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THE CAPE TOWN CONVENTION AND DRAFT MAC PROTOCOL: AN OVERVIEW

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I. INTRODUCTION

1. This paper provides an overview of key provisions of the Convention on International Interests in Mobile Equipment 2001 (“Cape Town Convention”) and the draft Protocol thereto on mining, agricultural and construction (“MAC”) and also of additional drafting proposals prepared by the Secretariat in consultation with States, legal experts and the private sector. This overview should be read with the Explanatory Report,¹ consisting of an article-by-article annotation of the draft Protocol, the legal analysis,² supplemented by research Appendices,³ which sets out the main legal and technical issues related to the draft Protocol and the analysis of the Harmonized System codes listed in the draft MAC Protocol Annexes.⁴ All of these are available on the MAC Protocol website.⁵ For a detailed and up-to-date analysis of the Convention and provisions common to the Aircraft Protocol and draft MAC Protocol reference should be made to the Official Commentary on the Convention and Aircraft Protocol,⁶ especially Parts 2 and 3.

The background to the Convention and Protocols

2. For many years the financing of high-value equipment regularly crossing national borders, such as aircraft objects, railway rolling stock and space assets, has been impeded by the absence of uniform laws governing the rights and priorities of creditors under security, title reservation and leasing agreements. A bank taking a charge over an airframe to secure a purchase-money loan might find that while under the law of its own country it enjoyed strong default and insolvency remedies as well as an ability to preserve its priority by registration in a national registry, once the aircraft flew to another country the creditor’s rights became subject to that country’s laws, which might provide more limited default remedies and might give priority to the interest of another creditor

¹ DCME-MAC – Doc 4 corr., available <https://www.unidroit.org/english/documents/2019/study72k/dc/s-72k-dc-04-corr-e.pdf>.

² DCME-MAC – Doc 5 corr., available <https://www.unidroit.org/english/documents/2019/study72k/dc/s-72k-dc-05-corr-e.pdf>. The introduction identifies the provisions of the draft Protocol in respect of which the consultations referred to above indicated the need for revision of the text.

³ DCME-MAC – Doc 5 corr.– Appendices, available <https://www.unidroit.org/english/documents/2019/study72k/dc/s-72k-dc-05-corr-app-e.pdf>.

⁴ DCME-MAC – Doc 6, available <https://www.unidroit.org/english/documents/2019/study72k/dc/s-72k-dc-06-e.pdf>.

⁵ <https://macprotocol.info/>.

⁶ 4th edition, UNIDROIT, May 2019.

arising under a transaction concluded while the aircraft was situated in that other country. This *lex situs* rule, by which a dealing in an object is governed by the law of its location at the time of the dealing, is ill-suited to interests in mobile equipment, where the applicable law changes every time the object moves from one country to another.

3. The consequent uncertainties relating to creditors' rights under cross-border transactions relating to such mobile assets had the effect either that credit was refused altogether or that the costs of finance and of export credit insurance were substantially increased. The purpose of the 2001 Convention on International Interests in Mobile Equipment (the "Cape Town Convention") and its associated Protocols is to reduce the uncertainty, with its consequent risks and costs, by laying down uniform substantive law rules governing the interests of creditors under such transactions, by establishing an International Registry in which such interests can be registered; by prescribing priority rules for competing interests based on the order of registration; and by providing creditors with safeguards for their investment in the event of the debtor's insolvency. The Convention and Aircraft Protocol - the only protocol currently in force - and the facility to effect faster repossessions as well as registrations in the highly efficient International Registry established in Dublin have helped to reduce aircraft financing and credit exposure fees by billions of dollars a year. The Convention has been ratified by 79 States and the Protocol by 76 States and approved by the European Union.

The two-instrument approach

4. The Convention is a framework instrument applicable equally to aircraft objects, railway rolling stocks and space assets and, prospectively, MAC equipment. It is complemented by a series of Protocols each of which is designed to meet the particular needs of the industry concerned. A unique feature of this two-instrument system is that the Protocol controls the Convention, which does not enter into force until the relevant Protocol is in force and which takes effect subject to any modifications made by the Protocol. To preserve the uniformity of these instruments the policy has been to restrict such modifications to what is now necessary to meet the commercial needs of the relevant industry. For the same reason the Aircraft Protocol has been accepted as the prototype the provisions of which will be adopted in subsequent Protocols except so far as otherwise required to address the particular concerns of the industry in question. In consequence the Convention and Protocols provide a high degree of uniformity of rules across all categories of equipment falling within their scope, a uniformity which could not be achieved by a series of stand-alone Conventions and which is designed to minimize the need to resort to conflict of laws rules to determine the applicable law.

5. There are currently three Protocols to the Cape Town Convention: the 2001 Aircraft Protocol, the 2007 Luxembourg Protocol relating to railway rolling stock (likely to come into force in 2020) and the 2012 Space Protocol. The purpose of the Protocol on Mining, Agricultural and Construction ("MAC") Equipment, the draft of which is to come before a diplomatic Conference in Pretoria in November 2019 for adoption, is to extend the Convention and its benefits to the financing of high-value MAC equipment. Most of the provisions of the draft MAC Protocol follow those of earlier Protocols. However, the Protocol contains special provisions dealing with categories of equipment to be covered, immovable-associated equipment, inventory and amendments.

II. KEY FEATURES OF THE CONVENTION

Conditions of application

6. In order for the Convention to apply the following conditions must be satisfied:

- (1) The parties have entered into a security agreement, a title reservation agreement (that is, a conditional sale agreement) or a leasing agreement with or without an option to the lessee to purchase (Article 2(1), (2)).
- (2) The agreement relates to equipment which, as defined by the relevant Protocol, belongs to one of the following categories:
 - (a) airframes, aircraft engines and helicopters,
 - (b) railway rolling stock,
 - (c) space assets (Article 2(2), (3)),
 - (d) MAC equipment (see paragraphs 31 – 34 below).
- (3) The equipment is uniquely identifiable (Article 2(2));
- (4) The agreement is constituted in accordance with the formalities prescribed by the Convention (Articles 2(2), 7).
- (5) The debtor is situated in a Contracting State at the time of conclusion of the agreement creating or providing for the international interest - the “connecting factor” (Article 3).

7. Where these conditions are satisfied the Convention applies in a Contracting State even if its rules of private international law would otherwise lead to the application of the law of a non-Contracting State. The Convention may also be applied in a non-Contracting State whose conflict of laws rules lead to the application of the law of a Contracting State. In a Contracting State the Convention and Protocol must be applied in conformity with any declarations made by that State. The Convention provides that a Protocol may extend its provisions to outright sales and this extension is made by the Aircraft and Space Protocols. However, the Luxembourg Protocol and the draft MAC Protocol provide only for registration of a notice of sale.⁷ This registration has no Convention effects, its purpose being solely to give notice of the existence of the sale, which may or may not affect priority rules under national law.

Connecting factor

8. In order for the Convention to apply it is necessary that the debtor be situated in a Contracting State at the time of the agreement. The situation of the creditor is irrelevant. The Convention continues to apply even where the debtor moves to a non-Contracting State subsequent to the making of the agreement. To give maximum scope in the application of the Convention, Article 4 provides that the debtor is situated in any contracting State:

- (a) under the law of which it is incorporated or formed;
- (b) where it has its registered office or statutory seat;
- (c) where it has its centre of administration; or
- (d) where it has its place of business.

Constitution of an international interest

9. One of the many unique features of the Cape Town Convention is the creation of an entirely new form of property interest, the international interest in mobile equipment, deriving its force solely from the Convention, not from national law, and protected internationally by registration in an International Registry, a separate registry being established for each category of equipment.

10. An international interest is an interest in a uniquely identifiable aircraft object, railway rolling stock, space asset or, prospectively, MAC equipment granted by the chargor under a security

⁷ DCME-MAC – Doc 5 corr., Part 6S paragraphs 152 - 157, available <https://www.unidroit.org/english/documents/2019/study72k/dc/s-72k-dc-05-corr-e.pdf>.

agreement or vested in a person who is the conditional seller under a title reservation agreement or a lessor under a leasing agreement, whether or not including an option to purchase. The concepts of internationality and mobility are not defined, being considered inherent in the nature of the equipment as equipment of a kind readily movable from one country to another.

11. The formalities for constituting an international interest are simple. All that is required is that the agreement (a) is in writing, (b) relates to an object of which the debtor (chargor, conditional buyer or lessee) has power to dispose, (c) enables the object to be identified in conformity with the Protocol and (d) in the case of a security agreement, enables the secured obligations to be determined, but without the need to state a sum or maximum sum secured. In most cases an interest created under national law will at the same time constitute an international interest. The Convention does not displace national law but a duly registered international interest will usually have priority over a national interest. Nevertheless it may be desirable to perfect a national law interest in accordance with the applicable law, e.g. to capture proceeds going beyond the restricted definition in the Convention.

12. Registration is not a requirement of the constitution of an international interest, this being designed solely to give notice of it to third parties and protect its priority.

Default remedies

13. The Convention provides a set of basic default remedies but the parties may by their agreement provide additional remedies so far as consistent with the mandatory provisions of the Convention. The Convention remedies of a chargee are to take possession or control of the equipment, sell or grant a lease of the equipment, collect or receive any income or profits arising from its management or use, or, with the agreement of the debtor and other interested persons or on a court order, have the ownership of the equipment vested in the chargee. The remedies of a conditional seller or lessor are to terminate the agreement and take possession or control of the equipment.

14. The creditor may also, on adducing evidence of default, obtain a speedy order for preservation of the equipment and its value, possession, control or custody of the equipment, immobilisation of the equipment or lease of the equipment pending final determination of the creditor's claim ("advance relief"). In granting the order the court may impose such conditions as it considers necessary to protect the debtor in the event that the creditor, when implementing the order, commits a breach of its obligations to the debtor under the Convention or Protocol or fails to establish its claim at the substantive hearing.

15. Consistent with the previous Protocols, the draft MAC Protocol adds the remedies of export and physical transfer of equipment from the territory in which it is situated where these remedies are agreed by the debtor and also provides additional protection for the creditor in the event of the debtor's insolvency.

The International Registry

16. The Convention provides for the establishment of an International Registry to be run by a Registrar under the supervision of a Supervisory Authority, which creates the regulations governing the operation of the Registry. The registry system is asset-based, so that an international interest may be registered only in relation to objects which are uniquely identified.

17. There will be separate International Registries for each Protocol. Registry systems under the Luxembourg, Space and MAC Protocols are likely to follow the model of the International Registry for aircraft objects in being wholly electronic, with no human intervention at the Registry end and

provided at moderate cost with ready searchability and provision of search certificates.⁸ The Convention allows for registration of a prospective international interest where the equipment is identified and there is only lacking another element for the constitution of the interest, for example, the debtor's power to dispose. Once the international interest has been constituted no further act is required on the part of the creditor, the international interest taking effect for priority purposes from the time of registration of the prospective international interest. A Contracting State may also make a declaration providing for the registration of non-consensual rights or interests, for example judgments or orders for the attachment of equipment and State liens for unpaid taxes or charges, and upon registration these have effect as if they were international interests.

18. The registry system also accommodates a variety of other registrations: assignments and prospective assignments of international interests, acquisitions of international interests by legal or contractual subrogation under the applicable law, subordination of interests, notices of national interests, and pre-existing rights or interests. The last two of these are explained below. The Registrar is strictly liability for any errors and omissions on the part of the International Registry and for any system malfunction except for events of an inevitable or irresistible nature, but the Registrar is not liable for transmitting for factual inaccuracy of information transmitted by the Registry in the form in which it was received.

Priorities

19. The Convention priority rules are designed to be simple and to avoid the complexities of rules in national legal systems. The basic rule under Article 29(1) of the Convention is that a registered interest has priority over a subsequently registered interest and over an unregistered interest even if this is not registrable. This priority applies even if the first registered interest was acquired or registered with actual knowledge of the other interest and even as regards value given by the holder of the first registered interest with such knowledge. The purpose of this rule is to protect the integrity of the registration system and to avoid factual disputes as to whether a party did or did not have knowledge.

20. Any priority given by the Convention to an interest in equipment extends to proceeds. However, proceeds are narrowly defined as money or non-money proceeds arising from total or partial loss or physical description of equipment or its total or partial confiscation, condemnation or requisition. This restrictive definition reflects the fact that the Convention is not concerned with general receivables financing, which is covered by a separate Convention, the *2001 UN Convention on the Assignment of Receivables in International Trade*. Accordingly, if it is desired to capture proceeds going beyond the definition steps should be taken to perfect the interest on the national law. A conditional buyer or lessee is entitled to quiet enjoyment as against a third party whose interest is subordinate to that of the conditional seller or lessor.

Non-registrable non-consensual rights or interests

21. A Contracting State may make a declaration under Article 39(1) of the Convention that some or all of the categories of non-consensual rights or interests which under that State's law have priority over an interest equivalent to that of an international interest are to have priority over a registered international interest, whether in or outside insolvency proceedings. Such declarations typically cover non-consensual liens in favour of repairers for the cost of repairs, unpaid wages due to employees and amounts due to the State for unpaid taxes or sums secured by statutory liens, where not covered by a declaration under Article 39(1).

⁸ The International Registry for aircraft objects has been widely used to register interests in airframes, aircraft engines and helicopters and in January 2019 celebrated its millionth registration.

Protection on the debtor's insolvency

22. Article 30 provides that, without affecting the effectiveness of an international interest under the applicable law in the event of the debtor's insolvency, a registered international interest is to be effective in insolvency proceedings if prior to the commencement of those proceedings the international interest has been registered. This means that the insolvency law of a Contracting State must recognize the proprietary effects of a registered international interest, but Article 30 does not affect any rules of insolvency law relating to the avoidance of transaction as a preference or a transfer in fraud of creditors or any rules of procedure relating to the enforcement of rights to property which is under the control or supervision of the insolvency administrator, for example rules restricting enforcement to facilitate a restructuring of arrangement. The draft MAC Protocol contains further rules, based on the Aircraft and Rail Protocols, for the protection of a creditor from consequences of a debtor's insolvency.

Assignments

23. The Convention contains rather complex rules governing the assignment of associated rights, that is, rights to payment or other performance by a debtor which are secured by or associated with the equipment. The Convention does not apply to an assignment of associated rights which is not effective to transfer the related international interest. Conversely an assignment of an international interest is not effective unless some or all related associated rights also are assigned. In other words, the assignment must cover both the international interest itself and at least some of the associated rights.

24. The formalities for an assignment broadly track those of the creation of an international interest. Where the debtor has been given notice of the assignment in writing by or with the authority of the assignor and the notice identifies the associated rights the debtor comes under a duty to make payment or give other performance to the assignee.

25. The priority rules governing assignments distinguish between competing assignments of the same international interest and assignments of different international interests. Where the same international interest is assigned priority is determined by the order of registration of the assignments. On the other hand, where the assignments relate to different international interests the competing assignees stand in the shoes of their assignor and their priority is therefore determined by the order of registration of the international interests, not by the order of registration the assignments.

Internal transactions

26. Under Article 50 a Contracting State may declare that the Convention is not to apply to an internal transaction in relation to such State with regard to all types of equipment or some of them. In the first place a transaction is an internal transaction only where (a) the centre of main interests of all parties is situated, and the equipment located, in the same Contracting State at the time of conclusion of the contract and (b) the interest has been registered in a national registry. Secondly, a declaration under Article 50 operates only to exclude the provisions of the Convention governing relations between the parties to the transaction; it does not affect the provisions relating to registration and priorities or to insolvency. This provision is of very limited application and few States have so far made a declaration under it.⁹

⁹ Only five States have made declarations under Article 50, see <https://www.unidroit.org/english/conventions/mobile-equipment/depositaryfunction/declarations/capetownconv-aircraftprot-decltable-matrix.pdf>.

Jurisdiction

27. The Convention does not contain any general jurisdiction clause except so far as provided by written agreement of the parties, who may designate the Contracting State whose courts are to have jurisdiction over any claim brought under the Convention, whether or not the chosen forum has a connection with the parties or the transaction. This jurisdiction is presumed to be exclusive unless otherwise agreed. There are two qualifications. First, the only courts that have jurisdiction to make order against the Registrar of the International Registry are the courts of the place where the Registrar has its centre of administration. Second, the parties cannot exclude the concurrent jurisdiction of the courts to grant advance relief under Article 13, such jurisdiction being conferred on the courts of the territory where the object is situated or, in the case of the remedy of a lease of the object, the courts on the territory of which the debtor is situated.

The declaration system

28. A further distinctive feature of the Convention is its system of declarations by which a Contracting State declares that it will not be bound by particular provisions that run counter to its basic legal principles. The only mandatory declaration for States under the Convention is Article 54(2), which requires States to decide whether certain remedies under the Convention can be exercised by a creditor without the leave of the court. Under some types of declaration a Contracting State is not bound unless it opts into the provision in question. The Convention provides for only one type of opt-in declaration, namely that under Article 60(3). Under other types of declaration the State remains bound unless and until it chooses to make an opt-out declaration. Opt-out declarations under the Convention relate to Article 13 concerning advance relief, Article 43 as to jurisdiction over applications under Article 13 and Article 50 as to internal transactions. The Protocols contain further provisions allowing for declarations in relation to a variety of matters. Most of these additional declarations are consistent across all Protocols; a limited number of declarations are however specific to each Protocol.

Pre-existing rights or interests

29. Under Article 60(1), unless otherwise declared by a Contracting State the Convention does not apply to a pre-existing right or interest, which retains the priority it enjoyed under the applicable law before the date of the Convention. Article 60 leaves a number of questions unanswered, so that the Luxembourg, Space and draft MAC Protocols all modify its provisions to make its meaning clearer. The broad effect is to protect the priority under the applicable law of interests arising under the law of a State (whether or not a Contracting State) prior to the registration of an international interest under the Convention. Under Article 60(3) a Contracting State may make a declaration extending the scope of the Convention to cover pre-existing rights and interests arising under its national law but only with effect not earlier than three years after the date on which the declaration becomes effective. Article 60(3) therefore allows the holder of a pre-existing right or interest a minimum of three years from the time the declaration becomes effective to re-perfect that interest by registration in the International Registry. Such registration preserves the priority of the pre-existing right or interest under its national law.

Entry into force

30. The Convention and Aircraft Protocol came into force in March 2006 following deposit of the eighth instrument of ratification of the Aircraft Protocol. The Convention itself required only three ratifications but as regards any provisions relating to equipment it cannot enter into force until the relevant Protocol has entered into force and the Aircraft Protocol required eight ratifications. The Luxembourg, Space and draft MAC Protocols prescribe two conditions of entry into force. The first is

ratification by a prescribed number of States, in the case of the draft MAC Protocol five ratifications.¹⁰ The second is the deposit of a certificate with the Depositary of a certificate confirming that the International Registry is fully operational. It is open to a State to ratify the Convention without ratifying a Protocol, but this is not advisable as the Convention has no operative effect in that State until a Protocol is also ratified. On the other hand, a State may not ratify a Protocol without first ratifying the Convention.

III. KEY FEATURES OF THE DRAFT MAC PROTOCOL

Introduction

31. MAC equipment does not feature as a category of equipment specifically listed in the Convention, as it was not envisaged when the Convention was adopted in 2001. However, the Convention's extension is possible under Article 51, which provides the procedure for the adoption of new Protocols. An assessment made by Warwick Associates on behalf of UNIDROIT in 2018¹¹ estimates that over a ten-year period the MAC Protocol may increase the stock of MAC equipment in developing countries by USD 90 billion and that it is predicted to have a positive annual impact of USD 23 billion on GDP in developing countries and of USD 7 billion in developed countries, leading to a total impact on GDP equivalent to USD 30 billion a year.

32. Those involved in work on the MAC Protocol confronted two central problems not encountered with previous Protocols: defining the sphere of application, given the enormous diversity of objects constituting mining, agricultural and construction equipment; and the selection of criteria to limit the scope of the Protocol as far as possible to equipment of high unit-value. The Study Group, assisted by the private sector MAC Working Group and by research conducted by the National Law Center for Inter-American Free Trade, was able to resolve both problems by limiting the coverage of MAC equipment to the categories contained in 42 codes from some 5,000 commodity groups contained in the World Customs Organization Harmonized Commodity Description and Coding System (HS), an international product nomenclature developed by the WCO. Additional codes have since been proposed by States.¹² The HS is updated every five to six years, the latest revision being issued in 2017.

33. Categories in the selected codes are for the most part characterised by relatively high unit-value and identification of individual items by serial number. Other criteria for the selection are that the equipment is not general use equipment but equipment predominantly used in the mining, agricultural and construction sectors; that the selected codes should cover complete equipment rather than parts, while not excluding parts of high value which are commonly the subject of separate financing or leasing and to which a distinct listed code is allocated; and that the equipment is designed for on-site activity - production, cultivation and extraction - in the MAC sectors, as opposed to post-cultivation/post-extraction processing or refining.

34. The draft MAC Protocol to be submitted to the diplomatic Conference reflects agreement by the Committee of Governmental Experts on most of its provisions. However, work to date has revealed three key issues for decision by the diplomatic Conference, namely the effect of association of equipment with immovable property, the treatment of dealings in inventory and the procedure to accommodate changes in the HS codes. Further issues may arise during the course of the diplomatic

¹⁰ Draft MAC Protocol, Article XXIV(1)(a).

¹¹ *The MAC Protocol: An Economic Assessment of the Fourth Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Agricultural, Construction and Mining Equipment*, August 2018.

¹² For more information on the additional HS codes proposed for inclusion in the draft MAC Protocol Annexes, see DCME-MAC – Doc. 6, available <https://www.unidroit.org/english/documents/2019/study72k/dc/s-72k-dc-06-e.pdf>.

Conference, which will review all the provisions of the text and make such changes as are considered appropriate. Again, only an overview of the draft MAC Protocol is given in this paper and only the key provisions discussed.¹³

Sphere of application

35. The Protocol extends the Convention to cover international interests in mining, agricultural and construction equipment. These terms are defined only by reference to the HS codes listed in one or more of three Annexes, mining equipment meaning an object falling within an HS code listed in Annex 1, agricultural equipment an object falling within an HS code listed in Annex 2 and construction equipment an object falling within an HS code listed in Annex 3. It is open to a Contracting State to limit the application of the Protocol to the entirety of the equipment comprised in one or two of the Annexes. Individual items within an Annex cannot be excluded. Some codes are listed in more than one Annex. In that case the exclusion of equipment in one of the Annexes will not affect the application of the Protocol to the same category of equipment in another Annex. Accordingly, the purpose for which equipment within a code category is acquired or the use to which it is put is irrelevant.

Example

Tractors covered by HS code 870195 appear in all three Annexes. A Contracting State, Ruritania, has made a declaration excluding Annex 1 (mining equipment). A Creditor grants a secured loan for the purchase of a tractor covered by HS code 870195 which the Debtor intends to use and does use as mining equipment. Nevertheless, the transaction is governed by the Convention and Protocol in Ruritania because the tractor falls within Annexes 2 and 3. The fact that the Debtor does not use the tractor for agricultural or construction purposes is irrelevant.

36. Equipment includes all installed, incorporated or attached accessories, components and parts which do not fall within a separate HS code listed in an Annex, as well as all data, manuals and records relating thereto. So while code 871620 relating to trailers and semi-trailers includes parts of these, such parts do not constitute equipment within the Protocol except so far as they are of a category falling within its own distinct code.

37. The Protocol is also inapplicable to objects falling within the definition of “aircraft objects” under the Aircraft Protocol, “railway rolling stock” under the Luxembourg Protocol or “space assets” under the Space Protocol. So railway shunt tractors fall within the Luxembourg Protocol, not the MAC Protocol.

Identification

38. The draft MAC Protocol, following the Rail Protocol and Space Protocols, distinguishes the identification requirements for the constitution of an international interest, where identification may be quite general, from the requirements registration, where the identification must be precise. In the relations between the parties themselves a description of equipment is sufficient to identify the equipment if it contains:

- (a) a description of the equipment by item;
- (b) a description of the equipment by type;
- (c) a statement that the agreement covers all present and future equipment; or
- (d) a statement that the agreement covers all present and future equipment except for specified items or types.

¹³ For more detailed analyses, see the documents DCME-MAC – Doc. 4 corr. and DCME-MAC – Doc. 5 corr., available <https://macprotocol.info/diplomatic-conference/>.

39. So an agreement may create an international interest in after-acquired MAC equipment which will attach as soon as the equipment is acquired without the need for a new act of transfer. All that is necessary is that the equipment falls within a description covered by the agreement. By contrast an international interest cannot be registered unless it is identified by the manufacturer's serial number and such additional information as may be required by registry regulations to ensure uniqueness, compliance with these requirements being both necessary and sufficient to identify the object for registration purposes.

Choice of law

40. The Convention and Protocol attach high importance to party autonomy. Under Article VI of the Protocol, which applies only in a Contracting State which has made a declaration to that effect, the parties are free to choose the law governing their agreement whether or not the State whose law is chosen has any connection with the parties or the transaction.

Association with immovable equipment

41. Article VII deals with the treatment of immovable-associated equipment. This is defined as equipment that is so associated with immovable property that an interest in the immovable property extends to the equipment under the law of the State in which the immovable property is situated. This does not mean that an international interest in equipment which becomes immovable-associated equipment is necessarily extinguished, merely that a priority issue may arise in a competition between a claim by the holder of the immovable property and the holder of the international interest in the equipment. Article VII uses the term "associated" with immovable property rather than "attachment" or "affixation" to land not only because the meaning of these latter terms varies from jurisdiction to jurisdiction but also because under the laws of some legal systems the landowner acquires an interest in any object physically standing on the land, even without attachment, if it is intended to be on the land otherwise than temporarily and enhances the use or productivity of the land, for example, farming implements, oil tanks and machinery.

42. The laws of most countries distinguish between cases where the equipment can be readily detached from the land from cases where it is so strongly attached to the land that it is no longer removable from it and becomes part of the land itself, ceasing to be equipment. There are different ways of describing this condition, at least two of which are likely to be considered by the diplomatic Conference. The first is that the equipment loses its legal identity under the *lex situs*. The second, in broad terms, is that removal is not economic because the cost of severance and of repairs to the immovable property and the equipment would be disproportionate to the value of the equipment. This second test differs from the first in that it is fact-based and does not involve reference to applicable law. Where the equipment has already become part of the land by the time of the agreement the Convention and Protocol do not apply at all even if the equipment is later detached from the land. Article VII(1) deals with the effect of the association of equipment with immovable property in a non-Contracting State. This is left to be determined by the law of that State.

43. Article VII(2) requires each Contracting State to declare whether it opts for the entirety of Alternative A, Alternative B or Alternative C:

(1) Alternative A provides that where the equipment is removable its association with immovable property does not affect its status as equipment under the Protocol. The test for removability has been proposed by the Secretariat, based on additional consultations undertaken in 2018 and 2019.¹⁴

(2) Alternative B addresses two situations. The first is where the equipment loses its legal identity under the *lex situs*. It is then left to the *lex situs* to determine the effect of the

¹⁴ See DCME-MAC – Doc. 5 corr., Part 3I, paragraphs 75 – 83, available <https://www.unidroit.org/english/documents/2019/study72k/dc/s-72k-dc-05-corr-e.pdf>.

association. The second is where the equipment does not lose its legal identity under the *lex situs*. In that case the interest in the immovable property has priority over the international interest only if, prior to the registration of the international interest, the equipment became associated with the immovable property and the interest in the latter had been registered in accordance with the *lex situs*. The underlying idea is that the holder of each competing interest has an opportunity to search in the register protecting the other interest in order to see whether there is a prior ranking interest. Accordingly the international interest should have priority if the relevant equipment was not at the time of the agreement associated with immovable property and the international interest was registered prior to an effective registration of the interest in the immovable property.

(3) Alternative C leaves the effect of the association to be determined by the *lex situs*.

Modification of default remedies

44. Article VIII extends the Convention provisions on default remedies in line with earlier Protocols. Export and physical delivery are added to the remedies and the provision in Article 8(3) that the remedies of a chargee are to be exercised in a commercially reasonable manner is replaced by a more general provision that all remedies are to be so exercised. However, the exercise of remedies in conformity with a provision of the agreement is deemed to be reasonable except where such a provision is manifestly unreasonable. A duty is imposed on the relevant authorities in a Contracting State to expeditiously co-operate with and assist the credit to the extent necessary for the exercise of the remedies of export and physical delivery.

45. Article IX of the draft MAC Protocol adds sale and the application of the proceeds of sale to the forms of advance relief available under Article 13 where the parties specifically so agree and also crystallises the time within an order for advance relief by reference to a Contracting State's declaration. It is envisaged that this will be short in the light of the need for speed in repossessing the equipment to save it from cannibalisation or physical or commercial deterioration. Most declarations under the Aircraft Protocol specified a period of ten working days from the filing of the application. Subsequent Protocols have, like the draft MAC Protocol, substituted calendar days for working days for greater certainty as working days vary not only from one State to another but even within a State.

Remedies on insolvency

46. Article X contains important provisions dealing with the effect of the debtor's insolvency. These apply only where a Contracting State that is the primary insolvency jurisdiction - that is, the Contracting State where the debtor has its centre of main interests - makes a declaration to that effect. Three alternative versions are offered, Alternatives A, B and C. A Contracting State may choose one only of these alternatives and the alternative must be chosen in its entirety. Whichever alternative is chosen must be applied to all three Annexes. A Contracting State may also make no declaration, leaving the impact of insolvency to be governed by its own insolvency laws. Courts of another State in which equipment is situated must, in accordance with that State's laws, co-operate to the maximum extent possible with foreign courts and foreign insolvency administrators, that is, the those of the insolvency jurisdiction.

47. Alternative A prescribes a waiting period - specified in a declaration by a Contracting State - within which the insolvency administrator or, if none, the debtor must give up possession of the equipment. The equipment may be retained if within the waiting period the insolvency administrator or debtor cures all defaults and agrees to perform all future obligations under the agreement. Failing such performance, no further waiting period is given and the court may not intervene to extend the period or modify the debtor's obligations without the consent of the creditor. Alternative B obliges the insolvency administrator or debtor to offer performance as above but only on the request of the

creditor, and on default the creditor has to obtain leave of the court before repossessing the equipment. Alternative C is halfway between Alternatives A and B; the insolvency administrator or debtor, on whom are imposed the same obligations as in the other alternatives, may apply to the court to suspend its obligations beyond the end of the cure period to no later than the expiration of the agreement or any renewal of it.

Inventory

48. Previous Protocols have not made separate provision for international interests in inventory, that is, equipment held by a dealer for sale or lease in the ordinary course of its business. But MAC equipment is to be differentiated in that it may involve large inventories being regularly turned over. This raises two distinctive issues. The first concerns the position of a buyer in ordinary course of business, who in many legal systems takes free even of a registered interest, because the creditor knows that the inventory is held for sale or lease and that only through this will the dealer be able to repay the advance. Accordingly the creditor ought not, in the view of these systems, to be allowed to assert its security interest or title reservation or leasing rights against a buyer. This is the general principle adopted in Article XII but it is subject to any contrary rule of the applicable law. The second issue relates to the registration requirements and priority rules. An asset-based registration is not necessarily well-suited to inventory, which is constantly being acquired and resold by the dealer, so that the international interest is likely to be limited in duration, involving a flow of registrations many of which will then have to be discharged within a short period of time. With this in mind Article XII(4), as proposed to be amended, provides that a Contracting State may make a declaration that an interest in inventory created or provided for by an agreement under which the dealer is the debtor is not an international interest if at the time the interest arises the inventory is situated in a Contracting State which has made a declaration to the above effect. This would enable a declaring State to utilise a debtor-based registration that would facilitate financing over categories of equipment, or all equipment, present and future without the need for registration against individual items of inventory.

Debtor provisions

49. The debtor is entitled to quiet possession as against its creditor and the holder of any interest junior to that of the creditor or, if the holder of that interest so agrees, any interest senior to that of the creditor.

The Supervisory Authority and the Registrar

50. Article XIV deals with the designation and powers of the Supervisory Authority responsible for the oversight of the International Registry and for the appointment of the Registrar and with the role of the Registrar. The detailed operation of the International Registry is prescribed by regulations to be made by the Supervisory Authority. Under Article XVIII the search criterion for equipment is the manufacturer's serial number. The Registry must be accessible 24 hours a day except for suspension for necessary maintenance and repair. The Registry's liability for loss caused is fixed at the value of the equipment to which the loss relates, with a maximum of 5 million Special Drawing Rights or such greater amount computed in such manner as the Supervisory Authority may determine by regulations. The Registry is required to be insured against liability in an amount not less than that determined by the Supervisory Authority.

Final provisions

51. The draft contains standard final clauses and provisions as to declarations, review conferences and amendments. Of particular importance are the provisions relating to amendments to the Protocol. This issue was not fully settled during the Committee of Governmental Experts meetings in 2017, at which the Committee asked the UNIDROIT Secretariat to undertake further

research and prepare a proposal for consideration at the diplomatic Conference. The Secretariat's proposal¹⁵ for the amendments articles draws a distinction between substantive amendments to the text of the Protocols and Annexes and technical adjustments to the Annexes resulting from a revision of the HS System. Substantive amendments would require a two-third majority of the States participating in a Conference convened to consider the amendments. By contrast, technical amendments would be deemed to be adopted unless any Contracting State objected within 12 months of notification of the proposed adjustments, in which event States would have to seek agreement by consensus. Failing this a two-thirds majority of Contracting States present and voting would be required.

¹⁵ See DCME-MAC – Doc. 5 corr., Part 6X, paragraphs 189 - 216, available <https://www.unidroit.org/english/documents/2019/study72k/dc/s-72k-dc-05-corr-e.pdf>.