

Accessions and Non-Accessions under the Cape Town Convention: Special Focus on MAC Equipment

Marek Dubovec*

Abstract

This article examines the application of the Cape Town Convention and its Protocols to assets that may be affixed to objects, so as to become 'accessions'. The analysis focuses on Article 29(7) of the Cape Town Convention and the definitions of objects in the relevant Protocols. It examines the approach of the Cape Town regime with respect to accessions in various situations, which are likely to arise under the future Protocol on Matters Specific to Mining, Agricultural and Construction Equipment (MAC Protocol). It draws a distinction between accessions that are affected by the international interest in an object to which the asset is affixed and items that are accessories, referred to in the article as non-accessions. These distinct notions are contrasted with the treatment of accessions under some domestic secured transactions laws. Finally, the article provides some guidance especially to creditors, on how to ensure that their international interest is not compromised by the uncertainties of the applicable domestic law, which determines whether the rights of the person in an item continue after the installation.

This note examines the effect of a right in an item on the international interest in the object to which the item is affixed, and *vice versa*. The analysis focuses on two provisions of the Convention on International Interests in Mobile Equipment (hereinafter 'the Convention' or 'CTC') and its Protocols, including the draft Protocol on matters specific to Mining, Agricultural and Construction Equipment (hereinafter 'the draft MAC Protocol' or 'the future MAC Protocol'): i) Article 29(7)(a) of the Convention that provides the relevant substantive rule;¹ and ii) Article I(2) of the Protocols that sets forth the relevant definition of the object covered by that Protocol (collectively 'the CTC regime').² The Aircraft Protocol includes three separate definitions of aircraft engines, airframes, and helicopters,

* Executive Director of the Kozolchyk National Law Center and Part-Time Professor of Practice at the University of Arizona (James E. Rogers College of Law). I am grateful to Sir Roy Goode for diligently reviewing and commenting on multiple drafts of this article, and to Prof. Charles W. Mooney for invaluable insights that helped correct some mistakes.

¹ Article 29(7)(a) 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.'

² The Rail Protocol, Article I(2)(e) defines railway rolling stock as '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.' The definition of space asset in Article I(2) of the Space Protocol covers 'all installed, incorporated or attached accessories, parts and equipment and all data, manuals and records relating thereto.'

which can all constitute separate objects under the Protocol.³ Unlike the other Protocols, it treats engines as separate objects. The reference to 'item' throughout the text of this article is limited to items other than objects, thus excluding situations where an object may be installed on another object.

Items affixed to objects may have a significant economic value, which is especially the case for mining, agricultural, and construction (MAC) equipment. Owners of Caterpillar equipment often spend two to three times as much on parts as they spend on machines. In this respect, the former CEO of Caterpillar, Donald Fites, remarked that 'a machine sale is an annuity that continues to pay dividends over time as customers keep their equipment running.'⁴ For example, a single tyre on a Caterpillar 797 dump truck costs over US\$40,000, and a LeTourneau L-2350 tyre upwards of US\$63,000.⁵

I. Factual Situations

The rules of the Convention contemplate that some assets may be affixed (this term is used to avoid referring to the terms 'attached' and 'incorporated' included in the relevant definitions) to the object. Potential situations may include the scenarios presented below, which, as adaptations of actual court cases, are likely to arise in the context of the future MAC Protocol.

Scenario 1:

A third party sells a new engine for installation on an object encumbered by an international interest, and removes the old engine that is no longer functional. After the debtor defaults by failing to keep up with the instalment payments relating to the credit sale of the new engine, the third party removes the installed engine. This default and removal causes a cross-default that entitles the holder of the international interest to exercise its Convention and Protocol rights. On repossession, the holder of the international interest finds the object without an engine; both the old and the replacement engine are now in the possession of the third party.⁶ What are the rights of the holder of the international interest in the object with respect to both the old and new engine now in possession of the third party?

Scenario 2:

A variation of the first scenario involves an installation of an item that is more efficient than the old item, ie when the old item was functional and did not require repair or

³ Art I(2) of the Aircraft Protocol provides:

(b) the definition of aircraft engines covers 'all modules and other installed, incorporated or attached accessories, parts and equipment and all data, manuals and records relating thereto';

(e) the definition of airframes covers 'all installed, incorporated or attached accessories, parts and equipment (other than aircraft engines), and all data, manuals and records relating thereto';

(l) the definition of helicopter covers 'all installed, incorporated or attached accessories, parts and equipment (including rotors), and all data, manuals and records relating thereto'.

⁴ Bryan Gruley, David Voreacos and Joe Deaux, 'The Whistleblower behind Caterpillar's Massive Tax Headache Could Make \$600 Million' (Bloomberg Businessweek, 1 June 2017) <<https://www.bloomberg.com/news/features/2017-06-01/the-whistleblower-behind-caterpillar-s-massive-tax-headache-could-make-600-million>> accessed 4 December 2017 (citing Craig T Bouchard and James Koch, *The Caterpillar Way: Lessons in Leadership, Growth, and Shareholder Value* (McGraw-Hill 2013)).

⁵ 'Pricey Tyres: 10 Most Expensive Tyres in the World' (*Tyreshopper*, 10 November 2016) <<https://www.tyre-shopper.co.uk/news/pricy-tyres-10-expensive-tyres-world>> accessed 4 December 2017.

⁶ These were the facts in *AMCA International Finance Corp v Interstate Detroit Diesel Allison* 428 NW 2d (1988) (Court of Appeals of Minnesota), where Diesel sold an engine that it removed from an excavator in which AMCA held a purchase money security interest.

replacement.⁷ The creditor with an international interest in the object has not been notified of this replacement. Can the creditor claim an international interest in the old (now removed) or the new (currently installed) engine? Does it make a difference if the new engine was financed by a third party or purchased by the debtor using its own funds?

Scenario 3:

A debtor acquires a drilling rig, the purchase price of which is secured with an international interest. The debtor subsequently buys a rotary table, subject to the right of a third party, which is mounted by welding on the rig.⁸ After the debtor's default, the holder of the international interest repossesses the object, including the rotary table. Can the holder of the international interest dispose of the rig with the rotary table? If it does so, what rights does the buyer acquire with respect to the rotary table?

Scenario 4:

A debtor acquires equipment for use in its coal mining operation, and requests the creditor to finance the inventory of spare parts that are customarily acquired in such deals as necessary to minimize the down-time of that kind of equipment.⁹ Can the creditor acquire an international interest in the spare parts that may be affixed to the object from time to time? What sort of collateral description in the security agreement would be sufficient for the international interest or a security interest under the applicable domestic law to extend to those parts?¹⁰

The above scenarios illustrate that items may be affixed to objects as: i) additions; or ii) replacements. Items falling under the latter category may be: a) required (eg, a broken part being replaced); or b) desirable (eg, a more efficient part replacing the less efficient one). Replacements may affect the economic value of the international interest because the part on which the holder of the international interest relied as its collateral has been removed and replaced with a new part subject to the right of a third party. In contrast, the economic value of the object subject to an international interest may not be affected negatively by the addition. Nonetheless, both of these situations raise questions with respect to the ability of the holder of the international interest to enforce its rights against the object as a whole, including the affixed item, upon default of the debtor.

The above are just a few examples of the scenarios that may arise in connection with objects covered by the CTC regime. It can be expected that these situations will arise more regularly under the future MAC Protocol (eg, tyres mounted on MAC equipment wear out regularly). Thus, it is important for CTC users to understand the effect of the relevant provisions on the extent, priority, and enforcement of the international interest encumbering an object to which an item has been affixed. Furthermore, for the development of the MAC Protocol, the approaches underlying the application of these CTC rules may also inform the drafting of the provisions on the effect of

⁷ In *Sasia & Wallace v Scarborough Implement Co* 316 P2d 39 (1957) (District Court of Appeal, Third District, California), the debtor acquired 'six tractors, equipped as complete unit cotton pickers, with gasoline carburetion equipment. Thereafter, a third party sold to the debtor, under a title retaining contract, six butane tanks with butane carburetion equipment, and removed the gasoline tanks and equipment from the tractors and installed the butane tanks and carburetion equipment on them.'

⁸ These were the facts in *Brown v Green* 618 P2d 140 (WY 1980).

⁹ This was the issue in *In re Dixie Fuels Inc v Dixie Fuels Inc* 48 BR 514 (Bankr ND Ala 1985).

¹⁰ In *In re Dixie Fuels Inc* (n 9), the court assessed the sufficiency of the following description: 'along with all present and future attachments and accessories thereto and replacements and proceeds thereof'.

affixation of a MAC object to immovable property, a challenge that is unique to the draft MAC Protocol.¹¹

There may be other ‘affixation situations’ that could give rise to interesting questions, but remain outside the scope of this article. For example, it is plausible for a CTC object to actually become an accession, ie by affixation to a larger object that is not subject to the CTC regime at all. This situation is not likely to arise in the context of the three existing Protocols, but it may occur in the MAC Protocol context, such as when a cement mixer is affixed to a truck. The Convention does not provide a specific rule on this form of affixation, which is the reverse of the situation covered by Article 29(7)(a).

For the purpose of this analysis, it is useful to distinguish the various forms of affixation as well as the rights in the item to be affixed to an object. An item affixed to an object may be: i) owned by the debtor outright; ii) owned by the debtor subject to an encumbrance, such as a security interest created in favour of a third party; iii) owned by the debtor subject to a non-consensual lien; or iv) owned by a third party, such as a creditor that has retained ownership of the asset (eg, when the item was purchased by the debtor under reservation of ownership or leased for a period of time). A third party may assert an interest in the asset affixed to an object claiming: i) a right in an item that is unaffected under Article 29(7)(a); ii) an interest created under domestic law in the entire object to secure the performance of an obligation relating only to the item; iii) an international interest in the object; and iv) a non-consensual right or interest.¹² The Convention provides clear rules for a conflict between an international interest in an object and a right/interest that falls under any of these four categories.

Some uncertainty may arise when the third party asserts a right/interest that belongs under several of the above-mentioned categories. Suppose that, under the applicable domestic law, a third party takes a security interest in the entire object, rather than just the item affixed to such object the acquisition of which it financed. What is the effect of Article 29(7)(a)? First, one can argue that it does not apply at all because the situation concerns a conflict between a domestic and international interest in the same object. The alternative reading may be that it does apply to the item, so that the third party’s interest created under domestic law would be bifurcated and only the portion related to the item given the Article 29(7)(a) protection. This reading is better aligned with the underlying policy of Article 29(7)(a), which aims to protect holders of rights in items, who should not be penalized with loss of protection if they have done more (ie, perfected a security interest created under the applicable domestic law) than other holders that relied solely on this Article for the protection of their rights.

II. The Accessions Doctrine

Of the four types of rights/interests in the item, the first one is the most protective of the third party creditor. Article 29(7)(a) of the Convention defers to the applicable law to prescribe a specific test for when a right in the item remains unaffected. Typically, the right would be affected under the applicable law if the item becomes an accession as a result of which the right in the principal good would

¹¹ A number of court cases under Article 9 of the Uniform Commercial Code (UCC 9) discussing whether an item constituted an accession were influenced by analyses of whether the item constituted a fixture. James Nehf and Julian McDonnell, *Secured Transactions under the UCC* (Matthew Bender 1C, 2017) ch 17, s 17.01[2].

¹² Non-consensual right or interest is defined in Article 1(s) of the CTC as ‘a right or interest conferred under the law of a Contracting State which has made a declaration under Article 39 to secure the performance of an obligation, including an obligation to a State, State entity or an intergovernmental or private organization’.

extend to the accession.¹³ The accessions doctrine is similar to the fixtures doctrine that involves an affixation of an object to immovable property.¹⁴ Unlike the doctrine of first possession that allocates resources based on a competition among claimants, the accessions doctrine allocates resources to those who are more likely to competently manage the resource.¹⁵ Accession is the result of uniting an item with a principal good, so that the former becomes an integral part of the latter. The legal consequence of this unification is that ownership to the accession passes to the owner of the principal good.¹⁶ As a result, the right of a third party in an item may be extinguished if, under the applicable domestic law, the item has become an accession – an integral part of the principal good. Under other laws, affixation of an item to an object would make it an accession but it would not result in the extinguishment of the right in the item created before the affixation. Some of these differences are further explored below. If the international interest is held in the object which is the principal asset, the effect of the accession, determined by the *lex rei sitae*, will often be to expand the international interest on the basis that ownership to the accession passes to the holder of the international interest in the form of a lease or title reservation agreement or to the chargor under a security agreement.

At times, it may be difficult to distinguish between the principal asset and the accession. In common law countries, courts have applied several different tests, including whether an asset is more constant and durable, of greater value, more obvious or remarkable, or because its existence is more separate and independent.¹⁷ In contrast, civil law countries utilize a straightforward test of greater value characterizing as an accession the asset with a lesser value than the whole.¹⁸ Applying these tests, the determination of principal assets and accessions should be straightforward with respect to the types of objects covered by the Convention.

Deriving from Roman law, accession may occur by a natural increase, such as when trees bear fruits, or by a combination of two assets, such as when an engine is affixed to a bulldozer.¹⁹ Civil Codes typically provide for a general notion of accession, which is then divided into two types – natural increase and combination of assets.²⁰ The Convention is concerned only with the latter.

The manner of affixation is critical for the application of general accessions-related rules that may determine the effect of Article 29(7). On the one hand, some affixation may be so permanent that removal of the item would cause excessive damage, such as the removal of paint from a crane. On the other side of the spectrum is a ‘loose affixation’, such as where a stand-alone GPS unit is placed in the cabin of a tractor. The application of the doctrine may also vary depending on the identity of the person claiming a right in an item, which could be either the owner of the principal good or a third party.²¹ Another variable is when the third party acts in bad faith.

The accessions doctrine generally requires an item to become an integral part of the principal good for the rights in that item to be affected by the rights in the principal good.²² Forming an

¹³ The UNCITRAL Legislative Guide defines attachment to a movable asset as ‘a tangible asset that is physically attached to another tangible asset but has not lost its separate identity’. *UNCITRAL Legislative Guide on Secured Transactions* (UNCITRAL 2007) 7. The UNCITRAL Model Law on Secured Transactions has not incorporated the specific recommendations from the Guide covering attachments to movable assets.

¹⁴ Anthony Duggan and David Brown, *Australian Personal Property Securities Law* (LexisNexis 2012) 181.

¹⁵ Thomas W Merrill, ‘Accession and Original Ownership’ (2009) 1(2) *Journal of Legal Analysis* 459, 461.

¹⁶ See also German Civil Code, art 947(II).

¹⁷ Merrill (n 15) 477.

¹⁸ Mexico Civil Code, art 917.

¹⁹ AG Guest, ‘Accession and Confusion in the Law of Hire-Purchase’ (1964) 27 *MLR* 505, 506. See further Roy Goode, *Hire-Purchase Law and Practice* (2nd edn, Butterworth-Heinemann 1970) ch 33 (supp 1975).

²⁰ See Colombian Civil Code, art 713.

²¹ Guest (n 19) 507.

²² Steve H Nickles, *Secured Transactions under the UCC* (Matthew Bender 1C, 2017) ch 17, s 17.03, ‘When Does a Security Interest in Principal Collateral Extend to “Accessories”?’

integral part is a test found in many Civil Codes, which presupposes that an item becomes an accession, and thus forms an integral part of the whole, when it cannot be separated without destroying, impairing, or altering the principal good.²³ The Official Commentary to the Cape Town Convention provides one example of a similar accessions test, which is satisfied when ‘an asset is affixed to a more substantial object so as to be incapable of removal without significant damage.’²⁴ A different test is when ‘one item is joined to another with the result that the separate identity of one of the items is lost in the other.’²⁵ Other tests may look at whether the removal would destroy the commercial identity of the assets, or consider the intentions of the parties and the purpose of the attachment.²⁶ Often, domestic laws recognize multiple tests that courts must examine to determine their applicability to the facts presented before them, further increasing legal uncertainty. Some of these tests favour the creditor with an interest in the principal asset (object), while others favour the creditor with an interest in the affixed asset (item). Accessions are the opposite of accessories (non-accessions). Article IX – 1:201 of the Draft Common Frame of Reference (DCFR) defines accessory as ‘a corporeal asset that is or becomes closely connected with or part of a movable provided it is possible and economically reasonable to separate the accessory without damage from the movable.’²⁷ This test establishes a dividing line between accessions and accessories.

The application of the relevant accessions doctrine may depend on the factual scenario presented before the court. In this exercise, the court may be guided by the following factors:²⁸

- whether the component was intended to be a permanent attachment;
- the relative ease/difficulty in detaching the affixed item;
- whether the act of detaching the affixed item would result in damage to the principal object;
- the manner and extent to which the item is affixed;
- the relationship the item bears to the object to which it is affixed;
- the degree to which the item is a standardized part and its interchangeability;
- the purpose and use for which the annexation has been performed;
- whether the item and object are united in the prosecution of a common enterprise;
- whether the asset is united with the materials of another and whether the combined materials form a joint product; and
- whether the items were annexed before delivery of the equipment to the debtor, and the debtor purchased the completed units from a single seller, granting a security interest in the assembled units.

Some authors have highlighted that ‘the problem with the common law tests is that the meaning of the term accession tends to shift depending upon the relationship of the parties, a problem exacerbated by the multiplicity and essential vagueness of the tests.’²⁹ Generally, under the common law, all pre-affixation rights in the item would be extinguished on its accession to the principal good.³⁰ This rule reflected a policy that ‘prevented an economically inefficient severance of the lesser good

²³ Peru Civil Code, art 887.

²⁴ Roy Goode, *Official Commentary on the Convention on International Interests in Mobile Equipment and Luxembourg Protocol thereto on Matters Specific to Railway Rolling Stock* (2nd edn, UNIDROIT 2014) 104. Hereinafter the ‘Official Commentary’.

²⁵ Ronald CC Cuming, Catherine Walsh and Roderick J Wood, *Personal Property Security Law* (Irwin Law 2005) 499. *ibid.*

²⁷ See Ulrich Drobniq and Ole Böger, *Proprietary Security in Movable Assets* (Sellier 2015) 267.

²⁸ *In re Aztec Concrete* 136 B.R. 535, 538-39 (Bankr SD IA1992).

²⁹ Cuming, Walsh and Wood (n 25).

³⁰ Duggan and Brown (n 14) 182.

from the principal good. Because the value of the post-affixation whole would exceed the value of the pre-affixation parts following an often-damaging severance, this approach maintained the economic integrity of the end product.³¹ With respect to non-accessions under the common law, there was no conflict between a creditor claiming a security interest over the whole object and a non-accessions creditor who argued that it had retained ownership of the item, and thus the security interest in the whole did not attach to the item.³²

The Australian, Canadian, New Zealand, and U.S. secured transactions laws modified the common law accessions doctrine to provide more predictability and certainty, by including specific definitions of accession and elaborate priority rules.³³ Previously, a determination by the court that an item had become an accession would have been the end of the inquiry, as ownership to it would have passed to the owner of the principal good. In contrast, today under these secured transactions laws that is just the first step in an inquiry, followed by an application of the relevant priority rule under which the accessions creditor may still prevail because its right is not extinguished.³⁴ While the laws of the aforementioned countries enlarged the scope of the definition of accession, which seemingly would be detrimental to the rights of creditors who finance non-accessions, at the same time they provide priority rules that preserve the post-affixation rights of non-accessions creditors.³⁵ These laws now encompass within the notion of accession many common law accessories. For instance, Official Comment 2 to UCC 9-335 provides that '[t]his section applies to an accession... regardless of the cost or difficulty of removing the accession from the other goods, and regardless of whether the original goods have come to form an integral part of the other goods.'

In civil law jurisdictions, Civil Codes also establish that the right to an item is extinguished and passes to the owner of the principal asset on its affixation.³⁶ Civil Codes require an additional element for the ownership to pass in this scenario, which is that the parties must act in good faith.³⁷ Accordingly, if a person affixes an item to the principal asset in bad faith, as a result of which ownership would pass under the general rule, the bad faith element would preserve the right of the third party in the item. Neither Colombia nor Mexico, which recently reformed their secured transactions laws, provide a specific definition of accession or accessory. So, unlike in Australia, Canada, New Zealand, and the United States, the traditional Civil Code notion of accession continues to apply.

III. Convention Article 29(7)(a)

This section examines the circumstances under which Article 29(7)(a) protects third parties with a right in an item. Under this paragraph, a right in an item, held prior to its installation, is unaffected by the Convention as long as the right continues to exist under the applicable law. Examination of this formulation raises several questions, including:

- Does the term 'item' cover engines, parts, and accessories, or only some of them? In other words, what is the meaning of the word 'item' and its relationship to engines, parts, and other accessories referred to in the relevant definitions of the object?

³¹ David Frisch, 'UCC Section 9-315: A Historical and Modern Perspective' (1986) 70 *Minnesota Law Review* 1, 28.

³² See generally, Alvin E Evans, 'Some Applications of Title by Accession' (1942) 16 *University of Cincinnati Law Review* 267, 269.

³³ For New Zealand see Linda Widdup, *Personal Property Securities Act: A Conceptual Approach* (3rd edn, LexisNexis 2013) 182-83.

³⁴ Duggan and Brown (n 14) 182.

³⁵ *ibid* 182-83. The definition of accessions is not as far-reaching as to encompass items that are only slightly or temporarily connected with the principal object, such as the global positioning system (GPS) in a car.

³⁶ Mexico Civil Code, art 916.

³⁷ Mexico Civil Code, art 916; Colombia Civil Code, art 728.

- Is Article 29(7)(a) limited only to those items which are merely ‘installed’ rather than ‘incorporated’ or ‘attached’ (Article 29(7)(a) only uses the word ‘installed’, while the relevant definitions of objects also mention eg parts that are ‘incorporated’ and ‘attached’)? In other words, does the Convention then affect the rights and interests of a person when an item is incorporated into or attached to, rather than installed on the object?
- What is the meaning of ‘does not affect’? Does it mean that the international interest does not extend to the item at all or extends to it, but in a junior rank?
- What is the meaning of ‘rights held prior to installation’? For instance, is it sufficient for a security right in an item to be merely created, failing to satisfy any perfection requirements under the applicable domestic law, for it to be unaffected by the Convention?
- How should the holder of the international interest proceed on default of the debtor if an item, the right to which is unaffected by the Convention, has been installed on the object?

A. The meaning of ‘item’

The CTC regime does not define the term ‘item’. The Official Commentary notes that engines, equipment, components, and parts, prior to their installation or after their removal may be items for the purposes of Article 29(7).³⁸ The examples given imply that items are tangible assets that are installed on the object. However, nothing in the text of Article 29(7) suggests that it does not apply to intangible assets, such as an information system that automatically operates a harvester (eg, John Deere’s Machine Sync technology).³⁹

Article 29(7) concerns only those items that have been installed, but have not become an integral part of the object or can be separated without any significant damage. In some legal systems, these items are known as ‘accessories’, but since that term is used in the definitions of objects in the Protocols this note refers to them as ‘non-accessions’.⁴⁰ Thus, while an international interest in the object would be enlarged with the accession, it may not affect the right to a non-accession if the applicable law provides that such a right continues to exist post-installation. The applicable domestic law governs the conditions for the preservation of the right to the item. Article 29(7)(a) thus concerns only non-accessions – essentially those assets that may be readily identified and easily detached from the object.

The second issue is the relationship between the term ‘item’ and ‘accessories, parts and equipment’, referred to in the relevant definitions of an ‘object’ under the Protocols. Depending on the manner of installation and their relationship to the object, accessories, parts, or equipment, may constitute accessions or non-accessions. Arguably, under some of the accessions tests summarized above, engines and tyres may be easily removed from the object without any significant damage and thus constitute non-accessions. Under the other accessions test, an engine may be considered an accession because it is integral to the operation of the equipment.⁴¹ One may argue that tyres (as well as an engine on MAC equipment) should be treated as accessions because they are integral parts of the object, which may have little utility without them.⁴² Accordingly, the reach and limitation of the accessions doctrine applicable under the relevant domestic law determines the effect of the international interest on the installed asset, and may vary from jurisdiction to jurisdiction.

During its deliberations, the MAC Protocol Study Group considered whether certain assets that may be affixed to MAC objects should be included within the scope of the draft MAC Protocol

³⁸ Goode, *Official Commentary* (n 24) 2.168.

³⁹ Such software would be goods and thus qualify as an accession under UCC 9, but not under the Australian and Canadian Personal Property Security Acts. See UCC 9-102(a)(1) and (44); Australian Personal Property Security Act (PPSA) s 10.

⁴⁰ Nickles (n 22) 118.

⁴¹ *ibid* 122.

⁴² *ibid* 124.

as separate objects.⁴³ In earlier stages, the scope provision of the draft MAC Protocol contained a number of harmonised system (HS) codes developed by the World Customs Organization (WCO) that cover assets that may be affixed to MAC objects, such as blades that could be installed on bulldozers.⁴⁴ Ultimately, the Study Group decided not to include assets covered by such HS codes within the scope of the draft MAC Protocol, unless there was a demonstrable practice of separate 'accessions financing'.⁴⁵ Those assets that can be affixed to a MAC object and do not fall under a separately identifiable HS code may be components of the original MAC equipment or, when newly installed, depending on the application of the accessions doctrine, components of the MAC object or non-accessions.

B. The meaning of 'installed'

Article 29(7) does not apply to items that are accessions. A literal interpretation of Article 29(7) (a) and the definitions of 'objects' may lead to the conclusion that the CTC regime does affect rights in items that are 'attached' to or 'incorporated' into objects, because Article 29(7) mentions 'installation' as the only type of affixation.⁴⁶ For instance, is a spare tire that is carried on the extra rim of the mining machine installed on, incorporated into, or attached to the machine? While Article 29(7)(a) refers only to 'installed' items, the Official Commentary provides examples of assets that may be 'incorporated' into an object, such as spare parts incorporated into a locomotive, which would be covered by this provision.⁴⁷ These references in the Official Commentary may imply that no material difference in meaning is intended in the use of the words 'installed', 'incorporated', and 'attached'. However, one can question whether the intent of the drafters should operate as guidance if, in the light of the specific language in the Convention, there is a material difference between installation and incorporation under the applicable law. If attachment and incorporation covered factual situations that differ from installation, it is unclear what the effect of the Convention on such rights would be. A plausible interpretation could be that items attached or incorporated are affected by the Convention and become subject to an international interest. This narrow reading of the effect of Article 29(7)(a) would be consistent with the underlying policy that seeks to prevent the accessions creditor from affecting/impairing the rights of the creditor in the principal object.

Article 29(7)(a) is clear as to the non-applicability of the CTC regime to the rights in an item held pre-installation. To establish the CTC regime's non-applicability, first, it would be necessary to examine the applicable domestic law to determine whether installation has occurred and whether the right continues to exist in the object post-installation. Going by a literal interpretation of Article

⁴³ For the Reports from the meetings of the MAC Protocol Study Group see <<https://www.unidroit.org/work-in-progress/mac-protocol>> accessed 26 February 2018. The First Meeting of the MAC Protocol Study Group was held on 15-17 December 2014.

⁴⁴ For more information on HS codes see Teresa Rodríguez de las Heras Ballell and Megumi Hara, 'MAC Protocol and Treaty Design: Examination of the Delimitation of Scope and Mechanism of Amendment' (2017) 6 Cape Town Convention Journal [this issue] 10.

⁴⁵ See UNIDROIT, *Study 72K – SG4 – Doc. 2* (Issues Paper (Prepared by the UNIDROIT Secretariat), 2016) 15 <<http://www.unidroit.org/english/documents/2016/study72k/s-72k-sg04-02-e.pdf>> accessed 4 December 2017. The list of HS codes considered by the Study Group at its fourth meeting included three codes that could potentially cover such assets; one of these codes was demoted to Tier 3 as being unsuitable for the purposes of the MAC Protocol. For more detail, see UNIDROIT, *Study 72K – CGE1 – Doc. 4* (Legal Analysis (Prepared by the UNIDROIT Secretariat), 2016) para 17 <<https://www.unidroit.org/english/documents/2016/study72k/cge1/s-72k-cge01-04-e.pdf>> accessed 26 February 2018.

⁴⁶ The Rail Protocol refers only to 'incorporated' while the Aircraft and Space Protocols refer to both 'attached' and 'incorporated'.

⁴⁷ Goode, *Official Commentary* (n 24) para 4.196.

29(7)(a), if under the applicable law the item has been installed in such a manner that the rights in it continue to exist, they would remain unaffected by the international interest. The interpretation that 'installed' in Article 29(7) has a broader meaning that encompasses 'attached' and 'incorporated' would eliminate any difficulties for the parties, and eventually the courts, to determine whether an item has been installed or rather incorporated/attached. However, under this interpretation the international interest over the object would not affect the right in an attached/incorporated item thus impinging on the breadth of the international interest. A policy aimed at protecting the international interest would dictate a contrary interpretation under which the right in the attached/incorporated item would become subject to the international interest, in contrast to a right in an item that has been installed. This interpretation would be relevant only if the applicable law drew a distinction between items that are installed, on the one hand, and attached/incorporated, on the other hand. However, this is expected to be a rare occurrence.

C. The meaning of 'continue to exist'

The effectiveness of the rights of the holder of an international interest in an object as against an item will depend on the applicable domestic law that determines whether the right of the third party in the item continues to exist post-installation.⁴⁸ For Article 29(7)(a) to apply, two conditions must be satisfied in this context: i) the third party acquired its right pre-installation; and ii) that right continues to exist post-installation. Since this provision refers to a right 'held', rather than perfected or effective against third parties under the applicable domestic law, the Convention does not seem to affect any right in an item, such as a security interest, whether or not it was perfected prior to installation. Similarly, if the applicable law extends the effect of conditional sales and leases in items post-installation, the rights in those items would be unaffected by the international interest.

The Convention does not preclude the holder of an international interest from claiming an interest in the item, and gaining priority over the rights of the person in that item, under the domestic law. If the holder of the international interest has also taken an interest in the object under the domestic law, that interest may also extend to the item post-installation. In most cases, the satisfaction of the requirements for the constitution of the international interest would also satisfy the requirements of the applicable domestic law under which a security interest or other property right will be created/reserved in the object.

The extension of the property right created or arising under domestic law to the item is contingent on the security agreement covering such item and on the owner of the object acquiring sufficient rights in the item for the creditor's property right to extend to the item. In some systems, the second condition is satisfied only on the full payment of the purchase price, because until then the seller or supplier of the item remains its owner under a finance lease or conditional sale. As a result, there will be no priority conflict and the non-accessions creditor will have the right to remove the item. Under secured transactions systems that re-characterize conditional sales and financial leases as security interests, such as those of Australia, Canada, New Zealand, the United States, but also Colombia and Mexico, the right of the third party in an item may continue post-installation, but a security interest of the creditor over the whole would extend to the item. Accordingly, if the creditor has also satisfied the requirements for the constitution of an interest under domestic law, a priority conflict will arise. Naturally, the CTC regime does not provide a rule to determine the outcome of this conflict, which turns on the application of the domestic rule, such as the specific rule of the U.S. Uniform Commercial Code 9-335 or the general first-to-file or perfect rule of the Colombian secured

⁴⁸ For instance, under art IX – 2:305 of the DCFR a security right in goods continues even if the encumbered asset subsequently becomes an accessory.

transactions law. The applicable law may also provide for the right to enforce a security interest in the entire object, including any items. Even if a rule like UCC 9-335 subordinates the creditor's interest to that of a third party with a right in the item, the junior priority position still entitles the creditor to dispose of the object as a whole.

D. The meaning of 'does not affect'

Once it has been established that a right to an item continues to exist post-installation, the Convention does not affect that right. One may interpret this legal effect to mean that either: i) an international interest in an object does not extend at all (even in a junior position) to the item subject to a pre-installation right; or ii) that it does so but in a junior rank or otherwise in a manner that would not hinder the right to dispose of the object on default of the debtor. From a legal perspective, the former is the more plausible interpretation because the extension of an international interest to the item would affect the right in that item. From an economic perspective, the latter is more logical because it balances the need of the creditor to expeditiously dispose of the object as a whole and the expectation of the third party to be paid for the item it has financed. This interpretation is also better aligned with the underlying principles of the CTC regime, especially those that facilitate expeditious remedies. It could not have been the intent of the drafters to suspend enforcement until all items, subject to the rights of third parties, have been removed from the object.

Notably, paragraph 7 does not exactly fit under Article 29, which is supposed to resolve the priority of competing interests. While paragraphs 1-4 provide such priority rules, the language of paragraph 7 is, in essence, not a priority rule at all, but rather a rule of creation.⁴⁹ It is not strictly a priority rule because the international interest does not affect a right in an item created pre-installation. Since the international interest does not affect it at all, there cannot be any conflict between the international interest and the pre-installation right.

To some extent, Article 29(7)(a) is more generous to 'non-accessions creditors' than many domestic laws. For example, under UCC 9-335, a security interest in the whole would attach and become perfected as to an affixed asset characterized as an accession under the UCC (accession being defined in UCC 9-102(a)(1) in such a manner as to encompass the term 'items' as referred to in the Convention). UCC 9-335 also determines the priority conflict between the security interest in the whole and the security interest in the affixed asset (accession), providing that the security interest in the whole may have priority over a security interest in the accession. In contrast, under Article 29(7), the right in an item (ie, its priority) remains unaffected by the international interest. In a sense, the Convention's approach is based on the common law doctrine of accessions, which the secured transactions laws of Australia, Canada, New Zealand, and the United States have since replaced with a new definition of accession and an elaborate system of priority rules. While the civil law notion of accessions, as reflected in several Civil Codes, has not been altered in some recently enacted secured transactions laws (eg, Colombia, Mexico, and Peru), the creation and priority rules of these secured transactions laws allow the creditor with a security interest in the whole to acquire a security interest in any affixed item, with the same priority as that established for the security interest in the whole.

One may find it curious why the Convention affects non-consensual rights relating to items (eg, the right of a mechanic who replaced a broken engine), but not consensual rights in items, which could arise under the same circumstances. An explanation may be that in the former case the non-consensual right extends to the entire object (eg, the mechanic has the right to retain possession of

⁴⁹ The Official Commentary (n 24) 104 notes that 'article 29(7) is not strictly a priority rule.'

the bulldozer), while in the latter case the right extends only to the item (eg, a rotary table). The Convention provides priority rules that deal solely with conflicts between consensual rights and interests in the object as a whole.

E. The meaning of 'person'

In construing the statement of Article 29(7)(a) that the Convention 'does not affect the rights of a person in an item...', it would seem that the term 'person' should be understood broadly to include third parties as well as the debtor. However, an alternative interpretation would be that Article 29(7)(a) applies only to rights of third parties, excluding the debtor. In other words, if the debtor uses its own capital to buy and replace an engine, the replacement does not constitute an item and the international interest extends to the new engine. In contrast, if a third party has financed the new engine, it may be treated as an item under Article 29(7). Such interpretation draws a line between the nature of rights in the same asset and its effect on the international interest, depending on whether the debtor owns the item free and clear of any encumbrances or subject to a third party's right.⁵⁰ One may argue that if the debtor uses its own funds to buy replacement tyres, the secured creditor is not economically disadvantaged because it would otherwise need to provide some financing to the debtor to acquire the same tyres. Accordingly, why give any right or priority to the holder of the international interest? It is so for practical reasons. For instance, the debtor may have replaced functioning tyres where no replacement was necessary and thus effectively reduced the value of the creditor's security, as the old tyres subject to an international interest might have some economic value, while the international interest would not extend to the new tyres. The creditor's enforcement rights may also be affected by the debtor's removal of the tyres, making repossession significantly more cumbersome or forcing the creditor to replace them at the last minute, which could delay the final disposal of the object. In any case, an item (such as tyres or an engine) acquired with the debtor's own funds and installed on an object would become a component of the object and subject to the international interest. The benefits of Article 29(7) are practically confined to third parties.

There may be a risk that a particular item (eg, an engine) is regularly or occasionally removed for maintenance, in which case it would not, at least temporarily, be a component of the object subject to an international interest. If the secured creditor wants to ensure that its rights extend to the engine when it is not installed on the object, it should take an interest in it under domestic law. Since the CTC regime has no application to rights in items and components when not installed on the object, secured creditors should protect their rights in those assets, such as by perfecting security interests therein in accordance with the applicable domestic law. A security agreement should cover not only the principal object and associated items, but also 'all replacements thereof and all accessories, additions, parts and equipment now or hereinafter affixed thereto or used in connection therewith'.⁵¹ A description must reasonably/sufficiently identify the associated items under the applicable domestic law. For instance, in one case, a US court found a description of 'accessories thereto' to be sufficient to cover \$150,000 of spare parts to a \$3.5 million power shovel.⁵² Another US court found a description of 'all accession and additions thereto' sufficient to cover a rotary table welded on the rig.⁵³

⁵⁰ Frisch (n 31) 8.

⁵¹ Nehf and McDonnell (n 11) s 17.01.

⁵² *In re Dixie Fuels Inc* (n 9).

⁵³ *Brown* (n 8).

IV. Implications for the MAC Protocol

This section examines some of the provisions of the draft MAC Protocol relevant to the discussion above. In particular, it focuses on the definition of MAC objects as well as implements that may be attached to a MAC object. The draft MAC Protocol, discussed during the First Session of the Committee of Governmental Experts (20-24 March 2017) (the 'First Session'), defined the three types of objects it covers in a different manner from the (three) previous Protocols.⁵⁴ Instead of providing a specific definition, it simply referred to six-digit HS codes in the relevant annexes. Accordingly, unlike the earlier Protocols, it initially did not include any references to parts and accessories in the definitions of agricultural, construction, and mining equipment. This approach was re-examined in the light of the fact that some parts and engines of the objects covered by the draft MAC Protocol are listed under HS codes that have not been included within the scope of the draft MAC Protocol. Based on a specific proposal of the United Kingdom delegation during the First Session, the definitions were modified to include the language from the definitions of objects in the previous Protocols.⁵⁵ If an international interest is taken in a completed machine, an engine installed in the equipment, even if listed under an HS code not covered by the draft MAC Protocol, will be subject to the international interest. This modification avoids the plausible argument that such an engine is not encumbered by the international interest because its applicable HS code has not been included within the scope of the draft MAC Protocol. Such an argument would be particularly strong with a replacement engine that constitutes an accession, which an international interest would have otherwise extended to.

Similar to railway rolling stock and space assets, two MAC objects may be connected to one another. Trains may consist of separate bogies that are detachable and replaceable, and each bogie would constitute an individual registrable unit. Accordingly, which equipment constitutes an object for the purposes of registration depends on: i) how they are connected;⁵⁶ and ii) the intention of the user.⁵⁷ A space asset may be docked on another space asset or installed thereon. Under Article III of the Space Protocol, such docking and installation does not affect the international interest. Similarly, the international interest remains unaffected if a space asset is removed from another space asset, such as when transponders installed on a satellite are subsequently sold to a purchaser.⁵⁸ Article III(a)-(b) of the Space Protocol 'is intended to avoid the application of rules of domestic law concerning accessions under which an object which becomes annexed to or incorporated in a larger object passes into the ownership of the larger object'.⁵⁹

The draft MAC Protocol covers certain HS codes that include equipment known as 'implements'. As an example, HS Code 842481 ('Agricultural, horticultural or forestry machinery for soil preparation or cultivation; lawn or sports-ground rollers – Disc harrows') covers sprayers that may be pulled or self-propelled when mounted on a tractor. In the former case, the sprayer may be temporarily affixed to a tractor or a similar machine when in use. The draft MAC Protocol contains four additional

⁵⁴ See UNIDROIT, *72K – CGE1 – Doc. 2 corr* (Preliminary Draft Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Agricultural, Construction and Mining Equipment, February 2017) <<http://www.unidroit.org/english/documents/2017/study72k/cge01/s-72k-cge01-02corr-e.pdf>> accessed 4 December 2017.

⁵⁵ See UNIDROIT, *72K – CGE1 – Doc. 9* (Comments: Submitted by the Government of the United Kingdom, March 2017) <<http://www.unidroit.org/english/documents/2017/study72k/cge01/s-72k-cge01-09-e.pdf>> accessed 4 December 2017.

⁵⁶ According to the Official Commentary, 'a single train may consist of cars which sit on separate bogies which are readily detachable and exchange-able, each car being a separate registrable unit'. See Goode, *Official Commentary* (n 24) 167.

⁵⁷ According to the Official Commentary, 'if there is no intention to split it into shorter sections the relevant unit for registration purposes is the tram as a whole'. See *ibid* 166.

⁵⁸ Roy Goode, *Official Commentary on the Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Space Assets* (UNIDROIT 2013) para 5.20.

⁵⁹ *ibid* 426.

HS codes that cover discrete pieces of equipment that must be connected to other equipment in order to be used (in most cases pulled by tractors).⁶⁰

Thus, the question may arise whether an international interest in a tractor would automatically extend to a sprayer that is characterized as an accession under the applicable domestic law. The draft MAC Protocol answers this question in the negative, as it lists the sprayers under an HS code separate from the tractor so that they constitute discrete MAC objects. As a result, it dis-applies the accessions doctrine in a manner similar to the Aircraft Protocol, which treats engines as objects separate from airframes. Thus, a sprayer will remain a separate registrable object so that a registration covering a tractor will not make the international interest effective with respect to the sprayer installed on tractor.

V. Final Observations

The CTC regime attempts to balance the rights of a holder of an international interest in an object with those of a person in an item installed on the object. It draws a line between accessions and non-accessions. However, for the holder of an international interest, Article 29(7)(a) may create some legal risks because the applicable domestic law, which is often uncertain, determines where that line stands. The approach with respect to non-accessions raises several practical issues, such as the need for the holder of the international interest to determine whether the replacement engine or parts are subject to a third party interest before making an advance to the debtor. The fact that the right in an item is unaffected by the CTC regime should give pause to the creditor before making an advance against an item over which it may not have priority. This may not be a concern for a lessor or a seller who does not make future advances against the same collateral, but instead collects instalments. However, it might be a concern for a lender who relies on an object as collateral to secure running obligations of the debtor.

The CTC regime does not require any form of notification to the holder of an international interest when a third party claims a right to an item that is installed on the object but is removable from it. This should not be a concern when the non-accession is merely an addition on which the holder of an international interest did not rely, but it will concern the holder when the non-accession is in the nature of an item that replaced the original component on which the holder relied when extending credit. Taking an interest in any non-accessions under the applicable domestic law would also ensure that the holder of an international interest is properly notified before the non-accessions creditor takes any enforcement action.

Many domestic laws have been recently reformed to broaden the reach of the notion of accession thus facilitating the attachment and priority of an international interest thereto. Furthermore, the policy of Article 29(7) of the Convention protects the rights in items of third parties, but not the debtor. Even with respect to the rights in items held by third parties, the Convention does not suspend or otherwise affect the right of the creditor to enforce its rights in the object to which an item has been affixed. Nonetheless, it may be still advisable for the holder of an international interest in the object to also create and perfect an interest under the applicable domestic law in any non-accessions to gain priority over the rights of a third party.

⁶⁰ These include: i) 843210 ('Agricultural, horticultural or forestry machinery for soil preparation or cultivation; lawn or sports-ground rollers – Plows'); ii) 843239 ('Agricultural, horticultural or forestry machinery for soil preparation or cultivation; lawn or sports-ground rollers – Seeders, planters and transplanters'); iii) 843240 ('Agricultural, horticultural or forestry machinery for soil preparation or cultivation; lawn or sports-ground rollers – Manure spreaders and fertiliser distributors'); and iv) 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').