THE 2001 CAPE TOWN CONVENTION
ON INTERNATIONAL INTERESTS IN MOBILE EQUIPMENT

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THE LUXEMBOURG RAIL PROTOCOL – WHY IT MAKES SENSE FOR CHINESE OPERATORS

The Luxembourg Protocol to the Cape Town Convention is a new international treaty that introduces a global legal system to make it cheaper and easier for the private sector to finance railway rolling stock without the need for state guarantees or support.

The Protocol provides for the recognition and prioritisation of security interests held by creditors lending on, or leasing, all types of railway rolling stock (including passenger and freight locomotives and wagons, metro and light rail trains, trams and cable cars). This security will be registered in a new international registry, in Luxembourg, which is searchable through the internet by the public 24/7.

The Protocol introduces, for the first time a new global common unique permanent identification system (URVIS) for rolling stock. The United Nations has separately introduced the UN Model Rules on Permanent identification of railway rolling stock setting a minimum standard for the permanent marking of the URVIS number onto railway rolling stock.

The Protocol entered into force in contracting states on **8th March 2024**. Currently ratified by 6 states (Spain, Luxembourg, Sweden, South Africa, Paraguay and Gabon) plus European Union in respect of its competences. France, Germany, Italy, Mozambique, UK, and Switzerland have all signed but not yet ratified.

The Protocol is good for financiers, but it is also great news for Chinese operators. With its independent corporate structure it opens new opportunities for the China State Railway Group.

More security for lenders means cheaper financing for borrowers and lessees
Where the lender or lessor has to allocate capital against credits, due to the risk of default, the Protocol reduces the risks and therefore the expensive capital the bank must allocate against the loans or leases, resulting in lower bank cost of funds. The Protocol also simplifies both a financier's due diligence and the documentation. A common and familiar system will attract more foreign capital, creating more

competition amongst lenders, which is good for China and good for borrowers. If rail equipment is imported, there may be export credits available, which credits will be cheaper because of the greater security. All this translates to lower financing rates offered to operators.

More flexibility
By opening up private capital as a resource for operators, it means that they can obtain credit as and when they need it and not have to rely always on investments from the State. The Protocol also underwrites operating leases, by giving the lessors and lessees clear rights meaning that operators can choose when and for how long any equipment is needed. They will then only be liable in respect of that period for the monthly cost of the equipment. This both increases transparency for operators trying to assess profitability of particular routes and at the same time reduces the capital expenditure burden on operators' balance sheets. Operating leasing also facilitates operators being able to act as lessors, leasing out surplus rolling stock with greater security, both within China and possibly outside, for short or long periods and thereby monetising equipment which would otherwise be unused and creating an internal market in China for rolling stock. Operating leasing is also an economic driver for standardisation of equipment (because then residual values will be higher and therefore rentals lower). This not only saves costs for operators through lower rentals but also creates a second economic benefit for operators because it gives manufacturers economies of scale in turn leading to lower unit costs.

Certainty when buying or leasing
When the Protocol is in force, all operators buying or leasing rolling stock will be able to check in the international registry that no one else is making a claim against that equipment, thereby interfering with the operator's rights. Operators leasing rolling stock are also guaranteed "quiet possession" under the Protocol. Unless the parties agree otherwise, the operator cannot lose its right to use the railway equipment if complies with the terms of its lease.

One financing solution
Because the Protocol applies to all rolling stock, broadly defined, including conventional passenger and freight wagons locomotives but also covering trams, metro trains, light rail units, track laying and other track maintenance equipment running on rails and even cable cars, a Chinese operator can choose one financing solution for all of its equipment.

Protection of cross-border operations
With the development of the visionary Belt and Road Initiative, Chinese operators will be regularly moving rolling stock in and out of Chinese territory as the standard gauge high-speed rail network expands across Southeast Asia (e.g. to Laos and Thailand). Suddenly, the rolling stock that they are operating could be open to liens, attachments or other seizure in the foreign jurisdiction. This may make private or state-owned financiers much more nervous (who then may restrict financed equipment being operated outside of China) as well as threaten the ability of Chinese operators to operate rolling stock in those foreign jurisdictions.

The Protocol will secure both the operator and its financiers when China and neighbouring states have adopted the Protocol. Even if the equipment is not externally financed, the operator can protect the equipment through registering a notice of sale when it acquires the rolling stock as well as security interest if it can obtain secured finance for rolling stock internally which will be registered in the international registry. So, third parties in foreign jurisdictions, even if those jurisdictions have not ratified the Protocol, will be on notice of the respective rights in the rolling stock and this may already, as a matter of domestic law, change the legal position in favour of the operator.

With the expected introduction of variable gauge rolling stock in the coming years, freight wagons in future will be able to move from Western Europe to Eastern China over the two principal gauge systems (1435mm and 1520mm). The Protocol will be a valuable part of a mutual recognition system which will need to be adopted by each of the countries through which this rolling stock runs to ensure that operators, whether Chinese or foreign (or joint ventures between Chinese and foreign operators) will be fully protected wherever the rolling stock is situated the international rail network at any particular point in time.

Easier monitoring and cost-effective maintenance of equipment
One of the innovations of the Protocol is to introduce, for the first time, a global unique 16 digit permanent identifier for each item of railway rolling stock known as URVIS (Unique Rail Vehicle Identification System). These URVIS identifiers will be issued by the international registry in Luxembourg and never used again. The URVIS identifier will make it easier for operators, customers and financiers to track both the location and the status of the equipment wherever it is in the world. It will also make it easier to remarket equipment since the utilisation and maintenance record of each item of equipment can be tracked throughout its lifetime as well as facilitating predictive maintenance programmes based on the utilisation of each individual item of rolling stock potentially saving billions of dollars for operators. The URVIS identifier will also be very helpful in relation to local asset registries in China.

The Luxembourg Rail Protocol can be a highly effective tool for Chinese operators, giving them potentially cheaper funding, more flexibility and better security at minimal cost.

For more on the Luxembourg Rail Protocol, visit www.railworkinggroup.org., as well as the UNIDROIT website www.unidroit.org. Keep up to date with all the latest developments via the Rail Working Group's LinkedIn group page.