THE SOUTH AFRICAN ASSOCIATION OF FREIGHT FORWARDERS

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Submission to the National Ports Regulator

SUBJECT: TRANSNET NATIONAL PORT AUTHORITY

TARIFF APPLICATION 2013 / 2014 FINANCIAL YEAR

PREAMBLE:

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

The submission seeks to bring to the Regulators attention areas of the tariff proposal SAAFF believes, if granted, may have negative consequences for Importers, Exporters and South Africa's international trade

Included with this submission are two supporting annexure:

Annexure 1:

Provides a short description of the Freight Forwarding Industry internationally and in South Africa:

Annexure 2:

Establishes SAAFF as the sole voice of organised Forwarding in South Africa:

STRUCTURE OF SUBMISSION:

The main element of the submission will address those areas of direct concern to the Clearing and Forwarding industry and its clients. Issues of concern to other port users such as marine charges, pilot fees etc. do ultimately impact on the C&F industry its clients and consumers and will, where relevant, constitute a part of this submission.

SUBMISSION:

1) Executive Summary:

Multi Year Tariff Application Approach:

The Association notes that the proposal for a "Multi Year Tariff Application Approach" has not yet been approved by the Regulator and will be the subject of discussion in 2013.
The intention to provide port users with an understanding of tariff changes in advance and over a reasonable period of years is to be applauded.
The suggested process outlined in the executive summary of the application is however cause for serious concern.
Tariff increase calculations over recent years including the current one have utilised the inflation rate as a tool in assessing RAB and WACC. In other areas CPI has born little or no relationship to actual cost increases see Table 21 in paragraph 7.3.1. "Operating Expenditure"
As the Authorities assessment of possible cost and revenue are based on figures such as WACC and RAB and historic operating expenses which have little or no relationship to inflation rates we question the use of Consumer Price Inflation (CPI) and the intention to increase this by 3% with a floor of 8.5%. Annual increases at this level over a six year period will mean the final year will see a tariff structure over 63% higher than that in year one.
We draw the Regulators attention to past tariff increases, an example is the cargo dues rate for a 6m container which in 2003 was R1510.00 and in 2012 R2177.63 (excluding the rebate) an increase of +- 45 % over the ten year period or +- 4% per annum. Other NPA charges over the same period reflect similar changes.

We urge the Regulator to insist that the Authority reins in increases over future years to levels which are within Producer Price Inflation (PPI) rate, not CPI, and are broadly comparable with tariffs applied by similar Authorities elsewhere.

Tariff Methodology:

The Regulators Record of Decision (ROD) for financial year 2012/2013 included in paragraphs 4.4.1: directive 22(3)(a) "*That the application set out the manner in which the tariffs have been calculated and the model used for determining them. The NPA did not do so and indicated that they calculate the overall revenue required and the required tariff increase there from. They indicated that the methodology to calculate individual tariffs is the subject of the on-going "Tariff Review Project" or Tariff Strategy. As this process is at an advanced stage and they shall consult all stakeholders on the outcomes prior to the next tariff application, the Regulator agreed to await the outcomes of the process, on condition that the matter is resolved expeditiously".*

This was followed with Directive 23(1) (a): ***a systematic tariff methodology that is applicable on a consistent and comparable basis****. "No explanations were given as to a methodology that explains the variance between tariffs for the same cargo type but different commodities. The comments relating to the lack of a tariff methodology above refer. The applicant states that it is reviewing a methodology for calculating tariffs and the Regulator awaits the outcome of that process", and*

23(1) (f): ***the avoidance of cross-subsidisation, save where in the public interest. "****The low level of information detail with respect to services or facilities pricing and cost relationships etc, makes it difficult, if not impossible, to determine where and in which direction subsidisation takes place or if it does not. No claim or denial was made that any subsidisation existed, or that such subsidization that existed was in the public interest and on which grounds public interest was determined".*

Paragraph 8.4 "Pricing Strategy Overview" of the Authority's application addresses the progress being made toward a more appropriate pricing strategy and confirms various anomalies and shortcomings which the Regulator had identified in the past. The application proceeds to provide calculations and observations on possible improvements to the tariff structure. In paragraph 8.5 the Authority recognises the need to "engage with clients on the pricing strategy" and then in concluding the paragraph tables very material tariff adjustment proposals.
Though recognising that these adjustments do indeed address various unsatisfactory areas in past tariff's and will be welcomed by many port users there is no indication that any

"consultation with stakeholders" as required by the Regulator has in fact occurred. The Association is concerned that the Authority has tabled major changes to its pricing policy through this application rather than via prior discourse with all port clients.

Capped Revenue Requirement:

Page 8 of the executive summary addresses the capped revenue requirement as follows:
"Due to the non-finalisation of the tariff methodology and with the assumption that a multi-year tariff application of CPI + 3% will be considered next year; the Authority proposes to cap the Revenue Requirement for FY 2013/14 to R10 275m:"
Though any lowering in tariff increases is welcomed the reduction from 14.2% appears to be in some way conditional upon acceptance of a multi-year tariff which includes substantial increases over a six year period. We believe an understanding of how the reduction of 703m in marine revenue requirement from 9122b to 8410b is derived is essential. The Association believes this calculation should be made clear to the Regulator and port stakeholders.
The Association fails to understand how a decision on long term tariff adjustments can be made should it include any condition or assumption which requires subsequent approval by the Regulator and consultation with stakeholders.

2) Working Capital:

Provision for Leave Pay:

Paragraph 7.1.5 addresses the provision for leave pay accrued. The Association recognises that Generally Accepted Accounting Principles (GAAP) require that a provision be made for leave pay accrued and not taken. We question whether including this provision in labour expenses for the purposes of tariff calculation is appropriate.
2.5% of labour cost amounts to R42m which in the majority of cases will not or should not be a cash payment and therefore not constitute a real expense. We would request the Regulator examines the Authorities policy regarding the cash payment of leave not taken and if the amount allocated under this heading is appropriate.

3) Operating Expenditure:

In Paragraph 7.3.1 of the application total operating costs are forecast to increase by 13.7%. The major sources of this increase are Labour at 12.8% and Energy at 27.2%. Increases in some other cost items over a two year period since 2011 /2012 have reached exceptionally high levels, examples are Professional Services >139% Research and Development >387% and Group Service >130%.

The Association understands that to a large extent energy increases are outside the Authorities control and that labour costs in the current climate will likely increase at levels well above inflation. However increases of this magnitude over a sustained period will have a profound impact on the ability of the Authority to supply services at rates which are competitive with regional ports and do not again negatively impact on South Africa's international trade logistics costs.

4) Pricing Strategy Overview:

Paragraph 8.4 "Pricing strategy overview" has the following comments:

"……the current tariff structure presents several imbalances in the determination of the various tariffs, including: …….High differentials in the levels of cargo dues for different cargo types and commodities with no clear motivation for the differences"

In an effort to address these imbalances the application proposes changes to cargo dues which include increases in that for bulk cargo and material decreases in that for containerised traffic with a particular focus on containerised exports.

The Association welcomes these changes which begin to align some of the clear distortions in the tariff which have impacted negatively on those industries utilising containers over many years.

However one of the tariff anomalies which the Authority has chosen not to address and which this Association sees as a prime example of an extant distortion is that of cargo dues assessed on transhipment containers.

Though the Association understands the need for ocean carriers to have access to transhipment capacity and for ports to supply such capacity at competitive cost there are distinct areas which are of concern.

Table 5: "The Authority's services and corresponding revenue stream" makes clear that cargo dues are the revenue stream intended for the construction, rehabilitation and development of dry infrastructure. Our understanding has always been that cargo dues and previously wharfage were intended for this purpose, whether or not that actually occurred in the past is moot.

Dry infrastructure be it quay walls, buildings, yards etc. are utilised during any cargo handling procedure whether import, export or transhipment. Though the past differences in cargo dues on import and export versus that on transhipment containers will be reduced somewhat, should the regulator accept the proposed tariff changes, there will continue to be a major difference between the applicable rates. The R154.86 per TEU total in and out transhipment amount compares with R1866 on an imported TEU and R614 on an export.

The Association accepts that overall port costs for transhipment containers must be set at a level which matches those available in foreign ports in our region and does not discourage carriers to by-pass our ports. Assuming that offering a considerably reduced cost on transhipment containers ensures carriers do in fact service our ports it is logical to conclude that terminals are a material beneficiary of this traffic and should provide at least a portion of the discount. The current policy with the Authority being the only provider of low cost service effectively means that other port users, including this Association's clients, are carrying a substantial and unreasonable added cost burden. We would ask that the Regulator addresses this anomaly with the Authority and that at least a portion of the discounted cost is born by terminal operators.

5) Bunker fuel levy:

In Paragraph 8.6 **t**he application proposes a new levy to be known as the Bunker Fuel Levy. The application identifies the provision of new barges and supporting infrastructure such as enlargement and improvements to Berth 10 at Durban which are required to facilitate the delivery of bunkers. The levy is intended to finance the cost of these improvements and should realise around R30 million per annum.

The matter of the levy and its quantum is not a concern of the F&C industry however we would request the Regulator ensures that should the levy remain in place then the various capital costs and resulting assets have not been included in the calculations of WACC and RAB utilised to arrive at an overall increase in tariffs.

The Association has difficulty with the apparent change in policy regarding this levy. Our submissions over recent years have questioned why tariff increases have by and large been across the board covering all or most NPA activities and services regardless of the clear differences in cost structure, examples are areas where there is substantial labour involvement as against those where there is little or none. We question whether it is the Authority's intention in future to tariff users of specific infrastructure such as bunker berths or liquid bulk berths based on the actual cost of such development.

6) Volume Growth Forecast:

The Association has difficulty with the calculation of volume and revenue growth as outlined in Table 29, page 46 and Table 33, page 50.

Table 33 provides an estimate of marine business overall unit growth at around 5% per commodity with the exception of motor vehicles which are expected to remain stable.

Table 29 forecasts 2012 / 2013 gross revenue of 8,490m less the ad hoc rebate of 1,000m, (7,490m) The forecast revenue for 2013/14 including 498m in growth is 7,988, in fact a decline over 2012 / 2013 , pre- rebate, of 502m. This observation assumes the rebate will have been utilised by the end of the

financial year. There is no apparent explanation of this in the subsequent explanation on revenue growth.

No doubt the Regulator is aware that to date in this calendar year volumes in a number of critical areas are not reaching expectations.

7) Ports Regulators Record of Decision 2012 / 2013

<u>Post ROD processes and requirements.</u>

There are a number of requirements which the Regulator outlined in his ROD for financial year 2012 / 2013 outlined in Paragraphs 7.1 & 7.2 and which the Association is unable to find addressed in the current application.

We draw the Regulators particular attention to his requirements for higher granularity for the Authorities CAPEX programme and an enlargement on the processes through which the PCC's and NPC provided input. This is of concern to the Association as the Revenue Requirement basis for assessing tariff and tariff increases means that "per force" the cost any errors or miscalculations surrounding forecast volumes etc will fall to the account of port users, ultimately importers and exporters and not the shareholder.

Referring to the matter of CAPEX and infrastructure development we quote below from the submission made to the Regulator for the 2012 /2013 tariff year which was financed partly by this Association, the Ethekwini Maritime Cluster (EMC) and the South African Association of Ship Operators and Agents. (SAASOA)

"……. if it is accepted that the merits of…… projects have been adequately interrogated, the principle of expecting existing users to fund these projects merits scrutiny. In the case of a parastatal such as Eskom which provides a single basic service, expecting users to fund investment which will directly benefit them in proportion to their electricity usage is not unreasonable. When, however, many of the existing users do not require the proposed developments and are unlikely ever to benefit from them, then the justification for expecting them to pay for these investments appears questionable. This situation is exacerbated greatly should certain major port developments have been undertaken not for

sound commercial reasons that would have enjoyed the support of those groups of port users that could broadly be seen as beneficiaries, but rather for more overarching or political reasons, such as regional development imperatives. The overwhelming case in point is the development (and now the proposed costly extension) of the port of Ngqura in Algoa Bay, the construction of which was

undertaken largely for reasons of regional development in the Eastern Cape, one of the country's poorest provinces. The regional development arguments may well be compelling, although the largely transhipment business that will underpin port activity for the foreseeable future will not generate the returns that the other major ports do. However cogent the regional development basis for the port development may be, it is not reasonable on equity or efficiency grounds that port users in general, and particularly port users (such as bulk users of the port of Richards Bay) who derive no conceivable benefits from the Ngqura port, should share financial responsibility for its development. These investments might more reasonably be supported by the national fiscus"

We believe that this observation has continued relevance to the strategy surrounding port tariffs and request the Regulator examines this specific aspect.

Other matters raised in the ROD which the Association would wish to see addressed are:

- The asset valuation method,
- Transfer pricing between the NPA and other Transnet group companies and
- The NPA's depreciation policies.

8) Submission Conclusion:

As mentioned under 7) the Association has concerns with regard to the "revenue requirement methodology" utilised in this and all the Authority's previous tariff applications. Whilst recognising that the Regulator accepted this process as being appropriate for the Authority in paragraph 5.1 in his Record of Decision for the year 2010 / 2011 there are shortcomings. The process effectively shields the Authority and its management and shareholder from the consequences or poor or incorrect decision making in its capital expansion programme or in the financing arrangements for such programmes. Excessive operational costs if not properly controlled become a cost to the Authorities customers and not as would be the case in a private enterprise the shareholder. Port stakeholders have no option but to rely on the Regulator to oversee the performance of the Authority and ensure not only that that the Authority's mandate is properly fulfilled but is done so in an economic, efficient and cost effective manner.

The Association notes the considerable increase in WACC over recent years. The NPA application for the year 2011/ 2012 was based on a post tax WACC of 5.38% whereas the application under review includes a vanilla WACC of 8.33%. This has a substantial impact on bottom line revenue requirement and requires careful attention to the validity of theses calculations. Of equal concern is the extent of the market risk premium (MRP) and beta considering the position the Authority holds as the sole port landlord in the country and the protection it enjoys from state ownership. Whether using the JSE top 40 as a comparator is appropriate is a matter of concern as very few of the corporate members of the top 40 have as little embedded risk at the Authority.

The Association requests that the Regulator addresses the matter of the adjustment to NBV of R1.850 billion being the cost of the old Durban airport site and its inclusion in the regulated asset base whilst apparently no legal confirmation of the establishment of the “dig out” port is yet in place.

The three Records of Decision made by the Regulator since its inception have resulted in the National Port Authority increasing its focus on port efficiency by all port operators and has kept increases to a level substantially under that requested. We are confident that further progress will be made in this regard in the year 2013 / 2014.

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