**Record of Decision**

**Tariff Methodology for the Tariff Year 2027/28**

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## 1 Introduction

1.1 On 30 March 2026, the Ports Regulator ("the Regulator") approved the Tariff Methodology applicable to the tariff process of the National Ports Authority ("the NPA" / "the Authority").

1.2 In its assessment of the most prudent Regulatory Methodology, the Regulator will retain the Required Revenue Methodology, (i.e., rate of return approach) as the basis for assessing the Authority's revenue requirements in future tariff periods owing to its adaptability, and the balance it gives to achieve financial sustainability as well as affordability in the evolving port sector.

1.3 The Regulator is established through the National Ports Act No. 12 of 2005 (the Act) as an independent ports regulatory body, with a mandate to exercise economic regulation of the ports system in line with government's objectives. The Act requires that the NPA must, with the approval of the Regulator, determine tariffs for services and facilities offered by the NPA and annually publish a tariff book containing those tariffs.

1.4 The Directives to the Act further require that when considering the proposed tariffs, the Regulator must give due consideration to whether it is desirable that the tariffs which it approves enable the NPA to:

1.4.1 recover its investment in owning, managing, controlling and administering ports and its investment in port services and facilities;

1.4.2 recover its costs in maintaining, operating, managing, controlling and administering ports and its costs in providing port services and facilities; and

1.4.3 make a profit commensurate with the risk of owning, managing, controlling and administering ports and of providing port services and facilities.

1.5 In addition, the Regulator must have regard to whether the proposed tariffs reflect and balance

the following considerations:

1.5.1 A systematic tariff methodology that is applicable on a consistent and comparable basis;

1.5.2 Fairness;

1.5.3 The avoidance of discrimination save where discrimination is in the public interest;

1.5.4 Simplicity and transparency;

1.5.5 Predictability and stability;

1.5.6 The avoidance of cross subsidisations save where cross subsidisation is in the public interest; and

1.5.7 The promotion of access to ports and efficient and effective management and operation in ports.

## 2 Development of the Tariff Methodology

2.1 In order to provide regulatory certainty, improve the transparency of the tariff setting process and ensure its consistency, since 2015/16 the Regulator has published a multi-year tariff methodology. Regulatory practice is to set this methodology for a three year period. The revision of the methodology every three years allows for continuous refinement of the regulatory system, in order to better support the achievement of the objectives set out above.

2.2 The Methodology has allowed a significant smoothing of the Authority's return and at the same time, it has allowed the Regulator to establish an acceptable tariff trajectory whilst still ensuring the profitability of the NPA. The Methodology forms part of the Regulatory Framework adopted by the Regulator and serves as a regulatory guideline for the NPA to use in the submissions of the annual Tariff Application.

2.3 The publication of the Methodology increases transparency, accountability, as well as regulatory certainty as it aids stakeholders in formulating inputs and views on the Authority's applications which are considered by the Regulator in the decision-making process.

2.4 The National Ports Act at its inception envisaged that the incorporation of the NPA would occur, and made explicit allowance for this in Chapter 2 of the Act. Since the inception of the Regulator, therefore, the tariff approval process has had to take into account the potential impact of this event on the Authority and on the tariff itself.

2.5 Significant progress has now been made towards the achievement of incorporation. However, it is clear that incorporation is a complex and resource intensive process, the timing of which is difficult to predict. In order to allow incorporation to be factored into a three year revision cycle

for the tariff methodology, the Regulator has thus proposed greater flexibility in the tariff methodology itself, so that specific changes triggered by incorporation can be better timed to coordinate with the actual date of incorporation.

## 3 Need for additional consultation on elements of the methodology

3.1 Several of the issues included as proposals in the Tariff Methodology Discussion Document have proved to be more complex than originally envisaged and thus require additional analysis and further public comment periods. These are as follows:

3.1.1 The introduction of a historical cost adjustment factor to the regulatory asset base: the proposed size of the adjustment factor was set out in the roadshow presentations, but remains subject to revision. An additional round of public commentary on this is thus appropriate.

3.1.2 Inclusion of land outside port limits: the discussion document does not include a process for applying for inclusion in the RAB, or proposed principles for deciding on those applications. Potential interactions with the port promulgation process underway at Department of Transport have also yet to be fully explored. Additional drafting is thus required, which will in turn require additional consultation to be undertaken.

3.1.3 As noted by the Regulator during the roadshow, it would be desirable to introduce clearer guidelines on the use of the ETIMC, to make regulatory decisions on the use of this facility more transparent and predictable. Again additional drafting will be required, on which it would be desirable to undertake additional consultation.

3.1.4 In addition to the proposed change to the incentive cap, the consultation process raised several issues as regards the design of WEGO, including for example how to define previous best performance.

3.2 These concerns are, however, not evident as regards several of the other proposals set out in the discussion document, where additional public consultations are thus not required.

3.3 To ensure regulatory certainty and continuity, while also continuing to progress the tariff methodology, and allow for adequate public consultation, the following revision to the period of the tariff methodology will thus be followed:

3.3.1 In light of the need to conduct further consultations on the issues set out in paragraph 3.1 above, this tariff methodology will not be issued for three years, as has previously been regulatory practice. Instead the tariff methodology will be issued for the period 2027/28;

3.3.2 This tariff methodology will exclude changes to the four issues set out above on which additional public consultation is required; and

3.3.3 A three year tariff methodology will then be issued for the period 2028/29 – 2030/31. This document will include potential revisions to the issues as set out in paragraph 3.1 above.

## 4 Tariff Methodology Consultations

4.1 In order to continuously improve the level of transparency and consistency in the tariff setting process, the Regulator published a Discussion Document on 25 November 2025, requesting comments and written submissions on the proposed Methodology. The closing date for written submissions was 30 January 2026.

4.2 The Regulator undertook extensive public consultations with interested parties and the NPA regarding the proposed amendments to the Methodology. These consultations were conducted through roadshows, receipt of written submissions, and meetings. The concerns raised by stakeholders in these consultations have been considered in the final Tariff Methodology.

4.3 The Tariff Methodology is appended to this record of decision and has been published on the Regulator's website (https://portsregulator.org/).

## 5 The Regulator's Decision

5.1 Regulatory Methodology

5.1.1 The Regulator shall retain the Required Revenue Methodology approach in its determination of the NPA's revenue requirements. The details of this approach are set out in the appended Tariff Methodology.

5.1.2 The Regulator shall retain the current methodological determinations on all elements where there no change is proposed. These determinations are summarised in paragraphs 5.2 to 5.6 below. In the event of any inconsistency or conflict, the appended Tariff Methodology shall take precedence.

5.2 Market Risk Premium (MRP)

5.2.1 The Regulator shall retain the use of the Dimson, Marsh & Staunton (DMS) estimate of the mean MRP as measured against bonds for South Africa to determine an MRP for the NPA's cost of equity calculation.

5.3 Taxation

5.3.1 The Regulator resolves that the applicable tax rate will be the equitable tax rate, until the Regulator has been furnished with evidence of the Authority's incorporation. The equitable tax rate to be applied will be the average equitable tax rate over the previous five years.

5.3.2 The clawback will remain as a mechanism to be used to correct for the actual equitable tax rate in any year when appropriate audited segmental financial statements have been published.

5.4 Operating Expenditure (OPEX)

5.4.1 The prudency of costs will be considered in context of the definition of prudency as contained in the 2018 Valuation of Regulatory Asset Base Methodology, which describes a prudent landlord port owner as "acting efficiently in accordance with good industry practice to achieve the lowest sustainable cost of delivering the required services." The Regulator will consider whether additional prudency guidelines for operational expenditure should be developed in future.

5.4.2 Should the proposed required increases in OPEX be found to not be prudent, the Regulator may exclude portions of OPEX from the required revenue. The Regulator may assess prudency in OPEX by benchmarking against inflation. Where the Regulator uses inflation as a benchmark for prudency, the following considerations will hold:

- Above inflation increases will be allowed on items where the Authority has limited ability to control such cost escalations, and which are considered reasonable.
- When cost pass through is only allowed on items which are increasing at rates above inflation, then cost pass through will always result in cost escalation above inflation. Moving forward, cost pass through will thus be considered based on weighted average inflation in a basket of cost items, which at a minimum will include staff costs, electricity, water and fuel.
- Data provided on such items must include the total cost and volume procured of goods or services, over time, to allow inflation in unit costs to be analysed

5.5 Excessive Tariff Increase Margin Credit (ETIMC)

5.5.1 In the past, the Regulator has permitted the Authority to include an application for ETIMC in its tariff application. Moving forward, in order to prevent confusion about the Regulator's control of use of ETIMC, this will no longer be permitted.

5.5.2 The WACC return on the ETIMC will be adjusted for actual WACC achieved, as actual WACC becomes available.

5.6 Weighted Efficiency Gains from Operations (WEGO)

5.6.1 The WEGO model is intended to highlight specific challenges in the port system (and quantify same) through the assignment of weights to the selected KPIs in a manner that reflects where port performance challenges need to be addressed. No changes are proposed to the WEGO in the 2027/28 tariff methodology. The Regulator has resolved to

retain the 7.5% incentive cap as well as the 15% limit on efficiency gains/reductions. The Regulator further reserves the right to introduce an Operational Profit Reduction Ratio to penalise the Authority for unacceptable levels of system downtime, but does not propose to introduce this mechanism in the 2027/28 tariff methodology.

5.6.2 Further consultation will be undertaken in preparation for the tariff period 2028/29 – 2030/31, to determine whether revisions to the WEGO methodology are required.

## 6 Conclusion

6.1 The Tariff Methodology approved in terms of this decision is consistent with the Act and Directives. The decision takes account of the evidence, submissions and of the consultations and balances the interests of all stakeholders. The Regulator will continue to promote an efficient and effective ports system in South Africa.

**Signature:** _____

**Name:** Mr Aubrey Ngcobo

**Designation:** Chairperson: Ports Regulator of South Africa

**Date:** 30 March 2026

**Place:** Durban

# ANNEXURE

# Port Tariff Methodology

## Tariff Period 2027/28

March 2026

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**Acronyms**

| Abbreviation | Meaning |
|---|---|
| CAPM | Capital Asset Pricing Model |
| CWIP | Capital works in progress |
| EG | Efficiency gain or loss |
| ERTA | Economic Regulation of Transport Act |
| ETIMC | Excessive Tariff Increase Margin Credit |
| FLR | Freight Logistics Roadmap |
| HC | Historical cost |
| KPI | Key performance indicator |
| MRP | Market risk premium |
| NPA | National Ports Authority |
| PCC | Ports Consultative Committee |
| RAB | Regulatory asset base |
| RFR | Risk free rate |
| RoD | Record of decision |
| RR | Required revenue |
| TER | Transport Economic Regulator |
| TOC | Trended original cost |
| VoRAB | Valuation of Regulatory Asset Base Methodology |
| WACC | Weighted average cost of capital |
| WEGO | Weighted Efficiency Gains from Operations |

## 1. Introduction and background

In 2007, the Ports Regulator of South Africa ('the Regulator') was established through the promulgation of the National Ports Act, Act 12 of 2005 ('the Act') as '*an independent ports regulatory body*[1]', with a mandate to "*exercise economic regulation of the ports system in line with government's objective*[2]". The Act also sets out the functions of the National Ports Authority ('the NPA / the Authority') as the landlord of South Africa's (SA) ports and requires that "*the NPA 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*[3]*".*

Subsequently, the Directives to the Act (as approved on 13 July 2009, gazetted on 06 August 2009 and amended on 29 January 2010) require that when considering the proposed tariffs, the Regulator must give due consideration to whether it is desirable that the tariffs which it approves enable the NPA to:

- recover its investment in owning, managing, controlling and administering ports and its investment in port services and facilities;
- recover its costs in maintaining, operating, managing, controlling and administering ports and its costs in providing port services and facilities; and
- make a profit commensurate with the risk of owning, managing, controlling and administering ports and of providing port services and facilities.

Further, the Regulator must have regard to whether the proposed tariffs reflect and balance the following considerations:

- A systematic tariff methodology that is applicable on a consistent and comparable basis;
- Fairness;
- The avoidance of discrimination save where discrimination is in the public interest;
- Simplicity and transparency;
- Predictability and stability;
- The avoidance of cross subsidisations save where cross subsidisation is in the public interest; and

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*i.* Section 29 of the National Ports Act

[2] Section 30(1)(a) of the National Ports Act

[3] Section 72(1)(a) of the National Ports Act

- The promotion of access to ports and efficient and effective management and operation in ports.

In order to provide regulatory certainty, improve the transparency of the tariff setting process and ensure its consistency, since 2015/16 the Regulator has published a multi-year tariff methodology. Regulatory practice is to set this methodology for a three-year period. The revision of the methodology every three years allows for continuous refinement of the regulatory system, in order to better support the achievement of the objectives set out above.

### 1.1. Incorporation of the NPA

The National Ports Act at its inception envisaged that the incorporation of the NPA would occur, and made explicit allowance for this in Chapter 2 of the Act. Since the inception of the Regulator, therefore, the tariff approval process has had to take into account the potential impact of this event on the Authority and on the tariff itself.

Significant progress has now been made towards the achievement of incorporation. However, it is clear that incorporation is a complex and resource intensive process, the timing of which is difficult to predict. In order to allow incorporation to be factored into a three year revision cycle for the tariff methodology, the Regulator has thus proposed greater flexibility in the tariff methodology itself, so that specific changes triggered by incorporation can be better timed to coordinate with the actual date of incorporation. These changes are detailed in the discussion of the elements of the methodology which follow. In order to protect the achievement of regulatory certainty and stability, the following approach has been used:

- Clear process requirements are set out in order to trigger the methodological changes associated with incorporation
- Transparency commitments are made, to allow stakeholders to interrogate the basis of regulatory decision-making
- The principles which the Regulator must follow when making decisions are spelled out, to improve transparency, consistency and predictability

Despite these allowances, there nevertheless remains a possibility that the structuring of incorporation will affect the regulatory framework in unpredictable ways. Should the terms of incorporation affect the ability of the Regulator to achieve the mandate of the National Ports Act, or the tariff considerations set out in Directive 23, revisions to the tariff methodology will be undertaken as necessary to address these issues.

### 1.2. Transition to the Transport Economic Regulator

The Economic Regulation of Transport Act No. 6 of 2024 (ERTA) establishes the Transport Economic Regulator (TER). The ERTA then amends the National Ports Act so as to replace the PRSA with the TER. In effect therefore the PRSA will be transitioned into the TER, and the port regulation tasks currently undertaken by the PRSA will in future be undertaken by the TER.

As at March 2026, the President has assented to the ERT Amendment Act 2025, which is a necessary step for the transition of the PRSA into the Transport Economic Regulator. Implementation of this change will still require the promulgation of the Amendment Act. There are also a number of practical steps to be taken, for example as regards the staffing of the governance structures set out in the ERTA, and finalisation of ERTA regulations, to fully implement the changes envisaged by the ERTA.

Regulatory continuity in ports will be maintained during these processes. In terms of Schedule 2 of the ERTA, "a tariff or similar method of price regulation in effect immediately, before the effective date…. remains in effect ….until the date on which the Regulator first determines and publishes a new price control." Thus the published Tariff Methodology will remain applicable, until such a time as a revised methodology is published by the TER (a process which will also require public consultation, as an administrative action in terms of the Promotion of Administrative Justice Act).

### 1.3. Methodology period

As set out in the discussion document, the Tariff Methodology is typically issued for a period of three years. However, a number of the issues included as proposals in the Tariff Methodology Discussion Document have proved to be more complex than originally envisaged, and thus require additional analysis and further public comment periods. These are as follows:

- **The introduction of a historical cost adjustment factor to the regulatory asset base**: the proposed size of the adjustment factor was set out in the roadshow presentations, but as a preliminary number subject to revision. An additional round of public commentary on this is thus appropriate.
- **Inclusion of land outside port limits**: the discussion document does not include a process for applying for inclusion in the RAB, or proposed principles for deciding on those applications. Potential interactions with the port promulgation process underway at Department of Transport have also yet to be fully explored.

- As noted by the Regulator during the roadshow, it would be desirable to introduce **clearer guidelines on the use of the ETIMC**, to make regulatory decisions on the use of this facility more transparent and predictable.
- In addition to the proposed change to the incentive cap, the consultation process raised a number of issues as regards the **design of WEGO**, including for example how to define previous best performance.

These concerns are however not evident as regards a number of the other proposals set out in the discussion document, where additional public consultations are thus not needed.

In order to ensure regulatory certainty and continuity, while also continuing to progress the tariff methodology, and allow for adequate public consultation, the following revision to the period of the tariff methodology will thus be followed:

- The current tariff methodology will be issued for the period 2027/28 only
- This tariff methodology will exclude changes to the four issues set out above on which additional public consultation is required
- A three year tariff methodology will then be issued for the period 2028/29 – 2030/31. This document will include potential revisions to the issues as set out above.

## 2. Regulatory mandate

In line with the functions of the NPA, as defined in Section 11 of the National Ports Act, the revenue generated from the NPA's services is utilised inter alia to:

- Provide and arrange for road and rail access within ports;
- Regulate and control port access (navigation within port limits; enhancement of safety and security);
- Provide and arrange for tugs, pilot boats, and other services and facilities for the navigation and berthing of vessels in the ports; and
- Provide, control and maintain vessel traffic services.

The Regulator's approval is required for the tariffs charged for services and facilities offered by the NPA, in accordance with the National Ports Act, 12 of 2005 (the Act).

In terms of Section 72(1) of the Act, and Chapter 7 of the Directives of 2009, promulgated in terms of Section 30(3) of the Act as amended in 2010, the NPA must submit to the Regulator an application

regarding the tariffs it proposes to charge for the services and facilities that it offers. The Regulator's approval of such tariffs is subsequently required, and it therefore takes into consideration the Application, all subsequent submissions, written and oral comments received during the consultation process (including the responses thereto), as well as conducting its own research prior to publishing a Record of Decision (RoD).

Since the commencement of economic regulation with the 2009/10 RoD, the Regulator has issued a RoD for each application year in which an assessment of the NPA's compliance with the Regulatory Framework has been made. All RoD's have contained an outline of corrective action required and have made significant contributions to the development of the ports' regulation regime in South Africa.

Furthermore, the Regulator has formulated a long-term Tariff Strategy (the 'Strategy') which is based on a 'user pay' approach to cost allocation. The Strategy (updated in 2019/20) depends on the adapted Revenue Requirement (RR) approach to allocate costs to specific user groups. Tariffs from 2017/18 onwards were adjusted in accordance with the consulted and adopted Tariff Strategy. The Act, its Regulations, and the Directives constitute the South African Ports' Economic Regulatory Framework which, amongst other instruments, allows for a transparent tariff setting process.

## 3. The Elements

The Regulator currently applies an adapted Revenue Required approach. The exposition of the Revenue Required approach is as follows:

$$RR = (v - d + w)\, r + D + E + T \pm C \pm ETIMC \pm WEGO$$

Where:

| | | |
|---|---|---|
| *RR* | = | *Revenue Requirement* |
| *v* | = | *Value of the assets used in the regulated services* |
| *d* | = | *Accumulated depreciation on such assets* |
| *w* | = | *Working Capital* |
| *r* | = | *Regulated Return on Capital* |
| *D* | = | *Depreciation on the RAB accounted for in the tariff period* |
| *E* | = | *Operating Expenditure (OPEX)* |
| *T* | = | *Taxation expense* |
| *C* | = | *Claw-back* |
| *ETIMC* | = | *Excessive Tariff Increase Margin Credit* |
| *WEGO* | = | *Weighted Efficiency Gains from Operations* |
| *(v – d + w)* | = | *Regulated Asset Base (RAB)* |

More detail is now provided on the method of calculation of each of the elements of the model.

### 3.1. Regulatory Asset Base (RAB)

The RAB represents the value of those assets which the NPA is allowed to earn a return on. As the return earned on these assets is expressed in real terms, the value of total assets in the RAB is indexed to inflation each year, using the Trended Original Cost ("TOC") approach. Each year estimated capital expenditure (CAPEX) and depreciation is added to the closing balance for the previous year to arrive at an updated closing balance for the current year. The expected working capital balance is added to arrive at a total RAB estimate, which is averaged over the year to account for the progressive spending of capital works in progress (CWIP) over the period.

#### 3.1.1. Calculation and Adjustment of the RAB

The Regulator concluded that the appropriate (minimum) criteria elements, for the purpose of setting an appropriate RAB and asset valuation system must:

a) be based on a principled and sound rationale;

b) produce a reasonable asset value for existing assets;

c) result in an acceptable price-path;

d) ensure financial capital maintenance;

e) encourage efficiency and caution with respect to new investment decisions on the part of the NPA;

f) be reconcilable back to the NPA asset register, at least at a particular point in time; and

g) minimise regulatory information asymmetry problems.

The Regulator concluded that the TOC approach (satisfying the principle of Financial Capital Maintenance), based on the capitalisation dates and values in the NPA asset register, best meets the criteria.

Concerns remain as regards older assets capitalised before 1990, which have already been depreciated over a long period of time. The Regulator continues to regard the valuation of assets with capitalisation dates prior to 1990 on a historical cost (HC) basis as appropriate. However, this transition to HC will have a material impact on the RAB, and must be managed in a manner which is sensitive to the following regulatory objectives:

- the need to produce a predictable and stable price path
- the achievement of the incorporation of the Authority, which may be affected by the impact of RAB valuation on the credit rating of the Authority

Further consultation will be undertaken in preparation for the tariff period 2028/29 – 2030/31, in order to finalise the approach used in the methodology, as regards transitioning pre-1990 assets to HC. For the tariff period 2027/28, the TOC approach to asset valuation will continue to be used.

### 3.1.2. Rules for Inclusion in the Regulatory Asset Base (RAB)

The RAB covers all assets employed/owned by the NPA in the provision and supply of port capacity and services. The following sets out the criteria for RAB inclusion and valuation of assets (whether new or used), and treatment of maintenance on the RAB:

The amount by which the capital base may be increased in any specific year is the amount of the actual project capital expenditure incurred in that specific year provided that:

a) The amount does not exceed the amount that would be invested by a prudent landlord port owner acting efficiently in accordance with defined industry practice to achieve the lowest sustainable cost of delivering the required services; and

b) At least one of the following conditions is satisfied:

   a. The anticipated incremental revenue (subjected to the claw back mechanism in outer years if found to not be true) generated by the CAPEX exceeds the investment cost;

   b. The NPA can satisfy the Regulator that the new CAPEX has system wide benefits that, in the Regulator's opinion, justify its inclusion in the capital base; or

   c. The new CAPEX is necessary to maintain the physical safety and functional integrity of Authority infrastructure, installations and marine services equipment in the port system.

c) The fixed asset is long-term in nature and is operationally used and useable; and

d) Only assets which are in a condition that makes it possible to supply demand for port services in the short to medium-term (within 12-36 months) will be regarded as operationally used and useable.

Additional conditions regarding assets include:

a) New assets will be included in the RAB and subjected to the TOC methodology as set out if the expected life of the asset exceeds five years.

b) If the asset's lifespan is five or less years (i.e. depreciation periods of five years or less at the acquisition of said assets) it will attract straight line depreciation to be included in the tariff calculation. Maintenance on these "short term assets" may have maintenance costs included if used beyond full depreciation.

c) The NPA shall, with each tariff application, provide a list of temporary and long-term unused assets (i.e. all assets not used operationally). This list will be published.

d) CAPEX must be consulted on with the PCC and NPCC as per the requirements of the Act and Directives, the outcomes of which must be communicated to the Regulator.

e) All CAPEX must be submitted to the Regulator as part of the annual Tariff Applications for consideration by the Regulator on 01 August.

f) All CAPEX forming part of the annual tariff application to the Regulator must be accompanied by an approval letter signed by the Chairperson of the relevant Board/Governing body of the Authority, outlining capital expenditure approved in each port and all other business units of the Authority.

g) Growth related CAPEX adding new capacity should be presented separately with the related (anticipated or actual) volume growth and the expected time when that growth will be realised in the port system.

h) Asset replacement CAPEX must be presented separately indicating the capacity in the specific areas of the port system (with total volume replacement)

i) The NPA should also share and indicate the approximate ages of assets due for replacement.

j) Safety, Environmental and Compliance related CAPEX should be presented separately.

While some land outside port limits may be suitable for inclusion in the RAB, further consultation is needed to finalise the processes and principles involved. This will be finalised for the tariff methodology for the period 2028/29 – 2030/31. In the tariff for 2027/28, assets outside port limits will continue to be excluded from the RAB.

### 3.1.3. Calculation of the RAB

The RAB value for the period under review is determined using the following formulas:

$$\boldsymbol{RAB_y = \frac{1}{2}\left[RAB_{c,y} + RAB_{o,y}\right] + w_y}$$

$$\boldsymbol{RAB_{c,y} = RAB_{o,y}(1 + CPI_Y) + (CAPEX_Y.(1 + CPI_y)) - D_y}$$

Where:

| | | |
|---|---|---|
| $RAB_y$ | = | *value of the RAB used to determine the returns for period y* |
| $RAB_{o,y}$ | = | *opening value of RAB for the period y* |
| $RAB_{c,y}$ | = | *closing value of RAB for the period y* |
| $w_y$ | = | *forecast average net working capital over period y* |
| $CAPEX_Y$ | = | *value of expected capital investment over period y* |
| $D_y$ | = | *depreciation allowance for assets over review period y* |
| $CPI_Y$ | = | *annual rate of Headline CPI expected over period y* |

a) Working capital will be included in the RAB for the purposes of calculating the return as per the Tariff Methodology.

b) A *real* return will be applied in the case of assets that are valued on a TOC basis and a *nominal* return will be applied to the HC asset values in the RAB.

c) The net TOC value is determined by calculating the accumulated and annual depreciation on a straight-line basis over the elapsed life for those assets that are depreciated (with appropriate adjustments for refurbishments etc.).

d) The historic asset base as of 31 March 1990 will be used as an opening asset base (This asset base will be used as a basis to determine the current trended net value of NPA's assets).

e) Concession funded assets and prepayments (e.g. concessions that resulted in assets transferring back to the NPA) will be recorded on the regulatory asset base at R1 (One Rand).

### 3.1.4. RAB Depreciation

The fundamental contextual decision for the Regulator in determining the appropriate application of depreciation centres around the aim of regulation, specifically the intention to satisfy the principle of financial capital maintenance. Currently, to fully take into account CAPEX and inflation, the following formula is used in the calculation of depreciation:

$$D_y = (RAB_{(o,y)} + (RAB_{(o,y)}.CPI_{(y)}))/RUL$$

Where:

| | | |
|---|---|---|
| $RAB_y$ | = | *value of the RAB used to determine the returns for period y* |
| $RAB_{o,y}$ | = | *opening value of RAB for the period y* |
| $RAB_{c,y}$ | = | *closing value of RAB for the period y* |
| $D_y$ | = | *depreciation allowance for assets over review period y* |
| $CPI_Y$ | = | *annual rate of Headline CPI expected over period y* |
| $RUL$ | = | *remaining useful life in years* |

It must be noted that the Tariff Methodology includes the use of asset specific depreciation rates as opposed to an average asset life. The treatment of those assets that have exceeded their expected lifespan and/or depreciation periods are dealt with in Annexure C.

Depreciation will only be allowed in the calculation of the tariff upon commissioning of the asset. Efficient implementation and management of capital projects, timely completion of infrastructure construction, and on-schedule acquisition of capital equipment is thereby incentivised.

The following provisions apply:

a) The depreciation should be calculated on the historical cost of an asset (this is independent of the amortization of the trended portion) and be based on the remaining useful life of each asset; see Annexure B

b) The total accumulated depreciation and accumulated amortisation is deducted from the TOC cost of the RAB to obtain the RAB on which the return is calculated. See Annexure B

c) Mothballed and/or impaired assets will not earn a return, although the maintenance of mothballed assets with a definite plan for future use, will be allowed in the OPEX;

d) Similarly, maintenance on assets still in use, but fully depreciated, will be allowed in OPEX; and

e) A complete list of assets in this category must be compiled and updated on an annual basis by the NPA. The required information must be supplied to the Regulator.

### 3.1.5. Maintenance

Maintenance to be treated as *operational expenditure* (i.e. not capitalised and included in the RAB) for purposes of tariff calculation and will be defined as: "work undertaken within the port system with the intention of:

a. re-instating the physical condition of an asset to its original specified/design standard (e.g., dredging to the specified/design depth);
b. preventing premature asset deterioration or failure, to ensure functionality for the duration of the asset's designed useful life;
c. restoring correct operation within specified parameters;
d. replacing components of assets at the end of their useful/economic life with modern engineering equivalents;
e. making temporary repairs or servicing for immediate health, safety and security reasons; and/or
f. assessing assets for maintenance requirements (e.g., to obtain accurate and objective knowledge of physical and operating condition, including risk and financial impact thereof, for the purpose of maintenance).

Expenditure on assets or projects **may be included** in the RAB as capital expenditure when it results in the following:

a. an increase in the asset's useful function or service capacity (e.g. dredging to a greater than specified depth);
b. an extension of the useful life of an asset;
c. an improvement to the quality of the service(s) delivered through utilisation of the asset, or resolving the unintended consequences of a poor engineering design (e.g. the installation of a mooring system in Ngqura);
d. a reduction in future operating costs; and/or
e. the upgrade or enhancement becoming an integral part of the asset.

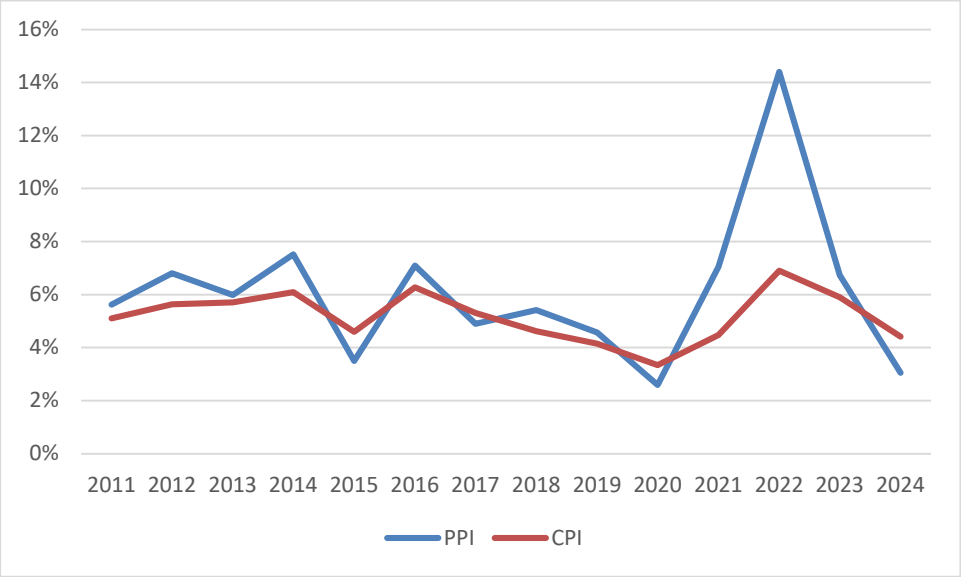
Maintenance dredging must be subjected to the criteria above. Annexure C summarises the treatment of different asset descriptions in the RAB.

### 3.2. Inflation Trending

The Regulator considered the use of consumer price inflation (CPI) versus producer price inflation (PPI). CPI provides information regarding changes in the overall level of prices of all goods and services bought by the average household, whereas PPI measures changes in the prices of locally produced commodities, based on findings from a sample of domestic producers.

While PPI is arguably more relevant to the Authority's costs as a producer than CPI, as shown in the figure below, PPI is considerably more volatile than CPI. Given the onus on the Regulator to produce a stable and predictable tariff regime, CPI continues to be the preferred measure of inflation in the tariff methodology.

ii. Figure 1: Annual CPI and PPI inflation




The inflation rate for calculating the trend in the value of assets between rebasing periods will thus be the Headline Consumer Price Index forecast in each financial year during the tariff period. The same inflation rate is used in the calculation of the Weighted Average Cost of Capital (WACC).

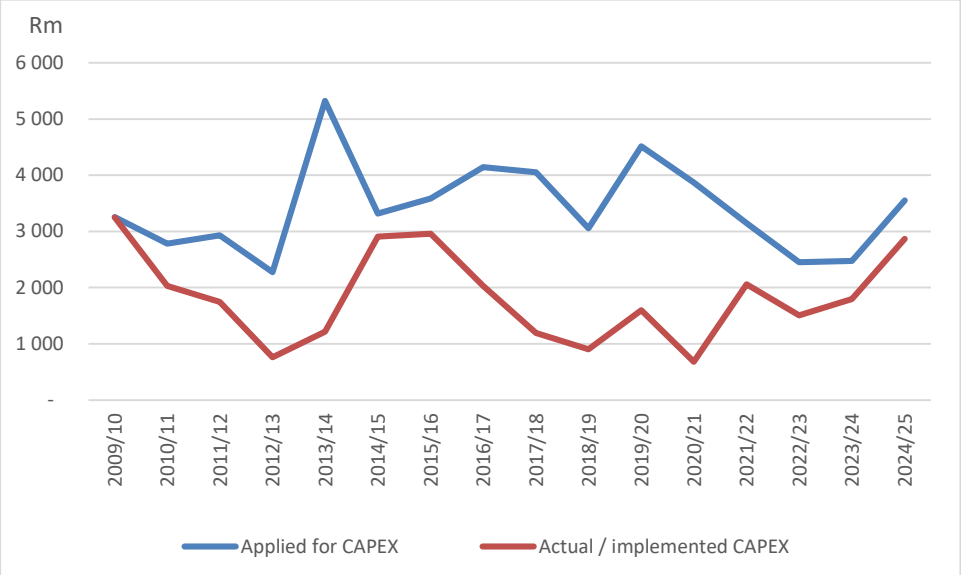
Due to the Regulator finalising a RoD by 01 December, it will utilise a final National Treasury published CPI forecast from the National Treasury's October/November Medium Term Budget Policy Statement (MTBPS). Should this information not be available timeously, the Regulator reserves the right to use alternative estimates, including estimates published by the South African Reserve Bank,

the Bureau of Economic Standards, other institutions, and its own economic forecasts in its assessment of future price changes.

### 3.3. Capital Works in Progress (CWIP)

The Regulator remains concerned about the operational efficiency crisis in South African logistics, as detailed in the Freight Logistics Roadmap. CAPEX spending is a key mechanism to improve the adequacy and quality of ports infrastructure, and to facilitate greater efficiency in ports operations. It is thus a concern that, since the inception of regulation, a pattern of systematic underspending on CAPEX by the Authority can be found. To date, only 54% of CAPEX applied for has been achieved.

iii. Figure 2: CAPEX achievements versus application




The NPA is required to submit the following documents with each tariff application:

i. CWIP projections for the tariff period, detailed as follows:
    a. per asset class;
    b. per service;
    c. per project; and
    d. monthly planned expenditure schedules.

All CAPEX which has been approved and not fully implemented is included in the claw-back process and the RAB, and the return is then adjusted accordingly. In addition, no depreciation allowance will be included until commissioning of the relevant asset. The Authority is expected to officially inform the Regulator of the commissioning of each asset in writing as part of its annual tariff application,

supplying the date of commissioning, final expenditure value, and any other information the Regulator may deem necessary.

The Regulator has in the past relied on the PCCs to "in principle" consider or support the NPA's CAPEX requirements. Going forward, the NPA's ability to implement projects, recent CAPEX implementation record, and the relevance and appropriateness of the CAPEX plan will also be taken into consideration by the Regulator. In addition, each project in the application[4] must be accompanied by an underlying motivation (business case), including volume projections etc. (see Annexure A). Whilst the NPA will be allowed to approach the Regulator to amend the CAPEX within the cycle, any amendments will require the same rigorous probity assessment.

As such, the assessment of determining the final closing balance at the end of the CAPEX period will require an assessment of actual achievement of the approved CAPEX plan. This will require an assessment of the various construction elements including disbursements, actual outputs, and any other relevant supporting documentation.

### 3.4. Working Capital

The regulatory purpose of the RR approach is to determine the revenue required by the NPA to recover its costs and an appropriate return. This must include the concept of the time value of money, as there is typically a lag between the time at which a particular cost is incurred, and when it generates revenue. Therefore, working capital is required to cover the time lag. To correct for the inherent assumption in the RR approach (that expenses and revenues occur at the same point in time), an allowance for the time difference is included.

The estimate of working capital included to adjust for the cash requirements related to CAPEX requirements, equates to the actual *net* working capital as per the latest available NPA annual financial statements (not the change in working capital), consisting of accounts receivable plus inventory less accounts payable (i.e. operating cash is excluded), adjusted by forecast volume growth and CPI inflation for the following year. In addition, CWIP *payables*, which are estimated at $1/12^{th}$ of the CAPEX projected for that year, are included. This is adjusted for the previous year's proportion of under-expenditure on the CAPEX programme. Volume and CPI forecasts used in the calculation of outer years' working capital will be updated as and when these numbers become available as part of the claw-back mechanism.

[4] More than R10 million

### 3.5. Weighted Average Cost of Capital (WACC) - Vanilla WACC

The WACC represents the risk adjusted opportunity costs of capital, and can be regarded as the minimum return required for an investment to continue to attract capital, given its level of risk. WACC provides a single weighted measure of cost of capital from both debt and equity sources.

A real WACC[5] will be applied and expressed in Vanilla terms (i.e. post-tax cost of equity and pre-tax cost of debt) to the post-1990 assets. A nominal WACC will be applied to pre-1990 assets. Accordingly, a separate allowance for the tax expense in the RR formula is required.

$$\boldsymbol{WACC_{vanilla} = k_d . g + k_e(1 - g)}$$

Where:

$k_d$ = *pre-tax cost of debt*

$k_e$ = *post tax cost of equity*

$g$ = *gearing, which is debt over total capital*

#### 3.5.1. Cost of Equity ($k_e$)

The post-tax Cost of Equity is calculated with reference to the Capital Asset Pricing Model (CAPM), which is expressed as:

$$\boldsymbol{k_e = r_f + \beta \times MRP}$$

Where:

*Rf* = *Real risk free rate*

*β* = *Measure of NPA's exposure to market (non-diversifiable) risk*

*MRP* = *The market risk premium over and above the risk free rate that investors might expect to earn*

The exclusion of the return on equity rate from the claw back calculation ensures that the use of a CAPM calculation establishes a clear and consistent determined risk premium above the RFR, significantly reducing the NPA's revenue risk as well as additional tariff volatility.

The Cost of Equity is historically a 'line drawn in the sand' with the intention of introducing stability into the system. The WEGO incentive / penalty does however affect the cost of equity.

[5] Adjusting for inflation will use Fisher's Equation: *(1+nominal WACC) = (1+real WACC)*(1+cpi)*

### 3.5.2. Risk Free Rate ($r_f$) (RFR)

The risk-free rate is approximated by the rate of return on an investment with a very low risk of default, typically a government bond in the market concerned. It serves as a benchmark for evaluating the returns of other investments, with any additional return considered a risk premium for taking on more risk.

Regulators are generally in agreement that longer dated government bonds should be used as a proxy for the risk-free rate, for two reasons. Firstly, to retain consistency in the calculations, the RFR should be set on a basis that is consistent with other variables in CAPM, notably the MRP. Secondly, this allows alignment with the average length of remaining life of an asset in the RAB, or at least the remaining debt maturity period.

The methodology utilises the South African Reserve Bank's published time series KBP2003M "Yield on loan stock traded on the stock exchange: Government bonds - 10 years and over," which adequately reflects the market's perception of sovereign risk and inflation over the regulatory period. As this time series includes multiple bond issues, it also avoids the potential anomalies that can occur in data series on single bonds.

As such the Regulator uses the geometric mean of the KBP2003. The calculation of the RFR average is done over the full period available in the SARB dataset, as the cost associated with the larger standard error of a shorter period surpasses any advantages of using a more recent shorter period RFR.

The Real RFR is deduced by using the Fisher Equation.

$$\mathbf{1} + \boldsymbol{i} = (\mathbf{1} + \boldsymbol{r})(\mathbf{1} + \boldsymbol{E}(\boldsymbol{I}))$$

Where:

| | | |
|---|---|---|
| *i* | = | *Nominal rate* |
| *r* | = | *Real rate* |
| *E(I)* | = | *Expected inflation* |

### 3.5.3. Market Risk Premium (MRP)

The MRP is in essence forward-looking and therefore cannot be observed but must rather be forecasted. A general consensus exists that the historical premium is, in fact, the best estimate of the forward looking MRP. To date, the Regulator uses the latest available Dimson, Marsh and Staunton (DMS) estimate of the mean MRP as measured against bonds for SA to determine an MRP for the NPA's cost of equity calculation.

The existence of negative serial correlation in the returns on South African equities results in an overestimation of the MRP when using the arithmetic mean. In addition, the relative (and recent) changes in terms of market diversification, improvements in the regulatory and legal frameworks safeguarding investors points to the appropriate risk premium forecast to be at the lower end of the long-term view.

As such the Regulator will retain the use of the geometric mean of the DMS MRP. The calculation of the MRP average is done over the full period available in the DMS dataset as the cost associated with the larger standard error of a shorter period surpasses any advantages of using a more recent shorter period MRP.

Use of the DMS forecast allows the Regulator to rely on the very long time series assembled by DMS, but does make the regulatory methodology reliant on a single service provider. The DMS calculations also use a different estimate of the risk-free rate than is employed in the rest of the tariff methodology. The Regulator therefore will undertake research to determine if alternative data sources can be determined for the MRP estimate. This will be undertaken as regards the tariff methodology for the period 2031/32 – 2033/34.

### 3.5.4. Beta (β)

As the NPA is not a traded company, there is no published beta (β) which reflects its risk relative to firms listed on the market. Therefore, the methodology must select a β to reflect the risks faced by the NPA, and ensure an appropriate return (for the risks faced).

The inclusion of a claw-back mechanism reduces exposure to systematic risk, as does the existence of an interventionist regulatory regime ensuring future returns to a state-owned monopoly with no domestic competitors to its business. As such it is appropriate for the Regulator to use a β substantially lower than that of other large domestic firms. The unique nature of the NPA as a regulated monopoly ports landlord with an implied government guarantee, also makes any comparison with other South African private sector port companies impossible.

The Regulator will thus continue to apply an asset beta of 0.35 over the period. The lower beta continues to reduce the risk adjusted equity returns on the RAB, which incentivises increased delivery of CAPEX, which will lead to higher values of the RAB and in turn higher returns. Efficient implementation and management of capital projects, re-establishment of engineering capacity in the NPA, timely completion of infrastructure construction, and on-schedule acquisition of capital equipment is thereby incentivised. The Hamada equation will be used to re-lever the beta to result in an equity β.

The structure of incorporation may affect the estimate of the asset beta. However the preference of the Regulator is to maintain an asset beta of 0.35 post incorporation.

### 3.5.5. Gearing (*g*)

The Regulator, taking into consideration previous applications, previous patterns of variation in the applications, various submissions, and its own analysis of the NPA's gearing, has determined that an appropriate gearing for the entity (an infrastructure heavy landlord monopoly) for the period is (at least) 50%. Further, this reflects a median position within a sample of ports as well as adequately signals a required re-investment of profits into the port system whilst balancing costs with a lower cost of debt.

If the NPA is corporatised with an independent Board, independent financial disclosure, borrowing powers, and control of its own cash flow bank account, the Regulator will consider using the actual gearing calculated through a due diligence process. The Regulator has not changed its position on gearing given the inability to observe the level of gearing for a stand-alone, separate NPA.

### 3.5.6. Cost of Debt ($k_d$)

Currently the NPA's actual, embedded (adjusted for an effective weighted) debt costs as allocated by Transnet is used to determine the cost of debt applied within the WACC. The cost of debt, as per the Annual Financial Statements, and the ability of the Authority to raise finance through the strength of its books should be used in the determination of the WACC. However, the actual embedded debt should be considered provided it reflects debt funding and credit risk of the NPA as a separate entity. Alternatively, the Regulator reserves the right to benchmark the NPA's cost of debt for the purposes of determining WACC.

Post incorporation, the Regulator expects to have greater clarity on the debt allocated to the Authority. It is anticipated that the embedded cost of debt will be replaced with the actual cost of debt of the incorporated entity.

### 3.6. Taxation Expense (T)

Delays to the incorporation of the Authority have resulted in several years of taxation at the corporate tax level, to the disadvantage of port users, the impact of which is not fully mitigated by the claw-back of excess funds in the following period. A more flexible mechanism for determining the tax rate used is thus needed, which will allow the timing of the move to the corporate tax rate to be more closely tied to the actual incorporation date of the Authority.

The mechanism which will be used is as follows:

- As per the incorporation process requirements in section 5, before 30 April prior to the date of the Tariff Application, the Governing Body / Board of the NPA is required to engage with the Regulator to determine the applicable methodology under which to apply. This determination process will now also include a determination of the appropriate tax rate
- In order to allow application of the corporate tax rate for the period, the NPA must meet the following standards:
    - Presentation of a detailed and credible plan for incorporation of the Authority during the application period
    - Evidence of consultation with and concurrence from the Department of Transport as regards the incorporation plans; which evidence shall be published by the Regulator
- Until such time as the determination process concludes that incorporation can credibly be expected to occur during the application period, the applicable tax rate will be the equitable tax rate
- Should the switch to the corporate tax rate be agreed to by the Regulator in good faith, and then the incorporation of the Authority does not in fact occur during that tariff period, the Regulator reserves the right to return to use of the equitable tax rate in the next tariff period. Should that occur, the Regulator will apply a claw back using the equitable tax rate.

The equitable tax rate is calculated as that rate which will result in the proportional sharing of the Transnet Group taxation liability by each of its profitable divisions/segments/business units. The equitable tax rate is thus the rate which if applied to the profits of each profitable division/segment,

will amount, if added together, to the full corporate tax payable by Transnet to the South African Revenue Services (SARS) on its pre-tax net profit in any one financial year.

The Equitable Tax Rate is calculated as follows:

$$\boldsymbol{te = t(\frac{Pg}{\sum Pi})}$$

*Where:*

$te$ *= equitable tax rate,*

$t$ *= 27% or the corporate tax rate,*

$Pg$ *= Transnet Group pre-tax net profit for the year,*

$\sum Pi$ *= Sum of pre-tax profits of profitable divisions/segments/ units for the year*

The equitable tax rate to be applied will be the average equitable tax rate over the previous 5 years. The clawback will remain as a mechanism to be used to correct for the actual equitable tax rate in any year when appropriate audited segmental financial statements are published. All fair value and similar once-off accounting adjustments on segmental profits will not be considered in the calculation of the equitable tax rate in future, and in the retrospective 5 years forming part of the calculation.

The calculation of the equitable tax rate is contingent on Transnet publishing or providing to the Ports Regulator annual audited segmental financials, showing group net profit as well as the profits and losses, costs and revenues, for each division/segment/business unit. Failure to do this will result in the Regulator not providing for taxation in the revenue required calculation, and revenue required for tax will be deemed to be a part of the allowed return on equity.

Post incorporation, the Regulator expects the Authority to be taxed directly by SARS. Forward looking tariffs will then continue to be based on an estimate of taxation due on the anticipated profitability of the Authority, and the clawback will be calculated using actual tax collections.

### 3.7. Operating Expenditure (OPEX)

The Regulator currently analyses operating cost estimates for the period on a detailed, line by line basis. The NPA is requested to provide detailed and complete motivation for each of the expenses applied for in its tariff application, especially on large items such as labour (including headcount), energy costs, and sundry costs. The prudency of costs will also be considered, in light of the definition of prudency as contained in the 2018 Valuation of Regulatory Asset Base Methodology, which describes a prudent landlord port owner as “acting efficiently in accordance with good industry

practice to achieve the lowest sustainable cost of delivering the required services." The Regulator will consider whether additional prudency guidelines for operational expenditure should be developed in future.

Should required increases in OPEX be found to not be prudent, the Regulator may exclude portions of OPEX from the required revenue. The Regulator may assess prudency in OPEX by benchmarking against inflation. Where the Regulator uses inflation as a benchmark for prudency, the following considerations will hold:

- Above inflation increases will be allowed on items where the Authority has limited ability to control such cost escalations, and which are considered reasonable.
- When cost pass through is only allowed on items which are increasing at rates above inflation, then cost pass-through will always result in cost escalation above inflation. Moving forward, cost pass through will thus be considered based on weighted average inflation in a basket of cost items, which at a minimum will include staff costs, electricity, water and fuel.
- Data provided on such items must include the total cost and volume procured of goods or services, over time, to allow inflation in unit costs to be analysed

Over and above the OPEX budget submitted in the Tariff Application, the Regulator will analyse drivers of OPEX including:

a) Port specific factors, including the volume of freight handled;

b) Business support which includes IT & telecoms, Head Quarters, Office equipment etc.;

c) Employee costs, renewal, additions etc.; and

d) Real price effects.

The Regulator will require separate reporting of OPEX items which are directly related to Capital Expenditure programmes i.e. research and development studies, environmental impact assessments, and so forth. This will allow stakeholders to track the Authority's progress on implementing its capital investment programme. Where costs incurred are to support the capital expansion programme of the Authority, the Regulator will consider the business cases of each programme or project to determine the merits of the applied OPEX.

The Regulator will require reporting on the Authority's staff headcount by salary band, the average remuneration level by salary band, and per staff remuneration for senior executives (which will be treated as confidential unless already publicly disseminated).

The Regulator continues to allow the inclusion of Transnet group costs in total allowed expenses, subject to the requirement that the NPA submits detailed explanations and motivations for the amounts transferred to Transnet. When the NPA becomes a corporatized entity, it will be expected that some of the costs will be undertaken by the Authority and as a result, group costs will reduce. Where/if Transnet continues to service NPA, it should be at a reasonable market cost of which the NPA will be expected to compare to transactions of similar nature in the open market, where available.

In addition, the NPA shall provide an externally and independently audited financial report (with all supporting documentation and detailed explanations including basis of allocation and policy documents that support such allocation) on all line items that form part of the group costs that have been expended for the NPA each year. This shall be provided in the year after the close of the financial year or until an alternative methodology or amendment of this methodology is published.

Furthermore, the Regulator reserves the right to claw-back all or any portion of the amount in future tariff decisions, should the Regulator not be satisfied that the expenditure is within the scope and mandate of the NPA, and that the amounts are reasonable, or reasonably allocated to the NPA.

### 3.8. Claw-Back

The key purpose of applying clawbacks is to ensure that the NPA and port users are not subjected to unfair gains or losses that are the result of incorrect forecasting, inaccurate information and system shocks. This reduces and shares the risks faced by all port system participants, including the NPA.

The main application of the clawback is to reduce the impact of differences between allowed revenue as calculated using volume and other projections at the time of the tariff application, and actual audited figures, and is intended to ensure the coherence and integrity of the regulatory regime. Port volumes are volatile, and the difficulty in forecasting imports and exports accurately presents significant challenges to the tariff methodology, especially in the outer years of a multi-year tariff period.

The following variables are estimated (in line with the Regulatory Methodology) on an annual basis, prior to the start of the following tariff year, for claw-back purposes:

a) RAB (excluding CAPEX): the RAB is adjusted annually to reflect actual working capital requirements in line with audited AFS numbers and inflation trending;
b) Depreciation is re-calculated based on the adjusted RAB;

c) Volumes: actual volume numbers are used to calculate the clawback;

d) Inflation (CPI): whilst the return on equity is not changed, the actual inflation rate is used in the recalculation of a number of variables, including the trending of the RAB, working capital forecasts, and other latest estimates during the assessment;

e) Taxation: the taxation allowance will be corrected to the actual applicable taxation cost, estimated using the equitable tax rate or as per the audited Annual Financial Statements, depending on the status of incorporation; and

f) WEGO penalties or incentives should be considered as part of clawback recalculation.

The forecast or estimation of these variables is conducted annually, and actual data is used in determining the claw-back pertaining to the previous tariff year where the 50% rule applies. The final clawback is determined in the following year when actual numbers are available. The return on equity rate will be fixed upon assessment for claw-back purposes – the amount included in the claw-back will still depend on RAB corrections. Detailed steps for the calculation of the Clawback can be found in Annexure D.

### 3.9. Excessive Tariff Increase Margin Credit (ETIMC)

The Regulator regulates in the long-term interest of the maritime sector and the South African economy. This requires that the Regulator not only confine itself to the immediate tariff decision but also consider ways to ease any future shocks to the system. It is generally accepted that CAPEX may spike at some point in the foreseeable future, but that these projects have not yet been specified to a level of detail that allows for accurate prediction. In addition, external market related factors such as unexpected (or expected) fluctuations in volumes, inflation, the RFR etc. may result in significant spikes to the tariff as well.

As such, the Regulator has, in the past, considered it prudent to avoid excessive future tariff changes by retaining and increasing the NPA's Excessive Tariff Increase Margin Credit (ETIMC), to allow the smoothing of unaffordable tariff spikes over multiple periods in the future or to apply a countercyclical tariff decision in time of depressed economic activity.

As the ETIMC is 'revenue collected from port users' before the NPA is entitled to it, it should yield a return for users to compensate them for the opportunity cost of their capital. The ETIMC will therefore earn a return which is equal to the WACC allowed by the Regulator, as the opportunity cost of the funds available to the NPA is indeed the WACC. This will be estimated as the full year's return on the opening balance of the ETIMC, plus/minus half the return on the amount

retained/utilised during the year. The return on the ETIMC will be factored into the balance and the calculation of the total available under the ETIMC facility will be published annually (as part of the RoD). The WACC return on the ETIMC will then be adjusted for actual WACC achieved, as actual WACC becomes available.

Currently, the Regulator further deems it necessary to define the use of the ETIMC facility in the following way:

> *"The Regulator may authorise the release of part, or the whole, of the value of the ETIMC facility only when conditions require an influence on tariff levels including, but not limited to, spikes in tariffs (defined as an average tariff increase in excess of the CPI inflation forecast) due to a sharp increase in capital expenditure, volume volatility, or any market related factor. Further, the Regulator may consider national objectives when making decisions to add to, or to utilise the ETIMC facility to adjust tariffs."*

The ETIMC facility is not intended to be used for the Authority's inefficiencies.

Further consultation will be undertaken in preparation for the tariff period 2028/29 – 2030/31, in order to determine whether clearer guidelines governing the use of ETIMC can be set. The intention of determining such guidelines will be to constrain the Regulator's discretion as regards use of ETIMC, and by doing so to make the use of ETIMC more transparent and predictable. For the tariff period 2027/28, existing approaches to ETIMC use will continue to be employed.

In the past, the Regulator has permitted the Authority to include an application for ETIMC in its tariff application. Moving forward, in order to prevent confusion about the Regulator's control of use of ETIMC, this will no longer be permitted.

### 3.10. Weighted Efficiency Gains from Operations (WEGO)

The RR methodology does not strongly incentivise increased efficiency or competitiveness, as the claw back mechanism takes away any increase in profitability the Authority may experience due to higher efficiency or the achievement of additional market volumes. Whilst the introduction of the Tariff Strategy is intended to have positive effects on sector efficiency, by linking prices more closely to actual costs, the impact of this will only be felt over the long term. Efficiency incentives are therefore addressed in an integrated manner through the inclusion of an efficiency measure within the Methodology, namely the Weighted Efficiency Gains from Operations (WEGO).

WEGO is designed to identify and differentiate between changes in agreed Key Performance Indicators representing performance at port system level and to incentivise the Authority on average improvements or disincentivise the Authority where performance has regressed. WEGO incentivises the efficiency of the Authority by allowing an increase or decrease on net profit earned by the NPA.

The formula for calculating WEGO is as follows:

$WEGO_t = (EG_{t-1} /0.15) \times IC \times Re_{t-1} - DA$

*Where:*

| | | |
|---|---|---|
| *EG* | = | *Agreed efficiency gain through operations, limited to a maximum of 15% and a minimum of -15%* |
| *IC* | = | *Incentive cap, set at 15%* |
| *Re* | = | *Return on equity as determined in the RR Formula .* |
| *t* | = | *Current financial year under review* |
| *DA* | = | *Downtime adjustment, as calculated below* |

Measured performance of a particular KPI in a port is compared against a WEGO historical best measured performance as the Baseline to produce a percentage efficiency gain or loss (EG) for that KPI in that port and contribute towards an overall/composite port level efficiency gain or loss (EG). A declining or negative value of *EGt-1* will result in an increased claw back over period *t*.

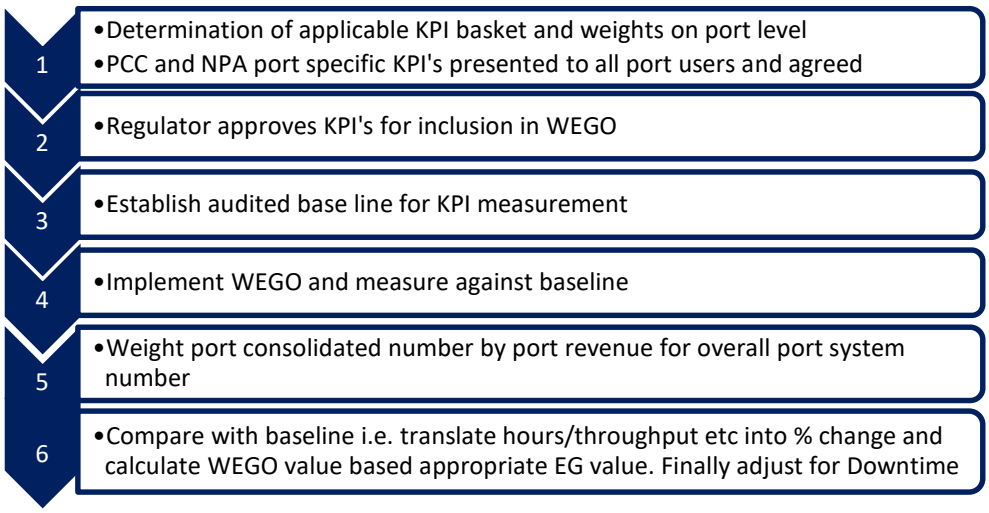
The methodology requires the NPA and port users through the Port Consultative Committees to submit to the Regulator their suggested key performance indicators as well as suggested weights on a per port basis. The Regulator then makes the decision regarding the final basket of KPIs and their weights each year through a Record of Decision. The selected and measured KPIs must reflect performance on both the water and land side to encapsulate performance across the port system.

The WEGO is intended to highlight specific challenges in the port system (and quantify same) through the assignment of weights to the selected KPIs in a manner that reflects where port performance challenges need to be addressed. Higher weights are assigned to KPIs reflecting poor performance relative to previous best performance, with lower weights assigned to KPIs where good performance must be maintained.

The Authority also maintains or intends to establish a set of performance indicators, namely the Terminal Operator Performance Standards (TOPS), Marine Operations Performance Standards (MOPS), Rail Operations Performance Standards (ROPS) and Marine Operations Performance Standards (MOPS) performance standards. It is required for these standards to be signed off by PCC representatives at a port level and agreed to with the Regulator.

For the calculation of operational efficiency, port revenue contribution will establish **the weighted contribution on a per port basis** to calculate the overall EG. All ports' PCCs must present signed off results to the Regulator for consideration and inclusion in the Tariff Assessment.

ii. Figure 3: WEGO calculation process




The Regulator reserves the right to introduce an Operational Profit Reduction Ratio to penalise the Authority for unacceptable levels of system downtime.

Should the Regulator decide to introduce an Operational Profit Reduction Ratio, the proposed mechanism is as follows. The adjustment of the WEGO allowance for downtime due to mechanical breakdown, unavailability of equipment, labour related incidents, or any other similar unplanned occurrence resulting in a services not being rendered, (excluding weather delays and '*force majeure*'), will be calculated on the basis of previous (3 year moving average) revenue streams as a ratio of the collected Cargo Dues per port and terminal. These ratios will be applied to the number of days of operational delay applicable at each terminal of each port and the resulting calculated reduction in cargo dues will be used as an adjustment to the WEGO calculated revenue amount (i.e. it will be an adjustment to profit or the Return on Equity).

$$Operational\ Profit\ Reduction\ Ratio\ (OPRR) = \frac{1}{365}\sum_{i=1}^{p}[PR_i \sum_{j=1}^{n}(D_j \times TR_{i,j})]$$

$$Downtime\ adjustment = OPRR \times TCD$$

*Where:*

| | | |
|---|---|---|
| $D_j$ | = | *Days lost per terminal j due to, mechanical breakdown, labour action or similar** |
| $PR_i$ | = | *Port Revenue Ratio- Proportional cargo dues per commercial port i*** |
| $TR_{ij}$ | = | *Terminal Revenue Ratio- Proportional cargo dues per terminal j in port i ****|
| *TCD* | = | *Total cargo dues collected in port system* |
| *i* | = | *Individual port reference* |
| *j* | = | *Individual terminal reference* |
| *n* | = | *Total number of Terminals in each port* |
| *p* | = | *Total number of Ports* |

- **Days lost will be based on recorded downtime due to equipment failure or unavailability, or labour strike. In the case of a 'go-slow' every day recorded as a "go-slow" strike action, 0.5 days will be assumed lost. Downtime due to weather delays and force majeure will not be taken into consideration.*
- ***The proportional cargo dues revenue ratio will be based on all cargo dues revenue collected from the individual ports as a share of total cargo dues revenue collected (moving average of the previous 3 years).*
- ****The proportionally cargo dues revenue ratio will be based on all cargo dues collected per terminal as a ratio of total cargo dues revenue collected per port. (Moving average of the previous 3 years).*

Information requirement to be submitted to the Regulator by the NPA (quarterly):

a) All Cargo Dues per terminal per port; and

b) All recorded operational delays per terminal per port with reasons for delays.

The incentive cap remains set at 0.075 for the tariff period 2027/28, which limits the size of the WEGO penalty/incentive to 7.5% of the total return earned on equity.

Further consultation will be undertaken in preparation for the tariff period 2028/29 – 2030/31, in order to determine the extent of revisions to the WEGO methodology that are required. This consultation will cover amongst others the following areas of WEGO design:

- The size of the incentive cap (IC)
- Whether efficiency gains (EG) should continue to be set at 15%
- Adjustments to the "Previous Best Performance" (PBP) principle
- Whether the downtime adjustment mechanism should be put into practice

## 4. Volume Forecast

The NPA is required to submit detailed volume forecasts with reasons, as well as revenue calculations based on the forecast volumes and current tariff levels, together with proposed tariffs for the period. The level of detail will be agreed to with the Authority. Prior to the finalisation of the Record of Decision, the Authority is required to submit the latest estimates with regards to current volumes, as well as any changes to forecasts etc.

The Regulator, based on the submission of the Authority, its own calculations and estimates, and various engagements and submissions from port users, will determine the final volume forecast. Any deviations from the NPA's submitted volumes will be set out in the RoD.

## 5. Incorporation process requirements

The exact corporate structure, dividend policies, transitional arrangements, debt allocation, and other matters related to the incorporation of the NPA, as envisaged in the National Ports Act, remain unknown at the time of publishing this tariff methodology. These details of the design of incorporation may affect the NPA's credit rating, which may in turn have implications for the Regulator's evaluation of the ongoing sustainability of the Authority. In addition, the incorporation status of the Authority will affect the taxation method used in its application. In order to facilitate the ability of the Regulator to assess these implications, the following arrangements will apply:

- During the month of April prior to the date of the Tariff Application, the Governing Body / Board of the NPA is required to engage with the Regulator to determine the applicable methodology under which to apply.
- In the instance of an announcement by the Minister of Transport on the incorporation of the NPA in terms of section 3(2), or alternatively section 3(2) and section 4(1) of the Act, the following information must be submitted to the Regulator within 30 days of announcement or incorporation as applicable:
    - Memorandum of Incorporation.
    - Proof of Registration (Registration/Enterprise number, registration certificate, etc).
    - Due Diligence analysis conducted.
    - All other assessments completed by the Department of Transport / Transnet / NPA.

- Full audited Annual Financial Statements.
- Full debt portfolio with conditions and other attached requirements.
- Debt Allocation Policy – transitional process.
- Complete and updated (to date) Asset Register.
- Comprehensive report on services provided by Transnet Group, including value of services.
- Detailed plan to acquire cost competitive replacements; and
- Dividend Policy that will apply (if relevant).

The intention of the Regulator is to maintain the stability of the tariff methodology and the tariff path during the incorporation process. However, as the exact structure of incorporation remains unknown, it may be the case that adjustments to the tariff methodology are needed at the time of incorporation, in order to achieve the objectives of the National Ports Act, or the tariff considerations set out in Directive 23. The Regulator therefore retains the right to undertake adjustments to the methodology at that time.

## 6. Confidentiality

The Ports Regulator remains bound by the confidentiality provisions of the directives.

The Ports Regulator strives to assure that all information, including internal, third party, personal and electronic data, is treated with complete confidentiality; maintain integrity of all such information; ensure that our information system and the information contained therein meet the needs of our core and supporting business operations; comply with all applicable statutory and regulatory requirements and perform reliable access control to protect our information system against unauthorised access.

**Annexure A: Information Requirements**

**The following information requirements must accompany the annual application of the NPA.**

**CAPEX**

- The Authority must submit to the Regulator its port development framework plans which reflect its policy for port development, land use and cargo handling strategies that give rise to Capital Expenditure projects within ports.
- All CAPEX projects (infrastructure and capital acquisitions) underway (to include, but not limited to, information pertaining to project stage, tender specifics, construction progress etc.); itemisation of Contractors and Consultants regarding Authority projects undertaken by the Transnet group in the prescribed CAPEX Register. The CAPEX register must be published and updated on a quarterly basis.
- Business cases must be provided to the Regulator on all CAPEX projects more than R10 million
    - The nature of the content and detail of business will be further defined and developed between the Authority and the Regulator. Further, the nature and content of the business case submissions would be summarised to focus on the more salient aspects including:
        - Objective of project
        - Demand to be addressed
        - Alignment to Port Development Plans
        - Solution alternatives
        - Project Costing
        - Financial Returns and Payback periods
        - Timing of Delivery
        - Key Risks
- All acquisition of land and other Capital Assets (including motivation thereof);
- All disposal/or removal of land and assets (including motivation thereof);
- All costs associated with CWIP that resulted in no commissionable assets or assets that have been (or expected to be) written off. A detailed list is required per project
- An Asset Replacement Schedule detailing those assets to be replaced in the next three years; and

- Itemized maintenance schedule for the next 3 years for all planned and unplanned maintenance projects above R1 million, categorized as OPEX as well as "capitalized maintenance".

**Real Estate**

- Completed, updated Lease Register (as per agreed template) setting out:
  - All port lessees
  - Leased area
  - Tenure of leases
  - B-BBEE levels; and
  - Rental received
- All infrastructure assets on the Authority's RAB, not operated by the NPA, and for which the NPA does not charge an operator for rental / lease.
- All information relating to lease improvements and the associated financial implications and incurred taxes.

**Operational performance**

- Data, results and progress applicable to the implementation and monitoring of Operator Performance Standards, as per TOPS/ MOPS/ ROPS/ HOPS.

**Financial information**

- Audited Financial Statements as well as port level financials. A full set of segmental financial statements of the Transnet Group must be included
- Staff numbers and cost to company per salary band, and per staff remuneration to be disclosed in the annual financial statements for staff in salary bands A and B
- Historical information: All NPA relevant annual debt stock levels as well as annual debt redemption payments itemised, as well as the relevant debt instruments and applicable interest/coupon rates since the inception of Regulation
- Current debt cost information including estimated debt costs (calculation and forecasts) for the current tariff year (i.e. the year that the application is made in) as well as the outlying tariff year. Schedule to reflect the estimated annual change to the relevant debt stock levels of the NPA; itemized annual debt redemption payments, as well as the relevant debt instruments and applicable interest/coupon rates.

**Other**

- Compliance Risk Management Plans (CRMP's) and its quarterly progress report for all mandatory legislative provisions in the National Ports Act; and
- All due diligence and other information pertaining to the implementation of Sections 3(2), 26, 27 and 28 of the National Ports Act.

**The following information must be submitted by the NPA to the Regulator on a quarterly basis:**

- Lease Information
  - Copies of all new agreements and licences entered or issued in the quarter, as well as the supporting documentation thereof, including Sections 79s, 72s, 56s, 57s, and lease agreements (inclusive of all annexures, including but not limited to updated rentals and terminal operator tariffs); and
  - All applicable B-BBEE certificates for the abovementioned licences and agreements
  - Schedule of vacant properties available for lease.
- All CAPEX projects (infrastructure and capital acquisitions) underway (to include, but not limited to, information pertaining to project stage, tender specifics, construction progress etc.), Itemisation of Contractors and Consultants with regard to NPA projects undertaken by Transnet Group Capital / Transnet Capital Projects, and B-BBEE certificates
- List all land paid for by the NPA/port users funds, transferred to Transnet properties or any other division
- Key performance indicators relating to port capacity, port performance, and volumes per port and all WEGO information requirements as per template
- All due diligence and other information pertaining to the implementation of Sections 3(2),26 and 27 of the National Ports Act; and
- Compliance Risk Management Plans and its quarterly progress report for all mandatory legislative provisions in the National Ports Act.

**Timelines**

All quarterly progress information must be submitted to the Ports Regulator by no later than the end of the month after the end of the applicable quarter, based on the reporting templates provided to the NPA by the Ports Regulator on 16 March 2016. The Ports Regulator reserves the right to amend these on an ongoing basis.

**Annexure B: RAB calculation**

The example below illustrating the calculation of depreciations and the TOC value (for new assets and those that postdates 1990 capitalisation dates) of the RAB is based on the following basic assumptions:

- Historical cost of R100 m
- Inflation 5% per annum
- Depreciation on a straight line basis over 30 years life of asset
- Service life of the asset is 30 years; and
- No adjustment in the Remaining Useful Life.

| **RAB Calculation** | | | **Yr 0** | **Yr1** | **Yr2** | **Yr29** | **Yr30** |
|---|---|---|---|---|---|---|---|
| | | | **R'm** | | | | |
| Original Cost | | 1 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 |
| Capex | | 2 | 100.00 | - | - | - | - |
| Depreciated original cost brought forward | | 3 | - | 100.00 | 96.67 | 6.67 | 3.33 |
| Current period depreciation | 2/RUL | 4 | - | 3.33 | 3.33 | 3.33 | 3.33 |
| Depreciated original cost carried forward | 3-4 | 5 | 100.00 | 96.67 | 93.33 | 3.33 | - |
| | | 6 | | | | | |
| TOC opening balance | 13 | 7 | - | 100.00 | 101.50 | 26.13 | 13.72 |
| Accumulated trend | | 8 | - | - | 4.83 | 19.47 | 10.39 |
| Current period trend | 7*cpi | 9 | - | 5.00 | 5.08 | 1.31 | 0.69 |
| Trended balance on which Return earned | 8+9 | 10 | - | 5.00 | 9.91 | 20.77 | 11.07 |
| Trend depreciation allowance | 10/RUL | 11 | - | 0.17 | 0.34 | 10.39 | 11.07 |
| Accumulated trend carried forward | 10-11 | 12 | - | 4.83 | 9.57 | 10.39 | - |
| TOC closing balance | 5+12 | 13 | 100.00 | 101.50 | 102.90 | 13.72 | - |
| | | 14 | | | | | |
| Total depreciation and amortisation | 4+11 | 15 | - | 3.50 | 3.68 | 13.72 | 14.41 |
| | | 16 | | | | | |
| **Regulatory Asset Base** | 3+10 | **17** | - | **105.00** | **106.58** | **27.44** | **14.41** |

**Annexure C: Asset treatment**

| Asset description | Remaining useful life | RAB depreciation and valuation treatment | Maintenance allowed as part of OPEX | Return allowed (included in RAB calc. for return purposes) | Notes |
|---|---|---|---|---|---|
| Short term assets | 5 years or less | Straight line historical cost | Yes | Yes | |
| Existing assets in use not fully depreciated | More than 5 years | Trended original cost | Yes | Yes | |
| Existing asset in use-fully depreciated | Any | If leased – lease revenue will be assumed value.<br>If not leased (e.g. breakwater – maintenance on the asset may be capitalized. | Yes/optional | Allowed to capitalise maintenance. Value on RAB for return calculation will be 0. | Risk of gold plating requires prudency assessment and NPCC approval for capex inclusion in RAB |
| Assets no longer in use | Any | Removed from RAB | Yes | No | |

*Notes:*

*Capitalisation dates will be 1990 if no capitalisation date post 1990 is available*

**Annexure D: Clawback calculation**

| Step | Action |
|---|---|
| Step 1: | Recalculate the Required Revenue for yr1 since we have actual numbers as at 31 March<br>(Let the Recalculated RR be *S1*) |
| Step 2: | Compare *S1* to yr1 AFS Revenue (*T1*),<br>subtract Bilateral Agreements (*B1*) |
| Step 1 & 2: | [Corrected RR yr1 – AFS Revenue yr1 – Bilateral Agreements yr1] or<br>[S1 -T1 – B1] |
| Step 3: | Add or Subtract 50% of the estimated Provisional Claw back Adjustment made in yr1 (*P1*) |
| Step 1, 2, & 3: | [*S1 -T1 – B1*] ± *P1* = Final Claw back yr1 adjusted in Yr3 ROD (*W1*) |
| Step 4: | Calculate then add or subtract Claw back Return for yr1<br>[(*W1* x *WACC yr1*)/2] (*V1*) |
| Step 5: | Calculate then add or subtract Claw back Return for yr2<br>[(W1 +V1) x WACC yr2)/2] (X1) |
| Thus Far: | Full Claw back yr1<br>(G1) = W1 + V1 + X1<br>Estimated Claw back for yr2<br>(*YY2*) = Revenue Required as per ROD yr2 – Latest Estimate Revenue yr2 |
| Step 6: | *YY2* x 50% = (*VV2*) |
| Total Clawback for ROD | G1 + VV2 |

The total Claw Back amount calculated will be included in the Revenue Requirement formula as set out in section 3.8.