

My Association; The South African Association of Freight Forwarders commonly known as SAAFF has submitted comments to the Regulator on all the Authority's tariff applications since the process began seven years ago.

Though the impact of port tariff increases does not directly influence our members revenue streams, port tariffs are among the cost items we pass on directly to customers, we believe that our mandate is to protect our members and their clients interests and wherever possible to address freight supply chain costs.

Only by ensuring South Africa is globally competitive both in price and service will the businesses of both our members and their clients grow an essential route to long term survival.

We thank the Regulator for the opportunities afforded to us over the years to make submissions on port tariffs and for this opportunity to address the Methodology.

Many port stakeholders believe that it is at best inappropriate for any port Authority to be related in one way or another to terminals or other operational port businesses.

Many of the reasons are obvious, some are that perceived or actual collusion becomes next to impossible to identify, oversight of operations, as required in chapter eleven of the National Ports Act, can become, at least for the Authority, loaded with potential relationship difficulties and other obstacles.

That the Authority is not an autonomous body places a considerable burden on the Regulator when attempting to assess the Authority's true financial situation, actual level of borrowing versus equity, real cost of debt, available cash resources, asset and equity *beta*, etc. all of which are major elements in final tariff setting decisions and are, by necessity, estimates.

These difficulties were recognised by the drafters of the NPA Act of 2005 where the incorporation of the Authority as a separate company was legislated.

Had this requirement been fulfilled at the time all aspects of tariff pricing would be not only simpler but more accurate.

We understand that the omission by the State to act on these provisions in the Act is not within the Regulators remit but we believe its impact over recent years has been both unnecessary and severe.

Revenue Requirement Formula:

We recognise that a Revenue Requirement process is appropriate for advance tariff setting for monopoly utilities and is common practice globally where either private sector or State owned utilities, often monopolies, are in a regulated environment as is the case with the National Port Authority.

In a relatively free market such as the United States where there are many privately owned regional electricity suppliers electricity prices are regulated due to the practical lack of customer choice with a Revenue Requirement formula commonly utilised.

Whilst the process can address the needs of the utility and those of its customers there are critical areas in the formula which if not accurate can and do result in misstated tariff requirements.

Among the issues which we believe must be addressed in any process of reassessing the current tariff methodology is the Regulatory Asset Base the valuation of which has been a matter of contention for port users since it was determined in 2008.

The Regulator has expressed reservations regarding the recalculated RAB and the use of the Depreciated Optimised Replacement Cost (DORC) method which was used by the Authority at that time.

We understand that a process of independent valuation of some of the Authority's assets is under way and look forward to its conclusions.

There are questions such as whether assets which had been completely depreciated over time were included in the opening RAB in 2008 and have consequently skewed the basis of the Authority's annual tariff applications.

An accurate assessment of the actual value of the Authority's assets is essential for there to be any confidence in the process of arriving at tariffs going forward.

All port users should have an understanding of the basic process used in valuing assets. In particular does the Regulator believe that the DORC is indeed an appropriate means of arriving at a valuation and consequent return on that valuation?

Would such valuation, when utilised as the basis for pricing, allow the Authority sufficient reserves to finance replacement of obsolete infrastructure when necessary without placing an unacceptable burden on port users or exceeding the return a monopoly such as the Authority would earn were it in a competitive market?.

Turning now to the Weighted Average Cost of Capital (WACC):

There are a number of issues in the current formulae used in determining the Authority's WACC which need to be reviewed, among them are:

Gearing:

In the Regulatory Manual for the concurrent tariff year the Regulator indicated that gearing of .5 would be appropriate. Gearing has a direct impact on the WACC calculation and therefore should be reassessed taking into account the Authority's actual level of borrowing versus equity rather than that of the Transnet group.

Market Return Premium

Not being either an economist or accountant I cannot give any comment of value on the calculations by Messrs Dimson, Marsh and Staunton three of the most globally respected experts in finance except to say their outstanding work on MRP is titled "Triumph of the Optimists". I imagine that name may well be ascribed to the Authority if and when an annual tariff application actually meets with the Regulators approval!

I am equally totally unqualified to comment on why the DMS risk premium calculation which we use today uses South African statistics from just after the Boer War up to current. I may need to undertake further studies to understand why but as it stands 5.4% is the number and we are stuck with it!

## Beta:

Over past years there have been comments tabled by industry on the use of an asset *beta* of 0.50 and consequent equity *beta* of 0.86. The points raised were invariably that as a state owned monopoly with a captured customer base that has no other options there is virtually no risk and that an asset *beta* of zero might be more appropriate.

Any arguments that reduced volumes or competition from other ports in the region represent material risks can be countered. The Revenue Requirement process presently shields the Authority and its shareholder from the impact of lower volumes either by increasing tariffs or using claw back and the ETIMC.

On intraregional competition, which could be considered a risk, the Authority has acknowledged that if anything improved performance by other ports in the region is a positive development for it and this attitude is demonstrated by the practical assistance provided to ports in Mozambique and more recently Benin.

My Association believes the Authority and the Regulator should clearly outline their thinking on the actual level of risk they believe should be applied to *beta* calculation and how such thinking is rationalised.

In such an assessment we assume the Authority will include any potential loss of volumes to ports in our neighbouring states.

## Weighted Average Cost of Debt:

My Association questions the use of Transnet's Weighted Average Cost of Debt (WACD) when reaching the vanilla WACC. It believes that the group WACD is moderated due to the Authority's position as the only true monopoly in the Transnet group with an extremely low or zero element of risk.

As an autonomous body it is likely that bond holders and other investors would view the Authority as a better risk and consequently accept lower rates of interest than those applied to the group as a whole or the other divisions, were they autonomous.

## Conclusion

The key to the current methodology is the Revenue Requirement Formula which as mentioned previously is an accepted means of arriving at pricing in advance usually at regulated utilities, often monopolies. It is recognised and used globally and as we have experienced here that with rigorous oversight and regulation it can ensure a fair level of tariff and control over potential price gouging.

However this review of the current Methodology provides an opportunity to examine whether it is the right option for the Authority, the shareholder and indeed for all port stakeholders, both users and lessees.

My Association would argue that for an entity to be effectively shielded against reduced revenue, or in the case of the Authority lower freight volumes particularly revenue rich container traffic, management's motivation to protect its bottom line by addressing operational and capital expenses will be impacted negatively. The shielding consists of the claw back process and ETIMC both of which as previously outlined can protect the revenue base during difficult times.

An example of this anomaly is the level of increase in operational expenditure over the past seven years which has averaged 13% in tariff applications this whilst cargo volumes have remained static or reduced over the same period. This would seem to indicate that being protected from more normal business constraints such as lower sales can result in management viewing cost control as insignificant.

On final point, our members along with the vast majority of port users and stakeholders are in businesses with shareholders who by the very nature of their investments are exposed to the local and global economic and financial variances that occur both positive and negative, rarely if ever do they have a virtual guarantee that their investments will provide the return that they expect or hope for. In fact shareholder returns are normally a direct reflection of the entities performance be it good or bad.

Our perception of the current Revenue Requirement formula is that it provides the shareholder, ultimately the state, with a gold plated guarantee of consistent

risk free returns regardless of the Authority's financial performance be it good or bad, this at a cost to all port users.

We believe changes to the methodology should recognise that shareholder returns reflect the annual financial performance of the National Port Authority and that much greater clarity is provided regarding gearing, cost of debt, beta, and asset valuations etc..

Thank you.

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