LUXEMBOURG RAIL PROTOCOL

On the right track

By **Howard Rosen**, Principal of Howard Rosen Solicitor, an English law firm based in Zug (Switzerland), specialising in legal and strategic advice on asset financing; expert consultant on international rail finance matters to the UNIDROIT Study Group for the preparation of uniform rules on international interests in mobile equipment; Chairman of the Rail Working Group responsible for the preparation of the draft Protocol on matters specific to railway rolling stock.

On 23 February in Luxembourg the points switched. For two weeks prior to that date, government delegates from over 42 countries and representatives of 12 international organisations (including the Rail Working Group) met at a Diplomatic Conference in Luxembourg, sponsored by the International Rail Organisation, OTIF and UNIDROIT, the Institute for Unification of Private International Law. The purpose of the Conference was to discuss the proposed Rail Protocol to the 2001 Cape Town Convention on International Interests in Mobile Equipment.

The final version of what is now known as the Luxembourg Rail Protocol has not yet been published; but based on what was agreed at the Conference, the Protocol will give a significant boost to the financing of railway rolling stock by the private sector. Its 34 articles create a new international legal system for recognition and registration of the security rights of banks and lessors financing or leasing rolling stock. It will thereby facilitate cheaper financing in some parts of the world, and open up new countries to private sector funding in others.

The Luxembourg Rail Protocol is part of the regime established by the Cape Town Convention, which creates a system for international recognition of the rights (an "international interest") of three types of creditors. These are vendors under a conditional sale agreement, lessors under a lease and financiers/banks taking security over an asset financed under a loan agreement. Each of these creditors is financing assets which, by their nature, can cross borders. The Convention itself sets out in abstract how an international interest is created and details the rights of the

creditor to recover the asset in the event of default or insolvency. There are rules on the priorities of competing creditors (basically first to register has priority), and the Convention also establishes the principle of an International Registry, searchable and accessible 24/7 through the internet, where the creditor should register its international interest.

The Aviation Protocol, also signed in 2001, applies the Cape Town Convention to Aircraft and came in force last year in various countries. The Luxembourg Rail Protocol applies the Cape Town regimen to rail rolling stock. In many cases it follows the concepts in the Aviation Protocol, but not entirely. An aircraft is clearly a different type of asset to a goods wagon, but there are also other policy considerations. For example, the Luxembourg Protocol does not follow the Aviation Protocol in relation to registration of contracts of sale, but instead creates the possibility of an informational registration of any sale outside the priorities' system. This is useful for existing rolling stock owners that have no liens on their assets but want to place others on notice of their interest.

It is important to note that the Luxembourg Protocol applies to all types of rolling stock, from trams to mountain rail wagons to TGVs, regardless of whether the assets actually cross borders. This is logical, since these days the creditor and debtor can be in different countries with the asset being operated in a third country. Moreover, since in many cases rolling stock will, or has the potential to, cross jurisdictional boundaries, the Protocol has to provide comfort to the creditor in case its rights are adversely affected by the laws of another jurisdiction. In addition, since few countries have any public record system for registering absolute or security title interests in rolling stock, the Protocol will make even pure domestic financings safer.

But the universal application of the Protocol, whilst yielding general benefits, could also create political or constitutional problems for governments. Commuters need to get to work even when an operator has not paid the rent on its equipment; freight rolling stock may be required for assignments of public importance – for example transportation of military equipment – and governments cannot always allow these services to be interrupted. The solution, developed by the Protocol, is both imaginative and pragmatic. Where (and only where) there are existing laws in place which would restrict creditor repossession notwithstanding debtor default or insolvency, states are permitted to make a special declaration in relation to "railway rolling stock habitually used for the purpose of providing a service of public importance". The state then has the right to hold the rolling stock in place, provided that the creditor is compensated. Where, in such a situation, there is no requirement to compensate, a further declaration is required so that all creditors are clear as to their risk.

The Protocol will come into force after ratification by four countries *and* when OTIF has certified that the International Rail Registry (to be based in Luxembourg) is fully operational. There is much for the preparatory commission to do before then: constituting the Supervisory Authority, finalising the rules for the Registry and mandating the delivery of the necessary IT systems. More work and negotiation are needed to ensure compatibility of diverse identification criteria for rolling stock across the world with the requirement of the Protocol for a unique and non-repeatable identifier.

But a major step forward has been made. When in force, the Protocol will shift rail finance from an esoteric market for a few specialist banks and lessors to the general market, thus opening the way for easier and cheaper cross border financing and operating leasing as well as securitisation of rolling stock receivables. In Europe, the adoption of the Protocol will coincide with the EU's push to make the rail system more open and competitive. In other regions, it will open up the rail sector to private sector finance for the first time, so it was no surprise that some of the most enthusiastic delegations at the Diplomatic Conference came from the developing world. In Luxembourg, the points switched and we are now on the right track for a competitive and broad market for rail finance. The Luxembourg Rail Protocol will have an impact well beyond the rail industry.

Professor Sir Roy Goode QC signing the Protocol on behalf of the UK government

For more information about the Luxembourg Rail Protocol and the Rail Working Group, see www.railworkinggroup.org