



Government of  
Poland

OTIF



**THE PRELIMINARY DRAFT RAIL PROTOCOL TO THE CAPE TOWN CONVENTION  
ON INTERNATIONAL INTERESTS IN MOBILE EQUIPMENT: AN OPPORTUNITY  
FOR GOVERNMENT AND INDUSTRY TO COMPARE NOTES IN THE RUN-UP TO THE  
DIPLOMATIC CONFERENCE**

(A colloquium organised by the International Institute for the Unification of Private Law (UNIDROIT),  
the Intergovernmental Organisation for International Carriage by Rail (OTIF) and the Rail Working  
Group, in co-operation with the Government of POLAND,  
at the Headquarters of the Organisation for the Collaboration between Railways (OSShD OSJD),  
Warsaw, 15-16 April 2004)

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Rome, July 2004

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**THE PRELIMINARY DRAFT RAIL PROTOCOL TO THE CAPE  
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AND INDUSTRY TO COMPARE NOTES IN THE RUN-UP TO THE  
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(A colloquium organised by the International Institute for the Unification of Private Law (UNIDROIT), the Intergovernmental Organisation for International Carriage by Rail (OTIF) and the Rail Working Group, in co-operation with the Government of POLAND,  
at the Headquarters of the Organisation for the Collaboration between Railways (OSShD OSJD), Warsaw, 15-16 April 2004)

The proposed Rail Protocol to the 2001 Cape Town Convention on International Interests on Mobile Equipment offers a new method of financing rolling stock which should serve to increase the number of funders willing to finance of rolling stock and decrease the cost of the finance due to reduced risks and a greater number of funding sources ready to invest in this market. The Rail Protocol will work by extending to both passenger, freight and other rolling stock, the concept of a international security interest created in an asset which will be recognised in every country which signs and ratifies the Convention and Protocol. In so doing, it will protect the manufacturer selling the equipment on credit, where it takes a reservation on title, protect the banks lending against the rolling stock when taking security on the assets as well as a lessor (and lessee) of rolling stock. Each of these parties will be able to register its interest at an international registry accessible "24/7" via the Internet. By

guaranteeing the priority of the creditor, it will facilitate secure financing and by having the security registered in an open registry, it will facilitate other parties being able to check status of specific items of rolling stock. The Protocol will also give additional remedies to creditors if monies due are not paid by the debtor both in relation to interim relief and final judgements as well as offering some new support if debtors become insolvent.

At the moment this is a project but well advanced. Government experts are currently considering the draft Protocol (three meetings have already taken place) and the final version of the Protocol should go to a diplomatic Conference for approval in 2005.

## PROGRAMME

### Thursday 15 April 2004

- 8.30 a.m. *Distribution of badges and documentation*
- 9.00 a.m. *Opening*
- Welcome from OSShD OSJD – *Feng Lingyun, Deputy Chairman of the Committee*
  - Welcome from UNIDROIT – *Herbert Kronke, Secretary General of UNIDROIT*
  - Welcome from OTIF – *Gerfried Mutz, Deputy to the Director General of OTIF*
- 9.30 a.m. *Introductory session*
- Objectives and Main Features of the Cape Town Convention on International Interests in Mobile Equipment - An Overview – *Herbert Kronke, Secretary General of UNIDROIT*
  - The fundamentals of asset-based financing from the perspective of a lender/lessor – *Michael Jung, First Vice President, KfW Kreditanstalt für Wiederaufbau*
- 10.30 a.m. *Morning refreshments*
- 11.00 a.m. – The case for a Rail Protocol: the role of the Rail Working Group and the view of the rail sector – *Howard Rosen, Solicitor; Chairman of the Rail Working Group*
- Practical interest of the future Rail Protocol from the points of view of:*
- Manufacturers – *Marie-Josée Riverin, Director Contracts, Bombardier Transportation*
  - Operators and financiers – *Mark Stevenson, Deputy Managing Director & Finance Director, Ahaus Alstätter Eisenbahn*
- 12.30 p.m. *Luncheon*
- 2.00 p.m. *Specific issues of particular importance under the preliminary draft Rail Protocol*
- Definition and identification of railway rolling stock (Articles I(2)(g) and 5) – *Henrik Kjellin, Ministry of Justice,*

*Sweden; Co-Chairman of the Rail Registry Task Force*

- Specific Remedies – *Howard Rosen, Solicitor; Chairman of the Rail Working Group*
  - Reconciling private financing with EU bankruptcy regime – *Jérôme Carriat, Administrator, European Commission, Directorate-General Justice and Home Affairs*
- 3.00 p.m. *Question-and-answer session*
- 3.30 p.m. *Afternoon refreshments*
- 4.00 p.m. *Specific issues of particular importance under the preliminary draft Rail Protocol (continued)*
- Public service exemptions – *Christoph Henrichs (Federal Ministry of Justice, Germany)*
  - Registration system
    - (i) Supervisor and Registrar – *Gerfried Mutz, Deputy to the Director General of OTIF*
    - (ii) Integration with existing registries – *Henrik Kjellin (Ministry of Justice, Sweden; Co-Chairman of the Rail Registry Task Force))*
- 5.15 p.m. *Question-and-answer session*
- 6.00 p.m. *Cocktail reception offered by Bombardier Transportation*

### Friday 16 April 2004

- 9.30 a.m. *Round table on the application of the Rail Protocol to Central and Eastern European countries – Why it makes sense*
- Speakers of the previous sessions as well as representatives of countries in the region*
- 11.00 a.m. *Morning refreshments*
- 11.30 a.m. *Round table (continued)*
- 12.00 a.m. *Conclusions and closing ceremony*

## **The Preliminary Draft Rail Protocol to the Cape Town Convention on International Interests in Mobile Equipment \***

AN OPPORTUNITY FOR GOVERNMENT AND INDUSTRY TO COMPARE NOTES IN THE RUN-UP TO THE DIPLOMATIC CONFERENCE – Colloquium organized by UNIDROIT, the Intergovernmental Organisation for International Carriage by Rail (OTIF) and the Rail Working Group, in cooperation with the Government of Poland, at the Headquarters of the Organization for the Collaboration between Railways (OSShD OSJD), Warsaw, 15-16 April 2004.

At the Third Joint Session of the Committee of Governmental Experts for the Preparation of a Draft Protocol to the Convention on International Interests in Mobile Equipment (hereinafter referred to as the *Convention*) on Matters Specific to Railway Rolling Stock (hereinafter referred to as the *Protocol*), and furthermore in view of the Diplomatic Conference for the adoption of the Protocol scheduled to be held in 2005, it was established that political awareness of the Convention and the Protocol should further be promoted by organizing seminars in those regions where most benefit could be expected from the Convention in relation to railway rolling stock. Providing representatives of Governments, railway operators, manufacturers, financiers and practising lawyers with the opportunity to compare notes on the adequacy or otherwise of the solutions advocated in the Protocol thus was believed to foster the interest of those States so far not involved in the project.

The very first of several colloquia to be held in various regions of the world by UNIDROIT, the Intergovernmental Organisation for International Carriage by Rail (OTIF) and the Rail Working Group focused on the countries of Central and Eastern Europe and, suitably, was held in Warsaw at the Headquarters of the Organization for the Collaboration between Railways (OSShD OSJD) on 15 and 16 April 2004. The colloquium, which was organized in

cooperation with the Government of Poland, was attended by a wide range of representatives both of Governments and the national rail industries of several mainly Central and Eastern European States,<sup>1</sup> as well as by several intergovernmental, international non-governmental and other organisations.<sup>2</sup>

The colloquium was opened by Mr F. Lingyun (Deputy Chairman of the OSJD Committee), Mr H. Kronke (Secretary General of UNIDROIT) and Mr G. Mutz (Deputy to the Director General of OTIF). While Mr Lingyun focused on the close cooperation between OSJD and OTIF in the development and improvement of international railway systems between Europe and Asia, Mr Kronke emphasised that the broader and in-depth analysis of the various economic and technical aspects of the Protocol, envisaged for the Warsaw colloquium, would be of considerable benefit in the run-up to the Diplomatic Conference for adoption of the Protocol scheduled for 2005. Finally Mr Mutz, in his opening statement, placed emphasis on the fact that government funding and guarantees in the railway sector would sooner or later cease to be the backbone of railway finance due to budgetary constraints and international competition law. Consequently, new methods for the financing of railway rolling stock would be required in future, one of them being the concept of asset based financing to be implemented by both the Convention and the Protocol.

The business of the colloquium was divided into four parts. In the introductory part, chaired by Mr W. Jarosiewicz (Director of the Polish Ministry of Infrastructure), firstly Mr Kronke outlined the objectives and main features of the Convention. Reporting on the present status of the Convention in respect of

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\* This notice will be published in the next issue of the Uniform Law Review/Revue de droit uniforme (issue 2004-2).

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<sup>1</sup> Bulgaria, Canada Croatia, Czech Republic, Germany, Hungary, Latvia, Poland, Romania, Russian Federation, Serbia and Montenegro, Slovak Republic, Ukraine, Sweden and Switzerland.

<sup>2</sup> Community of European Railways (CER), Commission of the European Communities, European Investment Bank (EIB) and OSJD.

signatures and ratifications, he expressed his delight in announcing that a U.S. Senate Committee had very recently recommended ratification of the Convention. Next, Mr M. Jung (First Vice President, Kreditanstalt für Wiederaufbau) outlined the fundamentals of asset based financing from the lender and lessor perspective. He particularly noted that there was a hefty backlog in the renewal of increasingly out-dated rolling stock in the countries of Central and Eastern Europe which, together with the looming end of traditional railway financing, demonstrated a strong demand for asset backed rolling stock finance. Finally, Mr H. Rosen (Chairman of the Rail Working Group) delineated the Working Group's role and the view of the rail sector with regard to the Protocol. He especially pointed out that the Protocol, by providing a new internationally protected type of security interest and a registry in which such interest could be recorded with consequent priority rights, would attract far more investors in the rail sector than hitherto and thus increase the sources of capital available for investment in new rolling stock, thereby at the same time reducing funding rates and lowering market entry barriers for private operators. Furthermore, bringing about a level playing field with aircraft and truck finance would significantly improve rail's competitive position in line with the European Union Transport Policy for 2010, which establishes the necessity of developing rail transport into one of the leading players in the transport system within the enlarged European Union.

The second part of the colloquium, chaired by Mr K. Kulesza (Head of Division, Railway Department, Polish Ministry of Infrastructure), highlighted the practical interest in the future Protocol from the points of view of manufacturers, operators and financiers. Ms M.-J. Riverin (Director Contracts, Bombardier Transportation), representing a manufacturer's view, pointed out that, under the Protocol, such rolling stock as was usable on different networks, due to its technical specification, would be especially suitable for operating lease concepts. It was her view that the greatest challenge ahead would be to achieve a sufficient number of ratifications of the Protocol to make an impact on the individual markets. Subsequently, Mr M. Stevenson (Deputy Managing Director & Finance Director, Ahaus Alstätter Eisenbahn)

examined the implications of the Protocol for operators and financiers. He especially drew attention to the fact that, there being a lack of a valid pan-European security concept, it was presently almost impossible to secure the financing of rolling stock on an asset-specific basis. The introduction of an asset registry under the Protocol would annihilate this shortcoming and thus significantly drive down railway operators' funding costs. The linchpin for the success of the entire project would be the way in which security interests were registered and the costs involved thereby.

The third part of the programme was chaired by Mr Kronke and dealt with several issues of particular importance arising under the Protocol. The first issue thereby taken up was that of the definition and identification of railway rolling stock under the Protocol and the Convention. Mr H. Kjellin (Swedish Ministry of Justice and Co-Chairman of the Rail Registry Task Force) stressed that Article I paragraph 2 (g) of the Protocol provided an adequate definition of railway rolling stock, excluding spare parts and objects not affixed to a railway vehicle, as well as railway infrastructure. Furthermore, he noted that, by allowing States to opt for the identification of an item of railway rolling stock by way of associating its identification number in the International Registry with a national or regional identification number already affixed to the respective item, Article V of the Protocol would put in place a cost-effective system for the identification of railway rolling stock, which at the same time would present the benefit of ensuring compatibility with existing or future national or regional systems of registration.

The second issue taken up was that of the specific default remedies created by the Protocol. In his second presentation at the colloquium, Mr Rosen particularly dwelt upon the modifications of the Convention remedies by the Protocol, which, inter alia, provides that any court order authorising the creditor to take possession of an item of railway rolling stock may also require the debtor to facilitate the creditor's exercise of its respective repossession rights (Article VII paragraph 1 of the Protocol). Mr Rosen suggested that this additional default remedy granted by the Protocol would prove to be of major significance in respect of the provision

of traction to a suitable delivery point. Moreover, he emphasized that Article VIII paragraph 2 of the Protocol deviated from the Convention inasmuch as it did not require debtor consent before a creditor could exercise its rights for interim relief. Finally, in respect of the remedies in case of bankruptcy established by Article IX of the Protocol, Mr Rosen pointed out that it was imperative for these rights to be exercised in a manner compatible with international bankruptcy rules.

Next, Mr J. Carriat (Administrator, European Commission, Directorate-General Justice and Home Affairs) elaborated upon the relationship between the Cape Town regimen and the EU bankruptcy regimen, thereby stressing the European Community's exclusive competence to negotiate, on behalf of its member States, for the adoption of the Protocol within the scope of application of existing Community insolvency legislation. Nevertheless, as the remedies on insolvency established by the Protocol could be reconciled with the European Insolvency Regulation (Regulation (EC) No 1346/2000) due to the flexibility introduced into the Protocol by way of the system of possible opt-in declarations, Mr Carriat concluded that the European Commission would support the Protocol and cooperate actively in view of its adoption at a Diplomatic Conference in 2005.

Mr Chr. Henrichs (German Federal Ministry of Justice) then dealt extensively with the public service exemptions under the Protocol. Pointing out that the railway companies were not only players in the financial markets but also providers of transport as a public service, he explained that, under Article XXV of the Protocol, States had the greatest possible flexibility in striking a balance between the creditor's interest to exercise its remedies in the case of debtor default on the one hand, and the policy interest to maintain the public functions of rail transport on the other. Although in theory practically all railway rolling stock used for transporting the public could be exempted from a creditor's remedies under the Protocol, Mr Henrichs concluded that the market conditions for the financing of rolling stock would provide an efficient counter-balance due to the fact that broad national exemptions would diminish the value of the international security interest

and thus at the same time increase the cost of borrowing.

The fifth issue taken up was that of the registration system. Mr Mutz outlined the function and tasks of the Supervisory Authority and the Registrar under the Convention and the Protocol, thereby emphasising that the Supervisory Authority, although designed to appoint and (where necessary) dismiss the Registrar and oversee its operation of the International Registry, was not entitled to give specific directions to the Registrar to change any data relating to a registration. In respect of the fees to be charged for the services of the International Registry, Mr Mutz pointed out that one of the main tasks ahead would be to assess and determine factors to be taken into account in the establishment of a satisfactory fee structure.

At the end of the third part of the programme ample opportunity was given to the participants of the colloquium to raise questions from the floor. Thereafter this first day of the colloquium was concluded in style with a cocktail reception very much appreciated by all the participants who utilised the opportunity for a personal exchange of views on the implications of the Protocol and the necessity of its implementation in due course.

The fourth and final part of the colloquium was designed as a round table talk on the application of the Protocol to the countries of Central and Eastern Europe. Mr S. Soltysinski (member of the Governing Council of UNIDROIT, Soltysinski Kawecki & Szlezak Legal Advisers, Warsaw) first gave an introduction to the new Polish law on secured transactions which provides for a registered pledge widely available for commercial purposes. However, as the 1996 Polish Act on Registered Pledges and Register of Pledges excludes non-bank foreign creditors that do not carry out business in Poland, he pointed out that foreign creditors would find it rather difficult to enjoy the benefits of the newly introduced registered pledge. With regard to the Protocol Mr Soltysinski firstly reminded the colloquium participants that in the long run EU competition law would phase out State subsidies in the rail sector; secondly, that State budgets were dwindling; and thirdly, that it was the intention of the European

Commission to provide for intramodal competition in the railway sector. He therefore argued that private sector financing was indispensable and the problems involved with it presently would be significantly alleviated once the Protocol came into force.

One issue of major importance to the participants from the various countries of Eastern Europe was that the costs involved in the operation of the Protocol needed to be kept minimal, in particular those for registration and the unique identification of rolling stock. If plates had to be affixed to every single item of railway rolling stock this could easily absorb the economic benefits brought about by the proposed new international regimen. On the other hand it was also positively noted that borrowing costs would most probably decrease in future due to risk reduction for lenders already involved in the rolling stock market, and the attraction to the rolling stock market of those lenders who presently were not prepared to enter the market. In line with this it was suggested that present loan agreements should provide for the reduction of loan interest if the Protocol were to come into force.

In respect of the possible public service exemptions under the Protocol it was pointed out that governments should be very thoughtful when excluding railway rolling stock from the scope of the creditor's rights as such an exclusion would have the potential to undermine the principal philosophy underlying the Protocol. In this context the question was also raised as to whether the State should not be placed under an obligation to compensate a creditor in the event of the State opting into one of the respective public service exemptions and thus cutting off the creditor's respective rights under the Protocol.

In his concluding remarks, Mr Mutz thanked the organisers for their efforts in preparing the colloquium. He also appealed to all participants to take an active part in furthering work on the Protocol in the run-up to the Diplomatic Conference scheduled for 2005.

Benjamin B. von Bodungen  
Research Assistant  
University of Mannheim

## **Welcome by the Deputy Chairman of the OSJD Committee**

### ***Mr Feng Lingyun***

Dear Mr Gerfried Mutz,  
Dear Mr Herbert Kronke,  
Dear Ladies and Gentlemen,

On behalf of the Chairman of the Committee of the Organization for Cooperation between Railways, let me extend a cordial welcome to all the participants in the Regional Seminar, which we are glad to receive in the Committee. We will try our best to provide you with all the necessary facilities and conference equipment.

Organization for Cooperation between Railways (OSJD) consists of number of railways from 25 States of the Eurasian region with operational line length of about 300.000 km, more than 4 bln ton annual volumes of carried goods and 3,3 bln served passengers. Structurally the Organization comprises six observers and several affiliated enterprises as well.

The OSJD activities are aimed at developments and improvement of international railway systems between Europe and Asia, elaboration of unified legal basis and complex services in the fields of railway transportation.

Today, OSJD railway network comprises 13 transports corridors with main lines constructed on common technical and operational criteria, necessary for speed and high-speed traffic. Lately the OSJD railways witnessed the influx of investments into infrastructure, significant increase of traffic capacity and a tendency towards stable growth of goods and passengers volumes.

OSJD plays special attention to cooperation with other international organizations, and it's been a long time that OSJD has been working together with the Intergovernmental Organisation for International Carriage by Rail (OTIF) with harmonization of the SMGS and CIM legal systems as the main objective. Discussions on the matter started in 1982. In 1991, they resulted in an agreement on the cooperation between the two participating organizations. In the year 2000, the

hands of the organizations decided to initiate elaboration of Common Standpoint, the document which stipulated corporation as activities, aimed at development of an effective railway legal system and increase of competitiveness of railways in the international transport market. With realization of the necessity to develop international railway traffic, eliminate obstacles and solve practical and technical problems, both organizations have coordinated paces for the future co-operation process. Thus, "Cooperation between OSJD and OTIF. Common Standpoint" was initiated 12 February 2003.

In cooperation with UN ESCAP, OSJD managed to perform demonstration runs of container block trains in traffic with Europe - Asia, thus showing considerable success both in increase of speed and, consequently, reduction of travelling time. For example: it took only nine days and 16 hours for a train to cover the distance from the Nakhodka border station (Russia) to the Buslawskaya border station (Finland) with average speed of 1020 km per day.

At the same time OSJD cooperates with UN ECE, UIC and other international institutes and organizations, which allowed to hold the Sixth Interdepartmental conference in order to discuss border crossing issues and methods of reduction of standing time of trains at border crossing stations. The events provided customs, border and railway bodies with an opportunity to discuss and take certain decisions to facilitate border crossing.

If we manage to agree on issues concerning standing time of trains at border crossing stations, the travelling time of a train in international traffic will be reduced significantly, which will have a favorable effect on competitive capacity of railways in comparison to other means of transport. Anyway joint activities and cooperation between OSJD and OTIF will lead us to inevitably favorable results and success.

In conclusion, I would like to which could like and success in all the initiatives and endeavours to all the participants in the Regional Seminar.

## **Welcome by the Secretary-General of UNIDROIT**

### ***Mr Herbert Kronke***

Mr Jarosiewicz,  
Ms Szymanska,  
Mr Feng Lingyun,  
Mr Mutz,  
Ladies and Gentlemen,  
Colleagues and Friends,

On behalf of UNIDROIT I should like to express our sincere gratitude to the Government of Poland for co-sponsoring and to the OSShd for hosting this seminar. To all participants and speakers a cordial welcome and to Mr Mutz, Deputy Director General of our partner Organisation OTIF, heartfelt thanks for having again efficiently shared the burden of organising this event.

The seminar is designed to provide an opportunity for Governments, railway operators, manufacturers, financiers and practising lawyers as well as export credit agencies to compare notes and to prepare for the Diplomatic Conference for the adoption of the Protocol to the Cape Town Convention on Matters Specific to Railway Rolling Stock.

The Diplomatic Conference is to be held in 2005. Experience shows that formal intergovernmental consultations and in particular a Diplomatic Conference for the adoption of a legal text benefit from broader and in-depth analysis of the underlying economic and technical aspects of the future instrument. We organised three regional seminars on the base Convention and the Aircraft Protocol in the run-up to Cape Town and the quality of the discussions in Cape Town was clear evidence that that had been the right approach. The draft Rail Protocol has so far had even less exposure outside the joint UNIDROIT/ OTIF sessions of a committee of governmental experts than the Aircraft Protocol had prior to the Diplomatic Conference. Moreover, only a relatively small number of delegations from Central and Eastern Europe, the Baltic as well as the CIS member States participated in the three sessions of governmental experts. This is why Warsaw will be the first round and a template for similar seminars in other regions of the world.

Experts advised us that Poland was not only an exceedingly important market for rail equipment but also a country where the Ministries, the rail operator and others were currently engaged in mapping out the future of rail transportation development and financing. Obviously, we did not need advice that Warsaw was a beautiful city and the lively metropolis of the region and that it would therefore be a very attractive venue for this conference. The attendance this morning is proof that it was an excellent choice. Ladies and gentlemen, I wish us all interesting and fruitful discussions.

## **Welcome by the Deputy to the Director General of OTIF**

***Mr Gerfried Mutz***

Mr. Secretary General,  
Ladies and Gentlemen!

At the opening of this colloquium on a draft Protocol to the Cape Town Convention on Matters specific to Railway Rolling Stock, I would like, on behalf of my Organisation, the Intergovernmental Organisation for International Carriage by Rail (OTIF) and its Director general whom I have the honour to represent, and finally in a personal capacity to extend to all of you a warm welcome here in Warsaw and to thank everyone in this room for coming. Mr. Isliker regrets very much that he is unable to be present today, due to other urgent commitments.

This Colloquium on a draft Protocol on Matters specific to Railway Rolling Stock is organised jointly by the OTIF secretariat, the UNIDROIT secretariat and the Government of Poland.

The proposed Rail Protocol to the 2001 Cape Town Convention on International Interests on Mobile Equipment offers a new method of asset based financing of rolling stock. This newly created tool should serve to increase the number of funders willing to finance rolling stock and decrease the cost of the finance due to reduced risks. The current system of financing rolling stock by government funding or government guaranties will come to an end one day or the other. In the long run, governments will not be willing to grant the necessary loans and the system is not compatible with international competition law.

The concept of a international security interest which will be recognised in every country which signs and ratifies the Convention and Protocol will protect the manufacturer selling the equipment on credit, protect the banks lending against the rolling stock as well as lessors of rolling stock. The Protocol will also give additional remedies to creditors if sums due are not paid by the debtor both in relation to interim relief and final judgements. It will offer some new support if debtors become insolvent.

At the moment this is a project but well advanced. Government experts are currently considering the draft Protocol (three meetings have already taken place) and the final version of the Protocol should go to a diplomatic Conference for approval hopefully in 2005.

Finally I would like to thank all the speakers for their efforts, the Polish Ministry for Infrastructure and the OSJD for the hospitality they are granting us for this colloquium.

**OBJECTIVES AND MAIN FEATURES OF THE CAPE TOWN CONVENTION ON  
INTERNATIONAL INTERESTS IN MOBILE EQUIPMENT – AN OVERVIEW**

Herbert Kronke

Secretary-General of UNIDROIT

## I. - The Conflict-of-Laws Rules as Source of Uncertainty

### France

Seller under reservation of title



### Netherlands

Buyer operates equipment  
Buyer grants rights to possession and control to Hungarian subsidiary



### Hungary



### Turkey



## II. – Intergovernmental Consultation Process

1. Working Model
  - a) Traditional
  - b) „Commercial Approach“
2. Objectives
  - a) Risk analysis
  - b) Predictability
  - c) Role of Rating Agencies
  - d) Win-win-win situation

### III. – The instruments

1. Two-tiered structure:  
Convention and Protocols
2. Aircraft Equipment (co-sponsor ICAO)
3. Railway Rolling Stock (co-sponsor OTIF)
4. Space Assets
5. Future

### IV. – Sphere of Application

1. International Interest Defined
2. High Value – Highly Mobile
3. International Registry as Prerequisite  
(details infra VI.)

## **V. – Details and Policy Implications**

1. Terminology
2. Party Autonomy
3. Relationship Convention Interest / National Interest
4. Default Remedies
5. Priorities
6. Insolvency

## **VI. – The Registry System**

1. Fully electronic
2. 24 hrs/day and 365 days/year
3. Asset based
4. Notice Filing

## **VII. – Non-Consensual Rights and Interests**

1. Article 39
2. Article 40
3. Article 16 (1) (a)

## **VII. – Non-Consensual Rights and Interests**

1. Articles 50, 52 - 58
2. Uniform Law – Desirability ?
3. Political and Economic Rationale

## **IX. – Jurisdiction**

1. Articles 42, 43
2. Article 44
3. Article 45 – Article X Rail Protocol
4. Article XIX, Rail Protocol

## X. - Conclusions

1. National and International Reactions
2. EXIMBANK letter
3. Signatures and Ratifications

## Bibliographic Entry Points

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Updated bibliography in every issue
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3. *Henrichs*, Das Übereinkommen über internationale Sicherungsrechte an beweglicher Ausrüstung, Prxis des internationalen Privat- und Verfahrensrechts - IPRax 2003, pp. 210 et seq.  
(German text of instruments pp. 276-297)
4. *Graham-Siegenthaler*, Neuere Entwicklungen im internationalen Kreditsicherungsrecht, Aktuelle Juristische Praxis/Pratique Juridique Actuelle – AJP/PJA 2004, pp. 291-309

**THE FUNDAMENTALS OF ASSET-BASED FINANCING FROM THE PERSPECTIVE OF A  
LENDER/LESSOR**

Michael Jung

First Vice President, KfW Kreditanstalt für Wiederaufbau



## Asset based Financing for Rolling Stock A Banker's View

Seminar for CEEC on the  
UNIDROIT draft Rail Protocol  
Warsaw, April 15/16, 2004



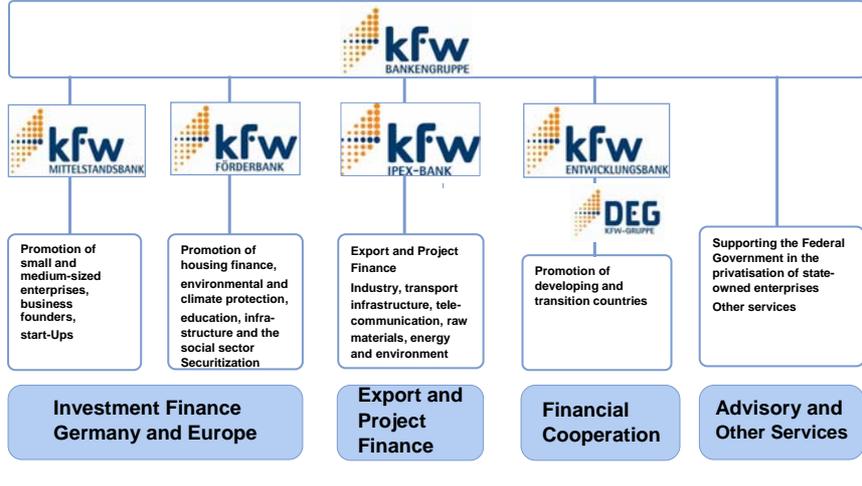
## KfW Group - Overview



<b>Established:</b>	<b>by law in 1948</b>
<b>Shareholders:</b>	<b>80% Federal Republic 20% Federal States</b>
<b>Headquarter:</b>	<b>Frankfurt am Main</b>
<b>Branch Office:</b>	<b>Berlin, Bonn, Cologne (DEG)</b>
<b>Foreign offices:</b>	<b>Brussels and 26 offices in developing and industrializing countries</b>
<b>Liabile Equity</b>	<b>EUR 10.4 billion*</b>
<b>Balance-Sheet Total</b>	<b>EUR 315 billion*</b>
<b>Rating</b>	<b>AAA / Aaa</b>
<b>Employees</b>	<b>3,600</b>

\* figures as of Dec. 31st, 2003, liable equity: regarding KfW

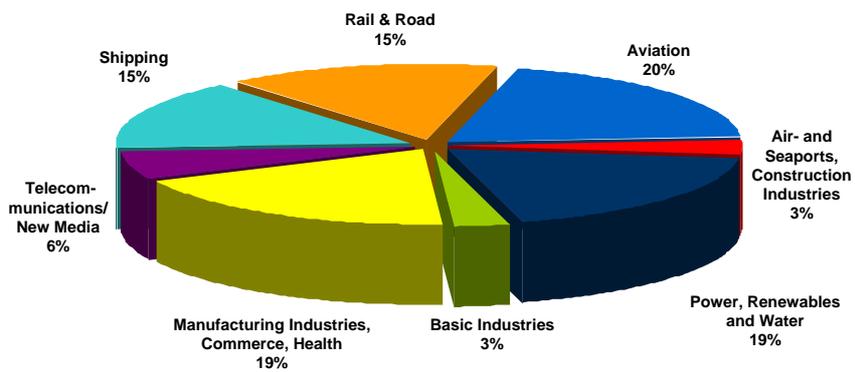
## KfW Group - New Brand Structure



3

## Portfolio

Total Volume as of Dec. 31, 2003: € 66.4 billion\*

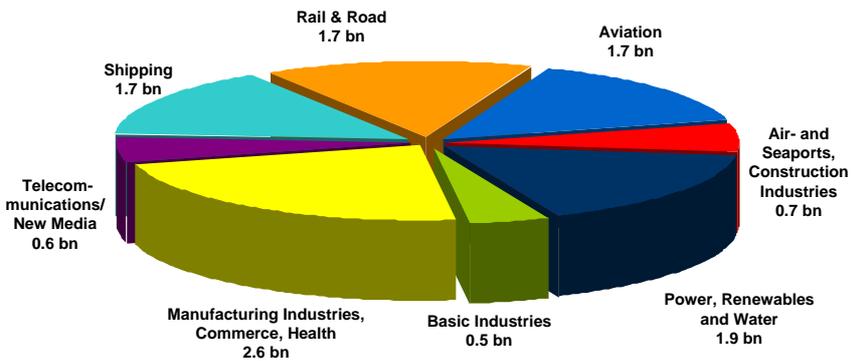


\* incl. domestic project/structured finance

4

## New Commitments 2003

Total Volume as of Dec. 31, 2003: € 11.4 billion\*



\* incl. domestic project/structured finance

5



6

## Our approach to financing (1)



### Our business scope:

We offer tailor-made credit products for the financing of:

- Rolling stock
- Railway infrastructure incl. signaling and communication systems
- MRT and bus systems
- Road infrastructure (incl. bridges and tunnels)
- Commercial vehicles
- Logistics

Among other things financed up to now: approx. 10,000 freight cars, 1,500 locomotives, 350 EMU's/DMU's; 175 Bi-level cars and 100 metro train-sets.

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## Our approach to financing (2)



### Our credit products:

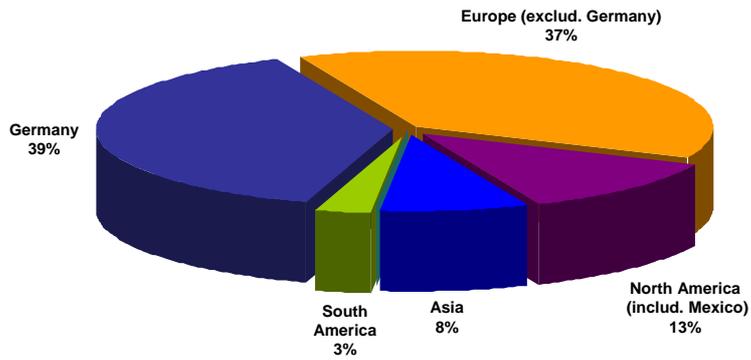
- Direct loans for sovereign and private investments (secured and / or unsecured)
- Export loans: uncovered and / or covered by various ECAs
- Finance, operating and tax leases in various jurisdictions
- Project financing
- Residual value risk financing
- LCs for selected transactions

These products can be offered in EURO, USD and all other major currencies to match customer requirements.

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## Our Portfolio by Regions

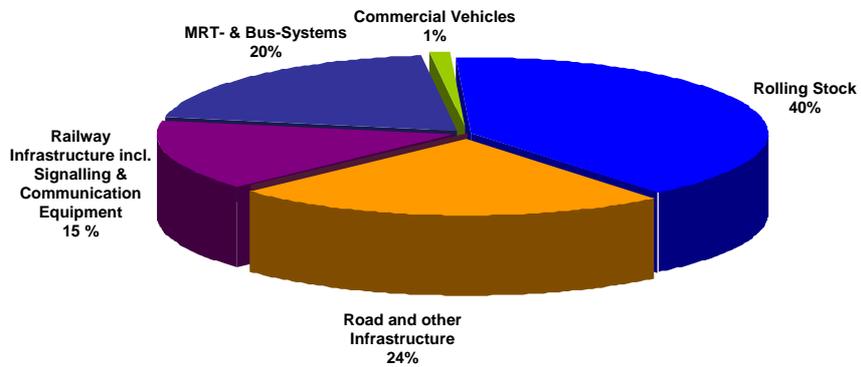
as of Dec. 31, 2003: € 10.0 bn



9

## Portfolio by Assets

as of Dec. 31, 2003: € 10.0 bn



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## KfW rail finance track record CEEC Countries



### Total volume of projects financed 1995-2003 in CEEC > EUR 1 bn

- **Czech Republic:**
  - ↳ Track rehabilitation of corridor I + II
  - ↳ New tilting trains
- **Slovak Republic:**
  - ↳ Track rehabilitation
  - ↳ Refurbishment of freight cars
- **Hungary:**
  - ↳ Track upgrade and electrification
  - ↳ New Track to border crossing with Slovenia
  - ↳ Refurbishment of rolling stock
  - ↳ New rolling stock ( DMUs, coaches, dual-system locomotives)
- **Slovenia:**
  - ↳ Border crossing to Hungary
  - ↳ Signalling equipment
- **Croatia**
  - ↳ Track maintenance / rehabilitation, spare parts, rails, switches

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## CEEC railways—backlog in rolling stock renewal



### Situation:

- Average age of freight cars > 27 years
- 95% of locomotives > 15 years
- Most EMUs / DMUs > 20 years (oldest 40 years)
- Few new passenger coaches after 1990

### Results:

- Dramatically declining passenger and freight volumes
- Cannibalizing redundant equipment
- No long-term rolling-stock replacement strategy visible

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## End of traditional railway financing



- Cash flow not sufficient to finance all replacements needs
  - Insufficient Government subsidies due to budget constraints
  - Limited / no sovereign guarantees due to accession criteria / IMF covenants
  - Eurofima financing requires sovereign guarantees
  - Commercialisation /Privatization of Railroads terminates outright Government support
  - Weak balance-sheets allow only limited on balance bank financing
- ➔ Strong need for asset backed / based financing

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## Asset backed / based – Getting the right understanding



- **Asset backed:** the asset is on the balance sheet of the Railway or a leasing company and serves as a security for the bank
  - **Asset based:** The asset is owned by a SPC and the financing is against the revenue earning capacity of the asset (similar to project finance)
- ➔ Focus here on asset backed financing

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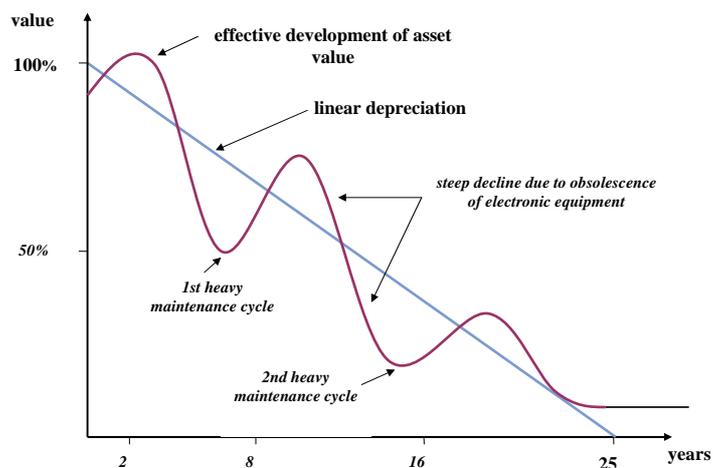
## Asset backed financing Bank's evaluation criteria



1. Borrower, seize + quality of balance-sheet and P&L-Account
2. Direct / indirect government support / intervention
3. Asset quality
  - Certification (not only in 1 country)
  - Specification / marketability
  - Technology (proven, but state of the art)
  - Environmental quality (emission standards / energy recuperation)
  - Reliability (track-record)
  - Purchase price / life cycle cost
  - Asset value – future development / danger of technical obsolescence
4. Insurance
5. Maintenance / Overhaul-concept
6. Operational concept: concession / franchise
7. Legal environment: asset registry, enforceability of asset pledges

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## Typical Asset Value Development



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## Calculating a bankable asset value



**base value**

*∕ provision for market fluctuations*

**= gross proceeds**

*∕ repairer's and workmanship lien*

*∕ cost of repossession of asset*

*∕ cost of storage (track rental / insurance / conservation)*

*∕ cost of repair / repainting / reconfiguration*

*∕ cost of remarketing*

*∕ interest during average remarketing period*

**= net remarketing proceeds of asset**

*∕ country specific provisions*

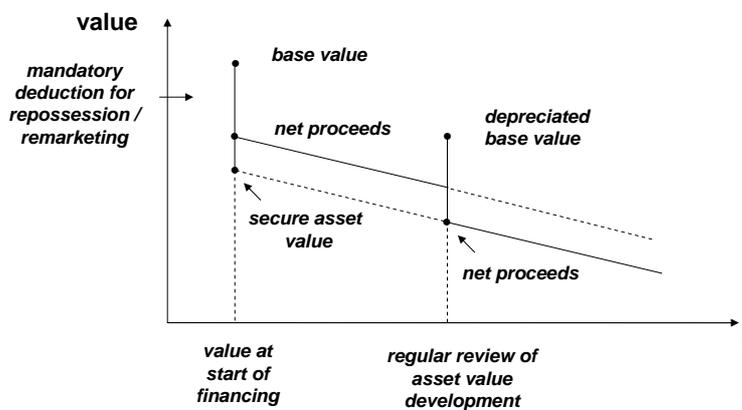
*∕ provision for interdependence of asset value and credit-standing of borrower*

*∕ provision for third party rights / taxes / receiver's fees (e.g. 9% in Germany)*

**= secure asset value**

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## Determining the future asset value



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## Asset repossession cost influence cost of financing



- **Low cost of asset repossession increase bankable asset value**
- **Asset repossession cost are determined by**
  - *Legal system / asset registry / enforcement*
  - *Acknowledgement of asset pledges*
  - *Standardised procedures*
  - *Clear rules for exporting distressed assets (customs rules, access to tracks, provision of loco-drivers etc.)*

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## Why is the Convention / Rail Protocol favorable for asset based financing



- **Unique identification numbers for rolling stock in the centralized International Registry**
- **Clear procedure to take possession, custody or control of asset**
- **Standardized waiting / cure periods**
- **Insolvency assistance by courts of Contracting States**
- **Obligation of insolvency administrator to preserve and maintain the rolling stock, e.g. keep it in operation in order to maintain its value**
- **No sales allowed pending a court decision on international claims**

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## Financing through operate leases



### Operating lessor require:

- Standardised assets (no „golden specs“)
- Technically proven assets with wide market presence
- Stable legal environment (free asset transfer)

### Pros:

- Short-term availability
- No burden to balance sheet
- Risk free return of asset after end of contract
- Vast experience of lessors

### Cons:

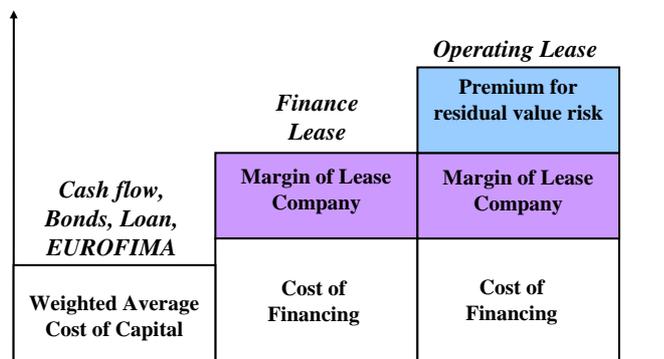
- Higher costs / rentals
- Limited range of operate lease companies (Angel Trains, HSBC Rail, Siemens Dispolok)
- Lessors enter only markets with proven security rights

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## Cost structure of financing options



Cost of financing



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## The appropriate rolling stock financing strategy mix



- Core equipment on balance-sheet with Eurofima, EIB, EBRD, KfW, etc. financing → partially sovereign guarantees required
- Freight cars should be leased from specialised companies like AAE, VTG, KVG, DEC, NACCO, etc.
- Equipment for start-up traffic / short-term transportation contracts should be leased
- Setting up of bi- / multilateral rolling stock procurement agencies
- Sale => refurbishment => lease back of equipment
- Purchase second hand material from „richer“ railroads, refurbish locally

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## Thank you for your kind attention.

### Contact details:

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First Vice President  
Acquisition and Structuring  
Rail & Road Financing  
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Telefax: (+49-69) 7431-2824  
e-Mail: michael.jung@kfw.de

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**THE CASE FOR A RAIL PROTOCOL: THE ROLE OF THE RAIL WORKING GROUP AND  
THE VIEW OF THE RAIL SECTOR**

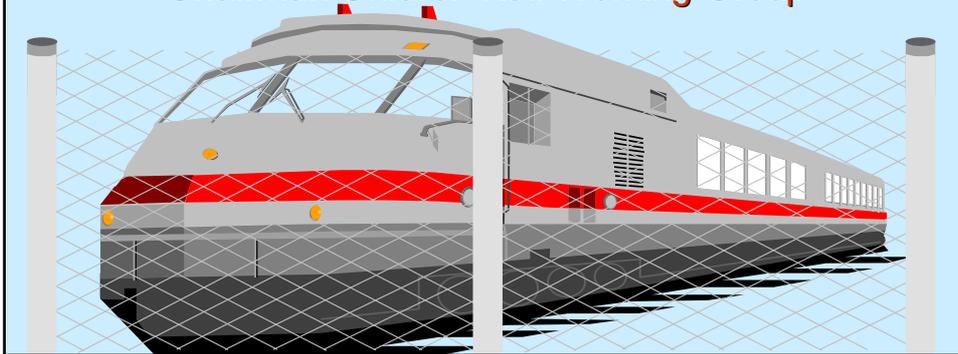
Howard Rosen

Solicitor, Chairman of the Rail Working Group

**The Case for the Rail Protocol  
to the Cape Town Convention**  
The role of the Rail Working Group and the  
view of the rail sector

**15<sup>th</sup> April 2004**

**Howard Rosen, Zug, Switzerland  
Chairman Unidroit Rail Working Group**



**Members of the  
Rail Working Group**

AAE Ahaus Alstatter Eisenbahn • ABB Asset Finance • ADtranz  
(Deutschland) GmbH • Angel Train Contracts Ltd. • Ansaldo Trasporti  
s.p.a. • Association of American Railroads • Bombardier Rail •  
Bruckhaus Westrick Heller Löber • Community of European Railways •  
Costaferroviaria • debis Financial Engineering GmbH • Ermewa  
International • Eurofima • European Investment Bank • Ferroviaria •  
FIAT • Firema • Freehill Hollingdale & Page • Freshfields • GE Capital  
• Howard Rosen Solicitor • HSBC Rail (UK) Ltd. • KfW Kreditanstalt  
for Wiederaufbau • Landesbank Schleswig-Holstein • Lenz & Staehelin  
• McCarthy Tétrault • SNCB SG • Nauta Dutilh • NIB Capital Bank  
N.V. • Theodore Goddard • Transnet Ltd. • Trinity Industries, Inc. •  
UIC International Union of Railways • Union of European Railway  
Industries • Deutsche VerkehrsBank AG • Wiersholm Mellbye & Bech

## Rail Working Group Central Committee

- Chairman: Howard Rosen, Howard Rosen Solicitor, Zug
- Treasurer: Michiel Munting, Angel Trains
- Secretary: Karin Kilbey: HSBC Rail

## Rail Working Group Central Committee

### Other Members:

- Gerfried Mutz, OTIF
- Louise Oddy, Angle Trains
- Anna Tosto, McCarthy Tétrault
- Patrick Honnebier, Utrecht University
- Roger Reinhold, ABB Asset Finance
- Maarten Van Dooren, Nauta Dutilh
- Oliver Ross, Theodore Goddard
- Dr. Konrad Schott, Bruckhaus Westrick Heller Löber

## Cape Town 16<sup>th</sup> November 2001

- Unidroit Convention On International Interests In Mobile Equipment, containing 62 Articles signed
- together with Aviation Protocol (a further 37 articles)
- 5 Resolutions including one supporting the next two protocols on Railway Rolling Stock and Space Assets

## Cape Town October/November 2001



## What the Convention seeks to achieve

- An answer to the Basic Problem - How to finance with security an asset potentially continuously moving across borders?
- Limited security in asset financed due to
  - Local (conflict of) Property Law
  - Local Bankruptcy Law
  - Potential conflict of priorities

## Application of the Treaty

- The Treaty provides a new protected type of security in relation to
  - Lessor's (and lessee's interest) under a lease
  - Vendor retaining title in equipment
  - Lender taking security in an asset financed under a loan

## Application of the Treaty

- The principal concept - an international security interest
- which usually will override conflicting local law interests
- and which will be registrable – and searchable - via the internet in an international registry

## Application of the Treaty

- System of Priorities for competing interests
- Provision also for assignments and prospective interests
- New remedies for interim relief and seizure of assets
- Creditor Protection on bankruptcy

## Why is the Treaty needed for Rolling Stock?

### The General Benefits

## Why is the Treaty needed for Rolling Stock?

- More capital investment required desperately to enable the rail sector to compete
- Financing very difficult if no creditworthy state backing but....
- ..... States skimp on investment
- No public asset based security system at all world-wide
- Extension of the Treaty to the Rail sector
  - will facilitate investment in rolling stock from the private sector into developed as well as lesser developed countries
  - And make existing financing cheaper

## Why is the Treaty needed for Rolling Stock?

- By reducing risk and attracting more banks in the rail sector, funding rates should reduce
- Facilitates funding without state guarantee and therefore increases capital investment (as happened in the UK post 1996)
- Lowers barriers to entry for private operators
- Eliminates substantial legal & insurance costs
- Reduces scope for disputes
- Allows redirection of aid/ECGD facilities

## Why is the Treaty needed for Rolling Stock?

- Improves Rail's competitive position by bringing a level playing field with aircraft and truck finance
- Makes Vendor financing easier and encourages capital investment
- Knock on effect for municipal transportation
- Lowers barriers to entry for private operators – encouraging competition
- Gives security to railways subleasing assets

## Why is the Treaty needed for Rolling Stock?

- Capital investment estimated at \$25 billion per annum
- Simplistically, delta between funding costs of private and public debtors c. 3% (estimated by Swiss private railways) = \$750 mio. per annum
- Multiplier effect: increases demand and facilitates liquidation of existing operator owned assets

## A Lawyer's Viewpoint

- ☹ The Convention will reduce risk and costs
- ☹ It should minimise the risk of disputes in the future
- ☹ Documentation and Legal opinions should be simpler



## Why is the Treaty needed for Rolling Stock?

### The Position in Europe

### The Position in Europe

*With all the various delays, the average speed of international rail haulage is only 18 km/hour, which is slower than an ice-breaker opening up a shipping route through the Baltic Sea!”*

*“Opening up rail transport to regulated competition ..... is the central precondition for revitalising the railways....What is needed is..... A veritable cultural revolution to make rail transport once again competitive enough to remain one of the leading players in the transport system in the enlarged Europe”*

**EU White Paper 2002: European Transport Policy for 2010:  
Time to Decide**

## The Position in Europe

% tkm	EU 15		CEC		US	
	Road	Rail	Road	Rail	Road	Rail
1970	47.9%	32.6%	15.4%	77.3%	22.4%	41.5%
1980	56.4%	25.8%	22.8%	67.8%	23.6%	39.1%
1990	68.0%	18.6%	31.3%	59.1%	27.2%	38.2%
1994	-	-	-	-	26.2%	37.6%
1995	73.3%	14.1%	41.1%	49.8%	27.2%	38.2%
1996	73.4%	14.0%	42.7%	47.7%	29.7%	41.1%
1997	73.2%	14.4%	46.0%	45.1%	31.2%	40.0%
1998	73.7%	14.1%	47.4%	42.2%	-	-

Difference to 100% is inland waterways & pipelines

Source EU DGVII

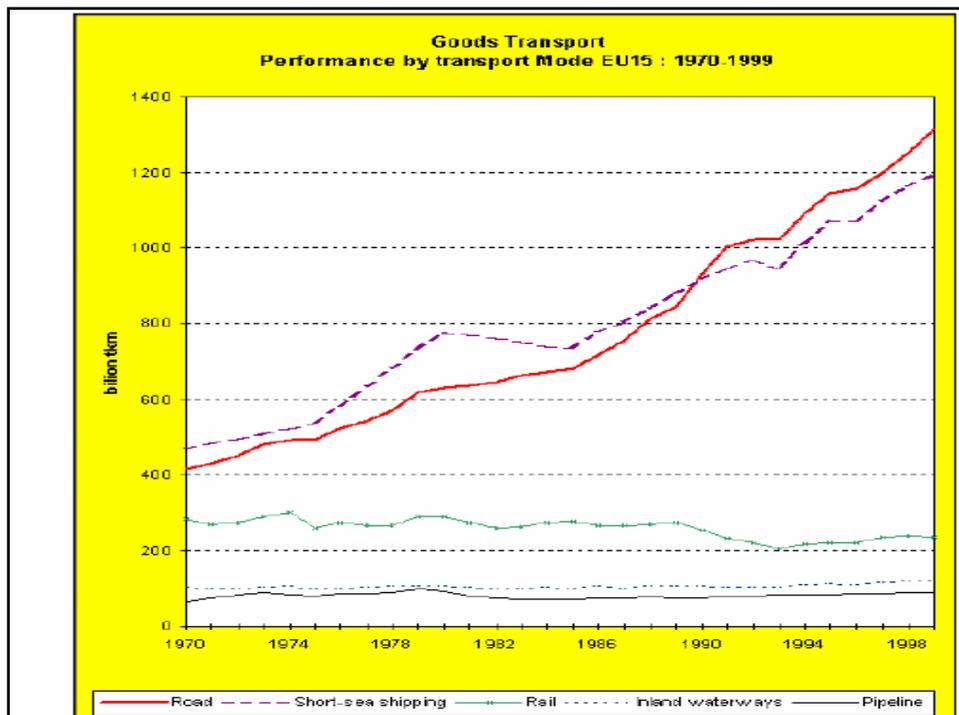
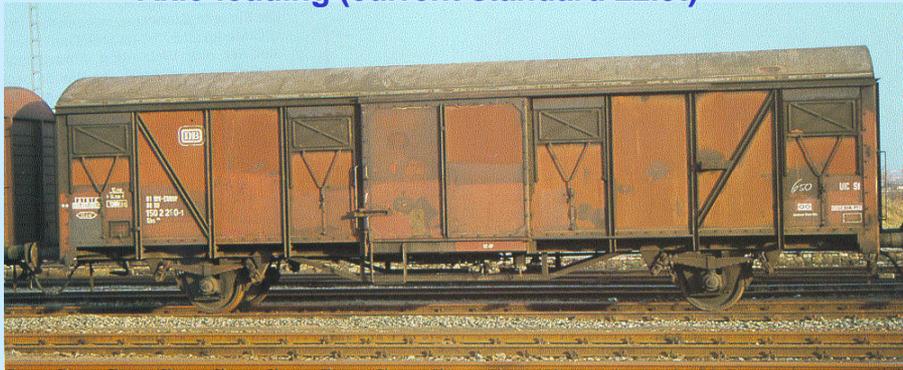
## The Position in Europe

000 Mio tkm	EU 15		CEC		US	
	Road	Rail	Road	Rail	Road	Rail
1970	416	283	55	274	602	1'117
1980	628	287	122	364	810	1'342
1990	932	255	144	270	1'073	1'510
1994	1'097	219	124	159	1'309	1'838
1995	1'146	221	132	169	1'345	1'906
1996	1'152	220	152	168	1'419	1'980
1997	1'205	238	175	168	1'534	1'969
1998	1'207	241	172	153	n/a	n/a
1990-98	30%	(5%)	19%	(43%)	32%	31%
1996-1998	5%	10%	13%	(9%)		

Source EU DGVII

## The Position in Europe

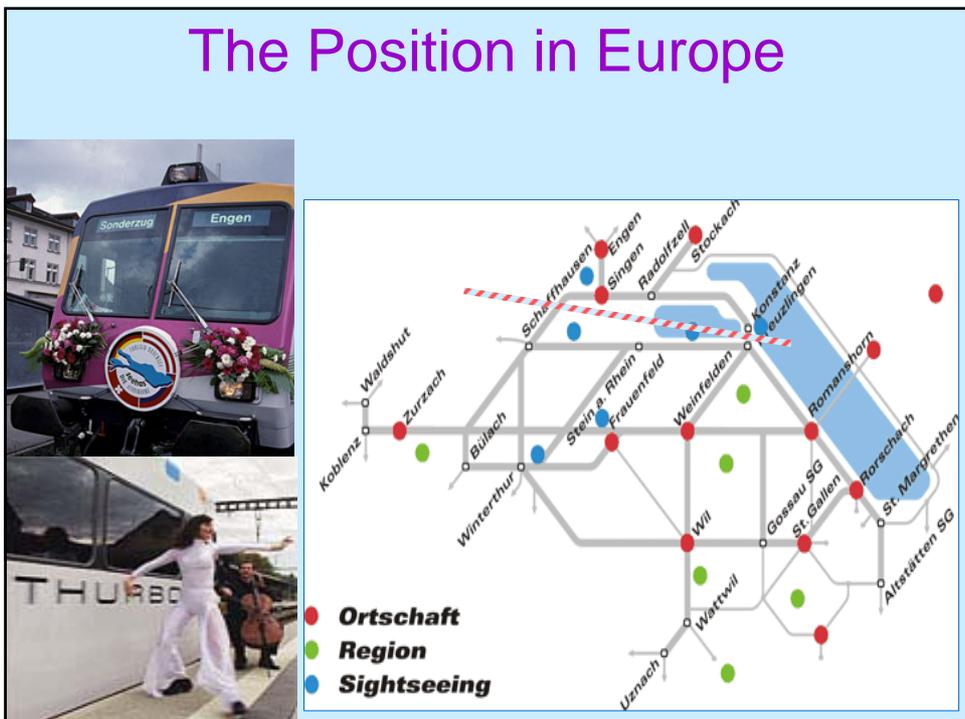
- European freight fleet: average age well over 20 years (usual useful life before major overhaul: 24!)
- Technical obsolescence is primarily a function of:
  - Laden speed (current standard up to 120 km/h)
  - Axle-loading (current standard 22.5t)



# The Position in Europe



# The Position in Europe



## The Position in Europe

- Certain types of rolling stock constantly cross borders
- Rail traffic needs to be more competitive
- Competitive access requires private sector funding
- No registry system (limited in the UK)
- Relatively few banks prepared to lend or lease rolling stock without clear or implicit state guarantee

## The Position in Europe

- Cost of private sector funding higher since fewer banks and higher risks
- Some areas of operations off-limits for banks above a certain level – e.g. Rumania
- Very restricted operating lease environment
- Assets can get lost
- Legal opinions and documentation can be costly

## Summary

- The Rail Protocol will provide a new level of security for asset backed financing in rolling stock
- It will assist by creating an internationally recognised security interest and a registry in which such interest can be recorded with consequent priority rights
- By creating more security it will facilitate financings or make them cheaper thereby in turn encouraging more capital investment

**PRACTICAL INTEREST OF THE FUTURE RAIL PROTOCOL  
FROM THE POINT OF VIEW OF  
MANUFACTURERS**

Marie-Josée Riverin

Director Contracts, Bombardier Transportation

# Unidroit seminar Warsaw

## The manufacturer's view on the Rail Protocol

April 15, 2004



### Agenda

- An introduction to Bombardier Transportation
- A short introduction to financing
- Operating Lease – an overview
- Bombardier's view on the protocol
- The ROSCO's view point
- Major challenges



# An Introduction to Bombardier



-  **Bombardier**
-  **Bombardier Aerospace**
-  **Bombardier Capital**
-  **Bombardier Transportation**



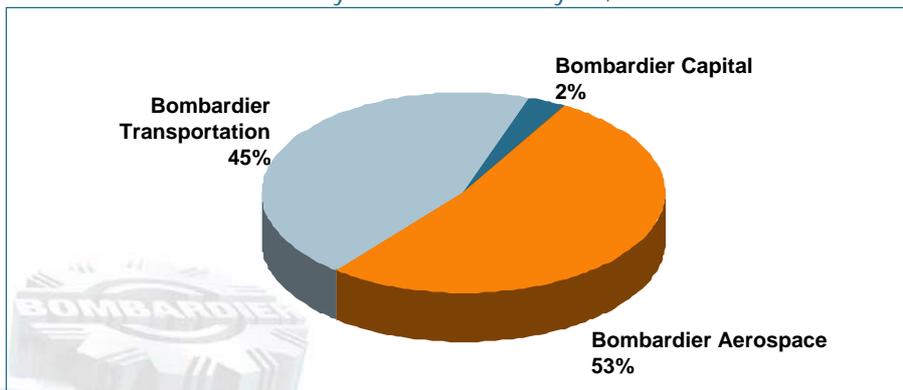
## Bombardier

- Corporate office based in Montréal, Canada
- Workforce of some 63,800 people worldwide
- Revenues of \$21.3 billion for fiscal year ended January 31, 2004
- More than 90% of revenues generated outside Canada
- Stock exchange listings: Toronto, Frankfurt, Brussels



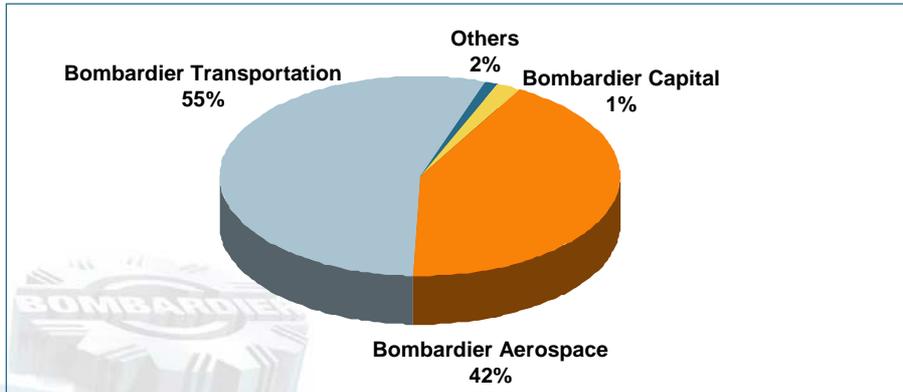
## Bombardier: a diversified company

Breakdown of revenues by product market  
for the year ended January 31, 2004



## Bombardier: a worldwide presence

A workforce of some 63,800 people  
as at January 31, 2004



-  **Bombardier**
-  **Bombardier Aerospace**
-  **Bombardier Capital**
-  **Bombardier Transportation**



Bombardier Aerospace is a world leader in the design and manufacture of innovative aviation products and services for the regional, business and amphibious aircraft markets. It also offers *Bombardier\* Flexjet\** fractional ownership, aircraft charter and management, technical services, aircraft maintenance and pilot training for business and regional airline.

\*Trademark(s) of Bombardier Inc. or its subsidiaries.



## Bombardier regional aircraft



**Bombardier\* Q100/200\***



**Bombardier\* Q300\***



**Bombardier\* Q400\***



**Bombardier\* CRJ200\***



**Bombardier\* CRJ700\***



**Bombardier\* CRJ900\***

\* Trademark(s) of Bombardier Inc. or its subsidiaries.



## Bombardier business aircraft



**Bombardier\***  
**Learjet\* 40**



**Bombardier**  
**Learjet 45**



**Bombardier**  
**Learjet 60**



**Bombardier**  
**Learjet 45 XR**



**Bombardier\***  
**Challenger\* 604**



**Bombardier**  
**Challenger 300**



**Bombardier**  
**Challenger 800**



**Bombardier**  
**Global 5000\***



**Bombardier\***  
**Global Express\***

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**Bombardier**



**Bombardier Aerospace**



**Bombardier Capital**



**Bombardier Transportation**

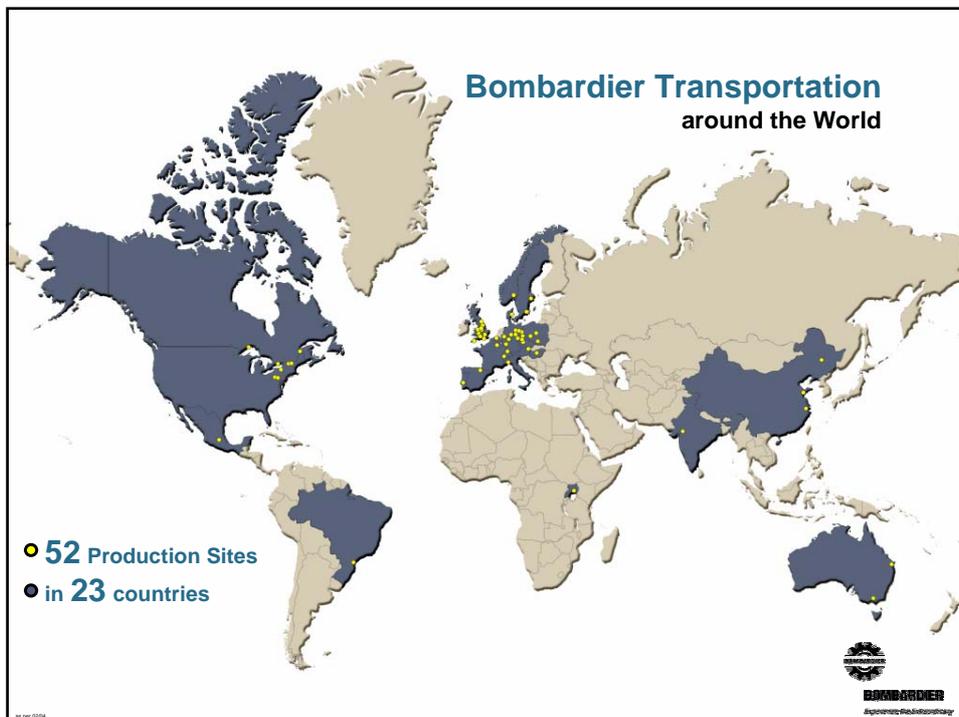


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**Bombardier Capital offers inventory financing to dealers and manufacturers in North America and interim financing of Bombardier Aerospace regional aircraft.**

-  **Bombardier**
-  **Bombardier Aerospace**
-  **Bombardier Capital**
-  **Bombardier Transportation**

## Bombardier Transportation Facts & Figures – Worldwide

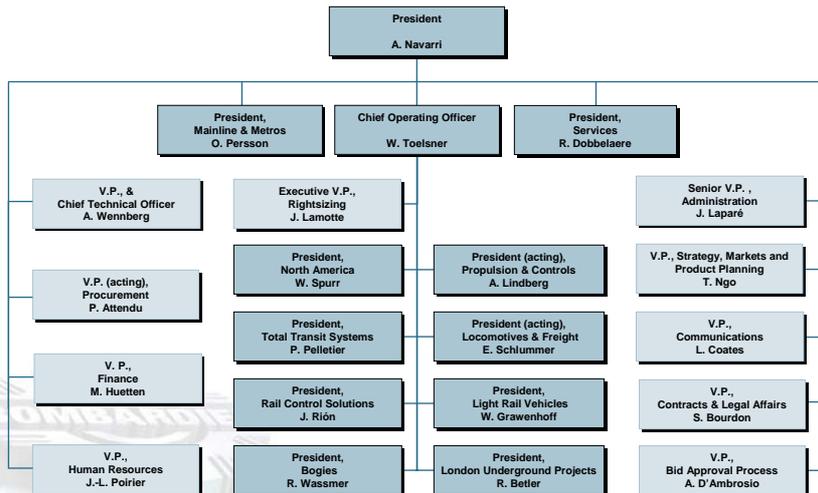


## Business objectives

- **Actively shape the rail industry as the leading global player**
- **Deliver on commitments to customers**
- **Strong financial results and profitable growth based on**
  - Enthusiastic, committed and responsive people
  - Long-term stability
  - World-wide network of capabilities
  - Quality products and services that deliver value



## Bombardier Transportation Organizational Structure



## Products and services Light Rail Vehicles

### FLEXITY® Outlook



**100% Low Floor**  
(Linz, Austria)

### FLEXITY Classic



**70% Low Floor**  
(Frankfurt, Germany)

### FLEXITY Swift



**High Floor** (Cologne, Germany)



**High Floor**  
(Rotterdam, Netherlands)

### FLEXITY Link



**Low Floor**  
(Saarbrücken, Germany)



**100% Low Floor**  
(Bruxelles, Belgium)



**70% Low Floor**  
(Dresden, Germany)



**Low Floor** (Stockholm, Sweden)



**Low Floor** (Istanbul, Turkey)



**100% Low Floor**  
(Milan, Italy)



**70% Low Floor**  
(Krakow, Poland)



**Low Floor** (Minneapolis, USA)

\* Trademark(s) of Bombardier Inc. or its subsidiaries



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## Products and services Metros



**MOVIA® - Guangzhou Metro Line 2** (China)



**C20 FICAS®**  
Stockholm (Sweden)



**Paris** (France)



**Berlin** (Germany)



**MOVIA - Shenzhen** (China)



**London (UK) - Sub Surface**



**London (UK) - BCV**



**New York** (USA)



**MOVIA - Bucharest** (Romania)



**MOVIA - Shanghai** (China)



**Munich** (Germany)



**Mexico City** (Mexico)

\* Trademark(s) of Bombardier Inc. or its subsidiaries



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## Products and services Commuter / Regional Trains

### Commuter Trains



Class 481 (Berlin, Germany)



Class 474 (Hamburg, Germany)



EMU M-7 (New York, USA)



Class 423 (Germany)



Class 424-426 (Germany)



CP 2000 (Portugal)

### Regional Trains



AGC (France)



ITINO\* (Germany, Sweden)



NINA\* (Switzerland)



Talent\* (Germany, Norway, Austria, Canada)



Regio-Swinger\* (Germany, Croatia)

### Double Deck Trains



BiLevel\* Coaches (Canada, USA)



DD-Coaches (Germany, Denmark, Israel, Luxembourg)



DD-EMU (Netherlands)

\* Trademark(s) of Bombardier Inc. or its subsidiaries

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## Products and services Intercity / High-speed Trains

### Interregional Trains



Electrostar\* EMU (UK)



Turbostar\* DMU (UK)



Contessa\* EMU (Denmark/Sweden)

### Intercity Trains



Voyager\*\* DEMU, (UK)



Regina\* EMU (Sweden)



ICM\* EMU, tilt (Switzerland)



I11 Coach (Belgium)



Airport Express (Norway)



ICE T EMU, tilt (Germany)

### High-speed Trains



ICE\*\*3 EMU (Germany/Netherlands)



JetTrain\* (USA, Canada)



Acela\*\* Express (USA)

\* Trademark(s) of Bombardier Inc. or its subsidiaries  
\*\* Trademark(s) of third parties

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## Products and services Locomotives / Freight Wagons

### Locomotives for Passenger Trains



TRAXX\* P160 AC (DB, Germany)



TRAXX P160 DCP (Italy)



TRAXX P160 AC1  
(LNVG, Germany)



High-speed Powerhead  
AVE\*\* 102 (Spain)



Class ALP 46 (New Jersey, USA)



DE 2000 (Greece)

### Locomotives for Freight Trains



TRAXX F140 AC (Germany)



Blue Tiger® Diesel-Electric  
Locomotive



TRAXX F140 AC  
(SBB, Switzerland)



TRAXX F140 AC  
(BLS, Switzerland)

### Freight Wagons



Low floor freight wagon

\* Trademark(s) of Bombardier Inc. or its subsidiaries  
\*\* Trademark(s) of third parties

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## Products and services Total Transit Systems

### Monorail Systems



Las Vegas (USA)

### APM Systems



Innovia® - Dallas/Fort Worth  
International Airport (USA)

### Light Rail Systems



Porto (Portugal)

### ART Systems



AirTrain JFK\*\* New York  
International Airport (USA)

### GLT Systems



Nancy (France)



CX-100® - Frankfurt Airport  
(Germany)



Eskisehir (Turkey)



Vancouver SkyTrain\*\* (Canada)



Neihu Line (Taipei, Taiwan)



Nottingham (United Kingdom)



Kuala Lumpur LRT System 2  
(Malaysia)

\* Trademark(s) of Bombardier Inc. or its subsidiaries  
\*\* Trademark(s) of third parties

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## Products and services

### Propulsion and Controls

- **Complete propulsion, train control and management systems and related services for all railway applications**
  - System solutions based on proven and state-of-the-art products
  - Top performance, high reliability and optimized Life Cycle Cost
  - IGBT power converter technology
  - Modular train control and communication systems



Mitrac<sup>®</sup> TC 1000 Traction Converter for Medium Power Application



Mitrac CC Driver's Desk



Mitrac DR 1000 Traction Motor for EMU's

\* Trademark(s) of Bombardier Inc. or its subsidiaries

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## Products and services

### Rail Control Solutions

- **Complete system portfolio**



INTERFLO<sup>®</sup> - Mainline Solutions



CITYFLO<sup>®</sup> - Mass Transit Solutions



ERTMS



Integrated Control Systems



Onboard Computer Systems



Wayside Interlocking Systems



Wayside Equipment



CITYFLO 650 Automatic Train Control

\* Trademark(s) of Bombardier Inc. or its subsidiaries

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## Products and services

### Services

- **Complete service portfolio**



Fleet Management (UK)



Fleet Management (Toronto, Canada)



Operations & Maintenance  
Atlanta Airport APM (USA)



Material Solutions



Vehicle Refurbishment (Netherlands)



Component Reengineering



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**BOMBARDIER**  
Engineering the future

## Products and services

### Bogies

- **Portfolio to match the entire range of rail vehicles**

- tramways, light-rail, metros
- mainline and high-speed
- locomotives and freight

- **Distinct optimum technical solutions**

- different drive systems
- independent wheel technology
- rubber-tyred wheel technology
- low-floor and articulated trains
- tilting and active suspension systems



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**BOMBARDIER**  
Engineering the future

## A short introduction to Financing

### Questions to customers of Bombardier Transportation

- **Why is financing required?**
  - Budgetary constraints
  - Balance Sheet considerations (on- or off- balance sheet)
  - Other Reasons?
  
- **What type of financing is required?**
  - Financing solution (e.g. debt or leasing)
  - Credit terms (e.g. short-, medium- or long-term)
  - Other specific requirements (e.g. currency)

## A short introduction to Financing

- **What security is available and from whom?**
  - Sovereign Guarantee
  - Loan repayment guarantee
  - Letter of Support or other assurances
  - Mortgage, Pledge or Assignment related to assets

## A short introduction to Financing

- Risk is the main influence when structuring a certain type of financing
  
- There are 3 main categories of risk which financiers of Rolling Stock / Rail Projects might face....
  - Credit Risk including country risk
  - Equipment Risk (Asset-based Financing)
  - Project Risk (Cash Flow-based Financing)



## Equipment Risk



- Equipment Risk occurs when a party relies on his rights as owner of the equipment, and hence the Future Market Value of the equipment, as Security.



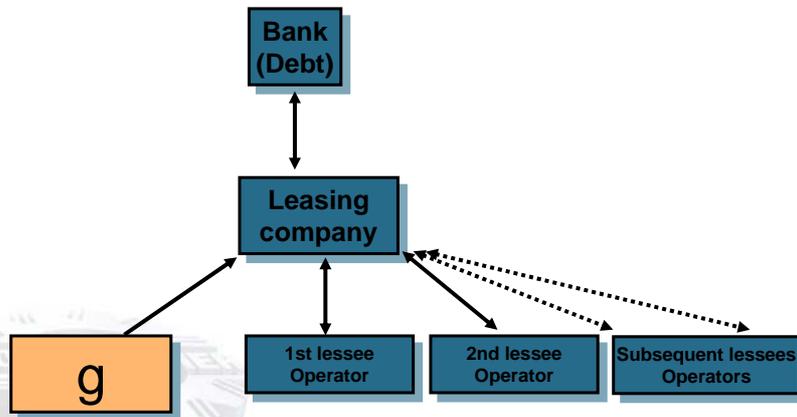
## Equipment Risk

- **Future Values are determined by:**
  - the economic life of the equipment
  - re-marketability of that equipment
    - continuity of use on existing system
    - existence and location of secondary market
    - uniqueness of technical specifications
    - infrastructure standardisation
  
- **Examples of finance structures incorporating equipment risk (asset-based financing) include:**
  - Mortgage-based loans
  - Operating Lease

## Operating Lease – an overview

- **Operating Lease**
  - Lessor takes risks and rewards of ownership
  - Off-balance sheet for the Lessee
  - For the Lessee, it represents a rental contract, similar to property rental
  - Typically short term (2 to 5 years) although longer term have been achieved in UK/Australia (8-15 years)
  - Asset likely to be required by Lessee for less than useful life, i.e. minimum lease term less than asset life
  - Specialized entities (Roscos) have been able to assume residual value risks given their asset management expertise

## Operating Lease



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## Operating Lease

### ▪ Operating Lessors

- Very few entities in the rail industry are willing to act as a true operating lessor and accept risks and rewards of ownership. Such lessors include:
  - ROSCO's such as Angel Train, Porterbrook, HSBC (all UK-based although partially expanding in Europe) – Passenger Rail
  - Locomotive & Freight cars lessors (AAE, GE, GATX etc....)

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## Bombardier Transportation products in Operating Leases

### Interregional Trains



Electrostar<sup>®</sup> EMU (UK)

### Intercity Trains



Voyager<sup>\*\*</sup> DEMU, (UK)

### Regional Trains



Talent<sup>®</sup> (Germany, Norway, Austria, Canada)

### Locomotives



TRAXX<sup>®</sup> P160 AC (DB, Germany)



Turbostar<sup>®</sup> DMU (UK)



DD-Coaches (Germany, Denmark, Israel, Luxembourg)



TRAXX F140 AC (Germany)

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 \*\* Trademark(s) of third parties



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**BOMBARDIER**  
 A General Electric Company

## Bombardier's view on the protocol

- In Bombardier Transportation's view the key to developing the rail market is adequate funding
- If financing resources are not available the rail business is limited especially as substantial amounts are needed for such capital investments
- A good example for a successful market development can be found in the UK
  - After privatisation in 1996 private funding was made available by the UK financial institutions mainly through operating leasing. Several entities were created (Roscos) for purposes of leasing new rolling stock to franchisees
  - Subsequently investments that were badly required after a long period of underinvestment in the network started to take place
  - The UK market has been very active in recent years in the procurement of new rolling stock. The underinvestment in the general infrastructure is still noticeable



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**BOMBARDIER**  
 A General Electric Company

## Bombardier's view on the protocol

- In Eastern Europe governmental entities face the challenge of budgetary restrictions
- The rail infrastructure is an important part of the overall transportation network in Eastern Europe
- Private funding of the rail network will therefore become a necessity in the coming years
- Unidroit would provide a legal framework that would allow financing institutions to enter into a market segment that is not yet “fully accessible” today



## Bombardier's view on the protocol

- Especially rolling stock that can be used on other networks due to its technical specification will be interesting for an operating lease concept
- Rolling stock that can be found in operating leases includes locomotives, freight cars, passenger cars for the regional traffic and Diesel Electrical Multiple units (DMUs)
- Bombardier Transportation products presently found in operating leases include the *Bombardier Electrostar*, *Bombardier Turbostar* & the Voyager Intercity products, German Double Deck & *Bombardier Talent* regional trains, *Bombardier TRAXX* locomotives & freight cars



## The financing institution's point of view

- **Bombardier's customers consist, in addition to operators, of specialized entities – the Rolling Stock Companies (Roscos) - all wholly owned by financial institutions**
- **Especially in Bombardier's aircraft business financing institutions play a major role as customers**
- **Therefore the financing institutions opinion on the Unidroit Rail protocol is important to Bombardier**
- **From our experience and direct dialogue the following issues concern ROSCOs and banks**



## The ROSCO's point of view

### Angel Trains view

- **The Unidroit Rail protocol should provide additional security to financial institutions and increase the access to private funds to finance rail infrastructure projects.**
- **Success for the Unidroit Rail protocol requires uniform system of vehicle and major component identification.**
- **Success for the Unidroit Rail protocol requires broad acceptance of the protocol by states in the markets.**
- **Success for the Unidroit Rail protocol requires limitation of "national solutions" to open these markets on the basis of easy registration of security interests.**
- **This will enhance liquidity of rolling stock and willingness of funders, like Angel Trains, to support investment in rolling stock.**



## Challenges

- A challenge is to agree on a protocol that is acceptable to Bombardier's larger markets i.e. EU & EU accession countries
- The biggest challenge will be sufficient ratification of the protocol to make an impact on the individual markets



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**PRACTICAL INTEREST OF THE FUTURE RAIL PROTOCOL  
FROM THE POINT OF VIEW OF  
OPERATORS AND FINANCIERS**

Mark Stevenson

Deputy Managing Director & Finance Director, Ahaus Alstätter Eisenbahn



## Contents

1. What is AAE? Why is AAE qualified to speak?
2. The past world of security over railcar assets
3. How does AAE work today?
4. The way forward?

## What is AAE?

- Founded 1903
- Location Germany (Münsterland)
- Head Office Switzerland (Zug)
- Railway Company with rental of freightcars
- Investment in modern railcar types
- Locomotives and maintenance facility

## AAE - Facts and Figures

- Fleet 18'025 railcars
- Average age of fleet 7.5 years
- Fleet investment value EUR 1 billion
- Shareholders' investment EUR 150 million
- Employees 74

## Memberships

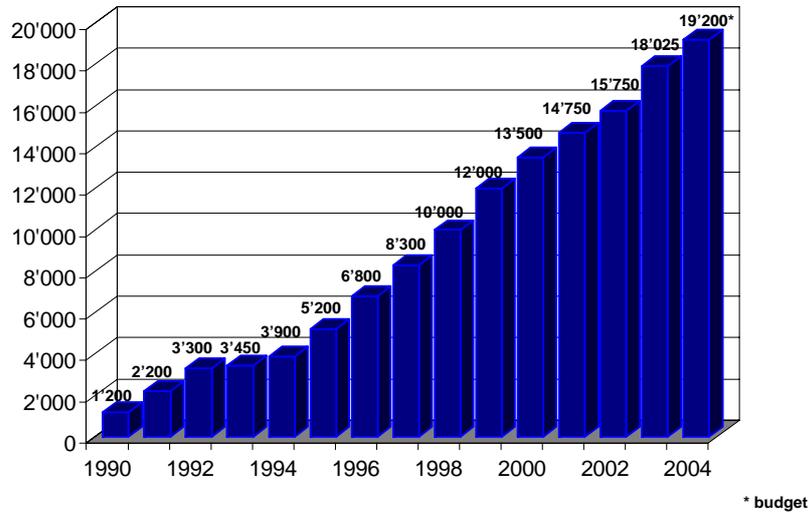
- UIC** (Union Internationale des Chemins de Fer)
- RIV** (Regolamento Internazionale Veicoli)
- BCC** (Bureau Centrale de Compensation)

AAE is acknowledged as a fully-fledged railway on an equal footing with the European national railways.

AAE complies fully with EU Directive 91/440.

AAE can operate in all European countries as a railway.

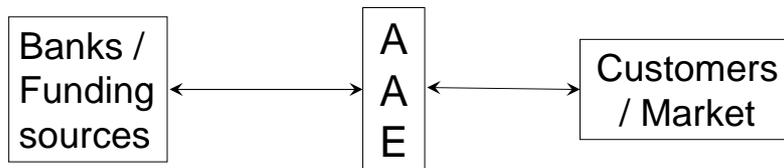
## Railcar fleet 1990 - 2004



## Customers



## AAE'S interaction with the market



AAE has an interest in Unidroit as:

- a financier / lessor,
- a borrower,
- an operator
- an issuer

## In The Past:

- Rail was primarily run and controlled by state-owned enterprises (or at least traction provided)
- Rail traffic was primarily a national business (relatively small amounts of cross-border traffic)
- Railcars were primarily funded by State budgets and there was relatively little 3rd party funding, at least not without a state guarantee
- Due to the lack of external direct funding, security was not a major concern.
- The State Railways worked within the RIV to safeguard their assets. Lost assets were always compensated.

## A Changing World

- The move to an open-market is being driven by many factors:
  - The European Union
  - Pan-European manufacturing and distribution systems
  - Open-access directives of the EU
  - Changes to the COTIF / RIV
- The market is moving increasingly towards:
  - Cross border traffic and pan-European operators
  - Private operators (including traction providers)
  - Interoperability of locomotives
- The financing world is also changing:
  - 3rd party funding of wagons
  - Leasing of wagons

## The Legal World

- The legal world is still anchored in the past:
  - National legal systems
  - Fundamentally different approaches to security
  - Pan-European enforceability impossible

**But why is this a problem?**

## The Current Situation and AAE

- AAE leases railcars to a customer based in Germany with a Sicherungsübereignung as security
  - In Germany the security is valid and enforceable, *But what happens if the car is seized in France?*
  - The lenders demand securities that are valid across Europe. *But how many and what might this cost?*
  - The lenders demand restrictions as to where the railcars may be employed. *But does this hinder AAE & its clients?*
  - How quickly can AAE recover its assets in the case of a lessee insolvency?
  - How can AAE demonstrate its ownership of the assets in an undisputable manner?
- Today all these questions are very difficult issues

## The Current Situation and AAE

- In 1998, AAE originated a M€255 asset-backed bond financing.
- The first step was a legal due diligence in 25 European countries to identify a valid pan-European security concept
- After spending €400,000 the conclusion was that it was impossible to secure the financing on an asset-specific basis
- AAE found an alternative route with Special Purpose Vehicle („SPV“) financing, but this is:
  - organisationally cumbersome, and
  - the interest rate margin was higher than if there was railcar-specific security
- AAE continues to use the SPV funding today

## The Way Forward

- The introduction of an asset register will allow AAE and its banks to create valid pan-European security interests
- AAE has already established a methodology to fund its railcar fleet, Unidroit will benefit more greatly new smaller operators who could otherwise perhaps not access 3rd party funding
- Registered security interests will drive down rail's funding costs and improve rail's access to funding liquidity
  - the banks will derive significant comfort from registration of their securities interests
  - the rating agencies will find it easier to rate AAE debt
  - the interest margin will (I hope) go down!
- The way in which security interests are registered and its cost is essential to the success of the venture

**SPECIAL ISSUES OF PARTICULAR IMPORTANCE UNDER THE PRELIMINARY DRAFT  
RAIL PROTOCOL**

**Definition and identification of railway rolling stock**

**Registration system: Integration with existing registries**

Henrik Kjellin

Ministry of Justice, Sweden  
Co-Chairman of the Rail Registry Task Force

## **Definition and identification of railway rolling stock under the Railway Protocol to the Cape Town Convention**

### **Registration system: Integration with existing registries**

1. The definition and the identification of the single object of railway rolling stock are two very important elements in the system to support asset-based financing suggested under the Railway Protocol to the Cape Town Convention. The definition of railway rolling stock is imperative as it determines what can be subject to an interest under the Protocol. And the implication of the identification of the single item subject to such an interest is vital to the validity of the security provided – if the creditor fails to prove that it holds an interest in a specific locomotive or railway car, its interest has no value.

2. In the deliberations on the Protocol, the question of identification has further proven to be quite sensitive, especially from the point of view of the interaction between the Registry to be created under the Protocol and other existing or forthcoming registration systems in different parts of the world. I shall return to this aspect after reviewing the general provisions on definition and identification of railways rolling stock.

3. The definition of railway rolling stock is to be found in Article II, paragraph 2 (g) of the Protocol. It includes two elements, the *railway vehicle* and all relevant information on the vehicle, such as operational and technical data, manuals, etc. The definition of railway vehicle, Article II, paragraph 2 (f), covers anything movable on or above rails or any other similar construction. The intention has been to include any vehicle that forms part of what we would describe as a *train*. But not only that, any other vehicle, used for maintenance or other purposes, is also intended to be included.

4. An interest under the Protocol covers not only the vehicle itself, but also parts of the vehicle as long as they are attached to or form part of it. The definition of railway

vehicle mentions traction systems, engines, brakes, axles, bogies and pantographs, but also more generally accessories, components, equipment and parts. Spare parts or anything else that even may be intended to be attached to the vehicle do not form part of the interest, as they do not fall under the definition. Moreover, the definition and hence the interest does not include any loose objects on the vehicle. This might be obvious in the case of cargo or baggage, but it also applies to possessions of the operator of the vehicle not affixed to it even if they are such that they could have formed part of it or even is intended to form part of it.

5. A single item of railway rolling stock will remain subject to the interest even if it is renovated or refurbished. The question of when a railway vehicle is renovated and when only spare parts from an old railway vehicle is used to build a new one, is not solved by the Protocol. This is viewed as a point for the financing agreement between the parties.

6. Even if it is a point relating to the sphere of application of the Protocol, it is fair to point out that the single item of railway rolling stock does not have to have any international connection to fall under the system provided by the protocol. It does not have to be intended for international transport or use. The international element under the Protocol lies in the financing agreement. The Protocol is intended to facilitate cross-border asset-based financing of railway rolling stock, whether used internationally or domestically.

7. As a last point in relation to the definition of railway rolling stock, it is important to keep in mind that the definition does not include infrastructure. This means that what in ordinary language is referred to

as *railway* is not included, which is quite reasonable as financing in such a case often can be solved through asset-based financing against the land. Having said that, it should be recognized that there has been discussions in relation to such parts of the infrastructure, which are not directly or indirectly fixed to the ground. One example is vehicles on wheels used between two countries to bridge a difference in gage. Another situation is railway transport where the traction is provided by an engine outside of the railway vehicle, such a cable cars.

8. For an interest to be valid it has to be provided in a uniquely identifiable object. This follows from Article 3:1 of the Convention. The result of a lack of precision of the identification of the object is that the security agreement is not valid. This flows from Article 7 (c), which provides that the object has to be identified in conformity with the Protocol.

9. How the identification is to be done is further defined in article V of the Protocol. This provision differs between the identification of an object in the Registry and the identification of the object in the real world. For the identification of an object in the Registry, the object (the single item of railway rolling stock) will be associated with a specific identification number provided by the Registry. For the identification of the object in the real world, the identification number shall be affixed to the single railway vehicle.

10. The Protocol provides an alternative way of identification in the case a railway vehicle already has an identification or registration number affixed to it. This could be a national or regional registration number provided for administrative reasons. In such a case the identification number of the Registry need not be affixed to the vehicle, but instead is the national or regional number associated to it in the Registry. This solution is provided to ensure compatibility of the international Registry with existing or forthcoming national or regional systems. One further argument for it has been the cost aspect – if the introduction of the new Registry system requires new identification numbers to be affixed to all existing railway rolling stock, the economical benefits of the new system may soon be swallowed.

11. The optional solution can only be used in a State that has made a declaration to that effect. Such a declaration shall specify the national or regional system intended to be used. The Protocol creates a system for scrutiny of such national or regional registration numbers and for advice to be given in the case it is unsure whether certain identification is provided by it.

12. If the optional system is used, the national or regional number of a railway vehicle may change. This can for example happen if the vehicle is exported to another state with another registration system. In such a case the debtor shall (and the creditor may) provide the new regional or domestic registration number. Where a single item of railway rolling stock has been transferred several times between different States with different national or regional registration systems, the Registry will contain a list of all of the national or regional registration numbers applicable to it during the validity of the security agreement.

13. Even if a state has made a declaration according to Article V:2 of the Protocol in order to enable the use of its domestic or regional registration system, the parties to a security agreement may still use the Registry identification number. In such a case it must, of course, be affixed to the vehicle.

14. This optional solution has during the deliberations shown to be vital to the support for a joint global Registry system by both North America and the EU Member States. It ensures the compatibility of the international registry system suggested under the Protocol with existing regional or national registration systems.

15. To summarize. Article II of the Protocol provides an adequate definition of railway rolling stock, which in an efficient way can be the platform for asset-based financing in the railway industry. In addition Article V of the Protocol (together with the relevant provisions of the Convention) puts in place a cost-effective system for the identification of railway rolling stock, compatible with existing or future systems in certain States or regions.

**SPECIFIC ISSUES OF PARTICULAR IMPORTANCE UNDER THE PRELIMINARY DRAFT  
RAIL PROTOCOL**

Howard Rosen

Solicitor, Chairman of the Rail Working Group

## Analysing the Specific Remedies

- Final and interim remedies
- Look first at the Treaty and then at the Rail Protocol
- How does bankruptcy affect the remedies
- Looking at Public Service exemptions

## Specific Remedies

- Delivery up of asset on default  
(Articles 8 –15 of the Convention and Article VII of the Protocol)
- Interim Relief  
(Articles 13 of the Convention and Article VIII of the Protocol)

## Default Remedies

- What do we mean by “default”?
- Article 12 firstly allows parties to agree on what it is
- And if there’s no agreement defines “default” as

a default which substantially deprives the creditor of what it is entitled to expect under the agreement

## Default Remedies

- Article 8: on default if parties have agreed or otherwise pursuant to a court order, creditor may
  - (a) take possession or control of any object charged to it;
  - (b) sell or grant a lease of any such object;
  - (c) collect or receive any income or profits arising from the management or use of any such object.
- Article 8 also dictates the application of surplus proceeds
- Article 9 provides power for vesting of title, either by agreement or by court order

## Default Remedies

- Article 10: on default under a title reservation agreement or under a lease

the conditional seller or the lessor, as the case may be, may:

- (a) ... terminate the agreement and take possession or control of any object to which the agreement relates; or
- (b) apply for a court order authorising or directing either of these acts.

## Default Remedies

- Article 8 is modified by Article VII of the Rail Protocol in three key areas:
  - Any court order for possession may also require the debtor to facilitate the creditor's exercise of its repossession rights (e.g. provision of traction to a suitable delivery point)
  - Presumption of reasonableness in relation to exercise of remedies if in accordance with agreement between parties unless manifestly unreasonable
  - Reasonable prior to notice to other interested persons shall be (at least) 14 days

## Relief pending final determination

- Why is it necessary?
- What is granted under the Treaty is in addition to whatever is available under local law
- Starting point is Article 13 of the Treaty

## Relief pending final determination

- Article 13 permits a creditor, pending final adjudication of its claim, to apply to the court for interim relief of the following types:
  - (a) preservation of the object and its value;
  - (b) possession, control or custody of the object;
  - (c) immobilisation of the object; and
  - (d) lease or, except where covered by subparagraphs (a) to (c), management of the object and the income therefrom.

## Relief pending final determination

- The Court may
  - require notice to be given to other interested parties and
  - add conditions dealing with the position if the creditor fails to substantiate its claim or to comply with an obligation to the debtor

## Relief pending final determination

- Article VIII of the Rail Protocol makes the following key modifications of Article 13:
  - No requirement for debtor consent before a creditor can exercise its rights for interim relief
  - Allows Contracting States to declare what “speedy” is
  - Allows sale of object if creditor and debtor agree

## Bankruptcy

- The Thoughts behind Article IX
- Analysing the three Options
- What's the best way forward?

## Bankruptcy

- The Thoughts behind Article IX
  - Balancing the rights of creditors, stakeholders and shareholders
  - The “hard” option (A), the “soft” option (B) and the compromise (C)
  - The EU law compatibility issue (briefly)

## Bankruptcy

1. This Article applies only where a Contracting State that is the primary insolvency jurisdiction has made a declaration pursuant to Article XXVII.

## Bankruptcy

### *Alternative A*

- On insolvency, delivery up of the railway rolling stock to the creditor no later than the end of the “waiting period”; (but should not be worse off than existing law rights)
- Unless and until the creditor is given the opportunity to take possession the railway rolling stock must be maintained and creditor may apply for any other forms of interim relief
- The insolvency administrator or the debtor may retain possession of the railway rolling stock if it has cured all defaults (other than a default constituted by the opening of insolvency proceedings) within the waiting period
- Insolvency administrator retains rights under the applicable law to terminate the agreement.

## Bankruptcy

### *Alternative B*

- On insolvency, the insolvency administrator or the debtor, as applicable, upon the request of the creditor, must notify creditor whether it will cure defaults or allow repossession
- If the insolvency administrator or the debtor, as applicable, does not give notice or if it does but fails to give possession, the court may permit repossession
- The railway rolling stock shall not be sold pending a decision by a court regarding the claim and the international interest.

## Bankruptcy

### *Alternative C*

- On insolvency, the insolvency administrator or the debtor, as applicable, cure all defaults other than a default constituted by the opening of insolvency proceedings and agree to perform all future obligations or give the creditor possession.
- But before the end of the cure period, the insolvency administrator or the debtor may apply to the court for a suspension of the redelivery obligations subject to an undertaking to pay all sums and perform all other obligations during the suspension period
- Court must decide within a given period failing which no suspension.
- Unless and until the creditor is given the opportunity to take possession the railway rolling stock must be maintained and creditor may apply for any other forms of interim relief
- Insolvency administrator retains rights under the applicable law to terminate the agreement.

## Public Service Exemption

- Why needed
- Application to remedies on default and bankruptcy
- Intentions and tensions

## Public Service Exemptions

‘ “public service rolling stock” means railway rolling stock habitually used for transporting the public on scheduled services or otherwise utilised by a Contracting State directly (and not provided, other than incidentally, to be used by third parties) in each case together with locomotives and ancillary railway rolling stock habitually used to provide such services ;’

Article I (2) (e)

## Public Service Exemptions

A Contracting State may, at the time of ratification, acceptance, approval of, or accession to this Protocol, declare which and to what extent the following subparagraphs shall apply to such Contracting State:

Article XXV

## Public Service Exemptions

(a) the remedies provided in [Chapter III of the Convention and Articles VII to X of this Protocol] shall not be exercisable within its territory in relation to the public service rolling stock specified in its declaration or determined by a competent authority of that State notified to the Depositary;

Article XXV

## Public Service Exemptions

- (a) the remedies provided in [Chapter III of the Convention and Articles VII to X of this Protocol] shall not be exercisable within its territory in relation to the public service rolling stock specified in its declaration or determined by a competent authority of that State notified to the Depositary;
- (b) the remedies provided in [Chapter III of the Convention and Articles VII to X of this Protocol] shall not be exercisable within its territory in relation to railway rolling stock as far as it is used for the purpose of providing a service of public importance as specified in its declaration or determined by a competent authority of that State notified to the Depositary;

Article XXV

## Public Service Exemptions

- (a) the remedies provided in [Chapter III of the Convention and Articles VII to X of this Protocol] shall not be exercisable within its territory in relation to the public service rolling stock specified in its declaration or determined by a competent authority of that State notified to the Depositary;
- (b) the remedies provided in [Chapter III of the Convention and Articles VII to X of this Protocol] shall not be exercisable within its territory in relation to railway rolling stock as far as it is used for the purpose of providing a service of public importance as specified in its declaration or determined by a competent authority of that State notified to the Depositary;
- (c) the Contracting State making a declaration under either of the preceding sub-paragraphs shall take into consideration the protection of the interests of the creditor.

Article XXV

## Conclusion

- Conceptually the Treaty and the Rail protocol recognises and delivers a key set of remedies on default BUT
  - Extensive rights for Contracting States to contract out or modify what the Treaty brings
  - Bankruptcy inevitably modifies such rights (and the provisions here may in turn be subject to, or need to be compatible with international bankruptcy rules)
  - Public policy reasons dictate that Contracting States must be able to keep up a public rail service
- In each case, there is a balancing act...

**SPECIFIC ISSUES OF PARTICULAR IMPORTANCE UNDER THE PRELIMINARY DRAFT  
RAIL PROTOCOL**

**Reconciling private financing with EU bankruptcy regime**

Jérôme Carriat

Administrator, European Commission  
Directorate-General Justice and Home Affairs

## Reconciling private financing with EU bankruptcy regime

As an introductory remark, I would highlight the momentum fixed by Unidroit and OTIF for organising this colloquium in co-operation with the Polish Ministry of Infrastructure. Indeed, ten new Member States are acceding to the European Union. Furthermore, a political agreement was reached on 17 March 2004 between the European Parliament and the Council on the full opening of rail freight markets in the Union. This is likely to give a new impetus to the adoption of the Rail Protocol by an enlarged Union.

The European Commission has been involved from the very beginning in the negotiation of the Cap Town Convention and its Aircraft Protocol, in view of enabling the Community to exercise its external competences. As a result, the Convention and the Protocol adopted in November 2001 contain the following provisions allowing the Community to preserve Community legislation: As a Regional Economic Integration Organisation (R.E.I.O.), the Community is provided with the status of a Contracting State; accordingly a system of opting-in declaration at the time of signature/ratification will ensure the necessary flexibility in the application of the Convention between E.U. Member States.

The Commission has a keen interest in the elaboration of the draft Rail Protocol as well. To this end, the Commission has received negotiating directives from the Justice and Home Affairs Council on 28 February 2003. This has enabled the Commission to participate to the 3<sup>rd</sup> session of Governmental Experts in Bern, May 2003 that proved to be very efficient. As a result, there was a broad agreement on a final draft.

In accordance with Article 300 (EC) and the AETR legal case of the ECJ, the Council's mandate authorises the Commission to negotiate for the adoption of the Protocol, on matters falling within the exclusive competence of the Community. In particular, the Commission shall ensure that the regime of the Protocol is compatible with the principles of Community legislation on insolvency proceedings, as laid down in Regulation (EC) No 1346/2000 and with

Regulation (EC) No 44/2001 on jurisdiction, recognition and enforcement of judgements (the "Brussels I Regulation"). Chapter III on the registry provisions may also have implication on the proposal for a Regulation establishing a European Railway Agency.

During the negotiations, the Commission and Member States which were co-ordinated by a special committee, negotiated for a number of clarifications and amendments to the draft Protocol. Different means of ensuring the compatibility of the Protocol with existing Community legislation may be considered as follows:

- a first possibility consists of drafting the text of the Rail Protocol as close as possible to the Aircraft Protocol that was adopted in Cap Town. Though the rail industry may have some specific needs to be dealt with in its Protocol, the later Protocol is based on solutions that were widely accepted and thereby likely to respect European insolvency law. Eventually, the Committee of Governmental Experts agreed on a compromise solution that meets both concerns.
- where it is not possible to find an agreement, some flexibility may be introduced into the Protocol. Therefore a system of opting-in declaration will give the choice to the Community which is the only competent to declare that it will apply certain provision of the Protocol, fully or in part, or that it will apply Community Regulations instead (disconnexion clause), or not to make such declaration (in such a case, common international rules would apply).

This working method may be illustrated by the following provisions of the Protocol:

ART. VII.1 (default remedies):

This Article stated that the competent jurisdiction is that in which the railway rolling-stock is located. Such rule of

jurisdiction was incompatible with the relevant Articles 2 to 7 of the Brussels I Regulation. This problem has been finally solved by a more general drafting of Art. VII.1.

For these reasons, the Commission may support the draft Rail Protocol and will co-operate actively in view of its adoption at the Diplomatic Conference in 2005.

ART. IX (remedies on insolvency):

This Article applies only by opting-in if the State of the primary insolvency jurisdiction has made a declaration. This criteria is compatible with Art.3.1 of the European Insolvency Regulation which states that the jurisdiction to open insolvency proceedings is that where the centre of a debtor's main interests (COMI) is situated.

Under footnote (22) it is mentioned that at present it is not quite clear what legal consequences the option of one alternative by the State of opening would have for its rolling stock located in another country which did not opt for the same alternative. However, such a case between EU Member States would be clearly governed by the provisions of the Insolvency Regulation – i.e. the Articles about automatic recognition and secondary proceedings.

Alternatives A, B and C have some implications on the European Insolvency Regulation, particularly on Article 4 (law applicable), 5 (rights *in rem* are not affected) and 18 (powers of the liquidator). For example, there are in the Protocol some priority rules for registered rights, an obligation for the insolvency administrator to preserve and maintain the rolling stock...

ART. X (insolvency assistance) applies only with a declaration.

ART. XVIII (relationship with other Conventions) has been amended in a way to preserve Community Regulations.

ART. XX contains the R.E.I.O. clause as in the framework Convention.

Following the 3<sup>rd</sup> session, a new ART. XXIII deals with the declarations to be made relating to certain provisions.

**SPECIFIC ISSUES OF PARTICULAR IMPORTANCE UNDER THE PRELIMINARY DRAFT  
RAIL PROTOCOL**

**Public service exemptions**

Christoph Henrichs

Federal Ministry of Justice, Germany

## **Public service exemptions**

### **I. The Problem**

I would like to talk about a specific problem that has come up in the course of the negotiations of the Railway Protocol. It is a problem of particular importance to the German delegation and it reflects the interests of the different players involved.

It particularly mirrors the double function of the railway company or the operator: On the one hand, the railway company or the operator is a player in the financial market. It has a financing or leasing agreement for its rolling stock; that financing is secured by a security agreement or a leasing agreement. The company is the debtor and the bank as the creditor has an interest to have his agreement with the debtor fulfilled. If the debtor does not fulfil his obligations or falls into insolvency, the creditor must be in a position to exercise his rights and is entitled to certain remedies.

Under the Cape Town Convention these creditor's rights to remedies are provided in Chapter III Articles 8 et seq. of the Convention for the case of default, and in Article IX of the Railway Protocol for insolvency. Essentially the creditor has the right to take possession and control of the secured object and then sell it or use the value of the asset in another way. This will take the rolling stock away from its current place and function in the network of the railway company.

This is where the second function of the railway company comes into play: It also provides an important service to the public, i.e. transport facilities which are essential for the functioning of a society or a city. As a result, if the creditor wants to exercise his rights in case of default, this may threaten the functioning of public transport and may in the extreme lead to a collapse: Certainly not if a few individual carriages fall under the creditor's attachment but in the case of insolvency of e.g. a local transport company which runs a City subway system, a complete collapse is perfectly possible.

These are two contradicting interests for which a solution must be found in order to balance the interests involved.

### **II. National German legislation**

Germany has a particular interest in this question because German national law has a provision to deal with this problem: It is the long-existing "Act on Measures to Maintain the Operation of Railway Undertakings in Public Transport" and it provides that railway stock used for public transport that has been pledged or transferred under a security agreement can only be exploited by the creditor if the supervising authority gives its consent. In other words, the supervising authority has a veto and can prevent the exercise of the creditor's rights to remedies.

I have tried to find out whether similar rules exist in the laws of the countries represented here, or whether those national laws recognize the importance of public transport as a public policy through some other mechanism. I have not been very successful in my research; I believe there are some rules to that effect in Austria, and I have heard from the colleagues in Hungary that apparently there are no rules. So in the course of this presentation you may want to think along and try to apply the provision in the Railway Protocol as I describe it for your own country. It may be interesting later on in the discussion to hear from you what the individual national backgrounds are.

### **III. Solution in the Aircraft Protocol**

The similar problem exists in the Aircraft Protocol although it is not as urgent: Planes are to a lesser degree an essential means of public transport that need to be maintained by all means. Also, if one airline falls into insolvency, there are usually alternatives because the market is much more internationalised: Other airlines serve the same routes or they can quickly take over the routes from that airline.

Nevertheless, the problem was also identified in the international context: There is a Convention for the Unification of Certain Rules Relating to the Precautionary Attachment of Aircraft, signed in Rome in 1933. It provides that under certain conditions aircrafts that are in use on a regular line for public transport and aircrafts ready for departure cannot be attached in

pursuit of a private claim of a creditor. When the plane is ready to go, a policy choice is made in favour of the ongoing traffic. The functioning of public transport supersedes the interests of the creditor.

This mechanism is mirrored in the Aircraft Protocol to the Cape Town Convention: As a rule, the Cape Town Convention supersedes the 1933 Convention but under Article XXIV of the Aircraft Protocol, a Contracting State to that Convention can choose and declare that it will keep that Convention untouched by the Cape Town Convention.

#### **IV. Solution in the Railway Protocol – First Draft of the Railway Working Group**

In the Railway sector, we have no similar Convention available. Of course, there is the COTIF Convention, but COTIF does not help. It only provides rules on competence issues, i.e. on the question which court is competent to give a judgement on a seizure, but does not substantially allow or prohibit seizures or other remedies.

As a result, a solution had to be found in the Railway Protocol itself. The problem was taken on board by the Railway Working Group. For the second session of the Committee of Governmental experts in March 2002, an article was presented that tried to find a balanced middle ground between protecting the interests of the creditor and the policy interest in the functioning of public service transport

We take a quick look at that provision but will not go too much into details because it is not the current wording of that article any more.

*>>>> Wording "Step 1", see Powerpoint presentation below <<<<*

You will notice at first glance that it is a highly complicated mechanism. Basically, the creditor if he wants to exercise his rights in the case of default, has to follow a two step procedure: First he has to notify the competent state authority which then has a period of seven days to act, and secondly, the creditor has to get the consent of the court to exercise his rights. The authority can in the meantime issue a what is called "public service application" to the court which denies permission to the creditor to exercise his rights. The court would be bound by this

refusal. However, the State authority would have to undertake to compensate the creditor for the loss of his rights of exploitation.

We can see it is a complicated interplay between creditor, State authority and court which leaves the creditor in quite an uncomfortable position: He would have to wait twice: first the waiting period for the State authority to pass a possible public service application and then for the Court decision. Also, a lot of uncertain factors would be involved in the system, eg. the discretion of the court. As a result, the mechanism was considered too complicated and it was felt that the financial markets would not be very happy to rely on such a system. Nevertheless it remains the merit of the Railway Working Group to have put the issue on the table and to start the discussion about the best mechanism to solve the issue.

#### **V. Opt out solution**

So a solution had to be found that would simplify the mechanism. The second session of the Committee of Governmental Experts in 2002 found an approach which is still the basis of the current provision as it stands, however in a refined manner. It is based on the typical mechanism that can be found back in other contexts of the Convention and in other international treaties: an opt out solution.

*>>>> Wording "Step 2", see Powerpoint presentation below <<<<*

The basic idea here is that the Contracting state is given the opportunity to declare in a general manner that the creditor's rights in case of default cannot be exercised under certain conditions.

#### **VI. Current draft**

We can leave this draft quite soon and turn to the provision in the form as it stands currently, that is after the third and last session of the Committee of Governmental experts in 2003. The opt out-idea by a State declaration was kept but refined. The result can be found in Article XXV of the current draft:

*>>>> Wording "Step 3", see Powerpoint presentation below <<<<*

I would like to take you through this draft a bit more detailed now as this is the current wording as the Railway Protocol enters the Diplomatic Conference next year:

## 1. **Structure**

We have one leading main clause: “A Contracting State may declare which and to what extent shall apply” which provides the structure of the whole article. Then follow three paragraphs all of which depend on this introductory clause.

In other words, the State is free under two aspects: first of all whether it makes a declaration at all or not. This will probably depend on the question whether national legislation so far contains similar possibilities for the state or not so that the State has an interest to keep those mechanisms up.

Secondly, if the State decides to make a declaration, it is free to decide which of the elements of Article 25 are contained in that declaration. There is no interconnection between the paragraphs in the sense that if a declaration covers one of the paragraphs, a declaration under another subparagraph must be made as well. This provides the greatest possible flexibility. We will come back to that observation later.

## 2. **Paragraph a)**

Let’s take a look at the individual subparagraphs now and let’s start with paragraph a):

### Definition “Public Service Rolling Stock”

Possible object of the opt out declaration of the state under paragraph a) is “public service rolling stock”. This term is defined in the Railway Protocol itself, in the Definitions Article I, paragraph 2 letter e).

>>>> *Wording Definition Public Service Rolling Stock, see Powerpoint presentation below* <<<<

Let’s take a look at this definition: The term “public service rolling stock” itself is not very specified because “public service” can be a very broad term. The definition, however, makes it clear that the term only refers to “transporting the public on scheduled service”. Only the transport of persons is covered by the term “public service rolling

stock”, not the transport of goods or freight. So any railway rolling stock used for transporting goods cannot be excluded under paragraph a) by a State declaration. I will come back to that observation in a minute.

The transport of the persons has to be on “scheduled services”. This makes sense because it is only on scheduled services that the transport of persons fulfils the public task to provide mobility for the people. If a group of people charter a specially equipped club train for a fun ride for their Christmas party or for going on holidays, it would certainly hinder their purpose if the carriage was attached by the creditor but there is no danger of public transport collapsing.

### Specification of the Rolling Stock

Coming back to the opt out rule in Article XXV, not all “public service rolling stock” in the sense of the definition in Article I is automatically covered if a state makes a declaration. The particular rolling stock has to be specified in the declaration by the state. The wording of the Article leaves it open in what way exactly the specification has to be made.

In a different context, the Railway Protocol itself provides detailed rules on identification. That is Article V which deals with individual identification numbers for the purpose of unique identification of each individual item of railway rolling stock. In that context there, such a detailed and strict system is necessary because it is essential for the functioning of the Registry to have an unambiguous description of each individual object that is charged with an international interest.

Here, however, the context is different. There is no obligation to specify and list each carriage individually. Given the potential number of objects of rolling stock involved in scheduled public service, this could be a very long list and would not be practical at all. It will be sufficient if the declaration makes it clear which parts of the railway rolling stock for public service are affected. It will be enough to determine them by collective elements like model type, belonging to a specific subgroup of the railway company or others, utilized for specific purposes, for example local or regional transport, or any other specification. The only condition will have to be that the identification will be clear enough for the creditor to determine whether

one object falls under the declaration under Article XXV or not.

Under paragraph a) there are two ways how the listing of the relevant parts of the public service rolling stock can be made: either in the declaration by the Contracting State itself or in a two step procedure: the State determines a competent authority and notifies it to the Depository, and then that authority can make the necessary specifications. This is a mechanism to provide necessary flexibility. It avoids the difficulties that the State authorities themselves would have to make their final and comprehensive decision which parts of the rolling stock they want to exempt already at the moment when they notify their declaration.

If you read the provision in paragraph a) carefully, you will find that the current text still contains a gap: In the second case only the competent authority itself needs to be notified to the Depository but not the actual parts of the railway stock they want to exempt. But of course this is necessary. This information needs to be published so the markets and the creditors have a chance in advance to check what their situation will be in case of default or insolvency of the debtor and can act accordingly. In other words, there is a drafting error that still needs to be corrected during the Diplomatic Conference.

#### Consequences: Remedies not exercisable

If an object of railway rolling stock falls under this declaration, paragraph a) also gives the consequence: The remedies provided in Chapter III of the Convention and Articles VII to X of this Protocol shall not be exercisable. These provisions contain all the remedies the creditor is entitled to when a debtor does not fulfil his obligations under the agreement – that is Chapter III of the Convention with some modifications and extensions in Articles VII and VIII of the Protocol – or when the debtor falls into insolvency – that is Article IX of the Protocol. In other words: Even though the creditor has his interest formally registered in the Registry, he has no access to the secured object when the debtor does not pay as arranged. It is obvious that this diminishes the value of a security agreement drastically – possibly to the extent that the creditor decides not to make any arrangement on that particular object, or at least certainly not for the same conditions as he would be willing to do if he had the

perspective to exercise his rights to remedies without hindrance. I will come back to this point a little later.

### **3. Paragraph b)**

Now we turn to paragraph b). At first glance it looks very similar to paragraph a), but the difference is the object of the declaration: In paragraph a) it was specific objects of public service rolling stock, as defined in Article I, which only means rolling stock for transporting the public, i.e. persons. Here in paragraph b) it is "*railway rolling stock as far as it is used for the purpose of providing a service of public importance*". This provision now refers to the carriage of goods and freight. However, not any cargo transport falls under this paragraph. The transport has to be a service of public importance. This alternative was only brought in at the last meeting of governmental experts. It was the merits of the British delegation who pointed out the need to cover cases beyond transporting the public. The transport of goods can be a matter of public importance as well, for example transport of military goods or atomic waste. The concern was that transports of that kind which were on their way should not be halted and interrupted halfway through, only because a private creditor of the railway company wanted to exercise his remedies in case of default. What a "service of public importance" actually is, remains a matter of interpretation and a certain degree of discretion. In any event, due to the reference to "public importance" there has to be a certain element related to state interests to qualify for this paragraph.

Apart from that, the paragraph works exactly the same way as paragraph 1 after which it is formed. Again, either the State in its own declaration specifies the relevant rolling stock or it transfers this right to a competent authority. Here again, the error needs to be corrected that the current wording does not provide for the determinations of that authority to be published.

### **4. Paragraph c)**

As we have seen, the exemption of the Railway Rolling Stock from the attachment of the creditor, leaves the creditor not in a very favourable position. Even though the debtor does not fulfil his obligations, the creditor has no possibility to exploit the asset. If we remember the first draft of the Railway

Working Group, in that version the state which denied the exercise of the creditor's remedies, had to make a legally binding obligation to compensate the creditor.

In the current draft, it is paragraph c) which deals with this situation. However, the clause in paragraph c) is quite vague, under two aspects:

First of all, what the state should do is expressed in a very general way. There is no explicit mentioning of the word "compensation" but only generally "the protection of the interests of the creditor". Also, there is no binding obligation to that effect but the state should only "take into consideration"- what the result of these considerations will be, is left open by the provision.

Secondly, it is important to remember that all three paragraphs a) to c) depend on the introductory main clause as we have seen before. According to this clause the State is free to decide which of the paragraphs and to what extent they want to apply. In other words, paragraph c) in all its vagueness is optional; the State is not even under the obligation to "take into consideration the protection of the interests of the creditor", not even to speak of a binding compensation.

It is obvious that potential creditors and the financial markets are not too happy with the provision as it stands now. It is rather vague and leaves it to the discretion – if you like: the double discretion - of the state whether and in what way the creditor will receive any kind of compensation for cutting off his rights. It makes the financial security behind the agreement with the debtor less reliable and less calculable. The financial players would probably have preferred a clause that would express a binding obligation of the state to compensate the creditor for his lost security.

On the other hand, the financial players are not alone in the process of drafting this Protocol. States do have public policy interests that need to be recognized in order to increase the likelihood of widespread ratification of the Protocol. There are State Parties in which – as in Germany as we have seen – existing national legislation allows similar interventions by the State without compensation. For those countries, it is important to keep this system as it is

untouched because any new obligation of compensation could cause a financial burden on the public budgets which they would not be willing to take.

## **VII. Conclusion**

Article XXV as it stands now tries to strike a balance between the interests of the creditor to exercise his remedies in case of default of the debtor and the policy interest to maintain the public functions of rail transport.

At first glance it seems that the balance went in favour of the state and the public services: The wording of Article XXV is very flexible in many ways: The states are not obliged to provide any compensation for the creditor and the theoretical range of rolling stock that can be exempted is very wide. In theory, practically all of railway rolling stock for transporting people could be exempted from the remedies of the creditors. One could even ask the question whether this small Article would not undermine the whole of the Railway Protocol.

But in practice it is not very likely that this will happen. Any use of the declaration under Article XXV will have direct effect on the costs of the financing because financiers will not be willing to provide the same conditions as they would if they had secure remedies in the case of default. Ironically this will immediately fall back on the state itself who makes the declaration because it will increase the price the state has to pay for getting public service organized. As a result, the state will probably think very carefully whether and to what extent it will make use of the option in Article XXV and will use it only in the most limited amount possible where it really feels the need for it.

So it stands to be expected that the market conditions for financing will strike a good counter-balance to the technically wide range of the provision. In any case, the provision as it has been developed through the negotiation process provides all the necessary flexibility.

I thank you for your attention.

**Seminar on the Preliminary Draft Rail Protocol to the  
Cape Town Convention on International Interests in Mobile Equipment**

**Public Service Exemptions**

• Problem

• **Double Function of the Railway Company:**

- Player in the financial market, debtor to a financing agreement with a bank  
----> bank has remedies in case of default or insolvency
- Provider of transport as public service
- ==> Collision of interests:
- If creditor exercises his right to remedies, public transport affected.
  
- ==> Balance of interests necessary.

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Cape Town Convention on International Interests in Mobile Equipment**

**Public Service Exemptions**

Step 1: Draft by Railway Working Group

• **Article \* - Public service rolling stock**

- 1. **A creditor shall not exercise** in relation to public service rolling stock any of the remedies specified in Chapter III of the Convention (as modified by this Protocol) or Article IX of this Protocol **unless it has:**
- (a) **notified the relevant public service authority** in writing, giving it not less than seven calendar days to **respond** or otherwise act; **and**
- (b) **received the prior consent of the court**, which consent shall be denied if it receives a public service application within seven calendar days of the said notification and makes the directions requested therein (which it shall make unless they are manifestly unreasonable, unlawful or impractical).

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**Public Service Exemptions**

- **Draft by Railway Working Group (continued)**
- 2. The **public service application** shall be an application by a public service authority in the Contracting State in which the public service rolling stock concerned regularly operates, shall be made to a court in that State and shall include:
  - (a) a certificate that the railway rolling stock, the subject matter of an application, qualifies as public service rolling stock;
  - (b) a legally enforceable undertaking from the public service authority to **compensate the creditor**, within a reasonable period of time, for amounts (i) outstanding at the date of the application from the debtor and (ii) due in the future from the debtor to the creditor from the date of the application in each case assuming no default but including usual (but not default) interest at not less than the rate stated or implicit in the agreement; and
  - (c) a proposal for directions for further dealing with such public service rolling stock.

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**Public Service Exemptions**

- **Step 2:** Draft developed by the Second Session of Governmental Experts, June 2002

**Article \* - Public service rolling stock**

- A **Contracting State** may, at the time of ratification, acceptance, approval of, or accession to this Protocol, **declare** that the remedies provided in [Chapter III of the Convention and Article IX of this Protocol] **shall not be exercisable** within its territory **in relation to the public service rolling stock specified in its declaration** or determined by a competent authority of that State notified to the Depository.

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**Public Service Exemptions**

- **Step 3:**
- **Current Article** (after 3<sup>rd</sup> Session of Governmental Experts May 2003)
  - **Article XXV - Public service rolling stock**
- **A Contracting State may**, at the time of ratification, acceptance, approval of, or accession to this Protocol, **declare which and to what extent** the following sub-paragraphs shall apply to such Contracting State:
  - a) ...
  - b) ...
  - c)...

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**Public Service Exemptions**

**Article XXV - Public service rolling stock**

**A Contracting State may**, at the time of ratification, acceptance, approval of, or accession to this Protocol, **declare which and to what extent** the following sub-paragraphs shall apply to such Contracting State:

(a) the remedies provided in [Chapter III of the Convention and Articles VII to X of this Protocol] shall not be exercisable within its territory **in relation to the public service rolling stock specified** in its declaration or determined by a competent authority of that State notified to the Depositary;

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**Public Service Exemptions**

**Definition of Public Service Rolling Stock**

**Article I para 2 (e):**

(e) “public service rolling stock” means railway rolling stock habitually used for transporting the public on scheduled services, together with locomotives and ancillary railway rolling stock habitually used to provide such services;

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**Public Service Exemptions**

**Article XXV - Public service rolling stock**

**A Contracting State may**, at the time of ratification, acceptance, approval of, or accession to this Protocol, **declare which and to what extent** the following sub-paragraphs shall apply to such Contracting State:

(a) the remedies provided in [Chapter III of the Convention and Articles VII to X of this Protocol] shall not be exercisable within its territory **in relation to the public service rolling stock specified** in its declaration or determined by a competent authority of that State notified to the Depositary;

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**Public Service Exemptions**

• **Article XXV - Public service rolling stock**

- **A Contracting State may**, at the time of ratification, acceptance, approval of, or accession to this Protocol, **declare which and to what extent** the following subparagraphs shall apply to such Contracting State:
  - **a) ...**
  - **b) the remedies provided in [Chapter III of the Convention and Articles VII to X of this Protocol] shall not be exercisable within its territory in relation to railway rolling stock as far as it is used for the purpose of providing a service of public importance as specified in its declaration or determined by a competent authority of that State notified to the Depositary;**

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Cape Town Convention on International Interests in Mobile Equipment**

**Public Service Exemptions**

• **Article XXV - Public service rolling stock**

- **A Contracting State may**, at the time of ratification, acceptance, approval of, or accession to this Protocol, **declare which and to what extent** the following subparagraphs shall apply to such Contracting State:
  - **a) ...**
  - **b) ...**
  - **c) the Contracting State making a declaration under either of the preceding subparagraphs shall take into consideration the protection of the interests of the creditor.**

**SPECIFIC ISSUES OF PARTICULAR IMPORTANCE UNDER THE PRELIMINARY DRAFT  
RAIL PROTOCOL**

**Registration system: Supervisor and Registrar**

Gerfried Mutz

Deputy to the Director General of OTIF

# International Interests Supervisor and Registrar

Rail Protocol to the Cape Town  
Convention

OTIF



## Two Instrument Approach

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- Convention non equipment specific
- Equipment specific protocols
  - Aircraft
  - Space assets
  - Railway rolling stock
- Equipment specific protocols prevail over the convention

OTIF



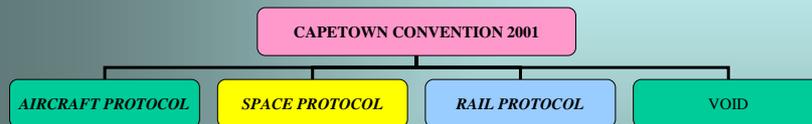
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Dr. Gerfried Mutz

15./16.04.2004

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## Convention and Protocols

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Any inconsistency is to be resolved in favour of the Protocol!

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## Registry principles

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- Different registers for different categories of mobile equipment
- Supervisory Authority - Registrar
- Electronic system
- No contract documents

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## Supervisory Authority

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Article 17 § 1 Cape Town Convention

There shall be a Supervisory Authority  
as provided by the **Protocol**

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## Supervisory Authority Aircraft objects

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- **In relation to aircraft objects:** the international entity designated by a Resolution adopted by the Diplomatic Conference: ICAO (subject to the willingness of ICAO to perform this function)
- ICAO (Specialized agency of the UN) already possesses juridical personality and the capacity to contract, to acquire and dispose of immovable and movable property and to institute legal proceedings
- 188 Contracting States

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## Supervisory Authority Rail Registry

- Article XIII of the Rail Protocol: the Supervisory Authority is a “Council of representatives” appointed by each State Party to the Protocol
- The Intergovernmental Organisation for International Carriage by Rail (OTIF) shall be the Secretariat of the Supervisory Authority

OTIF

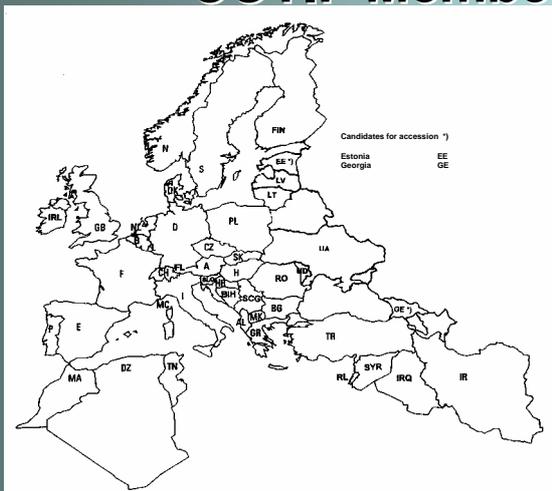


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## COTIF Member States



1. Albania	AL	22. Lithuania	LT
2. Algeria	DZ	23. Luxembourg	L
3. Germany	D	24. Macedonia, FYR of	MK
4. Austria	A	25. Morocco	MA
5. Belgium	B	26. Monaco	MC
6. Bosnia and Herzegovina	BH	27. Norway	N
7. Bulgaria	BG	28. Netherlands	NL
8. Croatia	HR	29. Poland	PL
9. Denmark	DK	30. Portugal	P
10. Spain	E	31. Romania	RO
11. Finland	FIN	32. United Kingdom	GB
12. France	F	33. Slovak Republic	SK
13. Greece	GR	34. Slovenia	SLO
14. Hungary	H	35. Sweden	S
15. Iraq	IRQ	36. Switzerland	CH
16. Iran	IR	37. Syria	SYR
17. Ireland	IRL	38. Czech Republic	CZ
18. Italy	I	39. Tunisia	TN
19. Latvia	LV	40. Turkey	TR
20. Lebanon	RL	41. Serbia/Montenegro	SCG
21. Liechtenstein	FL	42. Ukraine	UA

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## International Organisations

	Western Europe, Middle East	Central Europe, Asia	worldwide
governmental	UNIDROIT, UNCITRAL, ICAO, IMO		
	ECE/UNO <b>OTIF</b>		
	ECMT		
Associations	EUROFIMA	OSShD	
	CIT		
	UIC		

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## Supervisory Authority (Immunity)

- Article 27 of the Convention: the Supervisory Authority and its officers and employees shall enjoy, "such immunity from legal or administrative process as is specified in the Protocol"
- Exemption from taxes and other privileges may be provided for in the headquarters agreement with the host State
- At this stage, the Rail Protocol does not regulate the question of the Supervisory Authority's privileges and immunities

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## Supervisory Authority tasks (1)

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- Establish or provide for the establishment of the International Registry
- Appoint and dismiss the Registrar
- Ensure that any rights required for the continued effective operation of the International Registry in the event of a change of Registrar will vest in or be assignable to the new Registrar



## Supervisory Authority tasks (2)

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- Make or approve and ensure the publication of regulations pursuant to the Protocol dealing with the operation of the International Registry (after consultation with the Contracting States)
- Establish administrative procedures through which complaints concerning the operation of the International Registry can be made to the Supervisory Authority



## Supervisory Authority tasks (3)

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- Supervise the Registrar and the operation of the International Registry
- At the request of the Registrar, provide such guidance to the Registrar as the Supervisory Authority thinks fit
- Set and periodically review the structure of fees to be charged for the services and facilities of the International Registry

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## Supervisory Authority tasks (4)

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- Do all things necessary to ensure that an efficient notice-based electronic registration system exists to implement the objectives of this Convention and the Protocol
- Report periodically to Contracting States concerning the discharge of its obligations under the Convention and the Protocol

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## Supervisory Authority Decisions

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- A decision that affects (or affects adversely) only the interests of a State Party or a group of States Parties
  - shall be made if such State Party or the majority of the group of States Parties also votes in favour of the decision

OTIF



Supervisory Authority and Registrar  
Dr. Gerfried Mutz

15./16.04.2004

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## Supervisory Authority Basic features

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- International legal personality
- Appropriate immunity from legal or administrative proceedings
- Power to enter into any agreement necessary, including an agreement with the host State as to privileges
- Power to supervise the Registrar and the operation of the international Registry
- **Not entitled to give directions to the Registrar to change data relating to a registration**
- Owns all proprietary rights in the data and archives of the Registry

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## Registrar (1)

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- Ensure the efficient operation of the International Registry
  - perform the functions assigned to it by the Convention, the Protocol and the regulations
  - arrange for registrations to be entered into the International Registry data base and
  - arrange for registrations to be made searchable in chronological order of receipt
- Files shall record the date and time of receipt



## Registrar (2)

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- **Registrar is liable for errors and omissions in operating**
- The Registrar shall not be under a duty to enquire whether a consent to registration under Article 20 has in fact been given or is valid



## Registrar (3)

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- “Registrar” - not an employee but an independent entity or other person, natural or legal, appointed by the Supervisory Authority (or if otherwise provided by the relevant Protocol, designated by that Protocol) to run the International Registry



## Financial guarantee

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Article 28(4) of the Convention

- Insurance or
- Financial guarantee
- Rail Protocol [Article XVII(4)]
  - In respect of each event
  - not less than the maximum value of [an item of] railway rolling stock as determined by the Supervisory Authority
- Further consideration is still needed on this point



## First Rail Registry Regulations

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- The first regulations shall be made by the Supervisory Authority no later than [three months] prior to the entry into force of this Protocol
- Made so as to take effect upon the entry into force of this Protocol
- Prior to issuing regulations, the Supervisory Authority shall
  - publish draft regulations in good time for review and comment and
  - consult with representatives of manufacturers, operators and financiers

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## First Registrar

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- The first Registrar shall be appointed for a period not exceeding [10] years
- Thereafter, the Registrar shall be
  - appointed or
  - re-appointed
- for successive periods each not exceeding [10] years.

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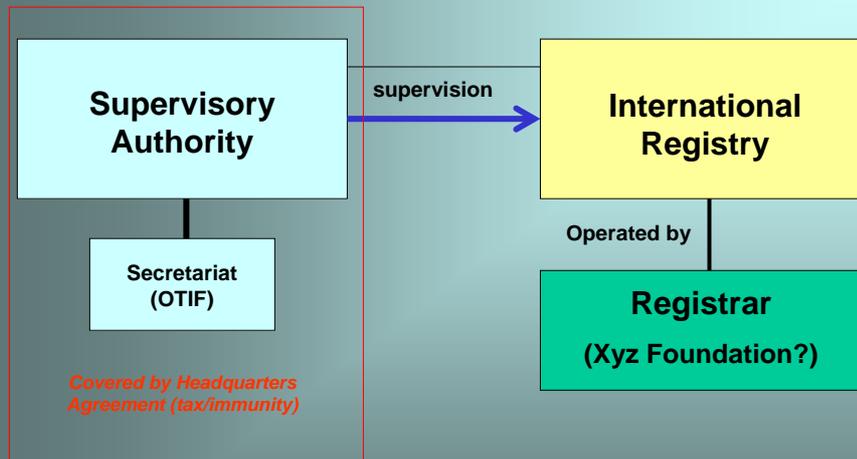


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## Structure of the International Registry



## Identification of railway rolling stock

- The Supervisory Authority shall, in regulations, prescribe a system for the allocation of identification numbers by the Registrar
- Enable the unique identification of items of railway rolling stock
- The identification number shall either be
  - affixed to the item of railway rolling stock or
  - be associated in the International Registry with a national or regional identification number so affixed.



## Search criteria

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- search criteria at the International Registry shall be established by regulations of the Supervisory Authority



## Basic features of the registry

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- Wholly electronic (registrations and searches)
- Publicity of ratifications and declarations via the Registry
- Notice based: establishes priorities, not validity
- Priority established on a first-in-basis
- Asset based: organised by object, not debtor
- Minimalist (documents not registered)
- Registrars role administrative, not interventionist



## Conditions to registration

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- Compliance with the electronic form
- Payment of the required fee
- Registrations that do not satisfy the foregoing conditions will be electronically rejected



## RRTF Mandate (1)

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- In relation to Article V (Identification of railway rolling stock):
  - (a) solicit, receive and summarize comments from stakeholders, including manufactures, operators and lenders on the operability of the system
  - (b) propose any additional measures to the system, including any draft provisions for the regulations with a view of implementing its objectives.



## RRTF Mandate (2)

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- In relation to Article XIII (Supervisory Authority and Registrar):
  - (a) assess, develop and propose any amendments to the draft Article (issues of immunity, legal capacity and domicile, internal rules of procedure)
  - (b) develop appropriate Regulation provisions with a view of implementing this provision, and
  - (c) solicit States or other entities interested in being appointed as the Registrar

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## RRTF Mandate (3)

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- In respect of Article XVIII (International Registry fees), assess and determine factors to be taken into consideration in the establishment of the fee structure, e. g.
  - Registry cost assumptions
  - Initial funding (Host State ?)
  - Annual fees, fees paid on filing, fees paid for searching and/or issued certificates

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## RRTF Mandate (4)

- Develop and propose the additional Regulation provisions and any other appropriate material necessary for the preparation of the Diplomatic Conference
- In performing the tasks set out above, the Registry Task Force shall in particular take into account the work done by the Preparatory Commission to implement the Aircraft Protocol and where appropriate a meeting of the Task Force

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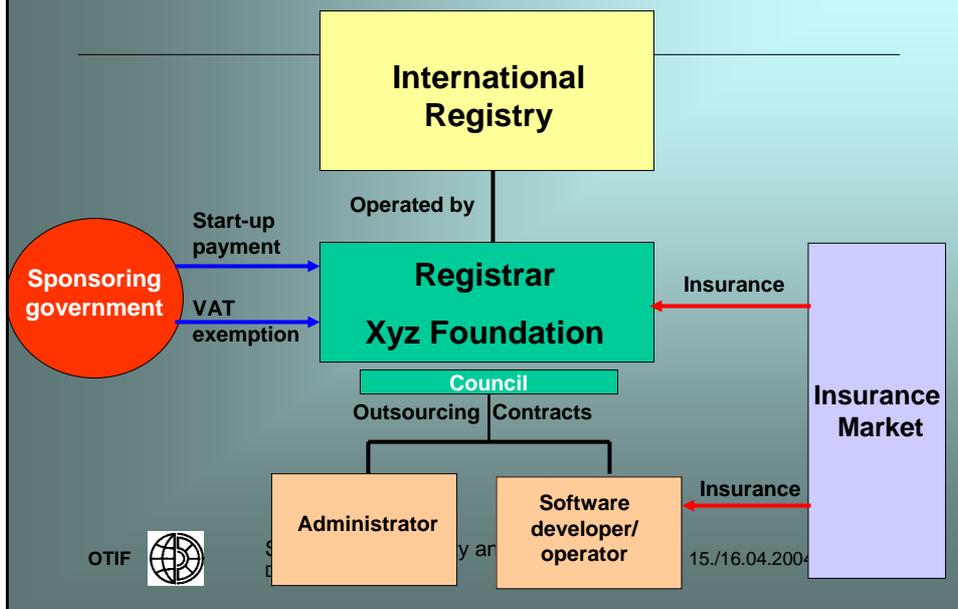


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## Operation of the International Registry



## Future work

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- Subgroups of RRTF (at work)
- RRTF (June and October 2004)
- Diplomatic Conference 2005 (?)

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**ROUND TABLE ON**

**THE APPLICATION OF THE RAIL PROTOCOL**  
**TO CENTRAL AND EASTERN EUROPEAN COUNTRIES**

## **International Influences and the New Polish Law on Secured Transactions : Harmonisation, Unification or What ? \***

*Frédérique Dahan* \*\*

*Gerard McCormack* \*\*\*

### **I. – INTRODUCTION :THE HARMONISATION ENDEAVOUR**

It is a cliché to say that we live in a world that has become increasingly global. It is true, however, that thanks to the ease of transport and communication, the people in the world are in contact with one another as never before. This is expressed in

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<sup>1</sup> For a mine of useful information on the Vienna Convention, including a list of Contracting States, see website <<http://www.cisg.law.pace.edu>>.

all fields from fashion to art, politics and, of course, business. Rare are the corners of the globe where what is happening is purely local – isolated from any outside influence. Focusing on the commercial aspects of globalisation, business activities have expanded beyond national boundaries. Investments have also become increasingly international with banks and financial institutions ready to invest on foreign security markets. Clearly, globalisation has posed a challenge for law and legal institutions.

In a perfect world, as business people adopt a single language to communicate with each other, there should also be a similar set of rules that allow legal transactions to be subject to the same conditions and to have the same effects in all places. There are, however, very few areas of law that have become truly international in the sense that all private actors are subject to the same rules, leading to the same result. International conventions on commercial law are relatively scarce, though a notable example is the United Nations (*Vienna*) *Convention on Contracts for the International Sale of Goods*.<sup>1</sup> Unification has sometimes been achieved by the work of independent bodies: for instance, the *International Chamber of Commerce* (ICC) has been remarkably successful with its *Uniform Custom and Practice for Documentary Credits* (UCP). Commercial law, and especially the proprietary aspects thereof, remain however to a large degree within the protected domain of domestic legislatures. As one distinguished commentator has pointed out, this may be by reason of the fact that property rights involve third parties

and, not infrequently, State-backed systems for the registration of proprietary interests.<sup>2</sup> Consequently, contract-based rules cannot operate in this sphere because it is only States or entities acting under powers delegated by States that have the ability to make legal instruments directly affecting property rights.<sup>3</sup>

Standardisation of law in the sphere of secured transactions is important at a time of internationalisation of financial markets and transactions.<sup>4</sup> Many institutions – governmental and non-governmental – have attempted to promote harmonisation. The *United Nations Commission on International Trade Law* (UNCITRAL) addressed this area as early as the 1970s but decided ten years later to suspend its work, considering that

“the world-wide unification of the law of secured interests was in all likelihood unattainable in view of the complexity of the matter and the higher priority accorded to other topics.”<sup>5</sup>

The work resumed in 1992 with the more limited task of preparing a Convention on assignment in receivables financing. In 2000, however, the Commission decided to resume its work on secured transactions with the preparation of a legislative guide.<sup>6</sup> The *International Institute for the Unification of Private Law* (UNIDROIT)<sup>7</sup> has produced a *Convention on International Factoring* (Ottawa, 1988) and more recently a *Convention on International Interests in Mobile Equipment* (Cape Town, 2001).<sup>8</sup>

Traditionally, the main technique for achieving harmonisation of laws across national frontiers has been the preparation of Conventions to which countries may adhere by a process of signature and ratification or adoption. The ratification process is, however,

<sup>2</sup> See, generally, Roy GOODE, “The Protection of Interests in Movables in Transnational Commercial Law”, *Unif. L. Rev. / Rev. dr. unif.* 1998, 453.

<sup>3</sup> *Ibid.*, at 455. Goode also points out (at 456) that “there are profound philosophical differences between legal families, and even between legal systems in the same family, as to the extent to which real rights in general and security interests in particular should be encouraged, and these bring in their train differences in legal concepts and characterisations. Of all legal constructs property rights are the most particular to a given legal system. The harmonisation of laws governing the creation, perfection and priority of real rights was thus perceived as an exceptionally daunting task.”

<sup>4</sup> Roy GOODE, “The Changing Nature of Security Rights”, in: Mads Andenas / Joseph Norton (eds.), *Emerging Financial Markets and Secured Transactions*, Kluwer, 1998, 1.

<sup>5</sup> Spiros V. BAZINAS, “UNCITRAL’s Work in the Field of Secured Transactions”, in: *Emerging Financial Markets ...*, *supra* note 4, at 211.

<sup>6</sup> For information, see the UNCITRAL website and links therefrom ([www.uncitral.org](http://www.uncitral.org)).

<sup>7</sup> See, generally, the UNIDROIT website (<http://www.unidroit.org>).

<sup>8</sup> The UNIDROIT website (*supra* note 7) contains a wealth of useful information on the latter Convention as well as a select bibliography. The Convention provides for the constitution and effects of an international interest in certain categories of high value mobile equipment and associated rights. However, Poland is not as yet a signatory of the Convention.

often attended by great delays and attention has switched to a “softer” option – namely, the preparation of Model Laws or General Principles, which act as an inspiration to reform-oriented legislatures. Model laws often lead to an increasing convergence of legislative provisions between neighbouring jurisdictions.

In Europe, a major initiative was undertaken at the beginning of the 1990s by the *European Bank for Reconstruction and Development* (EBRD) and this led in 1994 to the production of a *Model Law on Secured Transactions*. The EBRD identified the promotion of secured credit in the former communist bloc as a priority from the very early stages of its existence. The EBRD’s objective is to act as a commercial bank but also, more importantly, as a catalyst of change in the region by facilitating credit for other investors.<sup>9</sup> The Model Law was particularly aimed at the countries of Central and Eastern Europe and the former Soviet Union that were undergoing a process of transition from a Socialist-style command economy to a more free market oriented system.<sup>10</sup> Since

<sup>9</sup> John L. SIMPSON / Jan-Hendrik M. RÖVER, “An Introduction to the European Bank’s Model Law on Secured Transactions”, in: *Emerging Financial Markets ...*, *supra* note 4, at 165.

<sup>10</sup> There is extensive discussion of the EBRD Model Law in *Emerging Financial Markets ...*, *supra* note 4; see also FAIRGRIEVE, “Reforming Secured Transactions Laws in Central and Eastern Europe”, 1998, *European Business Law Review*, 245; MCCORMACK / DAHAN “The EBRD Model Law on Secured Transactions: Comparisons and Convergence”, 1998, *Company, Financial and Insolvency Law Review*, 65; DAHAN / MCCORMACK, “Secured Transactions in Countries in Transition

then, the Bank has provided direct legal assistance in the drafting and implementation of secured transactions laws to a number of countries in which it operates, such as Hungary, the Russian Federation, the Slovak Republic, Romania and Tajikistan.<sup>11</sup>

In a different context, the example of the United States is also telling. Its *Uniform Commercial Code* (UCC), drawn up in the 1950s, provided all the states in the United States with a model that they could adopt, adapt or reject. Article 9 of the UCC dealt in a comprehensive and systematic way with secured transactions,<sup>12</sup> and its success was immediate and complete. Not only have all American states adopted it – including Louisiana with its specific civil law tradition –, but it later served as a model for Canadian Provinces when they reformed their legal provisions in respect of personal

(The Case of Poland): From Model to Assessment”, 1999, *European Business Law Review*, 85; MISTELIS, “The EBRD Model Law on Secured Transactions and Its Impact on Collateral Law Reform in Central and Eastern Europe and the former Soviet Union”, 1998, 5 *Parker School Journal of East European Law*, 455.

<sup>11</sup> See, generally, Duncan FAIRGRIEVE (a member of the EBRD Secured Transactions Project), “Reforming Secured Transactions Laws in Central and Eastern Europe”, 1998, *European Business Law Review*, 245.

<sup>12</sup> For access to the recently revised text of Article 9, see the website of one of its sponsoring organisations, the National Conference of Commissioners on Uniform State Laws ([www.nncusl.org](http://www.nncusl.org)). See generally on the revised version of Article 9, the American Bar Association publication *The New Article 9* (2000); also *Chicago-Kent Law Review*, vol. 74, No. 3 (special issue), 1999.

property security. The common law provinces of Canada have adopted the provisions of Article 9 with slight individual modifications.<sup>13</sup> New Zealand has recently followed suit with the *Personal Property Securities Act 1999*. Thus, harmonisation of laws across jurisdictional frontiers can take many forms. In fact, some commentators take the view that the process is best seen as *an exchange of ideas and mutual influence*.<sup>14</sup>

It is against this backdrop that the question of harmonisation of secured transactions law in transition economies will be addressed in this article. We will examine the changes in this domain undertaken in Poland against the landscape of the international harmonisation efforts. Poland serves as a particularly appropriate example since it is one of the most “advanced” of the transitional economies in Central and

<sup>13</sup> See, for example, CUMING / WOOD, *Saskatchewan and Manitoba Personal Property Security Acts Handbook* (1994).

<sup>14</sup> It has been argued that “[i]n the legal context of inter-jurisdictional transactions, the ambiguity of harmonization is a function of its dependence upon the particular problem to be solved and the diverse legal elements related to that problem. Accordingly, harmonization of law can mean a process by which different laws are made easier to understand or to comply with. It can also mean the intellectual commensurability and consequential transferability of legal solutions outside their jurisdictional confines. Further, harmonization of law can refer to a process which facilitates the understanding of the structure and concepts of different systems of law.” See BOODMAN, “The Myth of Harmonization of Laws”, 1991, 39 *American Journal of Comparative Law*, 699 at 706.

Eastern Europe. As part of the transition process, it has embarked upon a fundamental overhaul of its commercial legal system and, in particular, the provisions of its domestic law pertaining to secured transactions. Our analysis will demonstrate that many of the concepts contained in the EBRD Model Law and the US UCC Article 9 did not take root in Polish soil. The result is a truly unique hybrid system that combines features from Poland’s pre-Communist Civil Law inheritance with more “developed” security law concepts borrowed from Anglo-American jurisprudence. There is, however, an important threshold question that needs to be considered; namely, why was reform in the sphere of secured transactions considered so important in Poland? This in turn leads on to the rationale of secured credit. This question will be tackled first.

## II. - THE RATIONALE OF SECURED CREDIT

What is the rationale that drives reform in the field of secured transactions? The EBRD Model Law makes it clear: the objective is economic. An efficient secured transactions legal system should decrease the risk of credit and as a result make borrowing more freely available and on better and longer terms. FLEISIG, who has worked in many Latin American countries, provides evidence of this link by examining legal deficiencies in the framework governing secured transactions over movable property in

Argentina.<sup>15</sup> The author concludes that

“three-quarters of the problem of high interest rates facing borrowers who do not use real estate as collateral is a problem that arises from the laws and legal procedures that govern lending against immovable property.”

According to the author (at 34),

“in most transitional and developing economies, instituting a modern system of secured transactions would probably reduce the cost of financing movable equipment to a few hundred basis points over the government dollar borrowing rate.”

In many respects, however, the “pattern of secured credit” is indeed complex and the factors that lead to the granting and taking of security are both more subtle and more variable than some American law and economics theorists would have us suppose.

A valuable empirical study undertaken by Professor Ronald MANN demonstrates the complexity of the issues.<sup>16</sup> On Mann’s analysis of the data, secured credit offers benefits but also imposes burdens on both the borrower and the lender.<sup>17</sup> Advantages for the lender are the

direct legal rights to bring about repayment through taking the secured property, whether via judicial intervention or by self-help remedies where available and appropriate. Indirect advantages, however, also operate before the lender tries to obtain payment. First, subsequent borrowings are limited since the borrower’s ability to grant a prized security interest to subsequent lenders is reduced. Second, the lender possesses leverage that increases the borrower’s incentive to repay the loan. Finally, the lender is able, often through specific covenants in the loan agreement, to restrain the borrower from engaging in risky conduct that would reduce its ability to repay the loan.<sup>18</sup> The advantages are, of course, counter-balanced by costs which may, in turn, explain why debts are not always secured. Filing fees represent a distinct element of expenditure in respect of secured transactions, though the level of filing fees is quite low in the Anglo-American world. There are also costs in respect of closing the transaction; in particular information costs concerning the value of the secured property and the borrower’s title thereto. By comparison, in an unsecured transaction, creditors focus on the creditworthiness of the borrower as a whole and, if the borrower is a quoted company, the information will be readily available to the creditor at low cost. It is arguable that this factor produces a significant bias in favour

<sup>15</sup> See, generally, Heywood FLEISIG, “Economic Functions of Security in a Market Economy”, in: *Emerging Financial Markets ...*, *supra* note 4, 15 at 19.

<sup>16</sup> Ronald J. MANN “Explaining the Pattern of Secured Credit”, 1997, 110 *Harvard Law Review*, 626.

<sup>17</sup> *Ibid.*, at 668.

<sup>18</sup> Of course clauses in an unsecured loan agreement may also impose restrictions on the conduct of the borrower.

of unsecured credit for public companies.<sup>19</sup>

The merit of this analysis is to bring home the proposition that no single factor can capture the multiple and interrelated considerations that motivate borrowers and lenders when they structure their transaction. The advantages and disadvantages of secured credit initially depend heavily on the legal context; *viz.* the existence of an adequate law on secured transactions that gives the lender an easily enforceable method of bringing about repayment of the amounts outstanding. However, the existence or non-existence of other structural elements also plays an important role in the pattern of secured credit. In a transitional economy, the costs of closing the transaction may be disproportionately high, for example because of high registration fees. This creates a disincentive for secured lending. On the other hand, information on the prospective borrowing companies is likely to be either unavailable or unreliable. This factor encourages the provision of secured credit, as secured credit tends to focus the lender's investigation and monitoring on one set of assets.

### III. – HOW TO DESIGN A NEW SECURED TRANSACTIONS ACT ?

If the rationale behind secured credit is not altogether clear and will depend on a multiple of costs-benefits that go beyond the sole legislative framework, the question of the actual content of the legislative framework is even more debated. While commentators may agree as to

<sup>19</sup> MANN, *supra* note 16, at 661.

the important role played by secured transactions, there is no uniformity of provision on this matter in Western jurisdictions.<sup>20</sup> A *Concept Paper on Secured Transactions Law*, prepared by the *American Bar Association – Central and East European Law Initiative* (ABA-CEELI) in 1997,<sup>21</sup> provided that

“the goal of standardization of these transactions, in fostering predictability and simplicity, should be central.”<sup>22</sup>

Yet legislators have a number of policy decisions to take in accordance with the social and economic context operative at any given time. Simplicity, for example, does not necessarily exclude providing different sets of rules for different situations. The predictability point requires considering the local context and raises the issue of familiarity: if the purpose of the new secured transactions law is to facilitate internal commerce by local parties, standardisation should allow for the arrangements to be like other arrangements with which the parties

<sup>20</sup> See Frédérique DAHAN, “Secured transactions law in western advanced economies: exposing myths”, 2001, *Butterworths Journal of International Banking and Financial Law*, 60.

<sup>21</sup> Available online (<http://www.abanet.org/ceeli/papers>). The experts contributing to the paper were: Joseph AUERBACH (Sullivan & Worcester); Randall L. CURRIER (Waters, McPherson, McNeill); Carroll D. FRENCH (retired Assistant General Counsel of American Can Company); Rew R. GOODENOW (Marshall Hill Cassas & de Lipkau); William H. HAGENDORN (Burlingham Underwood); Jan TORE HALL (Visiting Scholar at Yale Law School).

<sup>22</sup> *Introduction*, at 4.

are already familiar. If the purpose, however, is also to facilitate foreign participation in internal commerce,

“particular attention should be given to whether the new system is intended to be familiar to foreign parties, that is, to standardise practices with those in place in jurisdictions with which the foreign parties are familiar.”

Another question to address is the scope of the reform. Potentially, all types of secured transactions may be catered for but it behoves the drafting team to identify as precisely as possible the type of transaction that is particularly relevant for the jurisdiction in question. For instance, personal property or revolving property such as stock-in-trade (inventory) may be seen (and indeed is currently favoured) as the most promising, fast-growing type of wealth on which security could be given.

The EBRD Model Law provides a number of “Core Principles” which should guide the legislator,<sup>23</sup> among which:

(1) the security right must adhere to the essential qualities of a right *in rem*;

(2) the law should provide for the granting of security in the widest possible range of circumstances;

(3) the existence of a pledge over property must be effectively publicised;

(4) there should be a rapid and cost-effective means of recovering the debt from the secured asset; and

<sup>23</sup> See <[www.EBRD.com/english/st](http://www.EBRD.com/english/st)>.

(5) the cost of creating, maintaining and exercising the right should be kept at a reasonable level.<sup>24</sup>

Perhaps the most basic concept in the EBRD Model Law is that of a single security proprietary right which applies in respect of all types of assets and rights. This single security is given the label of “charge” and is clearly a property right and not a mere obligation. Moreover, the Model Law contains flexible definitions of the key notions of “debtor”, “secured debt” and “charged property”. Publicity, through registration in a register open to public inspection, is also required. The Model Law also features a broad right of enforcement with the secured creditor being granted the right to sell the charged property in whatever way it considers most appropriate. The overarching theme of the Model Law is minimum restrictions and contractual freedom with the parties to the loan transaction being entrusted with maximum flexibility to arrange their relationship in a manner that best suits their particular needs. The

<sup>24</sup> See FAIRGRIEVE, *supra* note 11, 245. These features are central to the philosophy of the EBRD Legal Team and when it assessed the extensiveness and effectiveness of pledge law in Central and Eastern Europe and the former Soviet Union in its 1997 *Transition Report*, it paid particular attention as to whether countries had reformed existing civil codes or adopted new laws to provide for the non-possessory pledge of movable property and established a cost-efficient mechanism for the registration and enforcement of the interests (*Transition Report*, at 17). These constituted a benchmark for progress in the transition process. See also SIMPSON / RÖVER, *supra* note 9, at 143.

Model Law, in all these features, did not really innovate. These features also constitute the backbone of the US UCC Article 9.<sup>25</sup> Despite notable differences with Article 9, the Model Law adopts many of the latter's features and offers them as an adequate framework for secured transactions law reform in Central and Eastern Europe.

At the beginning of the 1990s, all countries of the former Socialist bloc lacked what was felt to be an adequate secured transactions law.<sup>26</sup> Credit, especially for private enterprises, was very limited, if it existed at all:

“While secured lending in the United States and other Western countries following the War had adapted to better serve the needs of modern business, many of the Central and Eastern European countries actually took a step in

the opposite direction, discriminating against lending as politically incompatible with socialist economics.”<sup>27</sup>

In-depth reform was needed in all jurisdictions.<sup>28</sup> The transplantation of secured transactions laws in transitional economies of Central and Eastern Europe could be seen as providing a shortcut in the transition process, and legal transplants are also the seeds that can germinate into full-blown harmonisation of legal systems. This fact did not escape Western advisors working in the region. It was rightly suggested, however, that transplantation depends on a number of factors, including the compatibility of a particular country's legal system with that upon which the model is based,<sup>29</sup> and the potential for simplification to address the needs of an emerging market-based economic system.<sup>30</sup>

<sup>25</sup> On the comparison between Article 9 and the EBRD Model Law, see John S. SPANOGLE, “A Functional Analysis of the EBRD Model Law on Secured Transactions”, in: *Emerging Financial Markets ...*, *supra* note 4, at 157; also MCCORMACK / DAHAN, *supra* note 10, at 285.

<sup>26</sup> See Robert L. DRAKE, “Legal Aspects of Financing in Czechoslovakia, Hungary, and Poland”, 1992, 26 *The International Lawyer*, 505; also B.W. ROELVINK, “Security interests in the Czech Republic”, in: G. Ginsburgs *et al.* (eds.), *The Revival of Private Law in Central and Eastern Europe*, Kluwer, 1996, 557. We refer in this paper both to pledge law and to secured transactions law. The first expression is the term favoured by the countries of Central and Eastern Europe (see the new Polish Act) and the term now used in the EBRD's annual *Transition Report*. The Model Law, however, refers to “charge” as the most neutral expression to denote non-possessory security rights.

<sup>27</sup> IRIS, *The Law of 6 December 1996 of Registered Pledge and Pledge Registry*, English Annotated Translation, “Introduction”, at 2.

<sup>28</sup> See John SIMPSON, “Ten years of secured transactions reform”, 2001, *Butterworths Journal of International Banking and Financial Law*, 5.

<sup>29</sup> On this point, see in particular Thomas W. WAELDE / James L. GUNDERSON, “Legislative Reforms in Transition Economies: Western Transplants – A short cut to Social Market Economy Status”, 1994, 43 *International Comparative Law Quarterly*, 345.

<sup>30</sup> CEELI Concept Paper, Part III, “Selecting a Collateral Law Model”, at 1. It may be noted here that the recent revisions of Article 9 have significantly added to its complexity and perhaps increased its inappropriateness as a model to be used in transitional economies. See generally on the growing complexity of Article 9, HARRIS / MOONEY, “How

As noted above, since its creation in 1991, EBRD has given great attention to the question of secured transactions, and in 1994 produced the Model Law on Secured Transactions. The Model Law claims to be the result of a comparative survey of various laws on secured transactions, not only in Europe but also elsewhere in the world,<sup>31</sup> and to draw inspiration from both Common and Civil law systems. The principle that guided its drafting was to produce a text compatible with the civil law concepts upon which many Central and Eastern European legal systems are based,<sup>32</sup> while at the same time borrowing from common law systems since they “have developed many useful solutions to accommodate modern financing techniques.”<sup>33</sup> The Model Law contains 35 articles along with a detailed article-by-article commentary, plus a Schedule consisting of a model charging instrument and registration statement. The Model Law is not intended as a complete set

of rules but rather as “a basic system on which more sophisticated rules can be developed.” It has, of course, no legal force but was intended to be used as a skeleton for the legislators of the region to flesh out by drafting their own domestic laws on secured transactions. The EBRD Model Law is not the only model which was available to the countries of the former Communist bloc. Article 9 of the US UCC also exercised an important influence, not least by reason of the fact that it has itself served as a model in North America. One might say that the UCC has functioned as “a major and readily available resource for an effort to harmonise the law of secured transactions globally”<sup>34</sup> and consequently was pressed into service in Central and Eastern Europe.

Foreign advisors are also an important element of the influence of the West over law reform in Central and Eastern Europe. As noted above, EBRD did not limit its role to the drafting of the Model Law but also provided technical assistance to some

Successful Was the Revision of Article 9 ? Reflections of the Reporters”, 1999, 74 *Chicago-Kent Law Review*, 1357. The authors point out (at 1397) that “at a time when ‘legal’ writing is (slowly, but surely) becoming more ‘plain’ and ‘simple’, the trend in commercial-law codification appears to favour more detail, more forks in the road, less elegance, and ‘answers’ for ever more hypothetical cases.”

<sup>31</sup> The Advisory Board comprised academics and practitioners from diverse parts of the globe: from Western and Eastern Europe (France, Great Britain, Spain, Czech Republic, the Netherlands, Germany, Italy, Hungary, Belgium, Poland) but also from Canada, Australia, Russia, Japan and the US.

<sup>32</sup> *Introduction*, at V.

<sup>33</sup> *Ibid.*

<sup>34</sup> Elizabeth A. SUMMERS, “Recent Secured Transactions Law Reform in the Newly Independent States and Central and Eastern Europe”, 1997, 23 *Review of Central and East European Law*, 177–203, referring to Don WALLACE Jnr., “International Initiatives to Harmonize the Law of Secured Transactions”, lecture given in Dubrovnik (Sept. 1996). The specific advantage put forward in favour of Article 9 as opposed to the EBRD Model Law is that the latter was untested. See also Harry C. SIGMAN, “The Case for Worldwide Reform of the Law Governing Secured Transactions in Movable Property”, in: Jacob Ziegel (ed.), *New Developments in International Commercial and Consumer Law*, Oxford, Hart Publishing, 1998, at 229.

transitional economies. Several American organisations also contributed, in particular IRIS (*Institutional Reform and the Informal Sector*)<sup>35</sup> and ABA-CEELI. In Poland, when the Ministry of Justice established a Civil Law Reform Commission in 1990 which included a small working group devoted to the question of secured transactions, IRIS provided regular input to the Commission.<sup>36</sup> Its work ended in 1997, after the new law on secured transactions had been adopted.

As will be seen, while Poland, in its reform initiative, has embraced some of the aspects of Article 9 and the EBRD Model Law, it has resisted others. The new Polish law will now be examined.

<sup>35</sup> See the IRIS website (<http://www.inform.umd.edu/iris/present.html>). IRIS was launched in 1990 with initial funding from the US Agency for International Development (USAID) and employs more than 30 economists and lawyers. It helps to promote reforms relating to property and contract rights as well as in the general area of good government. It serves as a key resource for USAID in providing advisory and implementation in respect of the restructuring of market institutions.

<sup>36</sup> SUMMERS, *supra* note 34. There are a number of IRIS publications highlighting deficiencies in secured transactions law in Poland and asserting the need for reform – see, in particular, Ronald DWIGHT / Leigh Ann REICHENBACH, “Seeking Security in Poland”, *IRIS Reprint No. 42*. Tomasz Stawecki, a Polish lawyer, worked as part of the IRIS team in Poland and drew on his experiences there in writing about the new law – see STAWECKI, “Secured Transactions in Poland: Coping With the Traditional Thinking and the New Challenges for Central and Eastern Europe”, 1999, 32 *Uniform Commercial Code Law Journal*, 25.

#### IV. – THE 1996 POLISH ACT ON REGISTERED PLEDGES AND REGISTER OF PLEDGES : HOW THE ABOVE ELEMENTS COME INTO THE EQUATION

The Polish *Act on Registered Pledges and Register of Pledges* was adopted on 6 December 1996 and entered into force on 1 January 1998.<sup>37</sup> While at first glance, the provisions of the new Act are closely in line with the main features of the EBRD Model Law, a closer study reveals that significant differences remain.

##### A. Background

Poland is a civil law country and the Polish provisions on secured transactions have their roots in Roman law.<sup>38</sup> Next to the right of ownership which is indivisible, rights *in rem* include security interests. Roman law developed three types of real security instruments: *fiducia*, which required transfer of ownership to the creditor,

<sup>37</sup> The text of the Act is available online through the Polish Commercial Law Foundation website (<http://www.prawo.org.pl/clcf>). For commentary on the Act see, *inter alia*, Justyna CHABOCKA / Bruce LEGORBURU, “Implications of the Polish Act on Registered Pledge and the Register of Pledges”, 1998, 8 *Journal of International Banking Law*, 100; STAWECKI, *supra* note 36; and SUMMERS, *supra* note 34. Technically, the statute amended sections of the Civil Code, the Civil Procedure Code, the Banking Act, the Bankruptcy Act and the Securities Act. Relevant sections of the Civil Code continue to apply to issues not otherwise governed by the Act, except section 308 on the bank pledge that is repealed by the Act.

<sup>38</sup> Lech CHOROSZUCHA, “Secured Transactions in Poland: Practicable Rules, Unworkable Monstrosities and Pending Reforms”, 1994, 17 *Hastings International & Comparative Law Review*, 389.

*pignus*, which gave the creditor actual possession of the secured property, and *hypotheca*, where the debtor maintained ownership and possession of the collateral but gave the creditor a right over it upon default. Based on the principle of *numerus clausus* applicable to rights *in rem*, a catalogue of limited proprietary rights is strictly defined by statute. Although the specific content of the limited property right can be modified, parties may do so only to the extent permitted by law.<sup>39</sup>

With the changes occurring in commercial practice at the beginning of the century, secured transactions law had to keep pace and there is evidence that Polish law evolved in a similar manner as, for example, French law, by adopting *ad hoc* statutes for non-possessory security interests in various specific types of property, such as crops, timber, motor vehicles, machines and appliances.<sup>40</sup> The Polish Commercial Code provided for commercial pledges between merchants with particularly advanced rights of enforcement available to creditors. The system was, however, fundamentally reformed in 1964 under the influence of socialist ideology, with the adoption of the new Civil Code and the repeal of the 1933 Code of Obligations and the 1946 Law on Property. The non-possessory pledges mentioned above were abolished, and so were the provisions on commercial pledges. Mortgages,

although listed in the *code civil* as a property right, were regulated outside the Civil Code. These provisions remained generally unchanged until the 1996 reform. Tangible movable property could be used as security only by means of a possessory pledge or a bank pledge as governed by Articles 306 to 326 of the Civil Code.<sup>41</sup> It appears, however, that Polish banks did not make much use of this form of non-possessory pledge. The Polish banking industry preferred to rely upon assignments of receivables, as governed by Articles 327–335 of the Civil Code, at least partly because the rights of an assignee were stronger than those of a pledgee. Mortgages over immovable property were also common.

#### *B. General features of the Law*

The new form of security interest introduced by the 1996 Act is a registered pledge that is widely available for commercial purposes. The list of creditors who may benefit

<sup>39</sup> *Ibid.*, at 394.

<sup>40</sup> Aleksander W. RUDZINSKI, "A comparative study of Polish Property Law", in: D. Lasok (ed.), 1 *Polish Civil Law*, 1973, 57 at 68–69, 103, quoted by CHOROSZUCHA, *supra* note 38, at 392.

<sup>41</sup> Karen BUSCHARDT-PISARCZYK / Piotr TOMASZEWSKI, "A New Form of Securing Claims in Poland: The Registered Pledge", 1997, 10 *International Corporate and Commercial Law Review*, 369. With a possessory pledge, the debtor had to divest himself of possession of the subject property either by making delivery to the creditor or to a third party, as agreed upon by the parties. A specific type of pledge, the bank pledge, did not require dispossession of the debtor but was available only to *Polish* state-owned banks to secure a loan. With the amendments to the Civil Code, and a new Banking Act at the beginning of the 90s, the availability of the non-possessory pledge was extended to all banks operating in Poland, including Polish subsidiaries of foreign banks.

from a registered pledge is large.<sup>42</sup> It includes the State treasury and other State-owned entities, municipalities, domestic and foreign banks, legal persons whose statutory purposes is the granting of loans and credits, international financial organisations of which Poland is a member (such as the World Bank, the EBRD) and any other entities carrying out commercial activities in Poland.<sup>43</sup> However, it excludes non-banking foreign entities that do not carry out business in Poland, which may be a drawback for foreign investors. The only two requirements are the existence of a pledge agreement between the pledgor and the pledgee and its entry in a public register. The pledge agreement is required to be in writing<sup>44</sup> and to list the name of the parties, the object of the pledge and either the amount of debt secured by the pledge, or the maximum amount secured, if the secured debt is future or conditional and the amount is not determined at the time that the pledge agreement is made. The pledge becomes effective at the moment when the pledged assets are acquired by the debtor. The order of

<sup>42</sup> Technicalities in the operation of the pledge registry, mean that non-bank foreign creditors may find it difficult to avail themselves of the provisions of the law; on this point see, generally, STAWECKI, *supra* note 36, at 36–37.

<sup>43</sup> Thus, contrary to the position adopted by the EBRD Model Law, the security right can apply to consumer transactions, the criterion being based on the identity of the creditor, not on the nature of the transaction. The cost of filing, however, serves to discourage the use of the registered pledge device in low-value consumer transactions; on this point see STAWECKI, *supra* note 36, at 52–53.

<sup>44</sup> Article 3 of the *Pledge Law*.

priority of registered pledges will depend on the date on which an application for registration is filed, though in the case of applications filed on the same day priority is shared.

However wide this new concept of registered pledge may be, it still does not establish what Article 9 provides for – namely, the concept of a single security interest that applies to all secured transactions, whatever their name and modalities, independently from any specific reference to it by the parties. Article 9 created a new terminology completely eliminating the distinctions that were seen to plague this area of the law. This unitary security interest is one of the most innovative features of Article 9 and has garnered significant backing from one of the most eminent European specialists on secured transactions, who has said:

“In my mind, there can be very little doubt about the superiority of the North American unitary model over the diversified European approach. The main virtues of the North American model are the consistency and brevity of regulation which it makes possible; it also facilitates the establishment of a comprehensive system of registration. These advantages must be particularly persuasive to eastern and south eastern European legislators.”<sup>45</sup>

Yet the Polish legislator did not adopt such a concept. Alongside the

<sup>45</sup> Ulrich DROBNIG, “A Comparative Introduction to Security over Movables and Intangibles”, *in: Emerging Financial Markets ...*, *supra* note 4, at 6, 8.

registered pledge, possessory pledges and the assignment of rights by way of security remain valid legal devices, as does the mortgage over immovable assets (*hypotheka*). These devices all have their own set of rules. The registered pledge has simply been added to them. In general, the concept of a single security interest does not seem to appeal to the transitional economies.<sup>46</sup> In fact, however, Western European legal systems such as France, Germany or Austria have not adopted the concept either,<sup>47</sup> nor, is

<sup>46</sup> For example, in Hungary in 1996, the legislature amended the Civil Code to facilitate borrowing by making provision for several *specific* security instruments. On the Hungarian position see, generally, Istvan GARDOS and John SIMPSON, 1996, *Butterworths Journal of International Banking and Financial Law*, at 441 and 530 respectively; also HARMATHY, "The EBRD Model Law and the Hungarian Law", in: *Emerging Financial Markets ...*, *supra* note 4, at 197.

<sup>47</sup> See, for example, the presentation of the German Law on Secured Transactions by Karl KREUZER, "The Model Law on Secured Transactions of the EBRD from a German Point of View", in *Emerging Financial Markets ...*, *supra* note 4, at 195: "However, one should be aware of the fact that the introduction of a single registered security interest into German law would be, though desirable to my mind, nothing less than a revolution which would therefore naturally meet with fierce resistance. Furthermore, the German legislature made it clear in the scope of its recent reform of the German insolvency law that a reform of the security law which has been discussed for more than 70 years cannot be expected in the foreseeable future: if such a reform has been planned the legislature would have had to couple it with the insolvency reform by virtue of factual connection. So at the moment the

there a single comprehensive statute in English law that applies to all types of security. Transactions that are essentially the same in terms of economic effect are treated in substantially different ways by the law. The reason why Polish law has not embraced the single security interest concept may partly rest on the conservatism of Polish lawyers, who are reluctant to change the devices with which they are familiar. It was also easier simply *to add* a new security instrument to the existing ones – as Polish law does with the registered pledge – rather than to abandon entirely the existing system and start completely from scratch. Drastic measures such as these would also impose urgent and far-reaching requirements on banks in terms of staff training and overhauling their lending documentation. It would also require intensive judicial training to allow courts to familiarise themselves with the new system, although admittedly this argument would apply to any new Act. Be that as it may, the concept was not adopted in Poland and the reasons may be found in the realm of legal technique or legal tradition as well as in legislative policy and resistance to change.

*C. – Charged property (collateral) and the floating charge*<sup>48</sup>

The EBRD Model Law and UCC Article 9 both adopt the general view that personal property and real property should be dealt with separately, and

odds are against the implementation of the Model Law in Germany."

<sup>48</sup> The new Polish *Law on Registered Pledge* adopts the approach of referring to the charged property as "collateral".

that the idea of personal property should be understood as widely as possible. The Model Law provides that charged property may comprise anything capable of being owned; whether tangible and intangible, presently owned or to be acquired by the debtor in the future.

In Poland, under the previous provisions of the Civil Code, the subject-matter of an ordinary pledge had to be described specifically and handed over to the creditor. This prevented the creditor from taking a pledge over a class of revolving assets such as raw materials or stock-in-trade, or future assets - *i.e.* assets not in existence at the time of the pledge.<sup>49</sup> The only way to pledge this type of goods was for the lenders to amend the pledge agreement whenever the collateral changed form or whenever new property was acquired by the debtor. In the case of the bank pledge, dispossession of the debtor was not required before the security took effect but, for a bank pledge to be effective, it was necessary for the assets pledged already to be in existence. It was possible, however, for the parties to agree that the pledgor could use and dispose of the assets on condition that they would simultaneously be replaced with items of the same kind and quality. An "all property" clause, covering after-acquired property would not have fulfilled the requirement imposed by the Civil

<sup>49</sup> See the Introduction to the *Annotated English Translation of the Law of 6 December 1996 on the Registered Pledge and the Pledge Registry* by IRIS - Central Europe. Citations of the Polish law in this article are taken from the IRIS translation.

Code that the pledged property be specifically described.

With the introduction of the new registered pledge, it is now possible to pledge "any movable thing or property right which is transferable." This may include

"things which may be specifically identified, things identified as to type, if in the pledge agreement their quantity and means for differentiating them from other things of the same type is specified."<sup>50</sup>

The new Act goes a very long way in accepting that transformation of the charged property is not incompatible with the continued existence of a pledge. According to Article 8,

"the registered pledge shall continue on the collateral despite the alterations it may undergo in the manufacturing process, and in the event that the encumbered things are joined or mixed with other movable things in such a manner that it would be impossible, impractical or costly to restore them to their original state, the registered pledge shall encumber the whole of the things joined or mixed."<sup>51</sup>

<sup>50</sup> Article 7-1. There is an exception however, for ships registered in a special maritime registry.

<sup>51</sup> Paragraph 2 also provides: "Where things encumbered by separate registered pledges are joined or mixed, as specified in the preceding section, the pledges shall remain in force and shall encumber the whole of the things joined or mixed, and their priority of the pledge shall be determined according to the provisions of article 16."

It is also possible to pledge

“a collection of movable things or rights constituting an economic unit, even though the individual components may be replaceable, such as intellectual property rights, rights derived from securities such as shares and objects or rights which the debtor is to acquire in the future.”<sup>52</sup>

A registered pledge can now also cover future assets: the pledge document must simply specify the maximum liability for which the future assets act as security. Article 306 para 2 of the Civil Code, as amended, also permits a pledge to be created over future and conditional receivables.

In recognising the possibility of charging an “economic unit”, the new Polish law warrants comparison with the provisions of English law. In English law, it is of course possible to charge the entirety of a company’s business operations through the vehicle of the floating charge born of the ingenuity of 19<sup>th</sup> century English legal practitioners and their responsiveness to the needs of commerce. The floating charge is somewhat difficult to define strictly, yet its main feature is clear: namely, that the chargor remains free to dispose of the assets within the category covered by the charge in the ordinary course of its business without reference to the chargeholder, unless some event occurs which causes the chargeholder to intervene. Such an event is referred to as a “crystallising” event. A floating charge saves substantially on transaction costs.

<sup>52</sup> Article 7-2.

The fixed charge alternative over a fluctuating body of assets would involve a cumbersome process necessitating the execution of documents releasing charged property that the chargor wished to dispose of and substituting new charged property.<sup>53</sup> Despite superficial resemblance, the new Polish law on Registered Pledge does *not* contain provisions allowing for the creation of a floating charge as defined under English law, or “an enterprise charge” according to the EBRD Model Law. A pledge on an enterprise as a whole is not allowed as such.<sup>54</sup> Article 7 refers to a

<sup>53</sup> In many ways, the greatest insight displayed by the drafters of Article 9 UCC was to recognise that a fixed security interest was not necessarily incompatible with the debtor’s freedom to dispose of the collateral in the ordinary course of business. Professor Goode has pointed out: “The floating charge in this form was never recognised in American law, which eventually dealt with the problem in another way. Through a provision in Article 9 of the Uniform Commercial Code it was made clear that the debtor’s dealing was not inconsistent with the grant of specific security, and the interests of third parties were protected by a priority rule. Thus the floating charge, though a brilliant creation, turned out to be unnecessary, though it is still a powerful and widely used instrument.” See GOODE, *supra* note 4, at 2-3.

<sup>54</sup> Interestingly enough, the concept of “enterprise” was already present in the Polish Civil Code before the recent reforms. According to Article 55-1 of the Civil Code:

“An enterprise as a complex of material and non-material components, whose purpose is to perform definite economic tasks, covers that which is included in the enterprise, in particular:

“collection of *movable assets or rights* [our emphasis] constituting an economic unity, even though its composition may be changeable.” According to one commentator, this provision

“means that the parties must describe in detail in the pledge agreement the economic entity on which the pledge is being established, thereby achieving the effect of a pledge on an enterprise but without the problems involved with the enterprise’s real property or debts.”<sup>55</sup>

- 1) the business name, trade marks and other marks which identify the enterprise,
- 2) books of accounts,
- 3) real estates and movables which belong to an enterprise, including products and materials,
- 4) patents, utility models and design patents,
- 5) obligations and burdens connected with the running of the enterprise,
- 6) rights resulting from leasing and holding the premises occupied by the enterprises under tenancy.”

According to Article 526 of the Civil Code, when an enterprise is sold, both seller and purchaser assume joint liability for all the debts of the enterprise. Assignment of all or part of an enterprise became a popular device to obtain credit after World War II. As part of the overall financing package, the parties could agree that the debtor would continue to use the components of the enterprise to run the business and that the profits generated by the business would be used to pay off the credit granted.

<sup>55</sup> Tomasz STAWECKI, *The Bill on Registered Pledges in Poland*, 1995, at 9, which is cited in the IRIS Translation of the Polish *Pledge Law*.

Moreover, immovable property could not be included in a registered pledge, nor movable assets that become incorporated into immovable assets.

The difference between the Polish concept and the English floating charge is also clear when the question of enforcement is examined. Under English law, a secured creditor with a floating charge that covers the whole or substantially the whole of the assets of a business, is empowered to appoint an administrative receiver whose basic function is to realise or sell off the secured assets for the benefit of the chargeholder and who also has extensive powers to manage the affairs of the company.<sup>56</sup> By way of contrast, the Polish Law, in Article 27, provides that

“if the pledge agreement allows the creditor to satisfy the claim from the profits of an enterprise of which the collateral is a constituent part, a receiver may be appointed over the enterprise; the identity of such receiver must be specified in the pledge agreement.”

<sup>56</sup> Schedule 1, *Insolvency Act* 1986 confers various implied powers on an administrative receiver. Moreover, he has the power, with leave of the court, to dispose of property subject to a prior or equal security interest. An administrative receiver is required to be a qualified insolvency practitioner. It should be noted that a recent UK Government White Paper, “Insolvency – A Second Chance”, Cm. 5234, July 2001, proposes removing the general unilateral right of a floating chargeholder to appoint an administrative receiver.

The appointment of a receiver must have been foreseen at the time of the execution of the pledge and the identity of the appointee revealed.<sup>57</sup> This is a long way from the freedom conferred under English law to the holder of a floating charge who *may* unilaterally decide to appoint a receiver.<sup>58</sup> It appears that the provision of receivership has not been widely used in Poland and informed opinion suggests that it is unlikely ever to become standard practice. In any case, the receivership procedure would most probably be superseded once formal insolvency proceedings are commenced against the debtor and a liquidator (official receiver) is appointed.<sup>59</sup>

Here, once again, one can see that the specific legal context in Poland has brought about a result which differs significantly from the provisions of the EBRD Model Law and indeed from English law.

<sup>57</sup> It is also wise to nominate a substitute, should the receiver be unable to assume his duties.

<sup>58</sup> Also, Article 27, para 2, states that: "An enterprise, as mentioned in para 1, may be leased on the demand of the creditor in order to satisfy its claims from rent receipts, if the pledge agreement so provides. The pledge agreement may stipulate that the creditor must consent to the conclusion of the leasing contract."

<sup>60</sup> Article 91 of the *Bankruptcy Act* provides that: "The judge-commissioner may, at the request of the official receiver, appoint persons whom he will charge with the administration of a part of the bankruptcy estate which constitutes a separate economic entity ... The administrator of a separate estate performs his duties under the supervision of the official receiver and shall abide his orders."

#### *D. – Charge creation and registration formalities*

Perfection or registration requirements are crucially important in the realm of secured transactions. Two basic goals underlie such provisions. The first is public notice. If a security interest is perfected through filing in a register that is open to public inspection or by the creditor obtaining possession of the secured property, third parties who may be contemplating the advance of credit to the company are alerted to the existence of the security interest. Such knowledge may have an important influence on their lending and investment decisions. Second, compliance with perfection requirements may act as a measure of reassurance for the secured lender, as it gives the lender priority over later lenders, secured or unsecured, and also renders the security interest immune from later legal challenge. Perhaps the most impressive achievement of Article 9 has been to provide clear and simple procedural steps for the perfection of security interests.

There are two major issues with regard to registration that should be considered:

- The appropriate and practicable methods of registration and the accompanying technicalities plus the methods necessary to ensure the continuity of registration in diverse circumstances such as the transfer of property elsewhere, transfer of the security interest by the original creditor, transformation or attachment of the secured property to real property, etc.

- The categories of creditors against whom a security interest can be registered and those who remain unaffected, especially in the case of insolvency.

On the first issue, while there seems to be a general consensus in favour of the existence of an efficient register that may easily and cheaply be consulted, close scrutiny reveals that many options are actually open. First, it is important to determine whether registration should be effected against the name of the debtor or against the charged property (collateral) or perhaps, in certain cases, in respect of both categories. If the location of the secured property determines filing obligations, questions may arise as to where, in fact, the property is located: the property may be moved or is simply difficult to locate because of its inherent qualities, *e.g.* intangible property. Second, the place where to file must be determined, that is, whether there will be a centralised register or a series of local ones. Third, a great deal of care must be taken as to filing requirements; the standard of compliance required; the effect of errors and facilities for corrections. Last but not least, costs play a very important role, whether these be filing fees or taxes collected at the time of filing. On the second issue concerning the efficacy of filing or lack of filing, it is important to decide whether the register should determine priority or notice questions or whether actual knowledge may still be invoked. It may be that "the goals of predictability and certainty will be better served by

letting the results on the filing record be the key element of any issue."<sup>60</sup>

The EBRD Model Law includes a reasonable amount of detail as to the formalities necessary for the creation and registration of charges. As a matter of standard practice, two documents are required: a charging instrument and a registration statement. The charging instrument is required to be dated and must identify the chargor, the chargeholder, and the secured debt as well as the charged property. A registration statement has to be presented at the charges' registry within 30 days of the execution of the charging instrument in the case of a registered charge. The registration statement should state the chargor, the secured debt, the maximum amount secured, the charged property and that the charge is an enterprise charge if that is in fact the case. The rationale of the 30-day time limit is to avoid "secret" charges whereby the chargeholder takes a charge but does not register until he chooses. Registration is imperative for the purpose of third party notice but is also a condition of the validity of the charge as such. This may be seen as a sign of the influence upon the Model Law of the tradition of "notarisation" in many Civil Law jurisdictions, including those of Central and Eastern Europe. Registration of contracts by notaries continues to be a requirement for validity in most post-communist legal systems.<sup>61</sup> On the other hand, under

<sup>60</sup> CEELI concept paper, Section IX, at 18.

<sup>61</sup> See generally on the importance of notarisation in the former Socialist States, SUMMERS, *supra* note 34.

Article 9, perfection serves exclusively the goal of third party notice of prior security interests. Registration is not a condition of validity of the security interest.

In the Polish Law on Pledge, the register fulfils a crucial function. It is noteworthy that the concept of registration itself is not new in Poland. Under the previous regime for secured transactions, specific registers existed to register titles over ships, aircraft and publicly traded securities. A pledge over these assets had to be mentioned on the register as well. Moreover, land registers – referred to as Perpetual Books – were in place and maintained by local courts, where again mention was made of the title holder and the existence of a charge over land.<sup>62</sup> The major flaw of the former bank pledge was that each bank had its own register. There was no public central register of pledges. Consequently, it was impossible for a creditor (especially a foreign bank with no affiliate or branch in Poland) to check the level of collateral previously granted by a potential debtor and to ascertain whether certain property had been pledged. As one commentator pointed out:

“In a country like Poland where close to 1,750 banks were in business at the end of 1991, the recording of secured interests in individual bank registers is not a

<sup>62</sup> See, generally, the IRIS survey of asset-based lending in Central and Eastern Europe, 1995, *Butterworths Journal of International Banking and Financial Law*, Special Supplement, September 1995.

substitute for a centralised registration system.”<sup>63</sup>

Under the new law, creation and perfection of registered pledges requires the drafting of a pledge agreement and its registration by either the pledgor or pledgee at the appropriate registry within one month of entering into the pledge agreement.<sup>64</sup> On the expiration of the pledge, it should be deleted from the Register at the request of either party.

Supervision of the registry rests with the Minister of Justice. In November 1995, the Minister of Justice approved a report proposing a Norwegian-type self-financing central registries project.<sup>65</sup> The project was supported by World Bank financing amounting to \$100 million and included registers covering pledges and business entities and a new land registry system. Two decrees issued by the Ministry of Justice implemented the reform. The first, on “Internal structure and organisation of the central register and the delivery of information”, was adopted in October 1997, the second, on “Costs of copies and certificates”, on December 1997. As a result,

<sup>63</sup> See CHOROSZUCHA, *supra* note 38, at 409.

<sup>64</sup> Article 3, para 3. If the application for entry in the registry is not made within one month, it shall be rejected, which means that the pledge will not be recorded. If so, the parties must re-execute the pledge agreement and re-file an application to register the pledge.

<sup>65</sup> This report was prepared jointly by Polish officials and a team of Norwegian consultants. See generally on the pledge registration system in Poland, STAWECKI, *supra* note 36, at 48–53.

registration is effected through an application to a district commercial court, to a special section (*sad rejestrowy*), competent in the area where the debtor resides or has its seat (Article 36). The decision to make an entry into the registry is made by a single judge in closed session and the opinion is then delivered *ex officio* to the parties. The judge simply checks that legal requirements are fulfilled but does not check the accuracy of the information, *e.g.* whether the asset really exists. If he is not satisfied that the registration form has been filled in adequately and that the pledge agreement comprises all the assets mentioned, he may reject the application. A Central Pledge Registry was established in Warsaw, to provide the computerised links that give interested parties ready access to information on any district registry. The cost of registration and the subsequent change to the entry and search has been kept low.<sup>66</sup> Searches may be made either by borrower or by lender but not by secured asset. The biggest problem, not unexpectedly, is that the new system is overloaded. Initially, the problem of overload was compounded by the fact that the transitory provisions of the law required that all *existing* non-possessory pledges (*i.e.*, bank pledges taken under former Article 308 of the Civil Code) should be registered before 30 June 1998 in

<sup>66</sup> The cost of registering a pledge or a mortgage was established by the Decree of 17 December 1996 on the costs of filing civil actions. Registering a pledge costs 200 PLN, (approx. \$ 60), modifying the entry 100 PLN (\$30) and obtaining an excerpt, 20 PLN (\$6).

order to remain in force.<sup>67</sup> But there is further evidence of a backlog in the system because of unnecessary checks made during the registration process.

The system of registration introduced in Poland relies heavily on the efficiency of the judicial system.<sup>68</sup> Unless the courts are able to deal with a registration or information request in reasonable time, the whole system will lose credibility. The reforms will not be implemented properly and the benefit of the substantive provisions on perfection will be lost. This reaffirms a point widely recognised, namely that the efficacy of the institutional setting is a prerequisite for any effective reform of substantive law. It is too early to advance any definite conclusions, but the available evidence suggests that the courts are experiencing difficulties in meeting the challenge, if only because the law remains extremely vague as to the checks that the registrar must perform and the procedure for amendment, should an error have

<sup>67</sup> A delay of only three months was initially permitted – which would have meant a deadline of 31 March 1998, but this was subsequently extended to six months.

<sup>68</sup> See the statement (at 11) of the IRIS Annotated English Translation of the *Pledge Law*. “The district courts were chosen over other institutions for three reasons: competency, reliability and accountability. Of all Polish institutions, the court is considered the most reliable and the least corrupt. Despite the high cost of litigation, the court is generally considered competent and fair by the public and holds a high degree of prestige. Finally, court officials are held accountable, under Article 417 of the Polish Civil Code, as state functionaries.”

been made in respect of the entries on the register.<sup>69</sup>

*E. – Realisation of charged property*

It is clear that the manner in which the creditor can exercise its security right is a crucial factor in determining the value of the pledge. The provisions of the EBRD Model Law are particularly detailed on this score. As a matter of general principle, in the event of failure to pay the secured debt, the charge becomes immediately enforceable. Step one in the enforcement proceedings is the delivery of an enforcement notice to the debtor. The Model Law expresses a clear preference for self-help remedies with the chargeholder being given the right under Article 24 to sell the charged property without any court intervention. This right of out-of-court sale may be exercised provided that 60 days have elapsed since the delivery of the enforcement notice. The chargeholder also has the power, during this 60-day period, to take protective measures so as to ensure that the property remains available for sale.<sup>70</sup> These protective measures include taking possession of the property or, where this is impracticable, taking such steps as are necessary to immobilise the charged property so as to prevent the debtor or a third party from using it and to stop the debtor from transferring title to it. The idea of self-help enforcement can raise concerns, however, and not only in the countries of Central and Eastern

Europe. Allowing the creditor to realise the security interest over the property can endanger the interests both of the debtor and of other creditors. Control by the courts is often thought necessary to provide an appropriate safeguard. The transitional economies, are markedly reluctant to downplay the role of the judiciary in the enforcement procedure.

Here again, the position of the Polish legislator was determined not only by pressure to reform but also by the need to render any new provisions compatible with existing execution procedures as set out in the Polish *Code of Civil Procedure*. Article 21 of the 1996 *Law on Registered Pledge* provides that "satisfaction of the creditor from the collateral shall be carried out in judicial enforcement proceedings unless specific provisions of this law provide otherwise." This establishes a clear preference for enforcement by the courts, which remains the general rule. According to Article 777 of the *Code of Civil Procedure*, all creditors must first obtain an executory title, typically a civil court judgment on the merits of the claim.<sup>71</sup> They can then apply for an enforcement title, basically a judicial authorisation to execute the judgment. At this point, the creditor can apply to the bailiff (*kormornik*) for an instruction to make a final demand for payment and, if that demand produces no results, to take control of the

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<sup>69</sup> Article 41 does provide some rules as to how an order inconsistent with the application can be amended, but is silent as to the rights of third parties.

<sup>70</sup> Article 23 of the Model Law.

<sup>71</sup> Executory titles can also take the form of an arbitration decision, an administrative decision or a notarial deed in which the debtor confirms the existence of the debts and voluntarily agrees to execution on the charged property.

property which must be sold at public auction.<sup>72</sup>

While maintaining the enforcement provisions of the *Code of Civil Procedure*, the new Pledge Law also provides extensive rules for the provisional attachment of the charged property, should satisfaction of the claim by the debtor appear in jeopardy (see Articles 26 to 35). The new law has also introduced some limited self-help procedures. First, it is possible for the pledge agreement to provide for the sale of the pledged assets by public auction (conducted by a bailiff or a public notary) within 14 days from the date on which the creditor makes a request for such (Article 24 para 1). Second, Article 22 makes provision for claims to be satisfied without recourse to the ordinary execution procedures, by the creditor contractually acquiring title to the pledged property. Such transfer

<sup>72</sup> Polish Banks, under the former Article 53.2 of the *Banking Act*, benefited from summary execution proceedings. The bank's documents confirming the amount of the debtor's obligation and his duty to repay, were sufficient in themselves vis-à-vis the bailiff who would execute on the property without any further judicial requirement. This provision has now been amended under the new Art. 53-2.1 which requires either the official court seal or the debtor's voluntary submission before summary execution becomes possible. Article 312, para 2 of the *Civil Code*, however, still allows credit institutions to provide in their constitutional documents for alternative methods of obtaining repayment of loans that have been secured by a pledge. This has been interpreted as authorising banks to provide that in the event of default, ownership of collateral would pass to them - see, generally, CHOROSZUCHA, *supra* note 38, at 419.

of title is only possible if the value of the assets is specified in the pledge agreement or if the pledge is over a commonly traded commodity or publicly traded securities and if the Securities Commission has consented to such assignment.<sup>73</sup> This speedy means of enforcement does however require the parties to have so provided in the pledge agreement. Under both sets of out-of-court enforcement procedures, the pledgee must first notify the pledgor in writing of its intention either to transfer title of the asset or have it sold by public tender. The pledgor then has seven days within which to apply to the court to disallow operation of the procedure.

V. - WILL THE REGISTERED PLEDGE BECOME THE MAIN FORM OF SECURITY INTEREST ?

Does the reformed Polish law closely follow the EBRD Model Law and Article 9 of the Uniform Commercial Code? Is there some degree of harmonisation taking place in Eastern Europe which might spread to Western Europe? Certainly, the Polish drafters took these models into consideration when framing the new legislative provisions. This is not altogether surprising given the close involvement of Western, particularly US, advisers in the reform process. The new form of registered pledge is, however, specific to Poland. The drafters felt a need to maintain most of the existing system while ensuring that the new method of taking security was integrated into the existing provisions in respect of

<sup>73</sup> However, a possession order will still be needed to repossess the assets.

secured transactions and fitted into the existing execution and insolvency procedures. Still, if the new registered pledge were to take off as the main security instrument, in practice this would mean that one form of security interest – the registered pledge – would be available for all types of transactions. This was precisely the view held by one of the experts who contributed to the law reform process in Poland:

“It is clear that reform of secured transactions law in Central and Eastern European nations will not be accomplished in a single step. As a first step, the Central and Eastern European nations have not and probably will not enact the entire Model Law provisions. The EBRD may not even expect them to do so. They do need, however, to enact a registered charge system which will give them experience with a secured transactions system which is more effective. Hungary and Poland are attempting to take that path, by adopting a registered charge system that omits the unpaid vendors provisions. Unpaid vendors will continue to have whatever security is available under the prior law, but will not have the benefits of the new legislation – certainty of priority, protection from good faith purchasers, modern enforcement provisions and control of resale of the collateral. More experience with more effective secured transaction systems could then lead to subsequent enactment of a more comprehensive secured financing

system which could cover all secured creditors.”<sup>74</sup>

There is evidence that the registered pledge has become a popular security instrument with the lending community in Poland. Polish banks, on the other hand, still favour the use of absolute title as security, *i.e.* the transfer of title over property by way of security.<sup>75</sup> Large-scale project finance is often arranged on the basis that the lender will be repaid out of the stream of revenue generated by the project.<sup>76</sup> Although it is both possible and safe to pledge accounts receivable, creditors prefer to secure their loans by an outright assignment of receivables owed to the grantor of the security interest (the account creditor) by its account debtor.<sup>77</sup> Security interests over

<sup>74</sup> John SPANOGLE, *supra* note 25, at 172.

<sup>75</sup> This, despite the fact that Polish courts have never actually decided whether a transfer of title by way of security is effective upon the debtor’s insolvency. The *Bankruptcy Act* itself is silent on the matter. Given this climate of uncertainty, as certain commentators point out: “[c]reditors may feel that changing their security arrangement from a transfer of title to a registered pledge is going to give them greater certainty in the eyes of the law ...” On this point, see CHABOCKA / LEGORBURU, *supra* note 37, at 104–105.

<sup>76</sup> Rolf GIEBELER / Peter DASZKOWSKI, “Poland” (special report), 1998, *International Financial Law Review*, Project Finance Special Supplement, at 44.

<sup>77</sup> Leasing has also become very popular since 1989 and found widespread use in the economy. Polish law distinguishes two types of leasing: financial leasing and operational leasing. The latter is in fact simply a rent agreement, whereas the former serves as security for loans. Leasing is used in the

immovable property (*hypotheka*) also remain a very common way of securing credit, despite practical difficulties, in particular the fact that the *Perpetual Books* (the Land and Mortgage Registry) have not yet been computerised and the process of obtaining information on land ownership and land mortgages is a lengthy and formal one.<sup>78</sup> Furthermore, enforcement proceedings in respect of mortgages, as for ordinary pledges, are fairly complicated and time-consuming.

This problem may be taken as demonstrating the need for stronger and more effective means of securing loans. The inertia factor in favour of the status quo is strong, however, particularly where domestic lenders are concerned. While domestic lenders may shy away from the new concept of the registered pledge, it is true nevertheless that foreign lenders will derive great benefit from the system since it broadly follows a pattern with which they are more familiar. The new law has also abolished the disadvantage at which they found themselves vis-à-vis Polish banks. The new pledge law aims not only at building a reliable, enduring domestic regime that applies to secured transactions but also, and arguably more importantly, at reassuring foreign investors. An

case of privatisation where the management of a newly privatised enterprise enters into an agreement with the company for the right to "use" it.

<sup>78</sup> It takes several months, (in Warsaw up to a year) to have a mortgage officially registered. However, there is recent evidence that the mortgage market, both commercial and residential, is taking off in Poland. See "Loan a home", *Business Eastern Europe*, January 8, 2001, 5.

important difference with legal reforms undertaken in the West is that legal reform efforts of the transitional economies have not been primarily transaction-led but rather, have been directed at establishing a legal framework that will attract commercial activity.<sup>79</sup> Given the relatively high level of use of the new registered pledge concept, these efforts would appear to have borne fruit.<sup>80</sup>

#### VI. - CONCLUSION

Poland has gone a long way towards reforming and modernising its law on secured transactions with its new legislation pertaining to registered pledges. The new law was drafted with the benefit of Western assistance provided under the United States Aid programme. Notwithstanding this, the Polish legislator has firmly resisted the whole-scale incorporation of concepts borrowed from Article 9 of the US Uniform Commercial Code or indeed from the EBRD Model Law. In particular, the Polish *Law on Registered Pledge* does not contain the concept of a single security interest applying uniformly to all types of personal property. Nor does its legislation apply across the board to

<sup>79</sup> See generally on this point, SUMMERS, *supra* note 34.

<sup>80</sup> See, generally, STAWECKI, *supra* note 36, at 53-55, who states that "institutional lenders are slowly learning how to use the new law, but they, nevertheless, continue to learn. The Polish economy is still at the early stages of its development towards a mature and sophisticated system. If the financial community has already found one field of profitable enterprise, it will likely look for other fields."

all forms of transaction which, in functional economic terms, are intended to secure the performance of an obligation. Ownership-based security interests in general, and reservation of title clauses and finance leases in particular, remain unaffected by the new legislation. Enforcement is still mainly court controlled. The *Law on Registered Pledge* rejects the option of fundamentally recasting the Polish secured transactions system. Instead, it builds incrementally on the existing legal provisions. There is now the possibility of charging future assets, including future receivables, and there is also much-needed flexibility in the requirement that secured property must be itemised. Clearly, however, the Polish law has retained its specificity. Rather than adopting a completely new set of rules, the legislator has brought the existing provisions up to Western standards, offering lenders – both domestic and foreign – a system that promises flexibility and reliability. This, rather than harmonisation, may well be the way forward: a search for flexibility coupled with efficiency.<sup>81</sup> To the Western observer, however, a number of apparent incongruities remain in the overall framework. In the main, these exist at the level of detailed drafting. In many cases, however, the meaning and effectiveness of the legislative reforms will only be teased out by judicial decision or become settled as a result of

administrative practice. This brings home the point that legislative reform cannot operate effectively in a vacuum. The judicial and administrative infrastructure is crucial in ensuring the success of legislation. This is especially true in a system of secured transactions law, such as that in Poland, which is premised on public registration of security interests as well as on mainly judicial means of enforcement of security.

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<sup>81</sup> See George GRETTON, “Mixed Systems: Scotland”, in: *Emerging Financial Markets ...*, *supra* note 4, 279 at 282: “I love the legal diversity of the world, and I would wish it more rather than less. I must confess what is nowadays a dreadful heresy: I regard harmonisation with scepticism.”