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REPUBLIC OF SOUTH AFRICA

SAMSA
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To	**:**	**The Chairman: South African Ports Regulator**
From	**:**	**The National Ports Consultative Committee**
Subject	**:**	**Proposals to Transnet National Ports Authority's Alteration of its Tariff Methodology for the financial year 2021/2022 – 2023/2024**

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PROPOSALS TO TRANSNET NATIONAL PORTS AUTHORITY'S ALTERATION OF ITS TARIFF METHODOLOGY AND PRICING STRATEGY

1. PURPOSE

The purpose of this memorandum is to submit proposals and recommendations from the National Ports Consultative Committee to the Ports Regulator of South Africa in response to the NPA's proposed Tariff Methodology.

2. BACKGROUND

Section 82(1) of the National Ports Act, Act 12 of 2005, empowers the Minister of Transport in the appointment of the National Ports Consultative Committee (NPCC). The function of the NPCC, amongst others, is to consider the National Ports Authority's (NPA) tariff applications, to comment on those, and to propose meaningful alterations where it is felt that it is necessary to do so.

The NPCC has participated in the Tariff Methodology process since its inception. It is noted that the South African Ports Regulator has made significant progress in strengthening the port economic regulatory regime. This include the three-yearly review of the tariff methodology, tariff strategy and annual NPA tariff application review, considering inputs from port users across the port system. Consistent with previous responses to participate in the regulatory tariff call for inputs, an ad-hoc NPCC Telecon was convened to discuss the Tariff Methodology and WEGO Addendum published 27 November 2019. The aim of the meeting was to formulate and record any comments and proposed alterations for submission to the Ports Regulator of South Africa (PRSA).

3. NPCC TARIFF METHODOLOGY RESPONSE DISCUSSION

The meeting referred to was held Monday 27 January 2020. Participants deliberated on the Tariff Methodology as published by the PRSA. The meeting resolved that the NPCC's response to the PRSA should cover the following headings:

- Compliance with the National Ports Act, Port Regulations, Directives and the previous issues raised.

- Content and Completeness: Comprehensiveness of the Tariff Methodology and Port Tariff Methodology including all the elements.
- Volume forecast
- WEGO and related performance calculations
- To make Recommendations deemed necessary

3.1 Compliance with the Act, Regulations, Directives and previous Records of Decision.

3.1.1 Section 72(2) of the National Ports Act indicates that the Authority must, prior to any substantial alteration of tariffs, consult with the NPCC.

The PRSA economic regulatory process has created an enabling environment for industry to participate in the process in which the National Ports Authority's alters its tariffs. It is acknowledged that the National Ports Authority complied with the regulatory multi-year tariff approach applicable to the 2018/2019 – 2020/21 financial years.

3.1.2 Contents and Completeness – Port Tariff Methodology

3.1.2.1 Methodology Period

The NPCC acknowledges the strides made by the Ports Regulator in moving from a year-on-year methodology review to a multi-year tariff methodology review. Furthermore, acknowledging the maintenance of annual reviews within the three-year methodology period approach. The flexibility in allowing for individual year adjustments is well received by the industry. A three-year period without allowances for adjustments it would have been detrimental to the shipping industry as so many factors can change within this period.

NPCC's Recommendations:

The NPCC therefore recommends that the Methodology period with annual tariff adjustment be maintained.

3.2 Tariff Methodology Elements

3.2.1 Rate of Return Regulation – Revenue Required (RR) Methodology/ Revenue Cap

The NPCC acknowledges that this approach satisfies the Ports Act in respect of the ''Ports Regulator ensure that the approved tariffs allows the Ports Authority to:

- *Recover its investment in owning, controlling and administering ports and its investment in port services and facilities.*
- *Recover its costs in maintaining, operating, controlling and administering ports and its costs in providing port services and facilities; and*
- *Making a profit commensurate with the risk involved in port services and facilities.*

The NPCC supports that the Authority recovers its investment and costs etc. The issue of risk and its justification remains a challenge noting that the Authority largely operates in a monopolistic environment. Current risks include the Authority's consistent lack of investment.

Justification of the actual Revenue Requirement itself remains a challenge noting the lack of investment and lack of transparency related to the redistribution or reinvestment of net profits. Noting these comments, it is a concern that these monopolistic practices may contribute to excessive charges. Figure 1 below was previously submitted by Captain Sumeet illustrating port call cost differences.

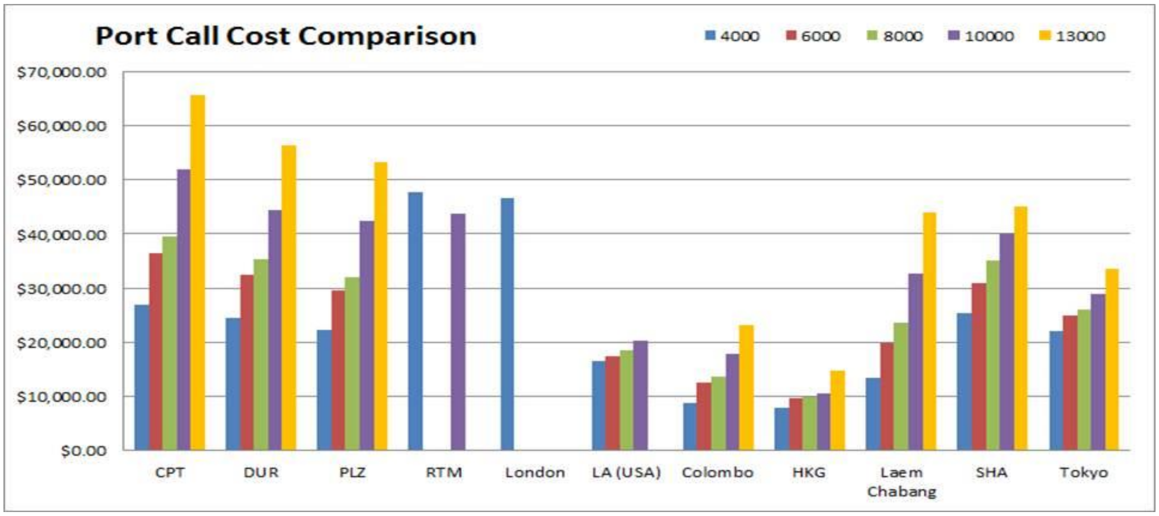

Figure 1: Port Call Cost Comparison

Whilst the actual RR itself requires justification as highlighted above, the NPCC welcomes the WEGO addition to the formula whish is further supported at a PCC level. The ETIMC component is acknowledged in respect of it being able "to offset moderately higher tariff increases".

3.2.2 Regulatory Asset Base (RAB)

The NPCC wish to acknowledge the strides made with regards to the RAB. This noting that the valuation of assets constituted a clearly identified and articulated sample of the overall RAB. Furthermore, the NPCC acknowledge and support the "appropriate minimum criteria for setting an appropriate RAB and asset valuation system". The PRSA determination to treat assets prior to 1990 applying the Historical cost basis and assets post 1990 using the Trended Original Cost (TOC) method is supported. The NPCC wish to acknowledge that the PRSA undertook to monitor that the National Ports Authority "correctly allocate capital maintenance applied to pre-1990 in the asset register satisfying the stipulated conditions".

The NPCC wish to highlight that the RAB component in the RR model constitutes a material component in tariff setting and overall efficiencies. In doing so noting the National Ports Authority's oversight obligations or impact of lack of exercising same which is an area requiring urgent attention.

3.2.3 Rules for Inclusion

The NPCC acknowledges the PRSA's "rules setting criteria for inclusion and valuation of assets and treatment of maintenance" as it relates to the RAB. The NPCC wish to express its appreciation for the long terms view noting that fixed assets consider a long terms approach and is <u>operationally</u> <u>used and useable</u>. The National Ports Authority's oversight role including monitoring and auditing remain a concern. By way of example in the case of a tug, which at the start of the financial year was in working order, and a month or two into the new financial year the same tug has to be taken out for repairs which could take 6-8 months to be repaired. Clarity is sought as to timing of the the adjustment to be done. In particular whether it is done in the next financial year to exclude the specific asset for the period it was out of commission? Important to note that the NPCC is not referring to normal maintenance but long-term repairs which may be anything over a month in our opinion and should be considered long term and not operational and used.

The NPCC further acknowledge the additional notes regarding assets. This including note 4 under Additional Notes articulating that "All capital expenditure must be approved by formal PCC and NPCC resolutions". Important to note that PCCs supporting or not supporting capex presented and consulted is a standard item on each of the respective PCCs Agenda. Capex spend is highlighted as a challenge in each of the ports where the PRSA consistently allows for capex spend. Important to note that the National Ports Authority and Transnet processes aggravate capex not spend resulting in efficiencies. This requires that the National Ports Authority be held accountable for its lack of capex spend. It is a concern that the National Ports Authority is not being held accountable. Examples include projects which almost get to fruition and which are cancelled due to tender related challenges etc.

3.2.4 Calculation of the RAB including RAB depreciation

The calculation as detailed by the PRSA is supported. It is important that the PRSA considers ongoing maintenance and refurbishment challenges. The NPCC recommends that the PRSA advise timelines to the RAB processes highlighted.

3.2.5 Maintenance

The NPCC acknowledges the differentiation criteria in maintenance treatment whether operational expenditure or capital expenditure. Important to note that maintenance within the SA port system regardless of whether it is operational or capital expenditure remain a challenge. This is largely due to lack of oversight and approval process as highlighted at PCCs amongst other.

3.2.6 Calculation of the RAB

The formula used to calculate the RAB is noted. The depreciation formula and treatment of depreciation is supported.

3.2.7 Inflation Trending

Inflation trending as articulated by the PRSA is acknowledged and supported.

3.2.8 Capital Works in Progress (CWIP) and Working Capital

The NPCC acknowledges the CWIP articulation and the challenges linked thereto. This is noted as a further reflection of the National Ports Authority oversight obligation as highlighted in the Ports Act of 2005 to ensure an efficient and effective port system. The NPCC wish to reiterate the many varied challenges CWIP represent across the SA port system.

The NPCC acknowledges the articulation of Working Capital. This including the various implications that the time value of money has. This further reinforces the importance of actual oversight as articulated in the Ports Act of 2005 and effective port management.

3.2.9 Weighted Average Cost of Capital (WACC) – Vanilla WACC

The NPCC acknowledges the Vanilla WACC formula and calculation.

3.2.10 Cost of Equity

The NPCC acknowledges the cost of equity post-tax referencing the Capital Asset Pricing Model (CAPM) formula and calculation. Including “the exclusion of return on equity from the claw back calculation using the CAPM calculation”. This noting the risk premium in relation to the RFR with the aim of reducing the Authority’s overall risk and potential tariff volatility.

3.2.11 Risk Free Rate (RFR)

The NPCC acknowledges the Authority’s risk profile as articulated by the PRSA and the RFR Fisher equation. Furthermore, highlighting previously mentioned risks, the Authority is creating for itself as a result of its own processes.

3.2.12 Market Risk Premium (MRP) and Beta

The NPCC acknowledges the MRP and the Beta respectively as articulated by the PRSA.

3.2.13 Gearing

The NPCC acknowledges the PRSA articulation. It further reflects on the monopolistic environment within which the Authority operates. Furthermore, the reinvestment or lack of investment of net profits.

3.2.14 Taxation

The NPCC acknowledges the Taxation expense as articulated by the PRSA.

3.2.15 Operating Costs

The NPCC acknowledges the articulation of operating costs. It is with concern that the NPCC notes the continued allowance of Transnet Group costs, which constitutes a contravention of the Act (National Ports Act 2005 – ActNo.12 of 2005) which states that the authority (NPA) must be corporatized. We are however pleased that the NPA will have to provide an externally and independently audited financial report including support documentation and detailed explanations, including basis of allocations and policy documents which support such allocations.

3.2.16 Claw Back

The NPCC acknowledges the articulation and relevance of the Claw Back. component. Its representation of fairness and risk management. This is a further reflection of the strides made within the economic regulatory regime.

3.2.17 Excessive Tariff Increase Margin Credit (ETIMC)

The NPCC acknowledges the articulation and relevance of the ETIMC. This is a further reflection of the strides made within the economic regulatory regime.

4.Volume Forecast

The NPCC acknowledges the articulation of the Volume forecast. Further acknowledging the importance of engaging stakeholders within the various economic subsectors to ensure accuracy of forecasts.

5.Weighted Efficiency Gains in Operations (WEGO)

The NPCC acknowledges the WEGO articulation and engagement with stakeholders. Important to not WEGO is supported at a port PCC level. The NPCC is in full support of the new proposal for the inclusion of downtime adjustments. We can all agree that this addition to the Tariff Methodology is the most exciting initiative that has been introduced by the Ports Regulator in the drive to improve Productivity. Terminal Efficiencies is paramount to the overall success and survival of the SA ports. We all recognize that the current state of the ports with all berthing/operational delays is mainly due to poor/dismal productivity by the Terminal Operator. It is also very important that the KPI's set must be approved by PCC in close consultation with NPA and TPT/ Terminal Operator for Containers as discussed at a PCC level. And must be bench marked against International Standards which must be reviewed annually so we can strive to always improve. By way of example with additional resources productivity should improve hence the targets set must also be tweaked accordingly. Port Users will gladly pay premium for improved productivity, reciprocally if they do not perform, they need to be penalised as well. This process must be properly policed for it be accurate and fair to all parties concerned and necessary corrective actions/measurements taken in order to ensure optimum productivity levels are maintained throughout the port system.

6. Recommendations

It is recommended that the PRSA:

Continue with the multi-year tariff Methodology and link timelines to the respective undertakings.

NPA to provide full disclosure as to its Revenue Requirements need and the application of funds by Transnet including the reinvestment of profits.

Take note of concerns, abnormalities identified, and recommendations made by the NPCC throughout this submission.

The ringfencing or corporatisation of the National Ports Authority be prioritised to ensure it exercises oversight and play the role of an “ACSA” of the Port environment.

Submitted for the Chairman’s consideration.