Could the Luxembourg Protocol enhance Belt and Road competitiveness?

China’s bold Belt and Road Initiative to develop new rail links to Europe and southeast Asia poses difficult questions regarding the title and security rights of rolling stock crossing borders, says Howard Rosen, chairman of the Rail Working Group.

China’s Belt and Road Initiative, sometimes called “One Belt, One Road,” is a visionary recreation of the historic Silk Route, forming a new land bridge between East Asia and Western Europe. Moving freight by rail takes half the time it takes by sea, and is more reliable and safer. Potentially it will revolutionise trade between Asia and Western Europe, but this, together with growing liberalisation, raises difficult questions for banks, lessors and operators claiming title or security rights in rolling stock that frequently crosses national borders.

Although locomotives may be changed at the border, rolling stock will inevitably run through different countries with diverse legal systems and distinctive approaches to securing the title interests of owners and secured lenders. Operators will need to be sure that their rights in rolling stock, operating in all the jurisdictions along the Belt, will be protected. Given the growing trend towards private financing of rolling stock within Europe, and the potential to expand this through secured debt or leasing, the ability of private creditors, as well as public and private operators, to repossess and redeploy rolling stock will be critical in future, particularly if the debtor is not a prime credit.

Furthermore, with public sector operators increasingly working commercially, often through joint ventures or operating leases to shippers, securing their property rights will be more and more important.

Chinese banks will probably be at the forefront of advancing credit for new rolling stock, due to China’s strategic interest. The Asia Infrastructure Investment Bank and other public institutions such as the European Bank for Reconstruction and Development and various export credit agencies, should also provide support for operators. Where the private sector invests in railway equipment, there can be several transactional steps between operators and investors, with the intermediate financing transactions subject to different laws - and no rules on priorities of claims. The picture is complex.

Currently, there is no global harmonisation of property law relating to railway equipment, nor any national rolling stock title registries or common system to uniquely identify rolling stock (in contrast with aviation). The result is a layer of extra risk that often means higher costs and puts rail operators at a competitive disadvantage to aviation when sourcing credit. To succeed, the Belt and Road Initiative must be economically competitive. Anything that attracts new investment, reduces risks and lowers costs will contribute to its success. Fortunately, the solution is at hand.

New system

The Luxembourg Protocol to the Cape Town Convention on International Interests in Mobile Equipment is an innovative global treaty that will make it easier for the private sector to finance rolling stock worldwide. It provides a new system of rights for creditors whose interests will be registered and searchable 24/7 at an international registry in Luxembourg. The registry will also issue unique identification numbers for all rolling stock, and thus track rolling stock wherever it is. The protocol lets parties choose which law to apply to financing, regardless of the debtor’s or rolling stock’s location.

The Luxembourg Protocol and its aviation protocol are in force in over 60 countries. When the Luxembourg Protocol comes into force towards the end of 2018, it will reduce creditor and operator risk, which in turn will facilitate more and cheaper private finance for rolling stock procurement; lower barriers to entry for smaller, lightly-capitalised operators; and facilitate rolling stock operating leases, leading to more standardised equipment and economies of scale for manufacturers. The result will be a more competitive and dynamic global rail industry.

For the Belt and Road Initiative, the Protocol offers an excellent new framework for financing railway equipment, with a common set of rules and creditor protections, regardless of the location of the rolling stock or debtor. Any owner, lessor or operator running rolling stock through jurisdictions along the Belt can be confident their property rights will be respected. And any financier or investor can take its security and value its asset, confident of its repossessions rights on debtor default or insolvency, or local government intervention.

To succeed, the initiative needs significant investment in infrastructure, facilities and rolling stock. Most will come as debt. At a summit in Beijing in May 2017, China’s president Mr Xi Jinping committed $US 55bn of lending capacity. Operators large and small will be linking their futures to the success of the initiative. The Luxembourg Protocol will both facilitate the major investment in rolling stock required, at a lower cost, while making rolling stock a safe but liquid asset. It is as visionary as the initiative.

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