Submission to the National Ports Regulator of South Africa

Reference: Transnet National Ports Authority (TNPA) Tariff Application 2014/15

Submission 1: 4th November 2013

Presented by: The FSA Port Tariffs and Regulatory Committee

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1. Preamble:

The Fruit South Africa (FSA) Port Tariffs and Regulatory Committee (hereon referred to as The Committee) have drafted this submission on behalf of constituents of Fruit South Africa. Constituents of FSA comprise The Citrus Growers Association of Southern Africa (CGA), The South African Table Grape Industry (SATGI), Hortgro Services (HORTGRO), The Subtropical Association of South Africa (SUBTROPS) and The Fresh Produce Exporters Forum (FPEF). Members of these associations comprise all producers and marketing agents of fruit for exporting purposes; this is a statutory requirement as approved by the Minister of the Department of Agriculture, Forestry and Fisheries in terms of sections 15, 18 and 19 of the Marketing of Agricultural Products Act no. 47 of 1996.

The Committee urges the Ports Regulator to exercise due diligence in consideration of the Authorities tariff application for 2014/15. Specifically, to address the potential economic impact of such application relative to the fruit export industry. While The Committee understands the nature of the application in reference to the Transnet Market Demand Strategy (MDS) and its importance to the economy, however due diligence must be exercised to ensure that the competitiveness of South African export commodities and specifically to that of the Agricultural sector is not put at risk. Inflation in the South African context remains at the fore putting excess pressure on manufacturing, production and [sea] supply chain costs and any further cost pressures on certain sectors will render that sector uncompetitive. Within the fruit export sector specifically, downward pressure on costs is fundamental to provide sustainability to the sector which is facing much uncertainly at this time. The Committee would implore The Regulator to exercise its mandate to ensure that utilization of the national asset “the ports” is commensurate to the Authorities policy statement, “Transnet’s commitment to reducing the cost of doing business in South Africa”.

The Committee would like to bring to the attention of The Regulator that fruit agricultural and export costs have increased by 70% over the period of 2007/8 – 2013/14. The main contributors of this increase have been electricity, (a 300% increase has been recorded since 1999), labour

(52% increased in basic wages in 2013 with an 8% increase over the next 3 years totalling 103% by 2016), production and packing materials, transportation (diesel costs are 55% of total transport costs of which has increased by 60% in recent years), port costs have increased by 30% (fruit has a strict cold chain requiring electricity to power cooling units and seasonality of fruit exports requires high THC's by terminal operators) and shipping costs have increased by 40% since 2000 (Marine diesel has increased by 50% since 2000 and shipping freight rates were increased by 30% in 2013 – see Maersk publication on GRI). Relief was offered to the fruit export industry by way of the R1bn rebate in the TNPA cargo dues tariff for export containers in the 2012/13 financial year. Further relief was offered by way of The Regulators decision for a 43.2% reduction in TNPA cargo dues tariffs for full export containers in the 2013/14 financial year. It would be meaningless for a 14.39% tariff increase to be granted to TNPA on the basis of the aforementioned.

2. Overview of Transnet (TNPA) Market Demand Strategy (MDS)

The South African fruit export business utilizes 90% of containerized sea transport to export fruit to global markets. The specific services and infrastructure rendered by the Transnet SOC Limited operating divisions for containerized cargo, is a key component in consideration of the Transnet MDS. Transnet has a capital expenditure plan of R307bn over the period of 7 years FY 2012/13 – FY 2018/19. A planned Capital Expenditure (Capex) of R47bn (15.6%) has been allocated to TNPA to be funded by cargo dues and other. R24bn (8%) will be allocated towards containerized services and infrastructure projects across all operating divisions. Transnet Port Terminals (TPT) will be allocated R9.8bn (3.3%) towards containerized business projects specifically and this CAPEX will be funded indirectly through Terminal Handling Charges (THC's) and other. In summary the Transnet MDS Capex program will be allocated primarily to non containerized business. Of the 8 ports (transit corridors) in which TNPA operate, R146.8bn has been allocated of which R78.5bn (53.4%) is non containerized business in the ports of Saldanha and Richards Bay.

The Committee would like to draw on the following conclusions relative to the Transnet MDS,

I. Capex allocation for the MDS is primarily directed at non containerized business.
II. TNPA forecast an income of R3.4bn (60% of total cargo dues revenue) for the FY 2013/14 derived from container cargo dues.
III. Containerized cargo dues forecast income for FY 2013/14 is 36% of TNPA total revenue.

IV. It is the opinion of The Committee that cargo dues levied on containerized business (full containers) should not be subjected to a base tariff increase.

V. Cargo Dues tariff increases should be marginalized to commodities with a higher Capex allocation. i.e. Iron Ore, Coal and Manganese commodities.

VI. TNPA Capex allocation to specific commodities should derive a proportional tariff increase relative to the Capex allocated to that commodity.

3. Comments on the Regulatory Manual for the Tariff Year 2014/15

The FSA Port Tariff and Regulatory Committee was initiated and established on the 29th October 2013. The formation of The Committee was initiated in response to comments made by representatives of the Ports Regulator at the Tariff Application Road Show held in Durban on 4th October 2013. The Committee has not had sufficient time to scrutinize the Regulatory Manual and the application by TNPA for the Tariff Year 2014/15. However The Committee has responded as follows:

I. Section 4 of the manual and specifically section 4.1.6 to 4.1.10 has not been adequately abbreviated by TNPA, therefore without such "granularity", The Committee cannot comment on the TNPA Application in regards to this requirement.

II. Section 5 and 6 refers to the Tariff Methodology and the Components of the Revenue Requirement Tariff Methodology. The Committee sought to procure the services of a professional consultant to respond, however due to the limited timeline, The Committee was unable to obtain a response.

III. The Committee implores the Regulator to analyse the operating cost estimates for 2014/15 on a detailed line by line item basis. If TNPA are unable to provide detailed estimates we urge the Regulator to exercise due diligence.

IV. The Committee would recommend that the Regulator exercise caution with regards to the allocation of the Excessive Tariff Increase Margin Credit (ETIMC). The ETIMC should be returned to the cargo owners by reducing tariffs or preferably by way of rebates (as was the case in FY 2012/13).

4. Findings on the TNPA 2014/15 Tariff Application:

The submission with reference to the tariff application considers the facts, whether in the general context or specific to the exporting of fruit from South African ports within the jurisdiction of the National Ports Authority. Findings are relative to the following documents:

I. Transnet National Ports Authority Tariff Application for Financial Year 2014/15. Supplemented by,
    a. Transnet National Ports Authority Tariff Application FY2014/15 Ports Regulators Road Shows (Presentation).
    b. Additional Information Requests from the Ports Regulator Tariff Road Shows (October 2013).

Section 1 Executive Summary

In terms of Section 72 (1) (a) of the National Ports Act, 2005 (Act No. 12 of 2005) (”the Act”). Transnet National Ports Authority, a division of Transnet SOC Limited (“the Authority”) is required, with the approval of the Ports Regulator (“the Regulator”), to determine tariffs for services and facilities offered by the Authority and to annually publish a tariff book containing those tariffs. The Port Directives were approved on 13 July 2009 (gazetted on 06 August 2009) and amended on 29 January 2010. In terms of these Directives, when considering the proposed tariffs for the Authority, the Regulator must ensure that such tariffs allow the Authority to:

a) Recover its investment in owning, managing, controlling and administering Ports and its investment in port services and facilities;

b) Recover its costs in maintaining, operating, managing, controlling and administering Ports and its costs in providing port services and facilities; and

c) Earn a return commensurate with the risk of owning, managing, controlling and administering ports and of providing port services and facilities.

The Committee agrees in part that the authority should:

I. Recover its investment in port services and facilities;
II. Recover its cost of operations to provide a service;

The Committee however does not agree in full that the authority should:

I. Earn a return commensurate with the risk of owning, managing, controlling and administering ports and of providing port services and facilities. The South African ports are national strategic asset operated to facilitate trade. The cost for services provided by the authority should be an enabler and contributor toward the competitiveness of South African trade. The financial structure of the national strategic asset should not be balanced against the recovery of opportunity cost of capital employed but rather be structured to enhance the competitiveness of the economy. The Committee calls for a review of this directive with the view of an amendment of such directive in the interest of protecting and enhancing the competitiveness of Southern African trade.

Section 3.2 Ports Directives

The Committee is of the opinion that TNPA has failed to deliver on these directives. The South African ports are an expensive, inefficient and ineffective asset to cargo owners of South and Southern Africa. The Record of Decision (ROD) by the Regulator must equate this in terms of revenue generation and specifically to that of 3.2.4. TNPA profits must also be reflective the service of the ports to the port users by way of incentivising the ports through profit incentives. In an open market, businesses are incentivised by producing good products at a good price and market forces determine the profits of one organization against another. Transnet and all operating divisions operate in a monopoly and therefore profits are not commensurate to service deliverables. The Regulator is urged to consider this principle in the 2014/15 ROD. The Regulator is further urged to consider the TNPA customer service index as a consideration.

Section 3.3.6.1 Regulatory Asset Base (RAB)

TNPA have determined the RAB to be R64,694m giving a Return on Capital of R3,772 by applying The WACC. The Committee cannot make a determination of the RAB; the contribution to the Revenue Requirement for FY 2014/15 application is 34.5%. The Committee cannot make a determination of this contribution to the required revenue; other than that the Regulator should exercise due diligence in the determination of the RAB.

Section 4.3 Market Demand Strategy (MDS)

The Committee wishes to express that the allocation of Capex to the MDS must be funded primarily by Government guarantees and less by the tariffs directly. Unless a tariff is raised against a commodity for which the Capex is allocated. i.e. Iron Ore, Coal and Manganese. TNPA revenue generation from containerized business far exceeds that of bulk commodities, the tariff application must bring a level of equity to the tariff rationale bearing in mind the aforementioned statement on the MDS Capex allocation.

Section 6.3 The Authorities Volumes

The Committee would agree with TNPA's determination of cargo volumes and marine services. The Committee would however sensitize the Regulator to the fact that Southern African cargo owners, through dissatisfaction of the borders and ports service levels, cargo could migrate to alternative ports out of the territory of TNPA. This may result in a reduced cargo volume base in the coming years.

Section 7.1.4 Operating Costs

The Committee expresses dismay at the level of operating costs of TNPA. The actual operating costs in FY 2012/13 was R3,109m, the budget for FY 2013/14 increased to R4,190m and further to a forecast for FY 2014/15 (in terms of the application) to R4,329m. This is a 34.7%

and 3.3% increase respectively. The Committee would propose the Regulator scrutinize the budget for FY 2013/14 which is translating to an over inflated forecast for FY 2014/15. The Committee hereby proposes the Regulator consider a forecast operating cost for FY 2014/15 of R3, 600m in determining the revenue requirement. This is based on the actual operating cost in FY 2012/13 of R3, 109m + 15.8% (related to inflation). The Committee wishes to convey that in a depressed economy there is the need for a realistic assumption of costs and particularly to that of decreasing operating costs, not increasing operating costs by 39.2% in a matter of two financial years. The Committee stands to reason that no cargo owners can accept such an inflated outlook on operating costs.

Section 7.2 Revenue Requirement

The Committee proposes the adoption of the following revenue requirement for FY 2014/15. This assessment utilizes a more realist operating cost of *R3,600m with an adjusted taxation base of **R900m. The tariff increase before ETIMC is reflected at 2.91% and the tariff increase after ETIMC of R454m is reflected at -2.97%. The Committee wishes to further convey that TNPA have not met the requirements of the Ports Regulators Regulatory Manual for FY 2014/15 within the application. The Committee is therefore of the opinion that the proposed revenue requirement be adopted reflecting the recalculated operating costs.

Table 1: Recalculated Revenue Requirement post ETIMC

	TNPA FY 2014/15	**Recalculated FY 2014/15**
	Rm'	**Rm'**
RAB	64 694	64 695
Real Post WACC	5.83%	5.83%
Return on Capital	3 772	3 772
Plus: Depreciation	1 671	1 671
Plus: Operating Expenses	4 329	*3 600
Plus: Taxation	1 057	**900
Plus: Clawback	118	118
Revenue Requirement	10 947	10 061
Less: Real Estate	-2 113	-2 113
Marine Revenue	8 834	7 948
Latest Estimated Revenue for FY 2013/14	7 462	7 462
Estimated Volume Growth for FY 2014/15	3.5%	3.5%
	7 723	7 723
Required Revenue FY 2014/15	8 834	7 948
Tariff Increase before ETIMC	**14.39%**	**2.91%**
Less ETIMC	454	454
Marine Revenue Required	8 380	7 494
Tariff Increase after ETIMC	**8.51%**	**-2.97%**

5. Conclusions and Key Recommendations

The Citrus Growers Association of Southern Africa has submitted facts relative to the cost of harvesting, production and logistics for the exporting of citrus. This is reflective of the general inflation of all fruit exports from South Africa which has increased by 70% in the past few years. Relief was given in the form of cargo dues tariff rebates and reductions in the 2012/13 and 2013/14 FY. It would seem meaningless to increase cargo dues tariffs by 14.39% before the use of the ETIMC or 8.5% post the ETIMC. In terms of the TNPA operating costs, The Committee urges the Regulator to consider the application in light of the inflated operating expenses reflected within the application. By recalculating the operating costs to be more realistic, it can be determined that there are no merits to the proposed 14.39% TNPA tariff increase for the FY 2014/15. By utilizing the ETIMC within the FY 2014/15 the Committee is of the strong opinion there should be no adjustment upwards of the present tariffs.

The Committee also wishes to express that in light of the TNPA Pricing Strategy under consideration, that there is no further increase in the tariff for full containers. There is no rationale to the tariff base levied on cargoes at present; therefore it would seem prudent to delay any further tariff adjustment until such time as the TNPA Pricing Strategy has run its course.