

Public Service and the Cape Town Convention

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All three protocols to the Cape Town Convention on International Interests in Mobile Equipment consider the balance between the rights of a creditor wishing to foreclose on its asset following a debtor default, and the rights states may wish (or may be obliged) to reserve to themselves to protect the public interest. The Aviation Protocol foresees minimal state intervention. The Luxembourg Rail Protocol and the Space Protocol specifically confront the issue of a 'public service exemption', but address the competing interests in radically different ways.

This paper looks at when the state can intervene to restrict a creditor's rights, in the context of the Convention, on 'public service' grounds. It also considers some of the definitional and substantive problems that arise both, when the public service requirement of the community overreaches a creditor's rights, and what the consequences should be for the creditor when that occurs.

1. Introduction

It's the classic conflict: the relationship between the state and the citizen. How to reconcile the responsibility of the state to advance the public good with the need to respect rights of private property? In pure communist systems, there were no rights of private property; but such an approach has never been successful in practice on a state level, and is now discredited even in theory. Today the conflict is a universal one that manifests itself in various ways, from the level of taxation on private income and wealth to key issues of public security and individual property rights, whether in tangible property or inchoate (such as data). In each case the inevitable result is a compromise, and the solution lies in finding the right balance between the competing rights.

The Universal Declaration of Human Rights states that 'No one shall be arbitrarily deprived of his property.'¹ The restrictions on state interference with personal property rights, and in particular the conditions under which the state may seize private property (an important element in the discussion that follows), are enshrined in many constitutions around the world. The US Bill of Rights states that '[n]o person shall be deprived of life, liberty, or property, without due process of law nor shall private property be taken for public use, without just compensation.'² The Basic Law of the Federal Republic of Germany states that 'Property and the right of inheritance shall be guaranteed',³ however it contemplates situations where private property may be sequestered: 'Expropriation shall only be permissible for the public good. It may only be ordered by or pursuant to a law that determines the nature and extent of compensation. Such compensation shall be determined by establishing an equitable balance between the public interest and the interests of

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¹ Article 17.

² 5th amendment.

³ Article 14.

those affected. In case of dispute concerning the amount of compensation, recourse may be had to the ordinary courts.⁴ The Swiss Federal Constitution stipulates that '[t]he compulsory purchase of property and any restriction on ownership that is equivalent to compulsory purchase shall be compensated in full.'⁵

This paper will look at how the drafters of the Cape Town Convention⁶ and the accompanying three protocols for Aircraft Equipment, Railway Rolling Stock and Space Assets⁷ have – or have not – dealt with this conflict, addressing the policy issues and how they have been reconciled.

2. The Cape Town Convention and its Protocols

Transport is a strategic issue for governments. In its 2011 White Paper on Transport,⁸ the EU Commission stated that '[t]he future prosperity of our continent will depend on the ability of all of its regions to remain fully and competitively integrated in the world economy. Efficient transport is vital in making this happen.'⁹ It went on to set out a detailed agenda for creating an integrated European transportation sector, with the railways playing an essential and growing role.

Almost since their invention, the railways and the public interest have never been far apart.¹⁰

Governments have regulated, nationalised and, in certain cases, privatised and re-regulated the railways. The railways have been a strategic sector for the state almost from their inception, not least because of their logistical importance during time of war. Interestingly, governments have recently specifically addressed both the problems of the public sector service obligations in the rail sector,¹¹ as well as the problem of financing rolling stock through the private sector.¹² We shall return to this below.

The Cape Town Convention itself does not deal with the issue except in relation to the preservation of certain non-consensual rights or interests.¹³ It was not considered to be a point of universal application that would apply to all assets covered by the contemplated equipment-specific protocols. The Aircraft Protocol, which was considered at the same time as the Convention, also did not address the matter directly, but did so indirectly. The 1933 Rome Convention¹⁴ had covered this area in relation to precautionary arrests. Article 3 thereof restricted such attachments if there was a public interest. It specifically exempted aircraft exclusively appropriated to a state service, including the postal service (but excluding commercial service) and aircraft actually in service on a regular line of public transport,

1845, where the Belgian government reserves rights to itself and imposes [Belgian] public interest conditions on the construction of a railway line.

¹¹ See for example Regulation (EC) No 1370/2007 of 23rd October 2007.

¹² See the EU's recent 4th Railway Package proposal at COM(2013) 25 final (which proposes a liberalisation of Regulation 1370/2007).

¹³ Article 39(1)(b) and only then to the extent covered in a declaration. The Aviation Working Group recommends only narrow categories of such rights, and similarly the Rail Working Group advises that the rights protected should be specific and quantifiable and where, under current law, they have priority without national registration or otherwise limited to customary categories for overriding liens (e.g. repairers) and also limited to claims arising following a declared default.

¹⁴ The Convention for the Unification of Certain Rules Relating to the Precautionary Attachment of Aircraft, signed at Rome on 29th May 1933.

⁴ Ibid.

⁵ Article 26.

⁶ The Cape Town Convention on International Interests in Mobile Equipment, adopted in Cape Town on 16th November 2001.

⁷ Adopted respectively in Cape Town on 16th November 2001, in Luxembourg on 23rd February 2007, and in Berlin on 9th March 2012, and referred to hereinafter respectively as the Aircraft Protocol, the Luxembourg Protocol and the Space Protocol.

⁸ 'Roadmap to a Single European Transport Area – Towards a competitive and resource efficient transport system' COM (2011) 144 final.

⁹ At para 2.

¹⁰ See, for example, the report of George Stephenson, Esq.: with the decree, grant, convention and the statutes of the [West Flanders Railways] Company, September

together with the indispensable reserve aircraft. The 1948 Geneva Convention clearly set out the recognition of property rights,¹⁵ but was seemingly content to leave the rest to the local laws of property although the Convention in any event did not apply to some types of public service aircraft, namely ‘aircraft used in military, customs or police services’.¹⁶

The Aircraft Protocol swept away the provisions of these two earlier treaties to the extent that they conflict with the rights (and specifically creditor rights) set out in the Cape Town Convention and the Aircraft Protocol,¹⁷ although it is open to a contracting state to choose, by declaration, to retain the applicable provisions of the Rome Convention,¹⁸ and this is the more relevant treaty in relation to the intervention of the state in challenging property rights of creditors. So the Aircraft Protocol intends to reverse the exclusion of certain aircraft used for a public service from the precautionary arrest regime. However, contrary to the later Luxembourg and Space Protocols, it does not seek to deal directly with the on-going possibility of a public interest in protecting certain assets from creditor repossession. The most obvious explanation for this is that in the 21st century, neither the industry nor governments see aircraft as being strategic assets in terms of societal dependence. Their withdrawal will be an inconvenience, but in the case of both passengers and freight transported by air, this is not viewed as essential. Or it may be that governments are persuaded that the political gain of facilitating cost-effective private sector finance for aircraft operators, and therefore a highly competitive aviation industry and cheap flights for the public, outweighs the political downside of withdrawal of service, particularly

in an industry where there are often alternative carriers on routes.

The Luxembourg and Space Protocols see things differently in relation to the assets covered by those protocols. The rail system is an essential component of the delivery of high volumes of passengers and goods in a developed economy (and the introduction of a rail system is seen as a key component of growth strategies for developing economies).¹⁹ In the European Union, legal provision is even made for governments or government agencies to ‘act in the field of public passenger transport to guarantee the provision of services of general interest which are among other things more numerous, safer, of a higher quality or provided at lower cost than those that market forces alone would have allowed.’²⁰ Satellites are now essential elements of communication networks in both rich and poor countries.

In each case the denial of public access to such assets²¹ will create a disproportionate and greater loss for the greater economy compared to the loss for the individual creditor if there is no removal. The withdrawn satellite feed can threaten essential lines of communication. The leased commuter train failing to run, forcing passengers onto roads to get to work or to stay at home, can result in a consequential loss for businesses and the economy far in excess of the rent lost by the unpaid creditor.

This is not to say that the drafters of these two protocols would not have preferred the creditor-focused approach of the Aviation Protocol, but they have had to accept that the political cost for governments of standing on the sidelines when such assets are repossessed and services are withdrawn, is too high.

¹⁵ Article I, Convention on the International Recognition of rights in Aircraft, signed at Geneva on 19th June 1948.

¹⁶ Article XIII.

¹⁷ Articles XXIII and XXIV.

¹⁸ Article XXIV(2). Logically the Aviation Working Group advises against making such a declaration.

¹⁹ See for example the ambitious programme of the Ethiopian government to construct 5,000 km of railway lines by 2020 from virtually nothing today – one line from Djibouti to Addis Ababa.

²⁰ Regulation (EC) No 1370/2007.

²¹ This needs to be qualified in relation to railway rolling stock because the definition in the Luxembourg Protocol is so wide and would, for example, cover people movers on tracks at an airport.

Interestingly, the two protocols do not take identical approaches.²² This can be explained partially by the fact that, for now at least, it is effectively impossible to physically repossess space assets in geostationary orbit hundreds of miles above the Earth, whereas physical repossession of rolling stock is certainly possible, if at times difficult in practice. But there is also a different philosophy. The Space Protocol essentially provides for a ‘cooling-off period’ where the financed assets ‘provide services that are needed for the provision of a public service in a Contracting State’.²³ The Luxembourg Protocol goes much further, providing a mechanism for the long-term retention of financed rolling stock where creditor repossession would be against the public interest. It is, therefore, the only one of the three asset-specific protocols that looks into finding the balance between state rights to seize or detain assets and private property rights. We shall look at both approaches in turn after addressing important preliminary aspects.

3. The meaning of ‘public service’

There is no definition of ‘public service’. These words are used, but not defined, in the Cape Town Convention itself, in the context of reserving priority (unregistered) rights of attachment for states, intergovernmental organisations ‘or other private provider(s) of public services’ to satisfy claims for amounts owed.²⁴

The term is also used directly in the Space Protocol. Article XXVII applies where ‘the debtor or an entity controlled by the debtor and a public services provider enter into a contract that provides for the use of a space asset to provide services that are needed for the provision of a public service in a Contracting State’.²⁵ A ‘public services provider’ is defined

as ‘an entity of a Contracting State, another entity situated in that Contracting State and designated by the Contracting State as a provider of a public service or an entity recognised as a provider of a public service under the laws of a Contracting State’.²⁶

In his explanatory notes preceding the Berlin Diplomatic Conference which took place in March 2012, Professor Sir Roy Goode QC pointed out that ‘[t]he phrase ‘public service’ is not defined but broadly covers a service to the public which Contracting States have an interest in ensuring is not abruptly terminated or suspended through the exercise of creditors’ remedies.’²⁷ The absence of a definition was also noted at the Berlin Diplomatic Conference itself.²⁸

As we shall observe below, because the Luxembourg Protocol establishes a public service exemption (or better, a restraint) by reference to a specific type of equipment, it applies by reference to ‘public service railway rolling stock’ being ‘railway rolling stock habitually used for the purpose of providing a service of public importance as specified in that declaration notified to the Depository’.²⁹

Again there is no definition of what is a ‘service of public importance’, but whereas we assume that a contracting state will specify, in a declaration filed with the depositary, what it means by this (with the risk of differently defined meanings in different contracting states), the determination of what is a public service is otherwise left to a local assertion by a contracting state, outside of the scope of the Cape Town Convention, or as may be decided by local law.

At first glance, the lack of definition is inevitable. Different political and legal considerations will apply across various jurisdictions, and indeed, the extent of public sector engagement in providing services to

²² Article XXV of the Luxembourg Protocol and Article XXVII of the Space Protocol.

²³ Article XXVII(1) of the Space Protocol.

²⁴ The non consensual rights under Article 39(1)(b).

²⁵ Article XXVII 1.

²⁶ Article XXVII(2)(b).

²⁷ UNIDROIT 2011 DCME-SP – Doc. 4.

²⁸ See UNIDROIT 2012 DCME-SP-Report, para 54.

²⁹ Article XXV(1); the Depository is UNIDROIT.

the community – from medical to transport to rubbish collection services – has been the subject of furious political debate in many countries. Another international instrument looking at the overlap between the public and private delivery of services, the UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects, published in 2001, points out that ‘the notions of ... public services are well established in the legal tradition of some countries, being sometimes governed by a specific body of law, which is typically referred to as administrative law ... However, in a number of other countries, apart from being subject to special regulations, public services are not regarded as being intrinsically distinct from other types of business’.³⁰

The Guide adds that ‘constitutional law of a number of countries refers generally to the duty of the State to ensure the provision of public services. Some of them list the infrastructure and service sectors that come under the responsibility of the State, while in others the task of identifying those sectors is delegated to the legislator. Under some national constitutions, the provision of certain public services is reserved exclusively to the State or to specially created public entities. Other constitutions, however, authorize the State to award concessions to private entities for the development and operation of infrastructure and the provision of public services’.³¹

But this is itself quite worrying. The overriding objective of the Cape Town Convention is to provide a transparent, secure and *consistent* system within which creditors know precisely where they stand.³² A declaration from a contracting state registered with the depositary can provide that certainty, whereas a change of local legislation, practice, or even political

party in government in a specific state that can change the definition of ‘public service’ is not immediately apparent to a creditor in another land.³³ What if there is a service provided under the same contract covering more than one jurisdiction where there is a difference of view between the jurisdictions as to whether the service is a ‘public service’? We shall return to this later in this paper.

4. Looking at the context

Before examining the specific public service articles of the Luxembourg and Space Protocols in detail, some context is also needed. Both articles represent compromises between ‘the industry’ (banks, operators, manufacturers, etc.) and governments looking to protect the public interest, noting that private finance of certain services delivered to the community, thereby releasing public money for other uses, is also in the public interest. Both also incorporate the common commercial approach that runs through the Cape Town Convention system, which can easily be missed by a pure reading of the respective texts, and which has become an unscripted *Salvatorische Klausel*³⁴ to cover potential but not actual disagreements between the representatives of public and private interests. This is that where there is choice or discretion incorporated into the instruments, governments

³³ See the interesting discussion on the definitional issue in the summary report of the Steering Committee to build a consensus around the provisional conclusions reached by the Government/industry meeting held in New York on 19th and 20th June 2007; Subcommittee on Public Service Paris 13th May 2009, UNIDROIT 2009 Study LXXIIJ – Doc. 16 at page 6, where the broad understanding appeared to be that the term ‘public service’ should not be defined in the Protocol, ‘lest one create an international duty not contracted for, it being preferable to leave the right to define “public service” to the individual Contracting States.’

³⁴ Literally ‘Safeguard clause’ although in this case technically it will be better described as ‘*Salvatorische Annahme*’ or Safeguard assumption since there is no written clause, only the design of other clauses allowing choices for governments to arrive at the most practical solution.

³⁰ At page 4.

³¹ Ibid pages 24–25.

³² In his official commentary on the Luxembourg Protocol, at pages 16–17, Professor Sir Roy Goode QC states that the Convention and the Protocol are governed by five underlying principles, namely: practicality, party autonomy, predictability, transparency, and sensitivity to national legal cultures.

will be well-aware of the fact that the more the security of the creditor is threatened, the higher the cost of credit for the debtor. So the drafters anticipate that governments will respond to such considerations (and will be pressed to do so in practice by the industry) both in the way they define the public service in practice, and the method and the extent to which they elect to use options available to them under the Convention and the Protocols to interfere with creditor rights and interests in the assets covered by the Protocols. This is consistent with the general approach of all the Protocols to be facilitative rather than prescriptive. The most obvious example of this is the provision in Article VIII of the Aviation Protocol allowing party autonomy on choice of law applicable to inter-party agreements, and followed by both the Luxembourg and Space Protocols.³⁵

We should note also that, unlike the aircraft and rail sectors, because of the nature of the space industry, the focus of the drafters in Article XXVII of the Space Protocol is on the relationship between the debtor and the party providing the public service, whereas the other protocols look primarily at the relationship between the creditor and the debtor. However, consistent with the asset-based approach of the Cape Town Convention, the ultimate question is the same, namely at what point can an overriding public interest in the use of the asset block its repossession by the creditor? This should also not disguise some fundamental differences in philosophy between the Protocols.

5. Qualifying a creditor's rights of repossession

As has already been noted, the Aviation Protocol essentially seeks to rule out a state or public agency intervening to block creditor rights of repossession. The trade-off and logic is clear. The greater the undermining of creditor rights on default, the greater the creditor uncertainty and therefore the higher the cost of

the funding. As a result, the Aviation Protocol aims to preclude a government or government agency intervening to stop repossession when repossession is permitted under contract between the parties, except where, in limited cases, this is to secure a specific financial claim of the government or its designated agency.³⁶

It is clear from reading background papers prior to the Berlin Diplomatic Conference that the Space Working Group, representing the space industry, broadly wished to follow the same line. There is great reluctance to concede any restriction of creditor rights in this area, and in the end the diplomatic conference broadly accepted this position, subject to some very limited constraints. So it was accepted that either a contracting state or the public services provider may (but was not required to) register a 'public service notice' at the International Registry where a contract provides for the use of a space asset to provide services 'needed for the provision of a public service'.³⁷ A *public service notice* is defined as 'a notice in the International Registry describing, in accordance with the regulations, the services which under the contract are intended to support the provision of a public service recognised as such under the laws of the relevant Contracting State at the time of registration'.³⁸ Only in such case as a public service notice *is* registered, would a creditor be prevented, on the occurrence of a debtor default, from making a space asset

³⁶ i.e. the registrable and non registrable non-consensual interests given priority under Articles 39 and 40 of the Convention, especially Article 39(1), (b) which some referred to at the Cape Town diplomatic conference as the 'Eurocontrol clause'. See also the discussion on contracting states' choices on Article XI of the Aircraft Protocol where the industry forcefully and cogently argues for the adoption of Alternative A where it is not already included in domestic legislation (as it is in section 1110 of the US Bankruptcy Code), for example Jeffrey Wool and Andrew Littlejohns 'Cape Town Treaty in the European context: The case for Alternative A, Article XI of the Aircraft Protocol' *Airfinance Annual 2007/2008*, pages 43-45.

³⁷ Article XXVII(1).

³⁸ Article XXVII(2)(a).

³⁵ Articles VI and VIII respectively.

unavailable for the provision of the relevant public service for a ‘cooling-off period’ of between three and six months.³⁹ We have to assume that the ‘relevant Contracting State’ is the state that has adopted the Berlin Protocol and in which the services are being provided. It is not clear what the creditor’s remedy is if the services are concurrently provided in more than one jurisdiction, and some but not all jurisdictions are contracting states filing such a public service notice, but the natural conclusion would be that one notice from one contracting state would be sufficient to block the creditor from immediately exercising its repossession rights.⁴⁰

Interestingly, this process does not block the creditor from changing the basis of use of the space asset during this ‘cooling-off period’ and the Protocol even contemplates the creditor itself providing services directly.⁴¹ So clearly, the *debtor’s* position is not entrenched during this period. The cooling-off period is intended to provide an opportunity for interested parties to ‘get around the table’ in good faith to find solutions for the ongoing provision of the public service via the space asset concerned,⁴² but unless a lack of good faith can be shown, once the cooling-off period has expired, assuming there is no agreement for the ongoing use of the asset, or compensation to the creditor, the creditor may repossess (or more accurately redeploy) the asset. Even these limited constraints on the creditor are softened further where the public services

provider fails to perform its duties under its contract with the debtor.⁴³

But the lack of detail of the scope for the contracting state to intervene may come back to haunt creditors. The contracting state is only required to make a declaration as to the length of the ‘cooling-off period’;⁴⁴ and it cannot make a declaration in advance on what is a public service that could potentially be covered by a public service notice. In addition, it seems that a contracting state can file this notice at any time, i.e. also after the creditor and debtor have concluded their contracts. The creditor is only protected if the international interest is registered by a creditor prior to the registration of a public service notice and ‘the international interest was created pursuant to an agreement made before the conclusion of the contract with the public services provider ... and at the time the international interest was registered in the International Registry, the creditor had no knowledge that such a public services contract had been entered into’.⁴⁵ But in any event, this ‘does not apply if such public service notice is registered no later than six months after the initial launch of the space asset’.⁴⁶ Further, the qualification of the creditor’s position by virtue of its knowledge (this is not defined but must include actual knowledge and possible constructive knowledge where the creditor ought to have known of the position) is interesting in its own right as generally, the Cape Town Convention tries to avoid imputing a creditor’s knowledge due to its actual knowledge of a rival claim.⁴⁷

Essentially therefore, the Space Protocol creates a mechanism, on the occurrence of a debtor default, for delaying creditor rights of repossession for a strictly limited period of time,

³⁹ Article XXVII(3) and (4) – the exact period to be decided by declaration.

⁴⁰ So the creditor may need to execute concurrent agreements for each jurisdiction so that it is not precluded from withdrawing services in jurisdictions where no such notice has been filed. This issue is also complicated by the complete exclusion of the transition provisions of Article 60 of the Convention through Article XL of the Space Protocol since contracting states may be ratifying at different times and therefore can only file public service notices at different times in respect of the same financed space asset providing a public service in more than one jurisdiction.

⁴¹ Article XXVII(5).

⁴² Article XXVII(7).

⁴³ Article XXVII(8).

⁴⁴ Article XXVII(4).

⁴⁵ Article XXVII(9).

⁴⁶ Article XXVII(10).

⁴⁷ See, for example, the express exclusion of ‘actual knowledge’ in Article 29 of the Convention dealing with conflicting priorities of international interests as well as Article XIV of the Aircraft Protocol.

and subject to careful parameters. The remedy itself is not denied. This is in stark contrast to the position taken in the Luxembourg Protocol.

The rail finance community would have preferred an approach similar, if not identical, to that taken by the Aviation Protocol, in terms of state interference with creditor rights in the rail sector. But it was understood early on in the drafting process that this would be impossible to sustain in the rail sector, bearing in mind both the constitutional or legal obligations on governments in certain jurisdictions to provide a rail service, and the fact that many operators of rail services across the world are either directly or indirectly state-owned, and therefore form part, in the Continental European sense, of the *service public*.⁴⁸ This may generally be described as a service provided by, or under the direction of, the state for the benefit of the community as a whole.⁴⁹ For example, the French state-owned rail operator SNCF describes itself precisely in this way,⁵⁰ and in many states, railways have been long part of the social fabric of the country.

In the United States, inter-city passenger services are generally provided by the National Railroad Passenger Corporation (Amtrak), a corporation established pursuant to an Act of Congress⁵¹ following the melt-down of privately held passenger operators in the late 1960s, which began service on 1st May, 1971, serving 43 states with a total of 21 routes. It receives continuing and significant public

⁴⁸ Indeed, governments are focused on the provision of public services in this sector being guaranteed not just against the claims of creditors, but also against interruption of service caused by strikes and other worker actions, and this remains an ongoing debate in many countries as to how far the 'public interest' may be defended.

⁴⁹ Webster defines this as 'the business of supplying an essential commodity, as electricity, or a service, as transportation, to the general public.'

⁵⁰ 'Notre Groupe à vocation de service public propose une offre complète de solutions de mobilité', SNCF website – www.sncf.com/fr/portrait-du-groupe/un-groupe-de-service.

⁵¹ The Rail Passenger Service Act of 1970.

subsidies, which eliminate the risk of default and the risk of the public service being discontinued. Similarly, local passenger services often fund rolling stock through state transport agencies and/or hypothecated local taxes.⁵² Subject to this major 'carve out', there is no public service restriction on creditor rights as a matter of Federal law.⁵³

The British government had to confront this issue specifically in the context of its rail privatisation programme in the 1990s, along with the competing rights of private sector lessors and the public where the government has a statutory duty to 'provide, or secure the provision of, services for the carriage of passengers by railway'⁵⁴ and is required to step in in certain circumstances when an operator fails.⁵⁵ This is not merely an academic concern: this eventuality occurred in the case of the East Coast main line franchise in 2009, when the franchisee, National Express East Coast (part of National Express), gave up the franchise. The UK government then assumed the role of the operator through East Coast Main Line Company, being a subsidiary the government's holding company, Directly Operated Railways⁵⁶. It is expected that this route will be reprivatized

⁵² See for example Metropolitan Transportation Commission Resolution 3918 where the Commission, which is the California regional transportation planning agency, resolved in 2010 to support financially the bulk of the rail car procurement programme of the Bay Area Rapid Transit (BART).

⁵³ See Section 1168 of the US Bankruptcy Code. There may of course be restrictions as a matter of private contract law or even state legislation, particularly where the debtor is a municipal or other public corporation.

⁵⁴ Section 30 Railways Act 1993.

⁵⁵ See Section 59 Railways Act 1993 and the provisions in Schedule 7 of the Act. The UK experience and particularly the right of the government agency to 'step-in' and force a continuance of the leasing arrangements to the replacement operator, in practice effected through a parallel direct contract with the creditor, was an important consideration in the minds of the drafters of the Luxembourg Protocol.

⁵⁶ Because of the need to re-tender and re-let the franchise – a process at that time taking at least 18 months – the government step-in was unavoidable.

only in 2015, and this case demonstrates that the problem has to be provided for, as there will always be a temptation for franchisees to overbid in competitive tenders.⁵⁷

Indian legislation goes further. In the Railways Act 1989, it is provided that ‘No rolling stock, machinery, plant, tools, fittings, materials or effects used or provided by a railway administration for the purpose of traffic on its railway, or of its stations or workshops, shall be liable to be taken in execution of any decree or order of any court or of any local authority or person having by law the power to attach or distrain property or otherwise to cause property to be taken in execution, without the previous sanction of the Central Government.’⁵⁸ There is also a similar 19th century restriction under German law⁵⁹ which excludes rolling stock from attachment for the satisfaction of payment claims, although it is doubtful if this applies to repossession under a lease,⁶⁰ and it probably does not apply to all the railway rolling stock as defined in the Luxembourg Protocol.⁶¹

As a consequence, many potential contracting states would have felt constrained from adopting the Luxembourg Protocol if legislative consideration had not been given to this problem in the Protocol. Moreover, although the Luxembourg Protocol was adopted five

years before the Space Protocol, the solution taken by the Space Protocol of simply using a cooling-off period but otherwise leaving creditor rights unrestricted would not have been acceptable to the rail industry or many states. This would not have dealt with the legal and sometimes constitutional requirements on governments to provide a rail service regardless of private contract rights or to preclude attachment of rail assets,⁶² and consequently the state’s ability in certain circumstances to step in and seize assets belonging to a ‘railway unit’ (i.e. the railway company together with its assets).⁶³ So the issue could not be ignored: the Luxembourg Protocol is the only protocol that actively considers how to reconcile the ‘classic conflict’.

6. Article XXV of the Luxembourg Protocol

The drafters of Article XXV of the Luxembourg Protocol crafted a very carefully structured mechanism to deal with this problem. As Professor Sir Roy Goode QC remarks⁶⁴, the drafting ‘was the subject of intensive discussion at the Diplomatic Conference.’ In fact, this is a majestic understatement. This was a highly controversial provision where delegates struggled to find a pragmatic compromise.⁶⁵ The end result is a good one, where the creditor’s rights

⁵⁷ See also the subsequent report by the Comptroller and Auditor General on the InterCity East Coast Passenger Rail Franchise issued by the National Audit Office, HC 824 Session 2010–2011, 24th March 2011, which describes the case in detail and makes recommendations for the future.

⁵⁸ Section 187.

⁵⁹ *Gesetz betreffend die Unzulässigkeit der Pfändung von Eisenbahnfahrtriebmitteln 1886* (Law in respect of the Inadmissibility of the Attachment of Railway Rolling Stock).

⁶⁰ See Benjamin B. von Bodungen and Konrad Schott ‘The Public Service Exemption under the Luxembourg Rail Protocol: a German Perspective’ *Uniform Law Review* 2007 at 573 *et seq.*

⁶¹ This is very wide – see Article I(2)(e) for the precise definition and also the discussion in the author’s article ‘The Luxembourg Rail Protocol: A Major Advance for the Railway Industry’ *Uniform Law Review* 2007, 427 at 430.

⁶² See also in this context the 1895 Prussian *Gesetz über Bahneinheiten* (Law in respect of Railway Units) which applies in some parts of the Federal Republic of Germany and the detailed discussion in von Bodungen and Schott’s article *supra*.

⁶³ The aim was to secure the continued operation of the railway unit. However, *in rem* rights in the entire railway unit (and enforcement thereof) remained possible. Enforcement of such rights would be achieved by public auction of the entire railway unit/company.

⁶⁴ In his official commentary on the Luxembourg Protocol at page 329.

⁶⁵ The concept of a ‘Public Service Exemption’ was first explored at the meeting of government experts in Bern in March 2001 – see also the history and discussion in the author’s article ‘Building a Railway to the Future – Progress on the Draft UNIDROIT / OTIF Rail Protocol’ *Uniform Law Review* 2001 at page 50.

are overridden only in restricted circumstances, but it has to be read very carefully to understand the subtlety of the drafting.

The first principle adopted was that the contracting state could only interfere with the creditor's remedies on debtor default or bankruptcy when it would declare by a declaration (which would be accessible to creditors via the website of the International Registry) that 'it will continue to apply, to the extent specified in its declaration, rules of its law in force at that time'⁶⁶ which preclude, suspend or govern the exercise within its territory of any of the [creditor] remedies.'⁶⁷ Such a declaration can only apply to 'railway rolling stock habitually used for the purpose of providing a service of public importance ('public service railway rolling stock') as specified in that declaration notified to the Depositary'.⁶⁸ So there has to be complete transparency to the creditor from the outset as to where its remedies could be affected in a specific jurisdiction, and the restrictions *only* apply if there are already state rights in place restricting creditor repossession and *only* for certain narrowly defined types of rolling stock. It is important to note here that the modification of creditor rights, where applicable, is by reference to assets and not contracts or the mission of the rolling stock.⁶⁹

⁶⁶ Professor Sir Roy Goode QC must be correct in stating in his commentary (at page 330) that this must include administrative rules and procedures, as well as legislative provisions and judicial decisions, but it is submitted that these must be binding and in force at that time; 'convention' or non-binding 'understandings' will not be enough.

⁶⁷ Article XXV(1).

⁶⁸ *Ibid.*

⁶⁹ An interesting comparison is with, for example, the UK Public Passenger Vehicles Act 1981 which, in Section 1 (1), defines a 'public service vehicle' as 'a motor vehicle (other than a tramcar) which

- (a) being a vehicle adapted to carry more than eight passengers, is used for carrying passengers for hire or reward; or
- (b) being a vehicle not so adapted, is used for carrying passengers for hire or reward at separate fares in the course of a business of carrying passengers.'

Creditors have to know from the outset that certain types of rail assets could be subject to the modification, and so the model types must be stipulated in the declaration. It was not possible to contemplate a situation in one jurisdiction where sometimes a leased locomotive would be subject to the 'public service exemption' and sometimes not, or that generic rolling stock would be covered because sometimes it was used to ferry passengers on commuter lines. In practice this means that the types of rolling stock that can be covered here are quite limited.

There was much discussion up to and at the Luxembourg Diplomatic Conference on what could constitute 'public service railway rolling stock'. The stipulation that the rolling stock had to be used *habitually* had not been agreed prior to the conference. The original proposal had been to apply the exemption to 'public service rolling stock specified in its declaration or determined by a competent authority of that State notified to the Depositary.' This was unacceptable to the rail industry and some delegations, and the final wording was only approved towards the end of the conference.⁷⁰ Given the revision that the rolling stock had to

So here it is not the type of vehicle but its mission. This becomes even clearer later in the section where it is stated in subsection 4 that '[f]or the purposes of this section a journey made by a vehicle in the course of which one or more passengers are carried at separate fares shall not be treated as made in the course of a business of carrying passengers if—

- (a) the fare or aggregate of the fares paid in respect of the journey does not exceed the amount of the running costs of the vehicle for the journey; and
 - (b) the arrangements for the payment of fares by the passenger or passengers so carried were made before the journey began;
- and for the purposes of paragraph (a) above the running costs of a vehicle for a journey shall be taken to include an appropriate amount in respect of depreciation and general wear.'

This definition is then imported into the UK Railways Act 2005 (section 40 (7)) in the context of the provision of alternative road passenger transport.

⁷⁰ Following the joint submission of the Federal Republic of Germany and the Rail Working Group on 19th February 2007.

be used *habitually* and not just occasionally for the purpose of providing a service of public importance, which assets would be covered? The British Royal train and special wagons for transporting nuclear waste were two examples discussed where the definition probably would apply. But rolling stock incidentally used to carry military equipment (clearly a service of public importance) but which would be used on other missions could not be in this category. And what about trams? Arguably they *could* also be included in this category by contracting states, but then governments would have to accept that private asset-based finance could be very difficult to source, or would be very expensive for such *category* of rolling stock (no ‘cherry picking’ is allowed under Article XXV(1) if it were included unless other safeguards were adopted. And commuter trains could also qualify under the same argument (but not the locomotives unless the traction unit is part of the train set). It may be argued that what constitutes ‘a service of public importance’ is a question of fact or law (or both) in the contracting state. Technically this may be correct, but in practice this is not a useful discussion, since if a contracting state considers that rolling stock designated in the declaration is providing such a service, this would be binding on the creditor in relation to the operation of the Luxembourg Protocol. If such decision were ill-considered or incorrect, then this surely could only be challenged as a matter of domestic law and cannot be altered retrospectively for the purposes of Article XXV. By the same token, if the law changes and that allows, or even requires, a contracting state to restate what constitutes public service railway rolling stock, any change must be by further declaration and cannot ‘adversely affect rights and interests of creditors arising under an agreement entered into prior to the date on which that declaration is received by the Depositary.’⁷¹

⁷¹ Article XXV(5).

The drafters then set out to define the safeguards which should apply. If, having made a declaration, the contracting state blocks repossession, use or control of public service railway rolling stock, it has an obligation to preserve and maintain such rolling stock from the time it steps in to take possession, until possession, use or control is restored to the creditor.⁷² During the period when the contracting state has stepped in to take possession, the creditor should receive the greater of the amount that is required to be paid to the creditor under local law and the market lease rental.⁷³ There are provisions covering when and to whom money should be paid.⁷⁴ So the basic conclusion of Article XXV is that, for public policy reasons, and only if those reasons already exist in relation to specifically pre-defined classes of rolling stock, the state can step in and stop repossession. But it can do so only on condition that the creditor’s position is not disadvantaged. What the drafters have neatly achieved is to reconcile the position of the creditor and of the contracting state, since the contracting state has a primary interest in the rolling stock still being provided for the public service, whereas the creditor, normally, does not have any particular interest in repossessing the rolling stock as such, but ‘wants its money’! Therefore, the obvious solution is to allow the state to intervene and take possession of the rolling stock as long as the creditor gets the benefit of the original bargain.

Another way of looking at this is that it is now considered morally and legally preferable in modern democracies that where the state expects a service to be provided to the public on terms that would not be commercial, it has to assume the difference between those terms and the market rate the provider would normally expect to receive. This approach is followed in recent EU legislation concerning public service transportation services, where in relation to public service obligations that aim at

⁷² Article XXV(2).

⁷³ Article XXV(3).

⁷⁴ *Ibid.*

establishing maximum tariffs for all passengers or for certain categories of passenger, 'the competent authority shall compensate the public service operators for the net financial effect, positive or negative, on costs incurred and revenues generated in complying with the tariff obligations established through general rules in a way that prevents overcompensation.'⁷⁵ Compensation is then calculated in accordance with detailed rules.⁷⁶

But there is a nuance here that should be carefully noted. The obligation on the state is not to pay the amount due under the lease had it continued. The working assumption is that the lease would have been terminated by the creditor because of a default by the debtor. Accordingly, in this situation the benefit of the bargain for the creditor is the value of the asset once it is repossessed. Therefore, subject to any provision of local law that provides for higher compensation, the creditor should effectively be placed in the same position as it would have been in had it repossessed the asset and re-marketed it, *but not the same position as if it had not terminated the lease*. The state does not provide a guarantee for the contracted rentals, and there is good reason for this. The rentals themselves under the lease could be constructed, between the parties, with any number of variables, including linkage to specific interest rates or steps upwards, so that the rentals increase during the term of the lease. The creditor then takes a risk, assuming that this is true asset-based financing, that the value of the asset may be lower than the present value of the outstanding rentals. The fact that the state steps in to take possession of the rolling stock should not be used to relieve the creditor of that risk, since this would give it more than originally bargained for.

And then it all seems to go wrong. Article XXV(4) seems to drive a 'coach and horses' through this careful compromise between the state and the creditor. A contracting state

whose rules of law do not provide for the asset preservation and compensation obligations we have just discussed 'may, to the extent specified in a separate declaration notified to the Depositary, declare that it will not apply those paragraphs with regard to railway rolling stock specified in that declaration.' Paragraph 4 seems to offer the creditor some small comfort by adding that '[n]othing in this paragraph shall preclude a person from agreeing with the creditor to perform the obligations specified in paragraphs 2 or 3 or affect the enforceability of any agreement so concluded.' So even if the state would not be prepared to assume such obligations directly, a government agency or public or private sector guarantor might ride to the rescue of the creditor.⁷⁷ Paragraph 6 also sternly reminds any state making a declaration under Article XXV to 'take into consideration the protection of the interests of creditors and the effect of the declaration on the availability of credit'. But the creditor knows that if it chooses, a state can ignore this instruction. What exactly is going on here?

The drafters of Article XXV understood that some states have a legal or constitutional dilemma in relation to public service railway rolling stock. Firstly, could they pre-commit in the Luxembourg Protocol the government's power to decide if a creditor's assets should be protected and the creditor compensated if the state intervened to preclude repossession on debtor default? Secondly, whilst a state may have a constitutional duty to 'keep the trains running' without pre-condition⁷⁸, to do so would arguably result in confiscation of assets without compensation which, as noted

⁷⁵ Regulation (EC) No 1370/2007, Article 3(2).
⁷⁶ Regulation (EC) No 1370/2007 see Article 6 and the detailed provisions in the Annex to the Regulation.

⁷⁸ In some cases it is a legacy originally from the 19th century.

at the beginning of this paper, is also often constitutionally unacceptable.

This is where the *Salvatorische Klausel* becomes critical. That a state has the *right* to make the second declaration under paragraph 4,⁷⁹ does not at all create an *obligation* to do so. It will be abundantly clear that no reasonable creditor would provide finance for rolling stock without a strong debtor credit or other third party guarantees if the second declaration is made.⁸⁰ Or if it does it will demand a substantial risk premium on the funding rate, thereby effectively closing out private finance for the rail industry in the state making such declaration, in precisely the cases where private sector finance is required. Essentially, therefore, there is a strong economic disincentive for a state to make this second declaration.

So the 'classic conflict' is resolved by trading use for compensation. Of course, this is not an original solution – in fact it is one that in many states is constitutionally mandated. And the technical liberty of a state to seize without compensation is in practice constrained by economic realities.

7. Comparison of alternative approaches under the Protocols

It is tempting to comment on the three alternative approaches taken through the three different protocols and to conclude which solution is the best. But this would be facile. It is, after all, part of the 'culture' of the Cape Town Convention that different industries will have different requirements, governments will have different concerns, and the solutions will therefore be customised. The very architecture of the Convention and the industry-specific protocols is designed to deal with this. Indeed there are constitutional constraints that may

apply to the rail sector, for example, but do not apply elsewhere, and constrain the industry from being more forceful in asserting the unrestricted rights of creditors. We must also recognise that whereas in the Aircraft and Rail Protocols, physical repossession is a real option, in the Space Protocol it is not, and therefore it is effectively dealt with as a legal construct. But it is still legitimate to look at how the Luxembourg and Space Protocols have used different legal approaches to tackle the same issue.

All three protocols rely on the assumption that governments will temper possible powers to restrict repossession by the understanding that the more such repossession is restricted, the more difficult it will be to provide private sector asset-based finance. The Aviation Protocol encourages states to eliminate any public service restraints in the 1933 Rome Convention. Otherwise it broadly stays silent in this area. The Luxembourg Protocol relies heavily on that assumption in relation to the practical application of the 'public services exemption'. There will be a tipping point where states feel that they have protected the public interest as much as they can, but have not gone so far as to then imperil the asset-based financing the Protocol is designed to encourage. The Protocol creates a system for clearly identifying where that tipping point is. The Space Protocol does something else. While it provides no mechanism for a declaration to be recorded at the International Registry and therefore publicly showing where assets potentially could be affected, it provides for filing of notice on a case-by-case basis. This effectively means a subjective assessment of whether the state is able to intervene.

A second concern is that the Space Protocol gives no mechanism for resolving what could be a real conflict between the public interest and the creditor. The 'cooling-off period' is effectively saying 'it will be all right on the night'. It creates a forum for the state and the creditor to talk to each other to see if they can find an amicable solution, but that is all. There is no mechanism to facilitate that solution and one must anticipate that unless the state provides an attractive outcome within the cooling-off

⁷⁹ This was deliberately kept separate to the declaration to be made under Article XXV(1).

⁸⁰ Noting that a key objective of the Convention is to facilitate true asset-based finance without (material) reference to the credit standing of the debtor, since it is this which will lower the barriers to entry to the respective industries.

period, the creditor will happily stand its ground and 'repossess' its asset. It will be intriguing to see whether governments will ultimately be prepared to accept such a situation.

There is also a basic question as to whether in fact the state needs to interfere at all to protect public services. Is this not something that can be cured by local legislation and/or by provisions in the private contract between the parties and the state? This is a seductive argument, and was advanced by some governments and the industry in the lead-up to the Berlin Diplomatic Conference. After all, one of the mainstays of the 'philosophy' of the Cape Town Convention is giving as much freedom as possible to the contracting parties to decide their own outcomes. In some cases, as in the UK, the state has direct agreements with creditors to secure the public service.

Tempting as this suggestion is, it is unhelpful. The freedom to contract also extends to the choice of law, which means that a government cannot be certain, unless it imposes mandatory provisions of public law, whether the public interest will be protected. Arguably it also pushes a government into either contracting with creditors in advance, or into directly interfering, at the time of the debtor default, with private interparty agreements in an unstructured way, due to political pressure, to ensure that the public interest is protected. Further, just leaving it to the contract is unrealistic, bearing in mind existing legislative and administrative safeguards of the public interest already in place in certain countries such as the UK. This indicates in turn that this cannot be left to the private sector to sort out on its own.

But even if the public service aspect of delivery is covered in a private contract, there is no guarantee of consistency or transparency, both of which are also clearly part of the Cape Town philosophy. 'Leaving it to the parties to decide' may be a perfectly valid response to issues of rights between the parties. It is not an answer to the concerns of public authorities wishing to safeguard the overall interest of the community while seeking to find an equitable solution for creditors denied their contractual

rights. It is surely much better to anticipate the inevitable problem and apply a consistent and predictable solution.

8. Conclusion

In conclusion, the three protocols take very different views on how to deal with the public interest where there is a threat of creditor repossession on debtor default. The Aviation Protocol tries to put this on one side, and given the large number of ratifications of the Aviation Protocol already, this appears to have been well-accepted by governments. The Space Protocol recognises that there is a public service issue, but deals with it only obliquely by facilitating, in individual cases, the right of a state to impose a cooling-off period of between three and six months. Neither preservation of the asset during the cooling-off period, nor indeed securing payment to the creditor during the time when its asset is frozen, are considered. The theory is simply that the parties will get around a table during the cooling-off period and attempt to find a solution. The Luxembourg Protocol takes a structured approach, defining narrowly the circumstances in which the state can block creditor repossession by reference to certain designated types of assets where the state has the power under existing domestic law. It then sets out a clear regime for preservation of the asset and compensation of the creditor when the asset cannot be repossessed.

The one thing these different approaches illustrate very clearly is that it was right to create industry-specific protocols as part of the Cape Town 'architecture' to cope with the different priorities and perspectives of the various industries. In each case the industry protocol does consider the 'classic conflict' but in markedly different ways, adopting different policy approaches that reflect the practical needs of the respective industry sectors. The real test will come when all the protocols are in force and governments and courts, under public pressure, seek to preclude creditor repossession because this is perceived to conflict with the public interest.

APPENDIX

The Luxembourg Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Railway Rolling Stock**Article XXV — Public service railway rolling stock**

1. A Contracting State may, at any time, declare that it will continue to apply, to the extent specified in its declaration, rules of its law in force at that time which preclude, suspend or govern the exercise within its territory of any of the remedies specified in Chapter III of the Convention and Articles VII to IX of this Protocol in relation to railway rolling stock habitually used for the purpose of providing a service of public importance ('public service railway rolling stock') as specified in that declaration notified to the Depositary.
2. Any person, including a governmental or other public authority, that, under rules of law of a Contracting State making a declaration under the preceding paragraph, exercises a power to take or procure possession, use or control of any public service railway rolling stock, shall preserve and maintain such railway rolling stock from the time of exercise of such power until possession, use or control is restored to the creditor.
3. During the period of time specified in the preceding paragraph, the person referred to in that paragraph shall also make or procure payment to the creditor of an amount equal to the greater of:
 - (a) such amount as that person shall be required to pay under the rules of law of the Contracting State making the declaration; and
 - (b) the market lease rental in respect of such railway rolling stock.

The first such payment shall be made within ten calendar days of the date on which such power is exercised, and subsequent payments shall be made on the first day of each successive month thereafter. In the event that in any month the amount payable exceeds the amount due to the creditor from the debtor, the surplus shall be paid to any other creditors to the extent of their claims in the order of their priority and thereafter to the debtor.

4. A Contracting State whose rules of law do not provide for the obligations specified in paragraphs 2 and 3 may, to the extent specified in a separate declaration notified to the Depositary, declare that it will not apply those paragraphs with regard to railway rolling stock specified in that declaration. Nothing in this paragraph shall preclude a person from agreeing with the creditor to perform the obligations specified in paragraphs 2 or 3 or affect the enforceability of any agreement so concluded.
5. Any initial or subsequent declaration made under this Article by a Contracting State shall not adversely affect rights and interests of creditors arising under an agreement entered into prior to the date on which that declaration is received by the Depositary.
6. A Contracting State making a declaration under this Article shall take into consideration the protection of the interests of creditors and the effect of the declaration on the availability of credit.

The Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Space Assets

Article XXVII – Limitations on remedies in respect of public service

1. Where the debtor or an entity controlled by the debtor and a public services provider enter into a contract that provides for the use of a space asset to provide services that are needed for the provision of a public service in a Contracting State, the parties and the Contracting State may agree that the public services provider or the Contracting State may register a public service notice.
2. For the purposes of this Article:
 - (a) 'public service notice' means a notice in the International Registry describing, in accordance with the regulations, the services which under the contract are intended to support the provision of a public service recognised as such under the laws of the relevant Contracting State at the time of registration; and
 - (b) 'public services provider' means an entity of a Contracting State, another entity situated in that Contracting State and designated by the Contracting State as a provider of a public service or an entity recognised as a provider of a public service under the laws of a Contracting State.
3. Subject to paragraph 9, a creditor holding an international interest in a space asset that is the subject of a public service notice may not, in the event of default, exercise any of the remedies provided in Chapter III of the Convention or Chapter II of this Protocol that would make the space asset unavailable for the provision of the relevant public service prior to the expiration of the period specified in a declaration by a Contracting State as provided by paragraph 4.
4. A Contracting State shall at the time of ratification, acceptance, approval of, or accession to this Protocol specify by a declaration under Article XLI(1) a period for the purposes of the preceding paragraph not less than three months nor more than six months from the date of registration by the creditor of a notice in the International Registry that the creditor may exercise any such remedies if the debtor does not cure its default within that period.
5. Paragraph 3 does not affect the ability of a creditor, if so authorised by the relevant authorities, temporarily to operate or ensure the continued operation of a space asset during the period referred to in that paragraph where the debtor is not able to do so.
6. The creditor shall promptly notify the debtor and the public services provider of the date of registration of its notice under paragraph 3 and of the date of expiry of the period referred to therein.
7. During the period referred to in paragraph 3:
 - (a) the creditor, the debtor and the public services provider shall co-operate in good faith with a view to finding a commercially reasonable solution permitting the continuation of the public service;

- (b) the regulatory authority of a Contracting State that issued a licence required by the debtor to operate the space asset that is the subject of a public service notice shall, as appropriate, give the public services provider the opportunity to participate in any proceedings in which the debtor may participate in that Contracting State, with a view to the appointment of another operator under a new licence to be issued by that regulatory authority; and
- (c) the creditor is not precluded from initiating proceedings with a view to the replacement of the debtor by another person as operator of the space asset concerned in accordance with the rules of the licensing authorities.

8. Notwithstanding paragraphs 3 and 7, the creditor is free to exercise any of the remedies provided in Chapter III of the Convention or Chapter II of this Protocol if, at any time during the period referred to in paragraph 3, the public services provider fails to perform its duties under the contract referred to in paragraph 1.

9. Unless otherwise agreed, the limitation on the remedies of the creditor provided for in paragraph 3 shall not apply in respect of an international interest registered by a creditor prior to the registration of a public service notice pursuant to paragraph 1, where:

- (a) the international interest was created pursuant to an agreement made before the conclusion of the contract with the public services provider referred to in paragraph 1; and
- (b) at the time the international interest was registered in the International Registry, the creditor had no knowledge that such a public services contract had been entered into.

10. The preceding paragraph does not apply if such public service notice is registered no later than six months after the initial launch of the space asset.