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The Ports Regulator  
The Marine, Suite 1101  
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08 October 2017

**Att: Mr. Mahesh Fakir**  
**Cc: Mr Chris Lotter**

Dear Sir

## INTRODUCTION

1. The Transnet National Ports Authority ("the TNPA") has applied for an increase in its weighted average tariff of 4.21%<sup>1</sup> or approximately CPI-0.9%.<sup>2</sup>
2. While, as a point of departure, SAASOA welcomes the TNPA's willingness to accept that weighted average tariffs need to decline in real terms, it must be pointed out that the TNPA's proposal is less favourable than the 2.5% nominal increase and substantial real reduction (CPI-2.9%) allowed in the previous of record of decision. Furthermore, the TNPA's proposed tariff is completely overshadowed by the its blatant refusal to play by the rules of the game.
3. The Ports Regulator introduced a revised methodology for valuing the Regulatory Asset Base (RAB). The TNPA has refused to use this method and instead has presented its application using the defunct methodology. This simply cannot be done. The adoption of the new methodology for determining RAB

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<sup>1</sup> (R10 398m / R9 977m) / R9 977m x 100

<sup>2</sup> Based on an inflation forecast for 2019/20 of 5.1%

has been formally recorded as a decision of the Regulator, and is binding on all role-players, including the TNPA and the Regulator.

## THE NEW RAB METHODOLOGY

4. In terms of the National Ports Act, 12 of 2005 (“the NPA”), the Regulator is assigned as one of its main functions, to “exercise economic regulation of the ports system in line with the government’s strategic objectives”<sup>3</sup>, and is obliged to *inter alia*:

- a. Consider proposed tariffs of the TNPA;<sup>4</sup>
- b. promote regulated competition;<sup>5</sup> and
- c. regulate the provision of adequate, affordable and efficient port services.<sup>6</sup>

5. It is plain that these are public functions and that the Regulator is an organ of state.

6. In performing these public functions, the Regulator is obliged to take certain decisions.

7. Section 41(1) of the NPA provides that:

“Any decision of the Regulator must-

- (a) be taken within a procedurally fair process in which the affected persons have the opportunity to submit their views;
- (b) be in writing;
- (c) include reasons for the decision.”

8. Section 72(1) of the NPA provides that:

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<sup>3</sup> Section 30(1)(a)

<sup>4</sup> Section 30(2)(d)

<sup>5</sup> Section 30(2)(e)

<sup>6</sup> Section 30(2)(f)

- (a) The Authority must, with the approval of the Ports Regulator, determine tariffs for services and facilities offered by the Authority and annually publish a tariff book containing those tariffs.
  - (b) The Authority may, with the approval of the Ports Regulator, amend the tariff book when necessary to do so.”
9. In the premises, any decision taken by the Regulator which pertains to the approval of amendments to the TNPA’s tariff book:
- a. Is a decision taken by an organ of state;
  - b. When exercising a public power or performing a public function in terms of an empowering provision;
  - c. Which adversely effects the rights of persons (either one or more port users, or the TNPA); and
  - d. Has a direct, external legal effect.
10. Such decisions therefore fall under the definition of “administrative action” set out in section 1 of the Promotion of Administrative Justice Act, 2000 (“PAJA”).
11. Administrative action taken by an organ of state is binding unless set aside on review. It is not open to a person to ignore the fact of that administrative action. This is true not only for a private person or body but also for an organ of state that is affected by its own administrative action or the administrative action of another organ of state.<sup>7</sup>

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<sup>7</sup> See MEC FOR HEALTH, EASTERN CAPE AND ANOTHER v KIRLAND INVESTMENTS (PTY) LTD t/a EYE & LAZER INSTITUTE 2014 (3) SA 481 (CC), paragraphs 87-97

12. As the Constitutional Court has pointed out in **MEC FOR HEALTH, EASTERN CAPE AND ANOTHER v KIRLAND INVESTMENTS (PTY) LTD t/a EYE & LAZER INSTITUTE 2014 (3) SA 481 (CC)**, at paragraph 89, if an organ of state was at liberty to disregard administrative acts it considered invalid:

“This a licence to self-help. It invites officials to take the law into their own hands by ignoring administrative conduct they consider incorrect. That would spawn confusion and conflict, to the detriment of the administration and the public.”

13. The only way to avoid the consequences of administrative action is to successfully apply for the review and setting aside of that decision. That must be done without unreasonable delay, and no later than 180 days after having received notice or acquired knowledge of the decision.<sup>8</sup>

14. In performing its mandate in terms of section 72, the Regulator has issued a Port Tariff Methodology. This stipulates the methodology to be applied by the TNPA in applying for an alteration to its tariff.

15. Prior to issuing the methodology for the tariff years 2018/19 to 2020/21 in March 2017 (“the March 2017 Tariff Methodology”), the Regulator requested and took into consideration submissions from interested parties. It then published the methodology in written form.

16. The methodology records the values to be pre-assigned to certain variables and the formulae or algorithms to be applied both in the application by the TNPA but also by the Regulator in evaluating the application.

17. To a very large degree, the methodology determines the outcome of the tariff application.

18. There is limited scope for the exercise of a discretion by the Regulator: it can interrogate values that have not been pre-assigned to variables and it can also adjust the final tariff by means of the ETIMC.

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<sup>8</sup> Section 7(1) of PAJA

19. Thus, SAASOA pointed out when commenting on the 2018/19 tariff application:

“Given that the Regulator’s methodology is now fairly well defined, there is only a limited scope to suggest changes to the calculations submitted by the TNPA. However, there are a number of respects where we believe that the TNPA’s estimates are either inflated, incorrect or inconsistent with the spirit of the approved methodology.”
20. The decision by the Regulator to adopt a particular methodology for use in determining tariff applications over an extended period following the date of adoption, is in itself a decision which has direct, external legal effect, and which has satisfied the requirements of section 41 of the NPA and is thus binding administrative action. It precludes the setting of tariffs using a different methodology, such as price-capping, as SAASOA have suggested, or using different inputs.
21. In the March 2017 Tariff Methodology, the Regulator made it clear that it intended introducing a Regulatory Valuation Methodology to complement the Tariff Methodology to “provide rules for future valuations of the RAB as well as the rebasing of the NPA’s RAB”.
22. Thus, the decision to introduce the March 2017 Tariff Methodology expressly provided for the methodology to be amended by a future decision on a Regulatory Valuation Methodology.
23. On 23 February 2018, the Regulator published a draft methodology and discussion paper in respect of the valuation of the RAB and gave interested parties until 22 March 2018 to make representations in connection therewith. The TNPA submitted representations.
24. On 28 March 2018, the Regulator adopted a new methodology for valuation of the RAB, in the form of a written document setting the new methodology and the reasons therefor, signed by its Chairperson. The document expressly stated that it was to be regarded as replacing any portions of the March 2017 Tariff

Methodology that were in conflict with its provisions and further that it was to apply to the calculation of the Required Revenue in the 2019/20 tariff application.

25. This document embodies a decision as contemplated in section 41 of the NPA, and which also constitutes administrative action that is binding on all role players.
26. It is thus not open to the TNPA to simply ignore this feature of the now amended Tariff Methodology. It can apply to review and set aside the inclusion of the RAB Valuation Methodology in the Tariff Methodology. However, to SAASOA's knowledge, no such application has been brought. As an organisation prominently representing numerous stakeholders in the business of the ports operated by the TNPA and an active participant in the tariff setting process, SAASOA would expect to have been joined in any such proceedings.
27. Furthermore, the Regulator, having used the option contained in the March 2017 Tariff Methodology that permitted it to adopt a different RAB Valuation Methodology, is now itself bound by that decision to use the new methodology. An organ of state cannot ignore its own administrative decisions;<sup>9</sup> this is an application of the *functus officio* doctrine.<sup>10</sup> It is not open to the Regulator to condone the TNPA's refusal to submit an application that conforms the present Tariff Methodology. Instead, the question of the RAB Valuation is one which can only be revisited in the methodology for the 2021/22 and subsequent tariff years.

## THE TNPA'S COMPLAINT

28. The TNPA has refused to apply the current RAB valuation methodology, because this would allegedly have the effect of reducing its opening RAB from R83.5bn to R38.1bn and reduce the alleged revenue attributable to RAB by R3.8bn, from R8.2bn to R4.4bn.

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<sup>9</sup> KIRLAND supra

<sup>10</sup> For a detailed discussion of the *functus officio* doctrine, see CARLSON INVESTMENTS SHARE BLOCK (PTY) LTD v COMMISSIONER, SOUTH AFRICAN REVENUE SERVICE 2001 (3) SA 210 (W), especially at 222G to 225J.

29. The TNPA claims that this significant revenue reduction, together with its commitments, would place its financial sustainability at risk. It also claims that the reduction in its RAB would impact its key financial ratios and credit metrics and that it would require recapitalisation every two to three years.
30. The TNPA does not, however, provide any detailed information in this regard.
31. The simple fact is that the TNPA has previously used the DORC method, notwithstanding reservations by the Regulator,<sup>11</sup> to considerably inflate the value of an elderly asset base it has since spent comparatively little on replenishing.
32. As we pointed on our comment on the 2018/19 tariff application, the TNPA spends considerably less in CAPEX on maintaining its existing capital base than the depreciation charge allowed. We requested that the Regulator take action in this regard and to some degree, the adoption of the revised method for valuing the RAB addresses SAASOA's concerns.
33. According to its 2017/18 annual financial statements, the TNPA spent just R1bn on CAPEX, both for expansion and maintenance purposes. It has spent only a little more than this in previous financial years.<sup>12</sup>
34. Furthermore, we have difficulty understanding how the new RAB valuation method can place the TNPA's financial sustainability at risk.
35. Under the new method, the TNPA will earn the cost of capital on all its future capital expenditure.
36. Furthermore, the TNPA considerably overstates the extent of its debt burden.

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<sup>11</sup> See Record of Decision 2010/2011, paragraph 5.6.2 (page 5)

<sup>12</sup> R2bn in 2016/17 and R2.9bn in 2015/16.

37. If regard is had to its annual financials, it is apparent that the TNPA only regards itself as carrying debt of about R21.7 bn. It reports a gearing of 24% on reported assets of R90.4 bn for the 2017/18 financial year. The Regulator has approved a gearing of 50% (50% debt: 50% equity). If the RAB is approximately R38.1bn, then debt of R21.7bn implies a gearing of approximately 57%,<sup>13</sup> fairly close to what has been assumed to be suitable for a port's operator such as the TNPA in terms of the Tariff Methodology.
38. Moreover, it was and remains open for the TNPA to request that the ETIMC reserve be credited to facilitate its adjustment to the new regime.

## THE REGULATOR'S DECISION

39. The RAB is fundamental to determining the Revenue Requirement.
40. In refusing to submit an application that calculates the RAB in accordance with the approved methodology, the TNPA has failed to comply with the requirements of directive 22(3), issued by the Regulator in conjunction with the Minister of Transport under GN 826 of 6 August 2009.
41. In our view, the Regulator has three choices.

### Choice 1: Allow the application to be supplemented

42. First, the Regulator could afford the TNPA an opportunity to supplement the application, in terms of directive 22(4), so that the application presents the information necessary to make a determination that is compatible with the approved methodology.

### Choice 2: Treat the application as a nullity

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<sup>13</sup> We say approximate, because we are combining an opening estimate of RAB for 2019/20 with a 2017/18 debt level.

43. Second, the Regulator can regard the application as being fatally defective and a nullity by virtue of its non-compliance with the approved Tariff Methodology. In essence, it could conclude that no valid application for revision of tariffs has been made in terms of section 72 of the NPA, and therefore that tariffs should remain unchanged in nominal terms. In real terms, this would entail a tariff adjustment of CPI-5.1%.

Choice 3: Determine the application with reference to the approved methodology

44. Third, the Regulator can elect to determine the application on the basis of the information furnished, in accordance with the approved methodology.

45. We are doubtful that the Regulator is empowered, in terms of section 72, to reduce tariffs in nominal terms unless the TNPA has proposed such a reduction.

46. To the extent that correcting the past overvaluation of the RAB would, in the absence of any adjustment to the ETIMC reserve, result in a reduction in the nominal tariff, we would suggest that the shortfall be made up by passing a credit to the ETIMC reserve that could be reversed over time in order to maintain an extended period of real decreases in the weighted average tariff.

47. Based on the TNPA's alleged opening balance for the RAB of R38.1bn, we have determined that the ETIMC credit would need approximately to be in the region of R4.3bn to maintain the nominal tariff.<sup>14</sup>

48. We present our calculations below:<sup>15</sup>

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<sup>14</sup> In the absence of detailed information from the TNPA that is in line with the approved methodology, we have used the 2018/19 RAB formula in conjunction with the revised estimate of opening BV furnished by the TNPA.

<sup>15</sup> The tax calculation, which entails estimating the cost of debt, is as follows:

ROC	2 628
KD	1 044
ROE	1 585

Opening BV	38 100
Indexing (5.1%)	1 943
Less Depreciation	(1 060)
Capex	4 513
Indexed Capex	115
Closing BV	43 611
Averaged Asset Base	40 855
Less Working Capital	(2 205)
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RAB	38 650
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ROC	2 628
DEPR	1 060
OPEX	6 291
TAX	287
RR before clawback, ETIMC	10 267
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Clawback	(1 353)
Revenue allowed	8 914
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Less Real Estate	(3 284)

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Grossed up ROE	1 864
Tax	287

MARINE REVENUE	5 630
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Vol adj. 2018/19 RR	9 977
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Required ETIMC credit	4 347
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49. We point out, as we have pointed out in previous submissions, that the TNPA's estimate for operating costs again appears to be considerably higher than what is likely to transpire. In its 2017/18 annual financials, it reported operating expenses of R4 503m, an increase of just under R500m on the figure reported for the 2016/17 financial year.
50. We do not believe that the TNPA should be allowed to significantly increase its operating expenditure. It needs to cut unnecessary expenditure and use its existing resources more intensively and efficiently. Real operating expenditure increases should never – in absolute terms - be allowed to exceed the projected annual increase in volume. We would therefore suggest that allowed operating expenditure for the 2019/20 tariff year should not be higher than R5 269m.<sup>16</sup> This would imply that a further R1bn would need to be credited to the ETIMC if the nominal tariff rates are maintained.
51. As to whether the Regulator should allow an increase in the nominal tariff, this falls within its discretion, but this would simply entail additional amounts being credited to the ETIMC reserve.
52. **We submit that it would be inappropriate to allow an increase in the nominal tariff.**
53. The Regulator, in adjusting the RAB methodology, has tacitly acknowledged that ports users have been overcharged at least since the TNPA's RAB estimates were accepted in the 2010/11 record of decision.

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<sup>16</sup> Per the 2018/19 ROD, inflation is 5.4%, volume growth 3.05%, therefore allowed increase would be 8.45% and per the 2019/20 application, inflation is 5.1% and volume growth 2.8%, therefore allowed increase would be 7.9%.  $R4\ 503m \times 1.0845 \times 1.079 = R5\ 269m$

54. The TNPA has for close on a decade been able to reap supernormal profits from the use of elderly capital stock that has been overvalued for the purposes of determining what constitutes its required normal profit. It has made minimal investments in new capital over the past few years, effectively paying the equivalent of massive dividends to the Transnet Group.
55. The Regulator is not – in our view – empowered to unilaterally impose lower nominal tariffs. However, the Regulator can ensure real decreases in the tariff by refusing to approve the nominal tariff increases requested by the TNPA.
56. The Regulator needs to ensure that there is an ongoing decline in real tariff levels over time, with a view to minimising and eventually extinguishing<sup>17</sup> the supernormal profits that the TNPA will otherwise continue to earn because the current nominal tariff level is too high.
57. Any supernormal profits earned by the TNPA belong not to the Transnet Group, but to ports users and must be credited to the ETIMC reserve with a view to being reversed at some point in the future.
58. If the Regulator exercises its discretion to allow the TNPA a nominal increase, then it is knowingly and actively authorising the earning of an additional supernormal profit by the TNPA. With respect, it is submitted that this is something it should not do.
59. Accordingly, it is submitted that if the Regulator is minded to determine the application, it should not allow a nominal tariff increase.

## CONCLUSION

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<sup>17</sup> Gross asset values will increase in nominal terms due to inflation, in turn increasing the allowed nominal return on capital, cet. par. New capital investments will increase the RAB and thus the allowed nominal return on capital. Operating expenses will also increase with inflation and increase the nominal allowed RR. The allowed RR will eventually increase to a point where it exceeds the revenue actually earned if tariffs are fixed in nominal terms (or increased rates considerably below CPI). This process will take some time, however.

60. For the reasons set out above, it is submitted that the Regulator should decline to allow an increase in the weighted average nominal tariff for the 2019/20 financial year.
61. Furthermore, given that the current nominal tariff allows the TNPA to earn supernormal profits, based on the revised methodology for calculating RAB, it is submitted that it will be necessary for weighted average tariff increases to be fixed in nominal terms for the foreseeable future, or decline considerably in real terms (i.e. CPI-x, with x is not much smaller than CPI).

Compiled by Advocate Andrew Christison, Economist of the High Court of South Africa.

Kind regards



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