Could the Luxembourg Rail Protocol be a game-changer for SA's logistics sector?

On 21 June 2023, The South African Cabinet approved the submission of the Luxembourg Rail Protocol to Parliament for ratification. Ratification is expected later this year. The Cabinet said in a statement that the protocol would boost economic growth by attracting private investment in the rail industry and that its approval was a sign of the country's commitment to rail reform.

Image source: Gallo/Getty

South Africa's economic growth has been hampered by poor infrastructure, especially its failing rail, road, and port systems. President Ramaphosa recently described the country's logistics networks as a "crisis of catastrophic proportions."

In line with the 2022 White Paper on Rail Policy which makes space for private sector investment and given that the National Logistics Crisis Committee (NLCC) has proposed greater private sector participation in addressing these issues, and the ratification of the Luxembourg Rail Protocol (LRP) could help to attract private investment and improve the country's logistics sector.

Providing insight on this is Vivien Chaplin, director of the corporate and commercial practice and head of the mining and minerals sector at one of South Africa's leading law firms, Cliffe Dekker Hofmeyr (CDH).

Calls for emergency measures

Over the course of the most recent reporting period, Transnet Freight Rail (TFR) lost more than 15 million tonnes of freight volumes due to irregular locomotive acquisition, maintenance problems and cable theft along its coal line.

"The consequences of this monumental loss have affected the country's biggest coal exporters, many of whom have already sustained substantial revenue losses due to the institution's failing rail infrastructure," says Chaplin.

One of the major repercussions of these failings is the country's increasing reliance on trucks as the primary mode of transport for goods and commodities, says Chaplin.

"And while the trucking industry has all but come to the rescue of South Africa's transport system, the sheer magnitude of unroadworthy trucks, reckless driving and irresponsible driver behaviour has become a major public safety hazard. "

With time, the inundation of national roads has led to a rise in collisions and accidents – many of them fatal, adds Chaplin.

"Unfortunately, many of South Africa's important ports are in no better condition than its national roads. In a wage strike that has persisted since late 2022, Transnet has incurred monumental losses, with exporting harbours operating at as little as 12% capacity.

"From bulk minerals to fresh produce, South Africa's ability to sustain its key exports is under serious threat."

The Transnet strike alone has been estimated to cost the South African economy up to R1 billion a day. When coupled with the challenges arising on numerous fronts in terms of job cuts, the loss of opportunities and the loss of capital investment, the logistical crisis represents one of the country's most immediate concerns.

Several stakeholders and industry experts have hailed private sector partnership and collaboration as a crucial factor in solving the ongoing crisis. To this point, the most recent confirmation of a private sector partnership set to develop and upgrade Pier 2 of the Durban Container Terminal has been a welcomed development.

And, as Chaplin explains: "In terms of the regulatory structures needed to support these interventions, the Luxembourg Rail Protocol is part of a much-needed progression."

LRP and its implications for SA's logistics

Formally known as the Luxembourg Rail Protocol to the Cape Town Convention on International Interests in Mobile Equipment on Matters Specific to Railway Rolling Stock, the LRP is a global treaty, adopted at a diplomatic conference in 2007.

The main objective of the LRP is to make it easier and cheaper for the private sector to finance railway rolling stock (from high-speed trains to trams) without state guarantees, thus enabling governments to focus their resources on infrastructure.

Once it has entered into force, the LRP will result in the creation of an international legal framework for the recognition and enforcement of the security interests of private sector investors (lenders, lessors and conditional vendors), where each are secured by railway rolling stock.

The LRP will also establish a unique rail vehicle identification system (URVIS) which will make it easier to track the location of rolling stock in real time.

It will also introduce an international public registry in Luxembourg accessible online 24/7, where private sector investors will register their security interests in the financed equipment and check for potential rival claims.

This will make it possible, for the first time, for all interested parties to easily learn of a creditor's security interest in an item of rolling stock, and for that creditor to be able to enforce its security in cases of debtor default or insolvency.

Public-private sector partnerships

Chaplin says that the majority of the advantages to be gained from the ratification of the LRP relate to the elimination of risk for private sector investors on rail equipment. Primarily, the LRP will lower barriers to entry into the industry for private sector operators and reduce the dependence of state and private operators on state funding.

Furthermore, the LRP will ensure that the security interests of private sector investors will be safeguarded through the establishment of the URVIS. It will also facilitate the short-term operating leases of rolling stock, not just into railway operators from private sector investors, but also between operators, ensuring more efficient use of rolling stock.

Ultimately, these developments have the ability to attract capital investment, which will, in turn, promote the expansion of rolling stock manufacturing facilities.

To date, four states have ratified the LRP (as well as of the European Union in regard to its competences), thereby satisfying the conditions for the Protocol's entry into force and once completed, South Africa will be the fifth state to ratify.

With the onboarding of Spain as an official member state in early 2023, the treaty entered its next phase, which will involve the opening of the International Rail Registry in Luxembourg City.

While this marks a significant stride forward in terms of addressing the country's logistical setbacks, significant policy shifts will be required from Transnet and the South African government to ensure a smooth adoption. Resistance from Unions may be on the horizon, as well as significant complexities in terms of the legalities, operational policies and risk allocation.

As Chaplin concludes: "Companies wanting to invest in this sector (which may include current mining, industrial and other exporters) now have a limited window of opportunity to prepare for the implications of this regulatory shift in order to realise its full potential.

Funding remains one of these chief concerns, particularly in light of Basel IV – the latest set of banking regulations governing the calculation of risk-weighted assets.

These companies will therefore require legal counsel with a solid understanding of the industry and South Africa's procurement and legal environment, to navigate the interface between public and private sector parties."