KEY POINTS

- Brexit will impact a number of areas relevant to rail rolling stock, ranging from import duties to overseas enforcement of English court judgments.
- Rolling stock ordered now will generally be delivered post-Brexit. Many consequences and implications remain uncertain, but there are already points which should be considered and addressed.
- These points apply both to rolling stock being imported from the EU into the UK, and to rolling stock being exported from UK manufacturing plants to the EU.
- Certain forthcoming European rail regulations may continue to be adopted into UK law irrespective of Brexit.

Feature

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Brexit: implications for rail rolling stock procurement, leasing and financing

Brexit will happen on Friday 29 March 2019 – one year from now – unless the Article 50 negotiations are extended. Even if a transition period is negotiated, the EC has announced that this should not continue beyond 31 December 2020. During the period since the referendum on 23 June 2016, much has been written about the progress of negotiations between the UK and the EU (or, more particularly, the lack of such progress) towards an agreement for the post-Brexit position and any transitional arrangements. Negotiations are about to begin in earnest, but already issues have emerged which need to be considered in the context of rail rolling stock, leasing and its financing.

THE CURRENT LANDSCAPE

The eminent English judge Lord Denning described EU law as "like an incoming tide. It flows into the estuaries and up the rivers. It cannot be held back". That was in 1974 and EU law has flooded into many areas. Brexit has been described by the World Trade Organization's former Director General, Pascal Lamy, as like "taking an egg out of an omelette, which is a pretty difficult thing".

Which metaphorical eggs do we need to consider in the context of rolling stock? By way of examples, UK rolling stock is often purchased and financed under EU procurement rules, frequently by operators owned by companies from other parts of the EU. Manufacturer prices reflect varying elements of Euro and other non-sterling costs. Importation from other parts of the EU benefits from the principle of free movement of goods, with limited concerns around customs clearances, quotas and tariffs. Value Added Tax (VAT) on acquisition, maintenance costs and rentals is fundamentally a European tax. Intellectual property rights are often protected under pan-EU laws. Manufacturing and leasing contracts include references to EU directives. Sales of rolling stock portfolios can benefit from securing single merger clearances valid for the entire EU. Judgments resulting from disputes are often enforced in other parts of the EU using the Lugano Convention.

The legal position until 29 March 2019 will not change, except pursuant to legislation which expressly comes into effect before such date. The lead times on rolling stock delivery are, however, significant. Rolling stock ordered now will generally be delivered after 29 March 2019 and therefore the post-Brexit implications need to be considered already, irrespective of ongoing speculation about an "Exit from Brexit".

EXIT FROM BREXIT?

There have been numerous calls for a second referendum and it is not known what will happen if the UK Parliament votes against the deal negotiated. There has been extensive speculation that Brexit will not actually happen. Having triggered Article 50 on 29 March 2017, could the UK still stop the process and instead decide to remain a member of the EU?

On 12 July 2017, the European Commission published its 'State of play of Article 50 negotiations with the United Kingdom'. This sets out their view and includes the following three statements:

- *"Once triggered, can Article 50 be revoked?* It was the decision of the United Kingdom to trigger Article 50. But once triggered, it cannot be unilaterally reversed. Article 50 does not provide for the unilateral withdrawal of the notification."
- *"What happens if no agreement is reached?* The EU Treaties simply cease to apply to the UK two years after notification."
- **"***Can a member state apply to re-join after it leaves?* Any country that has withdrawn from the EU may apply to re-join. It would be required to go through the accession procedure."

If the UK did apply to re-join the EU, there are questions over the terms which would apply, including whether the UK could retain its advantageous budget rebate. It also seems unlikely that the UK would be permitted to opt-out from joining the Eurozone. Even if the EU did accommodate a revocation of the Article 50 notification, there would be significant questions over these and other issues. Exit from Brexit would therefore present its own set of challenges.

EUROPEAN UNION (WITHDRAWAL) BILL

As part of the Brexit arrangements, the UK proposes to migrate all EU laws into UK law by means of the European Union (Withdrawal) Bill. This Bill was published on 13 July 2017 and was previously known as the Great Repeal Bill. Assuming it is passed by Parliament, it will come into force on Friday 29 March 2019 and will do three main things:

- **Repeal the European Communities Act 1972 (1972 Act):** The 1972 Act provides that EU laws take effect as national law

in the UK, so repeal of the 1972 Act results in EU law having no effect in the UK after 29 March 2019.

- **Incorporate all EU laws as at 29 March 2019 into UK domestic law**: This results in all EU laws as at 29 March 2019 continuing to apply after Brexit, but as part of UK domestic law. Such UK domestic law can then be amended in the usual manner and without reference to the EU.
- **Give Ministers of State the power to make secondary legislation to correct resulting "technical problems"**: These include references to EU institutions and references to EU law – this essentially parks a number of issues resulting from Brexit and enables Ministers to deal with them at a later date. Various such Statutory Instruments are anticipated in the transport sector.

The core structure of railways regulation in the UK (the Railways Act 1993) predates much European legislation. There are, however, aspects of railway law and regulation which find their origins in European law, including in relation to safety, licensing, interoperability and access to facilities. Rolling stock contracts typically include various references to EU law, such as directives 2004/49/EC (as amended by directive 2008/110/EC) in relation to safety, and the various interoperability directives such as 2008/57/EC. These directives will be imported into UK law on 29 March 2019, but they will be fixed at such date and will not be amended to reflect subsequent changes to EU law without separate UK legislation. Parties should consider the implications of future divergence of UK and EU law in contract negotiation.

Under the European Union (Withdrawal) Bill, we should probably expect the current procurement rules to remain relevant to rolling stock acquisition to the same extent as at present, but this will have to be monitored and confirmed in due course.

TRADE DEAL AND WTO IMPORT DUTY RATES

Around the time of the 23 June 2016 referendum, the future trade arrangements being discussed broadly fell into five different categories:

- **EEA**: Remain in the European Economic Area (example: Norway), which would retain elements of existing EU membership including significant ongoing payments to the EU, similar financial services rules (including reciprocal passporting arrangements) and free movement of goods and people, but with reduced influence for the UK in the EU.
- **EFTA**: Join the European Free Trade Association only (example: Switzerland), which would preserve some limited ties with the EU and would require negotiation of numerous new bilateral trade agreements.
- **EU Customs Union**: Form a customs union with the EU (example: Turkey), which would facilitate more comprehensive free trade arrangements than the WTO option below, but would otherwise involve limited integration.
- **Bilateral Network**: Negotiate a network of bilateral trade agreements, which some Brexit supporters thought could provide the UK with more favourable trading terms (including with the EU).
- **WTO**: Rely on World Trade Organization (WTO) membership only, which would enable UK/EU trading based on established WTO models and rules at a global level.

The position has since evolved and the first three options above appear to have been discarded for various reasons, including issues arising from the "freedoms of movement" and judgments of the European Court of Justice. There now seems to be relative agreement that the options for future UK/EU trade lie somewhere between a Canada-style free trade agreement and a "no deal" WTO tariff arrangement.

The suggestion of a Canada-style agreement (based on the "EU-Canada Comprehensive Economic and Trade Agreement" or "CETA" – which took seven years to negotiate) has met with mixed reactions. The Prime Minister, Theresa May, said in her speech in Florence in September 2017:

> "As for a Canadian style free trade agreement, we should recognise that this is the most advanced free trade agreement the EU has yet concluded and a breakthrough in trade between Canada and the EU. But compared with what exists between Britain and the EU today, it would nevertheless represent such a restriction on our mutual market access that it would benefit neither of our economies … We can do so much better than this."

There is particular concern that a Canada-style agreement would not provide sufficient access to the EU in the services sector.

In the absence of a trade agreement, the UK is already a member of the WTO but there remain issues which would need to be resolved. In particular, the UK would need to:

- agree the percentage of existing EU quotas which the UK will be able to utilise post-Brexit; and
- announce the rates of import duties which will apply post-Brexit.

In relation to the first point, fortunately EU quotas are of limited relevance to rolling stock.

Turning to the second point regarding the rates of import duties, there is a general non-discrimination principle of the WTO that a country will not impose different rates on different countries. At present, the applicable rates are set at EU level and published in the EU's WTO "Schedules" – these rates apply to all EU member states in their trading with other countries where no trade agreement exists. Post-Brexit, the simplest solution for the UK's trade with non-EU countries would be for the UK to lodge a set of UK Schedules with the WTO which mirrors the EU's then existing Schedules. The issue arises, however, that (in the absence of a UK/EU trade agreement) the general non-discrimination principle would require the UK to apply those same import duty rates to all countries, including EU countries – this

would be a significant change from the existing position where the principle of free movement of goods generally results in a zero rate of import duty.

The relevant rates of import duties which would apply post-Brexit under WTO rules vary significantly. Different rates of import duties apply to completed rolling stock and the materials used in rolling stock manufacture. The current rate of UK import duty on importing complete Electric Multiple Units (EMUs) and Diesel Multiple Units (DMUs) from outside the EU (in the absence of any other trade agreement) is 1.7%. It is likely that the same rate would apply for exports of rolling stock from UK manufacturing plants to the EU.

Although a relatively modest amount in percentage terms, it is important to agree at an early stage who will be responsible for paying such import duty if there is no trade agreement and WTO rules instead apply to imports from (and exports to) the EU. It seems unlikely that the UK Department for Transport (DfT) will agree to fund such duty amounts directly on imports into the UK. Financiers may agree to fund such import duty amounts but they will likely require the same residual value position at lease expiry, in which case the full import duty amount plus financing costs on it will be paid by operators/lessees through increased lease rentals over the initial lease term.

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VAT AND OTHER TAXES

Although VAT is fundamentally a European tax, it is unlikely that there will be any major structural changes in the short term. The Taxation (Cross-border Trade) Bill continues to evolve during its passage through Parliament, but it may result in UK suppliers being required to pay VAT at the point at which imported goods cross from the EU into the UK and then recovering amounts following sale to the final customer. Such requirement to pay amounts upfront (rather than accounting for them as part of a subsequent paper exercise) could cause cashflow issues, but it remains to be seen how the legislation will develop.

In addition, the jurisdiction of the Court of Justice of the European Union (CJEU) is expected to cease on the UK leaving the EU. This means the UK Courts will no longer be bound by VAT and other decisions of the CJEU, although the UK government plans to give CJEU case law prior to 29 March 2019 status equivalent to other case law so that it may be used to interpret laws derived from the EU for so long as such laws remain on the UK statute books.

More generally, there are a number of instances where the design of UK tax legislation has been restricted by the need to comply with the EU freedoms, EU state aid rules and CJEU case law. Post-Brexit, it will be interesting to see whether the UK continues to aim for "EU compliant" tax legislation, particularly as EU jurisdictions may in turn consider this in assessing the extent to which they treat UK companies in a manner distinct from their treatment of EU companies.

CUSTOMS CLEARANCE

At present, goods move around the EU relatively freely. Post-Brexit (and in the absence of an agreement to the contrary), the UK/EU frontier will have two sides and both will require their own customs checks. There is the possibility of delays in clearing customs, whether on only one side of the frontier or on both sides. Again, it is important to agree at an early stage who will be responsible for bearing this risk. Manufacturers will wish to avoid being in default under their supply agreements simply because otherwise compliant rolling stock has been delayed at customs checks – they may seek to amend definitions of "Permitted Delay" to address this risk. Operators contractually required to introduce new fleets may seek to amend the "Committed Obligations" provisions to consider such risks. Financiers may be prepared to fund the additional interest costs resulting from such delays, but again they will likely require the same residual value position at lease expiry – so ultimately the costs would also be paid by operators/lessees through increased lease rentals over the initial lease term.

JURISDICTION CLAUSES

Contracts with entities in other EU countries are common, including manufacturing agreements, parent guarantees and bank bonds. Parties often agree to English law and the jurisdiction of the English courts, with a non-exclusivity provision for enforcement of any judgment against overseas assets.

This English law/English courts combination also has wider appeal for contracts with limited (or no) UK connection. During his recent tenure as Lord Chancellor, David Lidington said:

> "People are drawn to the UK from other nations as they have been for centuries and will continue to do so long into the future. They come here because they are seeking decisions that come with a recognised guarantee of impartiality, integrity and enforceability. They seek our high-quality specialist practitioners and judges who have an unrivalled reputation."

In relation to the enforcement of judgments of the English courts in other EU jurisdictions, the Lugano Convention 1988 governing the jurisdiction and the enforcement of judgments in civil and commercial matters is key. The effect of the Lugano Convention is materially the same as the 2001 Brussels Regulation (as a technical point, the 2001 Brussels Regulation has been recast but the Lugano Convention has not yet been aligned with the recast regulation) and it governs issues of jurisdiction and enforcement of judgments between EU member states and certain

Feature

Biog box
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EFTA countries (namely Iceland, Norway and Switzerland).

In August 2017, the UK government published a position paper regarding civil jurisdiction cooperation with the EU. This paper indicated the UK would continue its participation in the Lugano Convention. This confirmation is important as it goes some way to ensuring that judgments obtained in the English courts pursuant to an English jurisdiction clause may continue to be enforced in other Lugano Convention states, but until the statutory arrangements are formally in place it may be helpful for cross-border contracts to consider provisions stating that disputes will be referred to arbitration in London and specifying the rules which are to apply.

OTHER BREXIT PROVISIONS

In developing transactions, parties should also consider other provisions and issues in the context of Brexit. These include:

- people, especially given that a significant proportion of the three million resident EU nationals may not be entitled to remain in the UK post-Brexit;
- modifications to the "change in law" provisions. Brexit itself is now "foreseeable", but many of the details remain unclear;
- intellectual property rights and how these will continue to be protected;
- competition clearances, with the caseload of the UK authorities likely to increase and result in corresponding delays; and
- supply chain contracts, including to ensure that any Brexit risks are appropriately addressed along the entire supply chain.

FRANCHISE BIDDERS

Recent UK franchise competitions have included a significant number of EU-owned bidders. Such companies may be concerned whether they will still be permitted to bid in UK franchise competitions. UK-based companies may similarly be concerned whether they will be permitted to bid in EU markets. In relation to bidding for UK franchises, the DfT has for some time been seeking to increase the number of bidders competing for each franchise and it seems unlikely that the UK would stop EU-owned companies from bidding.

FINAL THOUGHTS

Certain EU laws are likely to continue to be relevant to the railways regardless of Brexit. Indeed, we may see future EU laws continuing to be adopted in the UK even after 29 March 2019. One example may be the new European regulations which are ready to be enacted – these include the recast First Railway Package and the new Fourth Railway Package which takes the "separation" requirements (including the separation of track and train) further than before. Theoretically, Brexit provides opportunities to remove the requirement for separation between infrastructure management and train operations and implement greater vertical integration, but it currently seems likely that these new European regulations will be adopted by the UK, irrespective of Brexit. ■

Further Reading:

- Brand new trains being pushed off-lease: implications and options for financiers (2017) 6 JIBFL 353.
- The EU (Withdrawal) Bill and the courts: peering through the glass darkly (2017) 10 JIBFL 603.
- LexisNexis Loan Ranger blog: Implications for aviation finance post-Brexit.