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REPUBLIC OF SOUTH AFRICA

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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 2018/2019**

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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 2018/19 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 7th 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 Durban held Monday and Tuesday 11-12 September 2017 supported by NPCC Representatives. Participants had intensive deliberations on the Port Authority's tariff application with reference to the anticipated draft Tariff book. 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. This included the number of issues previously submitted to the PRSA and not addressed or which was considered to be materially less pressing but remaining a concern. 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 2017/18 Record of Decision.

- Content and Completeness: Consideration given in respect of the provision of sufficient information in the tariff application, or not.
- Methodologically Consistent: Consistency in applying the Methodology.
- Pricing Methodology: Comment on TNPA's application of the Pricing Methodology.
- Level of Content Detail: To comment on the level of content provided in the Application
- To analyse and comment on the draft Tariff Book
- Recommendations: Propose Recommendations deemed necessary.

3.1 Compliance with the Act, Regulations, Directives and the Record of decision for 2018/2019.

3.1.1 Section 72(2) of the National Ports Act, indicates 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, discussions in each of the eight PCC meetings regards 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: Concerns remain that the Authority's oversight role is lacking with regards to Terminal Operators deliverables and accountability and broader impact on the port system.

It is understood that the PRSA has commenced an independent review of the Authority's RAB. The current RAB estimate continues to be perceived as benefitting the Authority. Until such time as the RAB value has been reviewed and clarified, the PRSA role is similarly perceived as being compromised.

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

d. Directive 23(1)(g) - Concerns expressed by Port users regards issues raised such as the dust issue in the Port of Saldanha, Ongoing congestion in the Port of Durban, challenges linked to Quay 700 series in the Port of Richards Bay continue to suggest that discussions are taking place in the background with little progress. 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. The NPCC maintains that Incentives and penalties be applied to underutilised or over-maximised assets. The entrance channel in Durban remains and still is an example where the Shipping lanes into the port are silted-up reducing the draft from 12.5m t0 12.2m. This has a direct impact on vessels calling or leaving the port. This issue remains an issue.

b. Noting the concerns earlier the National Ports Authority's Regulated Asset Base is deemed to be accepted as the opening RAB. It has to be further acknowledged that this is matter of national importance which requires urgent attention. The PRSA prioritisation of the valuation of the Ports Authority's Regulated Asset Base remains incomplete and requires further attention. The incorrect Regulated Asset Base incorrectly informs the Revenue Required Model which contributes to the cost of doing business in South Africa.

c. It is noted that the Authority continues to use the Revenue Requirement model as the current best alternative.

3.2 Contents and Completeness

The NPCC recommends that the Authority publishes its land rental rates of land under their custodianship. The Authority is mandated to provide equal opportunities to all port users without favour or prejudice.

3.3 Methodological Consistency

3.3.1 The Regulatory approved multi-year Methodology published 30 May 2017 applicable 2018/2019 – 2020/2021 serves as a mandatory guideline. It is again acknowledged that significant strides were made. It is also appreciated that the updated Methodology allows for annual reviews and adjustments. Also noted that the Revenue Requirement Approach is based on the Tariff Methodology as approved by the PRSA and used by the Authority.

a. Revenue Requirement Model is used in compliance with the Tariff Methodology. Consistent with the Tariff Methodology the formula is 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*

3.3.2 The NPCC Recommendation

a. The NPCC is lead to understand that the PRSA continues to scrub the RAB. It is therefore the understanding of the NPCC that this project remains incomplete and until such time that the PRSA confirms that the evaluation process has been finalised, until then the NPCC remains uncomfortable with the possible impact this incomplete project may have on the Tariff Methodology. Consistent with our previous submission, it appears that there are no restrictions in terms of how NPA justifies a revenue requirement in excess of R12b. The NPCC remains uncomfortable with the distribution of the Authorities profits within the holding Company.

b. Depreciation – The NPCC is mindful of the disparity of the lifespan of infrastructure which impacts directly om the depreciation matrix in the calculation.

c. Inflation trending – It is 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 NPCC remains uncomfortable with a +3 inflation factor.

d. Capital Works in Progress (CWIP): It is important that the Authority have the space to implement the Capex Plan supported at the respective PCCs. Noted that the some of the Capex projects have been omitted from the Capex Schedule. It is of concern that approved capital, subsequently cut back may result in unintended risk exposure. See additional comments from the Richards Bay PCC i.e Port of Mossel Bay and Port of Richards Bay an example of same.

e. **Working Capital:** The NPCC Recommends that the PRSA provide assurance that the Authority's accounts are separated from the Group Holding account. Main aim to ensure that challenges do not arise as a result of the Authority's accounts being part of the Transnet divisional accounts in the event of any challenges impacting the Authority's working capital negatively. The separate allowance for Tax expenses is an area which the NPCC will deal with in more detail under Taxes. Recommended that the PRSA ensure that this is dealt with appropriately.

f. **Weighted Average Cost of Capital (WACC)**: Vanilla WACC was previously considered and discussed in great detail in previous submissions. The NPCC supports the application as is contained in the Tariff Methodology.

g. **Cost of Equity –** The NPCC supports the calculation as contained in the Tariff Methodology.

h. **Risk Free Rate** - PRSA Regulatory risk free rate method supported.

i. **Cost of Debt**: Not enough detail was provided. The NPCC Recommends that the Authority provides assurance that the cost debt structure in the calculation considers the Authority's cost of debt and not include consolidated Transnet debt or cost of debt structure related to combined divisions within Transnet. The NPCC requires assurance from the PRSA that TNPA's risk rating will be sanitised to exclude Transnet Group risk profile. Standard and Poor and Moody's expressed comments of Transnet's debt risk has to be carefully considered and how this impacts the Authority. This would further safeguard against inappropriately including Transnet's exceptionally high Debt risk ratio in the Revenue Requirement calculation thereby inflating tariffs.

j. **Tax**: The NPCC requires assurance from the PRSA that the Authority is taxed on its stand-alone profit and not on its watered-down profit due to Transnet Group or divisional influences. This is deemed important due to the Authority not being corporatized or appropriately ring-fenced in compliance with the Ports Act of 2005. This would curtail unintended financial inflation.

k. **Operating Costs**: The NPCC requires assurance from the PRSA that Labour and Energy costs included in the NPA's Application are limited to the Authority's direct costs only. This noting the Transnet cost portion. Main concern that costs not directly linked to the Authority may increase the Opex budget and in turn the tariff.

l. **Claw-Back:** The Claw-Back principle addressing under or over recovery as directed by the Tariff Methodology and applied by the Authority is supported.

m. **Excessive Tariff Increase Margin Credit (ETIMC):** The ETIMC calculation as directed by the Tariff Methodology and applied by the Authority is similarly supported.

n. **Volume Forecast:**

Resources used by the Authority to inform its Volume Forecast is not entirely clear. The NPCC considers forecasting of volumes into the SA port system and within the SA Port system as one of the fundamental drivers for capacity provision. Assurance is required by the PRSA that the Authority's Volume Forecast aligns with global thinking and consideration of global developments and local implications. The Volume Forecast approach in terms of its accuracy may contribute meaningfully to the Authority's specialisation Strategy per Port or Ports amongst other and the provision of capex or timeous redirecting of volumes as and when required. I.e. Drewry projections, FTW forecasting and Baltic Dry Index etc.

o. **Introduction Of The Efficiency Incentive**: The PCC KPI Subcommittees have been pushing for the introduction of well-considered KPIs for each of the Ports since 2012. NPCC comments hereto are as follows. The effectiveness of the WEGO Matrix is directly proportional to the accuracy of the extrapolated data presented to the Authority by the Terminal Operators. Misalignment between TPT Terminal KPIs and PCC KPI Subcommittee in Richards Bay, as an example, bears witness to this anomaly. This level of misalignment highlights the need for alignment across the entire port system. This requires proper measurements, extrapolation and ratification of information across the Port system. The NPCC does not have the confidence and comfort that this is in play and may render the WEGO principles of inclusion in the Methodology to be inconclusive.

4. Pricing Strategy

Objectives of the pricing strategy as articulated by the PRSA is supported. The progressive move to cost reflective tariff structures as guided by the PRSA together with the development of an efficient pricing system is acknowledged.

4.1 Implementation of the Pricing Strategy

The NPCC supports the longer term view taken by the PRSA in respect of smoothing tariff imbalances over a period of ten years. This is acknowledged in the Authority's Application.

The principle of differential strategic pricing is widely supported at a port PCC and NPCC level. This further calls for a clear strategy from the NPA as to the different areas of specialisation per port. This, amongst other, remain an outstanding NPCC Agenda item. The Authority's Africa Strategy, Container Strategy linked to its Transhipment Strategy, Ship Repair Strategy etc. all remain outstanding.

4.2 Unitised Automotive Tariff:

The NPCC noted the tariff disparity between unitised Ro-Ro vehicles vs. containerised vehicles. The NPCC requests the PRSA's undivided attention to addressing this issue.

4.3 Bunker Tariffs:

The NPCC requires assurance from the PRSA that the Authority, through its licencing process, ensures reliable, predictable, effective bunker services across the entire port system. The NPCC further recommend that the PRSA investigates the validity of the exclusivity granted to Aegean in the Algoa Bay district.

4.4 Marine Service Tariff Structure

The 2018/2019 Tariff Application makes reference to the proposed Marine Service Tariff Structure based on cost recovery, and user pay principles scheduled for implementation in 2019/2020. Clarification is sought regards the Authority's early warning and related implications for Port users in this segment.

Furthermore that the PRSA provide assurance that SA ports would be dredged to designed advertised chart datum prior to implementation of the new tariffs and maintaining its drafts'.

It is further proposed that the Tariff Structure considers the implications due to lack of dredging and provides for same. It is important that Marine infrastructure is aligned with the proposed tariff structure. You cannot be expected to pay top dollar tariffs if the draft does not allow the shipping line to optimise their uplifts in the port system.

4.5 An update on clauses in the Tariff Book

The NPCC recommends that the Tariff Book includes transparency in the rental matrix.

5. Level of Content Detail:

5.1 Ports Authority Business and Oversight:

The NPCC needs assurance that the challenges related to the provision of Port Capacity as well as the inherent challenges in the Integrated Port system be dealt with. NPCC recommends that the Authority be assisted to exercise its oversight role.

5.2 Ports Infrastructure and Capex Plans

The Authority's Capex Plan supporting the overall provision of infrastructure remains questionable.

The PCC Port Performance Roadshows were held during July 2017 as outlined below to ensure to consult as widely as possible.

PCC Roadshow KPI Workshop: June / July 2017 Port	**Date**	**Venue**	**Time**
Saldanha Bay	29 June 2017 (PCC Roadshow	TNPA Hall	09:00 – 13:00
Saldanha	29 June 2017 (KPI)	TNPA Boardroom	14:00 – 17:00
Cape Town	30 June 2017 (PCC roadshow	Lagoon Beach Hotel	09:00 – 13:00
Cape Town	30 June 2017 (KPI)	Lagoon Beach Hotel	14:00 – 17:00
Richards Bay	03 July 2017 (PCC Roadshow)	TNPA Hall	09:00 – 13:00
Richards Bay	03 July 2017 (KPI)	TNPA Hall	14:00 – 17:00
Durban	04 July 2017 (KPI)	TNPA Office	09:00 – 17:00
Durban	05 July 2017 (PCC Roadshow)	Garden Court Marine Parade	09:00 – 13:00
East London	07 July 2017 (PCC Roadshow)	East London ICC	09:00 – 13:00

East London	07 July 2017	East London ICC	14:00 – 17: 00
Ngqura	18 July 2017 (PCC)	Garden Court Kings Beach	09:00 – 13:00
Ngqura	19 July 2017 (KPI)	TNPA Boardroom	14:00 – 17:00
Port Elizabeth	18 July 2017 (PCC)	Garden Court Kings Beach	09:00 – 13:00
Port Elizabeth	19 July 2017 (KPI)	TNPA Boardroom	14:00 – 17:00

Main aim was to have a technical consultation with Port Users regards the Port Development Framework Plans and Capex provision. The engagement platform further facilitated consultation and discussion regards 6 year Capex plans per port and how efficiencies dovetail with this process.

Draft challenges particularly in the Ports of Durban, East London and PE requires attention. This notwithstanding that Dredging is an Agenda Item on the PCC Agenda for all eight commercial ports.

5.2 Authority's Total Revenue

The CPI+3 projection remains inappropriate and excessive.

5.3 Tariff Application Approach

The NPCC has discussed the Tariff Application in detail under the Tariff Methodology. It should be noted that smoothing the overall Marine tariff imbalance over a period of ten years may be burdensome on the entire value chain. The NPCC therefore recommends that the smoothing process is applied over fifteen years. This will allow the Authority to get its infrastructure and related efficiencies to a world class standard at which time the tariff smoothing period could be reviewed.

6. Port Efficiencies

The NPCC recommends that the Authority is held accountable to expedite the effective performance deliverables as it applies to Terminal Operators.

6.1 WEGO

The NPCC acknowledges the initiative of the PRSA to heeding the call made by the PCCs and NPCC previously to include an efficiency matrix in the tariff methodology. It is conceded that this initiative is in its infancy phase and the NPCC expects that there might be teething problems initially but is looking forward to seeing the benefits to the value chain.

The respective ports submits its individual proposed measures and weighting as requested by the PRSA.

7. Tariff Application Summary

The NPCC recognises the urgency with which the NPA wishes to rebalance the revenue streams and commend the PRSA to provide the checks and balances ensuring that this process is structured and sustainable.

8. Background to Final Recommendations.

In support of the ongoing observations from the NPCC delegates during deliberations over the past 3 days, we submit the following as background to the PRSA in consideration of the NPA's tariff increase application for 2018/2019.

8.1 Debt Risk

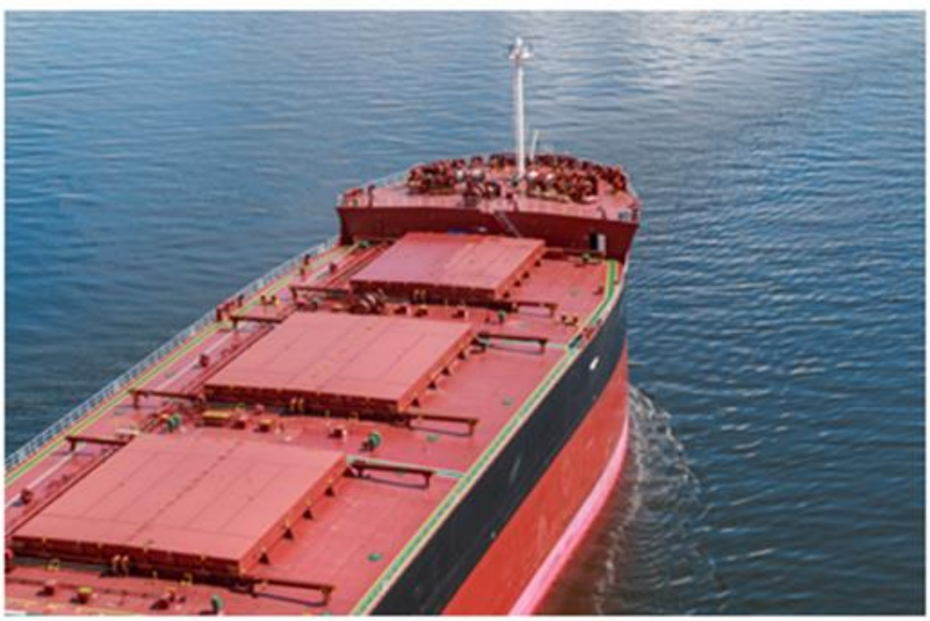
During an investor risk seminar held in Sandton on the 13th of September, 2017, the credit rating agency Moodys tabled that South Africa (currently hanging on to just one point above 'junk investor' status) is STILL not in a good place for, among others, the following reasons;

- A gradual erosion of the institutional framework
- Low economic growth and high unemployment
- Persistent structural bottlenecks
- Accumulation of public debt and Government contingent liabilities.

All, or a combination of some of the above, the NPCC supports that there remains an uncomfortably high emphasis on debt risk in the methodology matrix and not enough assurance that this risk is sanitized from the much larger Transnet Group's over-all risk.

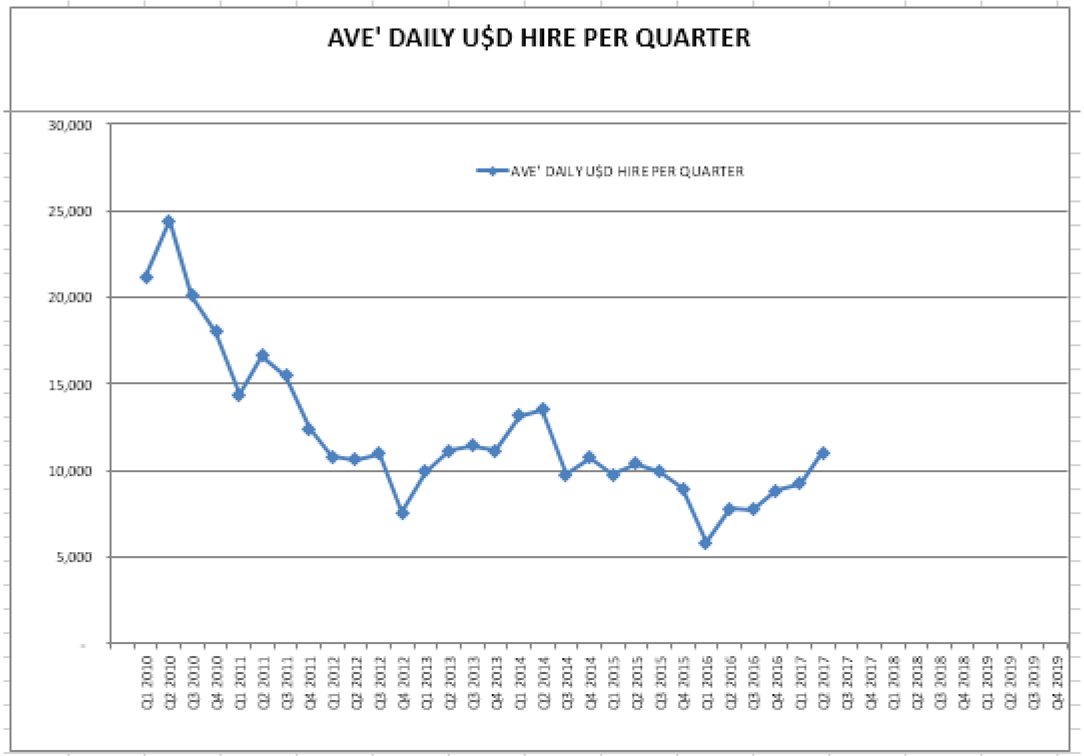
8.2 Port Systems Fluidity

It was suggested that the South African port systems are anything but ready to embrace early signs of a renaissance global economy. This statement is further corroborated by the Baltic Dry Index reflecting a first time high in 3 years.



Sept 11 (Reuters) – The Baltic Exchange's main sea freight index, tracking rates for ships carrying dry bulk commodities, touched a near three-year high on Monday, supported by higher rates across all vessel segments. The overall index, which factors in rates for capesize, panamax, supramax and handysize shipping vessels, gained 23 points, or 1.73 percent, […]

Graph 1 below depicts the trend in DAILY HIRE RATES in the DRY BULK market and it can clearly be seen that the market is hardening.



Graph 1: Average Daily Hire Rate Per Quarter

Major container lines, some of which have been more successful than others in 'riding the storm' of the collapse of their market as triggered by the capitulation of HANJIN LINES last year, are showing early signs of growth and marginal profits again. Chrome and Manganese prices are bullish and volumes growth in the exports are noted.

Yet container line operators continue to be frustrated with silting (shallowing) of their berths at DCT, shallow draft challenges at the entrance at the Port of East London and a major breakwater design fault at the port of Ngqura resulting in frequent swell/surge related operational delays.

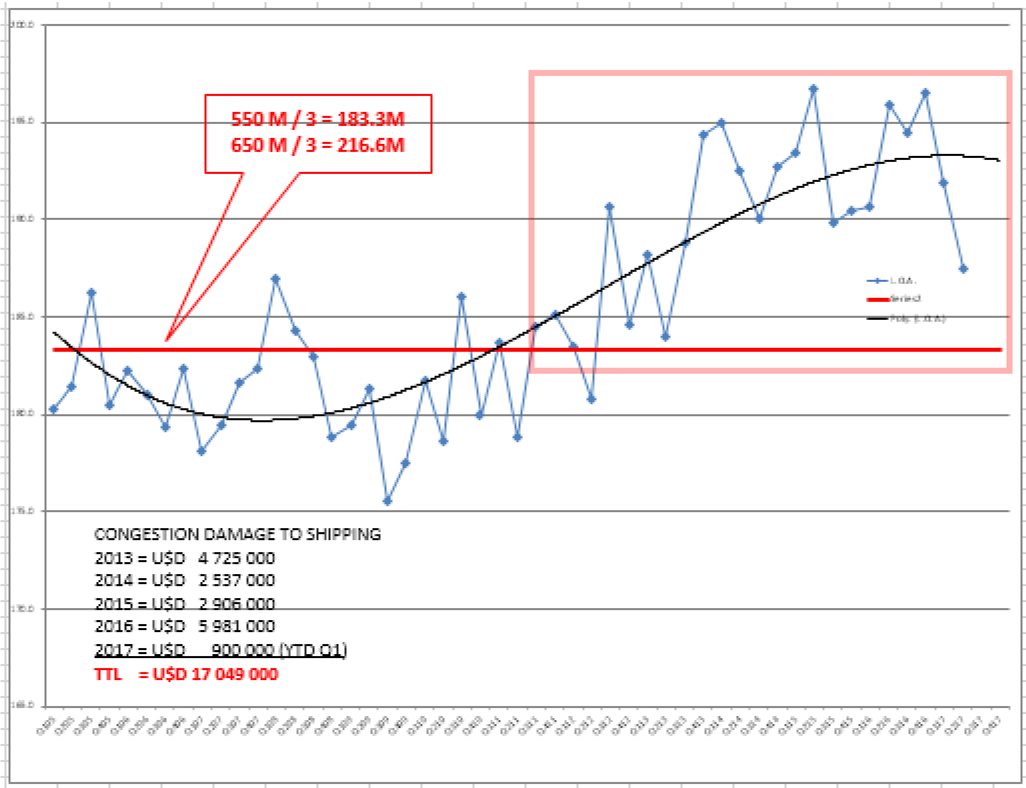
The South African port systems are not ready to respond to the upturn and as such, are not ready to capitalize on the ethos of unlocking the Oceans Economy.

8.3 The Port of Richards Bay

The Port of Richards Bay MDS model continues to attract / drive high volume zero beneficiated coal / magnetite / chrome volumes though a 40 year old MBT infrastructure, capable of handling only 2 vessels at a time due to the presence of only 2 conveyor belts. These conveyor belt systems at best handle a load rate of 1500 to 1800 t/hour on high density product or 1000 to 1200 t/hour on coal (when operational). These load rates pale into insignificance when compared to 17 000 t/hour at the modern Port Hedland Terminal (Aus).

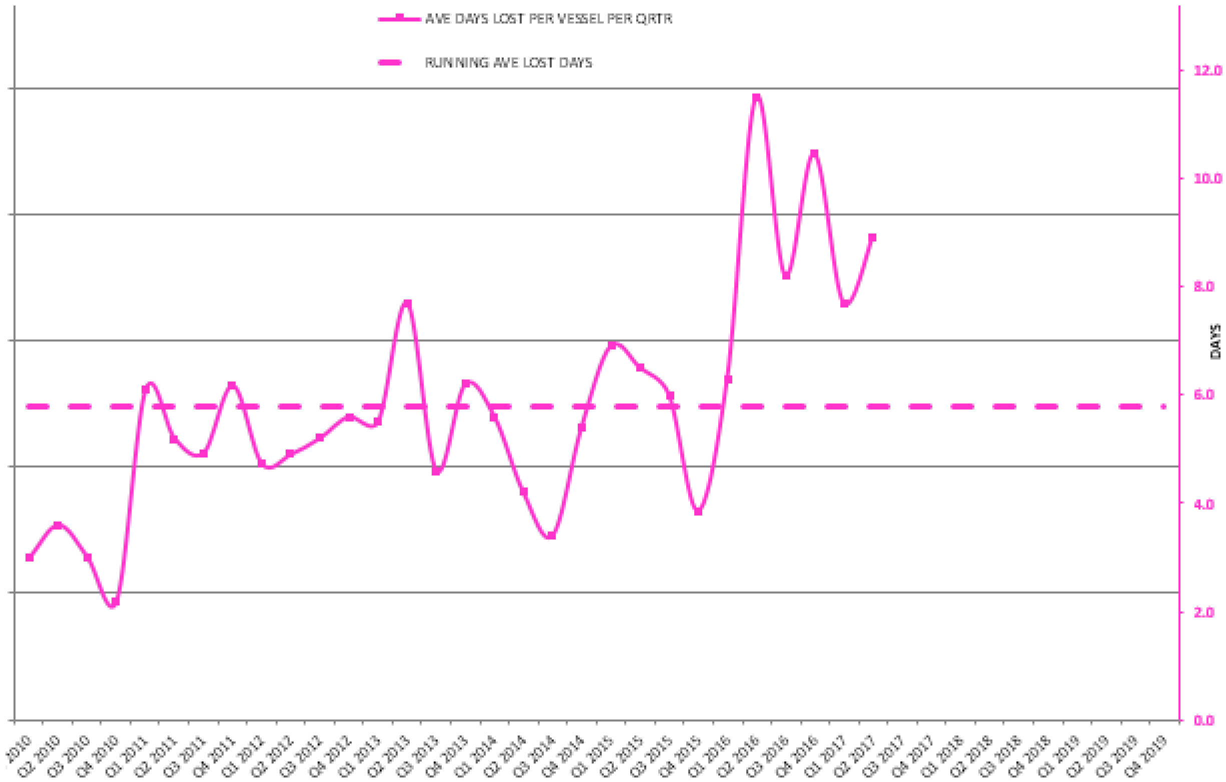
The resultant volume 'overflow', caused by congestion at MBT, is often absorbed (if not directly targeted by MPT) to be handled by ship's gear over the 7-SERIES berths. International shipping trends, while pursuing the holy grail of 'scale of economics' predicate the deployment of larger vessels. This combined, with increasingly more other (traditionally 'non-core') volumes (COAL / PHOSPROCK) over the 7-SERIES berths, continues to affect extended anchorage detentions while vessels await a berth designed in the 80's!

The effects of the 'scale of economics' matrix in shipping lines strategy is depicted below where it can be clearly seen that vessels lengths on average, have long pushed through the critical design ceiling of 183.3 m LOA which would facilitate 3 BULK CARRIERS to be serviced at the 7-SERIES at the same time.



The real time loss risk already carried by the collective shipping lines seeking 7-SERIES service is a staggering USD 17 000 000 since data capture began in 2005.

As congestion at the breakbulk berths and/or the MBT berths has an accumulative effect, the extended anchorage detentions at the Port of Richards Bay currently exceeds 5.8 days per vessel call.



Despite regular assurances from the Authority at the PCC that the project of BERTH 708 EXTENSION is not ‘off the capex radar but rather getting attention as a fringe spend’, the Port of Richards Bay continues to be overlooked in CAPEX allocation for this critical intervention.

In its oversight role NPA is not seen to be proactive enough to test the Terminal Operator’s views of the actual v/s design capacity at the BMT. The infrastructure is superfluous and in the new age of production driven logistics value chain management, falls far short of effective modern bulk handling.

To this end the Authority should be reminded that one CHROME producer has already evacuated the Terminal in favour of better service at Port Maputo. Although it may be tempting to see this as an isolated loss to the Terminal Operator, and with more producers being lured to Maputo by competitive cost rates, better volume handling rates, it points to revenue loss to the Port as well as investor confidence erosion.

9. Final Recommendations:

It is recommended that the PRSA considers Observations and recommendations made throughout this submission. Furthermore we wish to draw his particular attention to the following three main points:

9.1. Prioritisation of Terminal efficiencies.

9.2 Strategic importance of Dredging Maintenance.

9.3 Overall need to rejuvenate the Port system.

9.4 Importance of the Authority's exercising its oversight role.

9.5 Port system promoting sustainable green ports concept starting small.

We believe that these five critical interventions will go a long way to realizing the goals and aspirations of Ops Phakisa and in so doing unlocking the Oceans economy. Given the global market indicators and the current state of the port system the NPCC can only support a Tariff increase of CPI.

Submitted for the Chairman's consideration.