THE SOUTH AFRICAN ASSOCIATION OF FREIGHT FORWARDERS

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Submission to the National Ports Regulator

SUBJECT:

THE NATIONAL PORT AUTHORITY'S TARIFF APPLICATION FOR THE 2020 / 2021 FINANCIAL YEAR

PREAMBLE:

The South African Association of Freight Forwarders (the Association) makes this submission on behalf of its members and its member's clients.

This is the 10th annual submission by the Association to the Regulator on the National Port Authority's tariff applications, as such previous information submitted on the Freight Forwarding Industry globally and SAAFF's position as the sole voice of the industry in South Africa has been omitted from this submission but are available on request.

SUBMISSION:

Tariff Methodology

The Executive Summary in the Authority's application draws attention to the "inherent limitations" in the approved Tariff Methodology when volumes and revenue have been impacted by major changes to the economic climate and global trading volumes, as has been the case during the recent past. Recognising that its own calculation of revenue requirement for the 2020 / 2021 financial year results in an untenable increase of 19.74% the Authority has requested that a substantial sum from the ETIMC be utilised to bring the increase to an inflation linked percentage of plus 3.8% for the forthcoming three years.

The Association supports with reservations the use of the ETIMC in this instance and appreciates the Authority's recognition that in current circumstances the Methodology is, simply put, not fit for purpose.

It is noted that should the Regulator approve an increase of 3.8% each of the three years in review then the overall increase will amount to 11.18% whereas using the Authority's methodology calculation the overall increase amounts to 10.0%.

Revenue Requirement Formula:

In past submissions the Association has indicated that it recognises that a Revenue Requirement formula is an appropriate process for advance tariff setting for monopoly utilities and is common practice globally where either private sector or state-owned utilities are in a regulated environment. However, it is clear from the Executive Summary and the resulting percentage calculations that in the current economic environment the Methodology does not deal with the drastic drop in volume and revenue that was clear prior to the pandemic and was exacerbated during lockdown.

In an environment where many private sector companies have either failed or are finding survival difficult, the Methodology allows the Authority to retain a WACC that indicates the shareholder is expecting an increased return on capital in 2021 / 2022.

With many of its members and their clients fighting to stay in business whilst experiencing considerable drops in volume and revenue this Association cannot support any increase in tariff and believes a reduction across the board would be a more appropriate Record of Decision.

Regulatory Asset Base (RAB):

It is unclear from the Authority's tariff application if the Regulators March 2018 approved asset valuation methodology has in fact been used to value the RAB. It is not apparent whether the pre 1990 assets been valued and depreciated on the Historical Cost basis. There is also no indication if the Trended Original Cost (TOC) method for post 1990 assets was utilised to value those assets. The Authority's tariff application should make clear the process used to arrive at the starting RAB post the 2018 ROD on asset valuation.

Weighted Average Cost of Capital (WACC):

Weighted Average Cost of Debt.

The weighted average cost of debt (WACD) at a rate of 10.85% used in the WACC calculation materially exceeds current capital market yields which range between 3.55% on the R208 to a maximum of 10.32% yield on 10 year and longer bonds. With interest rates and yields both locally and on global markets likely to remain low for the foreseeable future we question whether the Authority and Transnet are not in a position to borrow at materially lower rates than that used in the WACD.

Tax Calculation

The tax rate of 14.05% is 1.37% lower than the 15.42% included in the 2019 / 2020 application. In all previous applications the standard corporate tax rate of 28% was used. It is reasonable to assume that over those previous year's tax liability was in the range of that being applied now and that the Authority benefited from including considerably higher tax rates in its applications than was in fact the case. We question whether the Regulator took this anomaly into account when issuing the ROD for the 2019 / 20 financial year and if not whether port users have been unfairly treated in this regard over the entire period of regulation.

Cargo Volume Forecast:

In the current global economic climate forecasting freight volumes is at best conjecture with so many unknown factors impacting on this country's economic future and that of all of its trading partners. The application addresses as best it can a possible scenario for all the major commodities handled. The Association believes that the indicated volume / revenue forecast of 7.54% for the forthcoming three years is, if anything, overly positive but it supports the broad approach the Authority has taken in this regard.

Operating Expenditure:

As has been the case in previous applications the Authorities operating cost are indicated to increase at a level considerably in excess of inflation.

For some time, South Africa's inflation rate has been in the region of 3%. (July 2020 3.2%). For the Authority to require increases approaching three times that in the current economic climate is untenable. The Authorities clients; shipping lines, terminal operators, importers and exporters are all facing the direst economic circumstances.
The Authority is not isolated from these pressures, the Association asks the Regulator to insist that operating costs reflect the current situation and that cost constraining actions are introduced as a matter of urgency.

Group Overhead Costs:

The Association notes that unlike the Authority the Transnet group is *"continuously striving to contain the increase…. to be within a reasonable inflationary range"*
There are two material increases in these costs which are noted:
Post Retirement Benefit Obligations increased from R16.6m actual 2019 / 2020 to R42.6m projected this financial year and 39.2m 2020 / 2021.
Transnet Capital Projects costs increased from R14.4m actual 2019 / 2020 to R95.1m projected this financial year and R96.9m projected for 2021 / 2022.
The Association asks the Regulator to request evidence as to why these two expenses have increased exponentially over recent years.

Port Tariff Incentive Programme ("PTIP")

During the Regulator's road shows officials of the Authority indicated that since its inception only one application for relief in terms of the PTIP had been received, this was for technical reasons rejected. As the object of the programme is to motivate beneficiated exports the complete lack of interest by exporters or potential exporters would indicate that the Regulators actions in reducing export cargo dues on containerised cargo has largely made the programme irrelevant.

The current Cargo Dues rate for a six-metre export container is R458.94, around US$27. It is highly unlikely that any further reduction either on specific exports or across the board will have the impact the programme desires. The Association recommends that the programme be cancelled.

Excess Tariff Increase Margin Credit ("ETIMC")

As indicated in the opening paragraph of this submission the Association accepts, that to ensure increases in port tariffs are at zero for 2021 / 2022 it will be essential to draw down from the ETIMC. The application does not indicate how much this draw down should be nor does it provide the current value of the fund. For any reasonable comment to be made on the application this information is essential.

It is therefore assumed that there are sufficient funds to support the Authority's request for an increase of 3.8% and for zero change to tariffs should the Regulator so decide.
The Association's concern is that replenishing the ETIMC in future will, perforce, be at the expense of port users. The Association questions whether the building up of an immense store of wealth to protect against swings in volume and revenue is an appropriate accounting method as opposed to the efficient management of operating cost and cash reserves.

Energy:

In previous submissions the Association has raised the question of the Authorities approach to the matter of alternative energy sources with a request that future applications include an indication of efforts the Authority is making in this regard. There is no indication in the application that efforts are being made to constrain the use of various forms of energy or generally addressing important questions around climate change. As the dominant logistics entity in South Africa the Authority has the opportunity and responsibility to become a leader in addressing these critical issues both in its own operations and among terminals and other lessees.

<u>Submission Conclusion</u>

The Authorities responsibilities extend to: "*ensure that adequate, affordable and efficient port services and facilities are provided*:" (NPA Act 2005).

Though understanding the Regulator has no direct oversight over facilities such as terminals it should require the Authority to insist that operators, particularly those with effective monopolies such Transnet Port Terminals, consider the current economic situation when deciding on tariff levels in 2021 / 22 and retain them at current levels.

As in the past this Association and all port users have relied on the Regulator to ensure that the Authorities tariff increases are kept within an inflationary range. **The situation virtually all port users face during the current pandemic and consequent economic recession clearly requires that tariffs at best undergo no increase at all.**

D.H. Watts,

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South African Association of Freight Forwarders *September 30th 2020*