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BRIEFING

A CAPE TOWN CONVENTION FOR
ROLLING STOCK: GATHERING
MOMENTUM?

JULY 2015

- MOMENTUM TO ADOPT AND IMPLEMENT THE LUXEMBOURG PROTOCOL IS STARTING TO TAKE HOLD
- THE INTENTION IS TO MAKE THE FINANCING OF RAILWAY EQUIPMENT MORE ATTRACTIVE
- AS THE RAIL MARKET IS LIBERALISED CERTAIN ISSUES WILL NEED TO BE RESOLVED – PARTICULARLY IN RELATION TO SECURITY



The 2007 Luxembourg Protocol (the “Luxembourg Protocol”) to the Cape Town Convention on International Interests in Mobile Equipment on matters relating to railway rolling stock (the “Cape Town Convention”) was signed in 2007, but momentum to finally adopt and implement it is only now starting to take hold. With a similar aim to the Cape Town Convention Aircraft Protocol, the intention of the Luxembourg Protocol is to make it more attractive for private financiers to finance railway equipment and therefore to render the market more dynamic and competitive across the world.

“THIS EVOLUTION HAS BROUGHT TO LIGHT CERTAIN ISSUES WHICH WILL NEED TO BE PROGRESSIVELY RESOLVED IN ORDER TO ATTRACT MORE FINANCIERS TO THE ROLLING STOCK MARKET.”

Historically, rail systems have been heavily controlled by the country State. The rail-related projects have therefore been highly dependent on each government’s priorities and budget. Consequently, they have not always benefited from investments as and when required.

A move towards liberalization of the market in the last few years has attracted private financiers. This evolution has brought to light certain issues which will need to be progressively resolved in order to attract more financiers to the rolling stock market.

Challenges for private finance

Private financiers typically require security to be taken over the rolling stock assets they are financing, in order that they can repossess such assets in case of default and/or insolvency by their debtor. However, a special statutory mortgage regime, which is generally available in ship and aircraft financing, is not commonly available in respect of rolling stock.

“THE LUXEMBOURG
PROTOCOL CREATES A
FRAMEWORK FOR THE
REGISTRATION AND
RECOGNITION OF
SECURITY INTERESTS...”

The private financier is therefore forced to rely on other less secure security, such as a chattel mortgage or a pledge over the rolling stock, assignments of earnings, account pledges, shares pledges and/or parent guarantees.

As these types of security are predominantly not registered in any registry, there is generally no common database to which one can turn in order to view creditors' rights over a rolling stock asset and therefore the ranking of priority of such creditors in respect of such asset.

Furthermore, for rolling stock assets which operate cross-border, security created under a certain law may not be recognized in the jurisdiction where the asset is located at the time of enforcement of the security. Financiers would, prior to completing the financing, certainly effect due diligence in the jurisdictions where the rolling stock is most likely to be operated during the term of the financing to ensure that the security which is being granted is, to the greatest extent possible, enforceable in each of these jurisdictions. However, such due diligence can be costly and cannot encompass each and every possible jurisdiction where the rolling stock could potentially be located during the financing term.

There is also no uniform way of describing rolling stock. Each asset will have:

- a manufacturer's serial number which will not normally change throughout the life of the asset but will be structured differently in different parts of the world, and
- a running number which provides a description of the type of asset and other information and which can change throughout the life of the asset.

The Luxembourg Protocol creates a framework for the registration and recognition of security interests of financiers, lessors and certain types of vendors in transactions involving rolling stock. Its aim is also to create a common system for repossession of rolling stock assets on default and/or insolvency by their debtor, thereby achieving a similar position to the Aircraft Protocol.

The central registration database created by the Luxembourg Protocol will be an international registry accessible at all times through the internet allowing financiers, lessors and relevant vendors to register their interests in the rolling stock, and third party prospective creditors (amongst others) third party prospective creditors to view registered interests.

It is important to note that the Luxembourg Protocol applies to all rolling stock, the definition of which is set out in Article 1 (e) of the Protocol and includes “all vehicles moveable on a fixed railway track or directly on, above or below a guideway, together with traction systems, engines, brakes, axels, 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”.

Although there is no particular guidance in the Luxembourg Protocol as to the meaning of the term “vehicle” and there are debates as to the eligibility of certain types of assets, the intention of the drafting was clearly to be wide and to encompass those vehicles used as a means of physical transportation (i) running on a fixed railway track and (ii) running directly on, above or below a guideway.

One of the further aims of the Luxembourg Protocol will be to encourage export credit agencies to apply discounts to the premium which they charge on a rolling stock financing if the country in question is a member of the Cape Town Convention and makes the required declarations regarding the adoption of certain more creditor friendly "Alternatives" (see below) of the Cape Town Convention.

Insolvency

The Luxembourg Protocol provides for different "Alternatives" in case of insolvency of a debtor, from which each Member State will be able to choose its preferred procedure. Creditors will need to be aware that the consequences of a debtor's insolvency will vary depending on which "Alternative" a Member State has opted for. This will partly depend on a Member State's vision and interpretation of rail services as a "public service".

A debtor will need to be located in a State which has ratified the Luxembourg Protocol in order for its creditors to be able to register their interests in the central registration database created by and therefore benefit from the rules set up by the Luxembourg Protocol. Of course, the wider the number of States which ratify the Luxembourg Protocol, the more effective the system will be.

Next steps

The Luxembourg Protocol has been signed and ratified by the European Union (a prerequisite for the Luxembourg Protocol to be ratified by the Member States of the European Union) and Luxembourg. It has also been signed (although not yet ratified) by Italy, Switzerland and Germany, and is likely to be signed by the United Kingdom in the near future.

Discussions are currently ongoing with a number of other countries, both within and outside the European Union, regarding their potential signing of the Luxembourg Protocol. The Luxembourg Protocol will need to be ratified by four States before it enters into force, so there is still some work to be done.

WATSON FARLEY & WILLIAMS IS A MEMBER OF THE RAIL WORKING GROUP, "A NOT-FOR-PROFIT GROUP ESTABLISHED AT THE REQUEST OF UNIDROIT (THE INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW) TO REPRESENT THE POSITION OF THE RAIL INDUSTRY RELATING TO THE ADOPTION AND IMPLEMENTATION OF LUXEMBOURG PROTOCOL".

FOR MORE INFORMATION

This Briefing is the first in a series which will aim to keep you informed and updated on the progress of the Luxembourg Protocol. Should you wish to discuss any of the matters raised, please speak with the author below or your regular contact at Watson Farley & Williams.

ALEXIA RUSSELL
Partner, Paris
T: +33 1 56 88 44 38
arussell@wfw.com

REX ROSALES
Transport Sector Head, London
T: +44 20 7863 8975
rrosales@wfw.com

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