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Dear Chairman,

NATIONAL PORTS AUTHORITY PROPOSED INCREASE IN CARGO DUES APPLICABLE TO RICHARDS BAY COAL TERMINAL COAL EXPORTERS

This submission is made in response to the Tariff application made by the National Ports Authority as published on its website and presented at the hearing held in Johannesburg on the 20th November 2012. The purpose of this letter is to provide the Regulator with further information in making a recommendation in terms of the proposed increase on cargo dues for coal exported out of Richards Bay Coal Terminal ("RBCT"). Relevant stakeholders, including Xstrata Coal South Africa ("Xstrata"), have not previously been provided an adequate opportunity to comment on or object to the proposed increase.

In summary Xstrata objects to this proposed increase for the following reasons:

- Under the National Ports Act, cargo dues are meant to cover the provision and maintenance of port infrastructure. RBCT was initially constructed (R45 million in 1976 money terms), expanded through a number of phases (R 2,6 billion to 2010) and continues to be maintained (sustaining capital of R650 million to date) and operated (costs on average R550 million per annum) by its shareholders/users and not TNPA. It does not appear that TNPA has adequately taken this into account in arriving at the proposed increase in cargo dues.
- The proposed increase will negatively impact on Xstrata's business, the coal mining sector's competitiveness, as well as South Africa's economy more generally, particularly in respect of exports and potentially also employment in the coal mining sector;
- The other ports within South Africa and internationally used by TNPA on a comparative basis to determine the level of cargo dues are not appropriate or comparable, and
- The tariff application seeks to increase cargo dues on divergent bulk commodities with no regard to the complexities or situation of those relevant commodities but seeks to treat them all as one with no further reasoning as to why this is correct.



- Furthermore the simultaneous increase in cargo dues for bulk commodities and 43% reduction in rates for containers and automobile dues suggests that there may be an element of cross subsidisation in the tariff application from the National Ports Authority. We request that the matter of cross subsidization be reviewed.

This submission provides further detail on these likely effects.

AUTHORITY OF TNPA TO INCREASE CARGO DUES

Based on what is set out below, it is respectfully submitted that:

Section 73(1) of the National Ports Act 12 of 2005 provides,

"The Authority may charge fees, in accordance with a tariff determined in terms of section 72, for –

...

(b) the provision and maintenance of port infrastructure, port terminals and port facilities, including -

...

(iii) cargo dues for the provision and maintenance of port infrastructure..."

The basis of Xstrata's objections to the proposed increase is set out below:

THE COSTS OF RBCT ARE BORNE BY ITS MEMBERS AND USERS

First and most importantly, the costs involved in constructing, establishing and maintaining RBCT have always and continue to be borne by its members and users. This is unlike other ports and terminals in South Africa. As set out above, cargo dues are meant to cover "provision and maintenance of port infrastructure". Because the members, and not TNPA, paid for establishment of RBCT and continue to bear the cost of its maintenance, Xstrata submits that the proposed significant increase in the level of cargo dues is unreasonable.

More detail regarding the history and operation of RBCT is set out below which substantiates this position.

History and development of RBCT

The Richards Bay Coal Terminal opened in 1976 as a result of the Transvaal Coal Owners Association ("TCOA") being awarded a contract to export coal to Japan in 1972 which required an export port. The terminal was built on unused, reclaimed swamp land which today totals approximately 276 ha.



As an indication of the total cost of the most recent "Phase V" expansion required the reclamation of 9.4 ha of previously unused swamp land which cost approximately R188m. In 2010 Rand terms this means that the reclamation of the original 276 ha mentioned above equates to approximately R5,5bn. All the cost for construction of the terminal and its facilities was borne by the various shareholders of RBCT which were the then shareholders of the TCOA (which are today in essence the same companies). Only the quay was constructed by the Ports Authority. Because this was done on reclaimed land, the recovery of cargo dues and other fees was included in the lease for the coal terminal. The lease costs are payable by RBCT, through charges on its shareholders and other users.

Cargo dues are raised to cover the "dry" infrastructure of the port. This is limited to the provision and maintenance of quay-walls, roads, railways, buildings, fencing, security and lighting which fall outside terminal boundaries (Nicco Walters, NPA, personal communications, 2005).

The investment by the members of RBCT is important. In a number of ports in South Africa, the investment undertaken by RBCT in Richards Bay would typically have been undertaken by (and at the expense of the Ports Authority (now TNPA). It is critical that in determining the level of port fees which should apply to RBCT, the Regulator avoid the potential problem of 'double counting'. The costs borne by TNPA at the portion of the Richards bay Port operated by RBCT are significantly lower than they would be in other ports. The members of RBCT should not have to pay for the construction, maintenance and operation of RBCT in addition to paying tariffs to TNPA for performing similar functions.

EFFECT OF THE INCREASE ON XSTRATA, THE COAL MINING INDUSTRY AND THE SOUTH AFRICAN ECONOMY

Xstrata submits that the proposed increase in cargo dues will adversely impact on the business of Xstrata, the South African coal mining industry and the economy more generally. This is primarily as a result of the effect that the increase will have on the cost of coal exports from South Africa.

Importance of the coal industry and exports

South Africa is the seventh largest coal producer in the world. South Africa's coal benefits from having low sulphur content relative to coal mined elsewhere in the world. This reduces the pollution caused when it is burnt, making it highly desirable internationally. As a result, South Africa one of the largest exporters of coal in the world.

The South African coal market exported approximately 69 million tonnes of export coal which equated to over US\$7.1 billion in foreign earnings in 2011. In 2011, coal accounted for 7.1% of South Africa's total merchandise exports, valued at R50.5 billion. Coal exports are therefore regarded as critical to South Africa's economy. In 2011 the value of sales of coal mined in South Africa was R88 billion.



RBCT is the largest single coal export terminal in the world. 94% of South Africa's coal is exported through RBCT with the remainder being exported through the Port of Durban and the Navitrade terminal in the Port of Richards Bay.

In 2011 Mining in general delivered 8.8% of South Africa's GDP directly and applying the indirect multiplier and induced effects of mining, this is closer to an overall contribution of 18%. Of this, coal directly accounts for 1,9% of South Africa's gross domestic product.

Domestically, the coal sector's main markets are

- energy (Eskom, where coal is used as a fuel to produce electricity),
- petrochemicals (mainly Sasol, using coal as a feedstock for the production of synthetic fuels and various chemicals)
- steel where coal is used for blast furnaces or ferro-alloys where coal is used as a reductant for furnaces
- the cement, paper and sugar industries; coal is used in industrial processes or boilers, and
- coal merchants (for domestic and small industrial users).

Approximately 77% of South Africa's electricity is generated from coal, while 30% of the country's liquid fuels are produced from coal by Sasol.

The coal mining industry directly employs 78 580 workers (a 6% increase on 2010 employment numbers) and last year paid R16.1 billion in wages according to the Department of Mineral Resources.

In 2008, the capacity of RBCT was approximately 76 million tons per year. In 2009 the capacity of RBCT was expanded to 91 million tons per year by shareholders and new BEE user entrants. However, the volume of coal exports in 2011 through RBCT only reached 66 million tons well below port capacity.

The effect of an increase in the cost of exporting coal from South Africa would put further pressure on the industry as set out below.

Economic effects of the increase in cargo dues

One of the 'Objectives' contained in the National Ports Regulator's 'Regulatory Principles', published under the National Ports Act states is to,



"Facilitate and enhance the expansion of international trade and tourism in general, and export in particular"

The cargo dues payable on all coal exported through RBCT contribute to the cost of South African coal purchased internationally. South African coal competes with American, Australian, Colombian, Russian and Indonesian coal on the world market. The international coal market is highly competitive and volumes purchased in each transaction are typically large. As a result, even small changes to the price at which exports can be sold in the international market result in significant shifts in demand.

Exports are extremely important to the coal industry. A decrease in competitiveness in the export market (due to an increase in costs) would have a significant impact on levels of demand for South African coal generally. Decreased international demand would have negative consequences for South Africa's balance of payments as well as production levels at coal mines. This would indirectly result in job losses.

As a result, amendment of any aspect of the input cost, including the level of cargo dues, should be carefully considered. Xstrata estimates that the proposed increase of 104% in cargo dues would increase cost to the industry by R230 million per year (measured for the TFR expected performance for 2013/2014 year). This comes at a time when coal prices have fallen over 30% from the prices of 18 months ago.

It is therefore of critical importance that factors that impact the costs of coal producers are reviewed holistically. Only increases which are strictly necessary should be approved and implemented.

Effect on Xstrata and the South African coal mining sector

South African coal-mining is dominated by six major players, each of which produces more than 10 million tons of coal every year. They are BHPB Energy Coal SA (part of BHP Billiton), Anglo Coal, Sasol Mining, Exxaro Coal, Optimum Coal, and Xstrata.

It should be noted that ARM Coal – part of the African Rainbow Minerals group ("ARM") has directly and indirectly a 30% share in Xstrata's South African coal operations, and a 51% share in the Goedgevonden (GGV) coal JV, also with Xstrata. ARM Coal, a joint venture between ARM Ltd and Xstrata Coal has also applied and received an additional 3.2 Mtpa of export capacity at RBCT. This is indicative of Xstrata's objective to grow their coal export base via transformation.

The majority of coal exports are of lower ash content (less than 15% ash). Most of South Africa's coal, which is consumed by Eskom, is "high ash" (above 25% ash). Export coal production does support Eskom coal production on multi product mines. The proposed increase in cargo dues on export coal will have negative consequences for the mix of revenue of Xstrata and the industry.



Xstrata operates multi product mines. This means that it produces both export quality coal and coal which has a higher ash content, and is sold to Eskom. Xstrata's business model is supported by the fact that it has a mix of exports and income derived from sales to Eskom in the turnover base. The viability of the mines would be seriously questioned if Eskom was Xstrata's only source of income.

For 2012, Xstrata and Arm Coal will be the third largest exporter of coal from South Africa, accounting for approximately 20% of the exports from RBCT. The impact of the proposed 104% increased cargo dues on Xstrata alone would potentially approach R50 million per year.

To deal with this sudden increase in costs, Xstrata would have no option but to cut back on costs elsewhere in its business. This may result in inevitable job losses.

Effect on employment

An increase in costs without a commensurate increase in international commodity prices could result in a reduction in mining activities in South Africa. Introduction of a significantly higher cargo due adds a fixed cost to every coal export mining operation. The unintended consequences of this system are increased cost of export production and possible job losses.

In addition, as noted above, if South Africa's coal exporters are forced to raise the prices offered into the international market as a result of the increased cost of exports, demand for South African coal would decrease.

The adverse effects on employment of such a dramatic increase in the cargo dues applicable to RBCT could therefore be significant.

COMPARISON WITH OTHER PORTS

As part of its explanation to industry for the proposed increase in cargo dues, TNPA presented a comparison with other commodities exported from South Africa and a comparison with other ports throughout the world. Xstrata suspects that the proposed increase has simply been calculated with reference to benchmarking the coal industry with comparable iron ore (dry bulk) rates on Saldanha port cargo dues.

Due to the size, nature and technical specifications of RBCT, Xstrata submits that the ports used are not a proper basis for comparison.

Xstrata believes that this logic is flawed as it:

- does not take into account the historical development of the RBCT including the very significant investment made by the coal exporters in establishing RBCT in comparison to the investments made by users at other ports, and



- compares RBCT, a bulk export terminal to minor general ports which are predominantly import ports. These are dramatically different to a dedicated bulk export port, or very small export ports without any of the benefits of scale as are achieved at RBCT. The main competitors to RBCT and South African bulk coal exports are Colombia, Russia, Indonesia and Australia. Other than one Australian port, no comparison is made to the other key global industry players, their port costs and what the equivalent of cargo dues might be. This is important vis a vis South Africa's competitiveness globally.

Cargo due comparison to other commodities

The TNPA presentation also compared the coal cargo dues to other commodities (namely iron ore). It concluded that cargo dues applicable to other commodities were higher and that cargo dues applicable to coal should be brought in line with these levels.

To illustrate why this comparison is flawed, it is necessary to examine technical differences between RBCT and the Saldanha port. Saldanha is responsible for the export of iron ore which, after coal, is the next most important commodity exported from South Africa in terms of volume.

RBCT

RBCT is built on 276 hectares and its quay is 2,2 kilometres long. It has six berths and four ship loaders, with stockyard capacity of 8,2 million tons in total. RBCT has capacity to export 91 million tons per year of coal. This makes it the largest single export port in the world. However, the ability to export these volumes is limited by TNPA's sister company, Transnet Freight Rail ("TFR")'s capacity. TFR provides the railway services linking the coal mines to the port.

In 2011, TFR was only able to deliver only 66 million tons of coal to RBCT, which limited coal exports to the same volume. RBCT also handles over 700 ships a year, each of which is charged by the TNPA for various services that it is required to use while in port for example tugs and pilotage.

Saldanha Bay Port

The second largest commodity exported from South Africa by volume is iron ore. This is exported out of the Saldanha Bay port. In 2011 exports of iron ore were 51.9 million tons, compared to coal exports of 68.8 million tons during the same period.

The port at Saldanha has a 990 metre long jetty containing two iron ore berths linked to the shore along a 3.1km long causeway/breakwater. There is also an 874m long multipurpose quay for the handling of breakbulk cargo and a 365m tanker berth at the end of the ore jetty. This port also handles imports of anthracite, coking coal and steel pellets, which requires additional investment in equipment in order to offload. The cost of the multipurpose quay and all other related sites was borne by the TNPA.



Different standards

Based on this brief description, it is clear that the Saldanha port (and other ports) are not an appropriate basis for comparison in determining the level of cargo dues which should apply. The size and scale of Richards bay as a port, and of RBCT as a privately constructed terminal, its operating costs and its unique development, independent of the Ports Authority, substantially distinguishing it from any other terminals in South Africa.

Blindly applying a particular cargo due which applies at any other ports is therefore not a sound basis to determine the cargo dues which should apply to RBCT. Richards bay also as a multi purpose port, not a dedicated port like Saldanha, has greater synergies amongst its many users and also greater shipping volumes across all its terminals.

Cargo Dues comparison to other ports internationally

The TNPA also compares the coal tariffs charged by other coal terminals around the world. This comparison is in our view again flawed for the following reasons:

First, RBCT is a 'bulk coal export terminal'. There is no facility for offloading vessels. As a result, no additional investment in offloading equipment is required as would be required at ports which accommodate both exports and imports. While the Port of Richards Bay imports various commodities the charges for loading and offloading and the infrastructure required for this, taking the TNPA's approach of "user pays", should be part of the actual loading charges for that terminal. Where that is not the case these extra import volumes also use the port infrastructure and should contribute dues to fund these.

1. RBCT's size gives it certain volume related benefits, which have been largely derived from RBCT's investment in infrastructure. TNPA's investment is limited to the quays and general port maintenance.
2. Comparison with different ports falling within different regulatory regimes should be done with extreme caution. There may be value from reviewing such appropriate port tariff structures, however only as a broad reference, and perhaps as a sanity check.

Appropriate benchmarking

Xstrata Coal South Africa is a subsidiary of Xstrata Plc which is the world's largest exporter of coal. It therefore has access to cargo dues applicable to a number of ports around the world. Xstrata has compared the cargo dues suggested by TNPA for RBCT to comparable coal export ports worldwide:

- The port of Hay Point which, through its two coal terminals of Dalrymple Bay and Hay Point in Australia, exported 99.5Mt of coal in the 2010/2011 year. Dalrymple bay has a cargo due equivalent of AU\$ 0.297 per tonne (harbour due and tonnage due) equivalent to R2.70 per tonne at current exchange rates.



- The Gladstone terminal in Australia has equivalent cargo due costs of AU\$0.2817 per tonne or R1.99 at current exchange rates.

LEVEL OF CARGO DUES

In terms of section 73(1) of the National Ports Act, the level of cargo dues which may be charged under section 73(1)(b)(iii) must be determined "in accordance with" the approved 'base tariff'.

The presentation and letter mentioned above indicated that the revised cargo dues relating to dry-bulk coal will increase on 1 April 2013 from the 2012 level of R 2.94 to R6.00 per ton. This amounts to a year on year increase of over 104%.

If calculated on the overall base tariff increase as requested by the National Ports Authority of 5.4%, the cargo dues applicable for the 2013/2014 tariff year would be R3.10/t. The 5.4% is well within the country's core consumer inflation targets of between 3 and 6 per cent. This level would facilitate growth in South Africa's exports.

Xstrata submits that if an increase in the level of cargo dues payable by users of RBCT is necessary, then the increase should be in line with the approved base tariff. This should not exceed an increase of between 3% and 6% on 2012 levels. An increase of over 104% is, simply put, both excessive and unreasonable.

SUBMISSION ON RELEVANT FACTORS

Based on what is set out above, Xstrata submits that the following factors should be considered by the Regulator in determining whether to approve the increase proposed by TNPA:

- The port infrastructure of RBCT, including the further expansion thereof in Phase V, has been paid for by the coal industry. The TNPA has paid only for quay walls the last of which was built as part of the overall port expansion to 91 million tonnes in 2009 and the capital expenditure plan submitted by it shows no capital expansion for coal for the next 2 years at any recognised coal export terminals in either RBCT, Durban or Navitrade. The applicable cargo due should therefore not be a return on investment based on total historical expenditure by the Ports Authority as may be the case with other ports.
- As authorised under section 73 (1)(iii) of the Act, cargo dues may be levied for "...provision and maintenance of port infrastructure ..." . Cost recovery through the dues must then be restricted to actual or clearly budgeted activity by the TNPA for the purposes of such provision or maintenance.



- Moreover, account must be taken of additional sources of income derived by the TNPA from users, which could otherwise amount to double counting;
- The TNPA charges each vessel that arrives at each port for the cost of the services that it uses. The 700 vessels at operating through RBCT each year pay the relevant port fees, compared to Saldanha's 400 vessels. TNPA would therefore earn significantly more through imposition of the same tariff for port fees on RBCT despite the fact that the two ports are dissimilar in terms of cost to the TNPA.
- The new RBCT phase V investment by the shareholders and new interested coal export parties shows the intent of the industry to grow exports. With the planned addition of rail capacity, National Port Authority stands to benefit significantly in the long term from an increase cargo export volumes without any required capital investment. A significant increase to cargo dues such as that proposed by TNPA should therefore not be necessary. Without increasing cargo dues the RBCT volume potential can increase TNPA's revenues by 34% in the next 5-8 years.
- RBCT is also liable for the "closure and rehabilitation " cost of the sites whereas at other terminal the users are not.

CONCLUSION

As explained above, the proposed increase in cargo dues will negatively impact on the business of Xstrata, the coal mining industry (and in particular its exports) and the South African economy as a whole. In addition, the basis on which TNPA has determined the proposed increase is fundamentally flawed.

The impact of the proposed increase to the cargo dues is likely to add approximately R50 million per annum to the cost of Xstrata's business, without any additional "value add" from TNPA. This is significant. It will be difficult for Xstrata to continue operating at current levels without substantial reductions in other costs (which may include labour costs) or increasing export prices. If Xstrata (and for that matter the other users of RBCT) was to increase prices, a decrease in demand for South African coal internationally would be the likely outcome. This would impact negatively on South Africa's balance of payments and the economy more broadly.

The careful consideration of the costs which are automatically attributed to coal mining companies in the export process is essential. Extensive consultation with industry participant and relevant stakeholders on these issues is of critical importance.

Xstrata respectfully requests that the regulator review the suggested cargo dues proposed by the TNPA for coal exports from RBCT.

In Xstrata's view, the proposed increase in cargo dues of over 104% should be rejected. The National Ports Authority should apply its mind to determine a more measured approach to



the level of cargo dues payable for bulk coal exports, specifically RBCT users as a unique, the largest and privately funded bulk terminal in South Africa, particularly in light of their application to the coal industry which is critical to the South African economy as set out above.

In Xstrata's view, if the level of cargo dues must be increased at all, an increase in line with inflation would be more appropriate in order to avoid the consequences set out above. Alternatively, an increase in line with the formula contained in the escalation clause in the lease agreement between RBCT and TNPA should apply.

We appreciate the opportunity to make submissions to yourselves and trust our letter to be of assistance in regulating this matter.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Murray Houston', written over a light grey horizontal line.

Murray Houston
Chief Operating Officer – Xstrata Coal SA