

# Commentary on 'A Comparison of the Position of Buyers under the Cape Town Convention, the Three Existing Protocols and the Draft MAC Protocol'

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## I. Introduction<sup>1</sup>

This commentary looks at Professor Gullifer's excellent paper from the perspective of the Luxembourg Rail Protocol<sup>2</sup> and the preliminary draft MAC Protocol<sup>3</sup>. Professor Gullifer has given us an extensive overview of how the buyer is treated under the Cape Town Convention<sup>4</sup> and the respective protocols. I particularly appreciated the carefully nuanced analysis of when a contract of sale, where closing of the transaction is subject to conditions, in fact is a title reservation agreement ('TRA') within the scope of all three of the existing protocols. I will come back to that later. But the first question you will ask is: why did the Rail Protocol reject the opportunity to extend most of the suite of the Cape Town system of rights and protections to buyers?

## II. Policy Considerations

In my view, there were a number of reasons. For a start, the Convention was not initially designed to deal with sales. Professor Gullifer's statement that the Convention's 'primary purpose is not ... to pro-

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<sup>1</sup> Consistent with Professor Gullifer's paper, references to 'OCR' are to Roy Goode, *Official Commentary on the Convention on International Interests in Mobile Equipment and Luxembourg Protocol thereto on Matters Specific to Railway Rolling Stock* (2<sup>nd</sup> edn, UNIDROIT 2014). The references to 'OCA' are references to Roy Goode, *Official Commentary on the Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment* (3<sup>rd</sup> edn, UNIDROIT 2013). References to the draft regulations are to the initial draft regulations for the operation of the International Registry under the Luxembourg Rail Protocol, published by UNIDROIT and OTIF on 13<sup>th</sup> April 2016 - see 'Draft Regulations for the International Registry' <<http://www.railworkinggroup.org/wp-content/uploads/docs/r0178.pdf>> accessed 26 February 2018. They will be updated to take into account the then current software being proposed for the operation of the International Registry, once it is clear when the Protocol comes into force.

<sup>2</sup> Luxembourg Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Railway Rolling Stock, often referred to as the 'Luxembourg Rail Protocol' and here the 'Rail Protocol'.

<sup>3</sup> Preliminary draft Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Mining, Agricultural and Construction Equipment, referred to here as the draft 'MAC Protocol', as set out in the UNIDROIT report of the second meeting of the Committee of Governmental Experts of October 2017 - see Appendix III in UNIDROIT, *Study 72K - CGE2 - Report* (Report (prepared by the UNIDROIT Secretariat), 2017).

<sup>4</sup> Hereinafter referred to as the 'Convention' or 'CTC'.

protect buyers of equipment, or to provide rules governing sales<sup>5</sup> is entirely correct. The original report from Professor Cuming on which the Convention and the protocols were largely based, focused on security interests and bolstering the rights of creditors where certain types of security were created over moveable assets.<sup>6</sup> Accordingly, in the Convention itself the buyer (as opposed to a conditional buyer) is viewed as a type of third party beneficiary, not a party whose rights are entrenched and supported in the same way as those of creditors. It was only the Aircraft Protocol<sup>7</sup> which introduced the gloss of analogising the buyer's rights to that of a creditor.<sup>8</sup>

### A. Different needs

The design of the Convention with the subsidiary protocols was driven by the recognition of different needs and different circumstances for different industries. At the time the work was being done, with government experts preparing the Rail Protocol, it was, and it remains, far from clear that this additional gloss was necessary for the rail sector. 15 years ago, when these issues were being debated, most rolling stock was owned directly or indirectly by the state. Even today, after a fair degree of liberalisation and more on the horizon, in Europe probably little more than 20% of rolling stock is purchased and held privately without state funding or support. So the urgent need to regulate the passage of title and sales of aircraft in the private sector was not replicated in the rail industry. But there was, and there remains, another fundamental reason why the two protocols go separate ways and perhaps I can assist Professor Gullifer to explain this policy difference.

The post-war regime for regulating ownership of aircraft under the Chicago and Geneva Conventions<sup>9</sup> relied on a system of marking and identification of aircraft and national aircraft registries where title would be registered and at which, in most cases, mortgages could also be recorded. Aircraft acquire a nationality based on where they are registered. The registries are publicly accessible and so generally establish a prima facie position as to who owns, and who has charges over, aircraft. Moreover, because of this nationality and registration locally, the Aircraft Protocol modifies the provisions of Article 3(1) of the Convention such that the nexus in terms of the applicability of the Convention is expanded from one test – where the debtor is 'situated'<sup>10</sup> – to a second test of the state where the aircraft is registered.<sup>11</sup>

No such regime exists in the railway world. There are no national rail registries recording ownership of railway rolling stock, let alone mortgages by reference to the assets shown in national rail registries.<sup>12</sup> The Rail Protocol covers a wide range of assets from conventional wagons and locomotives

<sup>5</sup> Louise Gullifer, 'A Comparison of the Position of Buyers under the Cape Town Convention, the Three Existing Protocols and the Draft MAC Protocol' (2017) 6 *Cape Town Convention Journal* [this issue] 98.

<sup>6</sup> Restricted Working Group responsible for determining the desirability and feasibility of the preparation by UNIDROIT of a model law in the general field of secured transactions. For an outline of a modern legal regime for the regulation of secured financing transactions by Professor R.C.C. Cuming (University of Saskatchewan) see UNIDROIT, *Study LXXXII A – Doc. 2* (1994).

<sup>7</sup> The Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment.

<sup>8</sup> The Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Space Assets (hereinafter the 'Space Protocol') followed, perhaps, on the rationale simply to stay in sync with the Aircraft Protocol as much as possible although the policy considerations may not have been the same.

<sup>9</sup> Convention on International Civil Aviation, signed in Chicago on 7 December 1944 and Convention on the International Recognition of Rights in Aircraft, signed in Geneva on 19 June 1948.

<sup>10</sup> A carefully negotiated term elaborated in Article 4 of the Convention.

<sup>11</sup> Article IV(2) of the Aircraft Protocol.

<sup>12</sup> Of course, there may be the possibility of registering a security interest against an item of rolling stock in general national registries recording charges on assets but this will vary from state to state both in terms of application and process as well as the legal effect. It may not always be possible to search against individual assets in such registries, which is obviously a serious drawback for any prospective secured creditor or purchaser.

to trams, metro trains and cable cars.<sup>13</sup> There is no concept of nationality of rolling stock.<sup>14</sup> To this day there is still no common system for identifying rolling stock and the Rail Protocol will introduce this for the first time. If one cannot reliably identify the asset over which a title interest is asserted, then registries cannot determine title or security rights. But paradoxically, because the aviation industry ran a risk of a conflict between a buyer's position registering title in a national registry and the secured party's position registering its interest under the International Registry, rules reconciling this potential conflict were clearly preferable.

The case for applying the Aircraft Protocol's approach on sales to the rail sector is therefore much weaker. As Professor Gullifer, and indeed other commentators, have pointed out over the years, the International Registry was never intended to be a title registry, only a notice based registry where registrations could be made indicating claims *in rem*. Of course, a *title* registry for railway rolling stock worldwide would be extremely useful. But this is a huge challenge not least because of the volume of items involved. There are probably about 44,000 aircraft in the world. We estimate that there are probably about 6 million items of rolling stock. Indian Railways alone has a freight wagon fleet of close to a quarter of a million wagons. The logistical challenge of marking all rolling stock with unique numbers and then creating a very clear system of rights, effectively forcing all holders of rolling stock to register title interests, would have attracted so much resistance, because of the burden on industry, it would have threatened the whole project. Moreover, with still predominantly state actors buying and selling rolling stock, the perceived need was very limited.

## **B. The drafting challenges**

The synthetic grafting of a secured transactions regime onto issues of taking clean title was not just rejected because this was somewhat contrary to the original intention of the Cape Town Convention but also due to the fact that it resulted in some quite contorted drafting. Moreover, bearing in mind that there is no nexus to the Convention through the nationality of, or registration of title in, the asset, and so only the 'situation'<sup>15</sup> of the debtor is the criterion for the protocol to apply, it would have been more than a little strange had Article III of the Aircraft Protocol been carried across into an equivalent provision of the Rail Protocol, cross-referencing into Article 3 of the Convention. This would have meant that, rather bizarrely, the Rail Protocol would apply to sales where the *seller* was situated in a contracting state whereas the security interests were only covered by the Convention when the *debtor* was situated in a contracting state. But as Professor Gullifer rightly points out, a contract of sale may actually start off as a title reservation agreement (and often does) so the vendor under a title reservation agreement, if situated in a contracting state, would not bring in the coverage of the Convention if the conditional purchaser were not situated in a Cape Town Convention jurisdiction, whereas the actual sale would do so. That seems rather bizarre; the reverse scenario even more so.

## **III. The Notice of Sale**

As a result, the compromise of permitting the registration of a notice of sale but it being outside of the priorities' and enforcement regime of the Convention was, and remains, quite an attractive al-

<sup>13</sup> Article I(2)(e) of the Rail Protocol defines railway rolling stock as 'vehicles movable on a fixed railway track or directly on, above or below a guideway'.

<sup>14</sup> In the past there had been a concept of *Heimatbahnhof*, or home station, for some types of rolling stock but this was never universally applied and is now obsolete.

<sup>15</sup> See above.

ternative. Article XVII of the Rail Protocol states that 'the regulations shall authorise the registration in the International Registry of notices of sale of railway rolling stock'. The draft regulations already have provided for this.<sup>16</sup> Further, it was accepted that 'any such registration and any search made or certificate issued in respect of a notice of sale shall be for the purposes of information only and shall not affect the rights of any person, or have any other effect, under the Convention or this Protocol'.<sup>17</sup> The last part of this sentence is important in that there is no indirect protection of the first owner under Article 29(3) of the Convention in any conflict between rival owners as long as both purported sellers have the power (and not just the right) to dispose. It should also be noted that because it is purely an informational notice, the registrar of the International Registry is not liable for errors and omissions.<sup>18</sup>

### A. Public domain

The drafters accepted that there was merit in placing into the public domain the notification of the sale without being required to bend current domestic law on the way that the *nemo dat* principle works in various jurisdictions. In this context, perhaps Professor Gullifer underestimates the impact in civil law jurisdictions of what we in the common law world would call ostensible ownership. In practice, the greatest concern of creditors in Continental Europe will be a third party purchaser taking good title to an asset which does not belong to the vendor on the basis that it is a bona fide purchaser without notice of the rights of the actual owner and it takes physical possession of the asset concerned.<sup>19</sup> With respect, I do not accept Professor Gullifer's statement that the 'railway rolling stock is very unlikely to be in the actual physical possession of the seller at the moment of the enquiry'.<sup>20</sup> Sale and leasebacks are common both in rail and aircraft finance.<sup>21</sup> The presumption can be dislodged however by notice and whilst of course giving the true owner protected rights under the Convention because of a registration of a sale, effectively underwriting the purchaser's good title, is attractive in theory, in many jurisdictions this will already be assured as long as there is actual or constructive notice, depending on applicable law, of the true owner's position – and of course Article 29(3) of the Convention continues to apply. This helps assure the buyer from the true owner and on the other hand undermines any valid transfer of title from a possessor that is not the true owner. In this context, the notifications in a public registry will have a critical impact on the validity of the buyer's title under national law.<sup>22</sup> It will also be helpful in demonstrating where a claimant is (or is not) acting in good faith, which can be an important factor in civil law jurisdictions.

So the adoption of the compromise was not significantly motivated by the need to generate additional funds for the registrar. In fact, there are plenty of other plans to generate income for the registrar. It was driven by a recognition that the limitation of the exception to the *nemo dat* principle was

<sup>16</sup> See section 5.6.

<sup>17</sup> Article XVII of the Rail Protocol.

<sup>18</sup> Section 7.2 of the draft regulations.

<sup>19</sup> For more on this see Howard Rosen and Benjamin von Bodungen, 'The Luxembourg Protocol to the Cape Town Convention on International Interests in Mobile Equipment on Matters Specific to Railway Rolling Stock-Overview and Current Status' (2014-2015) 46 Uniform Commercial Code Law Journal 329, 339 and Howard Rosen, Martin Fleetwood and Benjamin von Bodungen, 'The Luxembourg Rail Protocol – Extending Cape Town Benefits to the Rail Industry' (2012) 17 Uniform Law Review 609, 616.

<sup>20</sup> See Gullifer (n 5) 117.

<sup>21</sup> Indeed in countries such as Switzerland and Sweden, the Rail Protocol will make such transactions considerably easier.

<sup>22</sup> Swiss law is a good case in point where recording of the relevant transactions and interests in a public registry plays a critical role of dislodging the ostensible ownership presumption for the possessor of the asset being sold; it can also override the 'Faustpfandprinzip' under Article 884 of the Swiss Civil Code. Currently the Swiss Federal Supreme Court's position is that a sale and leaseback transaction is incompatible with this principle (BGE 119 II 236).

desirable but at the same time by a reticence towards adopting the significant complexity involved in extending the main regime of the Cape Town Convention to sales. On the contrary, had the main motivation been to generate revenue for the registrar, the drafters would have embraced the solution in the Aircraft Protocol where every sale in a chain is registered. However, the fact that there are no national registries at all relating to title to rolling stock means that any notice system advising the industry at large that there are claims to the asset under a sale will already be a significant step forward in securing the rights of the rightful purchaser and secured parties as a matter of domestic law.

The draft MAC Protocol follows the approach adopted in the Rail Protocol.<sup>23</sup> At the most recent meeting of government experts<sup>24</sup> this approach was confirmed.

#### IV. Reservation of Title

Back to what is a title reservation agreement and how it potentially impacts the position of a buyer under the Rail Protocol. For the purposes of the Convention, it is clear that a contract of sale and a TRA are mutually exclusive and a contract of sale exists only if the agreement to supply is not a TRA, not the other way around.<sup>25</sup> The same order of priority applies if under applicable law a title reservation agreement is considered to be security agreement,<sup>26</sup> where then the contract of sale and the security agreement cannot co-exist, but the focus here will be on the TRA.

A TRA arises if there are conditions set out in the sale agreement, whatever they may be, that need to be fulfilled before title passes.<sup>27</sup> Under Article 1(II) of the Convention, a TRA is 'an agreement for the sale of an object on terms that ownership does not pass until fulfilment of the condition or conditions stated in the agreement'.

##### A. The five objections

There seem to be at least five objections to this inclusive approach.

It must be admitted that at the Luxembourg Diplomatic Conference and the experts' meetings beforehand, the delegates' clear focus in relation to the TRA was on a party, often a manufacturer, providing credit under such agreement as a sales aid tool – a classic conditional sale agreement with deferred payments resulting in title only passing once payment in full had been made but with the conditional buyer already in possession. But the wording is not so restrictive. Some of us at least did not pay enough attention to the other scenarios where the definition would apply.<sup>28</sup>

It would have been perfectly possible to have restricted the TRA to agreements for sale where title could pass on payments being made. Any other conditional sale agreements would then be 'contracts of sale' and not TRAs for the Convention's purposes. Compare, for example Article 9 of the EU Late Payments Directive<sup>29</sup> (which allows Member States to provide that the seller 'retains title to goods until they are fully paid for if a retention of title clause has been expressly agreed between

<sup>23</sup> Article XVIII in the current working draft. See UNIDROIT, *Study 72K – CGE2 – Report* (Report (prepared by the UNIDROIT Secretariat), 2017).

<sup>24</sup> Second meeting of the Committee of Governmental Experts of October 2017. See UNIDROIT, *Study 72K – CGE2 – Report* (Report (prepared by the UNIDROIT Secretariat), 2017).

<sup>25</sup> CTC, Article 1(g); OCR para 4.13.

<sup>26</sup> See OCR paras 4.44 and 4.102.

<sup>27</sup> If there are no conditions to the transfer of title stated in the contract but the contract is silent and title passes through the application of applicable law, then this would not be a TRA; see OCR para 4.44.

<sup>28</sup> Although OCR para 4.44 does make it clear that there are potentially 'other conditions' which may be specified in the agreement.

<sup>29</sup> Directive 2011/7/EU of the European Parliament and Council of 16 February 2011 on combating late payment in commercial transactions.

the buyer and the seller before the delivery of the goods') with the broader wording in Article 1(II) of the Convention or, for that matter, Section 19 of the UK Sale of Goods Act 1979. But the narrow approach was not adopted by the drafters. In his explanatory report to the Cape Town Diplomatic Conference, Professor Goode, commenting on Article V of the (then) proposed Aircraft Protocol, stated that 'this Article is confined to contracts of sale, that is, to contracts under which title passes to the buyer immediately, as opposed to conditional sale agreements'.<sup>30</sup>

In other words, the contract of sale is the instrument by which title passes, for example a bill of sale. Whether deliberately or not, the drafters set out with the assumption that an agreement for sale of an item containing conditionality on title transfer could not be a contract of sale for the purposes of the Convention. The definition of the TRA went through all three government experts' reports prior to the diplomatic conference and the diplomatic conference itself without amendment.<sup>31</sup> This continues. In his commentary, Professor Goode elaborates that an "agreement" is also to be contrasted with "contract of sale", which is separately defined and denotes a contract of outright sale.<sup>32</sup>

In his discussion of what constitutes a 'sale', Professor Goode states:

The buyer's completion of payment *and* fulfilment of other title transfer provisions under a title reservation agreement and the lessee's exercise of an option to purchase contained in a lease *bring the contract of sale into existence and simultaneously a sale under that contract*.<sup>33</sup>

It could not be clearer. So Professor Gullifer confirms that a conditional sale agreement where non-payment conditions precedent to the passing of title exist in the agreement such as the goods must be delivered, or that the seller might have to perform some repairs or other work on the goods 'clearly falls within the definition of TRA in the Convention'.<sup>34</sup> It is submitted that if it is within the definition, it is a TRA even if this conclusion is inconvenient for some. But perhaps this is an unnecessary discussion since, irrespective of other conditions, it would be very unusual for an arm's length sale agreement to be entered into for rolling stock, aircraft or other movables where payment for the goods was not a precondition for the transfer of title. As soon as that is the case, it must already be a TRA.

A more interesting observation would be that the TRA was intended to deal with sales where the conditional buyer was already in possession of the object being sold. This explains the provisions of Article 10 of the Convention (whereby in the event of default under a title reservation agreement the conditional seller may 'terminate the agreement and take possession or control of any object to which the agreement relates').<sup>35</sup> Ignoring the fact that Article 10 seems to assume implicitly that only the conditional buyer can be in default of its obligations (see *When a default occurs* below on this), clearly this provision cannot apply when the conditional seller remains in possession. But there is no such limitation in the definition of the TRA and all creditor remedies under the Convention are only applicable when the conditions envisaged apply. There is no guarantee, even under a classic credit sale agreement that the debtor remains in possession. On the other hand, a sale pursuant to a purchase option under a lease explicitly envisages that the debtor is in possession even though the

<sup>30</sup> Report of 5<sup>th</sup> November 2001, see UNIDROIT, *DCME-IP/2* (2001).

<sup>31</sup> See for example the report of the Third Joint Session (Rome, 20-31 March 2000) in UNIDROIT, *Unidroit CGE/Int.Int./3-Report ICAO Ref. LSC/ME/3-Report* (2000).

<sup>32</sup> See Gullifer (n 5) 100. OCR para 4.7.

<sup>33</sup> OCR para 4.39 (emphasis added).

<sup>34</sup> The definition refers to 'fulfilment of the condition or conditions stated in the Agreement' so must mean that a TRA cannot just be a simple sale agreement where title automatically passes on the fulfilment of one condition (payment).

<sup>35</sup> See also Article 13 (where the assumption appears to be that the debtor is in possession) and the provisions in the Convention and the respective protocols for recovery by the creditor on debtor insolvency.

contract of sale only arises when the lessee has an unconditional right to acquire title.

Thirdly, Professor Goode in his commentary seems to hint that there has to be an *express* reservation of title in the agreement for it to be a TRA.<sup>36</sup> Is this to be differentiated from a stipulation of title passing on fulfilment of certain conditions? There seems to be no basis for this distinction in the Convention, as Professor Gullifer implicitly agrees, and in any event it is difficult to see when a condition or conditions to the transfer of title combined with an obligation to transfer on the fulfilment of the condition(s) is (are) in fact not an express reservation of title by the conditional seller even if it is not specifically stated as such.<sup>37</sup> If this analysis is incorrect, we could end up with detailed disputes as to what is an express condition. But, to avoid any possible ambiguity, practitioners will surely draft express reservation of title wording into the agreement and the discussion will be moot.

The fourth objection is that the inclusive reading of the definition effectively renders the contract of sale a nugatory term in the Convention. Not at all. A bill of sale would usually come into that definition. Professor Goode lists various possibilities.<sup>38</sup> There could be agreements for sale where the transfer of title occurs by operation of law rather than contract.<sup>39</sup> It may be an oral contract (at least in the context of railway rolling stock).<sup>40</sup> In relation to aircraft, once it is clear that the Aircraft Protocol has to be read as referring to the registration of *sales* and not of *contracts of sale* (as Professors Goode<sup>41</sup> and Gullifer agree) then the utility of the term is limited anyway. By definition, the contract of sale must be unconditional and is simply the precondition for the registration of the sale. It is clear that under the Convention, a contract of sale arises once the conditions to the transfer of title to the buyer have been fulfilled. This may, but not necessarily will, be the case for aircraft bearing in mind the additional requirements in Article V of the Aircraft Protocol for the contract of sale.

Lastly, it is argued that aircraft industry practice over the last 12 years is to consider all agreements for sale of aircraft as contracts of sale for the purposes of the Convention (and not TRAs). This is a paradoxical argument bearing in mind that it is the Aircraft Protocol, and not the Convention, which potentially seriously limits the category of contracts of sale due to the additional conditions in Article V. Even if this were persuasive, and for reasons given above it is not, this cannot indirectly rule the Rail Protocol which has not imported the system of applying the Convention to sales. Moreover, with one exception, it makes no material difference since it is the sale, not the contract of sale, which is being registered at the International Registry and the parties may register a prospective sale to preserve priority as soon as the conditional agreement for sale (a TRA) is entered into. The exception is that if neither the seller has its 'seat', nor the aircraft is registered, in a contracting state but the purchaser does have its seat in a contracting state, neither the sale nor the prospective sale could be registered but the agreement for sale could be registered as a TRA.<sup>42</sup> But in that case, our conclusion is only helpful to the parties by giving it another way to register an interest under the Convention.

It may be that, as Professor Gullifer remarks, 'whether an agreement is a "TRA" or a "contract

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<sup>36</sup> OCR para 4.13.

<sup>37</sup> This interpretation also presents another problem in the context of the Aircraft Protocol since the clear direction of the Convention is that TRAs and contracts of sale are mutually exclusive but this might not occur in respect of aircraft since Article V of the Aircraft Protocol imposes additional requirements on the contract of sale. So an agreement with a condition to transference of title which is not express would end up as neither a TRA nor a contract of sale. This cannot be correct.

<sup>38</sup> OCR para 4.13.

<sup>39</sup> OCR para 4.44.

<sup>40</sup> Article V(1) imposes a requirement in the Aircraft Protocol that the contract of sale must be written but there is no such requirement in the Convention.

<sup>41</sup> See Gullifer (n 5) 101. OCA paras 5.21 and 5.30.

<sup>42</sup> Article III of the Aircraft Protocol applying Articles 3 and 4 of the Convention. For example, the aircraft is registered in Switzerland, the seller has its seat in Germany and the purchaser its seat in Ireland.

of sale" is not ultimately practically important' in relation to the Aircraft and Space Protocols,<sup>43</sup> but certainly, in the rail sector and the sector covered by the MAC Protocol it is extremely important, not least because the use and registration of a TRA could be an elegant solution to those who would like to see a greater protection of the buyer's position in the Rail and draft MAC Protocols without the heavy modification of the Convention for sales as occurs under the Aircraft Protocol.<sup>44</sup> This may be a surprising conclusion to those who take it for granted that the international interest created by the TRA is designed to protect the *conditional seller* as a type of creditor. But this would not be the only place where the debtor acquires rights under the Rail Protocol – see for example its guarantee of quiet possession under Article XI.<sup>45</sup> It also follows from the fact that there is no restriction in the Convention in its definition of the TRA as to the party on which the condition is placed or the type of condition as long as it is set out in the agreement. Technically the conditional seller is still regarded as the creditor under the general 'Cape Town regime' but once the international interest becomes registrable (see the comments in *Identifying equipment* below) it will probably be in the interests of both parties to register the international interest and that will of course need the consent both parties.<sup>46</sup> Further support for our analysis comes from the symmetrical way the Convention treats the default under a TRA.

### **B. When a default occurs**

Although there may be a presumption that a default, a breach of contract, under a TRA derives from the failure of the conditional buyer to pay the price, the Convention states that '[t]he debtor and the creditor may at any time agree in writing as to the events that constitute a default or otherwise give rise to the rights and remedies specified in Articles 8 to 10 and 13'.<sup>47</sup> It then states:

Where the debtor and the creditor have not so agreed, "default" for the purposes of Articles 8 to 10 and 13 means a default which substantially deprives the creditor of what it is entitled to expect under the agreement.<sup>48</sup>

We can draw two conclusions from this.

The parties have the discretion to agree contractually as to what constitutes a default. If there is a condition on the *conditional seller* which is not fulfilled in accordance with the agreement (for example failure to deliver good unencumbered title to the equipment), this is also a default if stated as such in the agreement. The interesting question is what the conditional buyer's remedies are in that case, since the remedies in Article 10 and 13 of the Convention and Article VII of the Rail Protocol are only available to the conditional seller and it would surely be absurd if the conditional seller could exercise remedies as a result of its own default.<sup>49</sup> So we can conclude that Article 10 applies only to a default by the conditional buyer, not a default by the conditional seller.

If there are a number of conditions in the TRA incumbent on the conditional seller, the conditional buyer's remedies will be as set out in the agreement itself and applicable law<sup>50</sup> since the Convention provides no direct remedy. Although this seems to be a lacuna, in one sense, this is logical since

<sup>43</sup> Although this could even be helpful in the application of those protocols.

<sup>44</sup> In the light of the potential overlap in applicability, where the Rail Protocol is given precedence (see Article II(4) of the draft MAC Protocol (n 3)), it could be argued that this is essential so there is a consistent approach.

<sup>45</sup> Subject to the conditions stated therein.

<sup>46</sup> See section 5.3 (e) of the draft regulations.

<sup>47</sup> CTC, Article 11(1).

<sup>48</sup> CTC, Article 11(2).

<sup>49</sup> And this should be covered off by a contractual clause utilising the liberty to derogate in CTC, Article 15.

<sup>50</sup> See Article 5 (2) of the Convention.

the conditional buyer wants the asset with the conditional seller's conditions fulfilled. Contractually the parties can provide that the conditional buyer may waive any condition on the seller on the basis that the cost incurred by the conditional buyer in fulfilling such condition is offset against the purchase price. But since the conditional buyer has the money, it has effectively the supreme security of withholding all or part of the purchase price, unless the conditional purchaser has paid some of the purchase price as a deposit or advance payment and will then need to recover those payments under contract and possibly under statutory rights pursuant to applicable law.<sup>51</sup> Indirectly, the failure by the conditional seller to comply with conditions it must fulfil contractually gives a type of remedy under the Convention by enabling the international interest to continue to subsist and to be registered.<sup>52</sup>

In the absence of agreement, the failure of the conditional buyer under the TRA to comply with any condition other than payment, for example delivering an acceptance certificate when it is due, would also clearly constitute a default, which is also consistent with the inclusive approach to the definition of the TRA.

In summary, for the purposes of the Convention, a sale agreement is only a contract of sale if it is not a TRA (or a TRA re-constituted as a security agreement under local applicable law). Any agreement which contains a condition, whether to be fulfilled by the stated seller or buyer (or for that matter by third parties), to the passage of title to the buyer is almost certainly a TRA. This will have significance for a buyer of railway rolling stock, as will shortly become clear.

### **C. Identifying equipment**

We now need to recognise the subtle difference between the Aircraft and Rail Protocols as to when an international interest pursuant to a TRA can come into existence. Article 7 of the Convention states that an interest is constituted as an international interest 'where the agreement creating or providing for the interest ... enables the object to be identified in conformity with the Protocol'.

#### ***Article VII of the Aircraft Protocol states:***

A description of an aircraft object that contains its manufacturer's serial number, the name of the manufacturer and its model designation is necessary and sufficient to identify the object for the purposes of Article 7(c) of the Convention and Article V(1)(c) of this Protocol.

By contrast, Article V(1) of the Rail Protocol stipulates that:

For the purposes of Article 7(c) of the Convention and Article XVIII(2) of this Protocol, a description of railway rolling stock is sufficient to identify the railway rolling stock if it contains:

- (a) a description of the railway rolling stock by item;
- (b) a description of the railway rolling stock by type;
- (c) a statement that the agreement covers all present and future railway rolling stock; or
- (d) a statement that the agreement covers all present and future railway rolling stock except for specified items or types.

<sup>51</sup> As is the case for example in Germany.

<sup>52</sup> Unless the failure or default by the conditional seller is under a condition subsequent so that title is still transferred to the conditional buyer even though the conditional seller has not complied with all of its obligations. At that point, the TRA has come to an end.

Article V of the draft MAC Protocol follows the model in the Rail Protocol. Although the drafters' primary focus in the Rail Protocol was on facilitating floating charges constituting international interests, only making them *registrable* as soon as the charge crystallised, it equally applies in relation to TRAs. In addition, the statement that an agreement which actually stipulates that the goods must be identified before ownership passes cannot be a TRA seems at odds with the Convention and the Rail Protocol, since it is still a conditional sale and indeed Article V of the Rail Protocol accepts that this agreement creates an international interest even if the subject matter of the sale is not yet uniquely identifiable.<sup>53</sup>

Thus, the balance has swung further towards making TRAs and the consequent international interest easier to find. It also means that, at least for the Rail Protocol, the point when an international interest is constituted will be at a different time as to when it becomes registrable.<sup>54</sup> Accordingly, it provides a fourth example of unregistered interest referred to in 29(3)(b) of the Convention: an *international* interest which is unregistrable.

The assertion by Professor Gullifer that an agreement which stipulates that 'the goods must be identified before ownership passes'<sup>55</sup> is not a TRA where the condition for identifiability would be imposed by general law, is probably correct. But it makes little difference in practice since there will almost certainly be other conditions precedent in the agreement before title passes (eg payment). Nonetheless, what if the agreement also contained (just) this provision? This is not relevant for aircraft because the operation of Article VII of the Aircraft Protocol requires specific, rather than generic, identifiability to constitute the international interest. By contrast, an international interest *can* be created for railway rolling stock (and MAC equipment) because the identifiability threshold is lower under Article V of the respective protocols applying Article 7 of the Convention, albeit, as recognised above, one which is not registrable.<sup>56</sup> It is argued that the TRA exists because the definition in the Convention highlights its 'terms that ownership does not pass until fulfilment of the condition ... stated in the agreement',<sup>57</sup> so what is determinative is what is stated, not the legal effect. This must be correct on a policy level since otherwise there would potentially be an ongoing debate on the impact of applicable law as to whether a TRA exists and different results could arise in relation to an identical agreement over time even under one national law.

#### ***D. The agreement for sale***

A rolling stock operator that orders 100 new wagons under a contract with a manufacturer, where certain specifications and other preconditions to the sale are stipulated and the manufacturer sensibly requires compliance by the purchaser with certain conditions (eg it is licensed to operate rolling stock so that it can move the rolling stock out of the factory) as well as conventional conditions such as acceptance of the wagons and unconditional payment, will inevitably be a TRA. At this stage, the rolling stock has not been built, so cannot be identified individually but Article V of the Rail Protocol means that an international interest can already be constituted. During the manufacturing process,

<sup>53</sup> See OCR para 5.11.

<sup>54</sup> Therefore requiring a separate provision in the Rail Protocol (Article XIV), stipulating that the equipment that is the subject matter of the international interest must be uniquely identifiable in order to be registered, a *sine qua non* for any registry system, whereas this is not required under the Aircraft Protocol as the identification criteria in Article VII also seem to be, and are in fact, the criteria for registration of the international interest.

<sup>55</sup> See Gullifer (n 5) 100.

<sup>56</sup> The exception to this could occur where the object does not yet exist, since then the conditional seller cannot be said to have a power to dispose of the object under Article 7(b) but as soon as the object does exist and is in the possession or direct or indirect custody or control of the conditional seller (but simply not yet appropriated to the conditional buyer), the exception falls away.

<sup>57</sup> CTC, Article 1(II) (emphasis added).

the identification position will change, either through the allocation of a manufacturer serial number or, better, the URVIS<sup>58</sup> number issued by the International Registry in Luxembourg. Once the URVIS number is allocated and fixed to the rolling stock, it will be possible to register the international interest created by the TRA – even before the equipment comes off the production line.<sup>59</sup>

But in fact, and this is the critical conclusion of this commentary, *the vast majority of sales of railway rolling stock are under a contract which will fall into the definition of a TRA*. Except perhaps for a transaction within a group, there will be a detailed contract setting out the conditions precedent which will need to be complied with prior to title passing, not least payment but also acceptance of the equipment by the buyer. The conditions could also include mutual delivery of instruments of authority (eg board resolutions or powers of attorney), legal requirements such as compliance by the parties with safety, exchange control or even anti money laundering regulations, and delivery to a defined condition and status (particularly important for second hand equipment). As mentioned above, in the wording of the Convention this means that it is clearly an 'agreement for the sale of an object on terms that ownership does not pass until fulfilment of the condition or conditions stated in the agreement'.<sup>60</sup> The only possible scenario where this is not the case is an agreement which is completely silent on the passing of property, where the item is not specifically identified at the time of the agreement, and where payment has already been made (so that there cannot be an implied term that ownership will pass on payment). But this is hypothetical in practice and can be disregarded.<sup>61</sup>

### ***E. Neat solutions***

So where does this take us? On title passing, the international interest created by the TRA is discharged, its registration should be cleared and a notice of sale is filed. This raises the possibility of a rather neat tailoring of the two registrations, where:

- (a) the agreement for sale is a TRA;
- (b) an international interest is constituted as soon as the equipment is sufficiently identifiable under Article V of the Rail Protocol;
- (c) it is registered as soon as the more specific unique identification of the equipment occurs following Article XIV; and
- (d) it is discharged as soon as the conditions are fulfilled and title passes, whereupon
- (e) the notice of sale is registered.

Or perhaps not. The conditional buyer has a further intriguing option. The Convention provides that:

where the conditions of transfer of title under a registered title reservation agreement have been fulfilled, the holder of such interest shall, without undue delay, procure the

<sup>58</sup> Unique Rail Vehicle Identification System.

<sup>59</sup> For a more detailed discussion of URVIS, see Rail Working Group, 'Working towards a global common identifier for Railway Rolling Stock' <<http://railworkinggroup.org.nova.ch-meta.net/wp-content/uploads/docs/r0594.pdf>> accessed 26 February 2018.

<sup>60</sup> CTC, Article 1(II).

<sup>61</sup> It is submitted that even if the conditions to the transfer of title are set out in a civil code (for example, Article 213(1) of the Swiss Code of Obligations), this will not disqualify the agreement as a TRA unless the agreement makes no reference to the passage of title or there is a simple sale through the payment of an invoice – in practice highly unlikely for high value assets. Even if the condition stated in the agreement is invalid or unenforceable as a matter of applicable law, the better view surely is that the conditions to the transfer of title are still stated in the agreement.

discharge of the registration after written demand by the debtor delivered to or received at its address stated in the registration.<sup>62</sup>

The conditional seller under the contract must wait for the demand from the conditional buyer. The conditional buyer may decide, as long as it is the owner, not to call for the deregistration even though technically the international interest no longer exists.<sup>63</sup> There is a good argument to suggest that this gives the buyer protection against a third party claiming ownership in the equipment from, say, the buyer's lessee in possession<sup>64</sup> purporting to dispose of such equipment, under Article 29(3) of the Convention and the same would apply in the circumstances set out in Article 29(4).<sup>65</sup> It may be argued that this does not require the conditional seller to wait for the demand before making the application to discharge and that the creditor is always free to act against its own interest. However if indeed the continuance of the registration is for the benefit of the conditional buyer, the draft regulations state that the application for the discharge requires the 'consent of the named parties benefiting from the registered interest, given under an authorization'.<sup>66</sup> If the beneficiary is now the conditional seller, this means that its consent will be required by the registrar.<sup>67</sup>

The fact that the TRA is completed and the transfer of title thereunder has occurred<sup>68</sup> arguably does not disrupt the effect of the corresponding international interest in setting the priorities under Article 29 as long as the interest is still on the registry. This follows from both subsections in Article 29 stipulating that third parties acquire rights in the asset concerned 'subject to an interest registered' at the time the competing claim is either created or registered.<sup>69</sup> This must be the case even if the second buyer had actual knowledge of the true position since it is a clear principle of Article 29 that actual knowledge does not disrupt the priorities set out in the registry. Accordingly, the buyer could register the notice of sale, which is clearly informational and so does not affect the rights of any person, or have any other effect, under the Convention or the Rail Protocol, but hold in place the registration of the TRA<sup>70</sup>, which now works in favour of the buyer<sup>71</sup> for reasons given above and only calls for its discharge from the International Registry as a condition of any onward sale.<sup>72</sup>

But, to be clear, the non-discharge of the registration of the international interest created by the TRA does not render the registration of the notice of sale pointless. It is correct that the registration of the international interest may also have an effect as a matter of domestic law because of its potential to alter the position on the bona fide purchaser without notice (since there is now at least con-

<sup>62</sup> CTC, Article 25(1).

<sup>63</sup> Professor Goode comments that the debtor 'may require the holder of the interest to procure discharge of the registration' (OCR para 4.161), not that it must do so (unless the contract stipulates otherwise).

<sup>64</sup> Of course, the lease itself may be registered as an international interest if the lessee is situated in a contracting state but there may be cases where registration is not possible (eg it is a 'wet lease') or practical (eg a short-term lease of only a few days).

<sup>65</sup> Note in this context each of Articles 29(3) and (4) use the term 'interest' and not the defined term 'registered interest'.

<sup>66</sup> Section 5.9 (c).

<sup>67</sup> In practice this will probably be dealt with contractually whereby the parties will stipulate that the discharge of the registration will require the consent of the conditional buyer.

<sup>68</sup> Which means that the international interest has terminated.

<sup>69</sup> CTC, Articles 29(3)(a) and 29(4)(a).

<sup>70</sup> Professor Goode states as a clear principle that 'priorities and other rights against third parties derived from a registration come to an end when the registration is discharged' (OCR para 4.191) since otherwise the integrity of the registry system can be questioned.

<sup>71</sup> Of course, the registration of the TRA is primarily intended to protect the conditional seller.

<sup>72</sup> Under an agreement which then becomes, by definition and regardless of its other terms, a new and registrable TRA. The conditional buyer can protect itself against the subsequent non co-operation of the conditional seller by requiring delivery from the conditional seller, on completion of the sale, of an unconditional power of attorney in its favour to effect the de-registration.

structive notice of rival claims). However presumably it will be discharged in due course whereas the notice of sale may remain indefinitely on the registry, effectively also showing the succession of title interests in the object (useful in its own right).<sup>73</sup> The former has some effect under the Convention in relation to the rights of rival claimants to the object, the latter will only potentially have an impact as a matter of applicable domestic law. And lastly, the ability to register the international interest created by the TRA will be limited to when the conditional buyer is 'situated'<sup>74</sup> in a contracting state whereas the notice of sale can be registered regardless of the 'situations' of the buyer or seller.

### **F. An inclusive system**

And a last thought. As already noted, for the Aircraft Protocol, the Convention regime is applying to the registration of sales by reference to the 'situation' of the seller or the state of registration of the aircraft object. This means that the regime will not always apply. A seller based in Austria and the aircraft on the German aircraft register, for example, even if the purchaser is in the UK will be outside of the coverage of the protocol. By contrast, in that example, based on current ratifications of the Aircraft Protocol, if the contract is construed as a TRA, an international interest has been created and is registrable.<sup>75</sup> A notice of sale is however outside of the rights and priorities in the Convention, so it is submitted that registration of the notice of sale under the Rail Protocol can be made by anyone complying with the requirements for registration set out in the regulations regardless of the 'situation' of the buyer or seller.

Moreover, there is no requirement, and indeed no authority, for the registrar to discharge a notice of sale from the registry once made.<sup>76</sup> This means that there can be, and almost certainly will be, a continuous record of the sales on the International Registry under the Rail Protocol. Accordingly, in some cases, the level of information in the public domain about sales of equipment on the International Registry could be greater under the Rail Protocol compared to the Aircraft Protocol.

### **V. Conclusion**

The overriding objective of the Convention and its protocols is to create an inclusive system where the publication of prior interests in a public registry creates a fair and transparent business environment for buyers and financiers of certain types of assets. This argues strongly for very limited exceptions to the *nemo dat* rule. The drafters of the Aircraft and Space Protocols took the view that it was necessary to extend the Convention to expressly cover sales. On the other hand, both the Rail Protocol and the draft MAC Protocol opted for the simpler approach of noting a sale on the registry outside of the rights and protections of the Convention.<sup>77</sup> There are legitimate arguments in both directions.<sup>78</sup> But the conclusion at the Luxembourg Diplomatic Conference in 2007, when adopting the Rail Protocol, was to remain with the original concept of the Cape Town Convention and not to add on a treatment of sales, because it grafted on a significant area of complexity to what is already

<sup>73</sup> Although there is no specific provision for this in the Rail Protocol or the draft regulations, there is nothing precluding the registrar from accepting a request to discharge the registration of a notice of sale. On the one hand, Article XVII of the Rail Protocol does not prevent deregistration and it is assumed that the process will be in accordance with Section 5.9 of the draft regulations. This will probably be made clearer in the next iteration of the draft regulations.

<sup>74</sup> For the purposes of Article 3 of the Convention.

<sup>75</sup> Because the UK has ratified the Aircraft Protocol.

<sup>76</sup> And no such authority is, or can be, given in the draft regulations.

<sup>77</sup> Article XVIII of the draft MAC Protocol (n 3).

<sup>78</sup> Indeed at the diplomatic conference in 2007 there was a proposal before delegates to extend the Rail Protocol to sales on an opt-in basis but this was ultimately dismissed as unworkable.

a detailed instrument, because the circumstances in relation to national registration of sales are different compared to aviation, and because there was no pressing demand from the industry. A simple notice of a sale registered at the International Registry would go a considerable way to secure the position of the first buyer as a matter of domestic law.

Moreover, since virtually every contract of sale of rolling stock between unrelated parties comes within the definition of a title reservation agreement, there would appear to be an effective alternative through the registration of the international interest constituted by this agreement as soon as the equipment is generically identifiable, even if the equipment is not finished or complete.

This rationale will be equally valid for the MAC Protocol – arguably even more so with the added complexity of the categorisation and identification of equipment covered as well as national registration systems for some types of equipment in some countries. Further following the Aircraft Protocol in this area, bearing in mind the ability of a contracting state to choose whether to apply the MAC Protocol to one, two or three annexes specifying types of equipment<sup>79</sup> or even to disapply the Convention subsequently to one or more annexes<sup>80</sup> makes it practically impossible to envisage an inclusive system of recording sales. Moreover, as with the Rail Protocol, the MAC Protocol will cover a wide range of assets where there is no consistent treatment, including local registration, even in one country, let alone globally, of title rights. Lastly, because some mining equipment can also be rolling stock, and where there is an overlap the Rail Protocol will apply,<sup>81</sup> surely it makes sense to have a common approach?

Both the Rail and the draft MAC Protocols take a pragmatic approach. Essentially both protocols adopt the view that the legal disruption and complexity of creating new law under the Convention in relation to sales is unnecessary because once the International Registry is running, any prospective purchaser or prospective secured party will search in the registry and see any notices of sale.

However following Professor Gullifer's analysis, it is difficult not to conclude that the application of the title reservation agreement or TRA is wider than perhaps we originally imagined. In practice, it may be argued that under the definition of the TRA in the Convention, every arm's length agreement for sale of rolling stock will be a TRA since, at the least, title will be stated to be transferred on the payment of the price therefor and most likely subject to the fulfilment of other conditions. As a result, the registration of the international interest arising under the TRA constituted by the agreement for sale, complying with the formality requirements under the Convention and the Rail Protocol, potentially provides an important level of additional protection by creating rights in relation to the railway rolling stock concerned under the Convention, albeit temporarily, at least until the sale completes (and perhaps longer). But at the point of sale, the notice of sale may be registered, and this will not only be prophylactic but will also facilitate courts, as a matter of applicable domestic law, 'disarming' the *bona fide* purchaser without notice by ascribing to it either actual or constructive notice of the prior sale.

Moreover, unlike the treatment of the sale under the Aircraft Protocol, the notice of sale is outside the rights and priorities of the Convention and so registration is not dependent on the seller being situated in a jurisdiction which has ratified the Convention and the Rail Protocol. The end result is an inclusive and transparent notice system, which should protect the equipment from unexpected and unwelcome buyers and creditors as a matter of applicable domestic law and under the Convention. In the real world, that may well be enough.

<sup>79</sup> Article II(3) of the draft MAC Protocol (n 3).

<sup>80</sup> Article XXXI(4) of the draft MAC Protocol (n 3).

<sup>81</sup> Article II(4) of the draft MAC Protocol (n 3).