# PLUS ÇA CHANGE: NEW-BUILD rolling stock IN THE BREXIT ERA

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**look at how uncertainty over Brexit has brought change-of-law risk into focus in the rail leasing market**

**In any new-build rolling stock transaction, operators, manufacturers or owners – including their investors – may be avoiding difficult conversations around the consequences of Brexit.**

Businesses are being asked to prepare for Brexit, and rolling stock manufacturers (some overseas entities), operators (often owned by EU27 companies) and financiers (negotiating pricing which reflects varying elements of euro and non-sterling costs) need to be alert to possible changes.

Parties are considering whether the change-in-law protections under the manufacture and supply agreement between the manufacturer, the owner/lessor and the operator/lessee (the MSA) can be used to cover Brexit risks.

While the operating lease between the owner/lessor and the operator/lessee (the lease), may be silent on Brexit, parties should consider if the indemnity provisions should be drafted to capture costs and other risks emanating from Brexit consequences.

The key here is risk allocation. Who takes the risk and covers the costs of:

- Delays to the contract programme where equipment is held at the point of entry into the UK due to new customs clearance procedure;
- Any increased tariffs when the current import and export regime with EU-27 ends, be it at exit day, at the end of a transitional period or at a later date, or
- Any other additional hidden costs, unforeseeable at the moment, or even at exit day, due to the currently unforeseeable nature of the consequences of Brexit?

Parties should consider using the MSA and the lease to allocate Brexit-related risks, and here we explore some of the key concepts.

## MSA

**Change in Law.** This broad definition also usually captures industry standards, regulatory, and health and safety requirements within an umbrella term, say: "Applicable Law and Standards".

A change to the application or interpretation of a rule, or the application to a person or body to whom it did not previously apply, may be covered. If there is a change, it usually triggers a variation to the contract and protection for the manufacturer.

**Foreseeable Change in Law.** In most cases, foreseeable changes in law are excluded from any change-in-law protections. On or before the date of an MSA, a change could either be (i) passed and soon to be enacted, (ii) in a draft bill, a statutory instrument, or (iii) in a consultation paper, and would likely not be covered by a variation.

If changes are required to the rolling stock itself, say to the specification for safety to comply with a foreseeable change in law, the operator and owner would expect the manufacturer to pick up the costs.

While Brexit might be foreseeable, the consequences of it are not, so this should be considered in the drafting. Also, a manufacturer cannot assume this type of delay would be a 'permitted delay'.

**Variation Procedure.** This stipulates whether a manufacturer has a right to (i) recover any additional costs, and/or (ii) an extension to the contract programme, due to a change in law other than a foreseeable change in law. Manufacturers could, therefore, aim to invoke the variation procedure as a consequence of Brexit.

**Permitted Delay.** There are pre-agreed scenarios when the manufacturer can seek an extension to the contract programme. The manufacturer would not expect to pay liquidated damages (LDs) to either the owner or operator where there is a permitted delay.

In relation to Brexit issues, there is probably no market norm yet on who should meet costs.

Delays may occur if quotas are imposed causing additional administration, or through customs while determining which tariffs apply to a complex rolling stock vehicle, equipment and furnishings. Parties should consider issues carefully and draft to allocate these potential risks.

**MSA Indemnities.** One of the many extensive indemnities is where a manufacturer would indemnify the owner/operator for taxes or import duties accruing prior to transfer of title in the rolling stock to the Owner. Parties should carefully negotiate (i) the scope of indemnities, (ii) who constitutes an 'indemnified party' (e.g. additional financiers), and (iii) liability caps, including sub-caps to limit liability.

## LEASE

The owner (also as lessor) will try to ensure that:

1. The lease is effective immediately on transfer of title to the rolling stock from the manufacturer to the owner, and
2. The operator is on the hook for any liabilities and losses accruing immediately from the moment title is transferred to the owner.

Clearly, if there are changes in law under the MSA which lead to a variation, there is a potential increased liability for the owner and operator for the costs of the change. The lease will have to consider whether the lessor/financiers are liable for increased costs and how these will be funded (e.g. through rentals).

In the lease, if not in the MSA, parties could specify how LDs payable by the manufacturer (as a result of delay to the contract programme) are apportioned between owner and operator.

Clearly, if there is a permitted delay under the MSA due to Brexit-related reasons, the parties will need to agree in the lease who will take the risk of such a delay where no LDs are paid. This will of course have an impact on the financing. ■