THE 2001 CAPE TOWN CONVENTION
ON INTERNATIONAL INTERESTS IN MOBILE EQUIPMENT

RAIL WORKING GROUP

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INFORMATION SESSION FOR POTENTIAL BIDDERS TO BE THE REGISTRAR OF THE INTERNATIONAL RAIL REGISTRY

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Industry Perspectives

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The rail industry is conservative by its nature and tends to work carefully and methodically. In many parts of the world, historically, since the Second World War at least, rail systems have been either State-owned or very heavily controlled by the State, and not only does this contribute to the cautious approach when looking at new international instruments, in this particular case it also explains a mindset which is only gradually changing.

In the past, managers of State-operated railways had to tailor their procurement programme to funds available and other pressures on their budgets. In addition, in a number of countries, whatever was initially agreed or projected was always subject to government cutbacks and, sadly, in a number of countries this meant that procurement and other investment programmes in the rail sector were sacrificed when funds became scarce. What the Luxembourg Rail Protocol opens out is the possibility of State-owned operators commissioning procurement programmes independent of funding available either from central or local government. The industry has to get used to this and understand that it can finance in the future, based on the benefit of the additional procurement and in particular the improved service it permits to be delivered to the consumer rather than simply just investing wherever money is available at the time. Of course for the smaller group of private sector operators this is their perspective already but without the Protocol or direct or indirect State support, finance is not always available or, if it is, cheap.

That railways in general need more capital investment in rolling stock is beyond doubt. There will be variations between countries but generally not only is there an operating need in relation to existing, at times very old, rolling stock, but there is a fresh drive to move both passengers and freight onto the rails in various parts of the world coming from the increased environmental sensitivity. The difficulty, particular in this financial climate, is that governments themselves do not always have the funds available for the necessary investment and therefore there is no doubt that for the rail industry as such, the Luxembourg Rail Protocol is an important and very positive step forward.

All of this comes at a time therefore when there is a massive expansion in investment in rail infrastructure. The recent Berger report estimated annual rolling stock procurement at €24 bn. but today that must be a serious underestimation. The Chinese railways are developing very fast with particular emphasis on high-speed rail, India also has huge investment plans and both in Europe and the United States there is an increased governmental commitment to investment in the rail sector as a way of stimulating the economy as a whole. Interestingly, there is also a massive investment planned in rail in the Gulf region where the principal means of investment is being made through public-private partnerships, thereby leveraging in private expertise, rather than simply funding the investment from other revenues as, for example, Saudi Arabia could clearly do. Again, this brings into focus the need for private sector finance of rolling stock either as part of a BOT project or independent from such a programme, but made easier in that in a number of cases governments will step in to guarantee flow-through traffic, making it considerably easier to finance a transaction because of the security of the receivables.

We know that the Protocol will also have considerable relevance for the rail sector in the developing world. It will create conditions for the private sector to finance rolling stock in a way that, in many cases until now, was just not economically sensible. Of course it does not remove the political risk but aside from the fact that this can be insured against, the economic factors are changed significantly if there is a legal régime in place covering the respective rights of owners and secured parties.

The advantages for the developing world highlight one or two misconceptions which are often held within the industry. Although the origins of the whole Cape Town régime was to secure funders particularly in cases where assets by their very nature were crossing jurisdictional borders, in the rail sector, which generally has very little legal infrastructure for securing the position of creditors, pledgees or lessors of rolling stock, the Luxembourg Rail Protocol provides a detailed security régime also for domestic transactions. This should make a difference to funding going forward even where there is little movement of the financed rolling stock across a border.

The second misconception that I often find in practice is the view that the Protocol only applies if the rolling stock is located in a Contracting State. In fact, the Protocol applies where a debtor is located in a Contracting State. This could be the operator, as a lessee or as a pledgor of rolling stock being operated in various parts of the world which might, but not necessarily will, include the location where the lessee/pledgor is located. So, for example, financing through single-purpose vehicles established in convenient locations, either onshore or offshore, is a structure already used in the private sector when it is financing rolling stock. Moreover, there can be more than one debtor in a particular transaction. Imagine a situation, for example, where a manufacturer sells rolling stock to a lessor under a reservation of title. That lessor leases to an operator who could be operating rolling stock in various countries.

Neither the operator nor the lessor in that situation, may be located in the country where the rolling stock is operated.

A third common misconception is to underestimate the scope of the Protocol. The definition of rolling stock in the Protocol itself is very wide and will cover equipment ranging from high-speed rail train sets to trams to mountain railways to tunnel-boring machines and cranes at ports which also run on rails.

But the industry does have concerns, particularly to ensure that there is a real cost: benefit gain. If, in terms of bureaucracy or registration costs, etc the financial burden exceeds the benefits from wider private sector finance and a commensurate reduction in financing cost, then the industry will be very reluctant to move forward with the project. In particular therefore, the industry is looking for the Rail Registry to be setting its fee scales at a very attractive level and the same will apply in relation to cost of affixing identifiers (see below).

A second clear concern is the issue of identification of rolling stock. At the moment there is no uniformity across the world in defining a unique identifier and with the growing privatisation and commercialisation of the rail sector, it is highly arguable that this is now needed regardless of the Luxembourg Rail Protocol (for example for insurance or other tracking purposes). Traditionally in many parts of the world, rolling stock operates and is identified by reference to a running number. That number can change but in the past this was rarely an issue because the railways were principally State agencies, traditionally working together closely (and rarely competing). So, for example, the system that used to operate in Europe whereby running numbers were allocated by the Union Internationale des Chemins de Fer (UIC) as part of a close co-operation between the State railways where it was generally accepted that the agencies complied with the rules.

In many parts of the world those days have gone, and certainly in others those days are going, and that means today there needs to be a more specific and accurate description of rolling stock in such a way that it can always be identified uniquely under an independent system and is standardised throughout the industry. To that end, key stakeholders at least in Europe, have been working closely together on examining alternative permanent and unique identifiers. The Rail Working Group's working paper on this issued today, which was a result of detailed discussions and co-operation between the RWG, UNIFE, the European Rail Manufacturers' Association, the Community of European Railways and the UIC, is a new departure for the rail sector but a necessary one. This working paper may be found at http://www.railworkinggroup.org/r0184_240210%20RWG.pdf. Although this is certainly work in progress, it is hoped that the general approach indicated in the working paper could be adopted eventually worldwide by the rail sector.

In summary, the industry will take time to change and time to adapt to a new opportunity which is now being presented to it. We are confident however that that change will take place as long as the two key concerns mentioned above are addressed, namely that the incremental costs of implementing the Luxembourg Rail Protocol are kept to modest levels and that the industry can confront and deal with the needs both from the Luxembourg Protocol itself and beyond for a permanent and unique identifier for rolling stock. But the Protocol could not come at a better time for the industry and should play a key part in the commercialisation and renewal of the rail sector.