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To : The Chairman: South African Ports Regulator

From : The National Port Consultative Committee

Subject : Proposals to Transnet National Ports Authority's Alteration of Tariffs for 2017/2018

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PROPOSALS TO TRANSNET NATIONAL PORTS AUTHORITY'S ALTERATION OF TARIFFS FOR 2017/2018

1. PURPOSE

The purpose of this memorandum is to submit proposals and recommendations in response to the Ports Authority's Tariff Application for the 2017/18 financial year to the Ports Regulator of South Africa (PRSA) from the National Ports Consultative Committee (NPCC).

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 necessary to do so.

The current tariff application is the 6th submitted to be considered by the PRSA since the institution of the NPCC. As had been agreed on the first occasion, an ad-hoc meeting of the NPCC was convened to discuss the tariff application, and to formulate and record any alterations for submission to the Ports Regulator of South Africa (PRSA).

3. NPCC TARIFF RESPONSE DISCUSSION

The subject meeting was convened in East London held Wednesday and Thursday 21-22 September 2016 supported by NPCC Representatives. Participants had intensive deliberations on the Port Authority's tariff application with reference to the anticipated draft Tariff book. The main aim was to identify key issues as considered within the PCC meetings throughout the year, clarify grey areas and focus in particular on issues submitted by port users across the Port system to NPCC Representatives. The number of issues previously submitted to the PRSA that was not addressed or was considered to be materially less but still remain a concern. It was further noted that same issues

still require attention. To this end the meeting resolved that the outline of the NPCC response be as follows:

- Compliance with the National Ports Act, Port Regulations, Directives and the issues raised by the PRSA in the 2016/17 Record of Decision.
- Content and Completeness: Consideration given in respect of the provision of sufficient information in the tariff application, or not.
- To judge whether the Application was Methodological Consistent, or not
- To comment on the Pricing Methodology applied by the NPA
- To comment on the Level of Content Detail provided in the Application
- To analyse and comment on the draft Tariff Book
- To make Recommendations deemed necessary

3.1 Compliance with the Act, Regulations, Directives and the Records of Decision for 2016/17

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

a. Directive 22(3) b-c: The Authority has shown material improvement in its disclosure of information. However, it is still difficult to reconcile what was requested in the previous financial year with the execution programme to date, and discussions in each of the eight PCC meetings with regards to areas requiring attention both from a productivity and capex perspective in relation to what is being requested in this Application.

b. Capex Programmes – There is more coherence in respect of the authority consulting with the PCCs.

c. Directives 23(1) a-f: It is understood that the PRSA is in a slightly more empowered position to address in particular the

RAB review through an independent appropriately evaluation sampled process to assess the RAB. In respect of the holistic economic view the PRSA resource-related challenges continued to be perceived as benefitting the Authority and Transnet. This is further linked to the perceived lack of accountability of the Authority's oversight role and the broader negative impact across the port system. Until such as time as the RAB value has been reviewed and clarified it the PRSA role is similarly perceived as being compromised in that RAB value (using the DORC method) as a starting Regulatory asset base.

The Tariff methodology remains flawed with the current valuation value. This continues to violate the principle of fairness amongst others. The issue of cross subsidisation remains a concern

d. 23(1)(g) – Whilst strides have been made in the promotion of access to Ports. However significant work is still needed to be done in respect of running an efficient and effective operation across the port system. At a process level many of the issues raised at some of the PCCs are issues that can be addressed by the Authority albeit the intricacies of same. Concerns expressed by Port users regards issues raised such as the dust issue in the Port of Saldanha, Congestion port of Durban, Quay 700 series in Richards Bay suggest that discussions are taking place in the background with little relevant communication or engagement with affected parties. These are some of the issues to be addressed. Given the Authority's perceived lack in respect of its

oversight role it is difficult to support compliance with this provision.

3.1.2 NPCC's recommendations

a. Capex consultation at a PCC level constitutes support /approval or objection / rejection of Capex Plans.

   i. Incentives and penalties should be applied to underutilised or maximised assets. The entrance channel in Durban remains and still is an example where the Shipping lanes into the port silted-up and reduced the draft from 12.5m t 12.2m. This has a direct impact on vessels calling or leaving the port. This problem remains an issue.

b. The National Ports Authority's Regulated Asset Base (using the DORC model) has to be acknowledged as incorrect and therefore incorrect in the calculation. It has to be further acknowledged that this is a matter of national importance which requires urgent attention. The PRSA prioritisation of the valuation of the Ports Authority's Regulated Asset Base must be fast tracked. The incorrect Regulated Asset Base incorrectly informs the Revenue Required Model which contributes to the higher cost of doing business in South Africa.

c. The NPCC continues to maintain its stance as stated in previous submissions: *The NPCC continues to question the use of the Revenue Requirement (RR) Model as the most appropriate method in respect of its tariff adjustment application. It appears that not only does it seek to ensure NPA's sustainability and profitability, but also that of the entire business of Transnet. Admittedly this could be seen as speculative, but that is because there is not a high enough level of transparency that would enable assessors to determine the facts with any degree of precision, so that anomalies*

inherent in the model, are not easy to understand, or resolve. The RR Model continues to present an opportunity to NPA to continuously upwardly evaluate its regulated asset base to increase its revenue requirement. It appears that in this process, the main motivation is profit enhancement and we have our doubts whether that takes into account the responsibilities imposed on the Authority in terms of broader benefits to the economy and the need to create an environment that facilitates trade.

3.2 Contents and Completeness

The NPCC maintains the following position:

The NPCC Response to this issue remains as was submitted previously. The NPCC gathers from the Tariff application that the current Real Estate tariff model is premised on typical land valuation approaches without much regard to the nature of the business operated thereon. Furthermore, by virtue of Transnet Port Terminals (TPT) being one of the divisions of Transnet Ltd, assets leased to this organisation by the Authority are not recorded at fair value as these are considered owner occupied in terms of the accounting standards. Hence, in calculating the revenue requirement of the real estate business on this basis and combining the outcome with the balance of the authority's business, the risk exists that cross subsidisation could occur, which cannot be interrogated. While the NPCC accepts that a case can be made for cross-subsidisation in certain areas, as stipulated in the Ports Act, it must be transparent and open to examination otherwise it is possible that low productivity and inefficiencies could develop in certain areas of Transnet's business. The Authority is considered to evaluate port property in relation to property such as the V&A waterfront in Cape Town which is considered to be unfair as it is an operational port and should not have the same property value as a tourist area.

NPCC's Recommendations:

The NPCC therefore recommends that the land leased to TPT should be leased at the same rates as it would be to non-Transnet port operators and would like to encourage the Authority in future to be transparent on the total value of rentals acquired. Prolonging the position where TPT enjoys preferential lease rentals continues to negatively impact the balance of leaseholders who ultimately subsidises the TPT business. In much the same way as the cargo dues and marine tariffs are published. It is recommended that income derived from rentals similarly be published.

3.3 Methodological Consistency

3.3.1 The Regulatory approved multi-year Methodology published August 2014 applicable 2015/2016 – 2017/2018 serves as a mandatory guideline. Again significant strides were made. It is also appreciated that the said methodology allows for annual reviews and adjustments. The main concern however remains the incorrect valuation of the NPA's Regulated Asset Base which informs the Revenue Requirement Model. The level of transparency has improved. The transparency improvement reflects on the Authority and PRSA efforts to address issues raised but still there is a need for a higher level of granular transparency. This requires full disclosure and thus the ability to fully unpack information. The timelines from the time the Application is submitted to the PRSA, Roadshows held, and submission to the PRSA are very, very tight to address grey areas prior to submission. Given the efforts made by the respective parties the intention is to always find a credible way of addressing grey areas. This is an issue that simply has to be addressed.

3.3.2 The methodology applied in this tariff application is the Revenue Requirement approach of determining the opening regulatory asset base and depreciation. The Revenue Requirement approach takes into consideration the revenue requirement calculation in the tariff review year and the conversion of the revenue requirement into a tariff increase, taking into account estimated revenue for the current financial year.

a. The following formula used to calculate the Required Revenue: *= (cost of capital x RAB) + operating costs + depreciation + taxation expense – claw back – financing requirements costs of the previous year x (1 + cost of capital previous year) + financing requirements costs current year*

3.3.3 The NPCC Recommendation

a. It was initially accepted that this was an interim measure only. This being the sixth submission together with the PRSA resource limitations continue to be a problem. The current request for inputs to the Tariff Methodology allows for a rethink in respect of the relevance of the RRM. The NPCC acknowledges the work done to address the RRM and maintains its request that urgent intervention is required. The methodology is accepted noting that DORC RAB calculation is in itself unacceptable.

b. *The following assertion was made previously and still holds true: The TNPA's RAB is at the centre of this calculation and has been upwardly evaluated several times previously. This unrestricted upward evaluation for the same asset base is unacceptable. It is understood that this is a widely accepted method of calculation. Consistent with our previous submission,*

it appears that there are no restrictions in terms of how NPA justifies a revenue requirement in excess of R10b. There is further no explanation as to what happens to the additional profits created by said revaluation.

c. The NPA continues to use the current incorrect Regulated Asset Base. This calls for a strong motivation disclosing each and every item in the asset register.

d. The asset register should contain all assets up to 2005 and the value at the time. A separate register should list assets added per annum thereafter.

e. Depreciation – It is observed that the PRSA amended its depreciation calculation considering capital expenditure and inflation which may increase Revenue Required. The Issue of depreciation still seems to be discretionary to a large degree. Clarity has to be provided as to the actual depreciation per asset over its useful life.

f. Inflation trending – Supported that the PRSA uses the CPI published by National Treasury as it has shown to do. Inflation trending approach supported. The Authority's CPI + 3 has to be explained. No justification was given to same neither was it explained in any way. The +3 is therefore unacceptable noting that is not linked to the broader market forces in any factual way or form.

g. Working Capital – It is of concern that approved capital, subsequently cut back may result in unintended risk exposure. Port of Mossel Bay is an example of same. More detail is required to reconcile the R4bn+ indicated with the actual projects.

h. Weighted Average Cost of Capital – considered the methodology inputs to formula.
i. Cost of Equity – The calculation is a key determinant in the tariff setting process going forward.
j. Risk Free Rate - PRSA Regulatory risk free rate method is supported.

3.4 Pricing Strategy

Objectives of the pricing strategy as articulated by the PRSA supported. The principle of differential strategic pricing is widely supported at a port PCC level and NPCC level. This further calls for a clear strategy from the NPA as the different areas of specialisation per port. This is currently an NPCC Agenda item. This issue together with the Authority's Africa strategy remains outstanding.

a. The Port of Ngqura continues to be touted as a transhipment hub, but little seems to have emerged in terms of a pricing strategy to support this strategic intent. The PCC Meeting outcome of the immediate past quarter suggested that there is a need for clarity in respect of the differentiated value proposition per port and its complementarity within the system. The Port of Ngqura Authority highlighted in its response that this is an area still to be clarified.

b. As previously recommended the Authority should have re-categorised its business into Real Estate and Marine. Same was done however, there is a lack of transparency and detail in its presentation of its real estate activities, which makes it difficult to properly assess the impact of this business on the overall operation. There is a distinct lack of detail.

c. The NPCC maintains that in the previous application, the proportion of total revenue to be derived from real estate has increased markedly, with a concomitant decrease in the proportionate contribution from marine business, specifically cargo dues.

d. The logical inference is that tenants will need to increase their charges to cargo sharply. However, it appears that TPT (by far the largest tenant) continue to increase its tariff by more than the rate of inflation, and this anomaly requires further scrutiny. In the absence of any firm indications on TPT's proposed tariffs for 2016/2017, it is not possible for the NPCC to interrogate this in any great detail. The current state of affairs highlights the importance of fast tracking the Single Transport Economic Regulatory (STER) process. Whilst this process has to be fast tracked the PRSA has to play a bigger and more relevant role in this regard.

e. The current Application level of granularity remains questionable.

NPCC's Comments:

The NPCC maintains its position as follows:

a. The NPCC has noted that although the application goes into considerable detail in applying itself to the concept of Activity Based Costing, the results are not clear in the proposed tariffs, which still appears to contain many items that might be described as historical hangovers. Significant work has been done by the PRSA to balance the tariffs and rid same of historical hangovers. The concept of cargo dues, which does not exist in many other jurisdictions, militates against an activity based approach, since NPA does not itself engage in the physical activity of handling cargo, which is undertaken by the terminals to which it rents property. To that extent, cargo dues is viewed as an impost, rather than as payment for a service rendered. Similarly, this is an area that needs to be addressed.

b. In the areas where NPA does render a physical service, namely marine services, the concept of activity-based costing is clearly more appropriate for NPA. Here, it is the view of the NPCC that pricing methodology still contains historical legacies that should be reviewed in terms of current

competitive trends and activity-based costing. Pricing should take into account efficiencies and volume increases in each port and terminal. This remains a challenging area with the Authority being both the referee and the player.

c. The NPCC observed significant efforts to address issues raised previously regards tugs.

d. The current tariff book still does not differentiate between tug pilotage and helicopter pilotage but merely refers to pilotage in the Ports Act of 2005. No mention is made as to how the pilot would board the vessel at anchorage or in the port waiting to sail. In addition only two ports are currently servicing vessels by helicopter whilst others are being serviced by a pilot boat at significant lower charges. This remains a challenge and presents a marked difference in price. It is strongly recommended that the two be separated.

NPCC's Recommendations

a. As previously indicated the NPA has to clearly outline its strategy per port and how this ties into the overall Port system strategy both from a planning and a commercial perspective. The issue of the port system in respect of complementarity is understood however it is strongly recommended that the value proposition per port within the complementarity offering be clearly articulated and demonstrated.

b. The NPCC strongly believes that in order to attract additional vessels/volumes routed through the port of Ngqura, NPA needs to look at means of incentivising this port by offering Shipping Lines a

reduction in marine costs and engage with Transnet / TFR to improve the rail line connectivity to Gauteng and the like.

I. NPA's request to the shipping lines previously to re-route 400,000 TEUS over a 3 year period from Durban to Ngqura during the upgrading process of the Durban Container Terminal, can only be achieved at a huge cost to the shipping lines.

Herewith an illustration of the additional cost incurred by a shipping line to tranship containers which were normally handled at Durban port to now tranship those same containers at Ngqura:

A typical feeder vessel consumes 135 tons of fuel on average per day.

Transit Time: Durban/Ngqura/Durban = 2 days

2 days x 135 tons x USD700/ton = USD189 000.00

@ r.o.e 8, 5 = ZAR1 606 500.00

This is just the price for extra bunkers incurred, extra per vessel, and excludes the additional port call expenses.

NPCC Recommendation:

The NPCC recommends that the NPA subsidize these additional expenses incurred, or provide incentives by way of reducing the marine charges at the port of Ngqura.

c. The other area which needs to be addressed in order to sustain the viability of utilising the port of Ngqura is the equalisation of rail rates from Ngqura to Gauteng region; equal to the rates from Durban. This has been adopted as an important NPCC initiative. It remains costly in the interim.

NPCC Recommendation:

The NPCC further recommends no further increases be considered / granted until such time that detailed transparent costing and cost benefit analyses are done and shared with Port Users.

d. The cost of slow decision making and administrative inefficiencies weighs heavily on all port users as indicated previously. This remains an issue. The Ship Repair concessioning process bears testimony to this.

NPCC's recommendations:

The NPCC recommends integrated planning across all modes of transport.

3.5 Content specifics

3.5.1. **NPA's Regulated Asset Base**

a. The NPCC maintains its observation that over a three year period the NPA moved from a RAB of R12bn to R48bn without adding any significant additional assets. This was primarily through a revaluation of existing assets. This revaluation has been carried out during a period when real estate values have been negatively impacted by the global financial crisis. The dramatic upscaling of the Authority's RAB remains a material concern, thereby heightening the negative impact on the SA economy? This unprecedented artificial increase in the NPA's RAB presents a serious concern as it has a continuous major impact on the tariff calculation. While this approach may benefit Transnet and its shareholder, it has a direct impact on the cost of doing business in SA.

NPCC's Recommendation:

It is recommended that the PRSA RAB valuation process be fast tracked and that that a more realistic valuation of historic assets be used in calculating NPA's RAB when preparing future tariff applications. Furthermore that a RAB workshop be held as an important step where NPA must to disclose all its assets to being in the process. It is clear that many port users are unaware of the significance of this calculation and that it has to be simplified and communicated more effectively.

b. It is further observed that the Authority has done significant work to clean up its asset base. Clarity is to be provided regards the grey areas between Opex and capex.

E.g. Durban – Bay head shunting yard is only used by TFR. According to information available does TFR not pay any rental for the area? Reason given: - The Authority as the landlord must provide access to their facility. This is not valid as it is only TFR using the rail and is not a multi user principle as with the road act.

The Authority also requested approval for maintenance work and improvements to be done in this area in the OPEX and CAPEX budget which had questions from the Durban PCC regarding the responsibility of maintaining this area. This was not yet clarified to date and as we cannot find a directive to as to who should hat should be responsible for the Bayhead shunting yard we request the Ports Regulator to make a ruling on this.

This is only but one example that was picked up and there should be many more such areas which inflates the Asset base, increase the OPEX & CAPEX budget and result in TNPA not receiving revenue for property used by a single user as in all other cases where land is leased to single tenants or operators where the user pay principle applies.

NPCC's Recommendations:

RAB

Valuation of the RAB has to be prioritised.

The NPCC supports that the RAB be reviewed as a matter of urgency. It is understood that PRSA's approach in revaluating a sample of assets forms part of the process of cleaning up the TNPA RAB. It must be noted that during the period in which TNPA upwardly evaluated its Asset Base most commercial property prices dropped sharply given the macro economic climate at the time and to date. Property prices are still on the road to recovery. Furthermore Port property should not be compared with an being the V&A property prices.

Significant work has been done on the Authority's RAB. Final clean-up process must be prioritised. This will continue to strengthen the Authority's RRM whilst negatively impacting Port users and increasing the cost of doing business.

3.5.2. **Return on Assets**

In respect of the gearing ratio the NPCC observed that the Transnet Group operates on a gearing preference of 50%. The Transnet Group gearing preference of 45% is not unusual for an established company, but in an organisation that generates such a strong positive cash flow, we question whether NPA needs to follow suit. With an EBIT margin of around 60%, it is felt that the gearing ratio is excessive and should be modified accordingly. However, the intentions and application of value generated is what must be understood. Direct correlation to the NPA's strong and reliable cash flow track record and in particular its push for what it considers in its Revenue Required Model for 2016/2017. Given the stability of the prime lending rate financing debt, we continue to maintain the proposed gearing ratio is not appropriate

NPCC's Recommendation:

The NPCC maintains its position that the gearing ratios are excessive and should be modified accordingly. It is further maintained that the gearing ratio should be a constant and not be manipulated year on year.

The NPCC considered material changes regarding the prime rate, inflation R/$ exchange rate, should there have been any.

3.5.3. **Cost of Capital**

The vanilla WACC as calculated in the application is generally in line with international practice, but the methods used to select the Beta, MRP and risk free rate can lead to substantial differences in the final derived funding requirement. These need further examination, but the NPCC wishes to record that it is extremely difficult to unpack this in the absence of a final agreed tariff methodology, which is still under review.

We note that the PRSA has already decided to accept TNPA's calculation in respect of these parameters so we confine our comments to other variables still to be reviewed.

3.5.4. **Risk**

The NPCC supports the PRSA assessment.

3.5.5. **Risk free rate**

NPCC supports the PRSA assessment.

3.5.6 **Operating Costs**

Labour Costs: Labour costs requires more detail. The NPA stated in its application that Labour cost is a function of delivering on the Authority's mandate. In terms of operations efficiency, oversight and maintenance. It is difficult to reconcile positions previously requested

in relation to positions filled year to date. It is further questioned whether all of the NPA appointments add value or contribute positively to it delivering on its mandate. As highlighted in the previous submission a good example is the current Operations centres where many of the Senior Operations Managers are battling with comings to grips with what they are expected to carry authority on. This remains questionable.

NPCC's comments:

The NPCC supports job creation and employment. It maintains that there has been no detailed breakdown to assess duplication of services to date. It seeks to further understand how this will stem the current level of inefficiencies which has added cost to the chain. In the current climate the NPCC cannot support any increase that is in excess of inflation. The NPCC supports that the Labour cost component increase be consistent with that determination. Previous and new appointments made must contribute positively to the NPA's mandate and deliverables.

Maintenance:

Feedback within the PCCs has observed the concerns raised regards the deterioration of assets. The NPCC acknowledges that maintenance constitutes a very important part of any business. The number presented in the Application poses several questions. New equipment carries warranties which should reduce the need for maintenance in the same year. Not enough detail is provided. It is difficult to

reconcile this number with what was requested previously and actually followed through on. Similarly it is difficult to link this back to each of the Port PCC key projects. The issue of maintenance remains a challenge.

Contract Payments: Seems reasonable.

NPCC's comments:

No further comments.

Professional Services: NPA is suffering from Consultancy fatigue. NPA has become over reliant on consultants. The issue linked to current and proposed labour costs and particularly skills and competencies within the NPA remains questionable aside from services such as EIAs etc. Observing current operational challenges within the Port system amidst low volumes remains an issue.

NPCC's comments

Once again It is required that the expenses be specified per port.

Rental:

NPCC's Comments:

The NPCC maintain that NPA should provide a detailed breakdown per Port for each of the sub categories, i.e. internal and external land and buildings, machinery, equipment and furniture, etc. This should be further unpacked in respect of Rentals catered for linked to Transnet and or other divisions. .

A Rental breakdown to further explain NPA Buildings etc. that have been standing vacant is required.

Re-engineering, Integration, productivity and efficiency:

The NPCC questions the purpose served of the current engineers and the engineers in training serve. More detailed required to provide relevant inputs.

Sundry Costs: The proposed 100% budget increase in sundry operating costs to be clarified; particularly in view of current economic developments with port users making large economic operating costs sacrifices in pursuit of commercial survival. Tariff Application Page 76 of 78.

Group Costs: *NPCC's Comments*:

The Group costs component remains a challenge noting the severe constraints on the port system of which the DOA is one example. The Act requires that the Authority be corporatized. Clarity has to be provided as to the difference between the Shareholder compact and Authority Performance informed by Port Users to ensure the competitiveness of the port system.

Given the obligations imposed by the Group there is a need to understand the value being created to ensure a competitive port system and justify costs accordingly?

There is also a need for further interrogation of the cross subsidies between different divisions of Transnet, and how this impacts on the Authority. This is an area which is not explored by the PRSA but which needs further attention. Important to note that it was clearly stated at NPCC that the Act requires that the Authority be separated from Transnet. Stability in terms of excellent profit generation and a strong contribution to the asset base key considerations. Negative impact, slow decision making processes and lack of impartial role the Authority is required to play perceive to erode value and compromises SA both locally and internationally.

NPCC's Recommendations:

The need remains for a detailed explanation to be provided regards previous increases and value added given the constraints within the port system.

Depreciation: ***NPCC's comments***

The NPCC maintains its position. It appears that the depreciation period of assets is something of a moving target; this figure also relates to the re-valuation of assets previously referred to.

NPCC's Recommendations:

The NPCC recommends that guidelines regards depreciation be clearly defined and agreed to. This will require inputs from Port users.

Tariff Book

Comments:

No tariff book was submitted or made available for review.

NPPC recommendation:-

The NPCC recommends that TNPA subsidize these additional expenses incurred, or provide incentives by way of reducing the marine charges in order to compete against other global hubs ports offering similar transhipment facilities as the reduction in cargo dues for transhipment containers has of little significance to the additional costs incurred by the Shipping line.

Marine Services:

Pilotage: The applied methodology requires further explanation. Cape Town is generally lower than all the ports; Ngqura and PE appear to be penalised on their per 100 ton increments, and the Richards Bay anomaly has already been mentioned

NPCC's Recommendation:

The Committee request that the NPA explains the variance.

Tugs: The NPCC noticed that the Richards Bay surcharge is historical which has to be explained. The Port of Ngqura is being marketed as a transhipment hub, yet it appears to be penalised in the NPA's tariff application.

NPCC's Comments:

The NPCC resolves that NPA explains same. It is required that there be a differentiation in tug fees for different vessel sizes in the Port of Saldanha Bay.

The NPCC further recommends a 20% discount in Marine charges for the Port of Ngqura for all Transhipment vessels only.

Berth Dues: Positive; It was noted that berth delays are being considered to be billed directly to the Terminal Operator. However, to date this has not been formally communicated.

NPCC's Comments:

Same issue to be addressed.

Cargo dues:

As previously indicated, the NPCC records that the "one size fits all" approach often adopted in NPA's tariffs is not appropriate.

NPCC's Comments:

While there is no desire to revert to an ad valorem system, it is felt that (particularly in respect of containers); a more regional- and commodity-based approach is needed.

4. RECOMMENDATIONS

4.1 Labour

Labour costs remains the biggest contributor. This highlights the importance of the right skills at the tight level etc. Furthermore there is a clear indication that TNPA did not fill all its previous vacancies. It is a concern that inefficiencies in the Port system remains costly whilst NPA increases its headcount.

The NPCC previously questioned levels of employment in respect of getting the right skills at the right levels.

The Group's overhead labour cost remains questionable in relation to value add and challenges not being resolved within the Authority.

NPCC's Comments

The NPCC welcomes the initiative of the Authority to increase employment in the port sector, but such an increase must be justified in terms of volume, revenue growth and value-add, and not purely in terms of social responsibility. At the same time, employment policy must ensure that the requisite level of skills and experience be employed. Increase in employment in the port sector should not be a major justification for increasing tariffs.

NPCC's Recommendations:

The NPCC recommends, similarly to the recommendation last year, that a detailed study be carried out as to the number of people employed by all the Authority, Terminal Operators, Shipping lines, Shipping agents, Ship Repair / Building and Port Users across all Ports, so that an integrated picture of employment in the sector can be derived.

5. PREVIOUS RECOMMENDATIONS

Overall level of transparency and granularity – NPA to provide a greater level of detail throughout its Application as has been requested several times previously.

I. The TNPA asset base has to be scrubbed and separated from other Transnet divisions. All additions in the current RAB impacts positively on the TNPA strengthening its Revenue Required Methodology whilst negatively impacting Port users. The PRSA process has to be fast tracked.

II. The NPCC therefore recommends that the land leased to TPT should be leased at the same rates as it would be to non- Transnet port operators and would like to encourage the Authority in future to be transparent on the total value of rentals acquired. Prolonging the position where TPT enjoys preferential lease rentals continues to negatively impact the rest of the leaseholders who ultimately subsidises the TPT business. In much the same way as the cargo dues and marine tariffs are published, we feel that the income to be derived from rentals should similarly be published.

III. Rentals - The NPCC resolved that NPA should provide a detailed breakdown per Port for each of the sub categories, i.e. internal and external land and buildings, machinery, equipment and furniture, etc. This should be further unpacked in respect of Rentals catered for, linked to Transnet and or other divisions. The Rental breakdown to further explain NPA Buildings etc. that have been standing vacant.

IV. The NPCC recommends, similarly to the recommendation previously, that a detailed study be carried out as to the number of people employed by all i.e. the Authority, Terminal Operators, Shipping lines, Shipping agents, Ship Repair / Building and Port Users across all

Ports, so that an integrated picture of employment in the sector can be derived.

V. Previous recommendation that a world-wide comparative study be carried out assessing liquid bulk as the Ports Regulator has thus far benchmarked dry bulk items, coal and iron, only.

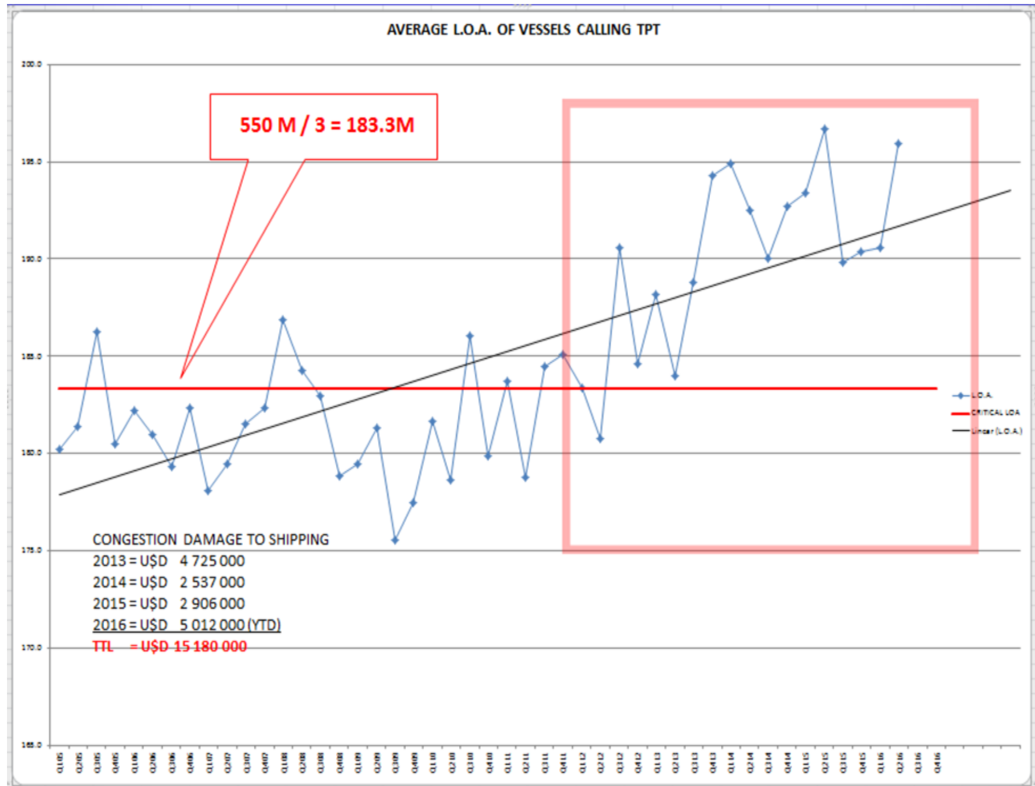
VI. Cargo Dues order Cancellation Fees: Way forward

6. Key issues to be considered:

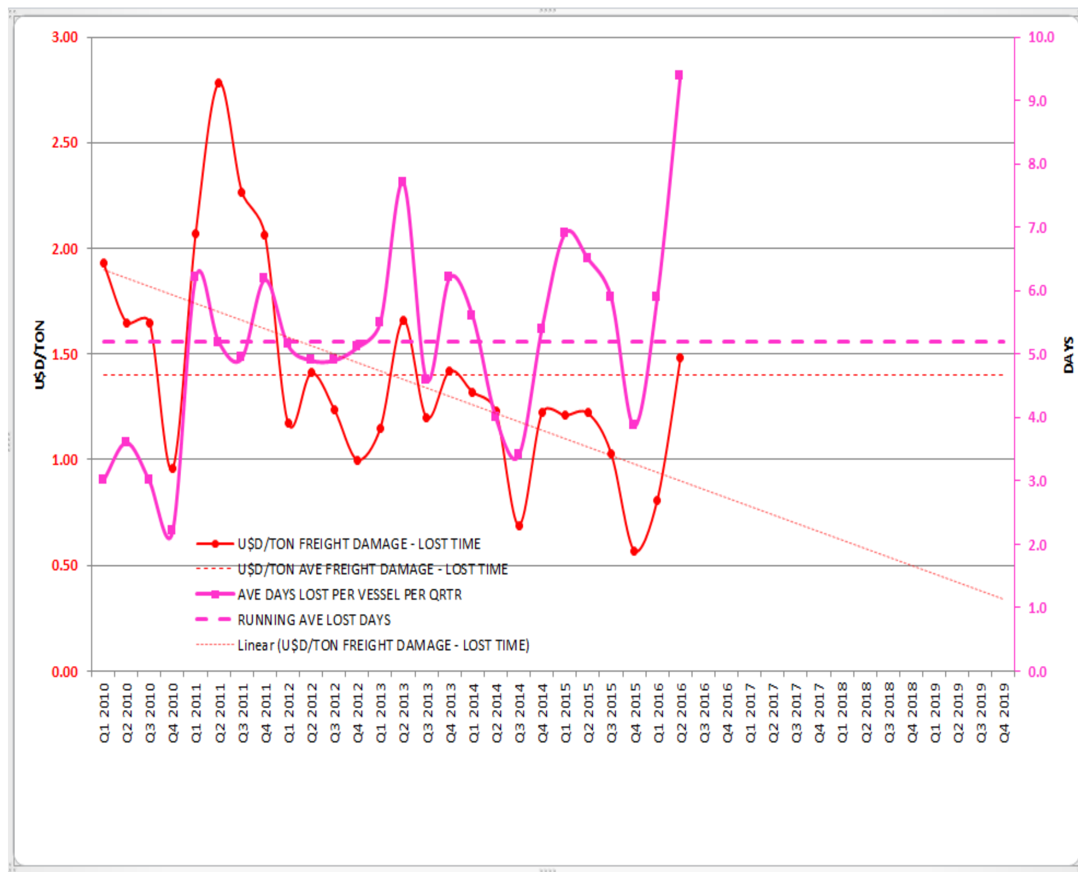
I. Port Performance:

a. Tariffs must be based on terminal efficiencies. This has to be a key variable in the calculation.
b. Volumes are down and Port performance remains one of the key challenges aggravating vessels still calling.
c. The issue of dredging remains a problem in respect of draft limitations with bigger vessels being unfairly penalized. Shipping Lines are being penalized unfairly with introduction of larger vessels where there are draft limitations i.e. Durban resulting in Vessel Owners not able to optimize payload. TNPA Tariff based on GRT of vessel instead of permissible draft of that port. Recommendation that until the deepening of the berths are completed that TNPA caps the GRT based on payload.
a. TOPS - TNPA has a defined oversight role, it has to be considered that specifically in RCB, since LOA measurement began in earnest from 2005, Shipping Lines have, in broad terms, collectively already lost close to U$D 15 MILLION in HIRE PAYMENTS through extended anchorage detentions for want of a 100M extension to berth 708, in so doing leasing 33%

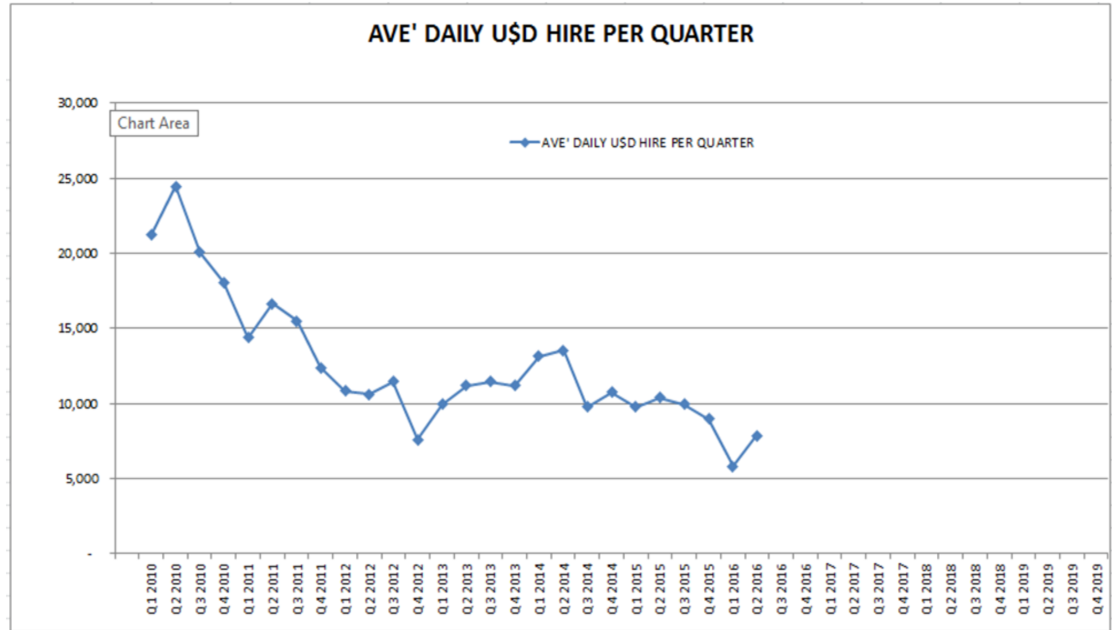
more berth capacity. Port Users would welcome the conceptual thinking of an outcome based penalty/incentive scheme, aligned with revised TOPS.



b. Currently Shipping Lines are forced to factor in around a 5 DAYS average extended port detention through TOPS related challenges. These costs are only marginally recoverable from the Cargo Owners through freight adjustments. Cargo Owners are already ‘against the wall’ in the world market scenario and have also very limited ‘manoeuvring’ space left over.



c. The RED DOTTED line (------------) is the one of the greatest concern. Shipping lines are writing off close to U$D1.50/TON of freight related to extended port detentions and Terminal inefficiencies at RCB. Margins are too this to be able carry this for much longer. In time to come (when the market turns and hire rates start to climb, these losses will increase and will drive Shipping Lines away for good and new markets are established!

d. 

e. At the time of this submission, the Bulk Berths at RCB are suffering between 10 to 14 DAYS berthing delays. One of the two 'flag-ships' of the Operation Phakisa initiatives, the "EARNEST SKY" had already spent 4 days anchor before she abandoned the anchorage to load at Maputo, only to return a week later and face still another 8 days at anchor.

e. It is common knowledge that currently shipping Lines are experiencing major Berthing/Operational delays at Durban severely negatively impacting the Lines unable to maintain its scheduling integrity as well as incurring massive additional costs.
f. Port of Durban berth deepening - additional volumes expected to be diverted to Ngqura but at a huge costs to the Shipping Lines. Issue of compensation to be considered in the tariff structure.
g. Previously SA Ngqura was considered to be perfectly placed for a transshipment hub between Far East and South America. The creation of pendulum services bypassing SA with services going from India to West Africa and Far East to West Africa. One therefore has to look at ways of offering incentives by way of reduced Marine Tariffs specifically for transshipments to encourage additional volumes routed through SA ports if we can be more competitive and efficiency levels improve.
h. We must look at ways of attracting additional volumes and only way is to portray to the rest of the world that SA has a competitive and efficient port system with necessary Infrastructure to handle the latest tonnage of vessels calling at

our ports which can be favorably bench-marked against International Standards.

i.

II. Marine Tariffs:

S.A. port tariffs suggested to be well below that of other international ports, herewith study done on selected ports illustrating that SA port costs are clearly not competitive:-

TEU Class	CPT	DUR	PLZ	RTM	London	LA (USA)	Colombo	HKG	Laem Chabang	SHA	Tokyo
4000	$27,000.00	$24,500.00	$22,200.00	$47,600.00	$46,500.00	$16,500.00	$8,800.00	$7,900.00	$13,446.00	$25,300.00	$22,000.00
6000	$36,400.00	$32,500.00	$29,500.00			$17,500.00	$12,500.00	$9,600.00	$19,800.00	$31,000.00	$25,000.00
8000	$39,500.00	$35,300.00	$32,100.00			$18,500.00	$13,700.00	$9,930.00	$23,600.00	$35,000.00	$26,000.00
10000	$51,965.00	$44,428.00	$42,300.00	$43,700.00		$20,400.00	$17,800.00	$10,600.00	$32,700.00	$40,000.00	$29,000.00
13000	$65,500.00	$56,214.00	$53,200.00				$23,200.00	$14,700.00	$44,000.00	$45,000.00	$33,500.00

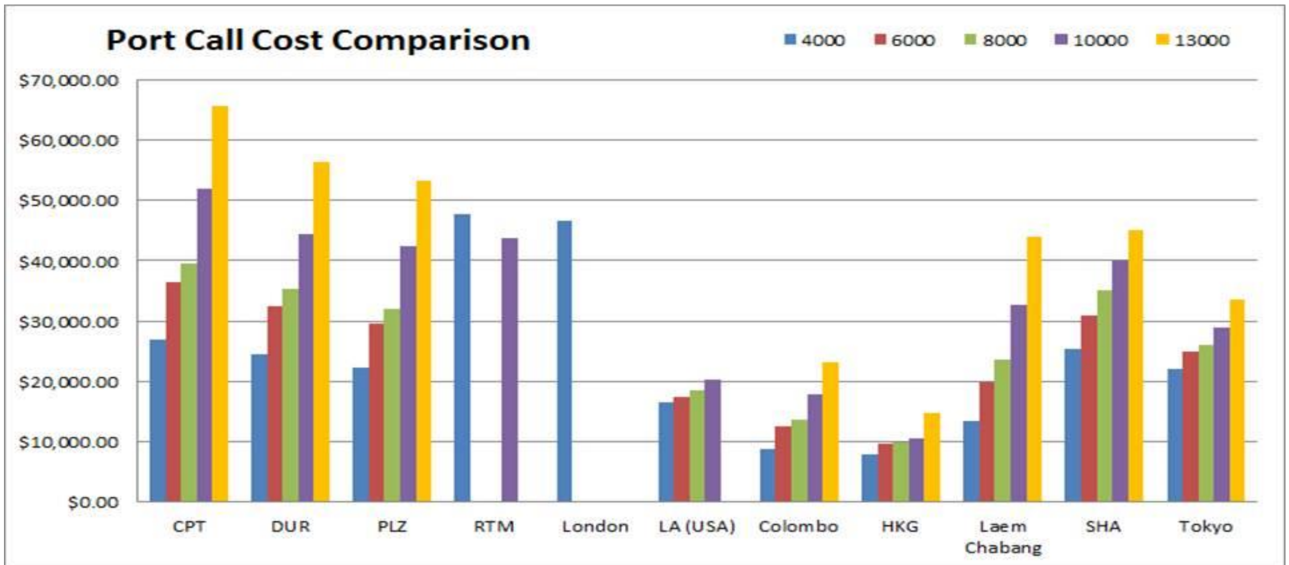
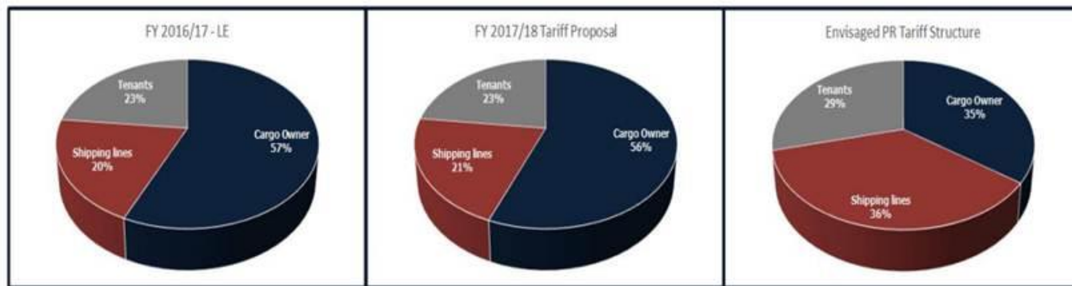
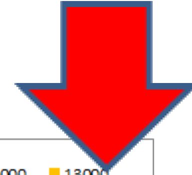


Figure 7: Transition to the Regulator's Tariff Strategy

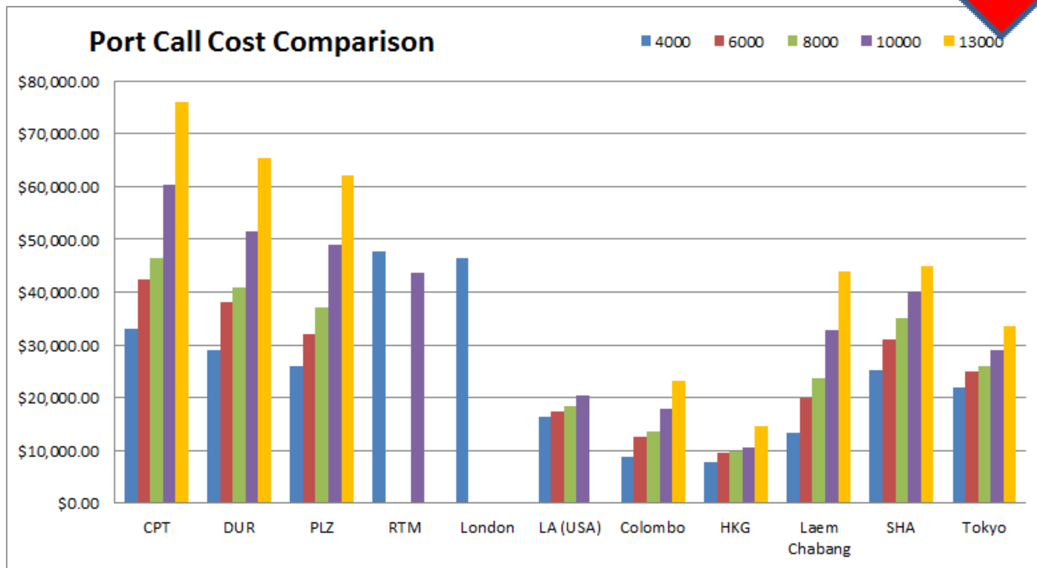


Concerns regards cargo dues adjustments and marine tariffs balancing act with the proposed increases. Concerns regards impact on Marine tariffs for various category of ships…..same holds perceived implications.

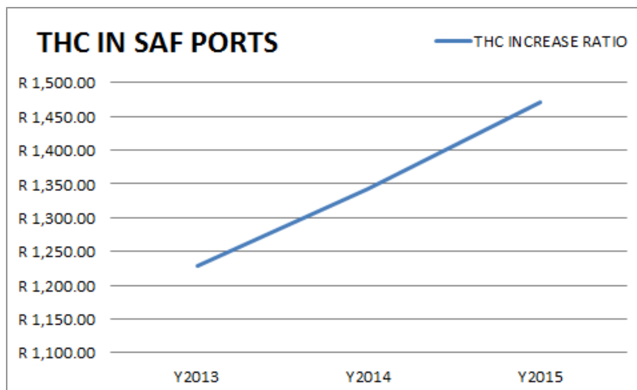
Difficult to justify increases given the current economic climate.



After shift of cargo dues towards the marine tariff…..



The rentals will increase and so will be the THC….its murder from both the ends.
Who suffers….the end user of the products?



The situation considered to be worse when one includes the entire port costs being paid by the Shipping Line which would have to include:

- TPT CTOC Agreement (10 percent of THC) absorbed by Shipping Line to secure Berthing Window/Slot.
- SAMSA Levy R122.56 per 100 GRT
- These are substantial additional charges paid by Shipping Lines which formulates part of Voyage calculation of vessel.

- In addition to actual costs, we strongly advocate that the Tariff must consider Terminal efficiencies as it stands to reason that the longer the port stay of the vessel the more one pays in Port Dues. This si further exacerbated when port authorities stop the working of vessels during shift working to address staff on various issues with no compensation in relation to charges or losses.

In view of above factors proposed Marine Tariff Increase of 13.25 percent for 2017/2018 period is considered to be totally unacceptable.

III. Global economic situation

a. In the current economic climate Shipping Lines are battling financially mainly due to global downturn as well as over capacity on most routes driving freight rates well below current market rates. This is clearly and evident with recent demise of HANJIN/7th largest Carrier in world let alone other prominent Lines also announcing huge financial losses and casualties in terms of company closures.

b. Important to be mindful and take serious notice that where in the past SA was seen as the gateway to Africa one has real threat that Walvis Bay is creating a hub, creation of direct services from Maputo, Beira, Nacala to other hubs without going through SA ports. Port Louis and Reunion also attracting additional volumes. The success of these ports can be directly attributable to the high SA port costs and poor operational performance in

spite of promoting a “smart port” concept that is still to be unpacked.

c. “Chinese shipyards look to have the most to lose if Maersk Line’s no new building policy spreads to other owners. In contrast the number of shipyards in Japan is just nine, while South Korea has just seven with containerships on their order books. China’s overall market share does not exceed 40%, as several of the yards can only build smaller containerships. South Korean and Japanese yards market share is 28% and 25% respectively.”

d. HANJIN’s demise may be the precursor of more big container operators seeking business rescue from SOE’s and big banks as the container operators continue to be driven to operate below the breadline. Caution has to be exercised when considering any large scale container handling expansion programmes.

e. Concern expressed regards debt risk which may become more aggressive should National Government be unable to defend a Rating downgrade from Standard & Poor in a few months’ time.

f. It has to be deemed a shaky business model to advocate large intended development spend to sustain investor confidence (which manifests itself in increased tariff pressure on Port Users through an inflated RAB) whereas in truth that horse has already shied as large investors (Future growth) have already removed their backing from Transnet.

g. Our neighbouring Port Of Maputo has held the tariffs unchanged for the past 3 years. Despite that they (Jan De Null) are aggressively dredging the approaches to the port at 115 MILLION U$D spend to attract deeper draft traffic. The same

cannot be said about Durban, Port Elizabeth, East London and remaining SA ports as maintenance lags and continue to lag.

h. The Port Users stress that the fact that while shipping on a global scale faces unsurpassed hardship in an unprecedented commodity price slump from which there is no visible signs of recovery for the next 2 to 3 years, any gesture to let Port Users shoulder the survival margins of the SOE may be the death knell for many.

i. Under the current global economic duress it would be seen as insensitive to all Port Users to factor in CPI "+3%" in the proposed tariff deliberations whereas all of Industry has already been forced to make huge cutbacks on operating costs just to keep the doors open. A target of 0% increase has to remain in focus.

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IV. Call for fast tracking of single Regulator for Transnet to prevent any cross subsidization of other affiliated Companies TPT/TFR within the Group is an absolute must. There should be no formation of another regulatory body aside from the STER.

V. Dry docking:

a. It must be noted that South Korean Heavy Industries shipyards have laid off 3 000 employees as new building orders slow down. (Reuters May 9, 2016) as Owners who have ordered in 2009 and 2010 are hard pressed to cover the debts which are all due on delivery now and the next few years. Timing of SHIP

BUILDING in terms of Op Phakisa should be deferred to allow hardware ownership market to stabilise or retreat. Current trends point to aggressive scrapping as low rates force OWNERS to keep hardware afloat below minimums to cover debts.

b. The three biggest ship building yards in the East being Hyundai Heavy Industries, Daewoo Shipbuilding & Marine Engineering Co. and Samsung Heavy Industries Co. are struggling with over-capacity and cancelled orders as oil is scheduled to drop still further from U$D40/barrel to U$D15/barrel and drilling / exploration will almost come to a standstill. This slowdown is already being seen in Japan, China and S'pore. South Africa will struggle to get a foot in the door in this market at this stage. It can be expected that OWNERS will be lured to the East for their dry-docking needs as good prices will be offered to keep the ship yards ticking over.

VI. Important Opex and Capex considerations:

a. This critical intervention is STILL not visible in the CAPEX for Richards Bay

b. What is the basis for asking for such high increases when TNPA is already making huge profits?

c. What is the justification of not upgrading the ports and marine services when each year the tariff increases takes such CAPEX/OPEX into account. Who is verifying this

d. The congestion challenges in the Port of Durban continues without proper intervention. Collaboration is happening in the

background and feedback given at PCCs. Yet no foreground progress reported resulting in material positive interventions. How does the application consider this process?

VII. Authority's Oversight Role:

a. Issues escalated to the PCCs and NPCC suggests a relatively dormant oversight role and perceived culture of not being accountable as an Authority. Handling of the dust emissions amongst issues raised. The PRSA being an observer to the process – How should this lack of ownership and accountability and impact of the competitiveness of the port system be considered.

b. Challenges related to lack of and follow up between communication between the Authority and Port users who raise issues. This with particular reference to the impact on the port system given the long lead times of port users receiving feedback from the Authority.

VIII. Operation Phakisa:

a. Challenges related to the action required in terms of maintenance of existing facilities as shown in the attached Excel spreadsheet prepared by NPA at Operation Phakisa workshops.

b. Lag time expressed as a concern. Antiquated cranes in the process of being addressed. Significance in the lag delivery period.

c. Observation that "Capex / Opex Operation Phakisa maintenance projects do not reflect poor maintenance of the asset.

IX. Final Key considerations:

a. In summary, within the current market conditions any increase would be counterproductive and seriously impact all maritime role players. It would be strongly perceived as negative by the wider industry and likely to result in more vessels avoiding SA ports.

b. It is strongly recommended that the PRSA use the ETIMC as much as possible to offset any proposed/required increase. The ETIMC is a mechanism which is precisely suited to the market we currently find ourselves in.

c. The 2016 financial results illustrates an EBITDA of 65% (R7 284m profit from Revenues of R11 114m. Most companies do not achieve this level of profit percentage. Generally many organisations reported to have earnings ratings of 3-5% profit margin. Globally some big businesses survive on a 1% profit margin. The huge NPA profits could be perceived to be an exploited monopoly to the detriment of all parties concerned.

d. Further questions arising from the ratio of revenues/profits for the different divisions. TFR has the bulk of revenues / debt / profits, but the ratio for TNPA is still excessive considering that it produces 28% of Transnet's profits and only 18% of total revenues.

e. The stated Capital Expenditure could easily have been paid for twice over with the 2016 years profits.

f. The cash flow generated from operations – TNPA is the highest at 78% with total Transnet sitting at 45%. It is recommended that the PRSA advise where the cash goes and how same is reinvested.

g. In summary without even looking at all the detail of how PRSA and TNPA calculate and rationalise their tariffs, it's very clear they are currently very cash flush, and excessively profitable entity, As such TNPA currently cannot really justify or warrant any form of increase in light of the current market sentiments. In fact there is probably strong evidence to justify a dramatic reduction in tariffs to assist stimulating the greater SA economy. This leads us to a further debate around how the ports fit into the wider economic structure, and how if they were restricted or reduced to a more realistic cost level what the quantum of positive spin off would be as an enabler for the greater SA economy as whole, but that really is a much bigger debate and no doubt beyond the scope of our and PRSA mandate.

7. It is recommended that the PRSA considers Observations and recommendations made throughout this submission:

I. That the RAB valuation process be prioritised and in doing so that funds be made available to the PRSA to prioritise same.

II. Zero percent increase.

III. The NPCC proposes that Marine charges be discounted by 20% for the Port of Ngqura only. This discount should be applicable to Transhipment vessels only.

IV. The NPCC proposes that the NPA carefully considers its need for ongoing consulting across its business and particularly where it borders on deliverables of executives and relevant senior staff who are required to have certain competencies.

V. Vessels calling the Port of Durban not charged on GRT due to the draft restrictions resulting in vessels not able to arrive fully laden. Discount on GRT for Durban should be given till such time that the port can accommodate the vessel with total GRT loaded.

VI. TNPA has made significant strides in its supplier development programme. However, much more has to be done in making the port space accessible to new entrants.

VII. It is noted with concern that recommendations previously submitted have not been taken into account.

Submitted for the Chairman's consideration.