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**TARIFF APPLICATION ROAD SHOW CONSULTATION REPORT.**

The Ports Regulator conducted road shows to take port users through the National Ports Authority's tariff application for the 2014/15 Financial Year as submitted. This application is submitted as an interim tariff whilst the Regulator considers the NPA's proposals on a multi-year tariff determination and pricing strategy. The Regulator has further guided the Authority through an interim tariff methodology which has been published. The methodology, for the first time, guides the Authority on the approach to the implementation of the Required Revenue methodology in line with the assessment approach followed by the Regulator.

As before, the road shows allowed the users to engage with, and seek clarity on, the Authority's tariff application. These were held in Cape Town (30 September 2013), Port Elizabeth (01 October 2013), Johannesburg (02 October 2013) and Durban (04 October 2013). These were attended by personnel from the office of the Ports Regulator of South Africa, and the National Ports Authority, together with industry stakeholders and ports users, collectively in the four cities. The NPA presented their application and the following is a summary of the salient issues raised in the road shows and the responses thereto:-

**PORT INVESTMENT PLANNING**

The NPA's capital plan is R57.6billion over a seven year period reflecting more capacity expansion programme into the future.

**Question**: Is the Dig-out Port going to be funded through private sector participation or from NPA?
**Response:** Transnet is exploring alternatives for the Dig-out port which has not been brought into the MDS, which means private sector involvement could be taken into account.

**Question**: Are there any expenses included in the R57 billion seven year programme for the Durban Dig-Out Port (DDOP) and how is the Dig-Out Port going to be handled in the future? What will the required funding for the Durban Dig-Out Port be?
**Response**: The Durban Dig-Out Port's previous expenses for land (R2billion) were clawed back from the RAB by the Regulator on the basis that it is not a proclaimed port and as yet does not fall in the ambit of the National Ports Act. No other costs relating to the Durban Dig-Out Port are included in the RAB. Transnet is exploring to what extent and in what capacity the private sector can play a role – i.e. options to fund the DDOP. At this point it is all exploratory.

**TARIFF APPLICATION APPROACH**

With advent of the tariff application methodology published by the Regulator which guides the Authority on elements listed above, the road show attendee raised specific questions related to the operational and labour costs as well as comments on the overall tariff increase as follows:

**Regulated Asset Base (RAB)**

**Question:** The value of the Regulated Asset Base has always been contested. What is the detailed breakdown of the R10.4billion revenue requirement? How much does the NPA need for services and infrastructure and how much of that is for Transnet group needs?

**Response:** The Regulator's interim methodology guides the NPA on cost of debt, operating costs, depreciation, tax computation, etc. The NPA being a division within the Transnet group, operational costs covers the functions that Transnet conduct on behalf of NPA. Although R10.9 billion is the required revenue calculation, Transnet is conscious of its role ito reducing the cost of doing business. Therefore in having assessed its funding requirement for FY 2014/15 - R10.4 billion is sufficient for Transnet to function within gearing parameters and ensure that its debt covenants are not breached.

**Question**: The NPA must clarify what is included in the RAB. Various questions were raised e.g. Why the shunting yards at Bayhead are part of NPA and not TFRs asset base, whether the Richards Bay PCC approved the Capex programme, and if Salisbury Island project is proceeding.

**Response:** The NPA has included the shunting yards because they contribute to the overall efficiency of the system within the port precinct. The Richards Bay PCC did approve the 2014/15 Capex Plan.

**Question**: The NPA's assets were valued some years ago, we still do not understand how they are valued.

**Response**: The current RAB is informed by what was in the 2013/14 Record of Decision. A higher number was requested because NPA anticipated to have spent more on CAPEX, however in this application the RAB has been reduced because the Authority anticipate not to spend the projected CAPEX amount for 2013/14. The figure has accordingly been updated which is why the number in the application is slightly lower than it is in the Record of Decision. At the end of March 2014, the Authority trends the opening balance of R63 billion by inflation (R3 billion) which brings the RAB to R66 billion.

**Response (PRSA)**: Acknowledging the challenges with the Authority's RAB, the Regulator will be conducting a valuation of certain of the assets in the NPAs RAB to gain confidence with the RAB figures.

**Question**: The principles adopted by the NPA are similar to those that are used by the Energy Regulator for tariffs. Is there any form of liaising with the Energy Regulator regarding the methodology?

**Response**: The NPAs tariff determination is based on the Required Revenue methodology and is very similar to the one used by NERSA and other regulators. However, the application of aspects of the Required Revenue approach responds to the port environment.

**Question**: will you look at, for example, fixing the tariff for 3 years?

**Response**: The NPA is looking at a multi-year tariff determination and has requested the Regulator to consider approving a five year tariff.

**Response (PRSA)**: The Regulator is considering the proposal and the best approach to facilitate a multi-year methodology taking into account the challenges with the current process and factors that must be considered and factored into a multi-year determination. The Regulator has issued an interim tariff manual for the 2014/15 period to the NPA whilst still making a determination on both the tariff methodology and the pricing strategy. It has made mention in the 2013/14 Record of Decision for a two phased approach to the 2014/15 tariff application. The first phase is the determination of the required revenue. The second part, informed by the need to rebalance the tariff book, will entail the Regulator determining the principles for rebalancing the tariff book and providing tariff strategy guidelines to assist the NPA in amending the tariff book, post the publication of the ROD on the Revenue Requirement application. The Regulator thus encourages inclusion of industry inputs that will talk to the principles as well as the structuring of the tariff book.

**<u>Clawback</u>**

**Question:** In terms of the clawback, has it been considered that if the automotive industry over-recovers that this be ring-fenced from the clawback?

**Response (PRSA)**: That option has not been considered because of the imbalances in the tariff book. That's why there has been an over or under recovery in certain sectors. The tariff book needs adjustments as it does not reflect the true cost of providing services to each user as it should. If the tariff does not reflect/recover the true cost then we must first get the tariff to be cost reflective and this must be addressed in the tariff strategy.

**Comment:** The imbalances of the past are considerable as far as the automotive industry is concerned at about R1 billion which the sector has not seen much redress on. The PRSA must address this imbalance by considering the comments that were made by the automotive industry.

**<u>ETIMC</u>**

**Question**: Clarification on whether the authority is requesting to access/release R455 million from the ETIMC in the tariff application is required.

**Question**: Given that ETIMC was introduced to ease the burden when industry is faced with significant tariff increases, for example in the ramping up of NPA's capex programme over the next few years, is this the time for accessing the ETIMC?

**Response**: The current tariff application is for 14.39% and with the requested amount of ETIMC to be released (R455 million) the NPA will effectively be then asking from users a tariff adjustment of 8.5%.

**Response (PRSA):** The Regulator is considering the triggers for releasing the ETIMC and will welcome and consider motivated submissions on the triggers and whether or not this is the time to access the facility from industry's submissions to this application.

**Labour costs**

**Question**: Clarity is sought on the breakdown of the labour costs which stands at 9.1% with a request that a detailed breakdown of these costs be provided to enable a distinction to be made for:

- Year-on-year labour head count
- Salary adjustments
- New employees
- Cost for operational centers (anticipated rental and number of new employees)

**Response**: The tariff application provides the breakdown on page 58. Further details will be provided by the NPA as requested and the Regulator will publish these.

**Operational costs:**

**Question**: Is it reasonable for the industry to pay for labour cost and tariff increase that is above inflation rate just to improve efficiency in the port system? Are users not hit by a *"double whammy"* if they are expected to pay for the increase in NPAs labour costs as well as fund the operational centers which are to drive efficiencies, which arguably the users are not yet benefiting from?

**Response:** The NPA has been criticised for not delivering what is required in terms of the Ports Act and thus needs experienced people to perform on its full mandate. NPA thus employed more people to perform and deliver as expected. For example, the NPA has taken a decision to perform helicopter service in-house. The cost of hiring and training the pilots in-house, partly, accounts for the doubling of the labour costs in the short term.

**Question:** In terms of your operating cost base, have there been initiatives taken for the NPA to tighten your belts in this tough economic climate?

**Response:** It would be highly irresponsible for a state-owned company to not tighten their belts like all other companies in this economic climate. The operating costs requested is actually lower than what the Regulator has allowed in its guidelines. NPA is asking for less than what it needs, though a fair portion of the increases are out of the NPAs control e.g. fuel, electricity and the exchange rate. The increase also include labour costs that goes with the quad-shift system that was introduced to increase efficiencies for certain marine services. The authority has also started to insource certain services that were previously outsourced, for example the helicopter pilotage services in the ports of

Richards Bay and Durban as well as security services. During the ramp up period there will be an increase in the labour costs due to the training of these staff and then a net reduction should be foreseeable in the future. On efficiencies the NPA has not been delivering in terms of some of the provisions of the Act and to meet those requirements, more resources are needed. The Terminal Operator Performance Standards (TOPS) process has been introduced to reduce inefficiencies. The skill sets that are required for TOPS to be effective in achieving this goal come at a price.

**Question:** Labour costs are very expensive, what is the head count from previous years. It would be interesting to know whether NPA is creating jobs as mandated by government.

**Response:** Page 58 of the tariff application contains a breakdown of the employees- the head count. The main reason behind the growth is to achieve the drive to increase operational efficiencies and the marine business.

**Rental/real estate**

The application envisages NPA rentals to increase by 13.5% and R2113million (R2.1billion) to be raised from lease agreements in the overall Required Revenue.

**Question**: Can real estate figures for the previous years be given and the expected continuum for growth on this stream of revenue be provided?

**Question**: Because leases are governed by contracts and therefore not subject to projected volume increase, should they not be excluded from the clawback in the following year? There is no under or over-recovery on rentals?

**Response**: Although the real estate business was previously excluded in its entirety in the Authority's application, the Regulator required that it should be included in the application to reflect the full Revenue Required. The way the methodology works is that there will be a clawback if there is over/under recovery in one area.

**PRSA:** The real estate component is a constant variable in the equation so that recovery will not come from the rental but volumes, as an example.

**Response**: The NPA is fairly certain it will not under recover on real estate although it may be renting new property at a higher rental.

**Question**: Is there a possibility for there not to be a blanket increase in rental increases which will negatively affect the smaller companies operating in the ports?

**Question**: With the Regulator requiring more transparency on real estate figures, will the Authority provide a breakdown of the wet infrastructure?

**Response**: The tariff system has evolved – as directed by the Regulator – so that revenue from real estate is now included in the Required Revenue figure. Globally, funding models in relation to wet infrastructure differs with some authorities not charging and therefore excluding wet infrastructure from the port charges. As a landlord port owner, NPA is looking at the model for including wet infrastructure taking into account costs to shipping lines that could be passed on to cargo owners. The proposed tariff strategy indicates how the authority believes this could be addressed, noting that the Regulator has indicated at the tariff methodology and pricing strategy road shows that it still has to be convinced of the efficacy of the proposed approach for charging wet infrastructure among the three main groups of users (shipping lines, cargo owners and terminal operators).

**Comment**: Industry understands the need for rentals to be adjusted and increased. We just need assurance that the levels will be market related.

### PRICING STRATEGY

**Volumes and overall costs**

Noting the challenges with disparities between projected and realised volumes which in turn influence the level of Required Revenue, attendees required clarification on the following:-

**Question**: What constitutes the weighted 3.5% volume increase and is the NPA confident that these will be reached in the 2014/15 financial year? How was the figure arrived at e.g. figures for break bulk? Is there a strategy for attracting new business to increase the volumes and thus reduce the Required Revenue?

**Question**: What can be done to ensure that the volume projection process is transparent and produces figures closer to realisable volumes?

**Response**: The weighted average of 3.5% talks to the volumes our key accounts managers discussed and agreed with stakeholders. The information from stakeholders will allow a better indication of volumes and tariff adjustment reducing the gap between what NPA asks for and what PRSA allows and accuracy will also minimise the incidence of clawback.

In relation to strategy for new business, the NPA operates the 9 commercial ports in the country. In the past there was a view, if cargo is destined for South Africa, it will come and the NPA leaves it up to cargo owners and terminal operators to attract more business. However, this has changed and the Authority has a few strategies, one of them being the transhipment strategy focussing on the Port of Ngqura which was shared at the National Port Consultative Committee (NPCC) that are aimed at or can assist in bringing new business, . The team has also completed a container strategy whose success is based on co-operation with cargo owners and terminal operators. Another strategy is for liquid bulk, focusing on the Port of Durban.

The NPA relies on the key accounts managers in each of the ports who interact with port users to determine, as accurately as possible, the volumes that they project to be moved per year. The figures that come out of this process are verified against the MDS and are validated at group level through various stakeholder engagement processes.

Industry players are requested to interrogate the projected figures in the current application and make their submissions accordingly.

**Comment**: The port is an enabler of economic growth. It is important to maintain and sustain current volumes as much as we attract new volumes. We have to look at logistics and overall costs as we are far from global markets, and develop an integrated approach to all these costs not just pricing by NPA which is just one element.

**Question**: 8.5% increase is a tall order in the current economic climate.

**Response**: Although 8.5% increase may be a tall order, the journey that has been traversed since the establishment of the Regulator has seen below inflation adjustments with last year being a 0% adjustment coupled with a reduction in container and RoRo cargo dues, etc. The question is whether the *negative increases* are sustainable and will the NPA be able to respond with appropriate capacity when there is demand to handle increasing volumes? The required R57 billion over the 7 year period is more than a doubling of our assets and the NPA's projected tariff determinations using the same parameters as per the interim manual, indicate that tariff increases would be between 7% and 17% - we want to stay away from 17%. In order to sustain this we cannot have below inflation increases. Industry need to make sure that volume projections are accurate and NPA must invest in the correct infrastructure at the right time. It is a balancing act.

The shareholding Minister for Transport (Minister for Public Enterprises) requires the reduction of logistics costs as part of transportable GDP in the economy by the Transnet Group. An important element for NPA is improvement of efficiencies in the system.

**Question**: Ship owners work on overall costing not just the tariffs. We cannot be complacent about the 8.5% increase. Despite the fact that we may pay less on the marine side in SA compared to other ports, there is more congestion in SA ports raising the question of cost effectiveness of the charges. We must be mindful of these influential factors.

**Response**: The 8.5% is a general overall adjustment. The NPA has made an application for reduced tariffs in transhipment and the pricing strategy takes a holistic view of the port system in applying the tariff increases and it attempts to make this process transparent.

**Response (PRSA)**: In considering the proposed multi-year tariff methodology and pricing strategy, the Regulator is considering how an efficiency factor can be introduced into the tariff process to address pricing and overall cost and performance of the system.

**Question**: Without the tariff book that normally gets reviewed with the tariff application, users are not aware of the volume projections made, making it difficult to give an indication as to whether the projections are realistic, too low or too high.

**Response**: The NPA will provide figures for realised volumes for the two previous years (2011/12 & 2012/13) as well as the first six months of the current financial year.

**Response (PRSA)**: As it considered both proposals on tariff methodology and strategy – which will include the principles for and rebalancing of the NPAs tariff book - the Regulator in the 2013/14 Record of Decision indicated that the 2014/15 tariff application will be a two-phased approach with an ROD on the Required Revenue application and then guidelines on the tariff strategy for NPA to amend their tariff book.

**Question**: How will the balance on the R1 billion rebate be redistributed?

**Response**: The residual amount of R121milion is earning a return and it will be slightly higher than R121million. The Regulator is considering the exact mechanism for distributing this amount and will also be considering proposals made by the NPA.

## Transhipment

**Question:** In terms of the 8.5% increase, looking at the current global economic climate, there is no shipping line that can sustain this increase. The lowering of cargo dues is important, but we need to incentivise transhipment even more to encourage additional volumes.

**Response**: Due to transhipment volumes being here today and gone tomorrow, the strategy should be to maximise the use of excess capacity. This is what the transhipment strategy aims to achieve. Incentives for the marine side are dependent on the pricing strategy. The marine side often is in a loss making position and is thus subsidised by other revenue contributors. It is difficult then to offer more discounts from a loss making position. The recovery of investment in the assets that shipping line uses should be from cargo dues, however the Regulator's studies have shown that marine charges in SA shores are cheaper compared to other ports around the world, effectively subsidising marine. This gap must be closed.

**Question**: The justification for transhipment in Ngqura must be reviewed because the status quo now is that the port is under pressure with ships being delayed.

**Response**: There have been delays in the Port of Ngqura. The *wind surge* was not anticipated. The NPA is conducting studies to find solutions to address these challenges.

## User pay principle

**Question**: How does the NPA plan to apply the user pay principle?

**Response**: The NPA has identified three main users (shipping lines, cargo owners and terminal operators). It then allocates infrastructure and the cost thereof to each of the users. Detailed proposals are made in the proposed pricing strategy.

## PORT EFFICIENCY

**Comment:** In terms of efficiency, we should be looking at it in comparison to international standards. Capital expenditure should be linked to productivity.

**Comment:** In support of the TOPS standards, in the year 2015 or so, Panama Canal will open which will change the whole face of shipping in the Southern Hemisphere. We need our tariffs to be highly competitive to make our ports attractive.

***Comment:*** The more efficient the port, the less the end cost will be to the user. Then the likelihood of forecasted growth will materialise and the tariff increase will be justified. The NPA must define the linkage between port efficiency and tariff increase.

**General and information request**

**Comment:** There is a concern about the National Port Consultative Committee (NPCC) and its effectiveness. Meetings have been delayed three times and Industry needs to know when the next meeting will be.

**Response:** The NPCC is a forum of the Department of Transport and a process is underway to secure a date for the next meeting.

**Question:** Will the Regulator be available to take the NPCC members through the tariff application as they prepare an NPCC submission.

**Summary of Information Request**

1. Quantification of the reduction of transport costs as a percentage of transportable GDP which is part of the shareholding agreement.
2. A breakdown of operational and labour costs that are part of the Required Revenue building block for 2014/15 including but not confined to the following:
   - Year on year head count for labour
   - Salary adjustments
   - New employees
   - Cost for operational centers (anticipated rental and number of new employees)
   - Real Estate figures for the previous years
3. The following strategy documents that have a bearing on volume projections and port operations:
   - Transhipment strategy,
   - Container strategy, and
   - Liquid bulk strategy
4. Realised volume figures for the 2011/12; 2012/13 and for the April to September 2013 to assist submissions with assessing the accuracy of the weighted 3.5% volume increase.