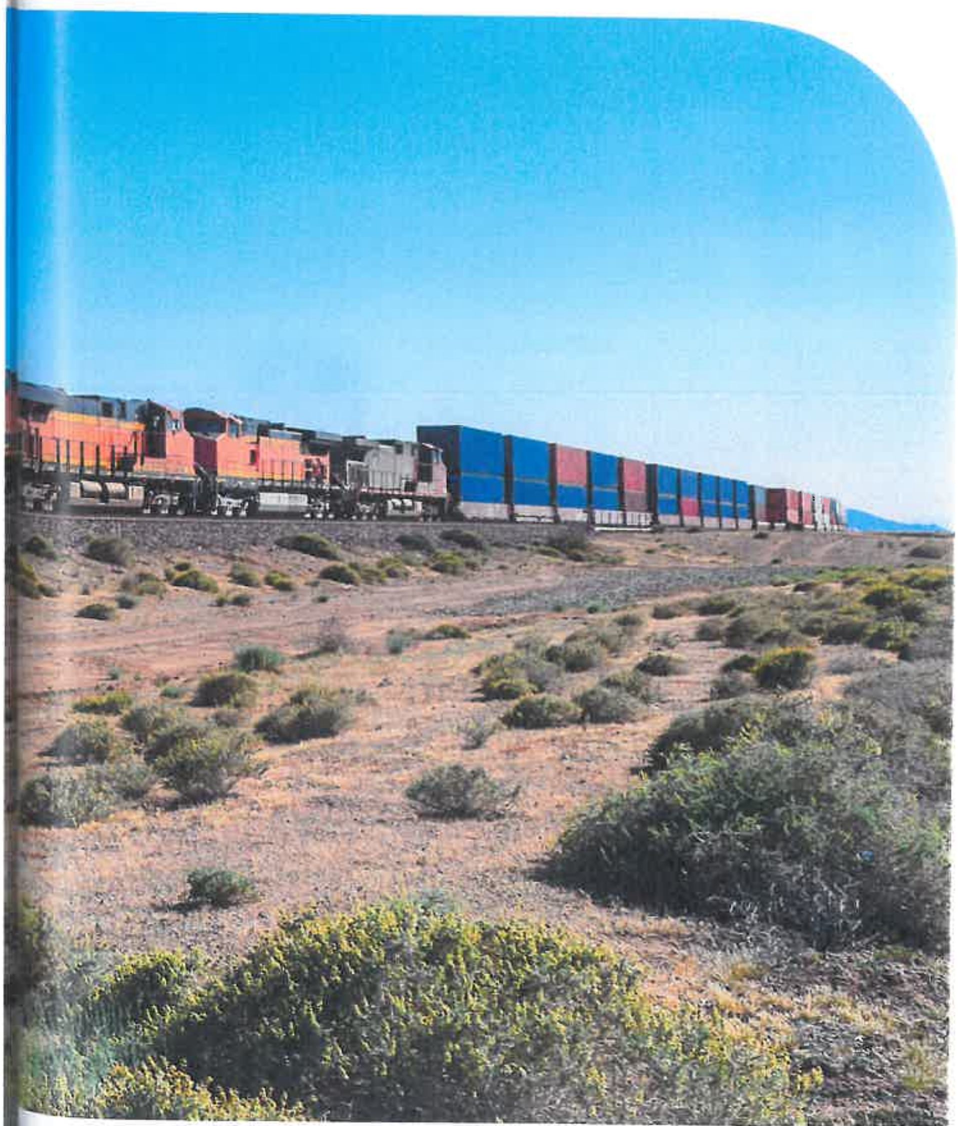
A LEGAL CHALLENGE FOR THE BELT AND ROAD INITIATIVE

At the beginning of May 2017, the first freight train service from the United Kingdom to Yiwu in Zhejiang Province, eastern China, completed its 12,000-kilometre journey. The landmark trip was made possible by the Belt and Road Initiative, a key part of which are new rail connections between east Asia and western Europe. This is a visionary project promoted, and in many cases financed, by the People's Republic of China.

The new network of rail routes, which echoes the ancient Silk Road, more than halves the time required to move goods between east Asia and Europe, compared with maritime transport. It also makes the process safer, more reliable and potentially cheaper than transporting goods by sea.



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HOWARD ROSEN

CHAIRMAN OF THE RAIL WORKING GROUP[1]

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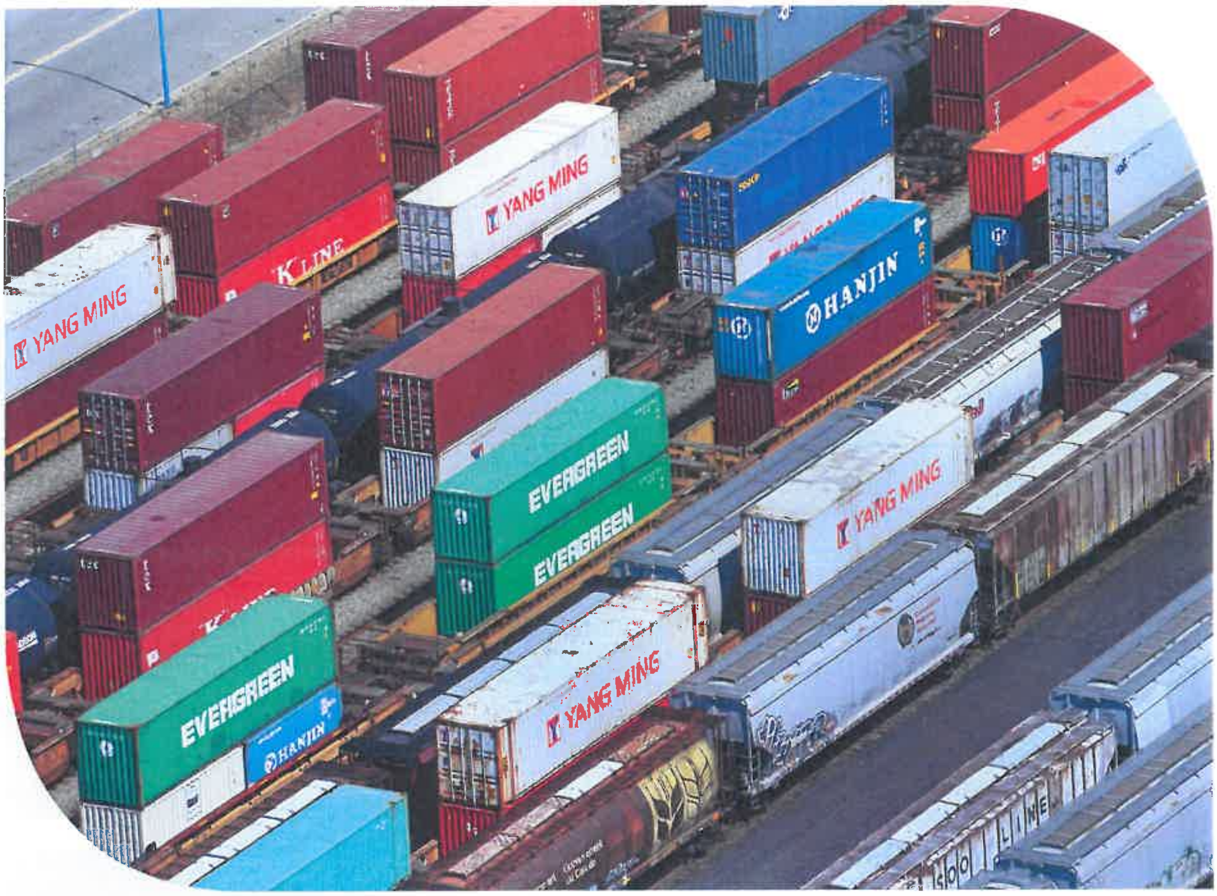
JELENA MADIR

CHIEF COUNSEL, EBRD

MadirJ@ebrd.com



MORE RISK, HIGHER COSTS

As things stand, the integrity of rolling stock as collateral is doubtful for two main reasons. First, there is no global harmonisation when it comes to property law in relation to railway equipment. This creates a great deal of uncertainty over the rights of creditors claiming security against rolling stock running through multiple countries with potentially very different legal systems and approaches to securing the title interests of non-possessory creditors. For example, the ability of a private creditor to repossess and redeploy rolling stock across the rail system is open to question. This is particularly critical where the operator or debtor is not an investment-grade credit.

The second reason for rolling stock as collateral being considered a weak form of security is that it can be difficult to clearly establish who holds ownership and security interests in the equipment. The rail sector has no national public registries in which title and security interests may be recorded and there is no common system for uniquely identifying rolling stock (whereas both facilities exist in the aviation industry).

The additional risk arising from these legal uncertainties translates into limited private credit for public or private operators seeking to purchase rail equipment. It also raises costs when such credit is available. Inevitably, this places the rail sector at a competitive disadvantage compared with other transport modes, despite the sound economic, social and environmental reasons for choosing rail.

Anything that can reduce creditor risk and lower costs will therefore help to secure the success of the Belt and Road Initiative and contribute to economic growth in the countries that it crosses. Fortunately, a solution is at hand.

A NEW SYSTEM OF RIGHTS

The Luxembourg Protocol to the Cape Town Convention on International Interests in Mobile Equipment is a new, ground-breaking global treaty that will make it much easier for the private sector to finance railway rolling stock worldwide. The protocol provides a new system of rights for the providers of private credit for rolling stock, secured lenders, lessors and vendors selling under a conditional sale agreement.

The Belt and Road Initiative is the principal reason for the recent dramatic increase in Eurasian rail trade. A study by consultancy firm Roland Berger for the International Union of Railways (known by its French acronym UIC) noted that, between 2014 and 2016 – a period that coincided with the progressive introduction of the initiative's new routes – Eurasian trade by rail expanded from about 25,000 twenty-foot equivalent units (TEUs) per year to 145,000.

The UIC study predicts that this will reach 636,000 TEUs per year, equivalent to 27 trainloads per day, by 2027. Others expect the 1 million TEUs per year barrier to be breached before 2020.

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NEW INVESTMENT NEEDED

This expansion has the potential to deliver a major economic boost to the countries crossed by these rail routes, many of which are EBRD economies. But in order to meet the rising demand for rail freight transport and enjoy the benefits of the railway boom, these states will need more rolling stock.

Unfortunately, many of these countries are struggling to finance their existing rail infrastructure and operations. As a result, public and private operators in these countries will likely need to obtain other sources of credit, including private credit, so that they can procure new equipment.

Financial institutions, including banks (such as the EBRD) and pension funds, along with private investment funds are ready to provide credit secured on rolling stock or to lease locomotives and wagons to operators without recourse to sovereign credit. But the availability and cost of this finance will depend on the integrity of the collateral at their disposal.