

The Luxembourg Rail Protocol – Extending Cape Town Benefits to the Rail Industry

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I. – INTRODUCTION

It is difficult to realise that a decade has gone by since the diplomatic Conference in Cape Town, launching the 2001 Cape Town *Convention on International Interests in Mobile Equipment* (hereinafter: the Convention). The Convention and the *Protocol thereto on Matters Specific to Aircraft Equipment* (hereinafter: the Aircraft Protocol) were adopted there, and the Final Act of the diplomatic Conference anticipated future protocols covering the rail and space industries.¹ Ideas put forward and discussed at the time have, in many cases now, become an established and accepted part of what is still a unique international treaty, focused on providing an innovative support mechanism for operators of high-value capital assets.

In February 2007, a second diplomatic Conference, held in Luxembourg and attended by participants from 42 States and 11 international Organisations, adopted a protocol, now generally referred to as the Luxembourg Protocol, applying the Convention to railway rolling stock.

The objectives of the Luxembourg Protocol are clear. It seeks to facilitate, worldwide, more extensive private sector finance for rolling stock, reduce barriers to entry to the rail sector, and resolve important cross-border legal issues as a result of more diverse, extensive and less expensive private sector finance for railway rolling stock. As of today, many rail operators are publicly owned and rely on a combination of public money and operating revenues to

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The text of the Convention, the Aircraft Protocol and the Luxembourg Protocol may be accessed at <www.unidroit.org>.

¹ Resolution 1, Final Act, 16 November 2001.

cover capital investment. The engagement of private sector banks, lessors and other financiers is very selective, based on limited demand historically and unquantifiable risks, in turn holding back new market entrants. This is restricting the creation of a more competitive and dynamic rail industry across the world, at a time when economic, social and environmental arguments for investment in the railways have never been stronger.

This paper will look at the differences between the Aircraft and Luxembourg Protocols, both in general terms and by examining some specific examples of divergences between the two instruments; analyse the position in relation to how ratification of the Luxembourg Protocol should proceed for individual Contracting States, by reference also to the recommendations made by the Rail Working Group on what declarations should be made by those States; take stock of where we are today in relation to the appointment of the Registrar and then the Luxembourg Protocol coming into force; and focus on some fascinating legal issues we have had to confront both when formulating the Protocol and now, as we move forward to implementation.

II. – OVERVIEW OF THE LUXEMBOURG PROTOCOL AND KEY DIFFERENCES WITH THE AIRCRAFT PROTOCOL

1. General observations

The starting point in drafting the Luxembourg Protocol was to follow the Aircraft Protocol where possible. This made sense for a number of reasons. The Aircraft Protocol was carefully constructed to adopt and adapt the detailed philosophy of the Convention. There was no sense in “re-inventing” a protocol just to differentiate the two protocols and we knew that it would be easier for States that had adopted the Aircraft Protocol to embrace the Luxembourg Protocol if many of the provisions were common. Moreover, many of the considerations for the aviation industry are genuinely similar for the rail sector. The Rail Working Group and some of the international rail organisations had already been involved in detailed discussions on the draft Convention and protocols well before the diplomatic Conference in 2001 and as a result, our concerns and ideas had also been reviewed carefully at the Government experts’ meetings before the initial diplomatic Conference. But it was always recognised that there would be variances due to the different detailed aspects of the equipment being financed under the “Cape Town regime”. Indeed, the structure of the Convention and the industry sector protocols was specifically predicated on this assumption.

We also had the privilege, before and at the Luxembourg diplomatic Conference, of observing the Convention and the Aircraft Protocol operating in practice, thereby opening out the possibility of creating more clarity where there was (unintentional) ambiguity in the Aircraft Protocol. That, however, had to be balanced with a concern not to undermine the operation of the Aircraft Protocol. The last thing we wanted to achieve was to create uncertainty by opening up parts of the Aircraft Protocol to the debate that there “must have been a reason” why provisions in the two protocols were not the same, leading to conflicting interpretations of what were intended as common approaches.

Digressions therefore were driven by three considerations, namely: creating more clarity where, on balance, this still made sense (e.g., the replacement of “working days” with calendar days), dealing with genuine industry and Government operational concerns, or reflecting the very different physical aspects of the assets being financed and secured.

However, the drafters of the Luxembourg Protocol had, from the outset, to take into account certain specific factors. The Protocol was designed to deal with all rolling stock, which covered an extensive range of assets from conventional locomotives and wagons to trams, mountain railways, monorail equipment, as well as boring machines and cranes on rails.² Furthermore, unlike in the aviation industry, there were no established national property registers for railway equipment and no common identification system for rolling stock. There was, and is, no international rail organisation operating worldwide in the same manner as ICAO,³ which was the obvious Supervisory Authority for the Aircraft Protocol, so provision had to be made for a specific body to be created by the Luxembourg Protocol as the Supervisory Authority, where we were able to draw in OTIF⁴ as the secretariat to that body.⁵

² Contrary to the aviation industry, however, we have seen no need to provide for international interests arising on fractional interests in railway equipment, nor did we see any practical possibility to extend the Protocol to cover engines powering the principal equipment as stand-alone assets in which an international interest may be created.

³ International Civil Aviation Organization.

⁴ OTIF, the Intergovernmental Organisation of International Carriage by Rail, is based in Berne (Switzerland). Its founding treaty has been adopted by 47 States operating principally in Europe and the Maghreb.

⁵ See Art. XII, Luxembourg Protocol.

2. Specific divergences

We cannot in this paper cover every difference between the two Protocols, but we set out below comments on seven important areas where the two texts are not identical.

(a) *Identification of rolling stock*

It was inevitable that the relatively simple identification criteria in the Aircraft Protocol could not be replicated in the equivalent protocol for the rail industry. There are relatively few aircraft manufacturers and they each have their own predictable, and fairly uniform, serial number systems which are already the reference point for registrations in national aircraft registries. It is a completely different story in the rail sector. There are, potentially, thousands of rolling stock manufacturers, past or present, worldwide. Some rolling stock has no manufacturer identification at all. Manufacturers may have merged with others or have gone out of business since the items were originally produced. Numbers can be replicated and recycled and there is no commonly accepted numeric, or even alphanumeric, manufacturer identification system across the world. Historically, most rolling stock has been tracked by its running number⁶ allocated by, or to, the operator. This can and does change and is therefore unsuitable for any recognition and registration system relating to property interests. There had to be new solutions and these had to address two separate issues, namely the constitution of an international interest and its registration.

Article V of the Luxembourg Protocol, dealing with the constitution of an international interest in rolling stock, has its roots in Article VII of the Aircraft Protocol. But with no manufacturer serial number which could be relied upon, an alternative approach was taken specifying various criteria that would suffice for this purpose. We also took the opportunity to make specific provision for international interests to arise in relation to floating charges.⁷

But such a generic approach could not possibly be sufficient for the purposes of identifying an asset with a view to registering an international interest relating thereto. We had to devise a new mechanism providing unique identification of the rolling stock and this resulted in Article XIV, one of the most critical and difficult parts of the Luxembourg Protocol.

⁶ The “running number” is the identification number given to the vehicle by the rail company that operates the vehicle.

⁷ See Art. V(1)(c) and (d), Luxembourg Protocol.

This article took a bifurcated approach to the problem. It delegated the detail to the Supervisory Authority which is required to set out in regulations “a system for the allocation of identification numbers by the Registrar which enable the unique identification of items of railway rolling stock.” The Protocol then prescribes that whatever the system, the identifier must either be affixed to the rolling stock or linked in the registry to another number (a manufacturer or running number) which is affixed to the rolling stock. In other words, there has to be a way of linking the number in the registry with the identification physically on the rolling stock. We will discuss the issue of “uniqueness” later in this paper.

(b) Remedies on insolvency

Article IX of the Luxembourg Protocol follows the system of Article XI in the Aircraft Protocol, but with one major difference.

From the creditor’s perspective, Alternative A remains the best solution unless such a system exists in current local law (as it does in the United States⁸). There remains a strong argument that the maximum economic benefits (for the debtor) can be realised only with the optimal creditor “self-help” protection under the Cape Town system. For the rail sector, this presents some very specific challenges. In countries where the rail system is at its most extensive, such creditor protection could be either unconstitutional or offend basic legal expectations reserving recourse to the judiciary before creditor action to repossess can be taken. There are public policy issues where the courts should at least be involved because otherwise a peremptory creditor action could have disproportionate effects on the wider community. In practice, it is also difficult for a creditor to move assets out of a jurisdiction on repossession without some element of judicial support, bearing in mind that the asset concerned will have to be moved on a rail system and that most of these assets do not have any system of independent locomotion.

Alternative C in Article XI is an option which does not appear in the Aircraft Protocol. It attempts to retain the basic creditor protection components in Alternative A but still reserves a right for an insolvency administrator (debtor) to apply to the court for suspension of the creditor rights of repossession as long as the debtor continues to make the payments to the creditor as per the original finance agreement (*i.e.*, it preserves the creditor’s

⁸ Sections 1110 and 1168, for respectively aircraft and rail assets, of the United States Bankruptcy Code.

bargain from the date when repossession would otherwise have taken place). In other words, it creates a limited and restricted judicial restraint on the self-help provisions in Alternative A. Many of the other asset-preservation paragraphs in Alternative A (but not in Alternative B) are replicated in Alternative C.

(c) *Liability of the Registrar*

Article 28(1) of the Convention provides that the Registrar technically has unlimited liability for errors and omissions, subject only to certain sensible caveats. The Aircraft Protocol makes no modification of this rule but in practice, the Registrar has few assets – retained earnings and possibly some equipment and software –, so the reality will usually be that the liability can be met only to the extent of any insurance of such liability being in place. Article 28(4) of the Convention leaves it to the Protocols to determine the level of such insurance and the Aircraft Protocol stipulates that this shall “not be less than the maximum value of an aircraft object as determined by the Supervisory Authority.”⁹

The drafters of the Luxembourg Protocol chose to take a different approach and recognise the reality from the outset. They therefore introduced a limitation of Registrar liability and specific insurance provisions in Article XV. But it is important to deal with these issues separately.

Article XV(5) actually specifies two limitations of liability. First, the Registrar can only be liable for damages “up to an amount not exceeding the value of the railway rolling stock to which the loss relates.”¹⁰ Then, the paragraph continues: “Notwithstanding the preceding sentence, the liability of the Registrar shall not exceed 5 million Special Drawing Rights in any calendar year, or such greater amount, computed in such manner, as the Supervisory Authority may from time to time determine by regulations.” Almost certainly the regulations will provide, initially at least, for the “greater amount” by creating a limitation of 5 million SDRs per event of loss. The liability only remains unlimited where the loss is caused by the Registrar’s gross negligence or intentional misconduct.

⁹ Art. XX(5), Aircraft Protocol.

¹⁰ So as to be clear the asset value is an overriding factor in the Registrar *liability* as opposed to the Aircraft Protocol system, where it is a factor in the *level of insurance* required in relation to the liability.

Article XV(7) then gives the Supervisory Authority discretion as to the level of insurance required in the light of the liability level it sets. The expectation is that the regulations, initially, will set a requirement of an annual insurance coverage of 15 million SDRs and for coverage of three events of loss in any year, each of up to 5 million SDRs.

(d) Registrar fees and profits

Unlike its aviation counterpart, it was clear from the beginning that the International Registry would be based in the Grand Duchy of Luxembourg.¹¹ By necessity, the concept of the role of the Registrar likewise did not follow the Aircraft Protocol model. As there was no State ready to provide direct financial support, the Registrar for the International Registry for railway rolling stock had to be able to stand on its own feet financially and potentially be profitable for anyone to take the risk of setting up and running the registry. So Article XVI(2) of the Luxembourg Protocol has replicated the first sentence of Article XX(2) of the Aircraft Protocol, providing that the fees had to be designed to cover the “reasonable costs of establishing, implementing and operating the International Registry ...,” but adding a new sentence: “Nothing in this paragraph shall preclude the Registrar from operating for a reasonable profit.” This has required us to find a very delicate balance.

Operators in the rail sector are concerned about the costs of registrations and searches in relation to financing of rolling stock. If the costs (which probably would be passed on to the operators by funders) of registrations and searches are too high, the economic benefit (through lower financing charges) to certain operators could become marginal. A high fee level would also discourage registrations and searches, in turn delaying the point at which the registry becomes financially sustainable. Yet the registry has to be at least self-financing over the term of the contract that the Registrar will enter into with the Supervisory Authority.

In this context, there are two subtle divergences from the Aircraft Protocol elsewhere in the Luxembourg Protocol which are specifically driven by the need to keep the fees at a reasonable and sustainable level. Article XVII(5) of the Aircraft Protocol provides for the appointment of the Registrar for successive periods of five years. By contrast, the Luxembourg Protocol, in Article XII(11), gives the Supervisory Authority the power to make an appointment for up to ten years. This divergence is deliberately designed to

¹¹ Resolution No. 3, Final Act, Luxembourg diplomatic Conference, February 2007.

ameliorate the necessary fee levels by creating potentially a longer write-off period for capital investments and a longer turnaround period for a system which is expected to run at a loss at the outset. Article XXIII(1) also assists by creating, unlike the Aircraft Protocol,¹² a dual-key system which states that the Luxembourg Protocol will enter into force on the later of (a) the first day of the month following the expiration of three months after the date of the deposit of the fourth instrument of ratification, acceptance, approval or accession, and (b) the date of the deposit by the Secretariat with the Depositary¹³ of a certificate confirming that the International Registry is fully operational.¹⁴ This will, in practice, allow the Secretariat to sanction the registry commencing operations only when it is reasonably clear that there will be sufficient critical mass and potential volume of registrations and searches to support the Registrar's investment on the basis of a modest fee structure acceptable to the industry.¹⁵

(e) *Article XVII: notices of sale*

Whereas the Aircraft Protocol extends the registration and search facilities and priorities generally to contracts of sale,¹⁶ the Luxembourg Protocol declines to do the same. It was felt that the Cape Town process was primarily concerned with security interests, not sales, and whilst it was advisable to deal with the latter in the aviation context, not least because of the real risk otherwise of a conflict between the noting of an owner's rights in a national registry and in the international registry, this was not a concern for the rail sector since there generally are no national property registries for rolling stock. Nonetheless, at the Luxembourg diplomatic Conference, the subject was discussed and it was felt that it would still be useful to have an informational record of sales without, however, applying the "Cape Town rights" to such registrations. We considered that being able to search against an asset and discover sales transactions on the registry could be helpful as a matter of local law, where for

¹² See Art. XXVIII(1), Aircraft Protocol.

¹³ *I.e.*, UNIDROIT.

¹⁴ Art. XXIII(1), Luxembourg Protocol.

¹⁵ A third divergence in practice will be that the Registrar will almost certainly be permitted to license others to use the registry facilities in situations agreed by the Supervisory Authority against payment to the Registrar, thereby creating a cross-subsidy for the fees to be charged by the Registrar to the industry in respect of its core services. We discuss this in IV.3 ("Ancillary services") below.

¹⁶ Art. III, Aircraft Protocol.

example, a (second) buyer would have more difficulties in arguing for superior ownership rights as a *bona fide* purchaser without notice of a first buyer's rights. In addition, we expect that, as a matter of practice, all prudent buyers and financiers will check the registry and not complete any purchase or finance if it appears that there could be a rival claim to security or absolute title in the assets concerned.

Accordingly, in Article XVII, the Luxembourg Protocol authorises the registration of notices of sale of rolling stock and applies Chapters III and V of the Protocol where relevant. Hence the identification requirements on registration will be as set out in Article XIV and the fees charged are also set by the Supervisory Authority, but the system of priorities and remedies does not apply and the registrations and searches may be for information purposes only.

(f) *Public service railway rolling stock*

As mentioned above, there is considerable concern about essential rolling stock being removed by a creditor where the loss to the community as a whole could be disproportionate to the loss suffered by the creditor if its repossession rights are not enforced. This was not a concern in relation to the Aircraft Protocol. Accordingly, Article XXV sets out some detailed rules as to where the existing laws of the Contracting State can override the standard provisions of the Protocol in relation to creditor remedies, subject to certain safeguards for the creditor.

Essentially, there are two steps. First, a Contracting State using this article must designate, in its declaration,¹⁷ rolling stock which is *habitually* used for providing a service of public importance. It should be noted that occasional use would not be sufficient.

Then, if the creditor is restricted in exercising its possession rights, any person taking possession other than the creditor has a duty to preserve and maintain the rolling stock until it is handed over to the creditor and is required to compensate the creditor for its loss of bargain unless there is a second declaration specifically excluding these obligations where local law does not provide for them.¹⁸

At first glance, this appears to “drive a coach and horses” through the remedies’ section of the Luxembourg Protocol, but there are some subtle

¹⁷ Which will be on public record, of course.

¹⁸ Art. XXV(4), Luxembourg Protocol.

defence lines for creditors. The modification of the creditor remedies can only take place where domestic law would provide for different remedies which effectively block creditor repossession rights. If there is no such domestic law, the declaration cannot be made. The designation is by rolling stock *type*, not the rolling stock's *mission*, since otherwise a creditor would not be able to judge when the public service exemption applies. This should ensure that a State makes such a declaration after detailed consideration, since it will effectively imperil private sector credit in relation to such assets.

Then there is a requirement to compensate the creditor, effectively putting it in the position of *status quo ante* any breach which would have triggered repossession, unless there is a *second* declaration effectively stating publicly that the creditor runs the risk of sequestration without compensation.¹⁹ Lastly, the Contracting State making one or two declarations under Article XXV is reminded to “take into consideration the protection of the interests of creditors and the effect of the declaration on the availability of credit.”²⁰

So Article XXV is a classic, and sensible, compromise. It accepts that a State may have to restrict creditor repossession rights for public policy reasons, but the State's power can only be exercised in narrow circumstances and as long as – except for extreme circumstances – the creditor (who has little interest normally in repossessing assets except as a way to realise their value after a default) receives what he had expected to receive under his agreement with the debtor.

(g) *Pre-existing interests*

The starting point is Article 60(1) of the Convention, which states that “[u]nless otherwise declared by a Contracting State at any time, the Convention does not apply to a pre-existing right or interest, which retains the priority it enjoyed under the applicable law before the effective date of this

¹⁹ The drafters of Art. XXV(4) calculated that for some States, this provision was essential to avoid any clash between the commitment to preserve and compensate, on the one hand, and their constitutions, on the other hand, especially where this was being agreed in advance. However, it is clear that no reasonable creditor would provide finance for rolling stock without strong Government assurances if the declaration is made, thereby closing out private finance for the rail industry in the State making such declaration. Essentially, therefore, there is a strong economic disincentive for a State to make this second declaration. In addition, State sequestration of assets without compensation may itself be unconstitutional in some States.

²⁰ Art. XXV(6), Luxembourg Protocol.

Convention.” So, in principle, any security interest created before a protocol comes into force in a Contracting State retains its priority regardless of any subsequent registration after the protocol comes into force. Article 60(3) opens up the possibility of a Contracting State making a declaration bringing pre-existing interests under the Convention “not earlier than three years after the date on which the declaration becomes effective.” But there is no back-stop: the declaration could stipulate a 20-year transition period.

The Aircraft Protocol essentially accepts the Convention’s approach. But the rail industry considers that, bearing in mind that most items of rolling stock are long-lived assets, with a useful life of 40 years in some cases, there are good public policy reasons to bring existing rights within the Cape Town system quickly. In this way, the registry can be as inclusive as possible and creditors and searchers, after a suitable transition period, will not have to look back to pre-existing rights overreaching what is registered.²¹ Thus, in Article XXVI, the Luxembourg Protocol goes much further by replacing Article 60(3) of the Convention with a new paragraph setting out in much greater detail how a Contracting State should, if it makes a declaration, deal with pre-existing interests and specifically adding a new aspect, namely, if pre-existing interests are to be brought under the Convention they must be subject to the Convention no later than ten years after the date on which the declaration becomes effective.

III. – RATIFICATION: THE PROCESS, KEY RAIL WORKING GROUP RECOMMENDATIONS AND THE “HALF A LOAF” APPROACH IN ARTICLE IX

1. Ratifications matrix and key recommendations

Certain provisions of the Convention and the Luxembourg Protocol are dependent on policy decisions by Contracting States. For these provisions, the Convention and the Luxembourg Protocol provide a system of declarations which allows Contracting States to make choices. Only a few of these declarations are mandatory,²² all others are optional. Furthermore, while Contracting States need to make the aforementioned mandatory declarations at the time of ratification of the Convention and the Luxembourg Protocol, all other declarations can also be made (or varied) at a later point.

²¹ The obvious analogy here is Governments’ desire, when recording interests in land in land registries, to ensure that all land is registered as quickly as possible.

²² Cf. Arts. 48(2) and 54(2) of the Convention, Art. XXII(2) of the Luxembourg Protocol.

The UNIDROIT Secretariat has prepared an explanatory memorandum to assist States and regional economic integration organisations in completing declarations.²³ It encourages all Contracting States to base their declarations on the forms included in the memorandum to ensure that they comply with the requirements of the Convention and the Luxembourg Protocol.

The Rail Working Group, in its turn, has prepared a declarations matrix to illustrate the optimal declarations or non-declarations intended to enhance the economic benefits to be derived from the Luxembourg Protocol. The recommended declarations include statements that remedies available under the Convention without application to the court should be exercisable without court action and without leave of the court.²⁴

With respect to the identification requirements for purposes of registration in the International Registry,²⁵ reference to the Registrar's or manufacturer's identifier affixed to the rolling stock is strongly recommended by the Rail Working Group. The use of national or regional identifiers is not recommended as there is a risk that they may be re-used and applied to different items of rolling stock. In any case, any alternative identification system must be one that uniquely identifies the rolling stock and does not expose the creditor upon non-notification of the change of identifier to the Registrar. Finally, for public service railway rolling stock, the continued application of national laws which preclude, suspend or govern the exercise of the remedies under the Convention and the Luxembourg Protocol is not recommended by the Rail Working Group.²⁶ The Rail Working Group also strongly advises against the disapplication of the Luxembourg Protocol provisions on maintenance and payment for use of the rolling stock prior to its return to the creditor.

While extensive work has already been invested by the Rail Working Group in this project, the current draft of the declarations matrix still requires final sign-off from the members of the Group before it is published on the Group's website. The Rail Working Group intends to encourage Contracting States to use the declarations matrix in connection with the weighing of

²³ *The system of declarations under the Convention on International Interests in Mobile Equipment and the Protocol thereto on Matters specific to Railway Rolling Stock: an explanatory memorandum for the assistance of States and Regional Economic Integration Organisations in the completing of declarations*, available on the UNIDROIT website: <www.unidroit.org>.

²⁴ Cf. Art. 54(2), Convention.

²⁵ Art. XIV, Luxembourg Protocol.

²⁶ Art. XXV, Luxembourg Protocol; see also above.

economic *versus* other policy considerations when determining their positions on declarations.

2. The “half a loaf” approach of the Rail Working Group on Article IX of the Luxembourg Protocol

Article IX of the Luxembourg Protocol introduces special rules that govern the creditor’s rights where the debtor becomes subject to insolvency proceedings. A Contracting State considering making a declaration under Article IX of the Luxembourg Protocol has a number of options and may choose to make no declaration or to apply Alternative A, Alternative B or Alternative C of Article IX of the Luxembourg Protocol to all or some types of insolvency proceedings.

The Rail Working Group urges Contracting States to adopt Alternative A of Article IX of the Luxembourg Protocol (except where such remedies already exist under national law). This provision is considered to be the single most significant provision of the Luxembourg Protocol in economic terms. Alternative A reflects the realities of modern structured finance by ensuring, as far as possible, that, within a specified and binding waiting period, the creditor either secures recovery of the respective item of rolling stock or obtains from its debtor the curing of all past defaults and a commitment to perform the debtor’s future obligations. The recommendation of the Rail Working Group to Contracting States is to provide for a waiting period of 60 calendar days under the insolvency regime established by Alternative A of Article IX of the Luxembourg Protocol. But if Alternative A is not possible for a State for public policy reasons, we recommend Alternative C.

Member States of the European Union have transferred their competence to the Union as regards matters which affect Council Regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings. Consequently, arguably they are barred from making a declaration pursuant to Article XXVII(3) of the Luxembourg Protocol that they will apply one of Alternatives A, B and C of Article IX of the Luxembourg Protocol.

The European Union, in its turn, decided to make no declaration with respect to the applicability of the insolvency alternatives in the context of the first equipment-specific protocol, the Aircraft Protocol.²⁷ This is due to the fact that a compromise was reached with the Member States that each Member State should be able to make its own decision as to which rule, if any, it wanted to adopt with respect to insolvency. The Rail Working Group expects

²⁷ *Official Journal of the European Union*, L 121, 15 May 2009, (p.) 5.

the European Union to adopt this approach also with respect to the Luxembourg Protocol. Although no declaration will be made by the Member States of the European Union under the Protocol, there is nothing to prevent the amendment of the national laws of a Member State so as to result in the same substantive outcome that might be expected if a declaration had been made by that Member State. Put differently, although Member States technically cannot opt into Alternative A at the time of ratification of the Luxembourg Protocol, they are free to craft their national insolvency law according to Alternative A. In essence, Member States thus retain their competence concerning the rules of substantive law as regards insolvency.

The Rail Working Group accepts that the remedies on insolvency under the Luxembourg Protocol may conflict with the national laws of any Contracting States that traditionally take into account not only creditors' interests in effective and prompt remedies, but also conflicting interests such as the protection of debtors, economy and jobs. Furthermore, the Luxembourg Protocol provides significant benefits to creditors even without application of its insolvency regime. In particular, the Luxembourg Protocol sets the framework for a worldwide registry of security interests applicable to all rolling stock accessible via the Internet 24 hours a day, 7 days a week, through which any creditor can check if any other party claims an interest in a specific item of equipment. In future, creditors will be able to register their interests in this registry which will then, in almost all cases, take precedence over any other unregistered security interest and over any subsequently registered interest. Lastly, the Luxembourg Protocol establishes a set of basic remedies in the event of the debtor's default outside an insolvency scenario.

Therefore, if a Contracting State should currently face legal, political or other difficulties in amending its national insolvency laws to reflect the realities of modern finance embedded in Article IX of the Luxembourg Protocol, this should not, in the Rail Working Group's view, impede its ratification, acceptance, approval of, or accession to the Luxembourg Protocol. Rather, the respective Contracting State should consider such ratification, etc. without making a declaration and revisit this issue at a later point in time (e.g., in the context of an overall review or amendment of its national insolvency legislation) on the basis of a subsequent declaration pursuant to Article XXX of the Luxembourg Protocol.²⁸

²⁸ A subsequent declaration will, however, only take effect six months after receipt by the Depository of the respective notification.

IV. – ESTABLISHING THE REGISTRY – THE CURRENT POSITION, KEY AREAS OF FOCUS AND ANCILLARY SERVICES PROVIDED BY THE REGISTRY

1. The current position

The Final Act of the diplomatic Conference in Luxembourg established a Preparatory Commission mandated to select, and contract with, a Registrar to run the International Registry.²⁹ Accordingly, shortly after the Luxembourg Protocol was adopted in February 2007, the process was initiated of engaging a Registrar. A preferred bidder was selected and negotiations began. However, after a number of months of negotiating the contract with the relevant organisation, it became apparent that there were fundamental differences between the two parties and negotiations were brought to a halt. The Preparatory Commission decided that it would start a new search for the Registrar.

In order to have the best pool of bidders from which to select the Registrar to operate the International Registry, UNIDROIT issued a request for proposals in June 2010. Four bidders were invited to a session of the Preparatory Commission in October 2010 to present their bids and to answer questions from members of the Preparatory Commission. As a result, two bidders were shortlisted and requested to provide further details regarding their bids, in order to provide the basis for a set of heads of terms on which negotiations for a full contract could be based. Once the information was reviewed, it was agreed that the bid from SITA would be selected as the preferred bid.

The Preparatory Commission established a negotiating group made up of the Preparatory Commission's joint chairs, representatives of UNIDROIT and OTIF, with the support of the Rail Working Group. The negotiating group has had a number of face-to-face meetings with SITA to develop the contract. At certain points in the negotiations, progress reports were made to the Preparatory Commission. At formal sessions of the Preparatory Commission, instructions were given to the negotiating group and negotiations are now continuing with a view to concluding the drafting of the contract in 2012. Once the draft has been agreed, it will be subject to formal approval by the Preparatory Commission.

²⁹ The Preparatory Commission was set up as the Provisional Supervisory Authority under Resolution No. 1 of the Final Act.

As noted above, during the Luxembourg diplomatic Conference, it was resolved that the Grand Duchy of Luxembourg would be the host State of the International Registry. Mindful of the position of the Grand Duchy and the obligations placed upon it through the Final Act of the diplomatic Conference, both SITA and the negotiating group have sought to retain a level of engagement with the Grand Duchy. Both parties have welcomed the assistance and guidance given by key Luxembourg Government officials to the establishment of the International Registry in its territory and in working towards its ratification of the Luxembourg Protocol.

2. Key areas of focus

In establishing the International Registry, the negotiating group has focused on five key areas: the development of the software supporting the operation of the International Registry; the portability of that software; the recovery of costs over a ten-year period; the requirement of sufficient ratifications; and the need to make the International Registry financially viable where user fees are modest and sustainable.

(a) Development of software

Under the contract, the Registrar will be required to develop the software needed for the International Registry to be able to undertake the types of registration required by the Luxembourg Protocol. Although the Rail Registry will be similar to the International Registry for aviation equipment set up pursuant to the Aircraft Protocol, there will be differences, so that a like-for-like use of existing software was not possible. Moreover, even the Aircraft Protocol software is currently being upgraded. As SITA is the majority shareholder of Aviareto, the Registrar for the International Registry for Aircraft, the negotiating group is keen to gain the benefits of SITA's experience with this Registry and of the upgrades that have been made to the original software.

It is intended that the software for the International Registry will be developed over a number of months, based on service requirements. Once the initial software has been developed, there will be a period of testing and proving of the software before it is ready to enter service as the backbone of the International Registry. Because of the number of scenarios and the rigorous testing that is required, there will be a significant time period between the award of the contract to the Registrar and the start of operations of the International Registry.

(b) Portability of software

Because the software will provide the cornerstone of the operation of the International Registry, the Preparatory Commission considers it essential that this specialist software be capable of transfer from the existing Registrar to any successor Registrar. This needs to be possible both at the expiration of the contract for the Registrar and also in the event of an early termination of the contract.

The contract will make it clear that source codes and other supporting information for the specialist software are to be made available to any successor Registrar. The only software that is not being made specifically portable is the relevant proprietary software. This is mainly because the companies that produce such software do not allow it to be sub-licensed. Because the licence is commercially available, it is expected that the new Registrar should pay the relevant proprietary software manufacturer for such licence(s) as it needs.

(c) Recovery of costs over ten years

As noted above, the Luxembourg Protocol provides for the first Registrar to be appointed for a period of no less than five and no more than ten years and in fact, the contract for the Registrar is being let over a period of ten years. In order to keep the charges to registry users to a figure that will not discourage usage, it has been agreed that the Registrar will amortise much of its costs over the full duration of the contract. This is primarily because there will be a number of significant costs associated with the setting up of the International Registry, such as the development of the specialist software and the establishment of the registry office.

We anticipate, therefore, that usage fees can be set by the Supervisory Authority at a modest level.

(d) Keeping down the cost of registration

Unlike conditions in the aviation industry, a rolling stock asset that may be the subject of registration may have a relatively low value, potentially in the tens of thousands of US dollars rather than millions. The mandate to the Registrar will from the outset include a requirement to facilitate group registrations and group searches. The registration fee as a function of the asset value will play a greater part, especially as fleets of vehicles are likely to be registered rather than a few airframes and engines. If the fees are too high, parties are likely to

decide that the benefits of registration are not cost-effective and there will be fewer registrations than expected. This is likely to lead to a downward spiral of needing to increase registry fees to cover the Registrar's costs and potentially further reductions in registrations, as a result. Accordingly, while the Supervisory Authority retains full control of the fee structure, the relationship with the Registrar will be key to finding the right balance between modest charges and ensuring economic sustainability of the registry.

There have been discussions as to whether there should be discounts available for group registrations of fleets of rolling stock and for searches against registered groups of assets. This would certainly have the benefit of reducing transaction costs, which might otherwise become a barrier to the transaction. However, the discussions as to what level of discount should be offered and against what fleet size remain ongoing. This will be subject to further work between the Registrar and the Preparatory Commission. We expect that the Registrar will be innovative, creating incentives for speedy and inexpensive population of the registry. Any such offers will need to be transparent and fair.

3. Ancillary services

Another method of keeping registry charges down is to permit the Registrar to have a secondary stream of income so as to allow it to offer ancillary services to users of the International Registry. An ancillary service is broadly defined as one which the Registrar is not obliged to provide in order to meet its obligations under the Luxembourg Protocol. It is simply an optional additional service for which the Registrar considers there will be a demand. The expected additional funds which are estimated to be available to the Registrar will be used in part to offset the costs of operating the International Registry and hence to reduce the registration fees for users. In the event of the ancillary services providing more funds than expected, the surplus funds may be treated as a profit by the Registrar and retained. Since an important aspect of the Luxembourg Protocol is that the Registrar should be able to operate at a reasonable profit,³⁰ it is expected that the Registrar will look to develop ancillary services. It should, however, be noted that any income expected to be received from ancillary services is not taken into account by OTIF in deciding whether the International Registry is able to commence operations.

³⁰ Art. XVI(2), Luxembourg Protocol.

Initially, two different types of ancillary service were anticipated, one which needed to use the website of the International Registry in order to be offered, and another which could be offered independently of the website. However, as the model for providing ancillary services was developed it was found that the distinction was becoming difficult to maintain and so this has been dropped.

Since it is essential that the Registrar itself incur no liability for the provision of ancillary services, as otherwise this could threaten the integrity of the Registry (bearing in mind the Registrar's limited assets), one important qualification for ancillary services is that they are not provided by the Registrar itself but rather by related third parties, and that the benefit is provided to the Registrar by a royalty fee.

Before any ancillary service may be offered, the Supervisory Authority is required to give its consent to the proposed service. There is a two-stage test for giving approval. The first is that the proposed service is not incompatible with the functions of the International Registry; the second test is that it does not constitute an inappropriate use of the resources of the International Registry. The reasoning behind the second test is that the ancillary service should not bring the International Registry into disrepute. Thus, for example, a service which promotes gambling is unlikely to be approved.

Once an ancillary service is approved, the provider is licensed to use the International Registry brand and advertising space on the International Registry website. It is, however, important to note that the ability to provide ancillary services is tied to the Registrar's contract with the Supervisory Authority and the rights associated with ancillary services cease on the expiry or termination of that contract.

V. – SOME INTERESTING FOLLOW-UP ISSUES

1. Defining “railway rolling stock” – an interesting debate

The Luxembourg Protocol is designed to cover all types of railway rolling stock and so the definition within the Protocol is fairly broad, being “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.”³¹ This does, however, trigger an interesting debate as to what actually constitutes a “vehicle”. This question is also essential, as it is the vehicle that is allocated a registration number and receives the benefits of a Luxembourg Protocol registration.

Under the Aircraft Protocol, it is a fairly straightforward activity to define an airframe or an aero engine. Within the rail industry, on the other hand, there are many different types of rail vehicle; some could be considered to be a more “standard” type of vehicle, e.g., a passenger carriage, while others are highly specialised, e.g., cranes for a breakdown train. There has been some debate within the Rail Working Group about those items that are on the margins of the definition as the regulations which the Group is helping to formulate are required to provide clear guidance as to what needs to receive a registration number.

The first and simplest part of the guidance is that a vehicle needs to be a free-standing item that can move along above or under a track. It may be an item travelling either under its own traction system or be un-powered and rely on the traction of another vehicle. The complications start when the item is either permanently or semi-permanently coupled to other items. There may be individual elements which have a running number, such as flatbed wagons, and which are coupled together for convenience. In other rakes,³² there may be individual elements that require the support of other elements such as TGV carriages, where each has its own running number but could not operate without the support given by the other elements. Another form of individual elements requiring the support of others are articulated trams, e.g., Zurich trams, where the elements are considered to be part of a single vehicle and the entire tram carriage has just one running number. It is also possible to look at smaller elements such as bogies which are attached to particularly large loads, e.g., steel beams, where the loads themselves form part of the vehicle for the duration of the journey.

As the definition looks at vehicles travelling on a fixed railway track or on, over or under a guideway, it could be argued that a road vehicle adapted to run on a railway line (for example, by having profiled rail wheels attached to it which when lowered onto the rails enable it to run on the railway line) should also be considered a vehicle for the purposes of the Luxembourg

³¹ Art. 1(2)(e), Luxembourg Protocol.

³² A “rake” is the name given to a set of wagons or carriages which are intended to run together on at least a semi-permanent basis.

Protocol. Cable cars and trolley busses arguably also use a form of guideway, so should they also fall within the Luxembourg Protocol?

2. How far we have come in practice

The discussions have led to a basic position evolving within the Rail Working Group. The first criterion is that for an item to be considered to be a vehicle, it must be able to be operated either with or without traction. A set of frames supported by a set of wheels is therefore a vehicle. If the item can be physically separated from other vehicles and can continue to be operated under normal industry conditions, it is entitled to receive its own registration number. In addition, if the item can be operated alone or contiguous to various other vehicles without the need for special adaptation or additional special equipment it, too, is entitled to receive its own registration number.

There is ongoing discussion as to whether articulated sections which require the support of other sections are eligible to receive their own identification number. The Rail Working Group has been considering existing rail practice and has concluded that if each section is considered to be a separate vehicle by the railway community, *i.e.*, by being issued with its own running number, then it should be entitled to have a separate registration number. As a result, each articulated section in a TGV set would have its own registration number, while an articulated carriage in a Zurich tram would have a single registration number.

Road vehicles which have been adapted to operate on railway lines do appear to meet the criteria set out in the definition and so would be entitled to receive their own identification number. However, if a road vehicle has no specific adaptation, but is capable of running along the top of a rail, it is not a vehicle for the purposes of the Luxembourg Protocol. This is to remove the possibility of having to register all road vehicles that may come into contact with railway lines and which were not intended to be covered by the Luxembourg Protocol.

The crossover between steel wheels on steel rails and rubber tyres on concrete “rails” is another area which has generated discussion. Certain lines in the Paris Metro, for example, use rubber-tyred vehicles and existing rail practice would conclude that these are indeed trains. The vehicles run on a guideway, are only intended to be used on the railway system and their operation requires them to remain within the “rail” system. The Rail Working Group supports these vehicles being given registration numbers.

The area of guided busses is still under discussion. In the case of a trolley bus, there is an overhead power supply. Without the power supply cables the vehicle may not be able to run for any great distance, so while the route of the power supply in practice dictates where the busses can travel, this is not as such a guideway. In addition, the bus is capable of being attached to another vehicle and running on a road without the need for the guideway. The same is true of buses that use a guideway in inter-urban areas but leave the guideway when in town or city centres. If a guideway is used for only part of the time, should it be considered a rail vehicle? Certainly, the bus industry is unlikely to consider that it should be governed by legislation relating to railways, so this may be a step too far! The better view surely is that any qualifying vehicle must run above, on, or below a permanent guideway³³ designed primarily for that purpose.

3. Unique identification

In the foregoing discussion concerning identification of rolling stock for the purposes of registering an international interest in accordance with Article XIV of the Luxembourg Protocol, there is a potential conflict between the two elements of Article XIV. The Registrar has the duty to protect the integrity of the registry system and ensure that the identifier is unique, yet some of the possible external identifiers (e.g., running numbers or manufacturers' serial numbers marked on the rolling stock) can change or be recycled. This may be perfectly acceptable in relation to immatriculation, but any creditor holding a security interest in the asset has to be absolutely clear that there is no confusion as to the asset in which it holds the interest or risk of another claiming an interest in the asset. There is no clarity in the Protocol as to whether "unique" means unique at the time when the international interest is created or unique at all times thereafter. There is no doubt, however, that it has to be the latter.

To that end, after the Luxembourg diplomatic Conference, the Rail Working Group developed the URVIS³⁴ identifier, a 20-digit numbering system³⁵ intended to identify railway rolling stock unambiguously with a

³³ Accepting, of course, that lines can be reconstructed and replaced.

³⁴ Unique Rail Vehicle Identification System.

³⁵ See "Allocation and Marking of Permanent Numbers on Rolling Stock" at <http://www.railworkinggroup.org/r0184_240210%20RWG.pdf>. At the moment, we are planning for the last four numbers to be check digits in order to create a solid protection system for inadvertent mis-filings of numbers.

number that can never be re-used and which is issued by the Registrar and, ideally, affixed to the item of rolling stock in question. We expect the regulations to adopt a system where the Registrar will issue the unique identifier which will then need to be affixed to the asset. This represents a new approach compared to what was originally envisaged, namely that the Registrar become the initiator and generator of the unique identifier, rather than just receiving and recording a number proposed by the parties or others. The approach adopted is the only sure way of ensuring that no duplication or recycling of identifiers occurs.

4. Application as a matter of local law

Article XVII of the Luxembourg Protocol provides that notices of sale shall be registrable in the International Registry. However, any such registration is for the purpose of information only and will not have any effect under the Convention or the Luxembourg Protocol.

The purpose of this registration facility is to give notice of the respective sale transaction to other creditors. Although the Luxembourg Protocol makes it clear that such registration vests no additional rights in the creditor under the Convention or the Luxembourg Protocol, national law may attribute legal effect to such registration.

The question is the same where a creditor registers a security interest that does not qualify as an international interest (and therefore the Protocol does not apply) since the debtor was not located in a Contracting State at the time the interest was created. Hence, registration in the International Registry may be deemed sufficient by national courts to override the basis for any *bona fide* acquisition by a third party of an item of rolling stock specified in a notice of sale or registered security interest, as the acquirer would be deemed to have at least constructive notice of the registered interest. If national courts were to adopt such an approach, it may become necessary for creditors to search the International Registry for registrations against a specific asset even if the Convention and the Luxembourg Protocol technically do not apply to such asset. It will be interesting to observe how courts ascribe the legal effect of a registration or notice in the International Registry as a matter of national law.

VI. – CONCLUSION

The extension of the Cape Town Convention to railway rolling stock presents a major new opportunity for the rail industry to secure finance from the private sector. But the design of the Convention, with its sector-specific

protocols, recognises that there must be different requirements and therefore different solutions for different industries. It is a balancing act, since it only makes sense to diverge from the Aircraft Protocol where it is absolutely necessary. Nonetheless it is clear that the drafters of the Luxembourg Protocol have had to deal with some challenging problems that were not issues for the aviation industry. Moreover, the solutions have been fascinating in that they have been both progressive and iterative. Progressive, in that the Cape Town regime foresees a cascade with basic principles set out in the Convention and specific rules for the industry sector in the corresponding protocol. These will then be modified by individual States as they decide where and to what extent they opt in or opt out of various provisions, and finessed by detailed provisions in the regulations, which will take into account ideas developed to implement the specific rules and will, in accordance with the Luxembourg Protocol, only be finalised as the Protocol comes into force. And iterative, since the Supervisory Authority will see a key element of its role, assisted by organisations such as the Rail Working Group, as balancing practical considerations with industry expectations. The next chapters of this tremendous initiative have yet to be written.

