FPT GROUP (Pty) Ltd.
REG NO. 1986/001611/07
D Berth, Duncan Dock, South Arm Road, Port of Cape Town, 8001
PO Box 6480, Roggebaai, Cape Town, 8012, South Africa
T: +27 21 401 8700
F: +27 21 401 8846
www.fpt.co.za

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NATIONAL PORTS REGULATOR OF SOUTH AFRICA
Attention: Mr R Khan
Chief Operating Officer
11th Floor, the Marine
22 Dorothy Nyemba Street
Durban

Per courier and
per email: riadk@portsregulator.org

Dear Mr Khan

RE: COMMENT ON TRANSNET NATIONAL PORT AUTHORITY ("TNPA") PROPOSAL FOR A NEW TARIFF STRUCTURE

FPT Port Leasing (Pty) Ltd ("**FPT Port Leasing**") and FPT Group (Pty) Ltd ("**FPT**") (together referred to as "**the FPT Group**") appreciate the opportunity provided by the National Ports Regulator of South Africa ("**the Regulator**") to the various stakeholders to provide comment on the TNPA 2013/2014 Tariff Application ("**the Tariff Application**"). FPT, as terminal operator in three South African ports, hereby provides its comments on specific aspects of the Tariff Application which directly or indirectly impacts the business of the FPT Group. For purposes of clarification it is pointed out that FPT Port Leasing is the principal lessee of the relevant terminals operated by FPT, and has sub-leased the terminals to FPT with the consent of TNPA. This correspondence is addressed to you on behalf of both entities.
For purposes of ensuring clarity, each comment provided shall be referenced to a specific section within the Tariff Application.

1. Tariff Methodology – Section 1.2 of the Tariff Application

One of the components comprising the calculation of the revenue required by TNPA ("**the Required Revenue**") is the claw back. This is said to ensure that TNPA and its customers do not gain or lose out from discrepancies between forecasts made at the time of the tariff application and actual figures of capital expenditure, operating expenditure, depreciation, taxation, volume figures, volume mix and tariff structuring.
However, we note that the methodology does not explain how the claw back will be applied in the case of either over or under recovery. In this regard, the question is asked whether the correction will be based on the percentage contribution of each of the stakeholders as referred to in section 6.1.2, being the contributions of port users to the Required Revenue.

Moreover, it is assumed by the FPT Group that the claw back does not apply to under or over recoveries prior to the implementation of the new tariff structure, as proposed in the Tariff Application. The Regulator and/or TNPA is requested to provide confirmation in this regard.
A further component of the Required Revenue mentioned in the Tariff Application is the Regulatory Asset Base, which comprises 55% of the total revenue requirement. For the purposes of the Tariff Application, it is assumed that all property was valued on the basis of the economic return expected, as per section 4 of the Tariff Application. The FPT Group requires greater clarification in regard to the basis of this calculation i.e. the equation for "economic return expected".

2. Design Principles applied to determine the new tariff structure – Section 4 of the Tariff Application

In terms of section 4 of the Tariff Application, the "User Pays" principle states that the level of rent paid by terminal operators will be value driven, such that the level of rent payable by a terminal operator will be aligned with the economic return expected by such terminal operator.
It is noted that the methodology does not explain the basis for determining the economic return expected. Is the economic return expected a return which is determined by the terminal operators based on the budgeted revenue of that terminal operator for a given financial period, or will this value be determined by TNPA? If the former is the case, will a percentage of this budget automatically be applied to rental? It is requested that TNPA provide more clarity in regard to how the concept of economic return will be determined and furthermore, whether such determination will be a fair assessment of the economic return of the relevant terminal operator.
Moreover, if economic return is to be considered as a factor for the determination of the rental payable by a terminal operator, the question posed is whether a low economic return would justify a decrease in the terminal operator's rental. In this regard, FPT's Cape Town terminal has shown consistent low economic return over the last few financial years. In the Tariff Application, TNPA states that the revenue it receives from tenants is approximately R1,7 billion. FPT Port Leasing currently pays TNPA an amount of approximately R50 million per annum in rental, which amounts to approximately 3% of the total revenue received by TNPA. It is clear from the above that FPT's rental is much greater than that of many other terminal operators. In light of all of the above, it is argued that a decrease, rather than an increase, in the annual rental would be justified in the case of FPT.

3. Comparison of cargo dues charged by ports that levy cargo dues/wharfage – Section 5.3.3 of the Tariff Application

The Tariff Application states that cargo dues are typically used to recover the cost of building port infrastructure
It is noted however, that private terminal operators do not receive cargo dues from cargo handled at their terminals, and they therefore do not have access to these funds to apply to the infrastructure.
The FPT Group therefore proposes that the cargo dues generated from cargo handled at the terminal be applied for terminal infrastructure upgrades, especially in view of the fact that TNPA will take possession and ownership of the terminal assets at the end of the lease, and is not obliged to compensate the lease holder for capital investments made which ultimately results in an increase in value of the asset. Port dues are also described as being applied to improve facilities. FPT has for more than 2 years operated with berths that are not at design depth due while waiting for dredging. This severely limits the type of vessels that can be handled, reducing the size of potential business for FPT.

4. Comparison of landlord port revenue structure - Section 5.3.4 of the Tariff Application

The Tariff Application states that when compared to other landlord ports, TNPA's rent contribution to total income is the lowest at 15%, with most landlord ports gaining 40% to 60% of total revenue from rental income.

The FPT Group would like to understand what the proportional contribution of Transnet Port Terminals ("**TPT**") is compared to private terminals when this calculation was performed. If lease costs of TPT are low in comparison to that of private terminal operators such as the FPT Group, it stands to reason that TNPA's rent contribution to total income of 15% will be materially skewed. As we understand it, TPT pays a historical rental due to the IFRS reporting method and IAS40, which classifies TPT as an intercompany rental, since both TNPA and TPT are divisions of Transnet Limited (SOC). This does not apply to private terminal operators, who have paid rentals based on amounts above fair market value. The current FPT Port Leasing rental already comprises 36% of the total revenue generated at all the FPT port terminals (full year figures for 2012), but in some cases such as Cape Town, this proportion is as great as 49%. If one considers that this includes other income that is generated by ancillary services, the percentage will be somewhat higher. In our view, there should therefore be no upward adjustment of FPT rental. This rental should in fact be reduced, since any increase in rental will directly impact rates to clients, since FPT does not have any room to absorb such increase. In this regard, and as stated above, the FPT Group's rental comprises 3% of the total revenue received by TNPA, and should therefore not be increased at all as this will prejudice even further FPT's competitiveness in the market. We request that each terminal be evaluated individually, taking into account historical factors. Alternatively, the increase in rental should be applied to TPT only so as to bring TNPA's rent contribution to total income ratio in line with ratios at other ports internationally.

5. Proposed asset allocation to port user groups - Section 6.1.1 of the Tariff Application

As per the proposed new allocation of assets, quay walls are allocated to terminal operators.

FPT currently pays for the first meter of the quayside leased in Durban and Cape Town, so this cost is already included in the FPT rental. FPT would like to be advised as to whether this includes any other costs associated with the quay walls such as maintenance, and the quantum of this amount as it has been incorporated in the revenue required. Additional costs to the existing premises costs will have a significant negative impact on FPT's ability to remain competitive.

6. Proposed Revenue required per port user group - Section 6.1.2 of the Tariff Application

It is suggested in the Tariff Application that the revenue required from terminal operators be increased from 19% of a total of R9.15 Billion, to 33%. This is an increase of 77% in value terms.

It is envisaged that most of this additional revenue will be generated by the increase in lease costs to the terminal operators. As mentioned above, FPT is not in a position to absorb an increase of this magnitude, which will then have to be passed on to the cargo owners, resulting in a negative impact on imports and exports. If this increase is not passed on to the cargo owners, and TPT's rental is not increased to a level commensurate with the FPT Group's rental, it will effectively mean that the FPT Group will have to exit the market as it will not be in a position to compete with TPT, thereby having a detrimental effect on competition between port terminal operators. This will ultimately result in increased costs for cargo owners and shipping lines as competition within the sector is reduced. FPT Port Leasing's rental should rather be viewed in the context of reducing it than increasing it further, particularly in light of the fact that FPT's contribution to TNPA's total revenue from its tenants amounts to 3% thereof, as stated above.

6. **Critical issues addressed by the proposed tariff structure - Section 7.1 of the Tariff Application**

The Tariff Application states that the proposed tariff structure aims at being transparent by using a set of principles and dynamic rules to set tariffs and specifically aims at avoiding tariff differentiation, discrimination and cross-subsidisation, except where in the case of public interest.
Private terminals such as those leased by the FPT Group have not been the beneficiaries of cross-subsidisation. It is assumed that references to cross-subsidisation are used in the context of TNPA and TPT. For the purposes of ensuring full transparency, which is the objective of the Tariff Application, the Tariff Methodology and the National Ports Act, stakeholders will need an explanation as to the degree of cross-subsidisation that has to be corrected, and would now be reflected in the Revenue Requirement. We ask TNPA to make these figures available to the stakeholder community.

7. **Implications of the new tariff structure for port users - Section 7.2.1of the Tariff Application**

In terms of the Tariff Application, required revenue from cargo owners will decrease by a preliminary 25%. The proposed tariff structure further aims at simplifying cargo dues through a single base rate charge for each different cargo handling type. It is postulated that the decrease in cargo dues should strengthen the competitiveness of certain industries in the export sector. However, as costs may be passed on to cargo owners by shipping lines and terminal operators, cargo owners may still end up bearing the majority of port related costs.

RO RO	-43%
Break Bulk	+65%
Liquid Bulk	+49%
Dry Bulk	+68%
Containers	-49%

Although there is an overall decrease in revenue required from cargo owners of 25%, this does not apply to all cargo types. This model clearly promotes containerization. The cargo dues for break bulk and dry bulk will increase significantly rather than decrease. Containers are the biggest beneficiary, but break bulk cargo, of which fruit is the major business of FPT, will not benefit from the decrease. This is prejudicial to cargo owners who only have the option of moving their cargo in break bulk form. They cannot derive the benefit of the reduced container rates, such as the USA Phytosanitary treated fruit programme. Since this is a large part of the FPT business, any change that increases the cost of export for these cargo owners will have a direct impact on the volumes handled by FPT, and thus result in loss of revenue. The Regulator is requested to consider a more equitable distribution in the cargo dues whereby Break Bulk and Dry Bulk receive some of the benefit of the overall reduction.
In addition FPT is impacted by the volume within its business which comprise Break Bulk and Dry Bulk, being a total of 70% of the total cargo handled by FPT in the 2012 financial year.Any changes in cargo dues that reduces volumes handled in port will significantly impact FPT's viability.

FPT does not have the opportunity to capitalize on the reduction in container rates due to the following:

- FPT has draft limitations, and can thus not handle large container vessels. This is aggravated by the fact that the berths have not been dredged for 2 years and currently are at design depth.
- FPT's license restricts it from handling geared vessels, the bulk of which are container vessels.

8. Beneficiation Promotion Programme (BPP) - Section 7.4.3 of the Tariff Application

The Tariff Application states that cargo dues will be determined by the beneficiation rating of a cargo. In this regard, the higher the stage of beneficiation, the greater the discount on cargo dues, ranging from 0% to 80%.

As has been stated above, fruit comprises the majority of cargo handled by FPT. We confirm that fruit cargo will be considered beneficiated cargo, as it is a commodity which goes directly to the supermarket shelves from the terminal.

9. Proposed terminal operator lease management agreement - Section 7.5.1 of the Tariff Application

The recommendations in the Tariff Application state that TNPA should move to a value based rental methodology that is based on the economic value that terminal operators are able to derive from access to the quay wall based on expected throughput, and that rental should be comprised of a fixed and variable component.

The methodology of determining economic value that an operator is able to derive is different to the current market valuation method applied to FPT Port Leasing. FPT requests that the basis of this calculation be made available to terminal operators so as to fully understand the impact of a possible change. It is also noted that there are a number of factors mentioned earlier in this document which impact the economic value that the FPT Group is able to derive from the access to the quay walls due to physical and licence limitation. All of these should form part of the calculation, particularly if these values are used as a productivity metric. In 2012 the FPT Group share of the total rental quoted at R1.7Billion was 3%. The FPT Group does not occupy 3% of the available quayside in South Africa. Clearly there is an existing over recovery from the FPT Group in terms of rental income.
It is important for the viability of the FPT Group as well as other private terminal operators that TNPA does not have control of the terminal handling charges, since the absorption of additional rental costs will severely impact the viability of the business, and a proportion will need to be passed on to the cargo owners.

It is further noted in section 7.5.3 of the Tariff Application that one of the criteria taken into account in determining the proposed lease management structures and which should be incorporated into the tariff design detail, is the level of investment required by the terminal operator, which will dictate the duration of the lease and rent level. Indeed, we believe that the level of capital investment in infrastructure by the terminal operator will necessitate an extension of the relevant lease so as to ensure an adequate return on investment for the terminal operator. Unfortunately, it has been the policy of TNPA in the past not to allow for an extension of lease terms where capital investment is made by a terminal operator in the terminal. Such a policy has a detrimental effect on the infrastructure quality within the various ports controlled by TNPA due to the failure of TNPA to stimulate an incentive for terminal operators to make a capital investment in the terminals. It is pointed out that the FPT Group has engaged with TNPA on a number of occasions regarding the need for development of terminals which it operates with a simultaneous extension of the lease to make such an investment sustainable. The FPT Group would welcome continued discussions with TNPA regarding further capital investment in its terminals, along with an extension of its various leases. These discussions would in any event be necessary in order to negotiate amendments to the current lease terms in order to provide for the increased rental proposed by TNPA.

10. General - Input from stakeholders - Section 5.1. Tariff Application

The terms of current lease agreements do not allow for long-term planning and investments in facilities, thereby undermining port efficiency, due to poor security of tenure and lack of clarity on the scope of activities allowed

The infrastructure of private terminals has not been improved by the authority. FPT as a private operator is required to fund all capital investment. The authority is not obligated to extend the lease, which would allow for a return on investment within a reasonable period. Currently, ownership and possession of all improvements to the terminals revert to TNPA at the conclusion of the lease. The terminal operator who has made the capital investment is required to tender for the property with parties who have done contributed to the development of the property. The investing company would be left with no asset, and no assurance of business continuation, hence no return on investment. As stated above, and for this reason, it is vital that negotiations be entered into between TNPA and the FPT Group for purposes of discussing further capital investment by FPT into the terminals, the extension of the relevant leases so as to ensure an adequate return on investment, which will in turn allow for an appropriate adjustment to the rental charged by TNPA which can be incorporated as an amendment to the relevant lease agreements.

There are unjustifiable disparities in the lease costs charged to different terminal operators – Section 5.1

An objective of the proposed tariff structure is to promote international competitiveness, and competitiveness in the ports. As a private terminal operator paying what we believe is above market value rental (particularly in Cape Town) and competing with TPT, the FPT Group has been at a distinct disadvantage for years. The lower cost base of TPT has allowed them to engage in price wars within the ports. This has resulted in a net decrease in revenue to the port, since the cargo, when finally procured by one of the terminal operators, is at a much lower rate, artificially driving down the rates in the port, and the resulting revenue and profit. We request that the Regulator and TNPA investigate and propose corrective action to address these historical discrepancies. Indeed, one of the objectives of the National Ports Act of 2005 is to strengthen the State's capacity to separate operations from the Landlord functions within the port.

Methodology: Multi-year Tariff

We request that the regulator does not approve a multi-year tariff, based on a 4year period (2014/2015-2018/2019). One of the objectives is to improve efficiencies in the port. There is no accompanying documentation that elucidates how this will be accomplished in TPT terminals and

TNPA functions, and what the annual metrics are. These should be matched to the revenue increases expected. An annual tariff will allow for demonstration of success before adopting a long term multi-year tariff.

While FPT welcomes a tariff structure that promotes fairness, transparency and competition, there is no reference to restitution of historical discrepancies that have negatively impacted the FPT business over the years. In addition, the magnitude of the increases and the specific elements affected by the proposed tariff, such as rental and cargo dues will reduce the viability of the business, which could result in FPT exiting this sector, leaving Transnet as the only operator in some ports, which does not align with the objective of stimulating healthy competition within the ports. For competition, all operators need to be working off the same cost base. This includes rental of properties, cost of equipment and maintenance. If future equity is achieved with the rental, there will still not be fair competition if the other components of costs are not addressed, and cross-subsidisation still exists.

11. In conclusion FPT requests that:

- The rental not be increased but rather decreased due to the fact that historically FPT has been at a disadvantage to TPT based on market valuation vs intercompany rental, and additional increases in rental will not make the business viable
- The basis for the calculation of the economic value that an operator is able to derive on which the rental is based, be made public
- That current limitations enclosed in lease and licence agreements as well physical limitations be taken into account when productivity metrics are determined.
- That TNPA is not given the power to regulate the terminal handling charges.
- That Cargo dues on break bulk and dry bulk are reviewed to ensure a more equitable distribution of the 25% reduction of costs to cargo owners, and that no additional benefit is provided to Container Cargo vs Break Bulk Cargo
- A multi-year tariff is not approved until TNPA is able to prove positive outcomes of the proposed methodology and tariff structure
- TNPA enters negotiation with the FPT Group for the redevelopment of the terminals and extension of the terms of the leases to ensure an adequate return on investment on such capital investment.

Yours Faithfully

DR D I FERREIRA
DIRECTOR
FPT GROUP (PTY) LTD AND FPT PORT LEASING (PTY) LTD