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### **Issues Paper**

(Prepared by the UNIDROIT Secretariat)

<i>Summary</i>	Analysis of major issues facing the creation of the MAC Protocol.
<i>Action to be taken</i>	Discussion.
<i>Related documents</i>	<i>UNIDROIT 2015 – Study 72K – SG3 – Doc. 3</i> <i>UNIDROIT 2015 - Study 72K – SG3 – Doc. 4</i>

### **Introduction**

1. The purpose of this document is to set out the most significant legal and technical issues facing the creation of the MAC Protocol. The document incorporates ongoing research being conducted by the Secretariat and details of the Study Groups views on issues across all meetings. As such, it is designed to be an evolving paper that documents the progress towards overcoming the legal challenges faced.

2. This third iteration of the paper has been expanded significantly since the second Study Group meeting, due in part to the extensive research conducted over the past six months.

3. Part I considers existing legal issues that the Study Group has not yet reached a position on. Part II provides a summary of legal issues that the Study Group has considered and resolved during previous meetings. There is no specific need for the Study Group to reconsider the legal issues in Part II of the document, its purpose is to provide a summary of previously resolved issues in the event that the Study Group wishes to give a previous issue additional consideration.

4. The document is to be considered in conjunction with the most recent Annotated Draft Protocol (*UNIDROIT 2015 - Study 72K – SG3 – Doc. 3*). This document will reference the Article(s) of the Protocol that will need to be adapted to solve the legal and technical issues considered.

5. It should be reiterated that the commentary in Part I of this document is a discussion tool, and should not be considered as providing final views of how legal issues should be solved.

6. The issues dealt with in this document are as follows:

## PART I - EXISTING ISSUES

- A. Scope - Use of the Harmonized System
- B. Scope - Preliminary List of HS Codes for inclusion under the MAC Protocol
- C. Use of Article 51(1) Criteria - High Value
- D. Use of Article 51(1) Criteria - Mobile
- E. Use of Article 51(1) Criteria - Uniquely Identifiable
- F. Fixtures
- G. Accessions
- H. Special Insolvency Regimes affecting farmers and agricultural enterprises
- I. Restrictions on the enforcement of security interests in farming equipment
- J. Insolvency Alternatives
- K. Application to sales
- L. Interaction between Article 29(3)(b) and the MAC Protocol
- M. Interaction between MAC and Rail Protocols
- N. Registration and Titling of MAC equipment
- O. Multiple purpose equipment
- P. Supervisory Authority

## PART II - RESOLVED ISSUES

- Q. Severability
- R. Merged Collateral
- S. Inventory
- T. Interaction with domestic secured transaction regimes
- U. Public service exception
- V. De-registration and export request authorisation
- W. Modification of Assignment provisions

## PART I – EXISTING LEGAL ISSUES

### A. Scope - Use of the Harmonized System

7. Following the conclusion of the second Study Group meeting, Unidroit has collaborated with the World Customs Organisation (the WCO) to further evaluate whether the Harmonized System can be used to delineate the scope of the MAC Protocol. Following these discussions, the WCO has agreed to assist with the MAC Protocol project and participate in the third Study Group meeting. Mr Ed de Jong (Senior Technical Officer, Tariff and Trade Affairs Directorate) will be participating on Day 1 of the meeting.

8. In UNIDROIT's initial discussions with the WCO, the WCO noted that the HS System is already used to define the scope of certain aspects of two other international instruments: the Agreement on Trade in Civil Aircraft and the Energy Charter Treaty.

9. The Agreement on Trade in Civil Aircraft is a multilateral treaty with 30 states party which entered into force in 1980. It is a World Trade Organisation Treaty which establishes an international framework to provide fair competitive conditions for trade in civil aircraft, parts and related equipment. It also eliminates customs duties and other charges of any kind levied on the importation of the products listed in its Annex, if such products are for use in a civil aircraft and incorporation therein. As a WTO Treaty, it was included in Annex 4 of the WTO 1994 Agreement.

10. The Energy Charter Treaty (ECT) is an international agreement which establishes a multilateral framework for cross-border co-operations in the energy industry. The treaty covers all aspects of commercial energy activities including trade, transit, investments and energy efficiency. The 1991 treaty has 51 member states.

11. Mr de Jong (Senior Technical Officer, Tariff and Trade Affairs Directorate) will present on how the HS System is utilised by these treaties and whether these approaches can be adapted for use in the MAC Protocol.

#### *Consideration at previous meetings*

12. At the first meeting of the Study Group, it was agreed that the best likely method of delineating the scope of the MAC Protocol was by use of the Harmonized Commodity Description and Coding System (HS).<sup>1</sup> The issue was considered in more detail at the second Study Group meeting, based on research done by the National Law Centre for Inter-American Free Trade.<sup>2</sup>

13. During the second Study Group meeting, it was noted that the HS System is broken down into 5,205 6-digit groups, covering 98% of international trade. The amendment process which occurs every five years, address 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 MAC Protocol were affected by the amendments, and these changes were structural rather than substantive.

14. Two possible approaches the MAC Protocol could take in addressing amendments to the HS system: 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. In concluding his presentation at the second meeting, Mr Dubovec highlighted that while there are several other goods classifications that are utilised globally for a variety of purposes, the HS

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<sup>1</sup> [UNIDROIT 2015 - Study 72K - SG1 - Doc. 5](#), paragraphs 6-9.

<sup>2</sup> <http://www.unidroit.org/english/documents/2015/study72k/sg02/s-72k-sg02-02-e.pdf>

system remains the benchmark and most utilised of all other systems, and is the most appropriate system for establishing the scope of the MAC Protocol. The Study Group also noted that it was not contemplated that the HS codes would be used for registration or search purposes under the International Registry.

#### *Background*

15. The following section contains the analysis of the HS system provided to the Study Group at its second meeting.

#### *Organisation of the HS System*

16. 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.

17. 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.

18. 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.

19. 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.

20. 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*

21. 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

22. 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.

23. 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*

24. 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).

25. 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>3</sup> In some circumstances, rather than amending the Convention and, thus the entire HS System, merely the Explanatory Notes are modified.

26. 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.

27. 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.

28. 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

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<sup>3</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).

period, no objections have been filed, the amendment will be deemed 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.

29. 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*

30. 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.

31. 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>4</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.

32. 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 UNCTAD'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*

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<sup>4</sup> See further Cebeci, T., Fernandes, A., Freund, C. and M. Pierola, "Exporter Dynamics Database" [World Bank Policy Research Working Paper 6229](#) (2012).

33. 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.

34. 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.

35. 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.

36. 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.

37. 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.

38. 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.

39. 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.

40. 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 the 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.

41. 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.

42. 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.

43. 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).

44. 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.

45. 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*

46. 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.

47. 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.

48. 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.

#### *Alternative Classification Systems*

49. 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.

50. The United Nations Statistics Division (UNSD) uses the following commodity classification systems: SITC, ISIC and CPC.<sup>5</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>6</sup>

51. 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.

52. 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.

53. 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.

54. 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.

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<sup>5</sup> The COMTRADE database of the UNSD also uses the HS System.

<sup>6</sup> See

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

55. The European Union uses the Combined Nomenclature (CN), according to which imported and exported goods must be classified.<sup>7</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.

56. 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.

57. 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.

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

58. Providing extensive information which can be used to analyse the preliminary list of HS codes continues to be a challenge, due to the fact that this information does not appear to be publicly available or comprehensively compiled and held by one organisation or company.

59. At the first Study Group meeting, the Study Group was provided with a list of 97 HS codes provided by the private industry during Consultations in Washington in 2013 and 2014. At the second Study Group meeting, this list was expanded to include an additional six codes suggested by General Electric mining, and further detail was provided:

- 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.
- Images of the sample equipment covered by the applicable HS codes.
- 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.

60. In preparation for the third Study Group meeting, the Unidroit Secretariat has further refined the preliminary list in the following ways:

- Where applicable, subheadings providing additional examples for HS codes with several sub-areas of equipment
- Expanded descriptions which provide more information about the various types of equipment included under the listed HS codes
- Additional comments taken from the official Explanatory Notes of the HS system

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<sup>7</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).

- 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
- 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

61. Consultations with German industry in August 2015 led to the addition of 7 new HS codes for consideration on the preliminary list. These codes cover:

- 841370 - Pumps for liquids, whether or not fitted with a measuring device - Other centrifugal pumps
- 843049 - Other moving, grading, levelling, scrapping, excavating, tamping, compacting, extracting, or boring machinery , for earth, minerals or ores; pile-drivers and pile-extractors; snow-ploughs and snow-blowers - other
- 843049 - Other moving, grading, levelling, scrapping, excavating, tamping, compacting, extracting, or boring machinery , for earth, minerals or ores; pile-drivers and pile-extractors; snow-ploughs and snow-blowers - Concrete or mortar mixers
- 847432 - Machinery for sorting, screening, separating, washing, crushing, grinding, mixing or kneading earth, stone, ores or other mineral substances, in solid form; machinery for agglomerating, shaping or moulding solid mineral fuels - Machines for mixing mineral substances with bitumen
- 847982 - Machines and mechanical appliances having individual functions, not specified or included elsewhere in Chapter 84 - Mixing, kneading, crushing, grinding, screening, sifting, homogenising, emulsifying or stirring machines.
- 87054 Special purpose motor vehicles, other than those principally designed for the transport of persons or goods - Concrete-mixer lorries
- 87162 Trailers and semi-trailers; other vehicles, not mechanically propelled; parts thereof - Self-loading or self-unloading trailers and semi-trailers for agricultural purposes

62. The additional codes have also been added to the Annexes in the draft Protocol. The Secretariat continues to do additional work on the potential of adding HS codes covering high-value aquaculture equipment, as suggested at the second Study Group meeting.

63. It is anticipated that the WCO may be able to provide additional information once the list has been further limited, perhaps by concentrating on the HS codes with the highest likelihood of inclusion based on the Article 51 criteria of high value, mobile and individually identifiable. As such, the Study Group may wish to discuss whether a priority list of equipment can be identified from the current list of suggested codes.

64. Ultimately, it appears that the likely best source for additional information on the suggested codes will be information voluntarily provided by the private sector itself. Following the first Working Group meeting on 10 September 2015, the Unidroit Secretariat sent out an additional note to the Working Group, which in part requested the following information:

- Please indicate which of the HS codes in the MAC Protocol Annex cover MAC equipment that your company is currently producing/exporting/financing/using
- Are there any other HS codes not in the list that cover MAC equipment that your company is producing/exporting/financing/using?

- Of the HS codes covering MAC Equipment which your company is producing/exporting/financing/using, which HS codes are the most important for inclusion under the MAC Protocol (on the basis that they cover the highest value equipment your company is producing/exporting/financing/using, or because it covers equipment that your company is more commonly producing/exporting/financing/ using, or on any other basis)?

65. Answers to these questions should provide the Study Group with a stronger basis to assess the suitability of each of the HS codes on the preliminary list for ultimate inclusion in the Protocol. It is anticipated that the Working Group will be able to provide further input on these questions at the final Working Group meeting in early 2016.

### **C. Use of Article 51(1) Criteria – High Value**

66. The natural starting point when considering the scope of the 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.*

67. 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 law.

68. At the first meeting of the Study Group, it was agreed that the best likely method of delineating the scope of the MAC Protocol was by use of the Harmonised Commodity Description and Coding System (HS System).

69. Utilisation of the HS System will allow the scope of the 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, and in some instances will also include parts (accessions).

70. Data collated from export and import agencies in different countries should allow the Study Group to determine the minimum, maximum and median prices of individual pieces of equipment, although this data is not yet available for consideration. The Working Group has been requested to provide what types of machinery they export under the listed HS codes, including approximate retail values.

71. Once this data has been collected, it will only be indicative of trends and should not be given undue weight. For example, a HS code that includes both multi-million dollar complete harvesters but also small parts may have a minimum price of \$1 and a maximum price of \$1 million dollars and a median price of \$2 due to the likelihood that many more small parts are exported than complete harvesters. Despite the low minimum and median prices, the HS code may still be a very strong candidate for inclusion under the Protocol.

72. The potential for inclusion of limited amounts of low value MAC equipment under a HS code that covers mainly high value MAC equipment should not be a determinative factor. Indeed, the possibility of the registration of low value equipment is possible in an existing 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 clearly also covers older and smaller railway rolling stock objects, regardless of their value.

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

#### **D. Use of Article 51(1) Criteria – Mobile**

74. The natural starting point when considering the scope of the 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.*

75. 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 law.

76. At the first meeting of the Study Group, it was agreed that the best likely method of delineating the scope of the MAC Protocol was by use of the Harmonised Commodity Description and Coding System (HS).

77. At the first meeting the Study Group concluded that there was no need to explicitly define mobility in the MAC Protocol.<sup>8</sup> At the first Study Group meeting it was noted that the definition of mobility also arose during the negotiation of the Luxembourg Rail Protocol and that a solution could not be identified.

78. To some extent, the use of the HS itself addresses the mobility criterion, as it is a system specifically designed for identifying different types of equipment that are traded internationally.

79. It should also be noted that majority of security interests registered under the International Registry for the Aircraft Protocol are aircraft that actually service domestic rather than international routes. As such, it is clear that demonstrated routine international mobility for every piece of equipment is not required for a Protocol to the Cape Town Convention to be successful.

80. The Study Group may also want to discuss whether equipment which is stationary in its operation (such as mechanical milkers, poultry installations and fruit presses) would still meet the mobility criterion, on the basis it is still internationally mobile in its trade, and is still capable of being packed up and moved between countries.

#### **E. Use of Article 51(1) Criteria – Uniquely Identifiable**

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<sup>8</sup> [UNIDROIT 2015 - STUDY 72K – SG1 – DOC. 5](#), paragraphs 11-13.

81. The natural starting point when considering the scope of the 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.*

82. 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 law.

83. At the first meeting of the Study Group, it was agreed that the best likely method of delineating the scope of the MAC Protocol was by use of the Harmonised Commodity Description and Coding System (HS). However, use of the HS system does not in itself restrict the scope of the MAC Protocol to uniquely identifiable equipment.

84. As consistent with the approach in the previous Protocols, identification of MAC equipment for registration purposes will be done via manufacturers' serial number. 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 objects that do not have a manufacturer's serial number.

85. One potential benefit of adopting a strict approach preventing the registration of MAC equipment without a manufacturer's serial number is that it would assist in preventing the registration of un-serialised low value commodity-like objects contained in the listed HS codes. Simply put, low value goods are less likely to have individual unique serial numbers than high value goods.

86. At the second Study Group meeting a compromise solution was made, 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. Professor Mooney queried how the Registrar could be satisfied that the Registry issued serial number is affixed to the correct object, under the Luxembourg Rail Protocol approach. The Secretary-General noted that this issue has yet to be fully resolved, but it will be dealt with in the Supervisory Authority's procedures.

87. The Study Group decided that this Article XV of the draft 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.

88. Further consideration was given to this issue at the first Working Group meeting in London on 10 September 2015. Working Group members indicated that their understanding was that generally the relevant MAC equipment was being manufactured with serial numbers, but it may not always be exported as completed machinery. Following the Working Group, the Secretariat requested further information from the Working Group members both in relation to the following serial number-related questions:

- (i) Does the fully completed equipment that your company is producing/exporting/financing/using listed under the HS codes in the MAC Protocol Annex have a unique manufacturer serial code?

- (ii) Do the parts/accessories/accessions that your company is producing/exporting/financing/using listed under the HS codes in the MAC Protocol Annex have unique manufacturer serial codes?

89. The Working Group should be in a position to report back to the Study Group on these issues at the fourth Study Group meeting.

## F. Fixtures<sup>9</sup>

### *Background*

90. Issues may arise where MAC equipment requires physical affixation to real property and thus could be treated as a fixture under domestic law. This is a difficult and complex issue, as any attempt by the MAC Protocol to interfere with domestic law in relation to fixtures may be resisted by States.

91. 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 particular, the following types of equipment drawn from *Study 72K – SG2 – Doc. 3* may require some degree of connection to immovable property that in some jurisdictions could be categorised as affixation:

- (a) 820713 – Rock drilling or earth boring tools.
- (b) 841350 - Other reciprocating positive displacement pumps.
- (c) 842620 - Tower Cranes. The tower crane is a fixed crane that is mounted on-site. It present itself like a vertical metallic structure having a horizontal boom that can turn over an angle up to 360°
- (d) 842649—Derricks etc self-propelled not on tires. A Derrick is a kind of crane with a movable pivoted arm for moving or lifting heavy weights.

92. The first Study Group meeting 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.

93. As instructed, a comparative analysis has been drafted by the UNIDROIT Secretariat. The study is based on both individual submissions by UNIDROIT Correspondents and independent jurisdictional research by the Secretariat.

### *Legal Framework*

94. Under the UNCTIRAL 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.

95. 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

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<sup>9</sup> NLCIFT pages 57 – 58.

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.

96. Article 60 of the Convention, however, gives priority to any pre-existing right in a Contracting State prior to the ratification of the Convention and its protocols.

#### *Definitional issues*

97. The issue of definitions was also raised in previous study groups, whereby, in particular in the Study Group of April 2015, the use of the term 'fixture' was questioned on the grounds that it would potentially create legal uncertainty taken into account that most civil law jurisdictions apply a broad approach over that term effectively covering any item placed on a piece of land. Similarly, the term 'attachment' was considered unsuitable due to its legal usage in certain common law jurisdictions.

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'.

#### *Treatment of security interests in affixable equipment under domestic legal regimes*

99. 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.

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

100. Detailed submissions were received from experts based in Colombia, Hungary, Spain, Japan, South American countries (Mexico in particular), the USA, Greece, Uruguay and Turkey. Additionally, the independent research of the Secretariat includes jurisdictional data on Quebec, France, Argentina, Italy, Germany, Syria, Egypt and England.

#### *Colombia<sup>10</sup>*

101. The 1887 Colombian Civil Code places major emphasis on the nature of the object and the intention of the landowner in the given context. For mobile equipment to be deemed immovable, and to be considered as a fixture to real estate property or land, the explicit intention of the landowner is a prerequisite. Where the nature of the equipment is deemed to be 'use, cultivation or benefice of the land', the equipment is likely to be considered a fixture. This clearly excludes equipment on lease.

102. In order to safeguard the rights of creditors who receive equipment 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 a movable property on the grounds that such a right has already been created in favour of a third party.

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<sup>10</sup> Extracts from the Colombia submission to UNIDROIT.

103. In case of 'movables by anticipation', the equipment is legally considered as 'separate unit of the immovable property'. The Colombian law on security interests has been reformed and is based on UNCITRAL Legislative Guide on Secured Transactions and OAS Model Law on Secured Transactions. One requirement of this reform law is that all pledged non-possessory equipment would need to be effected through online filing.

*Hungary*<sup>11</sup>

104. The 2013 Hungarian Civil Code provides a clear cut distinction between a 'component part' and an 'accessory'. The former refers to a part removal of which would significantly undermine the functionality and would significantly reduce the value of the remaining parent part (i.e. the land). The landowner would acquire the ownership of the parts which would subsequently become components to the parent item. However, a prior legal commitment with a third party on a component part would create an exception to this rule. The lasting relation between the parent and its component part is typically based on their physical relation although such is not necessary as it may also be based on the functional interdependence between them. Account is taken whether the purpose of a parent-component structure is definite, temporary or permanent and whether their separation leads to destruction or to a significant reduction of the value or usability as well as to a loss of their functional interdependence.

105. Case law decisions have also upheld this functional approach putting emphasis on the operative aspect of whether the structure has been rendered impossible even in cases of no physical damage. Parent and component parts enjoy joint legal rights, and only after separation the independent entities might be transferred or charged separately.

106. However, even relatively low costs of separation or transfer of equipment, would not neutralise the possible operational loss of the whole set-up. Functional relation plays a pivotal role, where either the equipment is permanently attached to an immovable property or in case of no physical attachment, the equipment acts as an accessory for better and more efficient functionality of the set-up as a whole. The term accessory refers to an additional movable item which is deemed to be necessary and beneficial for the proper use and maintenance of the principal part, whereby ownership could be extended to cover accessories under a rebuttable presumption. The relationship between the accessory and the principal part is one of an economic nature, whereby permanent physical connection is not required and the former might be subject to a separate legal transaction. Unless agreed otherwise by the parties, the legal status of the principal part also covers the accessory.

*Spain*<sup>12</sup>

107. The 1889 Spanish Civil Code considers the following as immovable property: lands, buildings, roads and anything which is joined to the ground. Also, anything which is joined to an immovable property on a fixed basis where its separation would either break the material or impair the object, and 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. Machines and utensils which are destined by the owner of immovable property, in the context of an industry or an undertaking, for the purposes of satisfying the needs of the undertaking, are also covered.<sup>13</sup> 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

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<sup>11</sup> Extracts from the Hungary submission to UNIDROIT

<sup>12</sup> Extracts from the Spain submission to UNIDROIT

<sup>13</sup> Spanish Civil Code 1889, Article 334.

they do not cause any limitation to a real lien of an immovable property, as well as securities representing mortgage loans.<sup>14</sup>

108. Similar to the French Civil Code, the Spanish Code includes a vaguely-worded provision whereby, unless stated through a provision of law or a statement of an individual, a mere inclusion of the term 'movable' shall not compromise ready money, credits, securities, artistic collections and etc.<sup>15</sup>

109. The 1954 Law on Chattel Mortgages and Non-Possessory Pledges (LHMPSD) takes a similar approach as 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. 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.

110. If the MAC equipment has been subjected to a security interest prior to its affixation to an immovable property, the three characteristics of functionality, identification and location should be maintained, except for cases when a wrongful act by the owner of the immovable property is detected.

#### *Japan*<sup>16</sup>

111. The Japanese Civil Code stipulates that a comprehensive evaluation of facts is required in order to determine whether mobile equipment is a fixture to an immovable property. The defining criteria should be taken into account in a socioeconomic context whereby the possibility of separation, the nature of the equipment as well as its process of formulation is thoroughly examined. Therefore, not only physical annexation is a prerequisite for an equipment to be considered as an accessory, but also the mere act of detachment would cause 'grave disadvantages socioeconomically'.

112. 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.

#### *Central and South America (Mexico)*<sup>17</sup>

113. The Mexican Civil Code defines equipment as immovable when it is permanently united with a real 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>18</sup>

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<sup>14</sup> Ibid, Article 336.

<sup>15</sup> Ibid, Article 346.

<sup>16</sup> Extracts from the Japan submission to UNIDROIT

<sup>17</sup> Extracts from the South America submission to UNIDROIT

<sup>18</sup> Mexican Civil Code, Translation by Michael Wallace Gordon 1980, Article 750.

114. Most South American countries' jurisdictions and commercial legislations tend to provide for rights for land owners 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.

115. 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.

#### *The United States*<sup>19</sup>

116. 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 former addresses mobile items that are physically attached to other movables in a fashion that the individual identity of each of these movables is well preserved<sup>20</sup>, whereas the latter covers the movable items and goods that are connected and affixed to an immovable property in a manner that interest in them would arise under real property law.<sup>21</sup>

117. The applied test to determine whether an object is an accession the 'readily identifiable and easily detachable' nature test. A movable item which forms an integral part of a principal movable item to which it has been attached, whereby physical injury to the principal movable item is rendered inevitable in case of detachment, shall pass by accession to the one having a chattel mortgage or other lien upon that principal article if the lien is enforced. In cases where the movable items are readily identifiable and detached without injury to the principal item, the rule shall not apply. In some circumstances courts would employ a broader approach and take into account an overall impact of detachment on the value of the structure as a whole.

118. In general terms, an interest arising through connection to immovable property has priority over a security interest of a movable item which subsequently becomes a fixture. An exception to this rule is when a 'fixture filing' by a creditor has been filed and its security interest has been perfected prior to the date in which an interest in real estate has been recorded.<sup>22</sup> On a national level, creditors are required to perfect their security interests in movable items and equipment, which would subsequently become fixtures, through a 'fixture filing'.<sup>23</sup> This filing is by means of a financing statement which would cover the equipment in question.

119. In order to determine whether a perfected security interest has priority over a conflicting interest arising from its connection to immovable property, certain issues will be considered under US law. In addition to the requirement that the security interests in a movable object should be duly perfected and the object should be of a readily removable nature, the movable item should either be a factory or office machine, or an item that by its nature is not primarily used (or leased for use) in the operation of a real immovable property, or items such as readily removable replacements of domestic appliances that are consumer goods.<sup>24</sup>

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<sup>19</sup> Extracts from the USA submission to UNIDROIT

<sup>20</sup> Uniform Commercial Code (UCC), Article 9. 102 (a)(1).

<sup>21</sup> Ibid, Article 9. 102(a)(41).

<sup>22</sup> Ibid, Article 9. 334(c) & Article 9. 334(e).

<sup>23</sup> Uniform Commercial Code (UCC), Article 9. 502 (a) & Article 9.502 (b).

<sup>24</sup> Ibid, Article 9. 334(e)(2).

120. The element of consent can also be pivotal when it comes to the priority rule. The security interest of a creditor in a fixture has priority over the interest of the owner of the immovable property, provided that the owner has either explicitly given his consent in writing, or has disclaimed an interest on the movable equipment in question.<sup>25</sup> Security interests in fixtures, which have been duly perfected, also hold priority over liens on the real estate that are obtained by legal or equitable proceedings.<sup>26</sup>

121. Where it is determined that a creditor has a priority security interest over an accessory connected to immovable property, they shall have the right and priority to remove their collateral from the real immovable property in question. However, they shall promptly be liable to reimburse the owner of the immovable property for any damages and physical injuries incurred in the course of removal.<sup>27</sup>

122. A number of leading case law decisions have placed significant emphasis on the element of intention as the guiding principle whether equipment is considered to be a fixture. A number of criteria are taken into account to complement and ascertain this element of intention. These are the degree of annexation, purpose of annexation, potential damage to the structure upon removal of the movable, the relation to the land of the party making the annexation as well as custom and usage.<sup>28</sup>

123. The 'integrated industrial plant' doctrine has been taken into account in a number of case law decisions in the State of Pennsylvania, whereby it has been upheld that all the machinery of a manufacturing plant which are deemed necessary for its constitution, and without which the functionality of the manufacturing plant will be completely compromised, become part of the immovable property.<sup>29</sup>

*Greece*<sup>30</sup>

124. Under the Greek Civil Code, the determinant element for the formation of a component part to an immovable property part is that it cannot be detached from the latter without being a detriment to the latter by either altering its substance or its intended functionality. Equipment in a building should be well-incorporated in that building, whereas a 'transitional' affixation would neutralise this effect.

125. An accessory, on the other hand, requires an economic motive, i.e. a business transaction within which an item is deemed to be an accessory and its temporary removal and separation from the principal item shall by no means compromise its mere nature as an accessory. In an agricultural context, however, the Greek Civil Code specifically recognises both equipment utilised for agricultural purposes as well as items used for the economic exploitation of the immovable property in question, as accessories, subject to certain conditions. This rule is also relevant in the case of a building permanently employed for industrial purposes where the attached equipment serving for those specific purposes are deemed as accessories, subject to same set of conditions.

126. The affixed part of immovable property may not become a distinct object of ownership or other rights *in rem*. In case of doubt, in a legal action, the principal item shall include the attached item on the basis whereby according to the Greek Civil Code the ownership of such immovable shall also extend to the movable when affixed to the immovable.

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<sup>25</sup> Ibid, Article 9. 334 (f).

<sup>26</sup> Ibid, Article 9.334 (e)(3).

<sup>27</sup> Ibid, Article 9. 604 (d).

<sup>28</sup> Teaff v. Hewitt (1853) 1 Ohio St. 511.

<sup>29</sup> Voorhis v. Freeman 37 Am.Dec. 490(1841).

<sup>30</sup> Extracts from the Greece submission to UNIDROIT.

127. A mortgage extends to the whole of the mortgaged property as well as to the affixed and attached items. Where a movable being affixed or attached to an immovable mortgaged property has been separated from the immovable and transferred to a third party, the creditor shall not be entitled to claim back the movable items.

*Uruguay*<sup>31</sup>

128. The Uruguayan Civil Code classifies assets in the two general categories of movables and immovables. Both the practical and operative use of mobile equipment as well as the longevity of its potential attachment to an immovable property are taken into account as major determinants in deciding whether a piece of equipment has become affixed or attached to an immovable property. The test is whether there is a presence of an intention for permanent use, next to the 'cultivation and benefit' of the real immovable property, even when the movable equipment could be removed without detriment. Mobile equipment can recover its identity and individuality once detached and employed again for other purposes.

129. Under Uruguayan legislation, security interests in mobile equipment take the form of either dispossessory or non-dispossessory pledges, whereas security interests in immovable property rights are considered as mortgages. Both non-dispossessory pledges and immovable property mortgages are required to be registered before the Public Registry in order to obtain legal effect. The earlier the date of registration, the prior a security interest becomes. The security interests in mobile equipment, that would subsequently become immovable, would remain in force provided that they have been duly recorded as such.

*Turkey*<sup>32</sup>

130. The 2001 Turkish Civil Code<sup>33</sup> (TCC) distinguishes between an 'integral part' and an 'accessory'. An integral part of a principal item is an essential part of that item where its detachment and separation would inevitably destroy or damage the principal item or alternatively, would change its character. Owner of the principal item would also hold the ownership of all its integral parts.<sup>34</sup>

131. An accessory is movable equipment which, based on either local usage or the clear intention of the owner of the principal item 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>35</sup>

132. 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>36</sup>

133. 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>37</sup> In the case of a mortgage where certain

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<sup>31</sup> Extracts from the Uruguay submission to UNIDROIT

<sup>32</sup> Extracts from the Turkey submission to UNIDROIT

<sup>33</sup> 2001 Turkish Civil Code No. 4721.

<sup>34</sup> *Ibid*, Article 684.

<sup>35</sup> *Ibid*, Article 686.

<sup>36</sup> 2001 Turkish Civil Code No. 4721, Article 940 II.

<sup>37</sup> *Ibid*, Article 862 I.

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>38</sup>

134. 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>39</sup>

135. 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.

### *Quebec*

136. 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>40</sup>. Canadian Common law on the other hand incorporates the term 'accessoire fixe' which would literally cover 'fixtures'.

137. Furthermore, 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'.

138. 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>41</sup>

139. The 1994 Civil Code of Quebec (CCQ), explicitly mentions that 'anything forming an integral part'<sup>42</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>43</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>44</sup> In the case of permanent attachment where the individuality 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>45</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>46</sup>

140. Under this approach, legal uncertainty can arise in the case where for example a driller has 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

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<sup>38</sup> Ibid, Article 862. II.

<sup>39</sup> Ibid, Article 862 III.

<sup>40</sup> Expropriation Act, RSC (1985), c. E-21.

<sup>41</sup> Harmonization Act, No. 3 of the Federal Law – Civil Law, SC 2011, c. 21, para. 127(2).

<sup>42</sup> Civil Code of Quebec 1991, c. 64, a. 900.

<sup>43</sup> Civil Code of Quebec 1991, c. 64, a. 901.

<sup>44</sup> Ibid, c. 64, a. 902.

<sup>45</sup> Ibid, c. 64, a. 903.

<sup>46</sup> Ibid.

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 to remain a movable.

#### *France*

141. The French Civil Code defines property as immovable either by nature, by destination or by the object to which the property applies.<sup>47</sup> The Act includes an extensive list of items for the purpose of clarification, whereby lands and buildings are among the properties that are immovable by nature and whereby all movables which are 'perpetually' placed by an owner of a tenement for the use and working of that tenement are considered immovable by destination. An attachment is rendered perpetual, or 'perpetuelle demeure', when its removal would cause damage or breakage either to the movable itself or to the principal immovable it has been attached to.

142. Under French law, property is deemed as 'movable' either by nature or prescribed by law.<sup>48</sup> Any obligation or action which would result in an exchange of payment or where the movable object has a financial, commercial and industrial objective is considered as movable. This would even apply in cases where immovables are also involved with enterprises belonging to the same context.<sup>49</sup> An object will only be deemed movable under this rule as long as the financial, commercial or industrial objectives exist.

143. A rather vaguely worded provision stipulates that the term movable which is included in provisions of law or of man with no addition or designation shall not cover certain items including ready money, precious stones, instruments of science, arts and professions.<sup>50</sup> Lacking any addition or designation, the term movable shall not cover anything involved in a business. The Secretariat's research could not determine the exact effect of the 'anything involved in a business' exception and the criteria for the 'any other addition or designation' threshold under French law.

#### *Argentina*

144. In the Argentine Civil Code, movable and immovable property is distinguished either by nature, or by accession, or by their representative character.<sup>51</sup> An accessory, on the other hand, 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>52</sup> This creates further legal unpredictability taken into account various other jurisdictions which have been studied, whereby accessory in general is a movable item which would preserve its individual identity after its attachment.

145. 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>53</sup> In cases where physical attachment is not existent, but the intention of the owner of an immovable is to make movable equipment an accessory to an immovable in question, then that equipment is also deemed to be immovable.<sup>54</sup>

146. 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

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<sup>47</sup> French Civil Code 1804, Translation by Georges Rouhette 2006, Articles 517 – 524.

<sup>48</sup> French Civil Code 1804, Translation by Georges Rouhette 2006, Article 527.

<sup>49</sup> *Ibid*, Article 529.

<sup>50</sup> *Ibid*, Article 533.

<sup>51</sup> Argentine Civil Code 1871, Translation by Frank Joannini, Article 2347 [2313].

<sup>52</sup> Argentine Civil Code 1871, Translation by Frank Joannini, Article 2362 [2328].

<sup>53</sup> *Ibid*, Article 2349 [2315].

<sup>54</sup> *Ibid*, Article 2350 [2316].

and security contracts.<sup>55</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>56</sup>

147. In case of usufruct, movable equipment which is destined to become part of immovable property shall be part of the property rights of that immovable, which is only valid for the duration of the usufruct.<sup>57</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>58</sup>

### *Italy*

148. Under the Italian Civil Code, there are two distinct criteria which define constructive immovable property, which is differentiated from immovable property per se. Everything that is naturally or artificially annexed to the soil is considered immovable per se. It is to be noted that not only topsoil but also underground as well as above ground, i.e. airspace, are covered within the scope of this definition.

149. For equipment to be considered as a fixture, firstly, there needs to be an actual and secure attachment to immovable property, i.e. land, and secondly, the object should be of permanent nature for its utilisation.<sup>59</sup> It is therefore implied that the equipment which is not utilised for any specific purpose is deemed movable even though its attachment is of a permanent nature. The intention of the owner of the principal immovable property is, therefore, not taken into account.

### *Germany*

150. The German Civil Code (BGB) defines an essential part of a structure as a part separation of which would inevitably act to the detriment of any of the parts of that structure, or would cause a change of nature. Once it is considered as an essential part, it cannot be the subject of separate rights.<sup>60</sup>

151. This includes items which are firmly attached to a land, seeds once they are sown and plants once they are planted. In case of a building, however, an essential part is a part that is inserted for construction purposes of that building. An exception applies where the attachment is on a temporary basis for carrying out a certain objective or purpose.<sup>61</sup>

152. 'Accessories' in German legislation, are movable equipment or items which serve an economic purpose in favour of the principal item without becoming a part of it. Yet, if the equipment or an item is serving an economic purpose on a temporary basis only, then such equipment or item shall not be considered as an accessory. Also, the temporary separation of an accessory from the principal part shall not compromise its nature as an accessory.<sup>62</sup>

153. In order to define the economic purpose criterion, two contexts are taken into account, namely, commercial and agricultural. In case of a building, it needs to be permanently equipped for commercial operations. In case of a farm, it needs the equipment and livestock which

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<sup>55</sup> Ibid, Article 2351 [2317].

<sup>56</sup> Ibid, Article 2353 [2319].

<sup>57</sup> Ibid, Article 2355 [2321].

<sup>58</sup> Ibid, Article 2356 [2322].

<sup>59</sup> Italian Civil Code 1942, Article 812.

<sup>60</sup> German Civil Code (BGB) 2002, Section 93.

<sup>61</sup> Ibid, Section 95.

<sup>62</sup> German Civil Code (BGB) 2002, Section 97.

are necessary for the commercial operation and functionality of the farm and its agricultural produce.<sup>63</sup>

### *Syria and Egypt*

154. 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 fixed property, movement of which would inevitably be detrimental to its substance or nature, is deemed to be immovable, whereas items falling outside this definition are considered movables.<sup>64</sup>

155. In cases where the owner of an immovable property who also holds the ownership of movable equipment which is attached to that immovable, displays an intention to utilise that equipment for particular purposes of services and exploitation of the immovable in question, then such equipment is considered as immovable by reason of its destined use.<sup>65</sup> The intention is a significant determinant both in Syrian and Egyptian jurisdictions.

### *England*

156. There are different types of fixtures under common law rules. Trade fixtures, or chattel fixtures, are created in the course of a commercial lease and would need to be returned to the tenant by the end of the lease, provided that its separation will not cause any substantial damage to the premises. In a number of case law decisions, a broad definition of the term 'trade' has been upheld, whereby, the term would literally cover any calling for the purpose of 'pecuniary profit', unless it is of exclusive agricultural nature.<sup>66</sup> Furthermore, the presumption that trade fixtures belong to the tenant upon which they possess the right of removal, can be rebutted if it is intended through clear and explicit language that they would belong to the realty in question.<sup>67</sup>

157. Domestic fixtures are items and equipment attached to a dwelling by a tenant for the duration of their stay and can eventually be removed by them subject to a similar 'substantial damage' threshold.

158. Agricultural fixtures have historically fallen outside the scope of a tenant's right of removal.<sup>68</sup> However, due to a statutory development, agricultural fixtures can now indeed be subjected to rightful removals by tenants.

159. The element of intention has played a significant role in determining whether a property is deemed a fixture or otherwise a chattel and movable, where a number of other factors complement the existence of intention.<sup>69</sup> The actual and physical annexation is, however, the *prima facie* consideration.<sup>70</sup>

160. English case law precedents have long differentiated between trade and domestic fixtures on the one hand and agricultural fixtures on the other hand. Applying the strict annexation test, the agricultural movables placed by a tenant during their term, would form part of the landlord's realty and therefore not removable by the tenant.<sup>71</sup> Movable equipment is deemed

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<sup>63</sup> Ibid, Section 98.

<sup>64</sup> Syrian Civil Code (Arabic Version) 1949, Article 84. The Civil Code of Arab Republic of Egypt, Article 82.

<sup>65</sup> Syrian Civil Code (Arabic Version) 1949, Article 84. The Civil Code of Arab Republic of Egypt, Article 82.

<sup>66</sup> *Coleman v. Monahan* (1927) 2 DLR 209.

<sup>67</sup> *Re Howard Laundry Co.* (1913), 203 Fed. 445.

<sup>68</sup> *Elwes v. Maw* (1802) 3 East 38.

<sup>69</sup> *Mitchell v. Cowie* (1964) 7 WIR 118. – *Teaff v. Hewitt* (1853) 1 Ohio St. 511.

<sup>70</sup> *Holland Hodgson* [1872] LR 7 CP.

<sup>71</sup> *Supra* note 45.

necessary for the operation of the tenant's trade or business for profit are considered to be trade fixtures.

161. In determining whether there has been actual or constructive annexation, the use for which the principal immovable property has initially been intended to be utilised for, and also whether there is an intention to make the movable equipment a permanent part of the immovable property is taken into account. Intention, therefore, features as one of the prominent criteria in English case law.

162. Physical attachment to an immovable property is not always the only conclusive element in court decisions. The degree of annexation and object of annexation also play decisive roles.<sup>72</sup>

163. While subjective intention of the parties involved has, in some cases, been dismissed as a determinant for whether mobile equipment is a fixture,<sup>73</sup> a mobile item is deemed to be a fixture when it is objectively intended to be annexed permanently and – is intended to have a lasting effect on the improvement of the immovable it has been annexed to. Where the attachment of the movable is on a mere temporary basis necessary for it to be used and enjoyed, the movable is not deemed to be a fixture.<sup>74</sup>

164. National approaches concerning movable and immovable property rights are highly diversified. The following key elements can be extracted from the various corresponding jurisdictions.

- The intention behind the affixing of equipment to an immovable property in order to 'utilise, cultivate or take benefit' in favour of the immovable property carries much significance in the Colombian Civil Code, whereby 'movables by anticipation' are deemed as movables on the grounds that the rights of third parties are foreseen.
- In the Hungarian Civil Code, The applicable test is of a 'functionality' nature to determine whether an object is a component part. a prior legal commitment and undertaking with a third party would act as an exception to the rule that a component part would fall into the sphere of the ownership rights of the owner of the parent immovable property to which it has been affixed.
- Under the Spanish Civil Code not only 'functionality' plays a pivotal role, but also a clear identification of the equipment's peculiarities as well as its location, which is further subject to registry under the authority of the Commercial Registry.
- The Japanese Civil Code accentuates the potential socioeconomic impact as a consequence of detachment from an immovable property. An object will be determined a fixture where its detachment would inevitably result in grave socioeconomic disadvantages. However, the threshold of defining a disadvantage as such has been left unaddressed.
- In USA, the Common law test for defining whether equipment falls into the category of accession is one of 'readily identifiable, easily detachable' nature. A movable item which forms an integral part of a principal movable item to which it has been attached, whereby physical injury to the principal movable item is rendered inevitable in case of detachment, shall pass by accession to the one having a chattel mortgage or other lien upon that principal article if the lien is enforced. Creditors are required to perfect their

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<sup>72</sup> Leigh v. Taylor [1902] AC 157.

<sup>73</sup> Elitestone Ltd v. Morris and Another [1997] 1 WLR 687.

<sup>74</sup> Botham v. TSB Bank (1996) 7 P C R D 1 – Court of Appeal.

security interests in movable items and equipment, which would subsequently become fixtures, through a 'fixture filing'.

- The Greek Civil Code excludes 'transitional affixation' from its determinant test to distinguish a component part from an accessory, where the former falls within the property rights of the immovable it has been attached to, provided that its detachment would be detrimental to the substance and functionality of the set-up, whereas the latter should be analysed in an economic context.
- The Uruguayan Civil Code places significance on the duration and operative nature of a potential attachment of mobile equipment to an immovable property, whereby the security interests in mobile equipment that would subsequently be considered as immovable, are upheld in Uruguayan law on the condition that they are duly recorded.
- The Turkish Civil Code makes a distinction between the phrases 'movable which has subsequently been affixed to immovable' and 'movable which has subsequently been attached to immovable'. In case of the former, where a mortgage lien has been established, the movable would also be covered by the mortgage. In case of the latter, the rights of third parties are preserved.
- The Civil Code of Quebec stipulates that 'anything forming an integral part' of an immovable, is deemed as immovable itself. In order to become an integral part, the act of attachment should be carried out in a manner that the individuality of the item would completely be compromised and the item should be employed for utility purposes of the principal immovable. In case where an intention for restoring the compound structure exists, a temporary detachment would not hinder the nature of the integral part.
- Under the French Civil Code, the term 'perpetual' is used to address a way of attachment removal of which would cause damage or breakage to either of the parts. A movable which has been perpetually placed by the owner of a tenement for operative purposes of that tenement is considered immovable by destination.
- The Argentine Civil Code includes the notion of 'immovable by accession' where it requires the attachment in question to be of permanent character. In the absence of any physical connection however, when the intention of the owner of the immovable for utilising the movable equipment as an accessory exists, such movable equipment would also be deemed to be immovable.
- The Italian Civil Code provides that in cases where an actual and secure attachment is existent, but the movable equipment in question is not utilised for any specific purpose, such movable equipment is still considered a movable.
- The German Civil Code requires for an economic context in order to distinguish between an 'accessory' and an 'essential part'. The latter cannot be subject to separate rights.
- The Syrian and Egyptian jurisdictions place significant consideration to the element of subjective intention, where the owner of the immovable, who also holds the ownership of the movable attached to the immovable, intends to utilise the movable for the purposes of services and exploitation of that immovable. In this case the movable in question is considered as immovable.
- Under English case law precedents, the criteria applied are one of an actual or constructive annexation whereby adaptation to the use for which the principal immovable property has initially been intended to be utilised for, and also an intention to make the movable equipment a permanent part of the freehold, are taken into account.

*Potential approaches under the MAC Protocol and drafting options*

*i. Retention of individual identity test*

165. The UNIDROIT Study Group put forward a proposal, in paragraph 72 of the final report, in its second meeting in April 2015, for the inclusion of an explicit provision in the draft Protocol, whereby the security interests arising from potentially affixable and mobile MAC equipment would prevail over national interests and provisions falling under domestic immovable property rights, provided that the equipment retains its unique and individual identity. Such a provision would therefore imply that in case the identity of the MAC equipment is impaired upon its affixation to an immovable, its registered international interests would respectively be extinguished under national interests arisen from that real immovable property.

166. The question of scope of applicability was raised at the second Study Group meeting, in terms of whether such provision would cover both pre-attachment and post-attachment stages. It was therefore maintained that the MAC Protocol provision would necessarily be limited only to the pre-attachment stage, i.e. where the MAC equipment in question would not have been attached to the immovable property yet. It was, however, also noted that this narrow approach might curtail the flexibility of financing the equipment in question.

167. Given that different jurisdictions are following diverse approaches in determining what constitutes individual identity, caution would be needed in drafting such a clause in the Protocol. A robust description of the elements constituting 'unique and individual identity' would be required in the Official Commentary.

168. Noting that the notion of time period plays a pivotal role in defining the existence of an implicit element of intention in some jurisdictions, the Study Group may as well wish to consider to lay out a 'minimum period' threshold, whereby in the absence of an explicit intention, such a threshold would assist in defining the existence of an implicit intention. This would require a case-specific analysis whereby the nature of the MAC equipment in question as well as the functionality interdependence would need to be considered.

169. An additional article reflecting this option is contained in the draft Protocol at page 30.

*ii. Defer to national laws/maintain status quo*

170. System without rule (passive approach): where mobile MAC equipment becomes affixed to immovable property and is considered a fixture in a certain jurisdiction, then, in the absence of any legal framework provided by the MAC Protocol, the national property laws of that jurisdiction shall be enforceable. In this case the MAC Protocol shall provide no legal protection for its potentially affixable equipment. The effect of such an approach would be that the any registered international interests of the MAC equipment in question may be extinguished if the equipment was found to be affixed to immovable equipment and thereby not individually identifiable. In the absence of clear-cut guidance, legal uncertainty would therefore remain.

171. Explicit MAC provision (active approach): in order to prevent legal uncertainty, an explicit MAC provision could stipulate the priority of domestic jurisdictions and applicable laws over the Protocol, in particular where national and registered international interests would be competing. 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.

*iii. Insert rule maintaining priority of International Registered Interest in mobile object*

172. Alternatively, the Study Group may wish to consider the inclusion of a provision which would uphold the rule laid down in Article 29 of the Cape Town Convention and would set

forth a full-scale legal protection of registered international interests in MAC equipment which would subsequently become affixed to immovable property and be considered as fixtures. This provision would cover both pre-attachment and post-attachment stages in order to secure and facilitate the financing of the equipment at all times. Furthermore, it would cover both situations whereby either the MAC equipment would retain its identity upon affixation and also where the identity would be completely compromised.

*Additional considerations*

173. The Study Group may wish to consider the inclusion of the following complementary elements in order to reach further legal predictability in line with the potential approaches under the MAC Protocol as outlined below.

*The element of 'party autonomy'*

174. In most jurisdictions, the determinant of intention, either subjective or objective, generally carries a decisive role in defining whether movable equipment is considered as a fixture or otherwise upon its subsequent attachment to an immovable property. The expression of intention can either be explicit or implicit, whereby latter would require various case-specific facts and motives to be taken into account. These can be addressed to a large extent through the inclusion of a 'party autonomy' clause, whereby it becomes '... subject to agreement between the parties'.

175. For example, Article 8<sup>75</sup> of the Cape Town Convention provides for certain 'default remedies' available for the parties only where they have explicitly been included in the contract by reciprocal agreement of the parties involved.

176. A similar approach could be considered in the case of MAC equipment which would subsequently become affixed or attached to an immovable property by allowing parties to effectively contract out of any rule included in the Protocol, if that is indeed the desire of both parties.

*Compensatory measures*

177. The MAC Protocol could safeguard creditors' rights concerning their security interests in MAC equipment, which would subsequently become affixed or attached to immovable property in a host State. Where the registered international interests under the Convention would be in conflict with national interests under domestic property laws of that State, certain compensatory measures could be included under the MAC Protocol.

178. The Japanese Civil Code considers the act of actual affixation 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. The claims can be brought against the owner of the real immovable property either directly by the stakeholder creditor, or indirectly by the grantor of the MAC equipment. To prevent the risk of double compensation against the owner of immovable property, such a measure in the MAC Protocol could include the limitation that the claim of unjust enrichment can exclusively be brought by a stakeholder creditor.

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<sup>75</sup> Cape Town Convention, Article 8 – Remedies of chargee.

### **G. Accessions<sup>76</sup>**

179. As of October 2015, the preliminary list of HS codes suggested by the private sector contains 22 codes that explicitly cover engines and 25 codes that cover parts. As such, it must be determined whether the MAC Protocol should allow the inclusion of HS codes containing accessions, and whether doing so would require the drafting of additional provisions.

180. The central issue is whether the MAC Protocol should allow an international interest in an accession (such as an engine) to continue to exist independently once installed in another object, and would have priority over a later-in-time international interest encumbering the entire object on which the accession was installed. Under the definition of railway rolling stock in Article I(e) of the Luxembourg Rail Protocol, engines installed in a train are covered as components of the car, but are not independent objects for the purposes of the Protocol.

#### *Inclusion of HS codes explicitly covering accessions*

181. At the first Study Group meeting it was noted that in negotiating the Luxembourg Rail Protocol a decision had been 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. The first Study Group meeting concluded that unless there was widespread commercial practice of separate financing of accessions to MAC equipment, then accessions would not be separately registerable under the MAC Protocol.

182. At the second meeting the Study Group concluded that for accessions to be included under the MAC Protocol, private industry would have to make a strong argument that they were of sufficiently high value and were in practice separately financed.

183. In effect, there may actually be no need to apply a different analysis in determining whether an HS code specifically applying to accessions should be included in the MAC Protocol. Where the type of accession as identified by an individual HS code is specific to use in the agriculture, construction and/or mining fields, where it is of generally high value, where it is uniquely identifiable and where there is evidence of commercial practice of separate asset financing (or at least the potential for it), then there would be a strong argument for including the HS code in the relevant Annex to the Protocol.

184. It should be noted that even if it were decided that all HS codes explicitly covering accessions (such as those referring to engines and parts) should be excluded from the Protocol, there is still a possibility that accessions indirectly falling under other HS codes covering mainly fully completed categories of equipment would still be registerable under the Protocol (on the basis that they contained an individual serial number). The only plausible way to prevent the registration of such accessions would be to include a draft provision in the Protocol providing that only fully completed pieces of equipment (and possibly implements, see below paragraph) were registerable. This approach is not without its own potential difficulties.

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

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

This Convention:

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<sup>76</sup> NLCIFT pages 52 – 56.

(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.

186. 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>77</sup> Paragraph 7(b) states that where the applicable law so provides, rights in such items which have previously been installed may be created in them after removal from the object.

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

188. Article 29(7) was discussed during the second Study Group meeting in relation to fixtures and the potential overlap of the scopes of the Luxembourg Rail Protocol and the MAC Protocol, however it is more relevant to the treatment of accessions. If accessions are excluded from the Protocol, then they would be potentially covered by Article 27(a), where the applicable law allows the creation and continuance of interests in the accession under domestic law prior to its installation on an object under the MAC Protocol. Regardless of the final approach determined for accessions, it does not appear necessary to modify Article 29(7).

#### *Differentiation between accessions and implements*

189. At the second meeting the Study Group also 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, and that this distinction should be reflected in the Annex to the Protocol if the Protocol does ultimately end up covering both accessions and implements.

190. Additionally, there is a potential practical issue regarding whether allowing accessions to be registerable would require creditors to make exhaustive searches in the international registry of all individually serialised parts of a complete piece of MAC equipment to ensure that no part was already the subject of an existing internationally registered interest.

191. Following the first Working Group meeting in London in September 2015, the Secretariat requested further information from the Working Group members in relation to the following accession-related questions:

#### *Questions for the Working Group*

- 1) Of the HS codes covering MAC Equipment which your company is producing/exporting/financing/using, please indicate whether each relevant HS code is covering:
  - a. fully completed equipment, or

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<sup>77</sup> Official Commentary to the Aircraft Protocol (3rd Edition), paragraph 4.197.

- b. parts/accessories/acquisitions, or
  - c. both fully completed machines and parts/accessories/acquisitions
- 2) On the basis that parts/accessories/acquisitions would need to individually registered on the International Registry to be included and protected under the MAC Protocol, and that such registrations would have transactions costs both in terms of the fee for registration and time needed to make such registrations, would you be supportive of the parts/accessories/acquisitions which your company is producing/exporting/financing/using being included under the scope of the MAC Protocol?

192. The Working Group should be in a position to report back to the Study Group on these issues at the fourth Study Group meeting.

#### **H. Special Insolvency Regimes affecting farmers and agricultural enterprises**

193. During its first meeting in December 2014, 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. This section was drafted by the National Law Centre for Inter-American Free Trade in collaboration with the Unidroit Secretariat.

194. 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>78</sup>

195. 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).

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<sup>78</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).

196. The following paragraphs summarise the insolvency treatment of agricultural producers in a number of selected countries, organised alphabetically.

#### *Brazil*

197. The current Brazilian Bankruptcy Law (Lei No 11.101, De 9 Fevereiro de 2005) introduced the concept of “company reorganisation.”<sup>79</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>80</sup> The Law provides for three forms of proceedings: i) judicial reorganisation; ii) extrajudicial reorganisation; and iii) bankruptcy.<sup>81</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>82</sup> However, 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>83</sup> The Code of Civil Procedure provides for special insolvency regimes for those debtors not eligible for relief under the Bankruptcy Law.<sup>84</sup>

#### *Canada*

198. 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.

199. Canada has also adopted the 1997 Farm Debt Mediation Act that applies to insolvent and over-indebted farmers.<sup>85</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>86</sup> Under this Act, a debtor is able to propose a re-structuring plan

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<sup>79</sup> Law No. 11.101 is available at [http://www.planalto.gov.br/ccivil\\_03/\\_ato2004-2006/2005/lei/l11101.htm](http://www.planalto.gov.br/ccivil_03/_ato2004-2006/2005/lei/l11101.htm).

<sup>80</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>81</sup> John J. Rapisardi & Joseph Zujkowski, Bankruptcy Basics under Brazilian Law, 252(02) New York Law Journal (July 2014).

<sup>82</sup> Id.

<sup>83</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>84</sup> Dennis Faber, Niels Vermunt, Jason Kilborn & Tomas Richter (eds.), Commencement of Insolvency Proceeding, National Report for Brazil (2012).

<sup>85</sup> See <http://laws-lois.justice.gc.ca/eng/acts/F-2.27/>.

<sup>86</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).

but creditors are not obliged to participate and may exercise their normal collection remedies once the stay is lifted.<sup>87</sup>

200. 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>88</sup>

201. 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 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.

202. 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>89</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>90</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*

203. Colombia’s 2010 Law No. 1380, establishes the insolvency regime for natural persons (with the exception of merchants)<sup>91</sup> while Law No. 1116 of 2006 governs corporate insolvency.<sup>92</sup> Depending on the nature of the agricultural business, the person may be eligible for

<sup>87</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>88</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>.

<sup>89</sup> See further <http://www.ruralsupport.ca/admin/FileUpload/files/handouts/Farm%20financial%20Handouts%20june%202010%20B&W.pdf>.

<sup>90</sup> See <http://www.qp.gov.sk.ca/documents/English/Statutes/Statutes/S17-1.pdf>.

<sup>91</sup> See [http://www.cconsumidores.org.co/index.php?option=com\\_content&view=article&id=101:ley-1380-2010-regimen-de-insolvencia&catid=19:legislacion&Itemid=126](http://www.cconsumidores.org.co/index.php?option=com_content&view=article&id=101:ley-1380-2010-regimen-de-insolvencia&catid=19:legislacion&Itemid=126).

<sup>92</sup> See [http://www.secretariasenado.gov.co/senado/basedoc/ley\\_1116\\_2006.html](http://www.secretariasenado.gov.co/senado/basedoc/ley_1116_2006.html).

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>93</sup>

#### *France*

204. 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>94</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>95</sup>

#### *Mexico*

205. The Mexican Insolvency Law of 2000 is applicable to all persons considered merchants under the Commercial Code, which includes farmers.<sup>96</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>97</sup> (near MX\$ 2,116,000.00 or US\$ 139,210.00).<sup>98</sup>

#### *Russia*

206. 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>99</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

<sup>93</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>94</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>95</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-48c9-9986-53814f7dffbf/France\\_%28as\\_published%29.pdf](http://www.reedsmith.com/files/Publication/dd0e30b6-2d8c-4912-b35e-0fe8a7bddc95/Presentation/PublicationAttachment/6dc8fc38-e58f-48c9-9986-53814f7dffbf/France_%28as_published%29.pdf).

<sup>96</sup> See <http://www.diputados.gob.mx/LeyesBiblio/pdf/29.pdf>.

<sup>97</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>98</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>99</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).

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>100</sup> Certain aspects of insolvency for agricultural producers are also governed by the Federal Law on Financial Rehabilitation of Agricultural Producers of 2002.<sup>101</sup>

### *South Africa*

207. Insolvency matters in South Africa are governed by the Insolvency Act No. 24 of 1936.<sup>102</sup> This Act does not entirely codify South African insolvency law and for a number of aspects, related legislation governs.<sup>103</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>104</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 resolute 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.

### *The United States*

208. 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>105</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.

209. 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.

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<sup>100</sup> Id., at 3.

<sup>101</sup> Jens Lowitzsch, *The Insolvency Law of Central and Eastern Europe*, at 386 (INSOL Europe).

<sup>102</sup> See <http://www.justice.gov.za/legislation/acts/1936-024.pdf>.

<sup>103</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>104</sup> See <http://faolex.fao.org/docs/pdf/saf20851.pdf>.

<sup>105</sup> See David Ray Papke, *Rhetoric and Retrenchment: Agrarian Ideology and American Bankruptcy Law*, 54(4) *Missouri Law Review* (1989).

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

210. 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.

211. 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.

212. 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.

213. 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.

214. 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.

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

215. Following the discussion regarding special insolvency regimes for farmers at the second Study Group meeting, the Secretariat was requested to conduct further research into restrictions on the enforcement of security interests in farming equipment. The following section is a comparative analysis of the restrictions that exist in various jurisdictions.

216. This section contains research done by the National Law Centre for Inter-American Free Trade, and also a compilation of responses received from the Unidroit Correspondents on the issue.

*Research conducted by the National Law Centre*

217. 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.

218. 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*

219. 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>106</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>107</sup>

220. 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>108</sup> The Victoria statute defines farming equipment to include a harvester, binder, tractor, plough or other agricultural implement.<sup>109</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>110</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>111</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.

#### *Canada*

221. 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>112</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.

222. 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,

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<sup>106</sup> See <https://www.agric.wa.gov.au/grains/farm-debt-mediation-wa-scheme>.

<sup>107</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>108</sup> See <http://www.holdingredlich.com/agribusiness-rural-industries/farm-debt-mediation-how-to-make-it-successful>.

<sup>109</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>110</sup> *Id.*

<sup>111</sup> *Id.*

<sup>112</sup> See <http://laws-lois.justice.gc.ca/eng/acts/F-2.27/>.

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.”

223. 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>113</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>114</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*

224. 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>115</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>116</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>117</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.

225. 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 the right to repossess the item extra-judicially. Instead, it must bring a suit against the hirer.<sup>118</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.

226. 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>119</sup>

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<sup>113</sup> See further

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

<sup>114</sup> See <http://www.qp.gov.sk.ca/documents/English/Statutes/Statutes/S17-1.pdf>.

<sup>115</sup> Hire Purchase Act, 1982 (Rev 2010), art. 8(e).

<sup>116</sup> *Id.*, art. 5.

<sup>117</sup> *Id.*, art. 3(1).

<sup>118</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>119</sup> No. 46 of 2012, available at

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>120</sup>

### Mexico

227. 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>121</sup> Unlike Australia, Canada and the United States, there is no mandatory mediation legislation for farm debt in Latin America.

228. 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>122</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 court officer will ask the debtor to select the goods that should be judicially seized.<sup>123</sup> If the debtor refuses to identify any goods, the creditor has the right to make such a selection.<sup>124</sup> The creditor’s right to select and

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<http://www.kenyalaw.org:8181/exist/kenyalex/actview.xql?actid=No.%2046%20of%202012>

<sup>120</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>121</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>122</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).

<sup>123</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>124</sup> *Id.*

seize goods is limited by Article 434 of the FCCP.<sup>125</sup> Two of the limitations found in Article 434 are relevant to this report.

229. 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>126</sup> The interested party must be the owner of the assets at the moment the estate exemption is created.<sup>127</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>128</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>129</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>130</sup>

230. 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>131</sup> The estate must not exceed the estimated amount of USD\$135,000.<sup>132</sup> However, the Family Code of the State of Sonora (*Código de Familia para el Estado de Sonora*),<sup>133</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

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<sup>125</sup> *Id.*, art. 434.

<sup>126</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>127</sup> *Id.*, p. 39.

<sup>128</sup> *Id.*, p. 49-50.

<sup>129</sup> *Id.*

<sup>130</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>131</sup> *Id.*, art. 723.

<sup>132</sup> *Id.*

<sup>133</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).

Sonora does not limit the value of the machinery and equipment that can be subject to the estate exemption.<sup>134</sup>

231. 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>135</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>136</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*

232. 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>137</sup> This monetary limitation does not apply to motor vehicles.<sup>138</sup> The definition of "motor vehicle" includes mechanically propelled vehicles intended for agricultural purposes.<sup>139</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>140</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>141</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>142</sup>

233. 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>143</sup> The ELA limits the rights of the lessee to enter into a sub-lease or create a pledge over the leased equipment.<sup>144</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>145</sup> If the lessee fails to do so, the lessor may terminate the lease agreement.<sup>146</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>147</sup> Section 38 of the ELA requires that if the judge is satisfied with the information on oath that the

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<sup>134</sup> *Id.*, art. 545.

<sup>135</sup> FCCP, *supra* note 123, art. 434 (IV).

<sup>136</sup> *Id.*

<sup>137</sup> Section 1 (a) HPA.

<sup>138</sup> *Id.*

<sup>139</sup> Section 20 (1) HPA.

<sup>140</sup> Section 9 HPA.

<sup>141</sup> Section 9 (5) HPA.

<sup>142</sup> Section 3 (a) HPA.

<sup>143</sup> Section 12 ELA.

<sup>144</sup> Section 20 (1) ELA.

<sup>145</sup> Section 36 ELA.

<sup>146</sup> Section 37.

<sup>147</sup> Section 38 (1) ELA.

lessee has defaulted on her/his obligations and the lessor has complied with the requirements of a default notice and termination notice,<sup>148</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>149</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.

#### *The United States*

234. 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>150</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>151</sup> Utah also included certain provisions governing the mediation of farm debts in Title V of its Agricultural Credits Act.<sup>152</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*

235. The following sections are summaries derived from the Correspondents' submissions.

#### *Hungary*

236. 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*

237. The Turkish Code on Enforcement and Bankruptcy<sup>153</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>154</sup>

238. 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>155</sup>

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<sup>148</sup> Sections 36 and 37

<sup>149</sup> Section 38 (3) (4) ELA

<sup>150</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>151</sup> See <https://www.revisor.mn.gov/statutes/?id=583>.

<sup>152</sup> See <https://www.govtrack.us/congress/bills/100/hr3030/text>.

<sup>153</sup> Turkish Code on Enforcement and Bankruptcy No 2004, 9 June 1932.

<sup>154</sup> *Ibid*, Article 82/No 4.

<sup>155</sup> *Ibid*, Article 84.

*Japan*

239. 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.

240. 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*

241. 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.

242. 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.

243. 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. As such, it is important for the Study Group to address this issue.

244. 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.

245. There are at least two clear options that could be adopted. The first is 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.

246. 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.

## **J. Insolvency Alternatives**

247. At the first Study Group meeting it was tentatively agreed that Alternatives A, B and C should be kept in the draft Protocol, pending further discussion. This decision was reaffirmed at the second Study Group meeting.

248. Given that Alternative B is included in all three previous Protocols, it would be reasonable for it to be included in the 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.

249. Alternative C features only in the 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>156</sup>

250. 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>157</sup>

251. 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 current proposal is to recommend that the MAC Protocol include Alternatives A, B and C, as consistent with the approach in the Rail Protocol. This approach is set out in Article IX of the draft Protocol.

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

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<sup>156</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>157</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.

### **K. Application to sales**

253. The first Study Group meeting discussed whether the 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.

254. 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 to be provided, and it generated additional fees for the International Registry.

255. It was further noted that while the registration of notices of sale under the Luxembourg Rail Protocol did not have any legal effect under the Convention or Protocol, it would likely have an effect under domestic law in jurisdictions where knowledge of a prior interest in an asset can affect the priority rules relating to that asset. This approach is still adopted in several countries. By way of example, knowledge of a prior interest may affect priority rules under the Spanish civil law. Conversely, the French legal system has a new rule where knowledge of a prior interest is irrelevant.

256. The first Study Group meeting decided that the approach in Article XVII of the Luxembourg Rail Protocol should be adopted in the MAC Protocol. As such, the draft Protocol now contains Article XVII governing Notices of Sale.

257. This issue received further discussion at the second Study Group meeting, as consensus on the issue was not reached. The first Study Group meeting also requested that the Secretariat conduct further research on the issue, including on how such notices of sale affect domestic law priority rules.

258. The Official Commentary to the Rail Protocol provides the following analysis of Article XVII of the 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.*

259. The first Study Group meeting also noted the additional benefits of this approach were that it allowed for more accessible information on the sales of equipment to be provided, and it will generate additional fees for the International Registry. 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 for 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 will do harm, it should be followed.

260. The counterargument articulated by Mr Deschamps at the first Study Group meeting is that the purpose of the 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.

261. The registration of a notice of sale in the MAC Protocol would most likely have an impact on security interests under the domestic law of country where notice of a prior interest might affect the priority or effectiveness of a subsequent interest, and where the law allows the notice of the interest to be constructive (constructive notice is the legal fiction that attributes notice of something to a party, even though actual notice may not exist). Theoretically, a party could be found to have constructive notice of the sale of an object on the basis that a notice of sale was registered in the MAC Protocol International Registry.

262. At the first Study Group meeting Professor De Las Heras stated that knowledge of a prior interest may affect priority rules under the Spanish civil law. Professor Riffard noted that the French legal system has a new rule where knowledge of a prior interest is irrelevant.

263. Based on further research done by the Secretariat, it appears that the publication of a notice of sale is unlikely to have substantive effect under secured transactions law in many civil law and have a limited effect in common law jurisdictions that have moved to modern secured transactions registry and title registry systems.

264. In European civil law jurisdictions, while there is significantly divergent practice in relation to the types of registries and which assets they cover (whether they are title registries or security registries, whether they are asset registries or personal registries, whether there is a uniform registry or many different ones, whether priority attaches at the point of application to the registry, completion of the registration or perfection of the security interest, their effectiveness against third parties), vast majority assign priority to a registration that is first in time.

265. The first in time rule exists in varying forms in France, Spain, Germany, Austria, Hungary, Lithuania and Poland. As priority in these jurisdictions is generally based on first-in-time registration, the notice of a prior unregistered interest in property or a notice of sale does not have any effect.

266. In relation to Common Law jurisdictions, under the Personal Property Securities Act 2009 in Australia, a buyer or lessee of personal property takes the personal property free of an unperfected interest in the property (unperfected interests being those not registered in the securities register).<sup>158</sup> Accordingly, constructive or even actual notice of an existing unperfected interest on the part of the buyer or lessee seemingly does not preclude the taking free.

267. Further research is required to determine whether constructive notice by virtue of registration on the MAC Protocol International Registry can affect the priority of interest in other jurisdictions, especially those using older common law equitable principles.

268. Ultimately, the decision of whether notices of sale should be registerable is a policy decision relating to whether it is appropriate for the MAC Protocol to provide for registrations that have no legal effect under the Convention and Protocol, but may have direct or indirect effects under domestic legal systems.

269. With the likely entry into force of the 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 law regimes. As such, the Study Group may wish to consider leaving the provision relating to Notices of Sale in the draft Protocol and defer the issue to the intergovernmental negotiation stage.

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<sup>158</sup> Section 43, Personal Property Securities Act 2009 (Cth).

#### **L. Interaction between Article 29(3)(b) and the MAC Protocol**

270. 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. Resultantly, the Study Group requested that the Secretariat conduct further research on the interaction with Article 29(3)(b) of the Cape Town Convention.

271. 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.'*

272. 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).

273. 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 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.

274. The Official Commentary to the 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.*

275. 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.*

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

277. 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 XXXIII 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.*

278. Based on the analysis in the Official Commentary, this appears to be an issue separate from the issue as to whether notices of sale should be registerable under the MAC Protocol. As noted by Professor Mooney at the second Study Group meeting, the issue is whether the MAC Protocol should allow secondary buyers to rely on 29(3) to take free of an interest even if they would not qualify for such priority under the domestic law.

279. It is open to the Study Group to consider whether the Rail Protocol approach should be followed, or whether an additional Article should be included in the draft MAC Protocol which modifies Article 29(3) to allow buyers to take free of an interest under the Protocol only where they can do so under their domestic law. No potential drafting options on this issue have been included in the draft Protocol.

#### **M. Interaction between MAC and Rail Protocols**

280. At the first Study Group meeting it was noted that there could be an overlap between the MAC Protocol and the Luxembourg Rail Protocol, due to the broad definition of railway rolling stock contained in the Luxembourg Rail Protocol.<sup>159</sup> 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. The Preliminary List of HS codes suggested for inclusion under the scope of the MAC Protocol does not include any item from Chapter 86.

281. However, that does not mean that some equipment types included in the List may not be used for a purpose that would seem to be covered by the Luxembourg Rail Protocol. Further research may identify additional types of MAC equipment that fall within the scope of both Protocols. It is also possible that other types of machinery could be modified to run on tracks, which would also bring them within the scope of both Protocols.

282. The first Study Group meeting suggested two alternative approaches for dealing with the overlap between the two Protocols: (i) limiting the scope of the MAC Protocol or by (ii) inserting a priority rule into the MAC Protocol. It was noted that if the MAC Protocol limits its scope by identifying specific types of equipment through the HS system, then it would have a stricter approach to scope than the description-based approach of the Luxembourg Rail Protocol. It was further suggested that if the 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.

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<sup>159</sup> [UNIDROIT 2015 - Study 72K – SG1 – Doc. 5](#), paragraph 25.

283. At the second Study Group meeting several approaches to this issue were discussed.<sup>160</sup> Professor Mooney noted that given the scope of the Luxembourg Rail Protocol is more certain, it may be desirable for the MAC Protocol to defer to the Luxembourg Rail Protocol.

284. Professor de las Heras queried whether railway rolling stock could be carved out of the MAC Protocol scope, by making a specific reference in the Annexes to the 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>161</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.

285. 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 and MAC Protocols. Mr Deschamps noted that in applying Article 29(7) to the 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.

286. Mr Böger cautioned that the MAC Protocol should only be limited in circumstances where there is a possible competing registration under the Luxembourg Rail Protocol. Mr Deschamps reaffirmed that the interaction between the Luxembourg Rail and MAC Protocols should be dealt with as a matter of scope, by excluding any type of equipment from the MAC Protocol that is treated as an object under the Luxembourg Rail Protocol. Mr Deschamps noted that this exclusion should only be triggered where a contracting state is party to both Protocols. The Secretary-General concurred with this approach.

287. The Study Group ultimately decided that the Annexes to the MAC Protocol should provide that the MAC Protocol 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.

288. This drafting is located in the Annexes a

#### **N. Registration and Titling of MAC equipment**

289. This section was prepared by the National Law Centre for Inter-American Free Trade on request from the Unidroit Secretariat, following discussions at the first and second Study Group meeting.

290. 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.

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<sup>160</sup> [UNIDROIT 2015 - Study 72K - SG2 - Doc. 6](#), paragraphs 33-43.

<sup>161</sup> 'Railway rolling stock' having the same definition is 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.

291. 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.

292. 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.

293. 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*

294. In Argentina, motor vehicles (automotores) are governed primarily by Decree No. 1.1144/97.<sup>162</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>163</sup> Judicial liens and security interests over motor vehicles must also be registered in the National Registry.<sup>164</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>165</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>166</sup>

### *Australia*

295. 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>167</sup> and its regulations (Road Act Regulations) are applicable to the registration of vehicles.<sup>168</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

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<sup>162</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>163</sup> *Id.*, art. 1.

<sup>164</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>165</sup> *Id.*, art. 5.

<sup>166</sup> *Id.*, art. 20(c).

<sup>167</sup> *Road Safety Act, 1986* (Vic.) (Australia), available at [http://www.legislation.vic.gov.au/domino/Web\\_Notes/LDMS/LTObject\\_Store/ltobjst9.nsf/DDE300B846EED9C7C-A257616000A3571/12CF03296668433CA257EC90017DD83/\\$FILE/86-127aa167%20authorised.pdf](http://www.legislation.vic.gov.au/domino/Web_Notes/LDMS/LTObject_Store/ltobjst9.nsf/DDE300B846EED9C7C-A257616000A3571/12CF03296668433CA257EC90017DD83/$FILE/86-127aa167%20authorised.pdf) (last accessed Sept. 23, 2015).

<sup>168</sup> *Road Safety (Vehicles) Regulations, 2009* (Vic.) (Australia), available at [http://www.legislation.vic.gov.au/domino/Web\\_Notes/LDMS/LTObject\\_Store/ltobjst9.nsf/DDE300B846EED9C7C-A257616000A3571/F66C78CAAE69CB61CA257E70001CBBA0/\\$FILE/09-118sra021%20authorised.pdf](http://www.legislation.vic.gov.au/domino/Web_Notes/LDMS/LTObject_Store/ltobjst9.nsf/DDE300B846EED9C7C-A257616000A3571/F66C78CAAE69CB61CA257E70001CBBA0/$FILE/09-118sra021%20authorised.pdf) (last accessed Sept. 23, 2015).

include railway locomotive or railway rolling stock.”<sup>169</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>170</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>171</sup>

296. In order to register a new tractor in Victoria, its owner must submit “the machinery pack which is essentially a vehicle registration form.”<sup>172</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>173</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>174</sup> The certificate of registration can be used as evidence of ownership of the tractor together with a bill of sale.<sup>175</sup>

297. 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.

#### Canada

298. 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

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<sup>169</sup> Road Safety Act, *supra* note 167, §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>170</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>171</sup> Road Safety (Vehicles) Regulations, *supra* note 168, §5 Definitions.

<sup>172</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>173</sup> Vehicle Registration form, available at <https://www.vicroads.vic.gov.au/searchresultpage?q=vehicle%20registration%20form> (last accessed Sept. 23, 2015).

<sup>174</sup> Telephone interview, *supra* note 172.

<sup>175</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).

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>176</sup> and its regulations (MVA Regulations).<sup>177</sup>

299. 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>178</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>179</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>180</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>181</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>182</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>183</sup>

300. New Brunswick’s Personal Property Security Act Regulations (PPSA Regulations)<sup>184</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>185</sup> The registrant must also indicate the type of serial numbered goods to which the registration relates.<sup>186</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 manufacturer.<sup>187</sup> On the other hand, for motor vehicles other than combines and tractors,

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<sup>176</sup> Motor Vehicle Act, R.S.N.B. 1973, c. M-17, available at <http://laws.gnb.ca/en/ShowTdm/cs/M-17/> (last accessed Aug 24, 2015). [MVA].

<sup>177</sup> New Brunswick Regulation 83-42 under the Motor Vehicle Act (O.C. 83-170), available at <http://laws.gnb.ca/en/showpdf/cr/83-42.pdf> (last accessed Aug 24, 2015). [MVA Regulation].

<sup>178</sup> MVA, *supra* note 176, §1.

<sup>179</sup> *Id.*

<sup>180</sup> *Id.*

<sup>181</sup> MVA Regulations, *supra* note 177, §7(6).

<sup>182</sup> MVA, *supra* note 13, § 21(1).

<sup>183</sup> MCA Regulations, *supra* note 177, §9.

<sup>184</sup> New Brunswick Regulation 95-57 under the Personal Property Security Act (O.C. 95-378), available at <http://laws.gnb.ca/en/ShowPdf/cr/95-57.pdf> (last accessed Aug 24, 2015).

<sup>185</sup> *Id.*, §25(1)(a).

<sup>186</sup> *Id.*, §25(1)(c).

<sup>187</sup> *Id.*, §25(2)(b).

the serial number is the vehicle identification number marked on, or attached to, the body frame by the manufacturer.<sup>188</sup>

### *Mexico*

301. 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>189</sup> and its regulations (Vehicle Registry Regulations).<sup>190</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>191</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>192</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>193</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>194</sup>

### *Nigeria*

302. 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>195</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>196</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>197</sup> There is no special administrative law or body for the regulation of heavy mobile equipment. The FRSC prescribes certain regulations for the operation

<sup>188</sup> *Id.*, §25(2)(a).

<sup>189</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>190</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>191</sup> Registry Law, *supra* note 162, art. 12.

<sup>192</sup> Registry Law, *supra* note 189, art. 2(X).

<sup>193</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>194</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>195</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>196</sup> See, Section 41, Lagos State Road Traffic Law, 2012.

<sup>197</sup> *Id.*

and safety of such heavy mobile equipment as a component of its road traffic and management responsibilities.

303. 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 Interests in Movable Property by Banks and Other Financial Institutions in Nigeria,” neither of which has taken effect as of October 2015.

### *Spain*

304. 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>198</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>199</sup>

305. The Vehicles Regulations distinguish between the rules (i) applicable to motor vehicles, and (ii) applicable to specialised agricultural vehicles (vehículo especial agrícola).<sup>200</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>201</sup>

306. 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>202</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>203</sup> ROMA Regulations exclude from its scope “construction and service machinery as well as machinery and equipment used in

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<sup>198</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>199</sup> *Id.*, at p. 2.

<sup>200</sup> *Id.*, at Annex II.

<sup>201</sup> *Id.*

<sup>202</sup> *Id.*

<sup>203</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.

the agri-food industry.<sup>204</sup> Registrations of agricultural machinery at ROMA are immediately and automatically transmitted to the Car Registry.

307. According to the Law of Movable Mortgage and Non-possessory Pledge,<sup>205</sup> vehicles subject to registration in an administrative registry and other motor vehicles may be encumbered by a movable mortgage.<sup>206</sup> This law establishes that a movable mortgage must be created in a public deed by a notary public and that the encumbered vehicle must be insured for at least the same amount as the secured amount of the mortgage.<sup>207</sup>

#### *United States*

308. U.S. laws require motor vehicles to be registered with the respective State Departments of Motor Vehicles.<sup>208</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.

309. 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*

310. 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

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<sup>204</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>205</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/lhmppsd.html](http://noticias.juridicas.com/base_datos/Privado/lhmppsd.html) (last accessed Aug 28, 2015).

<sup>206</sup> *Id.* Article 12 and 34.

<sup>207</sup> *Id.* Article 36.

<sup>208</sup> Such registrations must be renewed periodically (annually), and it essentially acts as a tax collecting device of the State.

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.

311. 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*

312. 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 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>209</sup> and
- cotton and farm trailers, water tanks, oversize feed and seed motor vehicles, automatic bale wagons, and cotton module movers.<sup>210</sup>

313. 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.

314. 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>211</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>212</sup> Several items from the MAC List may fall under this category of special mobile equipment.

### *Colorado*

315. 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

<sup>209</sup> California Vehicle Code, §5011.

<sup>210</sup> Id., at §36101.

<sup>211</sup> See *V C Section 565 Special Construction Equipment, available at [https://www.dmv.ca.gov/portal/dmv/?1dmy&urile=wcm:path:/dmv\\_content\\_en/dmv/pubs/vctop/vc/d1/565](https://www.dmv.ca.gov/portal/dmv/?1dmy&urile=wcm:path:/dmv_content_en/dmv/pubs/vctop/vc/d1/565)* (last accessed Aug 28, 2015).

<sup>212</sup> CVC §565. These vehicles are not designed for transporting persons or property and are only occasionally operated or moved over the highways.

only incidentally operated or moved over the public highways.<sup>213</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>214</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>215</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>216</sup> Colorado also issues certificates of title for this type of equipment.

#### *Florida*

316. 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>217</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>218</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*

317. 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>219</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;

<sup>213</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>214</sup> [C.R.S. 42-1-102\(93.5\)](#).

<sup>215</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>216</sup> (42-3-103(1)(a) C.R.S.).

<sup>217</sup> Op.Att’y Gen. Fla. 055-113 (1955).

<sup>218</sup> *Crane Rental of Orlando Inc. v. Ford S. Hausman*, 518 So. 2d 395 (1987).

<sup>219</sup> (N.C.G.S. 20-50). See also <http://www.hauling.org/pdf/haulingAgManual.pdf#page=6&zoom=auto,-312,551> (last accessed September 25, 2015).

- 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.

318. However, for-hire farm tractors and trailers are not exempt from registration.

#### *Texas*

319. 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.

320. Accordingly, an item of MAC equipment that does not have a serial number may be assigned one by the governmental authority.

#### **O. Multiple purpose equipment**

321. At the first Study Group meeting it was concluded that, in principle, the Protocol should not cover equipment that is general in nature.<sup>220</sup> In determining the purpose of equipment, it was suggested that the design rather than the use of the equipment should be considered. It is suggested that the use of the HS will further resolve 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 Protocol.

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

323. 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 Protocol.

324. The provisional list of HS codes for coverage under the MAC Protocol now contains an additional column indicating whether each code falls within the agricultural, construction or mining categories, or whether it covers equipment which is used in more than one of the categories.

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<sup>220</sup> [UNIDROIT 2015 - Study 72K - SG1 - Doc. 5](#), paragraphs 20-24.

## **P. Supervisory Authority**

325. At the first Study Group meeting the difficulty in identifying a Supervisory Authority for the MAC Protocol was noted, due to the diverse nature of the classes 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.

326. The Study Group raised the possibility of either the World Customs Organisation or the International Finance Corporation being the Supervisory Authority. The Study Group requested that the Secretariat do further research to further investigate possible candidates for Supervisory Authority, although research on outstanding legal issues should take priority.

## **PART II – RESOLVED LEGAL ISSUES**

### **Q. Severability**

327. It has been suggested during consultations that it may be worth splitting the MAC Protocol into three Protocols covering agriculture, construction and mining separately. The basis for this view is that the three fields are very different from one another, with diverse groups of stakeholders and categories of equipment that need to be considered. 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.

328. At the first Study Group meeting it was concluded that the Protocol should be maintained as a single Protocol, while allowing states to opt out of any of the three classes (agricultural, construction and mining) of equipment.<sup>221</sup> This opt out option for Contacting States is located in Article II of the Draft Protocol.

329. At the second meeting, the Study Group noted that severance of one class of equipment from the Protocol should only be contemplated if, later in the process, it becomes clear that one or more of the classes of equipment is radically different and it proves very difficult to deal with the classes together. While a possible divergence in the treatment of agricultural equipment in relation to insolvency has been identified, the divergence does not warrant severing agricultural equipment from the draft Protocol.

### **R. Merged Collateral<sup>222</sup>**

330. An established practice in the financing industries is to provide financing to customers for new equipment in the form of a financial lease which 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.

331. 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 Protocol, the security 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 Protocol, there is a significant burden on the creditor to comply with the

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<sup>221</sup> [UNIDROIT 2015 - Study 72K – SG1 – Doc. 5](#), paragraph 19.

<sup>222</sup> NLCIFT pages 60 – 61.

requirements of two distinct regimes to perfect its security interest in the entire package of assets (i.e. the creditors would have to register their interest in the new MAC equipment in the international registry, but the associated collateral equipment would require registration and compliance with the domestic secured transactions laws.)

332. 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.

### **S. Inventory<sup>223</sup>**

333. In principle, there is no problem with MAC equipment within the scope of the 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.

334. It was discussed at the first Study Group meeting whether the MAC Protocol should contain additional provisions dealing with the financing of equipment being held on inventory. It was suggested that the Protocol should not create a distinction between inventory and equipment. Further, the first Study Group meeting confirmed that for an interest in equipment to be registerable under the 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 MAC Protocol. The piece of equipment would become registerable once it became uniquely identifiable by serial number or other means.

335. The first Study Group meeting concluded that there was no need for the MAC Protocol to contain additional provisions covering inventory.

### **T. Interaction with domestic secured transaction regimes<sup>224</sup>**

336. 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 regime that provides for the creation and registration of interests therein creating a potential collision between such national laws and the Cape Town system, Article 29 of the Cape Town Convention provides that the international interest takes priority. Interests registered under the MAC Protocol should be expected to have priority over those interests made effective under national laws, as consistent with the previous Protocols.

### **U. Public service exception<sup>225</sup>**

337. Article XXV of the 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

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<sup>223</sup> NLCIFT pages 59 – 60.

<sup>224</sup> NLCIFT pages 68 – 75.

<sup>225</sup> NLCIFT pages 65 – 67.

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>226</sup>

338. Article XXV of the 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>227</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 stock.

339. Under Article XXVII of the Space Protocol, a debtor who enters into a contract providing the use of a space asset to provide 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>228</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 Rail Protocol.

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

341. 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 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.

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

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<sup>226</sup> Space Protocol Official Commentary, page 194.

<sup>227</sup> Rail Protocol Official Commentary, page 181.

<sup>228</sup> Space Protocol Official Commentary, page 196.

continuous public services. The Study Group agreed that this issue should be sufficiently covered by a note in the text of the revised annotated Protocol.

#### **V. De-registration and export request authorisation**

343. The first Study Group meeting discussed whether it was necessary to include an Article in the 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 instruments 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 or 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.

344. The first Study Group meeting noted that there seemed to be no need for an explicit de-registration provision for the 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 effect or refer to export/customs rules. The first Study Group meeting reaffirmed that this approach was correct.

345. 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 MAC Protocol, however more detail on the meaning of 'relevant administrative authority' should be provided in the Official Commentary to the MAC Protocol. This approach is reflected in Article VII(5) of the draft Protocol.

#### **W. Modification of Assignment provisions**

346. The first Study Group meeting discussed whether it was necessary for the 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 give other performance. It was further noted that this additional requirement was included in the 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.

347. 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 MAC Protocol to modify the original assignment provisions in the Cape Town Convention.