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The Pretoria Protocol for the Financing and Leasing of Mining, Agricultural and Construction Equipment Is Adopted

Adopted in November 2019, the Pretoria Protocol is expected to reduce the risk of finance, and increase access to financing, for sales and leases of mining, agricultural, and construction (MAC) equipment. However, much work lies ahead before the protocol can enter into force.

By Phillip L. Durham and Simon Stanley

The 2001 Cape Town Convention on International Interests in Mobile Equipment has four protocols that facilitate financing and leasing of aircraft, railway rolling stock, space assets, and now mining, agricultural, and construction (MAC) equipment.

The convention, which has already been heralded as the most economically significant international treaty of the 21st century, due to the success of its Aircraft Protocol,¹ becomes even more relevant with the adoption, on November 22, 2019, in Pretoria, South Africa, of the MAC Protocol (Pretoria Protocol).²

The purpose of the Pretoria Protocol is to provide a framework of uniform international law that protects security interests and title-retention rights in MAC equipment. An article in the Winter 2017

issue of this journal reported on the key features and economic and legal justifications for the Pretoria Protocol.³ This article follows up with updated economic impact estimates, details of the adopted text, prospects for future ratification, and an outline of work that remains to be done.

ADOPTION OF THE PRETORIA PROTOCOL

Work on the MAC Protocol began in 2005, initiated by the International Institute for the Unification of Private Law (UNIDROIT), and culminated in an intense and collaborative two weeks of negotiations at a diplomatic conference hosted by the Department of International Relations and Cooperation (DIRCO) in the Republic of South Africa.

Over 150 delegates from 43 states participated in the negotiations as well as one regional economic integration organization, three

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In particular, this newer protocol addresses states without modern secured transactions laws and where finance constraints have limited the supply of MAC equipment.

intergovernmental organizations, four international nongovernmental organizations, and one technical adviser.⁴ (For purposes of this article, *states* refers to the participating countries as UNIDROIT has referred to them.) The Republic of Congo, the Republic of Gambia, the Republic of Paraguay, and the Federal Republic of Nigeria all signed the protocol upon adoption.⁵

More than 20 states expressed confidence in the protocol's future impact on global economic development across the MAC sectors and indicated that their own internal process for signature consideration was underway.⁶ The MAC Protocol is now also referred to as the Pretoria Protocol in appreciation of the Republic of South Africa hosting the diplomatic conference.⁷

BENEFITS TO LENDERS AND BORROWERS

The Pretoria Protocol is modeled largely on the Aircraft Protocol, which is formally known as the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment.

This newer protocol is designed to reduce the risk of finance and increase its availability to increase financing, sales, and leasing of MAC equipment. In particular, it addresses states without modern secured transactions laws

and where finance constraints have limited the supply of MAC equipment. Suppliers and users of MAC equipment are both expected to benefit from increased supply, especially in developing economies.

Like its predecessors, the objective of the Pretoria Protocol is to provide certainty, predictability, and adequate protections of the rights of lessors and secured creditors to allow them to confidently lease and finance equipment across the world. The protocol will benefit secured creditors and lessors by providing predictable protection of their interests in MAC equipment, including during insolvency proceedings.

GLOBAL IMPACT

The global market for MAC equipment is valued at about \$200 billion annually.⁸ Among the 63 UNIDROIT member states, annual exports of MAC equipment exceed \$90 billion and imports total \$80 billion.⁹ The market for MAC equipment is diverse. Thousands of companies, large and small, manufacture MAC equipment,¹⁰ and the scope of the protocol includes secondhand equipment in the substantial secondary market.¹¹

Moreover, MAC equipment is essential to developing economies for exploitation of natural resources, construction of physical infrastructure, and expansion and intensification of agriculture, a key sector for GDP, employment, and

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A 2018 assessment of the economic impact of the MAC Protocol in the 63 UNIDROIT member states estimates that over a 10-year period, the protocol may increase the stock of MAC equipment in developing economies by \$90 billion.

food security. In economies with less access to credit, insufficient capital equipment constrains productivity, profits, and economic growth.¹²

The Pretoria Protocol has the potential to make an even bigger impact than the Aircraft Protocol that inspired its vision. A 2018 assessment of the economic impact of the MAC Protocol in the 63 UNIDROIT member states estimates that over a 10-year period, the protocol may increase the stock of MAC equipment in developing economies by \$90 billion.¹³

The assessment predicts that the MAC Protocol will increase GDP by \$23 billion in developing economies and by \$7 billion in developed economies, impacting GDP globally by \$30 billion annually.¹⁴ The impact could be even larger considering that ratification of the Pretoria Protocol is not limited to the 63 UNIDROIT members included in the assessment, and 80 states have ratified the Cape Town Convention.

WHAT IS MAC EQUIPMENT?

The scope of MAC equipment covered by the Pretoria Protocol is limited to equipment corresponding to 56 six-digit codes selected from the 2017 edition of the World Customs Organization Harmonized Commodity Description and Coding System (Harmonized System, or HS).¹⁵

The 56 HS codes selected for the Pretoria Protocol are contained in three annexes designed to allow a contracting state¹⁶ to exclude equipment used predominantly in one or two of the MAC sectors. Annex 1 contains mining equipment, Annex 2 contains agricultural equipment, and Annex 3 contains construction equipment.

A contracting state may not exclude only some of the codes in an annex but may limit the application of the protocol to equipment of only one or two annexes.¹⁷ The protocol applies to all equipment included in any annex for which the protocol is effective. Any intended or actual use of the equipment is irrelevant.¹⁸

For example, even for a contracting state that has excluded Annex 1 (mining equipment) and Annex 3 (construction equipment), because HS 842911 appears in all three annexes, a track-laying bulldozer falls within the scope of the protocol, whether it is used for mining, agriculture, construction, or any other purpose.

The World Customs Organization revises the HS codes every five to six years, most recently in 2017.¹⁹ The Pretoria Protocol includes provisions for adjustments to the annexes to maintain conformity with the Harmonized System as well as provisions to modify the annexes, including the potential addition of new HS codes, including the potential addition of new HS codes to expand its scope.²⁰

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Contracting states agree to ensure that the relevant administrative authorities expeditiously cooperate with and assist the creditor to the extent necessary, subject to any applicable safety laws and regulations.

The 56 HS codes included within the scope of the protocol were selected from codes proposed for consideration by UNIDROIT member states and industrial organizations. In 2017, following a five-year evaluation process, UNIDROIT's Committee of Governmental Experts approved 42 HS codes (out of 113), constituting \$109 billion in annual exports, for inclusion in the draft protocol.²¹

Subsequently, 71 proposals were made by six states regarding 42 additional HS codes. Of these, 14 were recommended for inclusion in the draft protocol.²² Additionally, one HS code was recommended for removal.²³ During negotiations at the diplomatic conference, all of the above recommendations were accepted, and one additional HS code was added to the annexes from proposals submitted for the diplomatic conference.²⁴

A PROTÉGÉ OF THE AIRCRAFT PROTOCOL TAILORED FOR THE MAC SECTORS

In the hope of duplicating its success, the Pretoria Protocol draws heavily on the Aircraft Protocol. With the goal of creating an easily ratifiable treaty, the Pretoria Protocol offers contracting states simple binary choices between retaining their local law or adopting provisions designed to produce the economic benefits demonstrated by the Aircraft Protocol.

For example, the Pretoria Protocol offers the insolvency provisions of the Aircraft Protocol that have been widely favored by ratifying states and thought to produce the most certainty and economic benefit.²⁵

Likewise, similar to the Aircraft Protocol's provisions for the secured creditor to de-register and export aircraft,²⁶ the Pretoria Protocol provides for the secured creditor to export MAC equipment from the contracting state in which it is situated.²⁷

Moreover, contracting states agree to ensure that the relevant administrative authorities expeditiously cooperate with and assist the creditor to the extent necessary, subject to any applicable safety laws and regulations.²⁸

Equipment Associated With Immovable Property

One issue addressed by the Pretoria Protocol that did not arise for the aircraft, space,²⁹ or rail protocols, is the association of equipment with immovable property, such as land. National legal regimes vary on their approach to extending immovable property rights to movable property. For example, when irrigation equipment is installed at a farm it may be considered a fixture, the rights to which run with the land.³⁰

This issue is further complicated by the question of whether such equipment's association with the land has caused the equipment to

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A second issue addressed by the Pretoria Protocol that does not arise under the previous protocols is the treatment of equipment held as inventory by a dealer.

lose its identity as property that is separable from the land. To provide certainty for creditors, while remaining flexible in the interests of contracting states, the MAC Protocol offers three alternatives regarding the treatment of MAC equipment associated with immovable property.³¹

Alternative A is expected to be selected by most states. It provides an objective test to determine whether MAC equipment is separable from immovable property. If it is separable, application of the protocol is unaffected. To be separable, the estimated value of the equipment after physical disconnection from the immovable property must be greater than the estimated cost of disconnecting the equipment and restoring any damage to the immovable property.³²

Furthermore, there is a rebuttable presumption that if immovable-associated equipment is severable from the immovable property at the time it became associated, or when an international interest in the equipment was created, whichever is later, the equipment continues to be severable.³³ Therefore, an evaluation conducted at the time of financing need not be repeated at a later date unless rebutted.

Alternative B applies national law to determine separability but gives priority to an international interest

unless two conditions existed before the international interest was registered: (1) the competing interest had been registered in accordance with domestic law, and (2) the equipment had become associated with the immovable property.

Alternative C simply applies the national law to determine the effects of association of the equipment with immovable property in relation to an international interest.

Equipment Held as Inventory

A second issue addressed by the Pretoria Protocol that does not arise under the previous protocols is the treatment of equipment held as inventory by a dealer. The International Registry is an asset-based system, with registrations by equipment serial number rather than debtor name. As such, it is not possible to register an interest over, for example, all of a dealer's equipment, as is commonly done in debtor-based filing systems in the United States or Canada.³⁴

Rather than requiring registration of international interests in each individual object held in inventory, which a dealer may hold for only short periods, the Pretoria Protocol provides contracting states with the option of excluding an interest in inventory from constituting an international interest.³⁵ This option may be attractive for states with established inventory financing

Adoption of the protocol does not bind the negotiating states to its provisions.

Two additional steps are required before the Pretoria Protocol can enter into force as binding international law for the contracting states that ratify or accede to the protocol.

regimes that include debtor-based filing systems where security interests in inventory may be registered more efficiently by asset category or general description.

For purposes of this provision, the location of a dealer's inventory is irrelevant.³⁶ An international interest in inventory cannot be created if the dealer is the debtor and is located in a contracting state that has decided to apply this provision.³⁷

NEXT STEPS FOR IMPLEMENTATION OF THE PRETORIA PROTOCOL

Adoption of the protocol does not bind the negotiating states to its provisions.³⁸ Two additional steps are required before the Pretoria Protocol can enter into force as binding international law for the contracting states that ratify or accede to the protocol: (1) five states must ratify the protocol, and (2) an International Registry must be fully operational.³⁹ Four states signed the protocol upon adoption, and many others indicated that they were moving forward with the internal processes necessary before signing.

The International Registry for MAC equipment is expected to be similar to the existing International Registry for Aircraft in that it will be globally available, via the internet, for electronic searches and registrations.⁴⁰

The diplomatic conference resolved to establish a preparatory commission that would act as provisional supervisory authority, under the guidance and supervision of UNIDROIT, to establish the International Registry under the Pretoria Protocol.⁴¹

The commission will meet on May 21 and 22, 2020, and will consist of up to 20 representatives appointed by UNIDROIT from nominations by states or from regional economic integration organizations that have signed, ratified, or acceded to the protocol, as well as by up to seven states that participated in the conference and up to seven states nominated by UNIDROIT.⁴² Other organizations, including the MAC Working Group, will participate as observers to the meetings.⁴³

Due to the COVID-19 pandemic, the first meeting will be a virtual meeting. The impact of the pandemic also casts uncertainty over the expected speed of ratification of the protocol. With a view to guaranteeing that the International Registry is operational by the time the protocol enters into force, the preparatory commission's goal is to ensure that all necessary regulations and procedures are prepared and approved within two years of its first meeting.⁴⁴

As provisional supervisory authority, the commission will ensure that the registrar managing the International Registry is

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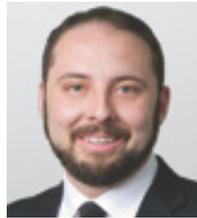
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selected in accordance with an objective, transparent, and fair selection process.⁴⁵ Pursuant to Article XIV(1) of the protocol, the diplomatic conference resolved to invite the International Finance Corporation to accept the functions of supervisory authority when the protocol enters into force. If the IFC does not accept this invitation, the conference will invite the preparatory commission to consider appointing another international organization or entity.⁴⁶ ■

Endnotes

1. Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment (Aircraft Protocol).
2. Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Mining, Agricultural and Construction Equipment (MAC Protocol or Pretoria Protocol).
3. See Phillip Durham and Marek Dubovec, “More Good News From Cape Town: How the New MAC Protocol Will Benefit the Mining, Agriculture and Construction Industries,” *Journal of Equipment Lease Financing* 35:1 (2017).
4. The MAC Protocol is Adopted! (UNIDROIT 2019), <https://www.unidroit.org/89-news-and-events/2772-the-mac-protocol-is-adopted>.
5. *Ibid.*
6. *Ibid.*
7. *Ibid.*
8. MAC Protocol Economic Assessment, paras 73, 75 (Warwick Economics and Associates, August 2018), <https://www.unidroit.org/english/documents/2018/study72k/1808-final-mac-protocol-ea.pdf>.
9. *Ibid.*, para. 75.
10. *Ibid.*, para. 81.
11. *Ibid.*, para. 102.
12. *Ibid.*, para. 16.
13. *Ibid.*, para. 204.
14. *Ibid.*, para. 204.
15. The Harmonized System comprises about 5000 six-digit codes that cover 98% of international trade and has been adopted by over 200 economies to categorize commodities traded in international commerce. See What is the Harmonized System (HS), World Customs Organization, <http://www.wcoomd.org/en/topics/nomenclature/overview/what-is-the-harmonized-system.aspx>.
16. A contracting state is a state that has consented to be bound by the protocol. See Vienna Convention on the Law of Treaties (1969), art. 2(f).
17. Pretoria Protocol, art. II(2).
18. *Ibid.*, art. II(1).
19. See “What is the Harmonized System (HS)?” *supra* note 15; and see <http://www.wcoomd.org/en/topics/nomenclature/overview/hs-multi-purposes-tool.aspx>.
20. See Pretoria Protocol, arts. XXXV, XXXVI.
21. The Harmonized System Codes Proposed for Inclusion in the MAC Protocol Annexes, paras. 5-6, app. 1, (UNIDROIT, July 2019), <https://www.unidroit.org/english/documents/2019/study72k/dc/s-72k-dc-06-e.pdf>.
22. Report of the Working Group on HS Codes to the Commission of the Whole, para. 7, (UNIDROIT Nov. 16, 2019), <https://macprotocol.info/wp-content/uploads/2019/11/DCME-MAC-Doc.-20-Report-of-the-HS-Working-Group-1.pdf>.
23. *Ibid.*
24. *Ibid.*, paras. 10, 12(e).

25. Pretoria Protocol, art. X includes the same provisions as Aircraft Protocol art. XI, Alternative A.
26. Aircraft Protocol, art. IX.
27. Pretoria Protocol, art. VIII.
28. Ibid., art. VIII(5).
29. The Protocol to the Convention on International Interests in Mobile Equipment on Matters specific to Space Assets (Space Protocol) was adopted by a diplomatic conference in Berlin, Federal Republic of Germany, on March 9, 2012. As of April 29, 2020, no state had ratified the Space Protocol. For entry into force, Article XXXVIII requires that 10 states ratify, accept, approve or accede to the protocol. See Status – UNIDROIT Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Space Assets (Berlin, 2012), UNIDROIT, <https://www.unidroit.org/status-2012-space>.
30. For an in-depth discussion of this topic, see generally, Benjamin von Bodungen and Charles Mooney, “Immovable-Associated Equipment under the Draft Mac Protocol: A Sui Generis Challenge for the Cape Town Convention,” *Cape Town Convention Journal* 6:37 (2017).
31. See Pretoria Protocol, art. VII.
32. Ibid., art. VII(4).
33. Ibid., art. VII(5).
34. Such as the Uniform Commercial Code collateral registries of each state.
35. See Pretoria Protocol, art. XII(2).
36. See *ibid.*, art. XII(2).
37. See *ibid.*, art. XII(2).
38. Negotiating states are states that took part in the drawing up and adoption of the text of the protocol. See Vienna Convention on the Law of Treaties (1969), art. 2(e).
39. Pretoria Protocol, art. XXV.
40. See, e.g., International Registry, <https://www.internationalregistry.aero/ir-web/>.
41. Resolution 1 of the diplomatic conference.
42. *Ibid.*
43. *Ibid.*; The MAC Working Group [MAC WG] was formed by UNIDROIT in 2015 to provide an avenue for MAC equipment industries to contribute to the MAC Protocol project. The MAC WG member companies and organizations represent the interests of more than 10,000 companies doing business on six continents. See <https://www.macwg.org/members>. Other organizations invited to participate as observers include the International Registries of the other protocols, World Customs Organization, World Bank Group, and the Kozolchuk National Law Center (NatLaw).
44. Resolution 1 of the diplomatic conference.
45. *Ibid.*
46. Resolution 2 of the diplomatic conference.



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