SCOPE OF SERVICES

TNPA/2025/09/0035/106088/RFQ

FOR THE PROVISION OF INDEPENDENT REVIEW OF TRANSNET NATIONAL PORTS AUTHORITY TARIFF METHODOLOGY FOR A PERIOD OF EIGHT (8) MONTHS

1. EXECUTIVE SUMMARY:

1.1. Section 30 of the National Ports Act, 2005 (Act No. 12 of 2005) (the Ports Act) requires the Ports Regulator of South Africa (PRSA) to exercise economic regulation of the ports system in line with governments strategic objectives.

1.2. In terms of Section 72 (1)(a) of the Ports Act, the Transnet National Ports Authority (TNPA) is required with the approval of the PRSA, to determine tariffs for services and facilities offered by TNPA and to annually publish a Tariff Book containing those tariffs.

1.3. In considering TNPA's proposed tariffs, and any subsequent proposed significant variations, PRSA must give due consideration to whether the final tariffs approved enables TNPA to:

a) Recover its investment in owning, managing, controlling and administering ports and its investment in port services and facilities;

b) Recover its costs in maintaining, operating, managing, controlling and administering ports and its costs in providing port services and facilities; and

c) Earn a return commensurate with the risk of owning, managing, controlling and administering ports and of providing port services and facilities.

1.4 In determining the tariffs, the **Tariff Methodology** approved by the PRSA is applied. The following is a high-level summary of the evolution of the Tariff Methodology since the inception of economic regulation in FY 2010/11 to date:

- **FY 2010/11 - FY 2013/14**:
  - No approved Tariff Methodology in place;
  - TNPA applied a Rate of Return/ Required Revenues (RR) Tariff Methodology, as agreed with PRSA;
  - Corporate Tax rate utilised;
  - Starting Regulatory Asset Base (SRAB) value based on TNPA's financial valuation method of Depreciated Optimised Replacement Cost used as a proxy for the historical/ acquisition/ original cost (initial recognition) and subsequently trended i.e. Trended Original Cost (TOC); and Depreciation considered on an average economic useful life of 40 years for all assets.

- **FY 2014/15**:
  - PRSA issued a Regulatory Manual applicable for the financial year and premised on a RR Tariff Methodology;
  - SRAB rolled forward with TOC and average useful life of assets (40 years) to form the Regulatory Asset Base (RAB); and
  - Corporate Tax Rate utilised.

- **FY 2014/15**:
    - PRSA issued a Regulatory Manual applicable for the financial year and premised on a RR Tariff Methodology;
    - SRAB rolled forward with TOC and average useful life of assets (40 years) to form the Regulatory Asset Base (RAB); and
    - Corporate Tax Rate utilised.

- **FY 2015/16 - FY 2017/18**:
    - PRSA issued first RR multi-year Tariff Methodology; and
    - RAB & Taxation rules per first iteration (Regulatory Manual) were still applicable.

- **FY 2018/19 - FY 2020/21**:
    - PRSA issued second iteration of multi-year RR Tariff Methodology;
    - Introduced Equitable tax approach to act as a proxy for the TNPA portion of the Transnet SOC Ltd (Transnet) tax bill, and removed the Corporate Tax approach; and
    - Introduced elements of Incentive Based Regulation to measure efficiencies in the form of the Weighted Efficiency Gains from Operations (WEGO).

- **FY 2019/20:**
    - PRSA issued independent asset Valuation Methodology (Hybrid Approach/VoRAB) to address PRSA unsettled position on TNPA's SRAB being used. This methodology considered pre-1990 assets at Historical Cost and post-1990 at TOC; and
    - VoRAB not implemented over the period due to TNPA demonstrating negative impact on financial sustainability. PRSA, however, restated the SRAB, shifting from the trending of the DORC values to the trending of historical or original cost of the asset with depreciation based on the useful life of each asset.

- **FY 2021/22 – FY 2023/24:**
    - PRSA issued third iteration of RR Tariff Methodology with rules for TNPA as an Operating Division (OD) of Transnet and a subsidiary of Transnet/ stand-alone entity;
    - VoRAB rules embedded into Tariff Methodology with provisions allowing for a deviation from the rule set and consideration of TOC should TNPA be corporatised into a subsidiary of Transnet or stand-alone entity1; and
    - Taxation for TNPA as an OD of Transnet based on the Equitable Tax approach with corporate tax applicable for TNPA as a subsidiary/ stand-alone entity.

- **FY 2024/25 - FY 2026/27:**
  - PRSA issued fourth iteration of RR Tariff Methodology;
  - Regulatory Asset Base valued at Trended Original Cost;
  - VoRAB rules embedded into Tariff Methodology with provisions allowing for a deviation from the rule set and consideration of TOC should TNPA be corporatised into a subsidiary of Transnet or stand-alone entity; and
  - Taxation for TNPA as an OD of Transnet based on the Equitable Tax approach with Corporate Tax applicable as a subsidiary/ stand-alone entity. Should corporatisation not be effected, clawback for tax based on equitable tax approach.

1.5 The formula for the RR **Tariff Methodology** is detailed below:

<u>Required Revenue:</u>

[Regulatory Asset Base (RAB) x Weighted Average Cost of Capital (WACC)] + Operating Costs + Depreciation + Taxation Expense ± Claw-back ± Excessive Tariff Increase Margin Credit (ETIMC) ± Weighted efficiency Gains from Operations = RR

1.6 In addition to the determination of revenues, the **Tariff Strategy** sets out the strategic pricing direction of the South African port system and aims to ensure fair, transparent, efficient and effective port pricing and is premised on the user-pay principle. The principles of the Tariff Strategy guide the differentiated tariff adjustments considered founded on the principles/ revenues of the **Tariff Methodology**.

1.7 The Port Directives require that TNPA submit a Tariff Application to the PRSA on an annual basis on or before 01 August or at such longer intervals as TNPA and PRSA may agree. Similarly, the Port Directives require the PRSA to decide on the Tariff Application within four (4) months of receipt. As such, the PRSA issues a Tariff Record of Decision on an annual basis targeted by 1 December.

1.8 In the past, the Ports Act, Port Directives, Tariff Methodology and Tariff Strategy, amongst others, made up the regulatory framework used to determine revenues and tariffs. In June 2024 the Economic Regulation of Transport Act, 2024 (ERT Act) was gazetted and will form part of the regulatory frameworks thereby having an influence on tariff setting process.

1.9 The regulatory framework is used to prepare the Tariff Applications and issuance of Records of Decisions (ROD). The requested RR and Tariffs adjustment by TNPA and subsequent approval by PRSA are generally different, year on year, and is illustrated in the ROD FY 2024/25 issued by the PRSA on 31 January 2024.

1.10 The following matters emanating from the ROD are worth noting:

- Average tariff adjustments below inflation and results in eroding of the tariff base;
- Lack of consistency, predictability and certainty in tariff differentiation with lack of alignment with Tariff Strategy;
- Indications of implementation of VoRAB in FY 2025/26 should TNPA remain an OD of Transnet (non-subsidiarisation);
- PRSA to undertake a benchmark study (regulated entities) on the appropriate Cost of Debt level for TNPA.

1.11 Another factor that could impact the Tariff Methodology, to give effect to Section 3 and/or Section 4 of the Ports Act, is the incorporation of TNPA into a subsidiary of Transnet or as a stand-alone entity, respectively.

1.12 Extensive work has been undertaken to achieve the incorporation of the Authority as a subsidiary of Transnet and which culminated in both the Ministers of Transport and Finance granting the approvals required in terms of section 51 and section 54 of the Public Finance Management Act 1 of 1999 towards the end of January 2025. These approvals were conditional in the sense that Transnet was required to ensure that the incorporation of the Authority takes place in a manner that ensures that Transnet remains financially sustainable and a going concern during the transition, and that the Authority's financial position is not unduly strained.

2. SCOPE OF WORKS AND DESCRIPTION OF SERVICE

2.1. The Scope of Work includes the following:

- Comprehensive assessment of the Required Revenue/ Rate of Return tariff methodology and components thereof, taking into account the following (but not limited to):
  - Impending incorporation of TNPA into a subsidiary of Transnet or as a stand-alone entity;
  - TNPA undergoing a build phase necessitating cash requirements earlier rather than later;
  - Due consideration of the requirements of the Ports Act and ERT Act;
  - Potential conflict between the Ports Act, ERT Act, and the regulatory framework, or alternatively identification of changes/amendments required to the regulatory framework due to the ERT Act;
  - Due consideration of other regulatory frameworks adopted by other regulatory authorities in South Africa;
  - Appropriate asset valuation methodology:
    - Irrespective of the corporate structure of TNPA;

- Consideration of TNPA's debt carrying capacity – inclusive of "take-on" debt for TNPA due to Corporatisation and post-Corporatisation debt required to support the capital investment programme; and
- Reasons/ justifications for the use of the recommended asset valuation method vs. Valuation of Assets Methodology.

- Considerations for properties outside port limits:
  - Given the provisions of port regulations and other legislation, is TNPA entitled to recover costs through tariffs whilst the property remains outside port limits?; and
  - Appropriate rule set for consideration of, among others, the treatment of land purchased outside port limits together with costs and revenues associated with such properties – should TNPA be entitled to recover such expenditure whilst the property remains outside port limits?
- PRSA distinction and treatment of Capital Expenditure (Capex) and Capital Works in Progress (CWIP)
  – Capex: Capital spend in the first year is treated as Capex and included in the determination of the RAB, with a return earned for a year.
  – CWIP: As soon as the asset is re-classified from Capex to CWIP, the PRSA no longer recognises the expenditure on the capital project until the asset is commissioned/operationalised. This means that no return is earned whilst the project lies in CWIP. Is this fair practice? Should TNPA be allowed a return on CWIP i.e., to recoup monies expended during the build phase before asset commissioning?;
- Appropriate funding model for a port infrastructure utility;
- Appropriate levels of debt and appropriate levels of cost of debt for a State-Owned Enterprise;
- Appropriate treatment of tax, irrespective of the corporate structure;
- Appropriate treatment of wear and tear provisions for the determination of tax;
- Appropriate cost of equity approach – determination of the levels of risk and the corresponding beta, together with considering risk premia to compensate for any additional/ emerging risk.
- Assessment of the impact of RR Methodology and decisions of PRSA on the tariff base, given the history of below inflation tariff adjustments;
- Independent Analysis of PRSA decisions to determine compliance with Port Directive requirements;
- Appropriate Implementation of the User Pay Principle: Ring-fencing/ vertically integrated Real Estate Business (Market based rentals) and Marine Business (Tariff Book); and
- With due consideration of Section 30 and Section 73(1)(b) of the Ports Act – does the PRSA have a mandate to regulate the Real Estate Business and utilise revenues generated by this

portfolio to cross-subsidise the Marine Business?

- The appropriateness of a Rate of Return methodology for the South African Port system.
- The roles of PRSA and TNPA in the context of tariff setting and tariff approvals.
- Can TNPA have un-regulated revenues and if confirmed the treatment and impact of such un-regulated revenues.
- How should private sector investments in port infrastructure (if deemed compliant with the Ports Act) be treated in the regulatory model, given that TNPA can only recover assets that **it owns**? What would be an appropriate mechanism for private sector to recover their investment?
- Provide written responses to stakeholder comments received through the PRSA public consultation processes and offer back-end logistical and administrative support during the PRSA roadshows. It is anticipated that there will be a total of four (4) PRSA roadshows to be held as follows:
  - **Western Region:** comprises Port of Saldanha, Port of Cape Town and Port of Mossel Bay;
  - **Central Region:** comprises Port of Port Elizabeth, Port of Ngqura and Port of East London;
  - **Eastern Region:** comprises Port of Durban and Port of Richard's Bay; and ○ **In-land Region:** Johannesburg.

  * Only two project team members will be required to travel .

2.1. The expected output from the service provider is a Tariff Methodology document that considers all that is listed in the scope of work and should be ready for implementation.

3. PROJECT DELIVERABLES

3.1. The anticipated project duration is six (6) months. Notwithstanding this indication, bidders may propose alternative timelines that demonstrate their capacity to deliver the required outputs efficiently and to the requisite quality standards. Transnet National Ports Authority reserves the right, at its sole discretion, to assess the feasibility and value-for-money of all proposed durations as part of the evaluation process. The final deliverable should be an electronic report in Microsoft Word and PowerPoint format. All data used to interpret, and analysis must be submitted in Microsoft Excel format. It is expected that the report(s) must at a minimum contain information reflected under each activity.

4. PHASED IMPLEMENTATION AND PAYMENT MILESTONES

4.1. The project shall be executed in distinct phases, each culminating in a key deliverable. Additionally, payments shall be made upon successful completion and acceptance of each phase by TNPA.

4.2. Table below provides a summary of the phased work and payment:

Phase	**Deliverable**	**Payment Milestone**
Phase 1: Foundational Assessment & In-depth Analysis	Foundational Assessment & Analysis Report. This report will cover the comprehensive assessment of the tariff methodology and its components. It will include analysis of: • The requirements and potential conflicts between the Ports Act and the ERT Act. • Appropriate asset valuation methodology. • Treatment of properties outside port limits. • The distinction and treatment of Capital Expenditure (Capex) and Capital Works in Progress (CWIP). • The impact of TNPA's impending corporate structure on the tariff methodology	Acceptance of the Foundational Assessment & Analysis Report by TNPA.
Phase 2: In-depth financial modelling and Strategic Recommendations	This report will provide key findings and recommendations on the appropriate Tariff Methodology for TNPA. It will include: • A proposed funding model for a port infrastructure utility • Appropriate levels of debt and cost of debt for an SOE. • Appropriate treatment of tax and wear and tear provisions. • Recommendations on the appropriate cost of equity approach. • An analysis of the User Pay Principle and PRSA's mandate to regulate the Real Estate Business. • How to handle unregulated revenues and private sector investments in the regulatory model.	• Acceptance of the Financial Model and Strategic Recommendations report by TNPA.
Phase 3: Final Document	• Final Tariff Methodology Document, ready for implementation. The final deliverable should be an electronic report in Microsoft Word and PowerPoint format, with all data submitted in Microsoft Excel format.	• Acceptance of the Final Tariff Methodology Document by TNPA.

Phase 4: Stakeholder Support	• Includes providing support during the PRSA public consultation process (roadshows and responses to written comments). • This phase will proceed according to the PRSA schedule and may not be sequential to the prior phases.	• Support provided for the PRSA public consultation processes

5. <u>SUPERVISION</u>

5.1. The Service Provider shall carry out the work, as reflected in the contract at intervals specified by Head Office - Finance.

6. <u>TO BE SUPPLIED BY SERVICE PROVIDER</u>

6.1 The Service Provider shall be responsible for providing the required labour and ad-hoc services required for the proper completion of the works.