

The Luxembourg Rail Protocol to the Cape Town Convention: its application to the UK and how it differs to the Aircraft Protocol

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The UK signed the Luxembourg Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Railway Rolling Stock (the “**Rail Protocol**”) on 26 February 2016 and the UK Government is about to commence a consultation process with a view to ratification. Most readers will be aware that the UK has already ratified the Cape Town Convention on International Interests in Mobile Equipment (the “**Cape Town Convention**”) (to which the Rail Protocol relates) in July 2015 and it became effective on 1 November 2015.

As at the date of writing, Gabon, Germany, Italy, Luxembourg and Switzerland are also signatories to the Rail Protocol – although, as yet, only Luxembourg has actually ratified it. The European Union has also signed and approved the Rail Protocol but, being a Regional Economic Integration Organisation, it does not count as a Contracting State in addition to its individual Member States. The current expectation is that the Rail Protocol will come into force for those states that have ratified or acceded to it sometime in 2017. In order for this to happen, it requires ratification by another 3 states and confirmation that the International Registry for railway rolling stock is fully operational.

As the Cape Town Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment (the “**Aircraft Protocol**”) (which was ratified by, and became effective in, the UK at the same time as the Cape Town Convention) did with aircraft objects, the Rail Protocol aims to create a global public registry which records and recognises the priority of security and other international interests over railway rolling stock with the aim of promoting certainty for creditors and, thereby, making the financing of railway rolling stock a more attractive and less risky prospect.

While both protocols relate to the one Cape Town Convention and are very similar in substance, there are differences and some of the key ones are discussed below.

Identification of assets

The Rail Protocol defines railway rolling stock to which it will apply widely; it means any “vehicles moveable on a fixed railway track or directly on, above or below a guideway, together with traction systems, engines, brakes, axles, 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” (Article I).

The Cape Town Convention requires that the assets to which it applies are “uniquely identifiable” and for the agreement constituting the relevant international interest to enable the object to be identified.

Unlike in the aviation industry, where the use of manufacturer and engine serial numbers to identify aircraft objects is the norm, railway rolling stock does not currently have the advantage of a globally recognised unique identification system for individual assets.

This is specifically addressed in the Rail Protocol whereby the Registrar will allocate identification numbers to items of railway rolling stock which enable their unique identification. Once the Rail Protocol is operational, the intention is that the International Registry will issue a unique number per item of railway rolling stock which will be required to be permanently affixed to the relevant item of equipment. This unique number will be issued under the Unique Rail Vehicle Identification System (“**URVIS**”) and its use will be mandatory in order to register interests with the International Registry. Unlike other identification numbers, this URVIS number will not be capable of being changed or recycled because each number will only ever be allocated to one item of railway rolling stock.

It is also open to individual Contracting States to declare which other system (if any) of national or regional identification numbers it wishes to be used in addition to the URVIS number. Any such national or regional identifying numbers will also need to be submitted to the International Registry in connection with a registration under the Rail Protocol in addition to the URVIS number.

As well as applying to existing assets, the description of railway rolling stock in any agreement to which the Rail Protocol is intended to apply can be expressed to include future railway rolling stock (Article V). If an interest in future railway rolling stock is intended to be created, it will be constituted as an international interest as soon as the relevant creditor acquires the power to dispose of that future asset without requiring any new act of transfer. This will be particularly useful in the context of facilitating large financings.

Default remedies

In addition to the remedies prescribed by the Cape Town Convention, the Aircraft Protocol specifically provides for creditors to procure deregistration of the aircraft and its export and physical transfer from the territory in which it may be situated following a default. A request for deregistration and export has to be made to the relevant aircraft registry under a validly recorded irrevocable deregistration and export authorisation (an “**IDERA**”) substantially in the form annexed to the Aircraft Protocol which the registry is then required to honour subject to satisfying certain conditions including applicable safety laws and regulations. If the relevant conditions have been satisfied, the registry and other administrative authorities are required to make these remedies available within 5 working days after valid notification by the creditor.

The Rail Protocol is less prescriptive in that it does not explicitly address deregistration of assets and set out a process to achieve that in the way that the Aircraft Protocol does. Under the Rail Protocol, a creditor is given the additional remedy of procuring the export and physical transfer of the railway rolling stock from the territory in which it is situated, with the relevant Contracting State required to ensure that the relevant authorities “expeditiously co-operate with and assist the creditor to the extent necessary for the exercise of the remedies...” (Article VII). Such remedies are to be made available by the relevant authorities within 7 calendar days after valid notification by the creditor that it is entitled to procure those remedies (Article IX (8)).

The less prescriptive approach taken in the Rail Protocol means that default remedies for creditors may differ considerably from state to state depending on what the processes are, if any, for export and physical transfer of railway rolling stock assets in that state. It also means that any transaction documentation used in a financing will need to address how any process for deregistration is to be effected and provide for necessary ancillary documentation to facilitate that.

Remedies on Insolvency

The Rail Protocol contains the same Alternatives A and B as the Aircraft Protocol regarding remedies available to a creditor upon the occurrence of an insolvency-related event in relation to the debtor (Article IX). The UK Government adopted Alternative A in relation to aircraft objects when it ratified the Aircraft Protocol by specifically providing for this in the implementing legislation.

As well as the creditor-friendly Alternative A and the more debtor-friendly Alternative B, the Rail Protocol provides for a further Alternative C. Alternative C requires that, following the occurrence of an insolvency-related event, the debtor (or its insolvency administrator) either (a) cures all relevant defaults and agrees to continue performing under the relevant transaction documents or (b) gives the creditor the opportunity to repossess the assets, in each case within the applicable “cure period”. The cure period is to be specified by way of declaration by the relevant Contracting State.

Alternative C further allows the debtor (or its insolvency administrator) to apply to court before the end of the cure period for an order allowing it to suspend its obligation to give the creditor the opportunity to take possession of the rolling stock for a period commencing from the end of the cure period until the expiration of the relevant agreement on such terms as “the court considers just”. Any such order will require the debtor to continue performing its obligations and paying sums accruing during such suspension period to the creditor. The creditor is prevented from taking possession of the assets pending any application for such court order. Should the debtor cure all relevant defaults during either the cure period or any suspension period and agree to continue performing its obligations, it will be permitted to retain possession of the assets rather than allow the creditor to take possession.

It remains to be seen what option, if any, the UK Government will adopt. It should be noted, however, that, as with the Aircraft Protocol, Article III of the Rail Protocol permits the parties to agree in writing to exclude the application of Article IX.

“Public service” considerations

A key aspect of the Rail Protocol which is not found in the Aircraft Protocol relates to railway rolling stock “habitually used for the purpose of providing a service of public importance (“**public service railway rolling stock**”)”. Article XXV allows a Contracting State to declare that it will continue to apply rules of national law which are in force at the time of the declaration which preclude, suspend or govern the exercise within its territory of any of the remedies specified in the Cape Town Convention and Rail Protocol in relation to such public service railway rolling stock. What constitutes “public service railway rolling stock” is also to be specified by the relevant Contracting State in its declaration.

Any entity (including a governmental or other public entity) exercising a power to take or procure possession, use or control of any public service railway rolling stock under national laws as a consequence of such declaration being made is required to (a) “preserve and maintain the railway rolling stock” and (b) pay the greater of any relevant amount required to be paid under national law rules and the market lease rental in respect of such railway rolling stock to the creditor.

A Contracting State is obliged to consider the protection of creditors’ interests and the likely impact on credit availability if it were to make any such declaration under Article XXV.

The UK Government will need to consider whether or not to make a declaration under Article XXV as part of its consultation process. Particularly relevant are its powers under section 30 of the Railways Act 1993 which allows the state to secure or continue the provision of passenger services where the relevant franchise agreement has been terminated or otherwise come to an end and there is no replacement. The purpose of this national legislation is to ensure that passenger services will continue to be operated regardless of an operator default. However, this could conflict with a creditor’s ability to repossess the relevant assets which is a key benefit of the Cape Town Convention and Rail Protocol, so is something that will need to be carefully considered.

Treatment of Sales

Article III of the Aircraft Protocol expressly extends certain provisions of the Cape Town Convention to apply to contracts of sale of aircraft objects as if they were agreements creating an international interest, thereby enabling contracts of sale to be registered with the International Registry for priority purposes.

The Rail Protocol does not provide for this. Article XVII provides for notices of sale of railway rolling stock to be registered with the International Registry but, importantly, this will be for information purposes only and is expressed not to affect the rights of any person, or have any other effect, under the Cape Town Convention or the Rail Protocol.

Conclusion

While there are a number of hurdles that need to be cleared in order for the Rail Protocol to become effective, there seems to be sufficient momentum behind the project for it to become a reality in the near future – not least because of the huge global success of the Aircraft Protocol which is now operational in over 60 states. We will be actively monitoring progress and if you have any questions please contact us.

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