the Private Sector Recommendations, the total value of global exports was US\$ 163.
- For **SITC Code 721** Agricultural machinery excluding tractors, that corresponds to the **8432 and 8433 HS Codes**, the 17 subheadings of which were included in the Private Sector Recommendations, the total value of global exports was US\$ 39.5 billion.
- For **SITC Code 722** Tractors that corresponds to **8701.90 HS Code**, the total value of global exports was US\$ 23.3 billion.

#### *The HS System as the basis to determine the scope of the MAC Protocol*

19. The List includes items of equipment from Chapters 82, 84, 85 and 87 of the HS System. The WCO Handbook notes that Section XVI, that includes Chapters 84 and 85 covering machinery, mechanical appliances and electrical equipment, is one of the most important in terms of the number of headings and subheadings.

20. The Study Group considered the HS System as the basis to establish the scope of the MAC Protocol identifying the relevant codes from an edition of the HS System. As a baseline to determine the scope of the MAC Protocol, the 2017 edition may be chosen. The List was prepared according to the nomenclature of the currently effective 2012 edition and will need to be verified, and if necessary adjusted, to correspond to the 2017 edition.

21. Since the HS System is periodically revised, a question arises as to whether and how the scope of the MAC Protocol should be initially established and then periodically adjusted, if necessary.

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<sup>29</sup> See further Cebeci, T., Fernandes, A., Freund, C. and M. Pierola, "Exporter Dynamics Database" [World Bank Policy Research Working Paper 6229](#) (2012).

22. One approach would be for the MAC Protocol to include a list of HS codes that could not be altered. The advantage of this approach would be the initial certainty it provides to the users and elimination of the risks and costs associated with adjusting the scope. However, the disadvantages of this approach seem to outweigh the advantages. Such a rigid approach would essentially foreclose the possibility of new types of equipment being added to the MAC Protocol. Furthermore, with new editions of the HS System, the codes identified in the MAC Protocol may no longer correspond to the codes actually utilised in export/import transactions and the MAC Protocol would then refer to obsolete items of equipment that are no longer being manufactured, etc. Accordingly, the MAC Protocol may have to include a mechanism for the periodical revisiting of its scope in light of potential changes in the patterns of international trade, emergence of new technologies and items of equipment, amendments to the HS System, etc.

23. At least two approaches for the adjustments of the scope of the MAC Protocol may be considered: i) automatic adjustments based on future amendments to the HS System itself, or ii) adjustments made independently from the periodic amendments to the HS System. The first approach may entail a mechanism included in the MAC Protocol itself for its automatic updates based on amendments to the HS System. Accordingly, the MAC Protocol may initially identify a list of HS codes from a particular edition and then automatically incorporate any changes to those codes from future editions of the HS System.

24. If this approach to adjust the scope of the MAC Protocol is not adopted, there will be a need to appoint an Authority to: i) determine whether the new edition of the HS System has affected the scope of the MAC Protocol, and ii) to actually implement the changes reflected in the new edition. The logical solution in regards to appointing an Authority would be to have the Supervisory Authority established under Article 17 of the Cape Town Convention (responsible for the establishment of the International Registry, appointing Registrars, making Regulations etc) perform this role. However, this will ultimately depend on whom is appointed to be the Supervisory Authority of the MAC Protocol. Since the scope of any international instrument is one of its most important aspects, ceding the authority to determine the scope of the MAC Protocol to an international organisation (i.e., the WCO that has no interest in facilitating access to credit secured with MAC equipment) may not be practical or politically feasible. It is also possible that Contracting States may want the Authority to be a diplomatic body of Contracting States. As such, the formation and constitution of the 'Authority' will require further consideration.

25. Once such body is established, the functions of the Authority may go beyond simply determining whether the new edition affects the scope of the MAC Protocol and implementing those changes. Instead, this body could be tasked with a function to assess the changes in the HS System from the perspective of the users of the MAC Protocol and determine whether, and to what extent, the changes should be implemented.

26. This Authority established under the MAC Protocol may review the scope periodically when the HS System itself is revised or do so independently of the WCO process (e.g., every three years). The advantage of this approach is that the interested parties themselves, appointed to the Authority, will retain control over the scope of the MAC Protocol. This approach may reduce the need to adjust an Annex to the MAC Protocol every time the HS System is amended, if, for instance, the new edition of the HS System has not affected the list of MAC codes.

27. If the Authority is given expansive functions which go beyond simply determining whether the new HS System affects the list of HS codes, it might have the power to reject changing the scope of the MAC Protocol even if some of the HS codes have changed. Accordingly, this Authority rather than the WCO would dictate and determine which assets should fall under the scope of the MAC Protocol. These powers may be useful given the nature of the HS System amendment processes whereby the WCO does not, and is not expected to, take into account the interests of those involved in the financing of MAC equipment. For instance, the WCO may hypothetically delete a particular HS code or merge it with some other code which would take an asset previously covered by the MAC Protocol outside its scope. The Authority may disagree with this approach if it determines, from the standpoint of the MAC equipment financiers and users, the code should not have been deleted or merged. The disadvantages of this approach may be the relative detachment of the scope of the MAC Protocol from an objectively determinable, reliable and widely-

accepted nomenclature and the potential confusion as to the difference between the codes that form the scope of the MAC Protocol and those presently used for other purposes, as well as the potential risk in questioning the decisions of the Authority.

28. This Authority may also be given the power to identify certain codes for elimination from or addition to the MAC Protocol independently of the HS System amendments. For instance, in the first five years of operation of the International Registry, no notices relating to transactions covering a particular HS code have been recorded which may indicate that those items of equipment have become obsolete, are not traded internationally or are acquired without any form of financing. Based on input from the industry, the Authority could then decide that another code should be added to the List because the items of equipment covered by the relevant HS code, at that time, satisfy the relevant requirements for inclusion under the MAC Protocol.

29. Any measures allowing for the elimination of codes covering certain types of equipment must be treated with extreme caution, as users of the system must be able to have confidence that their international secured interest under the Protocol will not be jeopardised by future alterations made by the Authority. Further, any decision to eliminate an existing code from the system should only have prospective effect in preventing new registrations in that type of equipment (i.e. prior security interests created under the Protocol in the type of equipment covered by the eliminated code would continue to have effect).

30. Overall, there does not appear to be a viable alternative to establishing the scope of the MAC Protocol according to a list of HS codes covering different types of MAC equipment. However, since these HS codes may change in the future, the MAC Protocol should also contemplate a procedure for periodical review of and changes to the scope. Affixing the scope to the future editions of the HS System that would be automatically incorporated into the MAC Protocol presents a number of risks, the chief of which is the ability of an international organisation to essentially dictate the scope of the MAC Protocol.

31. A preferable approach may be to appoint an Authority to assess the need to revise the scope of the MAC Protocol, either concurrently with or independently from the taking effect of a new HS System.

#### *Effect of HS Amendments on the MAC Protocol*

32. The Study Group considered designing the scope articles of the MAC Protocol to refer to an Annex which would contain a list of HS codes covering individual types of MAC equipment. In connection with this consideration, several questions, particularly of drafting nature, would need to be addressed.

33. First, should the list of HS codes refer to a particular edition of the HS System? Referring to a specific edition (e.g., the 6<sup>th</sup> edition) may have the disadvantage that every time the HS System is amended, the Annex would need to be amended as well. Including just the list of HS codes may not require an amendment to the Annex because the HS nomenclature for the MAC equipment may not be modified. Annex I to this document summarizes the effect of the last three HS System amendments on the list of HS codes preliminary selected by the industry to predict how significant the future changes to the Annex could be.

- *An amendment deletes a code that covers some MAC equipment:* codes are deleted only when the assets covered thereunder have become obsolete and no longer trade internationally. The question is whether the Annex should be revised to delete the relevant code(s). The advantage of deleting the code(s) from the Annex, the deletion being effective only prospectively, is clarity for the users who will be able to readily identify that the MAC Protocol no longer covers certain codes. The disadvantage of this approach is that in the case that a new edition of the HS System affects the MAC Protocol only by deleting a single code, depending upon how cumbersome the procedure to amend the Annex is, it might not be practicable to revise the entire Annex to delete a single code which has anyway become obsolete.
- *An amendment adds a new code that covers some new MAC equipment.* The first question is whether the new code does in fact cover some MAC equipment and whether that



equipment satisfies the requirements of the Cape Town Convention. In other words, an Authority will need to determine whether the scope of the MAC Protocol should be expanded. Such determination could be done by the Authority against a set of pre-established minimum criteria, the satisfaction of which would justify the addition of the new code to the Annex of the MAC Protocol. Setting forth such criteria rather than leaving the decision entirely up to the Authority would minimize the arbitrariness and subjectivity elements from the decision-making process.

- *An amendment merges two pre-existing codes.* Such amendments potentially affect the scope of the MAC Protocol in at least two ways. First, a code that was included in an Annex to the MAC Protocol is merged with a non-MAC Protocol code (this is very unlikely to happen). If the MAC Protocol adopts the first approach for its adjustments, which is to automatically reflect the changes from a new edition of the HS System, complications could arise with respect to the implementation of these new "merged codes." The second approach, under which adjustments to the scope of the MAC Protocol are made by an Authority, has the advantage of the Authority deciding that the previous code should be retained rather than replaced with this new merged code. The second kind of merger that could affect the scope of the MAC Protocol may happen when two MAC Protocol codes are merged. The implementation of this change would raise the same questions as with the previous type of merger.
- *An amendment that splits an existing code.* Again, at least, two possible situations affecting the scope of the MAC Protocol could arise. First, an existing MAC Protocol code could be split into two separate codes, both covering MAC equipment. This kind of amendment does not seem to present any complications with implementation, and the two new codes could replace the existing single code. Second, an existing code is split into two codes, only one of which covers MAC equipment. This is very unlikely to happen as long as the codes selected initially to establish the scope of MAC equipment do not inadvertently include non-MAC equipment. Second, how should changes be implemented if a new edition of the HS System does effect the MAC equipment previously included within the scope of the MAC Protocol? To answer this question, the nature of amendments needs to be addressed first.

34. A related issue is presentation of deletions and merged codes. The Study Group may want to consider how the deleted, new and merged codes will be presented in the Annex itself. At least, two approaches are possible: i) every time the HS System is revised the Annex would be opened and all the relevant codes from the new edition restated; or ii) only the changes from the new edition that affect the MAC Protocol would be included. Both approaches have their advantages and disadvantages. The disadvantage of the second approach is the need for an Authority to identify the changes in the new edition which may entail some cost and present a risk that certain changes may not be restated accurately. The disadvantage of the first approach is that the user would need to determine on its own what has been changed. However, since the user will most likely be the creditor, who considers extending secured credit to the borrower, they might not be concerned with the previous status of HS codes and their modifications.

#### *Other international instruments using the HS System to define their scope*

35. Following the conclusion of the third Study Group meeting, at which Mr Ed de Jong (Senior Technical Officer from the WCO) presented in detail on the operation of the Harmonized System, the Secretariat conducted further research on the use of the Harmonized System as a mechanism for defining the scope of other international instruments.

#### *Agreement on Trade in Civil Aircraft*

36. The Agreement on Trade in Civil Aircraft entered into force in January 1980 and currently has 32 signatories (as of February 2016). It is a plurilateral WTO agreement (whereby any reservation submitted by any signatory would require the consent of all other signatories) which aims to eliminate import duties for civil aircraft products as covered by its scope.

37. Articles 1 and 2 of the Agreement delineate product coverage through a dual approach. Article 1.1 provides for an object-definition assessment under which '*all civil aircraft, all related engines and their parts and components and all other parts, components and subassemblies of civil aircraft, as well as all ground flight simulators and their parts and components*' are covered. Whether used as original or replacement equipment, all of the items mentioned above are included within the scope of the Agreement.

38. Article 2.1.1 makes an actual end-use assessment and provides for the elimination of customs duties and other charges levied on, or in connection with, the importation of products which are classified under their respective tariff headings as listed in the Annex. This is subject to the condition that such products are required to be utilised in a civil aircraft and incorporation therein, whether in the course of its manufacture, repair, maintenance, rebuilding, modification or conversion. Concerning the actual end-use assessment of products, the duty-free treatment would also be extended to dual-use (multi-functional) products, provided that the potential importer certify that the product in question is to be utilised in a civil aircraft and incorporated therein.

39. Article 1.2 distinguishes the denomination 'military' aircraft from 'civil' aircraft whereby the former would fall outside the scope of coverage of the Agreement. All other products as set out in Article 1.1 would be covered. Article 1.1, however, neither provides any explicit reference to the HS coding nor to the Annex to the Agreement.

40. The Annex to the Agreement reiterates that signatories agree that products covered by the descriptions which are classified under the listed HS codes shall be accorded duty-free or duty-exempt treatment, in the event that the products are exclusively used in a civil aircraft or in ground flying trainers or for incorporation therein, in the course of their manufacture, repair, maintenance, rebuilding modification or conversion. The Annex further stipulates that other items, including incomplete or unfinished products are not included, unless they have the essential character of a complete or finished part, component, subassembly or item of equipment related to a civil aircraft. Materials in any form (e.g. sheets, plates, strips, bars, pipes) are therefore not included unless they have been cut or shaped for the incorporation in civil aircraft, which can be proven where the material has a civil aircraft manufacturer's part number. Furthermore, raw material and consumable goods are explicitly excluded.

41. Finally, the Annex also provides for an 'ex' extension to be added in front of the HS codes listed. This is to indicate that the product description referred to does not exhaust the entire range of products within the HS codes listed in the Annex. As such, in order for an item to be covered by the scope of the Treaty, not only is that item required to be covered by a specific HS code listed in the Annex but it is also required to meet the description in Article 1.

42. The approach of the Civil Aircraft Agreement to scope of application does not appear to be particularly useful for the MAC Protocol, primarily because it uses a description based-scoping article in addition to the use of the HS codes. Given the diversity in the range of agricultural, construction and mining equipment covered by the MAC Protocol, a description based approach would not be practical for the MAC Protocol. This problem was the main reason behind considering the WCO HS coding as opposed to an object description definition in the first place.

#### *The Energy Charter Treaty*

43. The Energy Charter Treaty (hereinafter, the ECT) entered into force on April 1994 and has 54 signatories (as of February 2016). The ECT provides for a multilateral framework for cooperation in the field of energy and the promotion of energy security. The treaty focuses on making energy markets more competitive, stimulating investments in the energy sector and minimising, or eliminating, barriers to trade.

44. Article 1(5) provides that the Treaty applies to 'Economic Activity in the Energy Sector', which is defined as *economic activity related to the exploration, extraction, refining, production, storage, land transport, transmission, distribution, trade, marketing and sale of Energy Materials and Products*.

45. Part I of the ECT covers definitions and purposes. Article 1(4) provides that the Treaty applies to 'Energy Materials and Products', as set out in Annexes EM I and EM II. EM I and EM II are based on the HS of the WCO<sup>30</sup> as well as the Combined Nomenclature of the European Communities.

46. Article 31 of the 1998 text of ECT foresaw the potential inclusion of energy-related equipment in trade-related provisions, subject to prior assessment of the Charter Conference at its first meeting. Article 1(4bis) of the amended text<sup>31</sup> therefore refers to Annexes EQ I and EQ II which provide for a list of energy-related equipment covered by the Treaty and which is compatible with the HS of the WCO.

47. HS codes covering types of energy materials and energy equipment that do relate to 'economic activities in the energy sector' but are explicitly excluded from the scope of the treaty are listed in Annex NI. The extension 'ex' has been added to the HS codes in Annex EQ I to indicate that the HS codes listed do not exclusively exhaust the entire range of products within the WCO nomenclature headings or the HS codes listed in the Annex. As such, in order for an item to be covered by the scope of the Treaty, not only is the object required to be covered by a specific HS code but it must be used for economic activities in the energy sector.

48. As such, the approach of the ECT to scope of application is one which explicitly refers to four Annexes which all refer to HS codes, coupled with the requirement that the objects be used in economic activities in the energy sector. The other restricting mechanism is the listing of certain parts of codes in Annex NI, which is a mechanism that has only been utilised sparingly (to exclude certain types of oils under code 27.07, wood fuels 44.01 and wood charcoal under 44.02).

#### *Relevance to the MAC Protocol*

49. As discussed in the preceding paragraphs, the approach to scope of the Civil Aircraft Agreement is not particularly useful for the MAC Protocol scenario, due to its reliance on using a description-based scoping mechanism. Similarly, the ECT requires the objects covered by the HS codes listed in its Annexes to be used in economic activities in the energy sector.

50. The potentially useful mechanism utilised by both instruments in the 'ex' designation placed before HS codes to indicate that not all items that fall under a certain HS code are within the scope of the instrument. If it was decided to exclude certain items from the MAX Protocol, such as parts, that were listed under an HS code that was listed in the Annex, then the 'ex' designation could be used to continue to apply the MAC Protocol to the completed equipment listed under an HS code, but exclude parts (on the basis there was a provision inserted in the Protocol explicitly providing that it did not apply to parts).

#### *Alternative Classification Systems*

51. There are a number of goods classification systems that are utilised globally by international organisations for a variety of purposes. The following paragraphs briefly describe the most internationally significant classification systems that could potentially be considered alternatives to the HS System for the purpose of establishing the scope of the MAC Protocol.

52. The United Nations Statistics Division (UNSD) uses the following commodity classification systems: SITC, ISIC and CPC.<sup>32</sup> All three of these systems have been fully correlated to the 6-digit level of the HS System. Accordingly, one can easily convert a SITC code to the relevant HS code. UNSD has also made the conversion and correlation tables available on its website.<sup>33</sup>

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<sup>30</sup> Modifications to the original text based on Article 2 of the Amendment to the Trade-Related Provisions of the Energy Charter Treaty adopted in 1998

<sup>31</sup> *Supra note 1*

<sup>32</sup> The COMTRADE database of the UNSD also uses the HS System.

<sup>33</sup> See <http://unstats.un.org/unsd/trade/conversions/HS%20Correlation%20and%20Conversion%20tables.htm>.

53. SITC stands for the Standard International Trade Classification. Currently, the 4<sup>th</sup> revision of SITC is in effect, adopted in 2006. SITC is divided into 10 sections which are further sub-divided into 67 two-digit divisions. The main difference between the SITC and the HS System is that the SITC is focused more on the economic functions of products at various stages of development, whereas the HS System deals with a precise breakdown of the products individual categories.

54. CPC stands for the Central Product Classification. Currently, the 2<sup>nd</sup> revision of CPC is in effect, adopted in 2008. CPC presents categories for all products that can be the object of domestic or international transactions. It includes products that are an output of economic activity, including transportable goods, non-transportable goods and services. CPC was developed to serve as an instrument for assembling and tabulating all kinds of statistics requiring product details. Such statistics may cover production, intermediate and final consumption, capital formation, foreign trade and prices. They may refer to commodity flows, stocks or balances and may be compiled in the context of input/output tables, balances of payments, and other analytical presentations. The scope of CPC exceeds that of the HS and SITC systems in that it is intended to cover the production, trade and consumption of all goods and services.

55. SITC as well as CPC use the HS headings and sub-headings to structure their own categorizations. The main difference among the HS, SITC and CPC systems is the purpose for which they were created.

56. ISIC stands for the International Standard Industrial Classification of All Economic Activities. Many countries have utilised the ISIC to develop their own national classification systems. Currently the 4<sup>th</sup> revision adopted in 2006 is in effect. ISIC is used primarily to collect statistics that are subsequently utilised to analyse the country's economic activity. Unlike the HS, SITC and CPC, ISIC is not a product classification system.

57. The European Union uses the Combined Nomenclature (CN), according to which imported and exported goods must be classified.<sup>34</sup> The CN has incorporated the HS System in full but the EU has included further 8-digit subheadings. The EU Commission updates the Annex every year and publishes it in the form of a Regulation.

58. The International Union of Railways has developed its own commodity code (NHM), which is based on the 4-digit level of the HS System. It includes a deviation from the HS System with respect to heading 27.10 that relates to petroleum products. NHM facilitates compilation, comparison and analysis of data exchanged between customers, railway undertakings and administrative bodies.

59. At the third Study Group meeting the Study Group requested that the Secretariat conduct further research on the GS1 mechanism. This research was conducted by the National Law Centre for Inter-American Free Trade.

60. GS1 is a global non-profit standards organization that seeks to bring efficiency and transparency to the global supply chain. Its origins lie in 1973 with the adoption of a single standard for product identification by U.S. industry leaders that came to be known as the GS1 barcode. In 1977, the European Numbering Association (ENA) created an identification system aimed at improving supply chain efficiency. Through the 1980's, the barcodes became used in other products and an international standard for electronic data interchange was created. In 1990, the European, U.S. and other arms of the GS1 joined forces to create a single organization with branches around the globe. Currently, GS1 is present in over 40 countries and has one million members and has expanded its work to create global standards in healthcare, e-commerce, transport and logistics.

61. GS1's reach may be broadly categorized into three categories: i) retail, ii) healthcare and transport, and iii) logistics. In retail, its work involves maximizing efficiency by helping retailers to integrate store

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<sup>34</sup> [http://ec.europa.eu/taxation\\_customs/customs/customs\\_duties/tariff\\_aspects/combined\\_nomenclature/index\\_en.htm](http://ec.europa.eu/taxation_customs/customs/customs_duties/tariff_aspects/combined_nomenclature/index_en.htm).

operations, delivery and inventory management. In healthcare, it works to increase patient safety through synchronizing health standards, ensuring maximal use of healthcare technology and monitoring medication. With regard to transport and logistics, the work of GS1 is focused on the use of its standards to provide accurate information on the whereabouts, origin, arrival time and destination of goods to manufacturers, retailers and logistics service providers to aid business decision making. To aid transport management, it maintains Logistic Interoperability Model (LIM) standards, which act as a guide to enhance coordination between transport and delivery factors.

62. GS1 provides the mechanisms to member companies to generate and assign ID keys. ID keys are unique identifiers for products, documents or physical locations where the products are currently situated. GS1 allows its member companies to generate 11 different ID keys that may relate to items such as the following: i) products, such as cans of soup; ii) locations, such as warehouses and factories; iii) assets, such as medical equipment; and iv) documents, such as shipment forms.

63. The work and products of GS1 appear to have only remote relevance to the MAC Protocol project. It would seem that any connection with MAC equipment will probably revolve around the identification of a MAC equipment manufacturer's country using GS1 country codes or a Global Trade Item Number (GTIN). The GTIN is a number that uniquely identifies trade items as they move through the global supply chain to the ultimate end user. Each item is allocated a unique GTIN. A GTIN can be assigned by a GS1 Company Prefix licensee anywhere in the world. GTINs are encountered most frequently at a retail point of sale and on inner packs, cases, and pallets of products in a distribution/warehouse environment. They are commonly used on purchase orders and in delivery and payment documents.

64. Overall, alternative classifications systems to the HS nomenclature do exist but all of them are either entirely based on the HS System or correlated to it. The largest international organisations, including the UN and the WTO, as well as the EU, all utilise the HS System as the basis for their respective nomenclatures. There does not appear to be a viable alternative to the HS System that could be considered as the benchmark when establishing the scope of the MAC Protocol.

## Appendix II – Research on Aquaculture Equipment

1. This report was presented to the Study Group at its fourth meeting (Rome, 7 – 9 March 2016).

### *Introduction*

2. Also known as aquafarming, aquaculture is the practice of actively cultivating (maintenance, production, feeding and surveillance of) freshwater, brackish water, saltwater as well as marine water populations under controlled conditions. It involves aquatic organisms (plants and animals) whereby their production is deliberately enhanced through regular stocking, feeding, fertilising as well as protection from the surrounding environment. Aquafarming can involve individual or corporate ownership of the stock which is being cultivated. Aquaculture is clearly distinguished from commercial or industrial fishing which involves the practice of exclusively catching wild fish carried out for commercial profit purposes.

3. Aquaculture can take different forms, i.e. land-related (inland) and mariculture (offshore/open ocean aquaculture) whereby the latter involves oceans and open waters. Both forms can involve cage farming systems with the latter being supplemented by mooring techniques (or permanent anchor installations). Offshore cage farming has also used the innovative technology of roaming closed cages which are powered by thrusters which are able to take advantage of ocean currents.

4. Technically speaking, aquaculture equipment can vary between different phases of cultivation and post cultivation. Cultivation covers both the maintenance and the production of aquatic organisms, whereas processing equipment would fall into the post cultivation phase. From a policy perspective, it appears that for the purposes of the MAC Protocol scenario, where the scope exclusively covers three industries of agriculture (including aquaculture), mining and construction, processing equipment and the post cultivation phase should be excluded from the coverage of the Protocol (otherwise facilities involved in processing or refining agricultural produce could arguably also be included within the scope of the Protocol).

### *Economic Significance*

5. Global trade in aquaculture equipment is considered to be relatively insignificant compared to agriculture equipment, yet it has seen a rise in recent years due to global demand for seafood cultivation and consumption. According to a recent research,<sup>35</sup> global demand for aquaculture supplies and equipment is expected to experience strong growth of 7.4 percent on an annual basis to reach \$63.3 billion in 2017.

6. Asia accounts for 90% of global aquaculture production and approximately around 50% of present global consumption to date. Asia, as the fastest growing aquaculture producing region, together with North America and Europe account for the biggest market share of equipment manufacturing in this industry.

### *Legal Issues*

7. For the purposes of the MAC Protocol under which the global and cross-border trade and investment in mobile equipment is to be carried out within designated borders and the jurisdictional location of prospective debtors is required to be well defined in order to enable the protection of security interests, offshore aquaculture could potentially fall within the scope of the Protocol provided certain conditions are met.

8. In the context of offshore equipment and the economic exploitation of natural resources, the territorial aspects from a legal point of view under international law should be considered. The *1982 UN Convention on the Law of the Sea* (UNCLOS), a widely ratified treaty, sets the legal framework and foundation for coastal zone management, whereby several jurisdictional zones are designated. The first

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<sup>35</sup> Freedonia Group Study (2999), *World Aquaculture: Feed, Equipment & Chemicals*. March 2013.

zone over which coastal states can claim complete sovereignty is the 'territorial sea' zone, which is calculated up to 12 nautical miles (nm) from the coastal baselines of the State in question.<sup>36</sup>

9. The so-called 'contiguous zone' adjoins the 'territorial sea' zone which may in turn not extend beyond 24 nautical miles from the baselines from which the breadth of latter is measured. As far as the 'contiguous zone' of a coastal State is concerned, the State may exercise such control necessary to not only prevent but also punish infringements with regards to its customs, fiscal, immigration or sanitary laws and regulations within its territorial sea zone.<sup>37</sup>

10. In addition, the 'exclusive economic zone' (EEZ) and the 'continental shelf' zone in general overlap whereby both zones are limited to 200 nm (370.4 km) from the baselines from which the breadth of the 'territorial sea' zone is measured.<sup>38</sup>

11. Unlike the 'territorial sea' zone, the EEZ (and the 'continental shelf' zone) does not form part of the territory of the coastal State over which the State enjoys full sovereignty. However, under UNCLOS, the State is granted sovereign exclusive rights on certain matters which include exploration, economic exploitation, conservation and management of the natural resources, whether living or non-living as well as exclusive jurisdiction with regards to the establishment and use of installations and structures.<sup>39</sup>

12. Further, Article 60 of UNCLOS gives exclusive rights to coastal States who have declared their EEZ to construct, authorise and regulate the construction, operation and use of installations and structures. The coastal State in question shall also have exclusive jurisdiction over such installations and structures, in particular jurisdiction with regard to customs, fiscal, health, safety and immigration laws and regulations.

13. Aquaculture is not explicitly mentioned, but given the size of offshore facilities in the industry, they would likely qualify as 'structures' that are constructed and operated for the purposes of economic exploitation of natural living resources within the EEZ of coastal States. Such clarification is needed in order to ensure national governance over development and management of facilities as such and to ensure legal protection for prospective investments.

14. Equally, article 60 of UNCLOS is applied mutatis mutandis to installations and structures within the 'continental shelf' zone<sup>40</sup>. Article 81 of UNCLOS explicitly assigns an exclusive right to coastal States to authorise and regulate any kind of drilling for any purposes within the zone.

15. UNCLOS also defines the 'high seas' which is open to all States, coastal or land-locked whereby no part of this zone can be subject to a sovereignty claim by any State.<sup>41</sup>

16. Concerning coastal States' jurisdiction over the EEZ and equally over the overlapping 'continental shelf' zone, any kind of licensing as well as the issuing of permits for aquaculture operations would therefore be regulated through the national public laws of the States and assigned authorities. Moreover, commercial law, including contractual rights and obligations would be regulated by the prevailing private laws of the jurisdiction in question, like commercial law.

17. In terms of the EU law stance on this matter, the CJEU 2012 judgement<sup>42</sup> was explicit in stating that any work carried out on fixed or floating installations positioned on the 'continental shelf' zone (and

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<sup>36</sup> Article 3 UNCLOS.

<sup>37</sup> Article 33 UNCLOS.

<sup>38</sup> Article 57 & Article 76 UNCLOS.

<sup>39</sup> Article 56 UNCLOS.

<sup>40</sup> Article 87 & Article 89 UNCLOS.

<sup>41</sup> Article 87 & Article 89 UNCLOS.

<sup>42</sup> Case C-347/10.

the EEZ to that effect) of a Member State, in the context of exploiting natural resources, shall be considered as work carried out in the territory of that Member State.

18. Given that the 'territorial sea' zone is part of a coastal State's sovereignty, the applicable law for offshore aquaculture equipment located in that zone would generally be the law of the place where the asset in question is located which would then be subjected to the property regime of the coastal State in question.

19. Equally, when an offshore facility is located in the EEZ and 'continental shelf' zone of a coastal State, the State then has exclusive jurisdiction over such structure as well as an exclusive sovereign right for the authorisation and regulation of its construction, operation and use. However, further reflection would be required concerning specific conflict-of-laws provisions relating to different States with regards to offshore installations and structures.

20. Security interests in offshore equipment with a direct connection to the seabed could attract the applicability of the State's immovable property law. The Romanian Civil Code 2009/201143 provides for offshore installations located in the 'continental shelf' zone of a State to be regarded as immovable property whereby the law of that respective coastal State would apply. If the equipment is located in another State other than the State of the forum where the lawsuit is filed, the law of that other State would apply. In countries such as the United States, statutory provisions have extended the scope of application of the country's property regime to offshore equipment located in their EEZ or 'continental shelf' zone.<sup>44</sup> Alternatively, it has been queried whether the home law of the owner of the offshore equipment in question could be referred to in situations where this law would have closer connection to the case.<sup>45</sup>

#### *Aquaculture Equipment Manufacturers: Major Global Market Players*

**Pentair Aquatic Eco-Systems** (Aquatic Eco-Systems Inc. + Point Four Systems Inc.) Merged under single global corporation of Pentair Ltd., Aquatic Eco-Systems Inc. as worlds one of the largest sources of aquaculture systems and supplies, claims over 13,000 products and equipment in aquatic industries. Aquatic Eco-Systems is located in Apopka, Florida, USA.

<https://pentairaes.com>

#### **AKVA Group**

Leading technology both in cage farming and land-based aquaculture operations, AKVA Group corporate headquarters are in Norway and has strong global presence in Chile, Denmark, Scotland, Iceland, Canada, Australia and Turkey.

<http://www.akvagroup.com/home>

#### **Faivre**

One of the world leaders in conception, manufacture and production of aquaculture machines since 1958 in France.

<http://www.faivre.fr/index.php/en>

#### **Catvis**

Known as a specialised supplier to the international aquaculture industry, Catvis operates from its main office in the Netherlands and from its daughter company Catvis Hellas in Greece. The company has permanent base in Spain, France, Italy, Turkey and the USA. It specialises both in land-based and offshore aquaculture as well as larval feed.

<http://www.catvis.nl>

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<sup>43</sup> Article 2613 (2) CC.

<sup>44</sup> 43 US Code § 1333.

<sup>45</sup> UNIDROIT 2013 - C.D. (92) 5 (c)/(d), p.35 para. 131



**Vonin**

A major developer and manufacturer of high quality fishing gear and aquaculture equipment both for land-based and offshore industries, Vonin has its headquarters in Faroe Islands. It operates across the globe and has branches in Greenland, Denmark, Canada, Norway, Russia, Lithuania and Iceland.

<http://www.vonin.com/en/home>

**Seafarm Systems**

Based in Tasmania, Australia since 1985, the company is Australia's largest supplier of sea cages for aquaculture. The company has a long standing distribution arrangement internationally in particular with Japan, Turkey, Denmark and Norway.

<http://www.seafarmsystems.com.au>

**Murre Techniek**

Based in the Netherlands, the company besides its advanced processing lines for the food-processing industry, it also specialises in an innovative harvesting installation system whereby cultivation and harvesting of seed mussels are combined, via floating EasyFarm breeding nets. Additionally, a new multifunctional MZI harvester is on its way to be developed which would maximise the exploitation of mussel breeding. The initiative is carried out via cooperation with the European Regional Development Fund under the South Netherlands Operational Programme (OP – Zuid).

<http://www.murre.nl/english>

**AquaOptima**

Since 1993 the company is a well-known supplier of RAS (recirculation aquaculture systems for water filtering purposes) for land-based farms worldwide. The company is located in Trondheim, Norway.

<http://aquaoptima.com>

**HESY Aquaculture B.V.**

Founded in 1984, the Dutch company is one of the world's leading suppliers in design and turn-key delivery of RAS.

<http://www.hesy.com/home>

**Aqualine**

Worldwide supplier of net cages to the aquaculture industry and specialising in tough maritime areas, the Norwegian company has offices in Australia and Chile.

<http://aqualine.no/en>

**Sterner Aquatech**

Based in the UK, the company is a leading name in supplying water treatment solutions to aquaculture industry worldwide. Its sister companies are Sterner FishTech AS in Norway and Sutherlands Electrical and Sutherlands Engineering in Scotland.

<https://www.sterner.co.uk/index.php>

**Inter Aqua Advance**

Based in Denmark, the company specialises in commercial and industrial RAS facilities as well as water treatment technologies.

<http://www.interaqua.dk/home.php>

**AQ1 Systems**

A world leading supplier of sensor based feeding control technology for aquaculture, the company specialises in acoustic and optical sensing technology. AQ1 Systems head office is located in Tasmania, Australia with offices worldwide in Japan, Thailand, Brazil, Ecuador and Peru.

<http://www.aq1systems.com/home>

**Veolia**

Based in Canada, Veolia Water Technologies offers the industry's leading solutions for environmentally responsible and sustainable aquaculture. The company aims at increasing production and reducing water consumption via its 'Kaldnes RAS' technology and claims a significant place in the global market.

<http://www.veoliawaterstna.com/markets/food-beverage/aquaculture>

**Xylem Inc.**

This American company mainly focuses on tank-based aquaculture, whether RAS or flow-through, via water quality instrumentation, flow and level monitoring and control, pumping, disinfection as well as heat exchange.

<http://www.xyleminc.com/en-us/industries/aquaculture/Pages/default.aspx>

**Aquafine**

The company specialises in ultra violet aquaculture systems for water treatment through disinfection and ozone destruction. Aquafine has its corporate headquarters located in California, whereas its European office is based in Germany.

<http://www.aquafineuv.com/Aquaculture>

**Scanz Technologies Ltd.**

The company's particular emphasis is on land-based and offshore aquaculture, as well as intensive recirculation fish farms and hatcheries. It is based in Auckland, New Zealand.

<http://www.scanztech.com>

**Arvo - Tec Oy**

Based in Finland, the company specialises in fish feeding systems targeting freshwater farms as well as water recirculation technology.

<http://www.arvotec.fi>

**Atlantium Technologies Ltd.**

Established in 2003 the company provides innovative water treatment solutions based on ultra violet disinfection, fiber-optics and hydraulics for the global aquaculture industry.

<http://www.atlantium.com/en/markets/aquaculture.html>

**AgriMarine Technologies Inc.**

The Canadian-based producer designs advanced land-based rearing environments as well as hatcheries. It also engineers floating semi-closed containment tanks. The company pioneers in innovative technologies of semi-closed containment tanks which combine the benefits of land-based fish farming with low operational costs of open net pen aquaculture, RAS, semi-closed raceway technology for man-made ponds and rehabilitated gravel pits, deep water injection oxygenation system (DIOS) in order to oxygenate water at lower power consumption, gas diffusion systems (GDS), autonomous control of aquaculture systems (ACAS), a remote user access system for control and monitoring, the Vacuum Air Lift (VAL) patent for water recycling as well as water circulation – gas exchange and particle extraction.

<http://agrimarine.com>

**BOC, the Linde Group**

The company's new SOLVOX technology was launched in 2014 which can be applied to any fish tank in order to optimise environmental conditions. The SOLVOX family of equipment comprises devices for optimised dissolution of oxygen in water, perfect distribution of oxygenated water to the fish as well as a regulation concept for smooth and reliable operation. Any type of aquaculture installation can be served with SOLVOX equipment. [BOC Solvox equipment Brochure](#)

### **Appendix III – Research on Association with Immovable Property**

#### *Introduction*

1. This document was originally presented to the Study Group in advance of the first teleconference on association with immovable property in December 2015 and an update provided in advance of the second teleconference in February 2016.
2. It provides the original legal analysis underpinning the association with immovable property issue, as well as prior drafting options developed by the Secretariat and refined by the Study Group:
  - (i) Draft Article from the first teleconference (December 2015)
  - (ii) Draft Article proposed by the German Ministry of Justice (December 2015)
  - (iii) Draft Article from the second teleconference (February 2016)
  - (iv) Draft Article from the Fifth Study Group draft (March 2016)

#### *Background*

3. There are a number of types of equipment contained in the preliminary list of HS codes for inclusion under the MAC Protocol that may require some degree of affixation to property in order to operate. In the most recent iteration of the list, of the 113 codes suggested for inclusion by private industry, the Secretariat has identified 26 that are likely to require some degree of connection with immovable property in order to operate. Of the 26 codes, five are on the Tier 1 suitable codes list (see bullet points below), ten are on the Tier 2 possible codes list, and 17 are on the Tier 3 unsuitable list. Further consultation with the MAC Protocol Working Group (which represents private sector interests) is required to confirm whether there are types of machinery under other listed HS codes which require connection with immovable property.
  - (i) 820713-- Rock drilling or earth boring tools, and parts thereof: With working part of cermets
  - (ii) 843039-- Coal or rock cutters and tunnelling machinery: Other
  - (iii) 843049 - Other boring or sinking machinery: Other
  - (iv) 847431 - Mixing or kneading machines: Concrete or mortar mixers
  - (v) 847432 - Mixing or kneading machines: Machines for mixing mineral substances with bitumen
4. The first Study Group meeting in December 2014 instructed the Secretariat to conduct further research in relation to how priority between interests in mobile affixable property and domestic interests in immovable property is currently resolved under domestic legal regimes.
  - (i) As instructed, a comparative analysis was drafted by the UNIDROIT Secretariat. The study was based on both individual submissions by UNIDROIT Correspondents and independent jurisdictional research by the Secretariat. In order to reach the best practice possible for the purposes of the MAC Protocol, the UNIDROIT Secretariat has set forth the two legal queries to its Correspondents.
  - (ii) What test is used in your jurisdiction to determine whether a piece of equipment has become affixed/attached to immovable property (i.e. does the equipment require permanent physical attachment to the immovable property or does it simply require some degree of connection to it)?
  - (iii) How does your jurisdiction treat security interests in equipment that becomes subsequently affixed / attached to immovable property?
5. A summary of the results of the comparative analysis is at Appendix IV below. National approaches concerning the relationship between movable and immovable property rights are highly diversified, especially in relation to what degree of connection is required for existing interests in equipment to be affected by its subsequent connection to immovable property. The comparative analysis highlighted the

following as possible factors in determining the effect on existing interests in equipment that is subsequently connected to immovable property:

- (i) *The relationship between the immovable property and the equipment* is often an element in determining whether existing interests in the equipment are affected. Where the functionality of the immovable property is affected by the equipment, or the use or exploitation of the immovable is compromised, or the equipment is considered an essential part, it is more likely that existing interests will be extinguished and the equipment will become part of the immovable property.
- (ii) *The ease of removal of the equipment* is often a determinative factor. For example, under United States common law, existing interests in 'readily identifiable, easily detachable equipment' were likely to be preserved. If removal of the equipment would cause physical injury/damage to the immovable property, it is more likely that existing interests will be extinguished and the equipment will become part of the immovable property.
- (iii) *The intention of the owner of the immovable property* in connecting the equipment to immovable property can also be a key factor in determining whether existing interests in the equipment are affected. Where there is the intention of permanent connection, it is more likely that existing interests will be extinguished and the equipment will become part of the immovable property. Whether subjective or objective intention has to be established also varies. Intention is a relevant factor under Argentinian, Colombian, Egyptian, English and Syrian law.
- (iv) Some domestic legal regimes created special legal rights in equipment which are preserved when the equipment is connected to immovable property. An example of this is the United States where a 'fixture filing' is required to perfect security interests in movable items and equipment.
- (v) The Japanese Civil Code considers the act of physical connection sufficient for movable equipment to become part of the immovable it has been affixed to. In turn, the Code provides for *compensatory measures in favour of creditors whose security interests have been extinguished* as a result, whereby it provides for possible parallel claims by way of subrogation on unjust enrichment.

### *Terminology*

6. One of the complicating factors assessing how 'affixable equipment' is regulated at a domestic level is the lack of consistent use of terminology. This matter was raised at the second Study Group in April 2015, where it was noted that the use of the terms 'fixture' and 'attachment' were questioned on the grounds that it would potentially create legal uncertainty, as its legal meaning might differ in common and civil law countries.

7. The comparative analysis confirmed a lack of uniformity in consistent use of terminology. The term 'fixture', as defined as movable equipment that legally becomes part of the immovable property once it becomes associated with it, is variously referred to under domestic legal regimes as 'component part', 'essential part', 'integral part', 'fixed accessory', 'immovable by accession' and 'attachment to immovable property'. The term 'accessory', as defined as movable equipment which retains its individual character and legal status upon association with immovable equipment is also referred to 'trade fixture' and 'chattel fixture'. For uniformity purposes, this paper will use the terms fixture and accessory, however such terms will not be used in the draft articles themselves.

8. A similar problem exists in relation to the terminology for the verb to describe the relationship between the movable equipment and the immovable property. The terminology is difficult because there are no uniform terms used in national legislation, and the closeness of the relationship required for equipment to become a fixture varies significantly. For example, some domestic legal regimes would need a strong physical connection to establish equipment as a fixture, whereas other regimes may simply need the equipment to be placed upon the land. As such, the draft articles should not use the verbs 'affixed',

'attached', 'joined', or even 'connected'. It is suggested that the best term may be 'associated with', which would be broad enough to cover the various rules under domestic law.

#### *Legal Framework*

9. Under the UNCITRAL Legislative Guide on Secured Transactions, which refers to fixtures as attachments to immovable property, the national security law governing immovable objects has priority over interests in mobile objects and that no loss of individual identity of the mobile object needs to occur for this priority of the national interest to come into effect. Under the UNCITRAL Legislative Guide, a party can remove an affixed mobile object; however, the party may do so only if it has priority as against competing rights in the immovable property and will owe an obligation to compensate the mortgagee under the domestic immovable property law for any damage incurred in removing the affixed object, other than any diminution in its value attributable solely to the absence of the fixture.

10. Article 29 of the Cape Town Convention explicitly stipulates that in cases of conflict between domestic legislation and the Convention, including its Annexed protocols, the international interests take priority. Taken into account this legal basis, and in line with previous protocols as legal precedents, it was initially anticipated that international interests registered under the MAC Protocol would be upheld and not extinguished by interests established under domestic laws by virtue of the equipment's subsequent affixation to immovable property.

#### *Policy and drafting options*

11. At the third Study Group meeting in October 2015 the fixtures issue was discussed in significant depth. Various options were proposed by Study Group members. The Study Group decided that the Protocol should include a substantive provision addressing fixtures, and that the draft Article should allow Contracting States to make a declaration in relation to the operation of the rule.

12. The following policy options were proposed for consideration by the Study Group:

- (i) *Maintain priority of international interest*: States could declare that an international interest in an object associated with immovable property will continue to exist and enjoy priority over a domestic interests resulting from its association with immovable property, even where that object would cease to being an individual asset under domestic law.
- (ii) *Create an individual identity test*: States could declare that they apply a specific test contained in the Protocol to determine whether the object retains its individual identity and thus maintains its priority international interest, free from any domestic interests arising in its association with immovable property.
- (iii) *Defer to national law*: States could declare that, where an object under the MAC Protocol becomes so associated with immovable property that it would be considered a fixture under domestic law, domestic law would apply and the international interest under the Convention would either be extinguished, or would be lose priority to a national interest. This provision would therefore act as an exception to Article 29 of the Cape Town Convention (which expressly words that in cases of conflict, the international interests recognised by the Convention and its protocols shall prevail). This option may require states to provide information on how the international interest would be affected if they make such a declaration.
- (iv) *Provide for a fixture filing system*: States could declare that the international interest will continue to enjoy priority, to the extent that it corresponds with the fixture filing system under domestic law. The policy option was suggested by the International Finance Corporation, and would allow for emerging markets to update their domestic secured transaction law while implementing the MAC Protocol.

13. In drafting provisions to implement the above policy options, the Secretariat took the following additional issues into consideration:

- (i) *Party autonomy*: As intention of the parties is an important factor in many of the domestic legal tests to determine the relationship between movable equipment and immovable property, the Study Group may wish to consider allowing parties to explicitly contract out of the rule governing fixtures in the Protocol. This could be achieved by including a party autonomy exception, 'unless an explicit contrary agreement between the parties exists'. This approach is consistent with other party autonomy clauses in the Cape Town Convention. For example, Article 8<sup>46</sup> of the Cape Town Convention provides for certain 'default remedies' available for the parties only where they have explicitly been included in the contractual agreement between the parties.
- (ii) *Timing*: It was tentatively decided during the second Study Group meeting in April 2015 that the timing of the association of the mobile equipment with the immovable property should not be relevant in applying the priority rule. For example, it should not matter whether a crane was already associated with immovable property at the time an international interest in it was registered on the International Registry. This approach was taken because it would give more flexibility to creditors to finance equipment already in use and associated with immovable property, which reflects existing practice in the finance industry.

#### *Declarations structure*

14. As noted above, the Study Group decided at its third meeting in October 2015 that the article governing fixtures should allow states to make a declaration applying a certain legal approach to the issue. The article governing fixtures could be structured as a mandatory, opt-in, or opt-out declaration.

- (i) *Mandatory declaration*: This structure would require contracting states to actively make a declaration applying a certain approach to the treatment of fixtures under the MAC Protocol. This would be consistent with the approach of Article 54(2) of the Convention, which requires Contracting States at the time of ratification to declare whether remedies under the Convention that do not explicitly require application to a court can be exercised without the leave of a court. The failure of a Contracting State to make a mandatory declaration would result in the Depositary refusing to accept an instrument of ratification. This is the preferred option in the draft articles below, as it has the benefit of requiring Contracting States to make an active decision in relation to this important issue and places all possible declarations of level footing.
- (ii) *Opt-in declaration*: This structure would allow Contracting States to apply an optional opt-in rule. This would be consistent with the Insolvency Remedies in Article XI of the Aircraft Protocol, which requires to actively apply either Alternative A or B. If a Contracting State chooses not to make a declaration, the default national insolvency law applies. Adopting this approach would be complicated, as it requires the Study Group to decide what the status quo situation would be. It does not appear possible to leave it to existing domestic law arrangements, as it would not be clear what would occur in the circumstance that an object subject to an international interest under the Protocol lost its individual legal identity under domestic law as a result of its association with immovable property. It would not be a simple conflict issue, as the situation would not be a conflict between a domestic and international interest if the object has ceased to be capable of being subject to separate legal interests under the domestic law, due to its association with immovable property.
- (iii) *Opt-out declaration*: This structure would apply a default rule, unless Contracting States made an optional declaration applying a different rule. This approach would

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<sup>46</sup> Cape Town Convention, Article 8 – Remedies of chargee.

require the MAC Protocol to provide for a uniform default rule for the treatment of fixtures. This approach would be appropriate if the Study Group decided that one approach was favourable over other approaches, but still wished to give Contracting States flexibility in regulating the relationship between mobile equipment and immovable property.

*Draft Article presented to the Study Group at the first fixtures teleconference*

*Association with immovable property*

1. A Contracting State, shall, at the time of ratification, acceptance, approval of, or accession to the Protocol, declare which of the following alternatives will apply in relation to the relationship between an object under the Protocol which is, or becomes,<sup>1</sup> associated with immovable property:

*Alternative A (maintain priority of international interest)*

2. An interest under this Protocol in relation to agricultural, construction or mining equipment will continue to exist and enjoy priority as against other interests as provided for by this Convention, despite its association with immovable property.

*Alternative B (create an individual identity test)*

2. Where agricultural, construction or mining equipment subject to an interest under this Protocol becomes associated with immovable property to an extent that the equipment loses its unique and individual identity (fixture), the law of the State where the equipment is located will determine whether such an interest in the equipment ceases to exist or is subordinated to an interest in the immovable property.

*Alternative C (apply domestic law)*

2. The Contracting State's domestic law will apply where interests arising in relation to immovable property law would effect interests in agricultural, construction or mining equipment capable of being the subject of an international interest under this Protocol.

3. In applying the state's domestic law under paragraph 2, an international interest in the agricultural, construction or mining equipment may be extinguished, lose its priority to a domestic interest or be otherwise affected, as provided by the Contracting State's domestic law.

*Alternative D (create fixture filing rule)*

2. An international interest in equipment that becomes associated with immovable property has priority over a conflicting interest of an encumbrancer or owner of the immovable property if the debtor has an interest of record in the immovable property or is in possession of the immovable property and the international interest:

- (A) is made effective by registration of a notice substantially complying with the requirements of the Protocol in the immovable property registry before the interest of the encumbrancer or owner is of record; and
- (B) has priority over any conflicting interest of a predecessor in title of the encumbrancer or owner;

*Alternative E (priority of readily removable equipment)*

2. An international interest in equipment that becomes associated with immovable property has priority over a conflicting interest of an encumbrancer or owner of the immovable property if before the equipment becomes associated with immovable property, the international interest is registered and the equipment is readily removable.

*Alternative F (priority based on consent, disclaimer, or right to remove)<sup>6</sup>*

2. An international interest in equipment associated with immovable property has priority over a conflicting interest of an encumbrancer or owner of the immovable property if:

- (1) the encumbrancer or owner has consented to the international interest or disclaimed an interest in the associated equipment; or
- (2) the debtor has a right to remove the equipment as against the encumbrancer or owner.



*Proposal by the German Ministry of Justice and for Consumer Protection presented to the Study Group at the first fixtures teleconference*

*Rules covering Issues of Fixtures and Accessories to Immovable Property*

The UNIDROIT Secretariat invited the Members of the Study Group to submit drafting proposals for rules covering the relationship between interests in movable equipment under the Draft MAC Protocol on the one hand and the national law of immovable property on the other hand. The German Ministry of Justice and for Consumer Protection submitted the following drafting proposal.

For fixtures, the drafting proposal in Article x suggested that the national law of the *situs* should be decisive for the fate of the (former) international interests in the assets that have become a fixture to immovable property.

For accessories, however, Article y suggested a more limited rule: Contracting States should be allowed to retain national schemes of security over immovable property that extend to accessories (especially the German *Haftungsverband der Hypothek*). Article y provided that the immovable property security interest under national law retained priority over an international interest in the accessory if the international interest had been created and registered only after the assets concerned had become subject to the security under national law over the immovable property. The objective of this rule was to avoid as regards accessories the unfair results described, amongst others, by Professor Riffard in the Second Session of the Study Group:

63. *Professor Riffard noted that a provision preserving the priority of an international interest in affixed property over a domestic immovable property interest could result in unfairness in circumstances where the equipment was already affixed to the immovable property at the time the international interest was created, and a mortgagee had reasonably created a domestic immovable property interest over the land, including the already affixed MAC equipment."* (see Report of the Second Session, Study 72K – SG2 – Doc. 6, para. 63).

For all other purposes, accessories would be subject to the rules of the MAC Protocol. This proposal was drafted in consultation with German Financing and Manufacturers' Circles and was supported both by the financing side and the manufacturers' side

Article x – Fixtures to immovable property

1. Where agricultural, construction or mining equipment subject to an interest under this Protocol becomes connected to immovable property to an extent that the equipment loses its unique and individual identity (fixture), the law of the State where the equipment is located determines whether such interest in the equipment ceases to exist or is subordinated to an interest in the immovable property.
2. Where interests in the agricultural, construction or mining equipment under this Protocol cease to exist or are subordinated to interests in the immovable property in conformity with the preceding paragraph due to the application of the law of the State where the equipment is located, the law of that State determines also whether a displaced or subordinated holder of an interest in the equipment obtains a claim (compensatory or other) against a holder of an interest in the immovable property as a consequence.

*Explanatory Comments*

The proposed Article x is based upon the proposal by the UNIDROIT Secretariat for a rule on fixtures in the fourth Study Group draft (Study 72K – SG3 – DOC. 3, page 30) and on the discussion of the issue of fixtures in the Issues Paper for the third session of the Study Group (Study 72K – SG3 – DOC. 2, paras. 90-98, 165-178).

Article x covers the situation where the movable asset which is subject to an international interest under this Protocol becomes a fixture to immovable property. The use of the term fixture here is based upon the terminology as applied by the UNIDROIT Secretariat in the Issues Paper for the third session of the Study Group (Study 72K – SG3 – DOC. 2, para. 98):

98. *Therefore, it is important for this section to set out some basic terminology to prevent inconsistent usage or misunderstandings. For uniformity purposes, the Secretariat has categorised the different terms in two groups. The term 'fixture' is taken to have the equivalent meaning of 'component part', 'essential part', 'integral part' as well as 'fixed accessories', whereas the term 'accessory' is considered to be the equivalent of the common law term of 'chattel'.*

Since the MAC Protocol (as an international instrument) generally takes precedence over national law, the MAC Protocol should contain a rule stating if and under which conditions the Protocol assumes that (i) a piece of equipment loses its legal status as a separate movable asset and (ii) rights in the immovable extend to the piece of equipment that has become a fixture to an immovable asset. Generally, the MAC Protocol could refer this issue to the national law of the situs, but this would have the consequence that the application of the Protocol in different Contracting States could lead to different results. Alternatively, the MAC Protocol could itself define under which circumstances an asset loses its legal status as a separate movable asset, but this requires the application of autonomous criteria under the international law of the MAC Protocol.

Paragraph 1 of Article x contains a combination of these elements. The general idea behind this rule and its legal objective is to provide that for assets that have become fixtures to immovable property, the law of the situs should determine whether any former interest in the equipment ceases to exist or is subordinated to an interest in the immovable property. If a piece of equipment is connected with an immovable asset in such a way as to lose its unique and individual identity, any enforcement of the creditor's rights under the Cape Town Convention System into the equipment (especially any self-help remedies) would no longer be sensible.

Paragraph 1 of Article x applies a double criterion for the determination of the circumstances under which the law of the situs should be applied: First, there is as an autonomous criterion under the international law of the MAC Protocol the question whether the asset has lost its unique and individual identity. This criterion would have to be defined autonomously under the Protocol and it ensures legal certainty in so far as market participants can rely on the fact that even such national law rules on fixtures that have less stringent criteria cannot lead to the loss of an international interest in the equipment where such equipment has not yet lost its unique and individual identity under the terms of the Protocol.

In addition to this autonomous criterion under the international law of the MAC Protocol, paragraph 1 also refers to the application of national law for the issue where separate rights in the piece of equipment cease to exist or are subordinated to rights in the immovable property. If the national immovable property law does not regard the piece of equipment (even though it has lost its unique and individual identity under the terms of the Protocol) as no longer being subject to separate movable property rights, then the holder of an international interest in the piece of equipment may still seek enforcement of its rights in the courts of the state where the asset is located. National law, however, does only apply where the asset has lost its unique and individual identity under the terms of the Protocol: Thus, there is no risk for the holder of an international interest to lose its rights under such national law rules on fixtures which might provide for less stringent criteria.

Paragraph 2 of Article x deals with issue of claims acquired by the (former) holder of an international interest as against holders of rights in the immovable property to which the piece of equipment has become a fixture. As described by the UNIDROIT Secretariat in the Issues Paper for the third session of the Study Group (Study 72K - SG3 - DOC. 2, para. 177 s.), some legal systems provide for such claims that can compensate the former holder of an international interest for its losses or that seek to revert an unjust enrichment to the detriment of the former holder of an international interest. Paragraph 2 of Article x provides that such claims are entirely subject to national law and the MAC Protocol does not regulate these issues.

## Article y – Accessories to immovable property

Option 1<sup>47</sup>

1. This Article applies only where agricultural, construction or mining equipment is located in a Contracting State which has made a declaration pursuant to Article XXIV(#).

## Option 2

1. A Contracting State may, at the time of ratification, acceptance, approval of, or accession to this Protocol, declare that it will apply this Article to agricultural, construction or mining equipment that is located in the Contracting State.

2. Where agricultural, construction or mining equipment subject to a registered interest under this Protocol is an accessory to immovable property under the law of the Contracting State and an interest in the immovable property under the law of the Contracting State extends to the equipment as an accessory, an interest in the immovable property under the law of the Contracting State has priority over the registered interest in the equipment under this Protocol if the following conditions are fulfilled:

(a) the interest in the immovable property has been registered in accordance with the requirements of the law of the Contracting State prior to the time of registration of the interest in the equipment under this Protocol and continues to be effective; and

(b) the equipment has become an accessory to the immovable property prior to the time of registration of the interest in the equipment under this Protocol.

*Explanatory Comments*

The proposed Article y contains a Contracting State Option for specific rules regarding priority conflicts between an international interest under the Protocol and a national immovable law interest where the piece of equipment concerned has become an accessory to immovable property, i.e. where the piece of equipment may not have lost its unique and individual identity, but is standing in another sort of close relationship to immovable property. In the fourth Study Group draft (Study 72K – SG3 – DOC. 3) as prepared by the UNIDROIT Secretariat, there was a proposed rule on fixtures only, but in the view of the German Ministry of Justice and for Consumer Protection an additional provision is necessary to cover accessories as well. Again, reference is made to the discussion of terminology by the UNIDROIT Secretariat in the Issues Paper for the third session of the Study Group (Study 72K – SG3 – DOC. 2, para. 98):

98. *Therefore, it is important for this section to set out some basic terminology to prevent inconsistent usage or misunderstandings. For uniformity purposes, the Secretariat has categorised the different terms in two groups. The term 'fixture' is taken to have the equivalent meaning of 'component part', 'essential part', 'integral part' as well as 'fixed accessories', whereas the term 'accessory' is considered to be the equivalent of the common law term of 'chattel'.*

Conflicts between national immovable property law and the rules of the Protocol on an international interest in movable equipment may not only occur where the piece of equipment concerned has become a fixture to immovable property so as to lose its unique and individual identity. Other conflicts between national immovable property law and the rules of the Protocol can arise where the piece of equipment is an asset that is an accessory to the immovable and national immovable property law provides that – even though the asset concerned retains its separate legal status as a movable asset – security rights over the immovable extend to the movable asset. This is the case under German immovable mortgage law and the rules of the so-called Haftungsverband der Hypothek: The mortgagee can exercise its right not only into the immovable asset, but also into all of its accessories. This rule is of particular importance in the financing industry for the agricultural sector: It is not only the land which is available as collateral for a mortgagee holding a mortgage over the land, but also the movable assets used as farm equipment (unless they are

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<sup>47</sup> In line with the approach followed in the fourth Study Group draft (Study 72K – SG3 – DOC. 3), the inclusion of Options 1 and 2 regarding paragraph 1 relates to the issue of how declarations are made under the Protocol.

bought under a retention of ownership so that the landowner has not yet become the owner of the movable equipment).

Under the general rule in Article 29 of the Cape Town Convention, such priority conflicts would be solved on the basis of a general priority of the registered international interest over other interests. While this rule is to be supported in general, there are some situations in which its application could lead to unfair results, specifically the situation envisaged in the discussions of the Study Group at its second meeting and reported in relation to affixed property in general in the Report of the Second Session, Study 72K - SG2 - Doc. 6 in para. 63:

63. *Professor Riffard noted that a provision preserving the priority of an international interest in affixed property over a domestic immovable property interest could result in unfairness in circumstances where the equipment was already affixed to the immovable property at the time the international interest was created, and a mortgagee had reasonably created a domestic immovable property interest over the land, including the already affixed MAC equipment."*

In such a situation, a holder of a security right over immovable property may hold a position that is perfectly valid under national law also as regards its extension to accessories. It would be very unfair to this holder of a security right over immovable property if his position could subsequently be lost as regards the accessories merely by reason of the fact that a subsequent creditor registers an international interest in the movable equipment.

The rule proposed in Article y contains a specific provision dealing with priority issues as described in the preceding paragraph. The rule is presumably of interest only for such Contracting States that have a system of security rights over immovable property including its accessories similar to the German system of the *Haftungsverband der Hypothek*; therefore the rule in Article y is proposed as a Contracting State Option that applies only if the Contracting State concerned has made a declaration to this effect when ratifying the Protocol. Since it has not yet been decided which system of declarations the Protocol is to follow, the proposed Article y contains two alternatives for the drafting of paragraph 1.

The substantive content of Article y is contained in its paragraph 2. This rule is specifically tailored at dealing with the priority conflict between the holder of a security in the immovable property and the holder of an international interest in the mobile equipment as described above. It is not the intention of this rule to provide for a general application of the German law system of the *Haftungsverband der Hypothek*. It is also not intended to allow too broad exceptions from the rules of the Protocol which would allow Contracting States to deviate from its rules in general whenever the assets concerned are accessories to immovable property. Such broad rules would compromise the harmonisation objectives of the Protocol and would go too far in weakening the situation of a holder of an international interest in movable equipment under the Protocol. The only objective of the rule in Article y is to provide that in situations as described above (see the reference to the Report of the Second Session, Study 72K - SG2 - Doc. 6 in para. 63), the rights of the holder of an international interest should not have priority on the basis of the general rule in Art. 29 over the rights of a holder of a right in the immovable under national law.

This exception to the general priority rule in Art. 29 of the Cape Town Convention shall apply only if the following restrictive conditions are fulfilled:

- First, the movable piece of equipment must be an accessory to an immovable and rights in the immovable must extend to the piece of equipment as an accessory. These conditions are not defined by the Protocol and it is referred to the law of the Contracting State where the asset is located (including both the conditions for the extension and for its termination). This reference to national law should not be a cause for concern: The legal consequences of Article y are so specifically tailored to the regulation of a specific priority issue and apply only if the additional requirements in litt. (a) and (b) are fulfilled, so that the reference to national law should not lead to an overly broad deviation from the rules of the Protocol.

- Second, the additional conditions set out in litt. (a) and (b) must be fulfilled:

(a) The security over the immovable asset must have been registered in accordance with the requirements of the law of the Contracting State prior to the time of registration of the interest in the equipment under this Protocol and continues to be effective (i.e. it must still be on the register). If the international interest in the movable asset has been registered in the international register prior to the registration of the national security over the immovable in the national register, the holder of the security over the immovable does not deserve protection. His rights in the movable pieces of equipment (by way of the extension of his rights in the immovable into its accessories) have been acquired only as a second-ranking security that must give precedence to the international interest.

(b) The piece of equipment must have become an accessory to the immovable before the international interest in the piece of equipment has been registered. If the international interest had already been registered when the movable piece of equipment became an accessory to the immovable, the holder of the security in the immovable could acquire his rights in the accessory at this point of time only subject to the earlier international interest.

*Immovable Equipment – Notes for second teleconference*

1. The purpose of this paper is to provide the Study Group with an updated draft article setting out possible options addressing the potential effect of international interests in MAC equipment under the Protocol on domestic interests arising out of immovable property law.
2. At the first fixtures teleconference, it was agreed that:
  - a. The article(s) governing fixtures/accessories should be a mandatory declaration under the Protocol, giving Contracting States flexibility in their approach to the issue, but also requiring states to make an active selection of the alternative they favoured.
  - b. Due to the complex and sensitive nature of the issue, the Study Group should provide the Committee of Intergovernmental Experts an array of options on how to address the potential effect of international interests in MAC equipment under the Protocol on domestic interests arising out of immovable property law.
  - c. The draft article(s) and various options need to take into account both fixtures and accessories, as discussed in the paper developed by the German Ministry of Justice and Consumer Protection in advance of the first teleconference.

*Regulation of accessories*

3. At the first teleconference it was confirmed that several jurisdictions allow rights in immovable property to be extended to accessories that are neither physically attached to immovable property nor had lost their legal nature as a separate movable asset. In Germany, any movable assets used in the operation of a business operated on an immovable could be regarded as accessories and the rights of the holder of a mortgage in the immovable would extend to these assets (e.g., movable equipment used on a farm).
4. The Secretariat is in the process of researching this issue further, in order to determine how many jurisdictions have such laws. However, it is already clear that several major European jurisdictions, including Germany, France and Spain, have such rules. While not all jurisdictions will have such laws, the effect of the laws are profound, as they can extend to all MAC equipment, regardless of whether it is affixable or physically connected to the immovable itself. As such, the Protocol must find an approach for dealing with both fixtures and accessories.
5. The German Ministry of Justice and Consumer Protection paper suggested including separate articles for fixtures and accessories.
6. The fixtures article provides that where MAC equipment becomes connected to immovable property to the extent it loses its unique and individual identity domestic law should apply, and also provides for domestic law to provide compensatory measures for parties who have their international interests in MAC equipment adversely affected.
7. The accessories article provides that interests in accessories under domestic immovable property law will have priority over international interests under the Protocol where (a) the domestic interest in the immovable was registered in accordance with the requirements of the law of the Contracting State prior to the time of registration of the interest in the equipment under this Protocol and continues to be effective; and (b) the equipment has become an accessory to the immovable property prior to the time of registration of the interest in the equipment under this Protocol.
8. In suggesting the accessories provision, the German Ministry deliberately restricted its application, as a broad rule could compromise the harmonisation objectives of the Protocol and would go too far in weakening the position of a holder of an international interest in movable equipment under the Protocol.
9. The German approaches have been incorporated into the draft article as Alternative C, as a possible declaration that could be exercised by States which recognise immovable property law interests arising in

accessories on the same basis as Germany. The outstanding issue remains that this approach requires the Protocol to define what a 'fixture' and an 'accessory' is. During early discussions, the Study Group considered using a 'unique and individual identity' test, however exactly how such a test would operate in practice is problematic, and the test does not provide requisite legal certainty without further definition. As discussed at paragraph 6 in the paper distributed in advance of the first fixtures meeting, the comparative analysis of the legal regimes of 17 different countries highlighted many different factors in determining the effect on existing interests in equipment that is subsequently connected to immovable property, including the relationship between the immovable property and the equipment, the ease of removal of the equipment and the intention of the party in possession of the immovable property.

10. To some extent, the exact formulation of the definition should be left to the committee of intergovernmental representatives for negotiation. However, the intergovernmental negotiations will be in a stronger position to consider issue if the Study Group can provide guidance on the issue. As such, the Study Group is invited to consider the following definitions of fixture and accessory at their second teleconference:

*Possible definitions of 'fixture':*

*Alternative 1 (Legal identity):* 'fixture' means agricultural, construction or mining equipment capable of being subject to an interest under this Protocol that becomes so associated with immovable property that it loses its individual legal identity under the law of the Contracting State in which the immovable property to which it is associated is located.

*Alternative 2 (Physical connection):* 'fixture' means agricultural, construction or mining equipment capable of being subject to an interest under this Protocol that is physically connected to immovable property to the extent that its removal would cause damage to the immovable property.

*Alternative 3 (Relationship with the immovable property):* 'fixture' means agricultural, construction or mining equipment capable of being subject to an interest under this Protocol that is physically connected with immovable property to the extent that its removal would compromise the functionality of the immovable property.

*Possible definition of 'accessory':*

'accessory' means agricultural, construction or mining equipment capable of being subject to an interest under this Protocol that is not a fixture and remains capable of being subject to separate legal rights, but nevertheless becomes associated with immovable property to the extent that that an interest in the immovable property under the law of the Contracting State extends to the equipment.

11. It should be noted that not all of the alternatives for the rules on fixtures and accessories that will be presented on the next pages use these terms (i.e. 'fixture' or 'accessory') and therefore require such definitions. However, if Alternative C is included in the Protocol, even where a Contracting State chooses a different Alternative that does not use the term 'fixture' or 'accessory', the definitions of these terms would still have to be a part of the Protocol since they remain relevant for the other alternatives, even if these are not applicable in the Contracting State concerned. Alternatively, Alternative C could require states making a declaration have to provide their own definition of 'fixture' and 'accessory' as applied in Alternative C.

*Draft Article presented to the Study Group at the second fixtures teleconference*

*Association with immovable property*<sup>48</sup>

1. A Contracting State, shall<sup>49</sup>, at the time of ratification, acceptance, approval of, or accession to the Protocol, declare which of the alternatives in the following paragraphs will apply in relation to the relationship between an international interest in an object under the Protocol which is, or becomes,<sup>50</sup> associated with immovable property and which is situated in the Contracting State<sup>51</sup> [or, if the debtor is situated in the Contracting State, in the Contracting State or in a State that is not a party to this Protocol]<sup>52</sup>. As regards such objects situated in a Contracting State, all Contracting States will apply the Protocol subject to the declaration made by that Contracting State.<sup>53</sup> [As regards such objects situated in a State that is not a party to this Protocol, providing that the rules of the Protocol are applicable, all Contracting States apply the Protocol subject to the declaration made by the Contracting State where the debtor is situated.]<sup>54</sup>

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<sup>48</sup> This article provides various draft provisions on dealing with interests in MAC equipment that could arise under domestic immovable property law. The purpose of this article is to provide a wide array of options for discussion during the intergovernmental negotiations. It is not suggested that all listed alternatives should be adopted in the final MAC Protocol.

<sup>49</sup> It was decided at the first Study Group fixtures teleconference that the fixtures article should be a mandatory declaration. The benefit of making the fixtures article subject to a mandatory declaration is that it gives states some flexibility in relation to how they implement this contentious aspect of the Protocol, while also requiring them to do so, as failure of a Contracting State to make a mandatory declaration would result in the Depositary refusing to accept an instrument of ratification. The language of Paragraph 1 is based upon Article 54(2) of the Cape Town Convention, which requires Contracting States to make a mandatory declaration in relation to whether a court's leave is required to exercise certain remedies under the Convention.

<sup>50</sup> This language provides that the timing of the association between the object and the immovable property is irrelevant. The timing of the association is a different issue to the timing of the registration of the international interest, which is considered further in subsequent articles.

<sup>51</sup> A declaration by one Contracting State shall not affect assets located in another Contracting State. If France chooses Alternative A1 and Italy chooses Alternative A2, in any lawsuit regarding assets located in France, both Italian and French courts would have to apply Alternative A1. The declaration by Italy does not have effect as regards assets in France (provided that, as in this example, France is also a Contracting State). For the issue whether a declaration by a Contracting State could affect assets located in a State that is not a party to the Protocol, see the following text in square brackets and the next footnote.

<sup>52</sup> The German Ministry of Justice and Consumer protection has raised for the Study Group's attention the additional matter of what occurs when MAC equipment subject to an International Interest under the Protocol is located in a state not party to the Protocol, and associated with immovable property, and the debtor to the international interest is located in a Contracting State. In such a situation, the Protocol would be applicable but the non-party State would have made no declaration as to the treatment of fixtures and accessories. Therefore, there must be some mechanism to determine the relationship between the non-party State's immovable property law and the rules of the Protocol as regards the international interest. The Germany Ministry suggested the text in the square paragraphs could clarify this situation: The declaration of the Contracting State where the debtor is situated would then govern also the relationship between the non-party State's immovable property law and the rules of the Protocol as regards the international interest.

<sup>53</sup> This sentence clarifies that a declaration - as regards assets that are situated in the Contracting State that has made the declaration - has effect not only before the courts of the Contracting State that has made the declaration, but also before the courts of the other Contracting States.

<sup>54</sup> This additional sentence (which stands in relation to the text in square brackets that is accompanied by footnote 4) again covers cases where MAC equipment subject to an international interest under the Protocol is located in a State that is not party to the Protocol, and associated with immovable property, and the debtor to the international interest is located in a Contracting State: In such cases, also the other Contracting States shall respect the declaration made by the Contracting State where debtor is situated.



*Alternative A1 (maintain priority of international interest)<sup>55</sup>*

2. An interest under this Protocol in relation to agricultural, construction or mining equipment will continue to exist and retain priority as against other interests arising under the law governing immovables despite its association<sup>56</sup> with immovable property.

*Alternative A2 (maintain priority of international interest)<sup>57</sup>*

2. An interest under this Protocol in relation to agricultural, construction or mining equipment shall not be affected by the equipment becoming a fixture to or incorporated in an immovable.

*Alternative B (apply domestic law, do not distinguish between types of associations)*

2. Where agricultural, construction or mining equipment subject to an interest under this Protocol becomes associated with immovable property to the extent that the association results in an interest in the equipment being created under the domestic law of the State where the equipment is located,<sup>58</sup> the law of the State where the equipment is located determines whether the interest under the Protocol ceases to exist, is subordinated to or is otherwise affected by the association with immovable property and the interest thereby created in the equipment.

3. Where interests in the agricultural, construction or mining equipment under this Protocol cease to exist, are subordinated to or are otherwise affected by interests in the immovable property in conformity with the preceding paragraph due to the application of the law of the State where the equipment is located, the law of that State determines also whether a displaced or subordinated holder of an interest in the equipment obtains a claim (compensatory or other) against a holder of an interest in the immovable property.<sup>59</sup>

4. Where a Contracting State makes a declaration to apply this alternative, the Contracting State will at the time of making the declaration deposit with the Depositary of the Protocol a list of interests arising in relation to immovable property law which subordinate or otherwise affect interests under this Protocol.<sup>60</sup>

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<sup>55</sup> Alternative A1 allows States to declare that an international interest in an object associated with immovable property will continue to exist and enjoy priority over domestic interests resulting from its association with immovable property, even where that object would cease to be a movable asset under domestic law. Alternative A1 does not distinguish between 'fixtures' and 'accessories'.

<sup>56</sup> 'Association' here is a deliberately broad term that attempts to cover all potential interests that can arise in MAC equipment under domestic immovable property law, including both 'fixtures' and 'accessories'. It is broader than 'connection' as certain rights under domestic immovable property law can still extend to equipment that is not physically connected to, or even touching the immovable property itself.

<sup>57</sup> This provision is intended to have the same substantive effect as Alternative A1, but is based upon the language in Article 2 of the Leasing Model Law. Under Article 2, an 'asset' is defined as '**Asset** means all property used in the craft, trade or business of the lessee, including immovables, capital assets, equipment, future assets, specially manufactured assets, plants and living and unborn animals. The term does not include money or investment securities. No movable shall cease to be an asset for the sole reason that it has become a fixture to or incorporated in an immovable.' Utilising this definition may not clarify whether it covers all interests arising out of MAC equipment becoming associated with immovable property (i.e. it may not clearly cover accessories).

<sup>58</sup> If the text in square brackets in paragraph 1 is not adopted, the reference could be to the law of the Contracting State. The same applies throughout the following paragraphs and alternatives.

<sup>59</sup> This compensatory mechanism in this provision is based on Japanese law. Under the Japanese Civil Code, with the actual joining of equipment to an immovable property, the independent property rights (including security interests) in the equipment will cease to have any legal effect. In order to safeguard the legal rights of creditors, the Code sets forth two possible compensatory measures against the owner of the immovable property, on the grounds of unjust enrichment. This can be done either directly by the creditor or alternatively through a claim by the grantor of the equipment by way of subrogation. However, the law lacks any protective measures against the risk of double compensation imposed on the owner in case both claims are brought simultaneously. This issue has not been substantively explored by Japanese case law, so the exact interaction of the Code and unjust enrichment doctrines remains somewhat unclear.

<sup>60</sup> This optional additional paragraph is based upon the mechanism in Article 40 of the Cape Town Convention. Article 40 requires States who make the optional declaration allowing certain non-consensual interests to be registerable in the International Registry to list the non-consensual interests that can be registered. Requiring Contracting States to

*Alternative C (create 'fixtures' rule and 'accessories' rules under national law)<sup>61</sup>*

2. Where agricultural, construction or mining equipment subject to an interest under this Protocol becomes associated with immovable property to an extent that the equipment becomes a fixture, the law of the State where the equipment is located determines whether such interest in the equipment ceases to exist, is subordinated to or otherwise affects an interest in the immovable property.

3. Where interests in the agricultural, construction or mining equipment under this Protocol cease to exist or are subordinated to interests in the immovable property in conformity with the preceding paragraph due to the application of the law of the State where the equipment is located, the law of that State determines also whether a displaced or subordinated holder of an interest in the equipment obtains a claim (compensatory or other) against a holder of an interest in the immovable property.

4. A Contracting State, shall, at the time of ratification, acceptance, approval of, or accession to the Protocol, declare whether also the rule in the following paragraph will apply.

5. Where agricultural, construction or mining equipment subject to a registered interest under this Protocol is an accessory to immovable property under the law of the State where the equipment is located and an interest in the immovable property under the law of this State extends to the equipment as an accessory, an interest in the immovable property under the law of this State has priority over the registered interest in the equipment under this Protocol if the following conditions are fulfilled:

- (a) the interest in the immovable property has been registered in accordance with the requirements of the law of the State where the equipment is located prior to the time of registration of the interest in the equipment under this Protocol and continues to be effective; and
- (b) the equipment has become an accessory to the immovable property prior to the time of registration of the interest in the equipment under this Protocol.

6. Where a Contracting State makes a declaration to apply this alternative, the Contracting State will at the time of making the declaration deposit with the Depositary of the Protocol a list of interests arising in relation to immovable property law which affect interests under this Protocol for the purposes of paragraphs 3 and 5, if applicable.

*Alternative D (create fixture filing rule, priority of readily removable equipment and priority based on consent, disclaimer, or right to remove)<sup>62</sup>*

2. An international interest in equipment that becomes associated with immovable property has priority over a conflicting interest of an encumbrancer or owner of the immovable property if the debtor

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provide a list will help provide clarity as to how exactly international interests under the Protocol may be affected by interests under arising under domestic immovable property law in Contracting States who decide to make such a declaration, and may also disincentivise states from making a broad declaration. If most Contracting States made a broad declaration under this article, the value and integrity of an international registered interest would be significantly diminished. It is suggested that the declarations memorandum maintained by the Depositary should require states also provide how the interests arising in relation to domestic property law would affect international interests under the Protocol.

<sup>61</sup> Alternative C is based upon Articles x and y from the German Ministry of Justice proposal. The only change from the original German-proposed article x is that Alternative C in para. 2 no longer contains a reference to what a fixtures is, whereas in the original German proposal the article defined a fixture as *agricultural, construction or mining equipment subject to an interest under this Protocol connected to immovable property to an extent that the equipment loses its unique and individual identity*. It is proposed that instead, Alternative C, para. 2 would require definitions of 'fixture' and 'accessory' to be inserted into the definitions section of the Protocol.

<sup>62</sup> This provision is modelled on UCC 9-334, and each paragraph was previously listed as separate articles (Alternatives D, E and F) in the paper for the first fixtures teleconference. As these articles are cumulative rather than mutually exclusive in the UCC, the Study Group is invited to consider whether they should appear under once single Alternative in the MAC Protocol.

has an interest of record in the immovable property or is in possession of the immovable property and the international interest:

- (a) is made effective by registration substantially complying with the requirements of the Protocol in the immovable property registry before the interest of the encumbrancer or owner is of record; and
- (b) has priority over any conflicting interest of a predecessor in title of the encumbrancer or owner;

3. An international interest in equipment that becomes associated with immovable property has priority over a conflicting interest of an encumbrancer or owner of the immovable property if before the equipment becomes associated with immovable property, the international interest is registered and the equipment is readily removable.

4. An international interest in equipment associated with immovable property has priority over a conflicting interest of an encumbrancer or owner of the immovable property if:

- (a) the encumbrancer or owner has consented to the international interest or disclaimed an interest in the associated equipment; or
- (b) the debtor has a right to remove the equipment as against the encumbrancer or owner.

*Association with Immovable Property Article in the 5<sup>th</sup> Study Group draft***Article VII<sup>63</sup>**Association with immovable property

1. A Contracting State, shall,<sup>64</sup> at the time of ratification, acceptance, approval of, or accession to the Protocol, declare that it will apply the entirety of Alternative A, B, C, or D of this Article in relation to an international interest in an object under this Protocol which is, or becomes<sup>65</sup>, immovable-associated equipment<sup>66</sup> and which is situated in the Contracting State.
2. As regards immovable-associated equipment situated in a Contracting State, all Contracting States will apply the Protocol subject to the declaration or declarations made by that Contracting State.<sup>67</sup>
- [3. *This Convention does not affect the rights of a person in immovable property located in a non-Contracting State which is, or becomes, associated with immovable-associated equipment.*]<sup>68</sup>

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<sup>63</sup> This article was added to the fifth Study Group draft, following consideration of the issues at the first three Study Group meetings and two out-of-session teleconferences.

<sup>64</sup> It was decided at the first Study Group fixtures teleconference that the fixtures article should be a mandatory declaration. The benefit of making the fixtures article subject to a mandatory declaration is that it gives states some flexibility in relation to how they implement this contentious aspect of the Protocol, while also requiring them to do so, as failure of a Contracting State to make a mandatory declaration would result in the Depositary refusing to accept an instrument of ratification. The language of Paragraph 1 is based upon Article 54(2) of the Cape Town Convention, which requires Contracting States to make a mandatory declaration in relation to whether a court's leave is required to exercise certain remedies under the Convention.

<sup>65</sup> This language provides that the timing of the association between the object and the immovable property is irrelevant. The timing of the association is a different issue to the timing of the registration of the international interest, which is considered further in subsequent articles.

<sup>66</sup> 'Immovable-associated equipment' is defined in Article 1(2) as 'immovable-associated equipment' means agricultural, construction or mining equipment capable of being subject to an interest under this Protocol that becomes so associated with immovable property that an interest in the immovable property extends to the equipment under the law of the state in which the immovable property is located.

<sup>67</sup> This sentence clarifies that a declaration - as regards assets that are situated in the Contracting State that has made the declaration - has effect not only before the courts of the Contracting State that has made the declaration, but also before the courts of the other Contracting States. While this type of clarifying paragraph is not present in previous Protocols, the clarification may be useful, as this will be the first Protocol applying the declarations made by a Contracting State in relation to equipment located in that state (as opposed to the location of the debtor as occurs in relation to a declaration applying alternative insolvency remedies). The Secretary-General has queried whether this provision is necessary.

<sup>68</sup> During the second teleconference the Study Group discussed what would occur in relation to international interests in MAC equipment that became associated with immovable property in non-Contracting States. The prevailing view was that in the absence of an express provision stating otherwise, Article 29 of the Cape Town Convention would apply, and the international interest would take priority over any domestic interest arising out of the equipment's association with immovable property. As Article 29 was not drafted to contemplate an international interest conflicting with an interest arising out of association with immovable property, the Study Group concluded that it would be prudent to consider including a draft Provision providing that international interests in MAC equipment does not interfere with immovable property-related interests. This drafting is based on Article 29(7), which provides that priority given under Article 29 does not affect pre-existing interests in items installed on objects. The German Ministry of Justice has suggested that this provision could be moved to the end of the Article.

*Alternative A (maintain priority of international interest)*<sup>69</sup>

2. An international interest in agricultural, construction or mining equipment will continue to exist and retain its priority as against any other interests arising out of its association with immovable property, notwithstanding that it is or becomes immovable-related equipment.

*Alternative B (apply domestic law to immovable-associated equipment)*<sup>70</sup>

2. Where agricultural, construction or mining equipment subject to an international interest is or becomes immovable-associated equipment, the law of the Contracting State making the declaration determines whether the international interest ceases to exist, is subordinated to or is otherwise affected by the association with immovable property and any interest thereby created in the equipment.

3. Where an international interest in agricultural, construction or mining equipment ceases to exist, is subordinated to or otherwise affected by any interest in immovable property pursuant to the preceding paragraph, the law of the Contracting State making the declaration determines whether a displaced or subordinated holder of an international interest in the equipment obtains a claim (compensatory or other) against a holder of an interest in the immovable property.<sup>71</sup>

[4. Where a Contracting State makes a declaration to apply this alternative, the Contracting State will at the time of making the declaration deposit with the Depositary of the Protocol a list of interests arising in relation to immovable property law which displace, subordinate or otherwise affect international interests.]<sup>72</sup>

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<sup>69</sup> Alternative A allows States to declare that an international interest in an object associated with immovable property will continue to exist and enjoy priority over domestic interests resulting from its association with immovable property, even where the domestic law would grant a priority interest in the equipment to the owner of the immovable property. Alternative A does not distinguish between different types of interests arising out of association with immovable property (i.e. 'fixtures' and 'accessories'). At the second teleconference it was discussed whether this Alternative should be framed using the language of Article 2 of the Model Leasing law. Ultimately it was decided that the current drafting provided a higher degree of certainty and clarity.

<sup>70</sup> The Study Group may wish to consider redrafting Alternative B as a substantive provision (as consistent with Alternatives A and C) rather than a conflict of laws provision.

<sup>71</sup> This compensatory mechanism in this provision is based on Japanese law. Under the Japanese Civil Code, with the actual joining of equipment to an immovable property, the independent property rights (including security interests) in the equipment will cease to have any legal effect. In order to safeguard the legal rights of creditors, the Code sets forth two possible compensatory measures against the owner of the immovable property, on the grounds of unjust enrichment. This can be done either directly by the creditor or alternatively through a claim by the grantor of the equipment by way of subrogation.

<sup>72</sup> This optional additional paragraph is based upon the mechanism in Article 40 of the Cape Town Convention. Article 40 requires States who make the optional declaration allowing certain non-consensual interests to be registerable in the International Registry to list the non-consensual interests that can be registered. Requiring Contracting States to provide a list will help provide clarity as to how exactly international interests under the Protocol may be affected by interests under arising under domestic immovable property law in Contracting States who decide to make such a declaration, and may also disincentivise states from making a broad declaration. If most Contracting States made a broad declaration under this article, the value and integrity of an international registered interest would be significantly diminished. It is suggested that the declarations memorandum maintained by the Depositary should require states also provide how the interests arising in relation to domestic property law would affect international interests under the Protocol.

*Alternative C (create fixture filing rule, priority of readily removable equipment and priority based on consent, disclaimer, or right to remove)*<sup>7374</sup>

2. An international interest in agricultural, construction or mining equipment that is or becomes immovable-associated equipment has priority over a conflicting interest in the immovable property to which the equipment is associated if the debtor has an interest of record in the immovable property or is in possession of the immovable property and the international interest:

- (a) is made effective by registration substantially complying with the requirements of the Protocol in the immovable property registry before the holder of the conflicting interest is of record; and
- (b) has priority over any conflicting interest of a predecessor in title of the holder of the conflicting interest;<sup>75</sup>

3. An international interest in equipment that is or becomes immovable-associated equipment has priority over a conflicting interest in the immovable property if before the equipment becomes immovable-associated equipment the international interest is registered and the equipment is readily removable from or is not physically attached to the immovable property.<sup>76</sup>

4. An international interest in immovable-associated equipment has priority over a conflicting interest of in the immovable property if:<sup>77</sup>

- (a) the holder of the conflicting interest has consented to the international interest or disclaimed an interest in the immovable-associated equipment; or
- (b) the debtor has a right to remove the equipment from or move the immovable-associated equipment away from the location of the immovable property.

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<sup>73</sup> Alternative C is modelled on UCC 9-334, and each paragraph was previously listed as separate articles (Alternatives D, E and F) in the paper for the first fixtures teleconference. As these articles are cumulative rather than mutually exclusive in the UCC, the Study Group is invited to consider whether they should appear under once single Alternative in the MAC Protocol.

<sup>74</sup> The Study Group may wish to consider redrafting the language of Alternative C to be more consistent with the language of the Cape Town system, rather than with the language of the United States Uniform Commercial Code.

<sup>75</sup> Subsection two creates a fixture filing rule.

<sup>76</sup> Subsection 3 provides for the priority of readily removable equipment where the international interest existed on the equipment before it became associated with the immovable property. As such, the substantive effect of this provision would be to create a priority rule for accessories, which would always be readily removable from the immovable.

<sup>77</sup> Subsection 4 provides for priority based on consent, disclaimer or the debtor's right to remove.

*Alternative D (distinction between different types of immovable-associated equipment)*<sup>7879</sup>

2. Where agricultural, construction or mining equipment subject to an international interest [under this Protocol] is or becomes immovable-associated equipment to an extent that the equipment loses its individual legal identity under the law of the Contracting State making the declaration, the law of the Contracting State making the declaration determines whether the international interest ceases to exist, is subordinated to or is otherwise affected by any other interest in the immovable property.

3. Where an international interest [under this Protocol] ceases to exist or is subordinated to or is otherwise affected by any other interest in the immovable property pursuant to the preceding paragraph, the law of the Contracting State making the declaration determines whether a displaced, subordinated or otherwise affected holder of the international interest obtains a claim (compensatory or other) against a holder of any other interest in the immovable property.

4. Where agricultural, construction or mining equipment subject to a registered interest under this Protocol is or becomes immovable-associated equipment without losing its individual legal identity under the law of the Contracting State making the declaration, an interest in the immovable property under the law of that State that extends to the equipment by reason of it being immovable-associated equipment, has priority over the registered interest in the equipment [under this Protocol] only if the following conditions are fulfilled:

- (a) the interest in the immovable property has been registered in accordance with the requirements of the law of the Contracting State making the declaration prior to the time of registration of the interest in the equipment under this Protocol and registration of the interest in the immovable property continues to be effective; and
- (b) the equipment became associated to the immovable property prior to the time of registration of the interest in the equipment under this Protocol.

[5. Where a Contracting State makes a declaration to apply this alternative, the Contracting State shall at the time of making the declaration deposit with the Depositary of the Protocol a list of interests arising in relation to immovable property law which affect interests under this Protocol for the purposes of paragraphs 2 and 4.]<sup>80</sup>

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<sup>78</sup> Alternative D is based upon Articles x and y from the German Ministry of Justice proposal presented at the first teleconference in December 2015. The benefit of Alternative D is that distinguishes between different types of immovable-associated equipment, and in doing so it restricts the circumstances under which an international interest in an accessory will be de-prioritised as against an interest arising from its association with immovable property. The potential issue with this Article is that is dependent upon the use of the additional criterion of the complete loss of individual legal identity, even though it does revert to the national law of the location of the immovable to determine the circumstances under which the loss of individual legal identity occurs.

<sup>79</sup> The Study Group may wish to consider redrafting Alternative D as a substantive provision (as consistent with Alternatives A and C) rather than a conflict of laws provision.

<sup>80</sup> This article is consistent with Alternative B paragraph 4, and likewise requires further consideration from the Study Group.

## Appendix IV – Jurisdictional analysis on association with immovable property

### Introduction

1. This paper was presented to the Study Group in advance of the first teleconference on association with immovable property in December 2015. In order to compile a comparative analysis of the treatment of fixtures under domestic law, the UNIDROIT Secretariat researched two key legal issues:

*What test is used in your jurisdiction to determine whether a piece of equipment has become affixed/attached to immovable property (i.e. does the equipment require permanent physical attachment to the immovable property or does it simply require some degree of connection to it)?*

*How does your jurisdiction treat security interests in equipment that becomes subsequently affixed / attached to immovable property?*

2. To assist in this project, the Secretariat requested input from its 52 correspondents based in different jurisdictions around the world. This paper contains analysis on the legal regimes in Argentina, Canada, Colombia, Egypt, France, Germany, Greece, Hungary, Japan, Mexico, Spain, Syria, Turkey, the United Kingdom, the United States and Uruguay.

### Argentina<sup>81</sup>

3. In the Argentine Civil Code, movable and immovable property is distinguished either by nature, or by accession, or by their representative character.<sup>82</sup> An 'accessory' is defined as an item which its existence and nature is dependent and governed by a principal item to which it is subject, or to which it is attached.<sup>83</sup> As such, the term 'accessory' under Argentinian law is more closely aligned to the meaning of 'fixture' used by this paper.

4. Any movable equipment or item which has physically been attached and linked to the soil is considered immovable by connection, provided that the connection is of a permanent character.<sup>84</sup> Even where there is no permanent physical attachment to the immovable property, the intention of the party in possession of the immovable to make movable equipment an accessory (in the Argentinian sense) to their immovable property will also deem the equipment to be immovable.<sup>85</sup> Where movable equipment is attached to a building, it shall retain its movable nature provided that either the purpose of connection is related to the profession of the owner of the building or the attachment is on a temporary basis.<sup>86</sup>

5. Public legal instruments which are proof of acquisition of real rights in immovable property are immovable by their representative character, except for the real rights of mortgage and security contracts.<sup>87</sup> On the other hand, public legal instruments which are proof of acquisition of personal rights are considered movable. This is also the case for those public instruments relating to movable equipment that is attached to immovable property for only a limited period of time for construction purposes.<sup>88</sup>

6. The Argentinian codes also deals with usufruct (a limited real right in civil law jurisdictions that allows a party the right to use property or equipment and derive a profit from it), under which movable

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<sup>81</sup> This research was conducted by the Unidroit Secretariat.

<sup>82</sup> Argentine Civil Code 1871, Translation by Frank Joannini, Article 2347 [2313].

<sup>83</sup> Argentine Civil Code 1871, Translation by Frank Joannini, Article 2362 [2328].

<sup>84</sup> Ibid, Article 2349 [2315].

<sup>85</sup> Ibid, Article 2350 [2316].

<sup>86</sup> Ibid, Article 2356 [2322].

<sup>87</sup> Ibid, Article 2351 [2317].

<sup>88</sup> Ibid, Article 2353 [2319].



equipment which is destined to become part of immovable property shall be part of the property rights of that immovable, however only for the duration of the usufruct.<sup>89</sup>

#### *Colombia*<sup>90</sup>

7. The 1887 Colombian Civil Code focuses primarily on the nature of the object and the intention of the landowner. If equipment is of a movable nature, then this nature prevails, subject to only one exception. For mobile equipment to be deemed immovable, and to be considered as a fixture to immovable property, it must (i) be owned by the landowner, (ii) be used for cultivation or benefice of the land and (iii) there must be a demonstrable explicit intention of the landowner to destine such property as part of the land. Therefore, leased equipment would never be deemed as a “fixture” of the land, as it is not owned by the landowner.

8. Colombian law also has protections for the rights of third party creditors who receive equipment which is not movable by nature as part of collateral and security for a disposed loan. The 1887 Colombian Civil Code sets forth the notion of ‘movables by anticipation’, whereby, equipment affixed to immovable property (i.e. an elevator) can be deemed as movable property on the grounds that such a right has already been created in favour of a third party.

9. Security interest laws in Colombia were reformed by means of Law 1676, 2013 which set forth the application in Colombia of the UNICTRAL Legislative Guide on Secured Transactions, and the OAS Model Law on Secured Transactions. Since the date of force of the law (February 20, 2014), all equipment pledged on a non-possessory basis (i.e. where the creditor does not keep the possession of the pledged good, but generally the debtor keeps such equipment for its business) must be perfected by a filing in an internet website ([www.garantiasmobiliarias.org.co](http://www.garantiasmobiliarias.org.co)).

#### *Canada*<sup>91</sup>

10. In Canada, the regulation of property and secured transactions law are matters generally coming under the legislative authority of the provinces and territories. There may be variations in the answers from one Canadian jurisdiction to another (in particular between the province of Quebec, which is a civil law jurisdiction, and the other provinces and the territories, which are common law jurisdictions). In particular, it should be noted that Quebec law does not use the term fixture although it has a similar concept.

11. As a general rule, equipment becomes incorporated to the immovable property so as to lose its individuality, then the equipment becomes part of the immovable property and is not a fixture. The law on security interests in movable property does not apply (or cease to apply).

12. Conversely, equipment will become a fixture (movable property that becomes attached to immovable property without being incorporated to the property) if it becomes physically attached to immovable property (the meaning of physical attachment not being however clear in all circumstances). The mere fact that equipment is placed on immovable property to be used for the operation of a business on or with that property (e.g. to operate a mine located on that property) is not sufficient to transform the equipment into a fixture. In such case, the equipment remains subject in all respects to the law governing security interests in movable property.

13. A security interest created in equipment that is or becomes a fixture is subject to registration in the registry for security interests in movable property. If registration is made before the equipment becomes a fixture, the security interest will rank prior to interests registered against the immovable

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<sup>89</sup> Ibid, Article 2355 [2321].

<sup>90</sup> The information on Colombian law is a summary of research submitted by UNIDROIT Correspondent Rafael Castillo-Triana.

<sup>91</sup> The information on Canadian law is a summary of research submitted by UNIDROIT Correspondent Mr Michel Deschamps.

property. If the security interest is registered after the equipment becomes a fixture, then the security interest will rank after those who have a registered interest in the immovable property; however, in such scenario, the secured creditor may register in the land registry a notice of the existence of its security interest and will thereby have priority over interests subsequently registered in the land registry.

*Quebec*<sup>92</sup>

14. The 1991 Civil Code of Lower Canada was reformed and was rendered obsolete in 1994. The amended text, the 1994 Civil Code of Quebec (CCQ), includes the phrase 'immeuble au sens du droit civil du Québec' or 'immovable within the meaning of Quebec civil law' which has been replaced by the determinant of 'immeuble par destination' or 'immovable by destination'. The latter was also included in the Expropriation Act.<sup>93</sup> Canadian Common law on the other hand incorporates the term 'accessoire fixe' which would literally cover 'fixtures'.

15. In order to harmonize civil law and common law terminologies, the Canadian Ministry of Justice published a series of 'Bijural Terminology Records' in order to achieve a higher degree of legal certainty. The harmonised provision explicitly includes the term 'fixtures'.

16. The Bijural Terminology Records provide that the term 'land' includes lands, mines, buildings, structures, fixtures and objects which are buildings under the civil law of Quebec. Also targeted are minerals whether precious or base, on, above, or below the surface, with the exception of minerals above the surface in Quebec.<sup>94</sup>

17. The 1994 Civil Code of Quebec (CCQ), explicitly mentions that 'anything forming an integral part'<sup>95</sup> of immovable property or a construction of a permanent nature is deemed as immovable. When movable equipment is affixed to an immovable in a fashion where its individuality is completely compromised and is employed for the utility purposes of the principal immovable, it is considered to form an integral part of that immovable.<sup>96</sup> However, in the case of temporary detachment, an integral part would maintain its immovable nature, provided that the intention of restoring the integration is existent.<sup>97</sup>

18. In the case of permanent attachment where the individuality of the equipment is not lost, the movable equipment in question shall be considered as immovable given the condition that it will remain within that structure and contribute to the utility of the parent immovable.<sup>98</sup> In cases where there is an economic element to the property's use, i.e. the operation of an enterprise or related activities, the affixed mobile equipment would remain movable.<sup>99</sup>

19. Under this approach, legal uncertainty can arise in the case where for example a drilling unit had been placed on an immovable property, like a land, and is being physically attached or joined to that immovable property on a lasting basis albeit without losing its individuality. The driller is considered an immovable, provided that it remains on the principal immovable property in order to ensure the proper functionality of that principal immovable. However, if a driller is placed on a land for special purposes, namely the operation of an enterprise or its activities, it would be considered as a movable object.

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<sup>92</sup> The information on Quebec law was conducted by the UNIDROIT Secretariat

<sup>93</sup> Expropriation Act, RSC (1985), c. E-21.

<sup>94</sup> Harmonization Act, No. 3 of the Federal Law - Civil Law, SC 2011, c. 21, para. 127(2).

<sup>95</sup> Civil Code of Quebec 1991, c. 64, a. 900.

<sup>96</sup> Civil Code of Quebec 1991, c. 64, a. 901.

<sup>97</sup> Ibid, c. 64, a. 902.

<sup>98</sup> Ibid, c. 64, a. 903.

<sup>99</sup> Ibid.

*Egypt and Syria*<sup>100</sup>

20. Largely inspired by the French Civil Code, both the Syrian Civil Code and the Civil Code of the Arab Republic of Egypt apply similar approaches when distinguishing immovable and movable property types. Any equipment fixed to immovable property the removal of which would inevitably be detrimental to its substance or nature, is deemed to be immovable, whereas equipment falling outside this definition is considered to be movable.<sup>101</sup>

21. In cases where the landowner of immovable property is also the owner of movable equipment which is attached to that immovable, and the landowner demonstrates an intention to utilise that equipment for particular purposes of services and exploitation of the immovable property, then such equipment is considered as immovable by reason of its destined use.<sup>102</sup> As such, the intention of the landowner is a significant determinant both in Syrian and Egyptian jurisdictions.

*France*<sup>103</sup>

22. According the French Civil Code, all things are either movable or immovable. As such, all things, tangible or intangible, should fall into one of these two categories.

23. Immovable are defined by article 517 which states that things are immovable either by (i) their nature, (ii) the object to they are applied, or (iii) their destination. 'Immovables by nature' includes land, buildings and windmills. 'Immovables by the object to which they applies' are incorporeal things which are given by statute the nature of an immovable on account of the object on which they bear : usufruct, servitude and right or action to recover an immovable.

24. An 'immovable by destination' is a movable thing deemed immovable by statute (French civil code art. 524 & 525) due to its being, at the initiative of the owner of an immovable thing, either :

- attached to it so as to remain permanently attached (ie its removal would cause damage or breakage either to the movable itself or to the immovable it has been attached to). This category is based on the existence of an apparent and physical connection between the movable and the immovable.
- placed thereupon for the use or cultivation of such immovable. It includes (art. 524) : farming implements, seeds given to farmers or sharecroppers, pressers, boilers, stills, vats, and barrels, tools necessary for working ironworks, paper-mills and other factories, straw and manure. In this case, the criterion used is the economic purpose of the immovable by destination. Movable that participate in the productive function of an immovable must share its nature.

25. Movable are defined by article 527 which states that things are movable either (i) by their nature or (ii) as provided by the Law. A thing is movable by nature if it can be moved from one place to another. Movable by declaration of the law are incorporeal things to which the law gives the status of movable. It includes secured debts, intellectual property rights, shares or interests in partnerships/corporations and intangibles business assets.

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<sup>100</sup> This research was conducted by the Unidroit Secretariat.

<sup>101</sup> Syrian Civil Code (Arabic Version) 1949, Article 84. The Civil Code of Arab Republic of Egypt, Article 82.

<sup>102</sup> Syrian Civil Code (Arabic Version) 1949, Article 84. The Civil Code of Arab Republic of Egypt, Article 82.

<sup>103</sup> The information on French law was submitted by Professor Jean-Francois Riffard, member of the MAC Protocol Study Group.

*Germany*<sup>104</sup>

26. The relationship between rights in immovable property and rights in movable equipment which becomes affixed is governed by the notions 'Bestandteil' (part) and 'wesentlicher Bestandteil' (essential part). Section 93 of the German Civil Code (BGB) defines essential parts as 'parts of a thing that cannot be separated without out or the other being destroyed or undergoing a change of nature'.

27. Objects that are firmly attached to immovable property are considered essential parts (s94(1)) and essential parts of a building include things that are inserted in order to construct a building (s94(2)). While physical attachment is a requirement, objects that can easily be removed can still be considered essential parts of immovable property. The test is effectively whether the movable is essential for the function which the building performs. Examples under recent jurisprudence include:

- An oil tank was considered an essential part of a building which need heating (BGH 19/10/2012, NJW-RR 2013, 652)
- A 10 tonne transformer station the size of a garage is an essential part of the immovable property which it is on by virtue of its weight (OLG Schleswig Holstein 21/5/2013).
- A compressor unit/system is an essential part of a building that is used as a garage (OLG Thuringen 3/1/1996).

28. Exceptions to this rule include objects connected to land for a temporary purpose, and objects that are affixed to immovable property belonging to a third party. For example, a tenant builds a garage on land they are renting. Although fixed to the ground, it will not become an essential part, but remain as separate property of the tenant because the tenant does have intention to attach the garage permanently to land owned by another party (Baur/Sturmer, 18<sup>th</sup> ed 2009, 15).

29. If a movable becomes an essential part, separate proprietary rights in the object cease to exist. Agreements between parties to the contract will have effect *inter partes*, but not *in rem* due to the mandatory character of the rules, which state that essential parts cannot be the object of separate rights. Equipment that is a part but not an essential part will remain legally independent, to the effect that security interests vesting in a third party will persist.

30. Separate from both parts and essential parts, s97(1) of the BGB defines 'accessories' as movables which, without being (essential or non-essential) parts of the immovable property, are intended to serve a permanent economic purpose and is in a special relationship that corresponds to that intention. S97(2) exempts temporary relationships from being accessories. To qualify as an accessory, (i) the object must be movable (the main property can be immovable or movable), (ii) the accessory cannot qualify as an essential part, and (iii) the quality of the economic purpose of the accessory must be identified by prevailing public opinion and non merely a value relationship, which is determined by examining the objects objective statue, actual use and other external circumstances.

31. In regards to geographical proximity, the courts set a low standard. It is not necessary that an accessory remains on the land it is serving (e.g. an excavator working outside of the business premises can still be an accessory). In the case of a farm, equipment and livestock intended for commercial operations are accessories.

32. Accessories are still capable of being the object of separate proprietary rights, and does not automatically share the legal status of the main object (be it immovable or moveable property). Under s311(c) of the BGB, a contract of sale or mortgage of an immovable will in case of doubt also include accessories, and a mortgage over land will automatically include accessories and non-essential parts (s1120

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<sup>104</sup> The information on German law is a summary of research submitted by Professor Eva-Maria Kieninger on behalf of UNIDROIT Correspondent Professor Jurgen Basedow.

BGB). Generally, execution against immovables held by a judgment debtor can also be directed against the *accessoire* to an immovable (s865 ZPO).

*Greece*<sup>105</sup>

33. The main criterion according to which a piece of equipment is an essential element/component (affixed) as compared to an accessory (attachment) of the immovable property<sup>106</sup> is the fact that it cannot be separated from the main thing without detriment of the part or the main thing or without alteration of its substance or its intended use (article 953 Greek Civil Code).

34. According to article 954 of the Greek Civil Code, affixed parts of an immovable property are (i) things firmly attached to the ground, including buildings, (ii) the products of the immovable as long as it is connected with the soil, (iii) underground waters and springs (iv) seeds when sowed and plants when planted.

35. Things that have only been attached to the ground for a transitional purpose shall not be deemed affixed part of the immovable (article 955 Civil Code). Buildings or constructions which have been erected on an immovable belonging of another person by a person exercising a right in rem thereon shall not be deemed affixed.

36. A fixture to immovable property may not become a distinct object of ownership or other rights in rem (article 953 Civil Code) whereas a real legal action on the immovable property shall in case of doubt include the attached thing (article 958 Civil Code). If a movable object has been linked to an immovable in such a manner as to be affixed to the immovable, the ownership of the immovable property shall also extend to the movable (article 1057 Civil Code). The ownership of a fixture shall after its separation from the immovable property also belong to the owner of the immovable (article 1064 Civil Code).

37. An accessory (attachment) is a movable object which without being affixed to the main property (movable or immovable) has been destined to permanently serve the economic purpose of the main property and has already been placed in regard to the property in a local relationship corresponding to such purpose (article 956 Greek Civil Code). A temporary separation of the accessory from the main property does not remove its quality as accessory (art. 957 Civil Code).

38. Regarding agricultural property the utensils tools and cattle destined for the economic exploitation of an agricultural immovable (property) shall be deemed accessories of the immovable property together with the agricultural products that are required for the further cultivation of the land until the new harvest and with the fertilizers originating from and existing on the said land provided that the other relevant conditions are being fulfilled (art. 960 Civil Code).

39. In case of a building constructed for the purpose of serving permanently an industrial enterprise the machines, utensils and tools destined for the enterprise shall be deemed accessories of the building if the other relevant conditions as described in art. 956 Civil Code are also fulfilled (article 959 Civil Code).

40. Where a movable being affixed or attached to immovable property subject to a mortgage is separated from the immovable and transferred to a third party, the mortgagee (creditor) shall not be entitled to claim back the movable thing from the third party (article 1283 Civil Code).

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<sup>105</sup> The information on Greek law is a summary of research submitted by the Hellenic Institute of International and Foreign Law.

<sup>106</sup> Immovables are the ground and its components. Movable are what is not immovable (article 948 Civil Code).

*Hungary*<sup>107</sup>

41. The 2013 Hungarian Civil Code provides a clear cut distinction between a 'component part' and an 'accessory'. Act V of the Civil Code provides that a component part is an object that is permanently joined with the principal property in such a way that their separation would cause the principal property or its separated part to be destroyed or would significantly reduce its value or usability due to the separation.

42. The Hungarian supreme court (the Curia) stated that a functional approach must be applied and despite of the physical, technical separability, the principal property-component part relation may be established if the principal property's operation is rendered impossible due to the separation even though they are not destroyed.<sup>108</sup> The lasting relation between the property and its component part is typically based on physical relation, but it is not necessary and it may also be based on the functional interdependence between them.<sup>109</sup> The underlying natural, physical, legal and economic relationship must be taken into consideration.<sup>110</sup>

43. Under this functional relation approach, not only industrial machines and equipment permanently fixed to the building and required for the technological process, but also additional tools not attached physically to the machines and equipment that are necessary for the proper functioning of the factory are component parts of an industrial facility.<sup>111</sup>

44. An accessory is an object that is in an economic (economical) relation with the principal property.<sup>112</sup> Permanent physical connection is not necessary. From the requirement of proper use and the lack of a thing-component part relation, it may be deduced that the equipments, machines, animals, products and crops not considered as component parts necessary and used for farming constitute accessories of the agricultural land.<sup>113</sup> In the case of an industrial facility machines, tools, raw material and equipment are considered equally as accessories if they used to carry out the industrial activity and do not qualify as component part.<sup>114</sup>

45. The accessory may be the subject of a legal transaction separately from the principal thing: it may be transferred or charged separately.<sup>115</sup> However, the legal status of the principal property covers automatically the accessory, unless otherwise agreed by the parties.

*Japan*<sup>116</sup>

46. The Japanese Civil Code stipulates that a comprehensive evaluation of facts is required in order to determine whether mobile equipment is a fixture to immovable property. A socioeconomic evaluation is made, under which the possibility of separation, the nature of the equipment as well as its process of

<sup>107</sup> The information on Hungarian law is a summary of research submitted by UNIDROIT Correspondent Tamás Szabados.

<sup>108</sup> K-H-KJ-2013-307. bírósági határozat a Kúria határozata közigazgatási ügyben (Kúria Kfv.I.35.601/2011/3.); KGD 2014. 199 (Kúria Kfv. I.35/465/2012/5.).

<sup>109</sup> Attila Menyhárd, A tulajdonjog, in Lajos Vékás (ed.), Szakértői javaslat az új polgári törvénykönyv tervezetéhez (Complex, Budapest, 2008), 605; Barnabás Lenkovics, Dologi jog (Eötvös József Könyvkiadó, Budapest, 2008), 45; Attila Menyhárd, Dologi jog (Osiris, Budapest, 2007), 76-77.

<sup>110</sup> Attila Menyhárd, A tulajdonjog, in Lajos Vékás (ed.), Szakértői javaslat az új polgári törvénykönyv tervezetéhez (Complex, Budapest, 2008), 605.

<sup>111</sup> BH 2004. 509 (Legf. Bír. Gf. I. 30.605/2002. sz.). Attila Menyhárd, Dologi jog (Osiris, Budapest, 2007), 77.

<sup>112</sup> Ferenc Petrik, A tulajdonjog, in György Wellmann (ed.), Polgári jog - Dologi jog (HVG-ORAC, Budapest, 2014), 62.

<sup>113</sup> Attila Menyhárd, A tulajdonjog, in Lajos Vékás (ed.), Szakértői javaslat az új polgári törvénykönyv tervezetéhez (Complex, Budapest, 2008), 606; Attila Menyhárd, Dologi jog (Osiris, Budapest, 2007), 82.

<sup>114</sup> Attila Menyhárd, A tulajdonjog, in Lajos Vékás (ed.), Szakértői javaslat az új polgári törvénykönyv tervezetéhez (Complex, Budapest, 2008), 606; Attila Menyhárd, Dologi jog (Osiris, Budapest, 2007), 82.

<sup>115</sup> Ferenc Petrik, A tulajdonjog, in György Wellmann (eds.), Polgári jog - Dologi jog (HVG-ORAC, Budapest, 2014), 62; Menyhárd, A tulajdonjog, in Vékás L. 606; Attila Menyhárd, Dologi jog (Osiris, Budapest, 2007), 82.

<sup>116</sup> Extracts from the Japan submission to UNIDROIT.

affixation is thoroughly examined. Therefore, for movable equipment to become a fixture to immovable property, not only physical Annexation is a prerequisite, but also the mere act of detachment would cause 'grave disadvantages socioeconomically'.

47. Under the Japanese Civil Code, with the actual joining of equipment to an immovable property, the independent property rights (including security interests) in the equipment will cease to have any legal effect. In order to safeguard the legal rights of creditors, the Code sets forth two possible compensatory measures against the owner of the immovable property, on the grounds of unjust enrichment. This can be done either directly by the creditor or alternatively through a claim by the grantor of the equipment by way of subrogation.

48. However, the law lacks any protective measures against the risk of double compensation imposed on the owner in case both claims are brought simultaneously. This issue has not been substantively explored by Japanese case law, so the exact interaction of the Code and unjust enrichment doctrines remains somewhat unclear.

#### *Mexico*<sup>117</sup>

49. The Mexican Civil Code defines equipment as immovable when it is permanently united with immovable property, detachment of which would be detrimental either to the principal immovable property or to the structure as a whole. This includes machines and utensils which are intended by the owner of the immovable property to be utilised directly or exclusively for industrial objectives and its exploitation.<sup>118</sup>

50. As consistent with the approach under Mexican law, most South American countries' commercial legislations provide for rights for landowners concerning interests in movable equipment connected to their immovable property. However, in practice companies have been able to contract out of such provisions. In order to stimulate foreign investment by increasing protection of creditors' rights, in particular in the mining industry, an explicit 'party autonomy' clause is often included in development and production agreements. Parties acknowledge with this clause that mobile, and attached, equipment do not become part of the property of the owner of the land, building or licensee of the mining rights.

51. Foreign parent companies often set up subsidiaries in most South American countries under the light of existing Bilateral Investment Treaties (BITs), transfer assets and mobile equipment to the subsidiaries on a temporary basis only, while retaining the ownership titles in an attempt to secure interest protection, to reduce the risks of expropriation as well as to shield against country-specific legislations on foreign investment.

#### *Spain*<sup>119</sup>

52. The 1889 Spanish Civil Code distinguishes between immovable or real state property and chattels or movable property. On the one hand, Article 334 lists what is considered immovable property. Along with lands, buildings, roads and anything which is affixed to the ground, the concept of immovable property does also comprise other assets anyhow related to an immovable property that are deemed 'immovable by destination' (*bienes inmuebles por destino o pertenenciales*) under the following criteria:

- Firstly, the criterion of the fixed attachment. Anything which is joined to an immovable property on a fixed basis where its separation would either break the material or impair the object will be deemed immovable property.

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<sup>117</sup> The information on Mexican law is a summary of research submitted by UNIDROIT Correspondent Ms Hernany Veytia.

<sup>118</sup> Mexican Civil Code, Translation by Michael Wallace Gordon 1980, Article 750.

<sup>119</sup> The information on Spanish law is a summary of research submitted by UNIDROIT Correspondent David Morán Bovio and Study Group member Professor Teresa de las Heras-Ballell.

- Second, an intentional criterion. In that regard, statues, paintings, and other ornamental objects that are placed in an immovable property by the owner of the immovable in a manner which would reveal the purpose of uniting them to the immovable on a permanent basis will be immovable property as well.
- Third, the criterion of purpose or function. Machines and utensils which are destined by the owner of immovable property, in the context of an industry or an undertaking, in order to satisfy the needs of that industrial activity or exploitation, are also covered.

53. Movable property is instead defined by exclusion. As per Article 335 Civil Code, any other property, which is capable of being transferred from one point to another without any potential impairment to an immovable property to which it is joined, is deemed movable. This includes income or pensions, which are related to a person or a family, provided that they do not cause any limitation to a real lien of an immovable property, as well as securities representing mortgage loans.

54. The 1954 Law on Chattel Mortgages and Non-Possessory Pledges (LHMPSD) takes a similar approach to the Hungarian Civil Code when defining the criteria for mobile, and attached, equipment. The test to determine whether equipment is a fixture or accessory considers its function within the industrial process rather than in the physical criteria as being affixed or attached to immovable property. Articles 20, 21 and 22 LHMSPD set out such factors to demarcate the scope of the chattel mortgage in a commercial establishment that would cover fixed or permanently installed facilities, as well as machines, equipment and furniture destined to satisfy business needs (provided that other conditions are met as well). Likewise, for instance, as regards security interests in aircrafts, as per Article 39 chattel mortgage in an aircraft would comprise, unless otherwise agreed, airframe, engine, propeller, navigation and radio systems, and so, even if they can be separated from the aircraft. In addition to its functional character, other factors like a clear identification of the equipment in question, its peculiarities, its general status and its location would also be taken into account.

55. On the other hand, as per Article 111 Mortgage Act of 1946, unless otherwise agreed by parties or expressly stated by statute, mortgages in real estate will not cover any movable object permanently located in the immovable property, regardless of the purpose (ornamentation, use, industrial exploitation), provided that it can be removed or detached therefrom without breaking the property or damaging the object. Accordingly, an agreement to extend the mortgage in such objects is otherwise feasible ("an extension covenant"). Such an extension covenant is arguably a commonplace clause in mortgage contracts today.

56. Considering the foregoing, several security interests can be created over the same movable asset with differing legal effects. In particular, movable and immovable mortgages and non-possessory pledges may concur over the same movable asset. The following example can better illustrate those situations of concurrence of varied security interests. Over industrial equipment, for instance, several security interests can be created. Firstly, unless agreed otherwise, a chattel mortgage over commercial premises covers equipment, tools and machines (Article 21 LHMPSD) – as well as trademarks, commercial names and other intellectual property rights -, provided that some conditions are met. Secondly, equipment and machines can be covered, if agreed, by the chattel mortgage over commercial premises as merchandise devoted to the running of the business activity (Article 22 LHMPSD). Thirdly, equipment can be encumbered by a specific chattel mortgage of industrial equipment (Article 42 LHMPSD). Fourthly, to the extent that equipment is not devoted to an industrial activity, a non-possessory pledge could be also created over it (Article 53 LHMPSD) when the conditions laid down by Article 42 are not satisfied. Finally, a real mortgage could be extended by agreement to cover equipment (Article 111.1. Mortgage Act)

57. Therefore, the following possible conflicting scenarios can be considered:

- Should an object be located on immovable property subject to a mortgage with an extension clause, and the object is detached from the property, the detached object is acquired by the third party free from any security interest, except in case of fraud or bad faith. Despite that the mortgage in the immovable property is deemed to extend



over those objects that are permanently located in it, a specific object is not subject to the mortgage until the mortgage is enforced – similar to the idea of “crystallization” in a “floating charge” -. In the meantime, the object can be removed free of any security interest.

- A possible conflict may arise between a mortgage in the immovable with an extension agreement and pre-existing security interests in objects that are located or to be used in that immovable or commercial establishment. Article 75 LHMPD provides for a rule to solve the conflict. When a chattel mortgage or a non-possessory pledge is granted over those movables (equipment, machines, instruments, tools) located or used in an immovable property a marginal notice (“nota marginal”) will be included in the margin of the registration of the title in the immovable in the Property Registry. Then, the chattel mortgage or the non-possessory pledge, provided that is annotated in the Property Registry as indicated, will have priority over any mortgage in the immovable where they are located, used or placed, that would otherwise extend to cover those objects.
- Article 75 LHMPD does not, however, provide for a solution in case that the chattel mortgage or the non-possessory pledge is created over an object that is located in an immovable property subsequently to a previously-created mortgage in the property with an extension clause. In such cases, it is discussed whether the same solution might be applied. Prior registered mortgage will gain here priority over the subsequent security interest created in the object, that was already covered by the extension clause of the mortgage.
- There is no express legal solution either, when the conflict arises between a reservation of title in an object located on immovable property and a mortgage in the immovable including an extension clause. It is argued then that all these cases can be solved on the basis that the security interests that has been previously registered will be preferential over any subsequently-registered security interest. Except for the cases of acquisition financing that will always prevail (as purchase money security interest), even if posterior, over the mortgage. Such a solution would be endorsed by Article 21 LHMPD that, in relation to chattel mortgages in commercial establishments, likely to extend over equipment, tools, furniture and other instruments, excludes from the scope of the chattel mortgage those objects whose acquisition price is not entirely paid.

### *Turkey*<sup>120</sup>

58. The 2001 Turkish Civil Code<sup>121</sup> (TCC) distinguishes between an ‘integral part’ and an ‘accessory’. An integral part of principal property (movable or immovable) is an essential part of that property where its detachment and separation would inevitably destroy or damage the principal property or alternatively, would change its character. The owner of the principal property would also hold ownership of all its integral parts.<sup>122</sup>

59. An accessory is movable equipment which, based on either local usage or the clear intention of the owner of the principal property to which it has been attached to, is permanently destined for the principal item’s use, enjoyment or preservation. It is therefore connected in a fashion that it would duly serve for its purpose. Accessories would retain their character even in case of temporary separation from a principal item.<sup>123</sup>

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<sup>120</sup> The information on Turkish law is a summary of research submitted by UNIDROIT Correspondent Professor Ergun Özsunay.

<sup>121</sup> 2001 Turkish Civil Code No. 4721.

<sup>122</sup> Ibid, Article 684.

<sup>123</sup> Ibid, Article 686.

60. Under the 2001 Turkish Civil Code (TCC), in cases of non-possessory chattels, movable equipment is required to be registered at a special public registry, in accordance with Turkish law, in order for any claim related to the equipment's security interests to have a legal effect.<sup>124</sup>

61. Where movable equipment has subsequently been affixed to immovable property upon which a mortgage lien has been established, such equipment is also covered by the mortgage. A mortgage lien, in general, includes integral parts as well as accessory items which are associated with the immovable property in question.<sup>125</sup> In the case of a mortgage where certain equipment is explicitly considered as an accessory, whereby it has been included in the land register's "notice" section, (e.g. machines or hotel furniture) such equipment shall be deemed as an accessory. However, if the equipment is not legally entitled to be considered as such, the rule will be ineffective.<sup>126</sup>

62. The Code further specifies that the rights of third parties are preserved in case where movable equipment has subsequently been attached to an immovable property.<sup>127</sup> It is noted under the Turkish analysis that the term 'affixed' is used consistently with its meaning in other jurisdictions, whereas 'attached' is used to correspond with the connection of an accessory.

#### *The United Kingdom*

63. To be further revised by the Secretariat.

#### *The United States*<sup>128</sup>

64. Under the Uniform Commercial Code (UCC), the Secured Transactions section provides for two different and distinct set of definitions on the terms 'accession' and 'fixture'. The UCC Section 9-102(a)(41) provides that 'fixtures' means 'goods that have become so related to particular real property that an interest in them arises under real property law'.

65. UCC Section 9-102(a)(1) defines accessions as 'goods that are physically united with other goods in such a manner that the identity of the original goods is not lost.' As such, the UCC definition of accession deals with objects that are attached to other movable objects, not immovable land.

66. This incorporation of the definition of "fixtures" is limited by UCC § 9-334(a), which further provides that "[a] security interest under this article may be created in goods that are fixtures or may continue in goods that become fixtures. A security interest does not exist under this Article in ordinary building materials incorporated into an improvement on land." Accordingly, while each state is free to develop its own definition of "fixtures," bricks, lumber and mortar, which start out as personal property and are subsequently incorporated into a permanent structure, lose their identity and become part of the real estate and may not be considered as fixtures.

67. Apart from this uniform "ordinary building materials" limitation, there is substantial disparity in the case law of the various states in classifying property as goods, fixtures or realty. In the absence of a statutory definition, applicable state case law must be consulted. While courts of the various states agree on: (1) the degree of Annexation, (2) the use of property attached to the real estate, and (3) the intent of the parties as criteria to be used in determining whether specific collateral is to be classified as goods or fixtures or real estate, the results under the case law in the various US jurisdictions in classifying property as a fixture are not always uniform or predictable.

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<sup>124</sup> 2001 Turkish Civil Code No. 4721, Article 940 II.

<sup>125</sup> Ibid, Article 862 I.

<sup>126</sup> Ibid, Article 862. II.

<sup>127</sup> Ibid, Article 862 III.

<sup>128</sup> The information on United States law is a summary of research submitted by UNIDROIT Correspondents Professor Louis Del Duca and Professor Peter Winship.

68. UCC § 9-502(a) & (b) requires a creditor to file a "fixture filing" in order to perfect a security interest in goods which are or are to become fixtures. UCC § 9-102(a)(40) defines a "fixture filing" as the "filing of a financing statement covering goods that are to become fixtures and satisfying UCC § 9-502(a) and (b)."

69. The general rule regarding sufficiency of the financing statement found in UCC § 9-502(a) requires that the statement:

1. provide the name of the debtor;
2. provide the name of the secured party or a representative of the secured party; and
3. indicate the collateral covered.

70. UCC § 9-502(b) adds that if the financing statement is filed as a "fixture filing and covers goods that are or are to become fixtures," the financing statement must, in addition to the above requirements found in UCC § 9-502(a):

1. indicate that it covers this type of collateral,
2. indicate that it is to be filed [for record] in the real property records;
3. provide a description of the real property to which the collateral is related [sufficient to give constructive notice of a mortgage under the law of this State if the description were contained in a record of the mortgage of the real property]; and
4. if the debtor does not have an interest of record in the real property, provide the name of a record owner.

71. UCC § 9-501(a)(1)(B) provides that a fixture filing must be filed in the office designated for the filing or recording of a record of a mortgage on the related real property. UCC § 9-301(3)(A) requires the fixture filing to be filed in the state in which the fixture is located.

72. These provisions are designed to give creditors easier access to information concerning encumbrances on fixtures. A search of the real estate records will normally suffice to disclose whether fixtures attached to specific real estate are subject to a creditor's security interest.

#### *Uruguay*<sup>129</sup>

73. According to Uruguayan law, objects are classified into two main types: movable and immovable depending on whether they can be moved place to place or not (section 462 and 463 of Uruguayan Civil Code).

74. Additionally, movable objects are considered immovable property by virtue of their use or their permanent physical attachment to immovable property. In this sense, section 465 of Uruguayan Civil Code sets forth that movable objects which are permanently intended for use, cultivation and benefit of a immovable property, even when they could be removed without detriment, are considered immovable property (eg. mining and farming tools, equipment part of an industrial establishment, etc)

75. The movable objects abovementioned will be considered movable assets again once they are separated from the immovable property in order to be used for others purposes (independent from the immovable property), pursuant to section 468 of Uruguayan Civil Code.

76. In conclusion, the attachment to immovable property or the permanent destination and use in relation to immovable property are the tests used by Uruguayan civil law to determine whether a piece of equipment has become part of immovable property.

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<sup>129</sup> The information on Uruguayan law is a summary of research submitted by UNIDROIT Correspondent Ms Cecilia Fresnedo de Aguirre.

77. Under Uruguayan Law security interests in movable assets are either dispossessory or non-dispossessory pledges, and in immovable assets are the mortgages. A non-dispossessory pledge and mortgage must be recorded in Uruguayan Public Registries in order to achieve effectiveness against third parties. Priority of security interests in the same object is determined by their registration date.

## **Appendix V – Research on special insolvency regimes affecting farmers and agricultural enterprises**

1. This appendix was drafted by the National Law Centre for Inter-American Free Trade in collaboration with the UNIDROIT Secretariat for consideration at the third Study Group meeting in October 2015.
2. States adopt different approaches to defining the scope of application of their insolvency laws. Some insolvency laws apply to all debtors with certain narrowly defined exclusions while other States distinguish between natural person debtors and juridical or legal person debtors and provide different insolvency laws for each category. A further approach distinguishes between legal and natural persons on the basis of their engagement in economic activities. Some of these laws address the insolvency of “merchants,” who are defined by reference to their engagement in economic activities as ordinary occupations, or companies incorporated in accordance with commercial and corporate laws and other entities that regularly undertake economic activities. Finally, a number of States have developed special insolvency regimes for different sectors of the economy, particularly the agricultural sector.<sup>130</sup>
3. Accordingly, States may:
  - (i) regulate the insolvency of farmers in their general insolvency law under the same rules that apply to all types of businesses;
  - (ii) regulate the insolvency of farmers in their general insolvency law but in a specific chapter (e.g., the United States);
  - (iii) regulate the insolvency of farmers in their general insolvency law that includes special provisions applicable only to farmers (e.g., Colombia, France and Russia);
  - (iv) exclude individual farmers from the application of their general insolvency laws, in which case their debts and assets are liquidated under the commercial law (e.g., Brazil);
  - (v) exclude only “small farmers” from the scope of their general insolvency law (e.g., Mexico);
  - (vi) provide for specific insolvency regimes that supplement their general insolvency law and that apply to farmers (e.g., Canada); or
  - (vii) provide for specific insolvency regimes that apply exclusively to farmers (e.g., South Africa).
4. The following paragraphs summarise the insolvency treatment of agricultural producers in a number of selected countries, organised alphabetically.

### *Brazil*

5. The current Brazilian Bankruptcy Law (Lei No 11.101, De 9 Fevereiro de 2005) introduced the concept of “company reorganisation.”<sup>131</sup> Article 1 of the Law states that its rules apply exclusively to businesspersons and business corporations. The Law’s reorganisation procedures and requirements were modelled on the United States’ Bankruptcy Code Chapter 11.<sup>132</sup> The Law provides for three forms of proceedings: i) judicial reorganisation; ii) extrajudicial reorganisation; and iii) bankruptcy.<sup>133</sup> The most frequently utilised proceeding is judicial reorganisation, that provides for a stay of 180 days during which the enforcement of creditors’ rights is suspended; the duration of the stay may not be extended.<sup>134</sup> However,

<sup>130</sup> See further UNCITRAL Legislative Guide on Insolvency Law, Parts I and II, at 38 (2004), available at [http://www.uncitral.org/pdf/english/texts/insolven/05-80722\\_Ebook.pdf](http://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf).

<sup>131</sup> Law No. 11.101 is available at [http://www.planalto.gov.br/ccivil\\_03/ato2004-2006/2005/lei/111101.htm](http://www.planalto.gov.br/ccivil_03/ato2004-2006/2005/lei/111101.htm).

<sup>132</sup> Jeffrey M. Anapolsky & Jessica F. Woods, Pitfalls in Brazilian Bankruptcy Law for International Bond Investors, 8(2) Journal of Business & Technology Law, at 398 (2013).

<sup>133</sup> John J. Rapisardi & Joseph Zujkowski, Bankruptcy Basics under Brazilian Law, 252(02) New York Law Journal (July 2014).

<sup>134</sup> Id.

Article 2 further provides that the processes of reorganisation and bankruptcy do not apply to cooperatives because they are subject to specific regimes. Finally, unless an individual farmer is registered as a businessperson with the Registry Board of Trade and meets other requirements specified by the law and Article 971 of the Civil Code, he or she may not be eligible for reorganisation.<sup>135</sup> The Code of Civil Procedure provides for special insolvency regimes for those debtors not eligible for relief under the Bankruptcy Law.<sup>136</sup>

### Canada

6. Sections 43 to 46 of the 1985 Federal Bankruptcy and Insolvency Act regulate the process by which a creditor files an involuntary bankruptcy petition against a debtor. However, Section 48 of the Federal Bankruptcy and Insolvency Act states that the rules laid down under Sections 43 to 46 do not apply to individuals whose principal occupation and means of livelihood is farming. Section 81 of the Bankruptcy and Insolvency Act provides for special claims of farmers for unpaid produce delivered to their bankrupt customers.

7. Canada has also adopted the 1997 Farm Debt Mediation Act that applies to insolvent and over-indebted farmers.<sup>137</sup> The Act prescribes certain procedures that override those applicable under the provincial and territorial secured transactions laws – the Personal Property Security Acts. An insolvent farmer may apply for a stay of proceedings in the event that a creditor seeks to enforce its security interest. The stay is initially imposed for a period of 30 days and can be extended in 30 day increments for a total of 120 days in certain circumstances. A farmer can apply for mediation even before he or she becomes insolvent but in that case there is no stay protection during the process.<sup>138</sup> Under this Act, a debtor is able to propose a re-structuring plan but creditors are not obliged to participate and may exercise their normal collection remedies once the stay is lifted.<sup>139</sup>

8. Bankruptcy laws also allow farmers to exempt certain assets from liquidation to facilitate their “fresh start.” Such assets include livestock, essential farm machinery and equipment, and farm tools, up to a value of \$7500. However, these exemptions apply only against judgment creditors and do not affect those creditors that have taken an effective and unavoidable security interest in these assets. Under Section 67, the insolvent debtor is entitled to exempt certain assets (e.g., retirement savings) that may not be utilised to satisfy the claims of creditors. Section 67 also defers to the applicable provincial law and many Provinces and Territories provide for specific exemptions applicable in bankruptcy. For instance, in Alberta a person is entitled to exempt farm property required for 12 months of operations and in Ontario, if the debtor is a farmer, he or she is entitled to exempt livestock, fowl, bees, books, tools and implements and other chattels not exceeding a prescribed amount, or \$28,300.<sup>140</sup>

9. Canadian provinces have adopted special laws that protect farmers outside of insolvency proceedings. For instance, the Manitoba Farm Machinery and Equipment Act regulates the manner in which repossession must be carried out, also providing for the arbitration of disputes concerning repossession of farm machinery and other farm equipment. This Act also imposes a limit on the extent of assets that farmers may provide as collateral to secure the payment of the purchase price of some equipment. Section 36(2) provides that “no part of the price of new or used farm machinery or farm equipment may be secured by a lien on any goods not sold under the sale contract or agreement of purchase and sale for the machinery

<sup>135</sup> Cooperatives are not eligible for bankruptcy because of their civil nature and the fact that their activity is not related to business. Therefore, their affairs may be administered in an out-of-court liquidation provided by Law 5.764/71. See Appeal 999.134/PR (Superior Court of Justice - 1st Group, AgRg, August 18 2009, DJe September 21 2009), in Court rules that agricultural cooperatives are not entitled to judicial restructuring, available at <http://www.internationallawoffice.com/newsletters/Detail.aspx?q=ec88ee9d-98fb-4c0a-a006-c565eb5e64c1>.

<sup>136</sup> Dennis Faber, Niels Vermunt, Jason Kilborn & Tomas Richter (eds.), *Commencement of Insolvency Proceeding, National Report for Brazil* (2012).

<sup>137</sup> See <http://laws-lois.justice.gc.ca/eng/acts/F-2.27/>.

<sup>138</sup> See [http://www.plea.org/legal\\_resources/?a=257&searchTxt=&cat=28&pcat=4](http://www.plea.org/legal_resources/?a=257&searchTxt=&cat=28&pcat=4).

<sup>139</sup> See further [http://www.bankruptcysask.ca/services.php?f\\_action=news\\_detail&news\\_id=9744](http://www.bankruptcysask.ca/services.php?f_action=news_detail&news_id=9744).

<sup>140</sup> Alysia Davies, *Federal Exemptions in Bankruptcy: Canada and Three Other Countries* (October 2008), available at <http://www.parl.gc.ca/Content/LOP/researchpublications/prb0228-e.htm>.

or equipment." Under Section 38(1), "A lienholder shall not repossess farm machinery or farm equipment that is subject to a lien without leave of the board and except in accordance with this Act." Accordingly, the secured creditor must apply to a board to sanction the intended repossession. Upon repossession, the secured creditor must retain the farm machinery/equipment for 10 working days allowing the farmer to redeem those assets.

10. The province of Manitoba also adopted the Family Farm Protection Act in 1986, under which a creditor cannot foreclose on farmland until the concerned farmer has had the opportunity to go through the mediation process.<sup>141</sup> When a creditor intends to foreclose, due to a default of the debtor, they are required to obtain leave of the court. Similarly, the Saskatchewan State Farmers Security Act also requires creditors to follow certain procedures before seizing or repossessing farm equipment.<sup>142</sup> For instance, secured creditors must give a 15day notice of their intention to take possession of equipment. When the farmer receives the notice of intention to seize the machinery, he or she has 30 days to apply to the court for a hearing. Once the farmer files a petition with the court, the creditor's right to take possession is suspended.

#### *Colombia*

11. Colombia's 2010 Law No. 1380, establishes the insolvency regime for natural persons (with the exception of merchants)<sup>143</sup> while Law No. 1116 of 2006 governs corporate insolvency.<sup>144</sup> Depending on the nature of the agricultural business, the person may be eligible for relief under one of the two regimes. The law for natural persons contains special provisions for debtors who are agricultural producers and fishermen, including their access to the resources available from the National Agricultural Reactivation Program. This program allocates financial resources for the benefit of agricultural producers and fishermen who are delinquent in the payment of their debts, with the purpose of allowing them to continue their activities during and after the renegotiation of their debts.<sup>145</sup>

#### *France*

12. The 1985 Law regarding the reorganisation and the judicial liquidation of companies is open to merchants, registered craftsmen, farmers and legal entities. The eligible debtors against whom bankruptcy proceedings may be initiated are defined in Article 620 of the Commercial Code, and include farmers. The Rescue Act of 2006 specifically mentions farmers as being eligible for rescue (reorganisation) proceedings.<sup>146</sup> The French law also provides for a special compromise arrangement procedure that remains applicable only to farmers. In those proceedings, for example, agricultural experts, and not judicial administrators, are nominated as conciliators.<sup>147</sup>

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<sup>141</sup> See further [http://www.ruralsupport.ca/admin/FileUpload/files/handouts/\\_Farm%20financial%20Handouts%20june%202010%20B&W.pdf](http://www.ruralsupport.ca/admin/FileUpload/files/handouts/_Farm%20financial%20Handouts%20june%202010%20B&W.pdf).

<sup>142</sup> See <http://www.qp.gov.sk.ca/documents/English/Statutes/Statutes/S17-1.pdf>.

<sup>143</sup> See [http://www.cconsumidores.org.co/index.php?option=com\\_content&view=article&id=101:ley-1380--2010-regimen-de-insolencia&catid=19:legislacion&Itemid=126](http://www.cconsumidores.org.co/index.php?option=com_content&view=article&id=101:ley-1380--2010-regimen-de-insolencia&catid=19:legislacion&Itemid=126).

<sup>144</sup> See [http://www.secretariassenado.gov.co/senado/basedoc/ley\\_1116\\_2006.html](http://www.secretariassenado.gov.co/senado/basedoc/ley_1116_2006.html).

<sup>145</sup> See further [http://www.loc.gov/lawweb/servlet/lloc\\_news?disp3\\_l205402204\\_text](http://www.loc.gov/lawweb/servlet/lloc_news?disp3_l205402204_text).

<sup>146</sup> Jones Day, Comparison of Chapter 11 of the United States Bankruptcy Code with the Rescue Procedure in France, at 23, available at <http://www.jonesday.com/files/Publication/1ec093d4-66fb-42a6-8115-be0694c59443/Presentation/PublicationAttachment/e5b46572-7aeb-4c34-ab2e-bee2f8f3d3c2/Comparison%20of%20Chapter%2011%20%28A4%29.pdf>.

<sup>147</sup> See further Reed Smith, Insolvency Law in France, available at [http://www.reedsmith.com/files/Publication/dd0e30b6-2d8c-4912-b35e-0fe8a7bddc95/Presentation/PublicationAttachment/6dc8fc38-e58f-48c9-9986-53814f7dffb/France\\_%28as\\_published%29.pdf](http://www.reedsmith.com/files/Publication/dd0e30b6-2d8c-4912-b35e-0fe8a7bddc95/Presentation/PublicationAttachment/6dc8fc38-e58f-48c9-9986-53814f7dffb/France_%28as_published%29.pdf).

### *Mexico*

13. The Mexican Insolvency Law of 2000 is applicable to all persons considered merchants under the Commercial Code, which includes farmers.<sup>148</sup> Article 5 provides that “small merchants” can only be subjected to the law if they voluntarily agree by means of a written consent. Small merchants are those whose valid and outstanding obligations are not higher than 400,000 UDIS<sup>149</sup> (near MX\$ 2,116,000.00 or US\$ 139,210.00).<sup>150</sup>

### *Russia*

14. In Russia, entrepreneurs and farmers of all sizes may be eligible for relief under a single law that excludes from its scope only individuals not engaged in any business activity.<sup>151</sup> Under Article 139 of the Law on Insolvency of 2002 No. 127-FZ, agricultural organisations are defined as legal entities whose primary activity consists of growing agricultural produce whose proceeds amount to no less than 50% of the entity’s total revenues. The essence of the first special rule regulating the bankruptcy of agricultural organisations is such that when the immovable property of the bankrupt organisation is sold, other agricultural organisations or farm enterprises have priority to buy it. The second special rule is such that the duration of external management of an agricultural organisation is extended to account for the seasonal nature of its operations and the necessity to wait until the end of the respective agricultural season. The Law on Insolvency also protects certain assets of the insolvent debtor to the extent that they are exempted from execution under the law of civil procedure. One of the consequences of filing for bankruptcy is the termination of the debtor’s status as a businessman, and the debtor may not seek registration as a business entity for a specific time period.<sup>152</sup> Certain aspects of insolvency for agricultural producers are also governed by the Federal Law on Financial Rehabilitation of Agricultural Producers of 2002.<sup>153</sup>

### *South Africa*

15. Insolvency matters in South Africa are governed by the Insolvency Act No. 24 of 1936.<sup>154</sup> This Act does not entirely codify South African insolvency law and for a number of aspects, related legislation governs.<sup>155</sup> One such legislation is included in Part III of the Agricultural Credit Act No. 28 of 1966 that contains special provisions regarding settlements by farmers (compromise with creditors) who are unable to pay their debts.<sup>156</sup> The Act authorises the appointment of a trustee or liquidator, but remains concerned primarily with immovable collateral. With respect to movable property, Section 23(d) provides that no person shall take possession of, or institute any proceedings for, the return of any tractor or other agricultural machinery or any agricultural implements or irrigation machinery or lorry or livestock sold to the applicant subject to a suspensive or resolutive condition and used exclusively in connection with his or her farming operations. The rescue regime for companies is also governed by the Companies Act No. 71 of 2018.

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<sup>148</sup> See <http://www.diputados.gob.mx/LeyesBiblio/pdf/29.pdf>.

<sup>149</sup> Mexico’s Investment Units (UDIS) are units based on price increases used to settle mortgage obligations or other commercial transactions. UDIS were created in 1995 to protect banks and focused mainly on mortgage loans.

<sup>150</sup> Exchange rate according to the Federal Diary of the Federation of 4/1/2015: 1 UDIS = MX\$ 5.29; 1 USD available at [www.dof.gob.mx](http://www.dof.gob.mx).

<sup>151</sup> INSOL International, Specifics of Personal and Corporate Bankruptcy Under Russian and Ukrainian Laws, at 1-2 (May 2014), available at [http://www.insol.org/emailer/June\\_2014\\_downloads/FINAL%20Technical%20Paper%20No%2029%20\\_21%20May%202014.pdf](http://www.insol.org/emailer/June_2014_downloads/FINAL%20Technical%20Paper%20No%2029%20_21%20May%202014.pdf).

<sup>152</sup> Id., at 3.

<sup>153</sup> Jens Lowitzsch, The Insolvency Law of Central and Eastern Europe, at 386 (INSOL Europe).

<sup>154</sup> See <http://www.justice.gov.za/legislation/acts/1936-024.pdf>.

<sup>155</sup> Country Report: South Africa, available at [https://www.justiz.nrw.de/WebPortal\\_en/projects/ieei/documents/public\\_papers/country\\_report\\_sa.pdf](https://www.justiz.nrw.de/WebPortal_en/projects/ieei/documents/public_papers/country_report_sa.pdf).

<sup>156</sup> See <http://faolex.fao.org/docs/pdf/saf20851.pdf>.



*The United States*

16. Beginning with the first enactment of federal bankruptcy law in 1898, American bankruptcy law has always paid special attention to and provided special protection for the American farmer.<sup>157</sup> The pro-farmer bankruptcy legislation of the Great Depression and the Family Farmer Bankruptcy Act of 1986 are just two examples. These Acts featured a special protection for farmers against involuntary bankruptcies.

17. The US Bankruptcy Code contains a special regime under chapter 12, available for "family farmers" with "regular annual income". Under Section 303, an involuntary petition may not be filed against a family farmer under Chapter 12. Not all farmers automatically qualify for special protections, which are limited by both the gross annual income and the aggregate debt of the farmer. Chapter 12 is a tailored bankruptcy regime to meet the economic realities of family farming, compared to Chapters 11 and 13, which are designed for corporate organisations and consumers, respectively. Under Chapter 12, debtors propose a repayment plan to make instalments to creditors over a period of three to five years. However, secured creditors must be paid at least as much as the value of the collateral securing the debt. The relief under Chapter 12 is voluntary, and only the debtor may file a petition under the Chapter. If the debtor files the petition under Chapter 12, all enforcement actions are "automatically stayed." Secured creditors may receive repayment of the debt over a period of five years.

*Effect of special insolvency-agricultural regimes on the MAC Protocol*

18. Special insolvency-agricultural regimes and provisions do exist in the legislation of many States. However, the deviations from the general insolvency law relate primarily to:

- (i) the (priority) claims of farmers against bankrupt customers;
- (ii) exemption of certain farming equipment from the pool of assets available for distribution; however these exemptions do not affect secured creditors and are limited in value;
- (iii) protection of the farmers' right to land;
- (iv) stays of actions against assets (i.e., collateral owned by farmers);
- (v) access to a public fund to facilitate the restructuring of debts; and
- (vi) limitation as to the ability to file an involuntary insolvency petition against the farmer.

19. For the most part, these special insolvency-agricultural regimes protect small-scale farmers that are unlikely to own large items of equipment to be covered by the MAC Protocol. However, MAC equipment may also be subject to secondary sales and financing provided to farmers in developing countries whose laws may include such special protections.

20. It is these countries that may consider applying their domestic insolvency law rather than choosing one of the insolvency alternatives set forth in the MAC Protocol. Such a choice might have a negative impact on the financing of construction and mining equipment with respect to which protections of this kind do not exist or are severely limited.

21. These States may then be interested in applying different insolvency regimes to the three different categories of equipment covered by the MAC Protocol, such as Alternative A to construction and mining equipment, and Alternative B, or their domestic laws to agricultural equipment. A further alternative would be to allow States to declare that a particular insolvency regime (e.g., Alternative C) applies to a defined category of agricultural producers.

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<sup>157</sup> See David Ray Papke, *Rhetoric and Retrenchment: Agrarian Ideology and American Bankruptcy Law*, 54(4) *Missouri Law Review* (1989).

22. The Study Group is invited to give further consideration on this issue, especially in regards to whether the existing insolvency provisions in the Protocol require amendment. There is no additional drafting in the current preliminary draft Protocol in relation to this issue.

## **Appendix VI – Research on restrictions on enforcement of security interests in farming equipment**

1. This research was completed by the National Law Centre for Inter-American Free Trade and presented to the Study Group at its third meeting in October 2015. It also incorporates data received from UNIDROIT Correspondents whom were consulted on the issue in July 2015.

2. Some countries have adopted laws that affect the powers of secured creditors to enforce their rights against farming machinery and similar equipment provided as collateral. However, research shows that any restrictions on these enforcement powers apply mainly to protect family and individual farmers who own low-value items. Furthermore, these restrictions do not eliminate the possibility of extra-judicial enforcement and rather only delay the process by requiring the secured creditor to either: i) provide special notices; ii) provide the debtor with certain grace periods for the opportunity to cure the default, or iii) initiate mediation prior to the foreclosure.

3. The following paragraphs provide an overview of some of these laws and the kinds of limitations they impose on secured creditors. Since the draft MAC Protocol is designed to apply only to high-value equipment, such protective measures of States should not be applicable to these types of transactions. This could pressure certain States to reconsider the value of the ratification of the future MAC Protocol or call for declarations that would allow them to continue to apply these types of protective measures to a narrowly defined set of transactions or equipment types.

### *Australia*

4. In Australia, enforcement rights of secured creditors are governed and recognised by the recently adopted Personal Property Securities Act of 2009 (PPSA), which is a federal law. In addition to the PPSA, some Australian states also regulate particular aspects of the enforcement of security interests against farmers. New South Wales and Victoria have adopted legislation that mandates farm debt mediation. Other states have no formal schemes or only have voluntary mechanisms in place (e.g., Western Australia).<sup>158</sup> Since these statutes provide for the use of non-uniform mechanisms, the Federal Government has been studying the possibility of adopting a common federal approach with respect to these protective measures for farmers.<sup>159</sup>

5. In general, these special non-PPSA laws require creditors, including those whose rights are secured with farming equipment, to initiate mediation through an independent third party prior to enforcing their rights.<sup>160</sup> The Victoria statute defines farming equipment to include a harvester, binder, tractor, plough or other agricultural implement.<sup>161</sup> While both parties to a security agreement may initiate mediation, in practice, it has been the creditors who have acted as the initiators in a significant majority of cases.<sup>162</sup> In Victoria, the mediation is conducted by the Small Business Commissioner. The fees associated with the mediation are reasonably low due to a partial subsidy from the government.<sup>163</sup> Under Section 6 of the Victorian statute, any action taken by the secured creditor in violation of its duties under the statute shall be void. Section 8 also imposes a moratorium of 21 days on any enforcement action which commences the day the secured creditor gives notice of its intention to enforce the rights to the debtor.

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<sup>158</sup> See <https://www.agric.wa.gov.au/grains/farm-debt-mediation-wa-scheme>.

<sup>159</sup> See [http://www.agriculture.gov.au/ag-farm-food/drought/assistance/approach\\_to\\_farm\\_debt\\_mediation](http://www.agriculture.gov.au/ag-farm-food/drought/assistance/approach_to_farm_debt_mediation).

<sup>160</sup> See <http://www.holdingredlich.com/agribusiness-rural-industries/farm-debt-mediation-how-to-make-it-successful>.

<sup>161</sup> See s. 3 of the Farm Mediation Act, No. 42 of 2011, available at [http://www.austlii.edu.au/au/legis/vic/num\\_act/fdma201142o2011209/](http://www.austlii.edu.au/au/legis/vic/num_act/fdma201142o2011209/).

<sup>162</sup> *Id.*

<sup>163</sup> *Id.*

### Canada

6. In Canada, every province and territory has its own PPSA. Like in Australia, the Canadian PPSAs recognise extra-judicial enforcement of security interests taken in any form of personal property, including farming machinery. The rights of secured creditors set forth in the PPSAs may be affected by federal and provincial legislation. On the federal level, the 1997 Farm Debt Mediation Act was adopted to apply to insolvent and over-indebted farmers.<sup>164</sup> Under the Act, a farmer may apply for a stay of proceedings in the event that a secured creditor seeks to enforce its security interest. The stay is initially imposed for a period of 30 days and can be extended in 30 day increments for a total of 120 days in certain circumstances.

7. Canadian provinces have also adopted special laws that protect farmers and impose limitations on the enforcement powers of secured creditors. For instance, the Manitoba Farm Machinery and Equipment Act regulates the manner in which repossession must be carried out, also providing for the arbitration of disputes concerning repossession of farm machinery and other farm equipment. Under Section 38(1), "a lienholder shall not repossess farm machinery or farm equipment that is subject to a lien without leave of the board and except in accordance with this Act." Accordingly, the secured creditor must apply to a board to sanction the intended repossession. Upon repossession, the secured creditor must retain the farm machinery/equipment for 10 working days allowing the farmer to exercise its right of redemption. This Act also imposes a limit on the extent of assets that farmers may provide as collateral to secure the payment of the purchase price of some equipment. Section 36(2) provides that "no part of the price of new or used farm machinery or farm equipment may be secured by a lien on any goods not sold under the sale contract or agreement of purchase and sale for the machinery or equipment."

8. The province of Manitoba also adopted the Family Farm Protection Act in 1986, under which a secured creditor cannot foreclose on farmland until the concerned farmer has had the opportunity to go through the mediation process.<sup>165</sup> When a secured creditor intends to foreclose, upon default of the debtor, they are required to obtain leave of the court. Similarly, the Saskatchewan State Farmers Security Act requires secured creditors to follow certain procedures before seizing or repossessing farm equipment.<sup>166</sup> For instance, secured creditors must give a 15 day notice of their intention to take possession of equipment. When the farmer receives the notice of intention to seize the machinery, it has 30 days to apply to the court for a hearing. Once the farmer files a petition with the court, the creditor's right to take possession is suspended.

### Kenya

9. The Hire-Purchase Act, adopted in 1982, regulates a transaction in which it "shall be implied... that the legal ownership of, and title, to the goods shall automatically be vested in the hirer upon payment by the hire-purchase price in full".<sup>167</sup> This type of transaction is similar to financial leasing that allows lessees (hirers) to acquire assets, mainly equipment. This Act also established the Registrar of Hire-Purchase Agreements.<sup>168</sup> According to Article 3(1), the scope of the Act is limited to those agreements covering obligations that do not exceed four million shillings, the equivalent of approximately USD \$40,000.<sup>169</sup> As a result, this Act is inapplicable to transactions covering high-value equipment, the financing of which the draft MAC Protocol seeks to facilitate.

10. The Act includes some limitations on the powers of secured creditors to enforce their rights in case of the debtor's default. After the borrower pays two thirds of the total sum due, the secured creditor loses

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<sup>164</sup> See <http://laws-lois.justice.gc.ca/eng/acts/F-2.27/>.

<sup>165</sup> See further <http://www.ruralsupport.ca/admin/FileUpload/files/handouts/Farm%20financial%20Handouts%20june%202010%20B&W.pdf>.

<sup>166</sup> See <http://www.qp.gov.sk.ca/documents/English/Statutes/Statutes/S17-1.pdf>.

<sup>167</sup> Hire Purchase Act, 1982 (Rev 2010), art. 8(e).

<sup>168</sup> *Id.*, art. 5.

<sup>169</sup> *Id.*, art. 3(1).

the right to repossess the item extra-judicially. Instead, it must bring a suit against the hirer.<sup>170</sup> If the secured creditor repossesses the asset in violation of the requirements of the Act, the agreement is to be deemed terminated and the hirer and its guarantor, if any, are to be released from all liability and entitled to recover all monies paid to the secured creditor.

11. The limitation on the enforcement rights of a secured creditor in the case of a borrower's default has been recently reinforced in the new Consumer Protection Act (CPA).<sup>171</sup> Section 20(1) of the Act provides that when a consumer has satisfied two thirds or more of the payment obligation under a future performance agreement, any provision in the agreement, or in the security agreement incidental to the agreement, under which the supplier may retake possession of the goods or resell the goods or services upon default in payment by the consumer, is not enforceable, except by leave of the High Court. Given the target of this protection – the consumer, arguably it would not be applicable to the owners and users of MAC equipment. However, Kenyan courts have already granted protection under this Act to legal entities, arguing that the Act protects a "person" rather than an individual.<sup>172</sup>

### Mexico

12. Latin American countries share some of the rules restricting secured creditors' rights to extra-judicially seize certain assets of the debtor if they are those seen as necessary to perform an economic activity or protect the debtor's family. The rules affecting secured creditors' enforcement rights in some Latin American countries (the minority)—which can be generally found in civil procedure codes—are specific to farming equipment or machinery (e.g., Mexico). However the rules of others (the majority), make no reference to farming equipment or machinery, covering instead only "instrumentalities that are necessary for the debtor in his/her profession, art or trade" (e.g. Argentina, Colombia, Chile, Guatemala, and Peru).<sup>173</sup> Unlike Australia, Canada and the United States, there is no mandatory mediation legislation for farm debt in Latin America.

13. In Mexico, if the debtor objects to extra-judicial enforcement, the secured creditor must resort to judicial enforcement mechanisms that are governed by the Commerce Code (Código de Comercio), the Federal Code of Civil Procedure (Código Federal de Procedimientos Civiles) (FCCP), and subsidiarily by the civil procedure codes of Mexican states.<sup>174</sup> It should be noted that these state codes mirror, almost in their entirety, the FCCP. Whenever a money judgment is entered due to default on a loan against a debtor who is a party to a security agreement and the debtor fails to voluntarily comply with the judgment, the creditor can request the court seize the goods (embargo) of the debtor to satisfy the debt and incidental costs. A

<sup>170</sup> When the owner retakes possession of the goods in violation of the requirements of the HPA, the agreement shall terminate and the borrower and his guarantor shall be released from all liability and entitled to recover all monies paid to the owner. See, Section 15, Hire-Purchase Act, CAP 507, available at <http://www.kenyalaw.org:8181/exist/kenyalex/actview.xql?actid=CAP.%20507>.

<sup>171</sup> No. 46 of 2012, available at <http://www.kenyalaw.org:8181/exist/kenyalex/actview.xql?actid=No.%2046%20of%202012>

<sup>172</sup> *Nairobi Metropolitan PSV SACCOS Ltd & ors v. County of Nairobi Government & ors*, (2013) eKLR, para. 2, available at <http://kenyalaw.org/caselaw/cases/view/93353/>.

<sup>173</sup> For Argentina see Civil and Commercial Procedural Code of the Nation [Código Procesal Civil y Comercial de la Nación], art. 219, available at <http://www.infoleg.gov.ar/infolegInternet/anexos/15000-19999/16547/texact.htm> (last accessed Aug 25, 2015). For Colombia see Civil Procedure Code Decrees No. 1400 and 2019 [Código de Procedimiento Civil Decretos No. 1400 y 2019 de 1970], art. 684(11), (1970) (Col.) available at [http://www.cancilleria.gov.co/sites/default/files/tramites\\_servicios/apostilla\\_legalizacion/archivos/codigo\\_procedimiento\\_civil.pdf](http://www.cancilleria.gov.co/sites/default/files/tramites_servicios/apostilla_legalizacion/archivos/codigo_procedimiento_civil.pdf) (last accessed Aug 28, 2015). For Peru see Civil Procedure Code [Código de Procedimiento Civil], Decreto Legislativo 12760, art. 179 (1975) (Peru), available at [http://spij.minjus.gob.pe/graficos/legcomp/sudamerica/bolivia/codigo\\_de\\_procedimiento\\_civil.pdf](http://spij.minjus.gob.pe/graficos/legcomp/sudamerica/bolivia/codigo_de_procedimiento_civil.pdf) (last accessed Aug 28, 2015). For Guatemala see Civil and Commercial Procedural Code [Código Procesal Civil y Mercantil], art. 306 (6), Decreto-Ley No. 107 (1964) (Guatemala), available at <http://www.minfin.gob.gt/archivos/leyes/tesoreria/Decretos/DECRETO%20LEY%20107.pdf> (last accessed Aug 28, 2015). For Chile see Civil Procedure Code [Código de Procedimiento Civil], Ley 1552, art. 445(12) (1902) (Chile), available at <http://www.leychile.cl/Navegar?idNorma=22740&idParte=0> (last accessed Aug 28, 2015).

<sup>174</sup> Code of Commerce [Código de Comercio], art. 1063 (1989) (Mex.), available at [http://www.diputados.gob.mx/LeyesBiblio/pdf/3\\_261214.pdf](http://www.diputados.gob.mx/LeyesBiblio/pdf/3_261214.pdf) (last accessed Aug 24, 2015).

court officer will ask the debtor to select the goods that should be judicially seized.<sup>175</sup> If the debtor refuses to identify any goods, the creditor has the right to make such a selection.<sup>176</sup> The creditor's right to select and seize goods is limited by Article 434 of the FCCP.<sup>177</sup> Two of the limitations found in Article 434 are relevant to this report.

14. The first limitation is known as "estate exemption" or patrimony (*patrimonio de la familia*) and can be found in Article 434 (I) of the FCCP. Under this Article, the creditor cannot judicially seize goods that are considered part of the debtor's estate exemption, even if these assets are subject to a security interest. This type of exemption is different from the one found in other laws (e.g., in the United States) and effectively precludes the creation and enforcement of a security interest. The estate exemption must be created by the interested party before a judge or a notary public and must be registered at the Public Registry of Property (*Registro Público de la Propiedad*) in order to be effective against third parties.<sup>178</sup> The interested party must be the owner of the assets at the moment the estate exemption is created.<sup>179</sup> Arguably, this protection would not apply to those assets the debtor is to acquire with the financing provided by the secured creditor i.e., purchase money security interests are unaffected. With respect to already-owned assets, the prospective creditor must search the registry to determine whether the assets offered as collateral have been declared as exempt. Assets subject to an estate exemption are considered to be completely separate from those of the debtor.<sup>180</sup> Therefore, debts of the debtor cannot be repaid with the protected assets and a creditor's only defense against an estate exemption is fraud.<sup>181</sup> For example, according to Article 739 of the Civil Code of the Federal District (*Código Civil para el Distrito Federal*) (*Federal District Code*), an estate exemption cannot be created by a debtor to fraudulently avoid creditors' rights.<sup>182</sup>

15. According to Article 723 of the Federal District Code, the estate can include, *inter alia*, the family's house and a farm together with all the "tools" necessary for farming.<sup>183</sup> The estate must not exceed the estimated amount of USD\$135,000.<sup>184</sup> However, the Family Code of the State of Sonora (*Código de Familia para el Estado de Sonora*),<sup>185</sup> which is the law applicable to family matters in the State of Sonora, Mexico, is more generous when establishing the assets that can be subject to the estate exemption. Instead of using the word "tools" as the Federal District Code does, Article 535 of the Family Code of Sonora specifically provides that "machinery and equipment" necessary for farming can also be part of the estate exemption. Another substantial difference between the Federal District Code and the Family Code of Sonora is that the Code in Sonora does not limit the value of the machinery and equipment that can be subject to the estate exemption.<sup>186</sup>

<sup>175</sup> Federal Code of Civil Procedure [*Código Federal de Procedimientos Civiles*], art. 437 (1943) (Mex.), available at <http://www.diputados.gob.mx/LeyesBiblio/pdf/6.pdf> (last accessed Aug 24, 2015). [FCCP]

<sup>176</sup> *Id.*

<sup>177</sup> *Id.*, art. 434.

<sup>178</sup> Fernando Antonio Cárdenas González, *El Patrimonio de Familia su Constitución, Modificación y Extinción ante Notario*, p. 39 - 47, *Revista de Derecho Notarial Mexicano*, núm. 111, México (1998), available at <http://www.juridicas.unam.mx/publica/librev/rev/dernotmx/cont/111/pr/pr6.pdf> (last accessed Sept 9, 2015)

<sup>179</sup> *Id.*, p. 39.

<sup>180</sup> *Id.*, p. 49-50.

<sup>181</sup> *Id.*

<sup>182</sup> Civil Code of the Federal District [*Código Civil para el Distrito Federal*], art. 739 (1928) (Mex.), available at <http://docs.mexico.justia.com.s3.amazonaws.com/estatales/distrito-federal/codigo-civil-para-el-distrito-federal.pdf> (last accessed Aug 24, 2015). When an estate exemption is created to fraudulently avoid creditor rights, the creditor can exercise his/her right of avoidance of all fraudulent acts (*acción pauliana o revocatoria*). Fernando Antonio Cárdenas González, *El Patrimonio de Familia su Constitución, Modificación y Extinción ante Notario*, *Revista de Derecho Notarial Mexicano*, núm. 111, México (1998), available at <http://www.juridicas.unam.mx/publica/librev/rev/dernotmx/cont/111/pr/pr6.pdf> (last accessed Sept 9, 2015).

<sup>183</sup> *Id.*, art. 723.

<sup>184</sup> *Id.*

<sup>185</sup> Family Code of the State of Sonora [*Código de Familia para el Estado de Sonora*], art. 535 (Mex.), available at <http://compilacion.ordenjuridico.gob.mx/obtenerdoc.php?path=/Documentos/ESTADO/SONORA/o521739.doc> (last accessed Aug 24, 2015).

<sup>186</sup> *Id.*, art. 545.

16. The second limitation to the creditor's right to select and seize goods in Mexico is found in Article 434(IV) of the FCCP. According to Article 434(IV), "machinery, tools, and animals necessary for farming activities" cannot be judicially seized.<sup>187</sup> The determination of whether the particular equipment is deemed to be "necessary" for farming activities is routinely done by a court appointed expert.<sup>188</sup> Unlike the estate exemption, this limitation does not have to be registered in the Public Registry of Property in order to be effective against third parties.

### *Nigeria*

17. In general, Nigerian law does not provide express limitations on the enforcement of security interests in Nigeria. The Hire Purchase Act (HPA), enacted in 1968, under which equipment of any kind may be financed, is limited in the scope of its application to transactions of a relatively low value.<sup>189</sup> This monetary limitation does not apply to motor vehicles.<sup>190</sup> The definition of "motor vehicle" includes mechanically propelled vehicles intended for agricultural purposes.<sup>191</sup> Therefore hire purchase agreements for mobile farm equipment may be governed by the HPA, even when they exceed the minimum monetary threshold. The Act imposes strict restrictions on the enforcement rights of secured creditors/owners, by requiring that once three fifths of the value of the motor vehicle has been paid, the owner may not repossess the equipment extra-judicially.<sup>192</sup> However the HPA does permit the owner, when three or more instalments of the hire-purchase price are due and outstanding, to remove the motor vehicle to a premise under its control for the purpose of protecting it from damage or depreciation, pending the outcome of the action.<sup>193</sup> The HPA also prescribes that any provision in a hire purchase agreement that seeks to grant the owner or its agents the right to enter upon any premise to repossess the equipment, or absolve the owner of any liability for any such act, will be void.<sup>194</sup>

18. In May 2015, Nigeria enacted the Equipment Leasing Act (ELA) to cover finance and operating leases, cross-border leases, leveraged leases and other forms of equipment lease arrangements. It provides for the establishment of an equipment lease registry in which all equipment leases must be registered within 14 days of their execution.<sup>195</sup> The ELA limits the rights of the lessee to enter into a sub-lease or create a pledge over the leased equipment.<sup>196</sup> When the lessee defaults in payment of the rentals, the lessor must serve the lessee a default notice, giving the lessee 15 days within which to remedy the default.<sup>197</sup> If the lessee fails to do so, the lessor may terminate the lease agreement.<sup>198</sup> Upon termination, if the lessor seeks to repossess the equipment and the lessee refuses to give up possession after receiving due notice, the lessor may apply to the Federal High Court by way of an ex parte motion for repossession of the leased equipment.<sup>199</sup> Section 38 of the ELA requires that if the judge is satisfied with the information on oath that the lessee has defaulted on her/his obligations and the lessor has complied with the requirements of a default notice and termination notice,<sup>200</sup> then s/he may issue a warrant to repossess the equipment. The lessor is also entitled to the rents due and may claim damages.<sup>201</sup> The ELA does not seem to impose any undue limitations on the ability of the lessor to enforce its rights upon default of the lessee.

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<sup>187</sup> FCCP, *supra* note 175, art. 434 (IV).

<sup>188</sup> *Id.*

<sup>189</sup> Section 1 (a) HPA.

<sup>190</sup> *Id.*

<sup>191</sup> Section 20 (1) HPA

<sup>192</sup> Section 9 HPA

<sup>193</sup> Section 9 (5) HPA

<sup>194</sup> Section 3 (a) HPA

<sup>195</sup> Section 12 ELA

<sup>196</sup> Section 20 (1) ELA

<sup>197</sup> Section 36 ELA

<sup>198</sup> Section 37

<sup>199</sup> Section 38 (1) ELA

<sup>200</sup> Sections 36 and 37

<sup>201</sup> Section 38 (3) (4) ELA

### *The United States*

19. The U.S. secured transactions law embodied in the Uniform Commercial Code Article 9 does not provide any special protections to farmers against repossession of their farming machinery.<sup>202</sup> Like the Australian states and Canadian provinces, a few U.S. states have adopted legislation mandating mediation of farm debts. One such state is Minnesota that enacted the Farmer-Lender Mediation Act.<sup>203</sup> Utah also included certain provisions governing the mediation of farm debts in Title V of its Agricultural Credits Act.<sup>204</sup> Under Section 583.22, Minnesota's Farmer-Lender Mediation Act does not apply to certain types of agricultural property, such as assets leased to the debtor or farm machinery that is primarily used for custom fieldwork. Section 583.26 requires every creditor, before commencing an enforcement action, to serve a notice of mediation on the debtor, to which they will have 14 days to respond. If the debtor does not respond to the mediation notice, they forfeit the right to mediate with the secured creditor.

### *Summaries from Correspondents*

20. The following sections are summaries derived from the Correspondents' submissions.

#### *Hungary*

21. The Hungarian Judicial Enforcement Act provides for a closed list of 'farmer' definitions, whereby based on eligibility, the individuals shall be exempt from remedial enforcements in favour of potential creditors.

#### *Turkey*

22. The Turkish Code on Enforcement and Bankruptcy<sup>205</sup> provides for special legal protection for farmers and agricultural equipment against any potential remedial enforcement brought upon by creditors for their security interests. Debtor farmers and their agricultural equipment and livestock are protected, provided that such equipment is deemed essential for the sustenance of the farmer and his family.<sup>206</sup>

23. However, in case of certain crops of agricultural nature that are secured prior to their harvest by a creditor, which are subsequently sold or transferred by the farmer to a third party, the creditor shall not lose his entitlement.<sup>207</sup>

#### *Japan*

24. The Japanese Civil Enforcement Act provides for an exemption from seizure for 'indispensable equipment for agriculture' subject to certain conditions. This includes assessment of whether the equipment in question can be substituted by alternative options, the scale and mode of debtor's farming as well as the conditions for ordinary farming in the region. Farmers are protected against mere seizure, however, transfer of such equipment is not prohibited. Therefore, the security interests which do not require actual seizure, namely 'security by way of assignment', are legally effective and enforceable against the agricultural equipment.

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<sup>202</sup> For instance, in *Deere & Co. v. New Holland Rochester*, Deere sought and obtained a pre-judgment replevin order of farming machinery that it had initially financed – a USD \$265,000 loan to acquire a harvester that the debtor subsequently traded in to Holland. *Deere & Co. v. New Holland Rochester, Inc.*, 2010 Ind. App. LEXIS 1899 (Ind. Ct. App. 2010).

<sup>203</sup> See <https://www.revisor.mn.gov/statutes/?id=583>.

<sup>204</sup> See <https://www.govtrack.us/congress/bills/100/hr3030/text>.

<sup>205</sup> Turkish Code on Enforcement and Bankruptcy No 2004, 9 June 1932.

<sup>206</sup> Ibid, Article 82/No 4.

<sup>207</sup> Ibid, Article 84.



25. Additional responses from correspondents in Colombia, Spain, Greece and Uruguay confirmed that there is no special treatment and legal privilege for farmers and agricultural equipment in these jurisdictions.

#### *Conclusion*

26. Whilst varying formulations are used, it is clear that the restrictions on the enforcement of security interests against agricultural machinery is designed to protect small, family farming operations:

- The Hungarian legislation adopts the approach of defining a limited category of farmers who are exempt from enforcement proceedings.
- Turkish debtor farmers are protected if their equipment is deemed essential for the sustenance of the farmer and his family.
- Japan has a discretionary mechanism that takes into account the size of the farming enterprise and farming conditions in the region.
- Mexico prevents judicial and extra-judicial enforcement against machinery necessary for farming activities.
- Certain states in Australia, Canada and the United States mandate mediation and delay enforcement actions for farmers, rather than outright preventing enforcement of security interests against farming equipment.

27. Kenyan protections are not specific to agricultural equipment and instead provide protections for lower value security interests that have been substantially repaid. Similarly, the majority of Latin American states (Argentina, Colombia Chile Guatemala and Peru) contain general protections for the extra-judicial seizure of assets which are necessary to perform an economic activity or protect the debtor's family.

28. As summarised above, the research indicates that at least seven jurisdictions have special legal regimes protecting farmers which delay, prevent or restrict the enforcement of security interests against farming equipment. While this is a low number of states, most are economically significant states from diverse regions of the world with divergent legal systems. It is also likely there are further jurisdictions with similar laws.

29. It is clear that the various legislative regimes are designed to protect small family farming enterprises only, which are unlikely to be using the high-value agricultural equipment to be covered by the MAC Protocol. However, it is foreseeable that a family farming enterprise could purchase a piece of internationally registerable equipment under the MAC Protocol, and then attempt to protect themselves from the strong enforcement mechanisms under the Convention the applicable domestic law protection.

30. There were two options that were presented to the Study Group. The first was to not address the issue in the Protocol, and simply require Contracting States that have such domestic protections to reform their domestic law to exempt agricultural equipment registerable under the MAC Protocol from the application of the enforcement restrictions. This was the options favoured at the third Study Group meeting.

31. The second option would be to provisionally include an article in the draft Protocol allowing States to limit the application of the Protocol (or possibly just the default and insolvency remedies) in relation to family farming enterprises, where such enterprises are protected by existing domestic legislation. This could possibly be an opt-in declaration, requiring States to declare exactly what family farming enterprises would be protected.

## Appendix VII – Research on Registration and Titling of MAC Equipment in Domestic Registries

1. This section was prepared by the National Law Centre for Inter-American Free Trade on request from the UNIDROIT Secretariat and presented at the third Study Group meeting in October 2015, following discussions at the first and second Study Group meeting.
2. This section examines whether certain items of MAC equipment are subject to laws that require the issuance of certificates of titles, similarly to those covering vehicles. Overall, the application of these laws to motor vehicles also cover certain items of MAC equipment, particularly tractors, that fall under the definition of “motor vehicle” as it is included in these laws.
3. These laws may require that security interest be noted on the certificates as a condition of their effectiveness against third parties. This form of achieving third-party effectiveness will be superseded by registration in the future International Registry.
4. The application of these laws may also have relevance to the ability of the secured creditor to enforce its rights efficiently and expeditiously. For instance, on default of the debtor, the assistance of relevant authorities may be necessary to procure de-registration of an ownership relating to the MAC equipment. Accordingly, consideration might be given to including an article, along the lines of Article XIII of the Aircraft Protocol, empowering the authorised party to procure the de-registration of the item and its export.
5. This section surveys a selection of relevant laws to enable the Study Group to more informatively determine whether a remedy of this kind would be appropriate for the MAC Protocol.

### *Argentina*

6. In Argentina, motor vehicles (automotores) are governed primarily by Decree No. 1.1144/97.<sup>208</sup> According to Article 1 of the Decree, the acquisition of ownership over motor vehicles is only effective between the parties to the transaction and against third parties when such a transfer is registered in the National Registry of Motor Vehicle Ownership (Registro Nacional de la Propiedad del Automotor) (National Registry).<sup>209</sup> Judicial liens and security interests over motor vehicles must also be registered in the National Registry.<sup>210</sup> According to Article 5 of the Decree, the definition of the term “motor vehicle” includes “agricultural machinery including tractors and combines, cranes, road construction machinery, and all self-propelled machinery.”<sup>211</sup> Once a motor vehicle is registered in Argentina, the National Registry must issue a motor vehicle title (Título de Automotor) to its owner that, among other information, indicates the chassis and/or engine number.<sup>212</sup>

### *Australia*

7. Each Australian state and territory established its own set of rules for the registration of motor vehicles. For instance, in the state of Victoria the Road Safety Act of 1986 (Road Act)<sup>213</sup> and its regulations

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<sup>208</sup> Decree No. 1.114/97 – Legal Framework of Motor Vehicles [Decreto No. 1.114/97 - Régimen Jurídico del Automotor], available at [http://www.dnrpa.gov.ar/portal\\_dnrpa/regimen\\_juridico/informacion/rja.pdf](http://www.dnrpa.gov.ar/portal_dnrpa/regimen_juridico/informacion/rja.pdf) (last accessed Aug 24, 2015).

<sup>209</sup> *Id.*, art. 1.

<sup>210</sup> *Id.*, art. 17. See also Digest of Technical Registration Rules [Digesto de Normas Técnico Registrales], Título I, art. 13 (2014), available at [http://www.dnrpa.gov.ar/portal\\_dnrpa/regimen\\_juridico/informacion/Titulo1.pdf](http://www.dnrpa.gov.ar/portal_dnrpa/regimen_juridico/informacion/Titulo1.pdf) (last accessed Aug 24, 2015). Under art. 17, judicial liens are effective for a period of three years after registration.

<sup>211</sup> *Id.*, art. 5.

<sup>212</sup> *Id.*, art. 20(c).

<sup>213</sup> *Road Safety Act, 1986* (Vic.) (Australia), available at

(Road Act Regulations) are applicable to the registration of vehicles.<sup>214</sup> A vehicle is defined by the Road Act as "a conveyance that is designed to be propelled or drawn by any means, whether or not capable of being so propelled or drawn, and includes bicycle or other pedal-powered vehicle, trailer, tram-car and air-cushion vehicle but does not include railway locomotive or railway rolling stock."<sup>215</sup> The Road Act defines the term tractor as "a motor vehicle that is designed for use in primary production, horticulture or other similar pursuits and is constructed: i) with an implement or implements; ii) to tow an implement or implements; or iii) to have an implement or implements attached to it."<sup>216</sup> The Road Act Regulations make reference to other potential MAC equipment, defining a special purpose vehicle as "a light vehicle" to include "a forklift, a straddle carrier, a mobile cherry picker, and a mobile crane."<sup>217</sup>

8. In order to register a new tractor in Victoria, its owner must submit "the machinery pack which is essentially a vehicle registration form."<sup>218</sup> The registration form requires the owner to provide a description of the tractor that includes identification elements such as chassis number, engine number, make, model, colour, fuel type, year and manufacturer.<sup>219</sup> Once all the requirements established in the machinery pack have been complied with and all forms have been submitted to the registrar, a certificate of registration and number plate will be issued to the owner of the tractor.<sup>220</sup> The certificate of registration can be used as evidence of ownership of the tractor together with a bill of sale.<sup>221</sup>

9. The 2009 Personal Property Securities Act (PPSA) regulates the attachment, perfection and other aspects of security interests in personal property, including vehicles. The PPSA requires that certain goods may be described by a serial number in a financing statement and provides for different legal effect depending on whether the registrant actually entered the serial number. Section 2(2) of the PPSA Regulations identifies the types of assets that may be described by a serial number, including "motor vehicle" which is defined in Section 1(7) to include any vehicle that is built to be propelled, wholly on land, by a motor that forms part of the property other than that which runs on rails, tram lines or other fixed path satisfying certain technical requirements, such as minimal speed of 10 km/h and power of at least 200 W. Arguably, a significant majority of MAC equipment would fall under this definition of "motor vehicle," to which special rules set forth in the PPSA apply.

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[http://www.legislation.vic.gov.au/domino/Web\\_Notes/LDMS/LTObject\\_Store/ltobjst9.nsf/DDE300B846EED9C7CA257616000A3571/12CF032966668433CA257EC90017DD83/\\$FILE/86-127aa167%20authorised.pdf](http://www.legislation.vic.gov.au/domino/Web_Notes/LDMS/LTObject_Store/ltobjst9.nsf/DDE300B846EED9C7CA257616000A3571/12CF032966668433CA257EC90017DD83/$FILE/86-127aa167%20authorised.pdf) (last accessed Sept. 23, 2015).

<sup>214</sup> *Road Safety (Vehicles) Regulations, 2009 (Vic.) (Australia)*, available at

[http://www.legislation.vic.gov.au/domino/Web\\_Notes/LDMS/LTObject\\_Store/ltobjst9.nsf/DDE300B846EED9C7CA257616000A3571/F66C78CAAE69CB61CA257E70001CBBA0/\\$FILE/09-118sra021%20authorised.pdf](http://www.legislation.vic.gov.au/domino/Web_Notes/LDMS/LTObject_Store/ltobjst9.nsf/DDE300B846EED9C7CA257616000A3571/F66C78CAAE69CB61CA257E70001CBBA0/$FILE/09-118sra021%20authorised.pdf) (last accessed Sept. 23, 2015).

<sup>215</sup> *Road Safety Act*, *supra* note 213, §3 Definitions. Furthermore, a motor vehicle is defined as "a vehicle that is used or intended to be used on a highway and that is built to be propelled by a motor that forms part of the vehicle but does not include (a) a vehicle intended to be used on a railway or tramway; or (b) a motorized wheel-chair capable of a speed of not more than 10 kilometers per hour which is used solely for the conveyance of an injured or disabled person...".

<sup>216</sup> *Order in Council, Declaration of a Class of Motor Vehicles to be Tractors (May 2014)*, available at [http://www.parliament.vic.gov.au/file\\_uploads/s16B\\_-\\_Road\\_Safety\\_Act\\_1986\\_9nhqJCM2.pdf](http://www.parliament.vic.gov.au/file_uploads/s16B_-_Road_Safety_Act_1986_9nhqJCM2.pdf) (last accessed Sept. 23, 2015). The Road Act further clarifies that a motor vehicle is not a tractor "if it is primarily designed to carry goods or passengers."

<sup>217</sup> *Road Safety (Vehicles) Regulations*, *supra* note 214, §5 Definitions.

<sup>218</sup> Telephone interview with VicRoads Contact Center, on file with the NLCIFT. See also *Machinery Pack*, available at <https://www.vicroads.vic.gov.au/searchresultpage?q=machinery%20pack> (last accessed Sept. 23, 2015).

<sup>219</sup> Vehicle Registration form, available at <https://www.vicroads.vic.gov.au/searchresultpage?q=vehicle%20registration%20form> (last accessed Sept. 23, 2015).

<sup>220</sup> Telephone interview, *supra* note 218.

<sup>221</sup> *Id.*, see also *Application for Transfer of Registration*, available at

<https://www.vicroads.vic.gov.au/searchresultpage?q=application%20for%20transfer%20of%20registration> (last accessed Sept. 23, 2015).

### Canada

10. A motor vehicle in Canada must be registered with the transportation office that must issue and deliver a registration certificate to the owner together with a registration plate. The registration certificate is the document used to transfer ownership over the motor vehicle. Unlike in the United States, where the transportation offices are involved in the notation of liens over motor vehicles, security interests over motor vehicles in Canada may be perfected by registration in the provincial personal property registries. The following paragraphs examine in detail the relevant sections of the Motor Vehicle Act (MVA)<sup>222</sup> and its regulations (MVA Regulations).<sup>223</sup>

11. The MVA distinguishes motor vehicles from farm tractors and special mobile equipment. MVA §1 defines "motor vehicle" as "every vehicle that is self-propelled and every vehicle that is propelled by electric power obtained from overhead trolley wires, and not operated upon rails, but does not include a farm tractor."<sup>224</sup> MVA §1 defines the term "farm tractor" as a vehicle "designed and used primarily as a farm implement for drawing plows, mowing machines and other implements of husbandry but does not include such a vehicle that is operated for remuneration other than in the agricultural operations of the owner thereof and that is incidentally operated on a highway."<sup>225</sup> MVA §1 defines "special mobile equipment" as "every vehicle not designed or used primarily for the transportation of persons or property and incidentally operated or moved over the highways, including road construction or maintenance machinery, ditch digging apparatus, well-boring apparatus, concrete mixers and any other vehicle of the same general class."<sup>226</sup> Other vehicles of the same general class (special mobile equipment) include equipment "used solely for the purpose of transporting and developing power for well drilling machinery, wood cutting, threshing or for like purposes, and to which some part of the equipment is permanently attached."<sup>227</sup> MVA §21 (1) provides that motor vehicles and special mobile equipment must be registered under the MVA, thus excluding farm tractors from the registration requirement.<sup>228</sup> However, MVA Regulations §9 establishes an annual registration fee for "crawler or caterpillar type of tractor or a farm tractor used for commercial purposes other than farming."<sup>229</sup>

12. New Brunswick's Personal Property Security Act Regulations (PPSA Regulations)<sup>230</sup> define "motor vehicle" as "a mobile device that is propelled primarily by any power other than muscle power in, on or by which a person or thing may be transported or drawn, and that is designed for use on a road or natural terrain, or that is being used in the construction or maintenance of roads, and includes a pedal bicycle with a motor attached, a combine or a tractor, but does not include a device that runs on rails or machinery designed only for use in farming, other than a combine or a tractor." Thus, combines and tractors are considered motor vehicles for PPSA Regulations purposes. Under the PPSA Regulations, serial numbered goods must be described by their respective serial number in the financing statement. The registrant must enter the last twenty-five characters of the serial number or all the characters if the serial number contains less than twenty-five characters in the financing statement.<sup>231</sup> The registrant must also indicate the type of serial numbered goods to which the registration relates.<sup>232</sup> According to the PPSA Regulations, the serial number for combines and tractors is the number marked on, or attached to, the chassis by the

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<sup>222</sup> Motor Vehicle Act, R.S.N.B. 1973, c. M-17, available at <http://laws.qnb.ca/en/ShowTdm/cs/M-17/> (last accessed Aug 24, 2015). [MVA].

<sup>223</sup> New Brunswick Regulation 83-42 under the Motor Vehicle Act (O.C. 83-170), available at <http://laws.qnb.ca/en/showpdf/cr/83-42.pdf> (last accessed Aug 24, 2015). [MVA Regulation].

<sup>224</sup> MVA, *supra* note 222, §1.

<sup>225</sup> *Id.*

<sup>226</sup> *Id.*

<sup>227</sup> MVA Regulations, *supra* note 223, §7(6).

<sup>228</sup> MVA, *supra* note 13, § 21(1).

<sup>229</sup> MCA Regulations, *supra* note 223, §9.

<sup>230</sup> New Brunswick Regulation 95-57 under the Personal Property Security Act (O.C. 95-378), available at <http://laws.qnb.ca/en/ShowPdf/cr/95-57.pdf> (last accessed Aug 24, 2015).

<sup>231</sup> *Id.*, §25(1)(a).

<sup>232</sup> *Id.*, §25(1)(c).

manufacturer.<sup>233</sup> On the other hand, for motor vehicles other than combines and tractors, the serial number is the vehicle identification number marked on, or attached to, the body frame by the manufacturer.<sup>234</sup>

### Mexico

13. Registration of vehicles in Mexico is mainly governed by the Law of the Public Registry of Vehicles (Ley del Registro Público Vehicular) (Registry Law)<sup>235</sup> and its regulations (Vehicle Registry Regulations).<sup>236</sup> The registration of a vehicle in the Public Registry creates a legal presumption that the vehicle exists, that the person who appears registered as the owner is in fact the owner, and that any notations in it are legally valid.<sup>237</sup> According to Article 2(X) of the Registry Law, the term “vehicle” is defined as “motor vehicle, trailer and semitrailer.” The definition of vehicle explicitly excludes “trains, military vehicles and those [vehicles] that by their nature have an industrial or agricultural use.”<sup>238</sup> Mobile and stationary mining, agriculture and construction equipment is not subject to registration in Mexico. The Mexican secured transactions legal framework, including the Code of Commerce and the regulations governing the secured transactions registry (Registro Único de Garantías or RUG) do not define the term motor vehicle (vehículo de motor), machinery or equipment.<sup>239</sup> As opposed to Canada, the Mexican legal framework does not specify whether serial numbered equipment must be described in the financing statement by its serial number or what the legal effect of such a description or non-description is.<sup>240</sup>

### Nigeria

14. In Nigeria, rights to some MAC equipment may be registered under the same process that applies to motor vehicles with the Federal Road Safety Commission (FRSC) office, and the relevant state motor vehicle registration office.<sup>241</sup> However, state agencies also have responsibility for vehicle registration. Many state laws classify tractors and bulldozers as “commercial vehicles,” thus requiring their registration.<sup>242</sup> A commercial vehicle is defined to also include “a hackney carriage, a stage carriage, a tractor, and any motor vehicle primarily designed for the carriage of goods or passengers, excluding any such vehicle used exclusively for carrying the personal effects of the owner.”<sup>243</sup> There is no special administrative law or body for the regulation of heavy mobile equipment. The FRSC prescribes certain regulations for the operation and safety of such heavy mobile equipment as a component of its road traffic and management responsibilities.

15. In Nigeria, vehicles may be financed under a variety of laws and common law security devices, including the Bills of Sale Act, the Companies and Allied Matters Act and the Hire-Purchase Act. In 20015, Nigeria adopted the “Equipment Leasing Act” as well as the “Regulations for Registration of Security

<sup>233</sup> *Id.*, §25(2)(b).

<sup>234</sup> *Id.*, §25(2)(a).

<sup>235</sup> Law of the Public Registry of Vehicles [Ley del Registro Público Vehicular] (2004), available at <http://www.diputados.gob.mx/LeyesBiblio/pdf/269.pdf> (last accessed Aug 24, 2015). [Registry Law]

<sup>236</sup> Regulations of the Law of the Public Registry of Vehicles [Reglamento de la Ley del Registro Público Vehicular] (2007), available at [http://www.repuve.gob.mx/docs/Reg\\_LRPV.pdf](http://www.repuve.gob.mx/docs/Reg_LRPV.pdf) (last accessed Aug 24, 2015).

<sup>237</sup> Registry Law, *supra* note 208, art. 12.

<sup>238</sup> Registry Law, *supra* note 235, art. 2(X).

<sup>239</sup> Code of Commerce [Código de Comercio] as amended on June 13, 2014 (1889) (Mex.), available at [http://www.diputados.gob.mx/LeyesBiblio/pdf/3\\_261214.pdf](http://www.diputados.gob.mx/LeyesBiblio/pdf/3_261214.pdf) (last accessed Aug 27, 2015). See also RUG Regulations [Reglamento del Registro Público de Comercio], as amended on Nov 16, 2012, available at [http://www.rug.gob.mx/Rug/resources/pdf/legislacion/Reglamento\\_RPP\\_16112012.pdf](http://www.rug.gob.mx/Rug/resources/pdf/legislacion/Reglamento_RPP_16112012.pdf) (last accessed Aug 27, 2015).

<sup>240</sup> Registro Único de Garantías Mobiliarias, *Guía del Usuario para el sitio rug.gob.mx*, p. 5, available at <http://www.rug.gob.mx/Rug/resources/pdf/guia%20de%20usuario/Manual%20de%20Usuario%20RUG.pdf> (last accessed Aug 24, 2015).

<sup>241</sup> FRSC rules require the registration of every operator and owner of articulated vehicles, as well as mandatory insurance and other legal process documents. They must also be incorporated. See Registration Requirements, FRSC Safety Requirements/ Guidelines for Articulated Lorries (Tankers/Trailers) Operations in Nigeria, available at <http://frsc.gov.ng/rtcenglish.pdf>, (last accessed Aug 28, 2015).

<sup>242</sup> See, Section 41, Lagos State Road Traffic Law, 2012.

<sup>243</sup> *Id.*

Interests in Movable Property by Banks and Other Financial Institutions in Nigeria," neither of which has taken effect as of October 2015.

### Spain

16. The registration of motor vehicles (vehículos de motor) in Spain is mainly governed by the General Regulations for Vehicles (Reglamento General de Vehículos) (Vehicle Regulations).<sup>244</sup> Article 2 of the Vehicle Regulations provides for the establishment of a registry for vehicles (Registro de Vehículos) (Car Registry). Unlike other registries in Spain, such as the Personal Property Mortgage and Non-Possessory Pledge Registry (Registro de Hipoteca Mobiliaria y de Prenda sin Desplazamiento de la Posesión) and the Registry for Conditional Sales (Registro de Reserva de Dominio y Prohibición de Disponer), the Car Registry has purely administrative functions, meaning that recordings do not "create, modify or extinguish rights, security interests and other encumbrances."<sup>245</sup>

17. The Vehicles Regulations distinguish between the rules (i) applicable to motor vehicles, and (ii) applicable to specialised agricultural vehicles (vehículo especial agrícola).<sup>246</sup> Specialised agricultural equipment encompasses different types of agricultural equipment such as agricultural tractors (tractor agrícola), rototiller (motocultor), agricultural truck (tractocarro), agricultural automotive machinery (maquinaria agrícola automotriz), carrier (portador), and agricultural machinery that is hauled (maquina agrícola remolcada). The Vehicle Regulations define "specialised vehicle" to include a "self-propelled or towed vehicle conceived or constructed to perform a determined type of work or service and that, because of its characteristics, is exempted from complying with technical requirements established by [the Vehicle Regulations] or exceeds the established limits [set forth in the Vehicle Regulations] for weigh and dimension, such as agriculture machinery and its implements (remolques)."<sup>247</sup>

18. Agricultural tractor is defined as "self-propelled specialised vehicle, with two or more axels, designed and manufactured to haul, push, or drag agricultural machinery."<sup>248</sup> According to Article 28 of the Vehicle Regulations, specialised agricultural vehicles must be registered in the Official Registry of Agricultural Machinery (Registro Oficial de Maquinaria Agrícola) (ROMA). The ROMA is governed by Royal Decree 1013/2009 (ROMA Regulations).<sup>249</sup> ROMA Regulations exclude from its scope "construction and service machinery as well as machinery and equipment used in the agri-food industry."<sup>250</sup> Registrations of agricultural machinery at ROMA are immediately and automatically transmitted to the Car Registry.

19. According to the Law of Movable Mortgage and Non-possessory Pledge,<sup>251</sup> vehicles subject to registration in an administrative registry and other motor vehicles may be encumbered by a movable mortgage.<sup>252</sup> This law establishes that a movable mortgage must be created in a public deed by a notary

<sup>244</sup> Royal Decree 2822/1998 [Real Decreto 2822/1998], as amended on July 18, 2015, BOE-A-1999-1826 (Spain), available at <https://www.boe.es/buscar/pdf/1999/BOE-A-1999-1826-consolidado.pdf> (last accessed Aug 27, 2015).

<sup>245</sup> *Id.*, at p. 2.

<sup>246</sup> *Id.*, at Annex II.

<sup>247</sup> *Id.*

<sup>248</sup> *Id.*

<sup>249</sup> Royal Decree 1013/2009 of June 19, about the characterization and registry of agricultural machinery [Real Decreto 1013/2009, de 19 de junio, sobre caracterización y registro de la maquinaria agrícola], BOE-A-2009-11678, available at [https://www.boe.es/diario\\_boe/txt.php?id=BOE-A-2009-11678](https://www.boe.es/diario_boe/txt.php?id=BOE-A-2009-11678) (last accessed Aug 28, 2015). The ROMA Regulations, under art 2, apply to agricultural tractors, rototiller, agricultural truck, agricultural automotive machinery, carrier, and agricultural machinery that is hauled as they are defined in the Vehicle Regulations.

<sup>250</sup> The ROMA Regulations also apply to "hanging machinery that is attachable to an agricultural tractor," forestry tractors, automotive machinery of any type, rated power, and weight, hauled machinery exceeding 750 kg of weight, machinery for distributing fertilizers, among other.

<sup>251</sup> Ley de 16 de diciembre de 1954, sobre Hipoteca Mobiliaria y Prenda sin Transmisión de la Posesión available at [http://noticias.juridicas.com/base\\_datos/Privado/lhmpsd.html](http://noticias.juridicas.com/base_datos/Privado/lhmpsd.html) (last accessed Aug 28, 2015).

<sup>252</sup> *Id.* Article 12 and 34.

public and that the encumbered vehicle must be insured for at least the same amount as the secured amount of the mortgage.<sup>253</sup>

#### *United States*

20. U.S. laws require motor vehicles to be registered with the respective State Departments of Motor Vehicles.<sup>254</sup> In addition, a motor vehicle may have to have a certificate of title, which is used to transfer rights in the vehicle, including by notation of a lien on the certificate itself.

21. The Uniform Certificate of Title Act, a model law adopted by the Uniform Law Commission in 2005, but not yet enacted by any State, applies to vehicles which are defined in Section 2(34A) to exclude "specialised mobile equipment that is not designed primarily for transportation of individuals or property on a road or highway." A comment to this Section explains that specialised mobile equipment includes "off-road motorized vehicles whose use of the roadway is only incidental to their off-road purpose including: motorized vehicles designed exclusively for off-road use; ditch digging apparatus; well-boring apparatus; construction equipment; road construction and maintenance machinery such as asphalt spreaders, bituminous mixers, bucket loaders, tractors other than truck tractors, ditchers, levelling graders, finishing machines, motor graders, road rollers, scarifiers, earth-moving carry-alls and scrapers, power shovels, and drag lines; self-propelled cranes; and earth-moving equipment. Specialised mobile equipment does not include a house trailer (which is not vehicle), or dump trucks, truck-mounted transit mixers, truck-mounted cranes and shovels, or other mobile equipment mounted on vehicles designed for transport of individuals or property on a roadway." Accordingly, some MAC equipment types would fall under the definition of specialised mobile equipment for which a certificate of title is not issued while other would qualify as ordinary motor vehicles.

#### *Arizona*

22. Arizona Revised Statutes (ARS) Section 28-1171(6) defines off-highway vehicle as "a motorised vehicle when operated primarily off of highways on land, water, snow, ice or other natural terrain or on a combination of land, water, snow, ice or other natural terrain." This definition differs from that of specialised mobile equipment set forth in the Uniform Certificate of Title Act. Given its broad breadth, several items of MAC equipment could require the issuance of a certificate of title. Under Section 28-2061 of ARS, "on the retail sale of a new off-highway vehicle as defined in Section 28-1171, the dealer or person first receiving the vehicle from the manufacturer shall apply, on behalf of the purchaser, to the department for a certificate of title to the motor vehicle in the name of the purchaser." On the transfer of ownership of an off-highway vehicle, a person shall apply for and obtain a new certificate.

23. Chapter 7 of Title 28 of the Arizona Revised Statutes (ARS) deals with certificates of title and registration. ARS 28-2001(2) defines a "serial number" as "the number placed on the vehicle by its manufacturer or assigned pursuant to Section 28-2165." Under that Section, if a serial number is altered, removed, obliterated, defaced, omitted or otherwise missing, the director may assign a special serial number. Under sub-section D, "the director shall furnish to the applicant a serial plate together with the authorisation of use that shall be immediately delivered to a department inspector or agent who shall permanently attach the serial plate to the item in a conspicuous position and certify the attachment on the authorisation of use."

#### *California*

24. The California Vehicle Code (CVC) refers to specialised equipment which it further sub-divides into types based on their use in specific industries. Certain specialised vehicles, including special construction, cemetery, special mobile equipment, logging vehicles, implements of husbandry, and cotton or farm trailers

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<sup>253</sup> *Id.* Article 36.

<sup>254</sup> Such registrations must be renewed periodically (annually), and it essentially acts as a tax collecting device of the State.

are generally exempt from regular registration. The owner of a qualifying vehicle is issued a specialised equipment (SE) plate and an identification card. As a requirement, a certificate of title is not issued for vehicles with the SE designation. However, the owner may voluntarily apply for a California certificate of title. SE registration is required for:

- special construction, special mobile, and cemetery equipment, and logging vehicles;<sup>255</sup> and
- cotton and farm trailers, water tanks, oversize feed and seed motor vehicles, automatic bale wagons, and cotton module movers.<sup>256</sup>

25. One type of SE is special mobile equipment which is: i) not self-propelled, ii) not designed or used primarily for transporting persons or property, and iii) only incidentally operated on the highways. Some examples of special mobile equipment include generators, log splitters, tar pots, chippers, cement mixers, and welders. Several items of MAC equipment may fall under this category of special mobile equipment.

26. California legislation defines special construction vehicle as "a vehicle used more than 51 percent of the time for highway construction that occasionally moves over the highways, and is oversize or overweight."<sup>257</sup> Such vehicles may also require special permits from the Department of Transportation or local authorities because of their size. Special construction equipment includes any vehicle used primarily for highway grading, paving, earth moving, or other highway or railroad right-of-way work.<sup>258</sup> Several items from the MAC List may fall under this category of special mobile equipment.

#### Colorado

27. Colorado laws define special mobile machinery as "machinery that is pulled, hauled, or driven over a highway and is either: (i) a vehicle or equipment that is not designed primarily for the transportation of persons or cargo over the public highways; or (ii) a motor vehicle that may have been originally designed for the transportation of persons or cargo over the public highways, and has been redesigned or modified by the addition of mounted equipment or machinery, and is only incidentally operated or moved over the public highways."<sup>259</sup> Special mobile machinery includes vehicles commonly used in the construction, maintenance, and repair of roadways, the drilling of wells, and the digging of ditches.<sup>260</sup> Vehicles that have been redesigned or modified with the attachment of special equipment or machinery weighing over 500 pounds in a manner that they became essential to the operation of the vehicle in accomplishing the purpose for which such vehicle is being used are also classified as special mobile machinery.<sup>261</sup> Most types of this category of equipment are used in the construction industry. All special mobile equipment must be registered in Colorado within 60 days of purchase.<sup>262</sup> Colorado also issues certificates of title for this type of equipment.

<sup>255</sup> California Vehicle Code, §5011.

<sup>256</sup> Id., at §36101.

<sup>257</sup> See *V C Section 565 Special Construction Equipment, available at [https://www.dmv.ca.gov/portal/dmv/?1dmv&urile=wcm:path:/dmv\\_content\\_en/dmv/pubs/vctop/vc/d1/565](https://www.dmv.ca.gov/portal/dmv/?1dmv&urile=wcm:path:/dmv_content_en/dmv/pubs/vctop/vc/d1/565)*, (last accessed Aug 28, 2015).

<sup>258</sup> CVC §565. These vehicles are not designed for transporting persons or property and are only occasionally operated or moved over the highways.

<sup>259</sup> Colorado laws also define mounted equipment which is "any item weighing more than five hundred pounds that is permanently mounted on a vehicle, including mounting by means such as welding or bolting the equipment to a vehicle." [C.R.S. 42-1-102\(60\)](#).

<sup>260</sup> [C.R.S. 42-1-102\(93.5\)](#).

<sup>261</sup> See City of Colorado Springs Tax Guide, Special Mobile Machinery and Equipment, *available at <https://www.springsgov.com/units/salestax/Tax%20Guides/Ag-special%20equip.pdf>* (last accessed Aug 28, 2015).

<sup>262</sup> (42-3-103(1)(a) C.R.S.).



*Florida*

28. Chapter 316 of the Florida Statutes defines "special mobile equipment" as "any vehicle not designed or used primarily for the transportation of persons or property and only incidentally operated or moved over a highway, including, but not limited to, ditch-digging apparatus, well-boring apparatus, and road construction and maintenance machinery, such as asphalt spreaders, bituminous mixers, bucket loaders, tractors other than truck tractors, ditchers, leveling graders, finishing machines, motor graders, road rollers, scarifiers, earth-moving carryalls and scrapers, power shovels and draglines, and self-propelled cranes and earth-moving equipment." Several Florida court cases construed this definition to distinguish between items that fall under the definition of motor vehicle and those that do not. In *M.J.S. v. State*, 453 So.2d 870 (Fla. 2d DCA 1984), the court decided that a construction backhoe is not a motor vehicle, as defined by Florida law. Similarly, the Florida Attorney General issued an opinion that "earth moving vehicle mounted on pneumatic tires and used solely for off-highway work is not a motor vehicle."<sup>263</sup> In another case, a Florida court held that "we believe the legislature intended to distinguish machinery that requires the use of public highways to transport itself from motor vehicles, which are used primarily to transport persons or property."<sup>264</sup> Accordingly, in Florida, most types of MAC equipment would not be subject to the statute that applies to ordinary motor vehicles, including their registration and titling.

*North Carolina*

29. In North Carolina, only commercial vehicles and trailers that are intended to be operated on any state highway are required to be registered with the North Carolina Division of Motor Vehicles.<sup>265</sup> Since most types of MAC equipment are not designed and intended to be operated on highways, they would be exempt from registration. Furthermore, N.C.G.S. 20-51 provides for specific exemptions from the registration, including:

- Farm tractors and trailers when used to transport farm implements, supplies, or products from farm to market or farm to farm;
- Farm tractors and trailers on any trip within ten miles from point of loading, not to exceed 35 miles per hour;
- Farm trailers attached to licensed motor vehicles used to transport most agricultural commodities, livestock, supplies or equipment from farm to market or farm to farm.

30. However, for-hire farm tractors and trailers are not exempt from registration.

*Texas*

31. In Texas, the Department of Motor Vehicles, under Section 501.032 of the Transportation Code, has the power to assign a vehicle identification number to an item of equipment, including a tractor, farm implement, unit of special mobile equipment, or unit of off-road construction equipment:

- on which a vehicle identification number was not die-stamped by the manufacturer;
- on which a vehicle identification number die-stamped by the manufacturer has been lost, removed, or obliterated; or
- for which a vehicle identification number was never assigned.

32. Accordingly, an item of MAC equipment that does not have a serial number may be assigned one by the governmental authority.

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<sup>263</sup> Op.Att'y Gen. Fla. 055-113 (1955).

<sup>264</sup> *Crane Rental of Orlando Inc. v. Ford S. Hausman*, 518 So. 2d 395 (1987).

<sup>265</sup> (N.C.G.S. 20-50). See also <http://www.haulingag.org/pdf/haulingAgManual.pdf#page=6&zoom=auto,-312,551> (last accessed September 25, 2015).

33. Following the presentation of this report at the third Study Group meeting, the Study Group affirmed that the MAC Protocol should continue to include Article VII(5) of the draft Protocol (modification of default remedy provisions) as based upon Article VII(5) of the Luxembourg Rail Protocol, and there was no need for a provision modelled on the de-registration and export request authorisation provision in Article XIII of the Aircraft Protocol.

**Appendix VIII – Research on the effect of registration of notices of sale under domestic law**

1. This paper was drafted by the National Law Centre for Inter-American Free Trade for consideration at the fourth Study Group meeting in February 2016.

*Notices of Sale under the MAC Protocol*

2. Article XVII of the Luxembourg Rail Protocol provides for the registration of notices of sale with respect to railway rolling stock. However, only the provisions relating to the mechanics of registration included in the Cape Town Convention and the Luxembourg Rail Protocol shall apply to such registrations. As a result, registration of a notice of sale shall have no effect under the Luxembourg Rail Protocol and such registrations and searches are only for informational purposes. As noted in the Official Commentary to the Luxembourg Rail Protocol: "The sole purpose of the registration facility is to give notice of the sale transaction with a view to securing a priority under national law." Whether or not such a registration produces any effect under the domestic law is not a matter for the Luxembourg Rail Protocol.

3. The Study Group requested further research as to the potential effect of registered notices of sale on the rights that arise under domestic law with the view to assess the impact of including an article on the registration of notices of sale in the MAC Protocol.

*Scenarios*

4. For a clearer understanding of the implications of notices of sales that may be registered in the future MAC International Registry, this section sets out some scenarios in which a notice of sale may be expected to have an effect under the applicable domestic law. The following analysis focuses on the scenarios that involve a sale of a MAC object.

*Likely unaffected transactions*

5. For the purposes of this Note, sales in the ordinary course of business have been excluded as it is very unlikely that a registered notice of sale in the International Registry would have any effect on buyers in these circumstances. As a result, if Buyer 1 acquired equipment from a dealership but did not take possession, subsequent Buyer 2 should be able to take free of any interests in the equipment as long as it qualifies as a "buyer in the ordinary course of business." The requirement for such a buyer is typically that it takes without knowledge that the sale violates the rights of another person in the goods.<sup>266</sup> Accordingly, a registered notice of sale would not affect the status of the buyer in the ordinary course of business unless the buyer: i) actually searched the MAC International Registry; ii) discovered a notice of sale; and iii) the notice of sale included some indication that an acquisition of the equipment covered by the registered notice would be a violation of the rights of the buyer. In any case, buyers in the ordinary course of business are not expected to search any registration system in order to gain priority as against any earlier-in-time buyer of the same equipment before buying MAC equipment from a seller whose ordinary course of business is the sale of such equipment.

6. As noted in a paper discussed by the Study Group at its October 2015 meeting, many MAC objects are subject to registration in domestic title registries. The laws that govern these registries may also provide specific provisions on the transfer of ownership independently of the general rules incorporated in Civil or Commercial Codes.<sup>267</sup> These provisions may condition the transfer of ownership on the registration of a title document relating to the equipment irrespective of the knowledge of the transferee. Accordingly, a notice of sale registered in the International Registry might not have any effects on the transactions related to such equipment whose transfer of ownership requires registration in the domestic title registry.

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<sup>266</sup> See UCC 1-201(9).

<sup>267</sup> See Arizona Revised Statutes Section 28-2058.

7. A registered notice of sale would also not seem to affect a national interest of the secured creditor. Knowledge of a competing claim would not be relevant for the creation and priority of a security interest under many domestic secured transactions laws. Accordingly, a domestic security interest would have priority even though the secured creditor knew about a notice of sale registered in the International Registry to the extent that the seller/debtor retained sufficient rights to create a security interest. If the seller has sold the equipment in a manner in which the sale divested it of all rights, a security interest would not be created whether or not a notice of sale has been registered.

8. This Note does not take into account the various situations that could arise in connection with the acquisition of stolen MAC equipment when the considerations protecting a good faith purchaser vary. It also does not take into account a prospective notice of sale that is registered in anticipation of consummating the sale transaction. The Official Commentary notes that such notices are highly unlikely to produce any effects under the domestic law.

#### *Potentially affected transactions*

9. At least two scenarios can be identified in which a notice of sale may have an effect on the rights of the parties involved. In both of these scenarios, the conflict between Buyer 1 and Buyer 2 is that of priority and not whether one of the transfers is invalid.

10. Registration of a notice of sale would seem to have some application in a narrow context when: i) MAC equipment is sold not in the ordinary course of business, and ii) the seller retains possession of the MAC equipment. If ownership is transferred to Buyer 1 who takes possession, thus divesting the seller of any power to transfer rights in that MAC equipment, there is nothing for Buyer 2 to acquire. However, if Buyer 1 allowed the seller to retain possession of the MAC equipment, many domestic laws empower the seller to transfer rights as if it were the owner so the notice of sale may play a role and affect the rights acquired by a subsequent Buyer 2.

11. A second scenario of the potential effect of a notice of sale is when Buyer 1 acquires ownership to MAC equipment but leaves the seller in possession. Subsequently, Buyer 2 acquires ownership to the same asset but also allows the seller to retain possession of the equipment. Before Buyer 2 takes delivery of the equipment, Buyer 1 registers a notice of sale. Accordingly, registration of a notice of sale may affect such buyer before Buyer 2 enters into a transaction or subsequent to concluding a sale contract but before taking delivery.

#### *Country Reports*

12. This section examines selected domestic laws and evaluates the potential impact of notices of sales registered under the MAC Protocol.

#### *Colombia*

13. Under Article 754 of the Colombian Civil Code, ownership rights over the equipment can be transferred to the buyer without the seller having to actually transfer possession of the equipment (i.e., *constitutum possessorium*). Since ownership has passed to the buyer, the seller no longer retains an interest in the equipment that can be passed to a subsequent buyer. Article 762 provides that "the person in possession is considered owner until another person proves his/her ownership rights." Thus, if possession of the equipment is transferred by the seller to Buyer 2, such Buyer will be deemed to be the owner until the original buyer (Buyer 1) proves otherwise. Colombian law only provides for a presumption of ownership in favour of the subsequent buyer (Buyer 2) until proven otherwise and the subsequent buyer does not have a defence of good faith purchase as against the claim of the original buyer. S/he may defeat the claim of the original buyer only under the statute of limitations and under Article 947 of the Civil Code. Thus, since Colombian law grants greater protections to the original buyer than to the subsequent buyer and good faith is not a relevant element in the determination of ownership or priority rights of the latter, the registration of a notice of sale would seem to have no effect under Colombian law.

*France*

14. Article 1583 of the French Civil Code allows the transfer of ownership over equipment to a buyer without actual delivery of the equipment to the buyer. Since ownership has been transferred to the buyer, any subsequent sale of the equipment by the seller is void under Article 1599 which provides that "the sale of a thing belonging to another is null." It should be noted that the general principle of "in matters of movables, possession is equivalent to title," recognized by the Civil Code in Article 2276, has been interpreted by the courts to override the nullity of contract.<sup>268</sup> In order for the subsequent buyer to be protected against the original owner pursuant to Article 2276, the subsequent buyer must receive actual ("real") possession of the equipment and act in good faith. The good faith element of this protection requires the buyer to be unaware that the seller did not have ownership rights over the equipment sold or that s/he should have known the seller did not have ownership rights over the equipment sold. Therefore, a registered notice of sale could affect the good faith status of the subsequent buyer if the subsequent buyer actually searched the International Registry or the court found that it should have searched the Registry.

15. A registered notice of sale may also have an impact on the right to damages. Article 1599 of the Civil Code provides that "...sale may give rise to damages where the buyer did not know that the asset belonged to another." Thus, a registered notice of sale could impact the right to damages of the buyer if the subsequent buyer did search the International Registry and found a notice of sale. However the buyer must actually know about a registered notice of sale rather than just be on inquiry notice that would require a reasonable person to search as relevant to the question of priority examined in the preceding paragraph.

*Germany*

16. Under Article 930 of the German Civil Code, a buyer of equipment that allows the seller to remain in possession acquires ownership. Since ownership has passed to the buyer, the seller no longer retains any interest that it may pass to a subsequent buyer under Article 929. However, since the seller remains in possession of the equipment, Article 932(1) empowers the seller to transfer ownership to a subsequent buyer. For such a subsequent buyer to acquire ownership and thus trump the rights of the first buyer, s/he must acquire the equipment in good faith. The elements of good faith are governed by Article 932(2) under which the subsequent buyer does not acquire the equipment if s/he knows, or as a result of gross negligently is not aware, of the fact that the equipment has been previously sold. A notice of sale registered in the International Registry may have an impact on the good faith protected status of the subsequent buyer if the buyer actually searched the International Registry or the court found that it acted with gross negligence in the failure to do so.<sup>269</sup>

17. The application of Article 933 of the Civil Code could also be affected by a registered notice of sale. Under this article, the subsequent buyer may acquire equipment but leave it in possession of the seller. Accordingly, both Buyer 1 and 2 acquired ownership but left the equipment in possession of the seller. For the subsequent buyer to qualify for the good faith protection, s/he may not acquire any knowledge before s/he takes delivery. Accordingly, if the first buyer registers a notice of sale before the subsequent buyer takes delivery this could affect the knowledge element of the good faith purchaser protection if Buyer 2 actually searched the International Registry or was grossly negligent in failing to do so before taking delivery of the equipment.

*Mexico*

18. Under Article 2014 of the Mexican Federal Civil Code, ownership of the equipment can be transferred at the time the sales contract is entered into, regardless of whether the equipment is delivered

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<sup>268</sup> Dimitar STOYANOV, *The Conflict Between the Legal Interests of the Original Owner and the Good Faith Acquirer of Movables – A Comparative Overview of the Solutions*, p. 98-102, LESIJ NO. XXII, VOL. 1/2015.

<sup>269</sup> See further Howard Rosen & Benjamin von Bodungen, *The Luxembourg Protocol to the Cape Town Convention on International Interests in Mobile Equipment on Matters Specific to Railway Rolling Stock – Overview and Current Status*, 46 No. 4 UCC L.J. ART. 3 at 6 (November 2015).

to the buyer. Article 2284 provides that when the seller remains in possession of the asset sold pursuant to a sales contract, s/he is vested with the rights of a bailee with respect to the asset. Furthermore, Article 2511 provides that the sale of another's property has no legal force or effect. As a general rule, since the person in possession of the equipment lacks ownership rights or other power to transfer rights over the equipment, s/he cannot transfer an interest to a subsequent buyer. However, Article 799 provides for an exception by creating a presumption of acquired ownership by the subsequent buyer in good faith. Under this article, the subsequent buyer who took possession in good faith is presumed to have acquired ownership as if from the actual owner of the equipment.

19. According to Article 806, a possessor in good faith is one that takes without knowledge that the transferor lacked ownership to the equipment. Article 807 establishes that there is a presumption of good faith in favour of the possessor and the person who alleges the existence of the possessor's bad faith has the burden of proof. Therefore, the registration of a notice of sale could have an effect on the subsequent buyer's good faith but the burden is on the initial buyer to prove that the subsequent buyer took with knowledge of its interest referenced in the registered notice of sale. However, Mexican case law has established that only knowledge of the fact that the seller had no ownership rights over the asset overrides the good faith presumption. It is unlikely that discovery of a registered notice of sale would impact such knowledge of the subsequent buyer as such registration is not determinative of the seller's rights in the equipment.<sup>270</sup> Unless Buyer 1 proves Buyer's 2 bad faith within three years, Buyer 2 would acquire full ownership to the asset by prescription.

### *Spain*

20. Article 1463 of the Spanish Civil Code allows the transfer of ownership of equipment from the seller to the buyer without the actual delivery of equipment (i.e., *constitutum possessorium*). Spanish law also recognizes the general principle "*nemo plus iura alium transferre potest quam ipse haberet*" (nobody can transfer property that is not its own).<sup>271</sup> Thus, as a general rule, since equipment remains in possession of the seller and ownership is transferred to the buyer, the seller has no interest that may be transferred to a subsequent buyer. However, Article 464 protects buyers in good faith of movable property by stating that the possessor of movable property has the right equivalent to title that it may pass to a good faith purchaser. Registration of a notice of sale could have an impact on the good faith status of the subsequent purchaser.

### *The United Kingdom*

21. In the United Kingdom, if a person sells machinery to a buyer but remains in possession, the seller retains a legal interest as a bailee. However, once the seller's intention changes, i.e. to sell the asset, s/he acquires a full possessory title subject to the right of the buyer.<sup>272</sup> The exception to the *nemo dat* principle is founded on the estoppel concept which puts the risk of a double sale on Buyer 1 because it was s/he who allowed the seller to remain in possession.<sup>273</sup> Under Section 24 of the Sale of Goods Act, a seller who remains in possession may pass good title "to any person receiving the same in good faith and without notice of the previous sale." Section 24 creates a presumption that the seller was expressly authorised by the owner of the goods to transfer ownership. The subsequent buyer must take delivery of the asset, either actually or constructively. Section 8 of the Factor's Act includes a parallel provision that allows sellers to pass good title to subsequent good faith purchasers. Registration of a notice of sale in the International Registry would seem to have an effect: i) if the subsequent buyer actually discovered such registration by

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<sup>270</sup> Buena Fe. Para usucapir es necesario mantenerla permanentemente durante el plazo de cinco años, Tribunales Colegiados de Circuito [TCC] [Collegiate Circuit Courts], *Semanario Judicial de la Federación y su Gaceta*, Novena Época, Tomo XXVIII, Septiembre 2008, Pag. 1191 (Mex.).

<sup>271</sup> José Manuel de Torres Perea, *Acquisition from a non-domino in Spanish civil law*, Papers of the Private Law of the Philippines and Spain International Scientific Congress, available at <http://www.eumed.net/libros-gratis/2015/1458/spanish-civil-law.htm>.

<sup>272</sup> Roy Goode, *Commercial Law* 58 (3rd ed. 2004).

<sup>273</sup> *Id.*, at 59.

searching the International Registry so that s/he would not be without notice of the previous sale, or ii) if the court interpreted the good faith element of the protection as requiring a search that the subsequent buyer failed to conduct.

22. These two Sections apply only in a situation in which the seller has in fact sold the equipment. In contrast, in a situation in which the seller merely entered into an agreement to sell and the buyer has registered a notice, the normal rules for the passage of title will apply. In this situation, the subsequent buyer could be liable to the person who originally agreed to purchase the equipment only if s/he took with notice of the breach of the agreement.<sup>274</sup> Discovery of the registered notice of sale is unlikely to impart such notice on the subsequent buyer unless the registration also indicated that the rights of Buyer 1 would be breached. In any case, the priority of Buyer 2 would not be affected because Buyer 1 would have not acquired any rights in the equipment.

#### *The United States*

23. Under the U.S. Uniform Commercial Code (UCC) 2-401, ownership to equipment may pass "in any manner and on any conditions explicitly agreed on by the parties." However, for an agreement between the two parties to transfer ownership, the equipment must be identified in a manner set forth in UCC 2-501. Under UCC 2-403, a person with voidable title has power to transfer a title to a good faith purchaser for value. The seller may also have power to transfer title to a good faith purchaser for value under the principles of law or equity, such as estoppel.<sup>275</sup>

24. Overall, a buyer of equipment must: i) qualify as a purchaser, which is defined in UCC 1-201; ii) act in good faith which is defined in the same section; and iii) take for value, as defined in UCC 1-204. The second element of the good faith for value purchaser protection may be affected by a notice of sale registered under the MAC Protocol. The judicial decisions that have interpreted this element under similar circumstances have reached different outcomes. On the one hand, a buyer may be disqualified from the protection if: i) s/he had a "notice of facts that would put a reasonably prudent person on inquiry," or ii) "failed to inspect records of title and prior ownership that would put the buyer on notice that the seller is not the true owner and would raise doubts concerning the seller's authority to transfer title."<sup>276</sup> On the other hand, other court cases also indicate "a buyer's failure to investigate, or inquire into, the seller's title does not deprive the buyer of good-faith purchaser status."<sup>277</sup> In any case, the buyer's knowledge or notice of facts is measured as of the time of sale and any knowledge/notice acquired thereafter is immaterial. Overall, the commercial reasonable standards, applicable in the particular circumstances, would determine whether any inquiry is necessary and whether the inquiry should include a search of the International Registry.

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<sup>274</sup> Michael G. Bridge, *Sale of Goods* 451

<sup>275</sup> Hawkland UCC Series § 2-403:2.

<sup>276</sup> 77A C.J.S. Sales § 413.

<sup>277</sup> *Id.*

## Appendix IX – Research on amendment procedures in other international instruments

### *The Civil Aircraft Agreement*

1. The Agreement on Trade in Civil Aircraft (hereinafter, the Agreement) entered into force in January 1980 and has 32 signatories (as of February 2016). It is a plurilateral WTO agreement (whereby any reservation submitted by any signatory would require the consent of all other signatories) which aims to eliminate import duties for civil air-craft products as covered by its scope.
2. Article 9.8 provides that the Annex to the Agreement (which contains the HS codes to which the Agreement applies, see the section regarding using the Harmonized System as a scoping device for more details) forms an 'integral part therein' of the Agreement itself, implying that any amendments to the Annex by the Committee would trigger a formal treaty action.
3. The WTO Analytical Index for the Agreement<sup>278</sup> provides that in 1982 the Civil Aircraft Committee (the Committee) adopted procedures for modifying the Annex of the Agreement.<sup>279</sup> For this, the Committee issued certifications for modifications. Such certifications were respectively issued in 1983, 1984 and 1985. These certificates incorporated 32 new categories of products as approved by the Committee. The WTO Analytical Index for Article 9.5 notes that the Agreement has only been subject to amendments in 1986 and 2001 as consistent with the adopted protocols. It thus appears that the certifications issued by the Committee prior to the adoption of protocols aimed at altering the coverage of the Annexes did not trigger formal treaty actions. Taken into account the actual effect of such certifications in modifying the product coverage through the Annexes, the result would inevitably be at odds with the formal treaty actions required for adoption of protocols on amendments.
4. The initial protocol for amending the Agreement which replaced the original Annex resulted in an expansion of the scope of its product coverage as well as its transposition into the HS nomenclature. This took effect on 1 January 1988. It was later followed by the 2001 Protocol Amending the Annex to the Agreement. It aligned its tariff nomenclature with the 2002 version of the HS and expanded the Agreement's product coverage. On the 5th November 2015, the Committee adopted a Protocol which updated the list of its aviation products in compatibility with the 2007 version of the HS.
5. Article 8 on Surveillance, Review, Consultation, and Dispute Settlement of the Agreement establishes the Committee which is comprised of representatives of all signatories. The Committee is required, among other responsibilities, to determine whether amendments are required to ensure the continuance of free and undistorted trade<sup>280</sup>. The Committee is also required to carry out an annual review of the implementation and operation of the Agreement.<sup>281</sup> A subsidiary body, in the form of the 'Technical Sub-Committee', may also be established by the Committee in order to ensure reciprocity and equivalent results with regards to the implementation of Article 2 which relates to product coverage, end-use systems, customs duties and other charges.<sup>282</sup> Among the terms of reference of the Sub-Committee is the examining of proposals for modifying the product coverage of the Agreement which is then reported back to the Committee.<sup>283</sup>
6. Signatories are required to undertake further negotiations with a view to broadening and improving the Agreement on the basis of mutual reciprocity, a process taken to be achieved under the auspices of the Committee.<sup>284</sup> Article 9.5 stipulates that signatories may amend the Agreement, having regards inter

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<sup>278</sup> [https://www.wto.org/english/res\\_e/booksp\\_e/analytic\\_index\\_e/aircraft\\_01\\_e.htm#fnt9](https://www.wto.org/english/res_e/booksp_e/analytic_index_e/aircraft_01_e.htm#fnt9).

<sup>279</sup> AIR/41; see also Secretariat Note in AIR/W/33

<sup>280</sup> Article 8.1

<sup>281</sup> Article 8.2

<sup>282</sup> Article 8.4

<sup>283</sup> The Committee set up the Technical Sub-Committee at its meeting of 20 February 1980

<sup>284</sup> Article 8.3



alia to the experience gained from its implementation. It further provides that such an amendment shall not come into force for any signatory until it has been accepted by such signatory.

7. As such, the Civil Aircraft Agreement scenario is one whereby the Committee, a supervisory authority which is constituted by representatives of all signatories, is in charge of reviewing the Agreement and adopting possible modifications and rectifications.

8. Ideally, the MAC Protocol will adopt a simplified mechanism which would allow for amendments and changes to the Annex, but without expanding the scope of the Agreement and without the need for creation of an amending protocol through a formal treaty action. Curiously, the opposite approach appears to have been adopted in the Civil Aircraft Agreement; the expansion of the Agreement to new HS codes was achieved through the Committee issuing certifications, however the realigning of the Annex with updates to the HS System has required the creation of formal Protocols amending the treaty.

#### *The Energy Charter Agreement*

9. The Energy Charter Treaty (hereinafter, the ECT) entered into force on April 1994 and has 54 signatories as of February 2016. The ECT provides for a multilateral framework for cooperation in the field of energy and the promotion of energy security. The treaty focuses on making energy markets more competitive, stimulating investments in the energy sector and minimising, or eliminating, barriers to trade.

10. The supervisory authority of the ECT, the Charter Conference (comprised of representatives of all Contracting Parties) is vested with the task of keeping the Treaty under regular review. Article 34(3) of the ECT provides a list of functions assigned to the Charter Conference. The Charter Conference is vested with the task of considering and adopting amendments to the ECT.<sup>285</sup> Additionally, it considers and approves modifications of, and technical changes to the Annexes to the Treaty.<sup>286</sup>

11. Article 42 of the ECT stipulates that any Contracting Party may propose amendments to the Treaty, which would then be considered for adoption by the next Charter Conference. The text of the amendment shall be communicated to the Contracting Parties by the Secretariat three months prior to the proposal for adoption. The amendments to the Treaty which have been approved by the Charter Conference are then required to be forwarded to the Depository in order for it to be submitted to all Contracting Parties for ratification, acceptance and approval. The instruments of ratification, acceptance or approval of subject matter amendments shall be deposited by the Depository. The amendments between the relevant Contracting Parties take legal effect 90 days after the receipt of approval from three quarters of the Contracting Parties and after the instruments have been deposited by the Depository.

12. As a supplementary instrument to the ECT, the Trade Amendment (TA) was adopted by the Charter Conference in 1998. It entered into force in 2010 and provides changes to the trade-related provisions and modifies the Annexes of the Treaty.

13. Ultimately, the TA extended the ECT to cover energy-related equipment, as contemplated by Article 31, and provided for this in the Annexes EQ I and EQ II. Specifically, the TA added pipelines, electric cables and towers, drilling platforms, nuclear reactors, central heating boilers, heat pumps, refrigerators, freezers, electrical transformers, accumulators, and even certain types of motor vehicles to the scope of the ECT trade regime. Importantly, in relation to customs duties, the TA provided for a progressive replacement of the soft law customs tariff pledges with a binding customs tariff standstill regime, as referred to in Article 29(6).<sup>287</sup> To move each type of energy material and energy equipment from soft law pledges to a binding customs regime, each HS code had to be moved from Annexes EM I and EQ I to Annexes EM II and EQ II. To move HS codes from one Annex to another where in the latter legally bound tariffs apply, the Charter

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<sup>285</sup> Article 34(3)(l) ECT

<sup>286</sup> Article 34(3)(m) ECT

<sup>287</sup> ECT, with incorporated TA – last updated: 14 July 2014

Conference is required to examine the potential move in its annual review, and is then subject to a subsequent conference vote, the outcome of which must be unanimous.<sup>288</sup>

14. Unanimity is required not only for adoption of amendments to the Treaty and for approval of modifications to Annexes EM (energy materials and products) and NI (non-applicable energy materials and products). Further, a unanimous vote is required for approval of technical changes to the Annexes to the Treaty.

15. Agreement of any matter falling outside the scope of Article 36(1), on the other hand, can only be reached by the Contracting Parties through consensus. This would also imply the approval of modifications to Annex EQ I (energy-related equipment) whereby adding items to Annex EQ I would not require a unanimous agreement but rather a consensus at the Charter Conference. If consensus is impossible to reach, qualified majority or three-fourth majority voting alternatively applies on specific matters, in particular budgetary matters as well as Treaty review intervals by the Charter Conference<sup>289</sup>.

16. As explained in the preceding paragraphs, the ETC adopts different processes for amending different aspects of the treaty and its Annexes, however all amendment measures are governed through the Charter Conference. Adoption of amendments to the texts of the Treaty, approval of modifications to Annexes EM and NI and approval of technical changes to all the Annexes in general would require a unanimous vote from all the Contracting Parties which are present and are voting at the Charter Conference meeting. Replacement of items from Annexes EM I to EM II and Annexes EQ I to EQ II would also require unanimity. Yet, approval of modifications to Annex EQ I would require the Contracting Parties to reach consensus. In the absence of consensus where there would be explicit objections, three-fourth majority voting would alternatively apply.

*Convention for the Unification of Certain Rules for International Carriage by Air (The Montreal Convention)*

17. It was suggested by the German Ministry of Justice at the second Study Group meeting that it may be desirable to add an additional provision to the article governing amendments which provides for an alternative amendment procedure for the Annexes listing the MAC equipment covered by the Protocol. It was suggested that this additional provision could be based upon Article 24 of the Montreal Convention.

18. Article 24 of the Montreal Convention provides:

*Article 24 - Review of limits (Montreal Convention)*

1. *Without prejudice to the provisions of Article 25 of this Convention and subject to paragraph 2 below, the limits of liability prescribed in Articles 21, 22 and 23 shall be reviewed by the Depositary at five-year intervals, the first such review to take place at the end of the fifth year following the date of entry into force of this Convention, or if the Convention does not enter into force within five years of the date it is first open for signature, within the first year of its entry into force, by reference to an inflation factor which corresponds to the accumulated rate of inflation since the previous revision or in the first instance since the date of entry into force of the Convention. The measure of the rate of inflation to be used in determining the inflation factor shall be the weighted average of the annual rates of increase or decrease in the Consumer Price Indices of the States whose currencies comprise the Special Drawing Right mentioned in paragraph 1 of Article 23.*

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<sup>288</sup> Article 34(o), 36(1)(g) ECT

<sup>289</sup> Article 36(2) to Article 36(5)

2. *If the review referred to in the preceding paragraph concludes that the inflation factor has exceeded 10 percent, the Depositary shall notify States Parties of a revision of the limits of liability. Any such revision shall become effective six months after its notification to the States Parties. If within three months after its notification to the States Parties a majority of the States Parties register their disapproval, the revision shall not become effective and the Depositary shall refer the matter to a meeting of the States Parties. The Depositary shall immediately notify all States Parties of the coming into force of any revision.*

3. *Notwithstanding paragraph 1 of this Article, the procedure referred to in paragraph 2 of this Article shall be applied at any time provided that one-third of the States Parties express a desire to that effect and upon condition that the inflation factor referred to in paragraph 1 has exceeded 30 percent since the previous revision or since the date of entry into force of this Convention if there has been no previous revision. Subsequent reviews using the procedure described in paragraph 1 of this Article will take place at five-year intervals starting at the end of the fifth year following the date of the reviews under the present paragraph.*

19. Paragraph 2 of Article 24 (underlined above) provides that where the Depositary determines during a five yearly review that if the inflation factor has exceeded a certain amount, it can revise the limits of liability under the Convention, which has automatic effect unless a majority of States Parties register their disapproval.

20. Such an approach could be adopted in relation to changes to the Annexes to the MAC Protocol that simply realign the codes in the Annexes to reflect revisions to the Harmonized System, but do not intend to expand the scope of the Protocol to new types of MAC equipment.

## GLOSSARY

### UNIDROIT INSTRUMENTS

Aircraft Protocol	Protocol to the Convention on International Interests in Mobile Equipment on Matters specific to Aircraft Equipment (2001)
Cape Town Convention <i>or</i> CTC	Convention on International Interests in Mobile Equipment (2001)
Luxembourg Rail Protocol	Luxembourg Protocol to the Convention on International Interests in Mobile Equipment on Matters specific to Railway Rolling Stock (2007)
MAC Protocol	Future Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Agricultural, Construction and Mining Equipment (incomplete)
Space Protocol	Protocol to the Convention on International Interests in Mobile Equipment on Matters specific to Space Assets (2009)
UNIDROIT Principles or UPICC	UNIDROIT Principles of International Commercial Contracts (editions issued 1994, 2004, 2010, 2016)

### OTHER INTERNATIONAL INSTRUMENTS

Civil Aircraft Agreement	Agreement on Trade in Civil Aircraft (1980)
Energy Charter Treaty <i>or</i> ECT	The International Energy Charter Consolidated Energy Charter Treaty
HS System	Harmonized Commodity Description and Coding System
Montreal Convention	Convention for the Unification of Certain Rules for International Carriage by Air (1999)

### INTERNATIONAL ORGANISATIONS AND OTHER ORGANISATIONS

AWG	Aviation Working Group
FAO	Food and Agriculture Organization of the United Nations
HCCH	Hague Conference on Private International Law
ICAO	International Civil Aviation Organization

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IFC	International Finance Corporation
NLCIFT	National Law Center for Inter-American Free Trade
RWG	Rail Working Group
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNIDROIT	International Institute for the Unification of Private Law
WCO	World Customs Organization

#### **GROUPS**

Rail Preparatory Commission	Preparatory Commission for the establishment of the International Registry for Railway Rolling Stock pursuant to the Luxembourg (Rail) Protocol
Space Preparatory Commission	Preparatory Commission for the establishment of the International Registry for Space Assets pursuant to the Space Protocol