TRANSNET NATIONAL PORTS AUTHORITY

TARIFF APPLICATION FOR THE MARINE LOADING FACILITY FOR FINANCIAL YEAR 2020/21 TO FY 2022/23

SINGLE POINT MOORING

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1. Executive Summary

Transnet National Ports Authority ("TNPA"), a division of Transnet SOC Ltd ("Transnet"), hereby submits a tariff application for its Single Point Mooring ("SPM")[1] petroleum loading facility, located offshore at the Port of Mossel Bay (hereinafter referred to as the "Loading Facility" or "SPM"). The aforementioned facility is licenced by the National Energy Regulator of South Africa ("NERSA") in terms of licence number PPL.lf.F3/213/2015).

The application for the approval of the Petroleum Loading Facility tariffs is submitted in terms of Sections 4(f) and 28(1) of the Petroleum Pipelines Act, 2003 (Act No.60 of 2003), ("the PPA") from FY 2020/21 to FY2022/23. This tariff application has been guided by NERSA's "*Tariff Methodology for the approval of tariffs for Petroleum Loading Facilities and Petroleum Storage Facilities, fourth edition*" ("the tariff methodology").

The Allowable Revenue ("AR") and Tariffs applied for by TNPA are shown in table 1 below:

Table 1: Allowable Revenue and Tariffs for FY 2020/21 to FY 2022/23

AR Summary	2020/21	2021/22	2022/23
	R'm		
WACC Return on RAB	-	-	-
Expenses	**37.54**	**39.42**	**41.39**
Maintenance	0.74	0.78	0.82
Production	36.80	38.64	40.57
- Harbour Costs/ Rental	14.89	15.63	16.41
- Marine Operator Costs	21.92	23.01	24.16
Depreciation	-	-	-
Clawback	-	-	-
Tax	-	-	-
Allowable Revenue	**37.54**	**39.42**	**41.39**
Volumes (m/l)	1 408	1 530	1 653
Tariff (c/l)	**2.67**	**2.58**	**2.50**

The AR translates into a tariff of 2.67 cents per litre ("c/l") for FY 2020/21 based on projected volumes of 1 408 million litres. Accordingly the tariffs for FY 2021/22 and FY 2022/23 are 2.58 c/l and 2.50 c/l based on projected volumes of 1 530 and 1 653 million litres[2], respectively.

[1] *Facility is owned by TNPA and operated by the Petroleum, Oil and Gas Corporation of South Africa SOC Ltd ("PetroSA").*

[2] *Volumes based on best forecast by Port of Mossel Bay for PetroSA own use (no third party agreements in place to date)*

2. Background

Section 16 (1) of the PPA requires that "any person who has to apply for a licence in terms of Section 15 must be the owner of the pipeline or facility in question and must do so in the form and in accordance with the procedure prescribed by rule, and an application must be accompanied by the application fee prescribed by rule."

In accordance with the PPA, on 31 July 2015, TNPA duly submitted its operation licence application to NERSA for approval. On 08 February 2016, NERSA issued TNPA with a combined petroleum loading facility operating licence and Conditions of Licence for the SPM and Conventional Buoy Mooring ("CBM"), located offshore at the Port of Mossel Bay.

The Conditions of Licence requires TNPA to submit a tariff application to NERSA for approval of its proposed tariffs. To ensure compliance with the conditions of licence, TNPA hereby submits a multi- year tariff application from FY 2020/21 to FY 2022/23[3], for approval by NERSA.

It must be recognised that whilst TNPA is the owner of this facility, it is operated by the Petroleum, Oil and Gas Corporation of South Africa SOC Ltd ("PetroSA"). PetroSA holds a long term lease for the use and operation of the asset, which is owned by TNPA.

3. Approach

The Tariff Methodology prescribes the following formula[4] to calculate the AR for a loading facility:

$$\mathbf{AR = (RAB \times WACC) + E + D \pm C + T}$$

Where:

AR	=	*Allowable Revenue*
RAB	=	*Regulatory Asset Base*
WACC	=	*Weighted average cost of capital*
E	=	*Expenses: operating and maintenance expenses for the tariff period under review*
D	=	*Depreciation and amortisation of inflation write-up*
C	=	*Clawback adjustment: to correct for differences between actuals and forecasts in formula elements from a preceding tariff period*
T	=	*Tax: estimated tax expense for the tariff period under review*

Application of the aforementioned NERSA AR approach as prescribed by the methodology, would assume that TNPA is responsible for the entire infrastructure value chain of owning and operating the loading facility. However, in this particular instance, TNPA is the owner of the facility, with PetroSA responsible for operating the facility.

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[3] *This marks the second tariff application submitted to NERSA for approval (First application not approved on 9 October 2019)*

[4] *Section 3.2 of the methodology*

The core functions of TNPA, amongst others is to promote the use, improvement and development of ports, and control land use within the ports, having the authority to lease port land under conditions it determines; and plan, develop and maintain port infrastructure. TNPA, therefore does not typically own or operate marine loading facilities, such as the SPM.

TNPA entered into a legal and binding lease agreement with PetroSA whereby the latter utilises the SPM for the discharging of condensate. The rental premium as stipulated in the lease agreement was informed by a "*willing buyer / willing seller*" [5] rental-premium setting approach. The rental premium agreed upon is intended to afford TNPA a recovery of its investment and any other operating costs associated with the ownership of the facility. The National Ports Act, 2005 (Act No. 12 of 2005), which regulates TNPA's functioning, further provides recognition of such lease arrangements entered into by TNPA.

The PPA requires that a tariff be approved for the licenced activity (PetroSA operations for own-use) in question, and further requires that the tariff be approved for third party access. It is therefore critical that the costs of the operator be considered in determining the tariff that would be charged to third parties, should this arise in the future.

Given this anomalous position in the context of TNPA's normal functioning and the PPA i.e. ownership and operating under different entities, a deviation from the traditional AR formula is required. Any attempt to recover TNPA's investment again under the NERSA AR methodology approach would imply double recovery (as rent paid to TNPA by PetroSA is included as part of the operators costs) and result in tariffs that are neither cost reflective nor fair.

Therefore, for the purposes of the application, TNPA has adopted an approach of excluding any return on investment, depreciation and other costs associated with its ownership of the SPM, whilst including all relevant operator costs including rental premium payable (per lease agreement). In addition, when considering the volumes of the facility, PetroSA's volumes for "own-use" are considered as part of the licenced activity, and not third party volumes.

TNPA is of the view that this approach allows for the determination of fair, non-discriminatory, simple and transparent tariffs that promotes access to affordable petroleum products whilst giving recognition to the contractual arrangements it has with PetroSA.

[5] *Differs from a Rate of Return approach*

4. Return on Asset

4.1. Regulatory Asset Base ("RAB")

The RAB represents the value of assets the entity is allowed to earn a return. The formula for the determination of the RAB as per the approved tariff methodology is on the next page

RAB = V – d + w ± dtax

Where:

V	=	*Value of property, plant, vehicles and equipment*
d	=	*Accumulated depreciation and accumulated amortisation of inflation write-up for the period up to the commencement of the tariff period under review*
w	=	*Net working capital*
dtax	=	*Deferred tax*

As the SPM loading facility is leased to PetroSA, TNPA is of the view that it may not be fair to earn a return on this asset. The return on investment of the asset would be embedded or priced into the rental premium. Therefore, the RAB in terms of this application is **zero** for FY 2020/21 to FY 2022/23.

4.2. Weighted Average Cost of Capital ("WACC")

Regulation 4(5) states:

"The allowable rate of return for licensees must be determined by using the expected efficient weighted average cost of capital (WACC). The WACC must be calculated using the weighted average of the licensee's-

a. Average cost of debt that can realistically be obtained during the period under review; and
b. Cost of equity capital calculated by means of the capital asset pricing model or any other appropriate model"

Section 5.1 of the methodology prescribes the formula to determine the WACC as follows:

$$WACC = \left[\left(\frac{Eq}{Dt+Eq}\right) * Ke\right] + \left[\left(\frac{Dt}{Dt+Eq}\right) * Kd\right]$$

Where:

Eq	=	Shareholders equity
Dt	=	Interest bearing debt
Ke	=	Post-tax, real cost of equity[1] derived from the capital asset pricing model (CAPM)
Kd	=	Post-tax, real[2] cost of debt

The WACC defines the return on assets a firm must earn in order to satisfy its creditors and shareholder. The regulatory cost of capital should reflect what an investor would require in return on investments with the same systematic risk as the regulated business. The objectives of an appropriate WACC is to earn a fair return on existing assets. The WACC return is then multiplied with the RAB to determine a return on asset.

As the SPM loading facility is leased to PetroSA, TNPA is of the view that it may not be fair to earn a return on this asset. The return on investment of asset would be embedded or priced into the rental premium.

5. Expenses

The rental premium together with the marine loading fees reflect the expenses of the operator PetroSA. Such operating expenses ensures that PetroSA sustains productivity in an efficient and safe manner.

The unique characteristics of the SPM loading facility must be taken into consideration when assessing the operating expenditure of the facility. As mentioned earlier, TNPA entered into a binding licence agreement, with PetroSA, in order for PetroSA to operate the facility. The aforementioned licence agreement informs the rental premiums applicable to the facility.

As described above, the tariff application is based solely on the recovery of the PetroSA operating expenses. The approach taken is premised on TNPA's interpretation of Section 28(3) of the PPA as well as Regulation 4(2) approved in terms of Section 33(1) of the PPA, that all operational and maintenance expenses related to the petroleum loading facility must be recovered. The approach further allows for fair and efficient tariffs to be determined for use by third parties.

The table below illustrates the operating expenses for the facility. The harbour costs relate to monthly rentals that PetroSA pays to TNPA, whilst the marine operator costs are monthly marine loading fees payable to marine loading facility operators. The table further highlights the projected operating costs to be R37.54m for FY 2020/21. The projected costs for FY 2021/22 and FY 2022/23 are R39.42m and R41.39m, respectively.

Table 2: Operating Expenses

Operating Expenses	2020/21	2021/22	2022/23
	R'm		
Maintenance	0.74	0.78	0.82
Production	**36.80**	**38.64**	**40.57**
Harbour Costs/ Rental	14.89	15.63	16.41
Marine Operator Costs	21.92	23.01	24.16
Total Operating Expenses	**37.54**	**39.42**	**41.39**

6. Land rehabilitation

TNPA is in the process of assessing and determining the rehabilitation of land requirements and associated costs. It is anticipated that external environmental and technical specialists will be required to assist in the assessment. TNPA will submit a detailed plan (requirements, costs and appropriate financial instrument) to NERSA, once this exercise has been completed, and the requirement established.

As an interim measure, TNPA plans to set aside a provision[6] (as at year end FY 2019/20) to ensure a temporary form of financial security.

7. Depreciation

Depreciation is the allowance provided for in the AR so that a firm can recover its investment in assets over the economic life of the asset (i.e. ***return of capital***). The regulatory depreciation allowance is the total of the depreciation of the historical cost as well as the amortisation of the trended portion of the assets. Again, the return of capital (capital redemption) is already factored into the rental agreement. Therefore, TNPA applies for a depreciation allowance of **zero** for FY 2020/21 to FY 2022/23.

8. Income Taxation

Section 7.1 of the methodology prescribes that: "*Each licensee must make a once off election between the use of either (a) flow-through (actual tax) payment, or (b) notional tax payment".* Both approaches use RAB * WACC approach. The return on asset based on this application is zero. Therefore, TNPA is applying for a **zero** Tax allowance for FY 2020/21 to FY 2022/23.

9. Clawback

Clawback is applied once the audited financial statements/audited Regulatory Financial Reports ("RFRs") of the relevant tariff period are available. Therefore, no clawback calculation is taken into account in this tariff application.

10. Allowable Revenue Calculation

The table below summarises the AR from FY 2020/21 to FY 2022/23 for the SPM loading facility tariff application for petroleum products.

Table 3: Allowable Revenue for FY 2020/21 to FY 2022/23

AR Summary	2020/21	2021/22	2022/23
	R'm		
WACC Return on RAB	-	-	-
Expenses	**37.54**	**39.42**	**41.39**
Maintenance	0.74	0.78	0.82
Production	36.80	38.64	40.57
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Depreciation	-	-	-
Clawback	-	-	-
Tax	-	-	-
Allowable Revenue	**37.54**	**39.42**	**41.39**
Volumes (m/l)	1 408	1 530	1 653
Tariff (c/l)	**2.67**	**2.58**	**2.50**

6 *Provision made in terms of the International Financial Reporting Standards*

11. Volumes

The allocation of the regulated volumes for the SPM relates to petroleum products only. The volume forecasts are based on the best estimate for PetroSA only, as there are no third party agreements in place regarding third party access, at this time. The petroleum loading facility volumes budgeted by TNPA for the period FY 2020/21 to FY 2022/23 are shown in the table below:

Table 4: SPM Volumes

Volumes	2020/21	2021/22	2022/23
SPM - Volumes (m/l)	1 408	1 530	1 653

12. Tariff

The table below is a summary of the proposed tariffs for the period FY 2020/21 to FY 2022/23:

Table 5: SPM Tariffs

Tariffs	2020/21	2021/22	2022/23
SPM - Tariffs (c/l)	2.67	2.58	2.50

13. Conclusion

In arriving at the AR requirement, TNPA has considered the legal and binding lease agreement entered into by TNPA and PetroSA. PetroSA's operating costs which includes the rental premium as per the lease agreement, together with marine operator costs, must be recovered to ensure a fair, efficient, non-discriminatory; simple and transparent tariff.

Application of the aforementioned approach results in an AR for the SPM petroleum loading facility of R37.54m and a tariff of 2.67c/l for FY 2020/21. Accordingly, the AR for FY 2021/22 and FY 2022/23 are R39.42m and R41.39m, resulting in a tariff of 2.58c/l and 2.50c/l, respectively.

End.