<u>SUBMISSION TO THE NATIONAL PORTS REGULATOR</u> **<u>13 DEC 2012</u>**

<u>TNPA PROPOSED TARIFF INCREASE 2013/2014</u>

1. Preamble

The South African Shippers Council (SASC) serves as a representative body of cargo owners and service providers in Southern Africa. The SASC's objective is to represent the interests of its members throughout the supply chain. In so doing SASC joins forces with other related Associations to promote a healthy logistics climate throughout the Southern African business environment. As a non-profit organization (NPO) it is registered with the Department of Social Development

In response to the invitation by the National Ports Regulator to comment on the National Ports Authority Tariff Application 2013/2014, SASC hereby raises the complaints and appeals outlined in the paragraphs that follow, on behalf of its members and in the interests of industry country-wide. These complaints and appeals are based largely on the fact that Transnet has to-date not yet commenced the transitioning of the Transnet National Ports Authority (TNPA) to the body proposed by Section 27 of the National Ports Act, Act No. 12 of 2005, i.e. the National Ports Authority (Pty) Ltd. This Section of the Act states that *on a date after the commencement of the Act, the National Ports Authority (Pty) Ltd will become the successor to the National Ports Authority of South Africa*. As such it would be subject to the applicable accountability structures of a company and would be operating within the same economic constraints as the organisations it serves, such as the cargo owners, service providers and other organisations shipping goods through South African ports. Specifically this would address the need for the Ports Authority to provide account, on a cost basis, and substantiate its port dues and increases. Further it would inhibit bond investments used to finance other sectors and therefore the underwriting of commitments, of other sectors, with the value of the ports' income. Ports dues cannot and must not be used to fund other sectors. As a limited company the Ports Authority would operate on a level playing field and be obliged to act within the framework of acceptable commercial law as is the case with the other players such as the above-mentioned cargo owners and service providers. The following points emanate from this major concern:

2. The 2013/2014 Tariff Application – Compliance with the Act and Directives

2.1 National Ports Act 2005 – Role of the Regulator

A. The National Ports Act (Act No. 12 of 2005, page 11, Ports Regulator of SA, www.portsregulator.org) states that the Objects of the Act are: "to promote the development of an effective and productive South African ports industry that is capable of contributing to the economic growth and development of our country."

Transnet, the state-owned operator of much of the country's transport infrastructure has an enormous mandate which includes lowering the cost of doing business in South Africa and enabling economic growth and job creation. The Transnet National Ports Authority (TNPA) has applied for a 5.4 % tariff increase for next year based on a multi year tariff increase. If the multi year tariff increase is rejected by the Regulator the proposed increase could be 14.2 %.

This potential increase will substantially raise the cost of exports and increase the uncompetitiveness of South Africa's ports and goods. South African ports are among the most costly in the world for certain commodities yet productivity and efficiency of our ports is often on par with third world ports and the worst performers at that.

TNPA should be looking to reduce costs to be in line with its productivity, or increase its productivity to bring it in line with the rest of the world. Poor service levels should demand only low charges. TNPA, like other state-sanctioned monopolies is relatively unburdened by the competitive constraints that force companies operating in the private sector to absorb higher input costs, or at least limit price increases, during tough economic times, and times are very tough, especially for exporters.

B. National Ports Act (Act No. 12 of 2005, page 12, Ports Regulator of SA, www.portsregulator.org) states that the Objects of the Act are: "to promote the development of an integrated regional production and distribution system in support of government policies."

By all means government policies have developmental goals in nature. The overriding goals and objectives of each and every chain are to transport and distribute products and services closer to final consumption in a more cost effective way adding value in the process. TNPA is being short-sighted by not taking into account supply chain partners when considering rate increases.

It was hoped that the lesson learned from factors that were responsible for the recession would bring business partners closer together in order to create cost effective solutions to the benefit of all.

C. National Ports Act (Act No. 12 of 2005, page 11, Ports Regulator of SA, www.portsregulator.org) states that the Objects of the Act are: "to promote and improve efficiency and performance in the management and operations of ports."

All major companies want to keep their competitive edge and to do so these days they must have a continuous improvement program in place to improve efficiencies and reduce cost thus ensuring a sustainable business. It is thus imperative that TNPA also have such a program with specific targets to ensure that they continuously improve and pass that advantage through to the shipper and customers. In addition, KPI's need to be incorporated which will measure the activities within the ports. This will inform the shippers of the monthly/quarterly results on certain activities, which if managed correctly can ensure continuous improvements.

Since SA companies are export driven, uncompetitive port related costs make them unviable and unable to bring products and services to the world markets in an effective and efficient manner in order to compete in these markets. SASC therefore, requests the Regulator to take careful consideration of all these factors when deciding on the approval of the TNPA proposed tariffs.

3. Ports performance

The lengthy delays in the South Africa ports are common knowledge. The following specific issues are raised in this regard:

3.1 Infrastructure development

SASC is of the view that infrastructure development framework should adopt a holistic approach and not be silo based. The port development cannot take place in isolation from landside development. For example, the port development should be coupled with rail infrastructure development such as railway lines, availability of locomotives and customer-tailored types of wagons to properly fit the developed port infrastructure. This approach will ensure that integrated supply chain development is attained to balance the demand and supply of infrastructure in South Africa and to thereby improve efficiencies and reliabilities in service delivery to all customers

3.2 Performance measurement

SASC calls for the consistent implementation of **KPI's** to measure turn around time in the port, the port operators will identify delays caused by trucks queuing. This will help port operators to improve the entire supply chain turn around time.

4. Pricing methodology

4.1 Revenue Requirement Approach to the Application

SASC is of the opinion that **Revenue Requirement Methodology** is not an appropriate approach. The revenue required stems mainly from revenue projection methodology which is heavily based on estimates. If the estimates are not realizable the economy is impacted negatively. However, claw back recovery mechanism is in place to correct any deviation that may occur, but claw back doesn't work due to TNPA changing the base line every year.

Further, making provision for lucrative bonuses for executive management is against the State President's proposal to cap increases for people who are earning above R550 000 per annum. TNPA must align itself with the overall strategy of the country.

4.2 Technical aspects of the Methodology

The TNPA must migrate from the current Pricing Methodology to activity based cost. The **activity based cost** is a costing methodology that identifies activities in a business and assigns the cost of each activity. This methodology serve as a tool for understanding cost based on performing processes. The factor that creates or drives the cost of the activity can be easily identified and therefore provide grounds to justify cost transparently. The activity based costing will present the opportunity for cargo owners to estimate costs and costing projection becomes more predictable. The current methodology applied by TNPA is lacking in terms of transparency, predictability and reliability as to how prices have been determined.

The question of whether the cost of the Durban **"Dig Out"** port is included in the calculations, in any way, also arises. This should not be included in the calculation as it is a long term project.

Revenue Calculation Model

Capped Revenue Requirement of 5.4%	
Description	**Rm**
Tariff book 12/13	8,490
Less Cargo Dues export program discount	-1000
Estimated revenue 12/13	7,490
Volumes growth 13/14 at 12/13 tariff book rates	498
Forecasted revenue after volume growth	7,988
Marine business	8,419
Tariff Adjustment	5.40%

The above table illustrates that the **Revenue Requirement for 2013/14** should be R8,419m for Marine Business. This means 2012/2013 is higher than what is required in 2013/2014 if the Cargo Dues export program discount is not going to be granted in 2013/2014 and in addition R0,071m will be given back to the industry. Therefore, all things being equal there should be no increase for the 2013/2014 financial year based on TNPA requiring a lower revenue amount.

If TNPA requires less how can they ask for a 5.4 % increase? The shortfalls in the calculations are the expected increase in volumes in 2013/2014. With the current economic conditions one can hardly make an accurate forecast of growth in volume due to unpredictability and the volatility of the economy. How is it possible to publish a rate for 2013/2014 on the basis that a pre-agreed rate will be used for the next 6 years? Additionally how will the rate be affected by adverse trading conditions? Should the call not be for upper and lower thresholds?

In the 2013/2014 application the proposed Required Revenue is driven by asset allocation principles resulting in the **terminal operator contributing 33%** of the revenue. It is evident that terminal operators are operating in an environment which is outside the jurisdiction of the Port Regulator and therefore, the Regulator has no say in the pricing strategy of TPT. This could amount to a paradigm shift of costs to TPT and in turn the terminal operator will pass the costs to the cargo owners who are alleged to have been relieved in terms of the new split in revenue proposal?

In the previous **ROD** it was reflected that the Beta proposed by the TNPA and the Ports Regulator were divergent. In this application TNPA investigated JSE Top 40 companies as a representation of good proxy. The question is do these 40 companies have the same operating environment as TNPA, whereby they have the ability to use the principle articulated by claw back in the event of deviation of projected revenue?

The Beta used in the current application is 1.13 which, in the opinion of SASC, is far too much given the less risky environment in which TNPA is operating. SASC suggest that a Beta below 0.5 will be adequate due to risk free operating environment.

The Regulatory Asset Base (RAB) for 2010/2011 was R12 billion and after re-evaluation it has been subsequently increased to R66 billion. It is implied that the Regulatory Asset Base was never cleaned out as there are still CAPEX plans for replacement of sleepers and rail lines in Durban at Bay Head shunting yard which is operated by TFR. Assuming that TPT has to pay for their own repair of railway lines, this should not be included in the RAB. TNPA should therefore not be allowed to use assets of other Transnet divisions to inflate the RAB.

The gearing is also suspected to have been inflated as TNPA constitute 36% of the gearing factor versus the 46% gearing component of Transnet. The gearing must be critically questioned to determine its legitimacy and validity.

The Multiplier Effect

It was previously stated that Durban Port is the most expensive port in the world in terms of services offered. This creates an environment where international shippers have to export out of South Africa as there are no locally owned vessels to provide the services. This allows international vessels to charge the cargo owners extravagant rates and pass down all their increases from TNPA or TPT to the cargo owners.

This situation results in the shipping vessels passing on all increases to cargo owners in the form of light dues, vessel traffic services, port dues, berth dues and rentals. This has a severe effect on the cargo owners as they are carrying the shipping vessels’ costs as well as the additional increases from TPT and TNPA creating a multiplying effect of costs for the cargo owners.

Additionally, all the delays at the Durban Port are increasing the cost of business to the shippers. This negatively affects the competitiveness of our exporters as the additional congestion charges are being forwarded to cargo owners resulting in business having to increase stock levels and having to incur substantial indirect costs.

5. Pricing strategy – Beneficiation and Industrialization

The main theme adopted in the current tariff application is a **Beneficiation Strategy** purposefully aligned to encourage downstream business developments. The industrialization will assist exporters to align with government’s drive to manufacture downstream with the purpose of creating employment and stimulating internal economic growth. The implementation of the Beneficiation Strategy will encourage containerised business against break-bulk due to the rebate or discount offered on containers. TNPA needs to carefully ensure that when this is implemented the ports infrastructure is developed to such levels that it will be able to handle the increasing container volumes envisaged in the roll out of the discount on containers business.

6. Conclusion

The Transnet National Ports Authority (TNPA) is the landlord in the South African port system and is responsible for safe, efficient and effective economic functioning of the national ports system which it manages, controls and administers on behalf of the nation. The Authority facilitates the development of trade and commerce for the economic benefit of the national economy and did not obtain the current infrastructure via a commercial sale that justifies the revenue approach and cross subsidization. Should Transnet National Port Authority continue to operate as does then it should register as a Pty Limited which should level the playing fields.

The South African economy has directed resources in developing port infrastructures and therefore the economy cannot afford to continuously finance these infrastructures instead of reaping the benefit of having set up these infrastructures for the good of the nation. Port infrastructure is a national asset and should facilitate trade and commerce to give exporters the impetus to grow the economy and create jobs.

Against the background of the above, SASC submits the following requests to the Ports Regulator:

- That the Ports Regulator implement a **zero** increase for 2013/2014 and until the price methodology and strategies are finalised on exports in the interests of the nation
- That beneficiation and industrialization be **promoted and incentivised** for those **exporters** that align with Government strategies
- That the implementation of **multi-year increases be rejected**

Finally, it should be noted that most of the concerns highlighted in this submission would be addressed by the corporatisation of TNPA, implemented according to Section 27 of the National Ports Act, Act No. 12 of 2005. This is the principle concern of SASC and highlights the requirement for TNPA to act commercially. SASC calls on the Ministers of Finance and Public Enterprises to initiate and commence with this transition and transformation to ensure a competitive and growing South Africa.