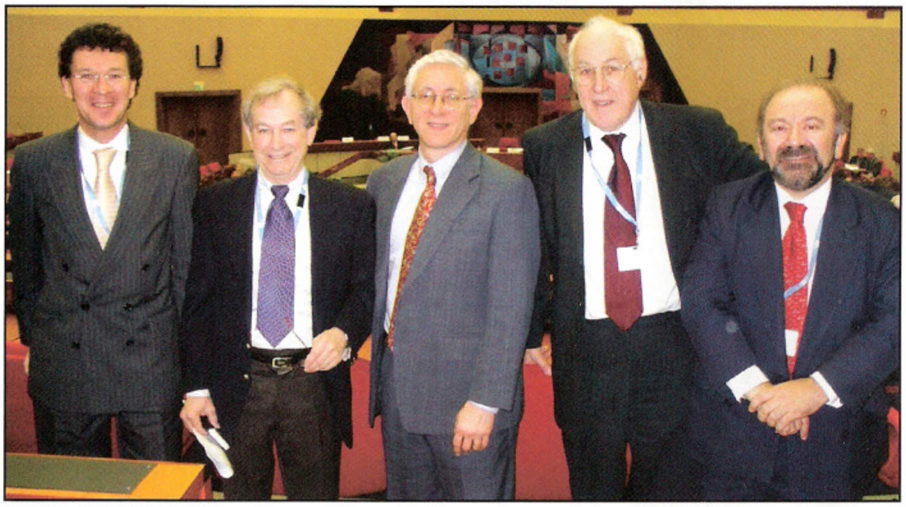
New Protocol Will Aid Train Procurement

The Luxembourg Rail Protocol on financing rolling stock, which was signed on February 23, should reduce procurement costs and expand the market for private funding of trains.



Left to right: Mr Philippe Dupont from the Luxembourg delegation, Mr Hal Burman, head of the US delegation, Mr Peter Bloch (US), Sir Roy Goode, head of the British delegation, and Mr Howard Rosen, chairman of the Rail Working Group. *Photo: Rail Working Group*

THE Luxembourg Protocol will create an international system to recognise and register the security rights of banks and lessors who lease rolling stock. "This is a significant step forward for the railway industry," says Mr Howard Rosen, chairman of the Rail Working Group of the Cape Town Convention on International Interests in Mobile Equipment. "The Protocol will be an important tool to ensure a dynamic rail industry in the 21st century, lowering costs in established markets, and opening up the rail industry to private sector finance in the developing world."

The Protocol was signed at a conference sponsored by the Intergovernmental Organisation for International Carriage by Rail (Otif) and the International Institute for the Unification of Private Law (Unidroit). It was attended by 42 countries and 12 international organisations including the Rail Working Group and the European Union (EU).

"Paying for rolling stock has always been tedious," says Rosen. "For state railways, funding comes through loans or subsidies, while some wealthier railways may buy rolling stock out of cash flow. However, investment in new rolling stock often depends on government funds being available rather than need. Private operators finance through a mix of their own equity, government subsidy, and private finance, although funding sources and volumes are limited. All this is about to change."

The Protocol will establish a new international framework facilitating private finance of rolling stock. It will create a system that recognises the secured title interests and priorities of financing banks and lessors, as well as vendors under conditional sales agreements. These interests will be registered in an international registry to be located in Luxembourg, but accessible through the internet. The Protocol will also allow rolling stock owners to register their title. By securing financiers against competing claims, particularly when assets cross into different jurisdictions, the Protocol should attract more and cheaper private capital into rail transport. It will be applicable to all types of rolling stock, even if it is used in only one jurisdiction.

The Protocol will trigger:

- the freeing up of resources for both governments and operators to invest elsewhere by enabling private finance even of state railways, particularly where the finance is recourse only to profits generated from rolling stock
- the development of more private operators as well as public/private joint ventures where, for financial or regulatory reasons, government finance is unavailable, and
- lower barriers to entry for operators and financiers.

The Protocol should create a mechanism for securing private funders in countries which urgently need rolling stock finance but where even state guarantees give insufficient comfort to private investors. Existing private finance should become cheaper both in terms of rates and legal costs, particularly when rolling stock is actually or potentially crossing borders.

> **"Specific support for rolling stock lessors should stimulate the development of a dynamic operating lease market."**
> **Howard Rosen**

"Specific support for rolling stock lessors should stimulate the development of a dynamic operating lease market," says Rosen. "Such a market has made a huge difference in the aviation industry. A similar development in rail transport would significantly improve the industry's competitiveness and its ability to respond quickly to new demand."

The Protocol will allow railways to use their limited resources more effectively, particularly where private investment would be impossible without privatisation.

Rosen expects the Protocol to help governments coordinate and harmonise rolling stock financing, particularly where they wish to encourage competition. Most importantly, the Protocol should facilitate equipment procurement in the private and public sectors based on commercial viability rather than availability of funds.

Part of the security for any private funder is the ability to repossess assets on default. This is not easy when the defaulting debtor controls both access to the rolling stock and the ability to repossess it. A government blocking the creditor's right to repossess trains may keep commuters happy, but funders will desert if they cannot realise their assets.

Although the Protocol generally requires delivery of financed assets to the creditor on a default, it has created a mechanism reconciling these two positions by allowing a state, in relation to "rolling stock habitually used for providing a service of public importance", to restrict a creditor's repossession rights but, with very limited exceptions, only as long as the creditor's economic interests are respected and paid out.

The Rail Protocol will offer new ways to finance rolling stock, which should attract more operators and funders into the market. It promises cheaper finance and a way for operators to drive their procurement policy by demand and commercial viability. It should also be a powerful tool for private funding of rolling stock in developing countries. **IRJ**