

TRANSNET

delivering freight reliably

ECONOMIC REGULATION OF TRANSPORT BILL 2020

Presentation to the Select Committee on Transport, Public Service and Administration, Public Works and Infrastructure

TRANSNET SOC LTD

07 June 2023

Table Of Contents

Chapter 1

Transnet Soc Ltd – **Custodian Of Rail, Ports And Pipelines**

Chapter 2

Value Propositions **Are Founded In Our Shareholder Mandate**

Chapter 3

Transnet Supports The **Single Framework Of Economic Regulation**

Chapter 4

Regulation Of **Integrated Network Industries**

Chapter 5

Balancing: **The Cost Of Regulation & Regulator Oversight**

Chapter 6

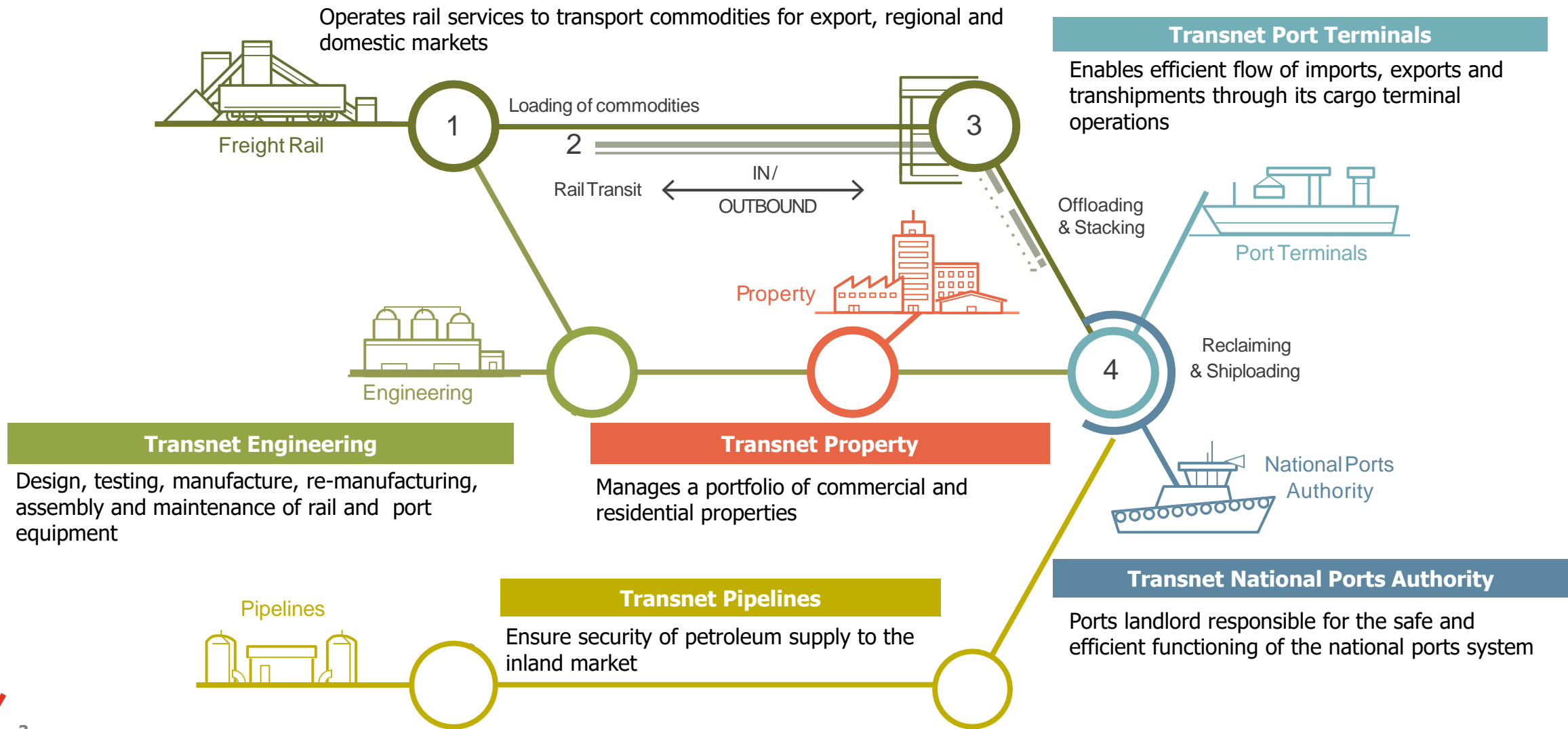
Further Recommendations To The Bill

Chapter 7

Overview Of Transnet's Comments



Transnet is the Custodian of Rail, Ports and Pipelines



1 – 4: Pit-to-port flow of commodities



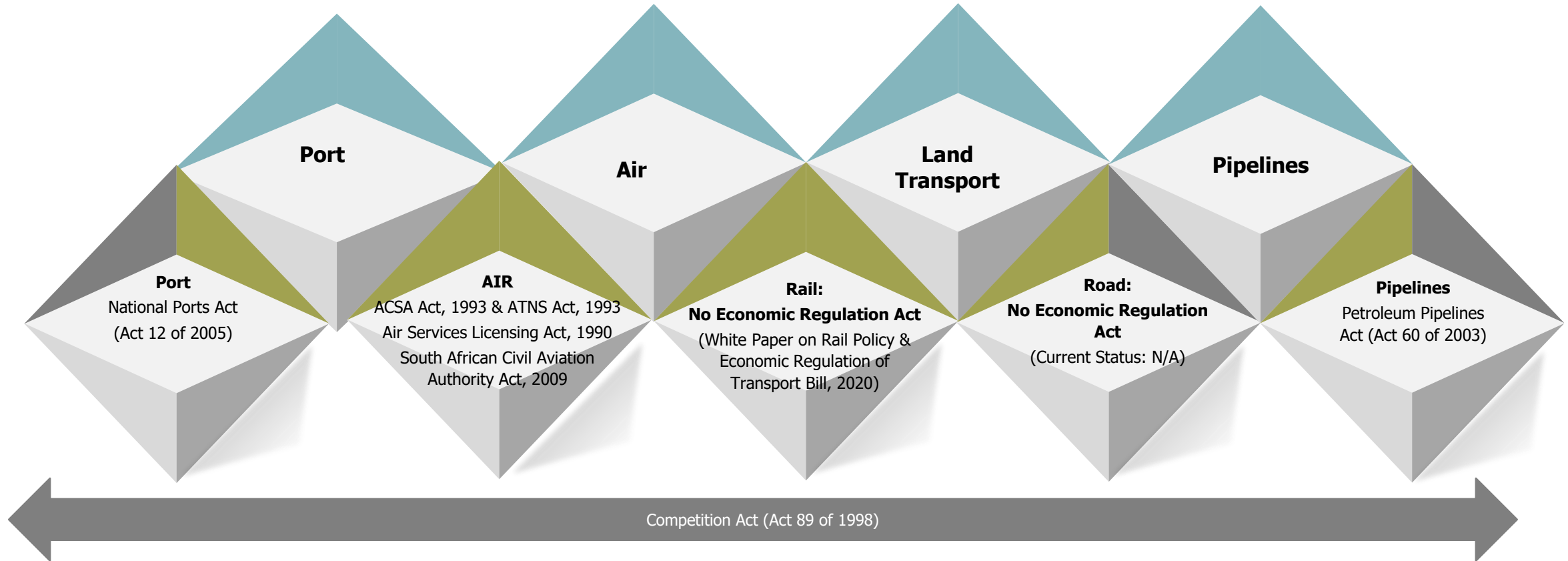
Our Value Propositions are Founded in our Shareholder Mandate

<h3>Value for the economy</h3> <ul style="list-style-type: none"> • Reduce total cost of logistics • Leverage private sector for infrastructure, rolling stock and operations • Integrate the SA economy – regionally and globally • Support market competitiveness • Modernisation and renewal of SA’s transport and logistics infrastructure • Road-to-rail migration – preserving road infrastructure 		<h3>Customer value</h3> <ul style="list-style-type: none"> • Predictable and reliable freight movement • Customer-centric business innovations • Distinctive product and service designs • Cost efficient 		<h3>Socio-economic value</h3> <ul style="list-style-type: none"> • Optimise social and economic impact of all our operations. • CSI initiatives that contribute to the socio-economic well-being of communities in the vicinity of our operations • Activities that enhance rather than deplete the natural environment 	
<h3>Value for suppliers</h3> <ul style="list-style-type: none"> • An ethical, fair, transparent and effective procurement process • A proactive and collaborative approach to local supplier development • Simple and efficient procurement processes 	<h3>Value for employees</h3> <ul style="list-style-type: none"> • Employer of choice • Safety and integrity in all we do • Opportunities to grow personally, professionally and academically • Democratic workplace 	<h3>Value for financial partners</h3> <ul style="list-style-type: none"> • A funding strategy for support based on strategic priorities and sound environmental, social and corporate governance principles • Capital investments likely to yield good and social returns • A reliable and credible borrower, which secures debt on the strength of its financial position without government guarantees 		<h3>Value for our Shareholder</h3> <ul style="list-style-type: none"> • Sustained financial returns and broad socio-economic value • Regulatory compliance, accountable business practices, ethical leadership and responsible corporate citizenship • Investment priorities closely aligned with Government’s infrastructure programme • Dividends payout 	





Transnet Supports the Single Framework of Economic Regulation



- The underlying modal legislative frameworks come from ***different historic perspectives and are not regulated in accordance with the same regulatory methodologies*** impairing, consistency and predictability.
- ***Harmonisation of Regulatory Methodologies should enable recovery of full economic costs*** which includes a reasonable rate of return across the integrated network of Rail, Ports and Pipelines with cognizance of the need for cross subsidies throughout the systems to ensure access to rail, pipelines and ports infrastructure across the country for various commodities and manufacturers.

Comparative Analysis of Economic Regulation in the Transport Sector

The table below sets out a comparative analysis of the regulatory instruments across the transport sector, having regard to the requirements of the ERT Bill as it relates to regulation of access, access regulation, pricing and request for information. The analysis below highlights that economic regulation in the transport sector is predominantly focused on rail and ports, whilst there is no economic regulation for road and very limited economic regulation for air.

Regulatory Instruments	Rail is	Road	Air	Ports
Regulation of Access	✓ (per the ERT Bill)	X	X	✓
Access Fee Regulation	✓ (per the ERT Bill)	X	X	✓
Pricing	✓ (per the ERT Bill)	X	✓ (Limited to Air Traffic Service Charge only)	✓
Request for Information	✓ (per the ERT Bill)	X	X	✓



Balancing: Cost of Regulation – Regulator Oversight

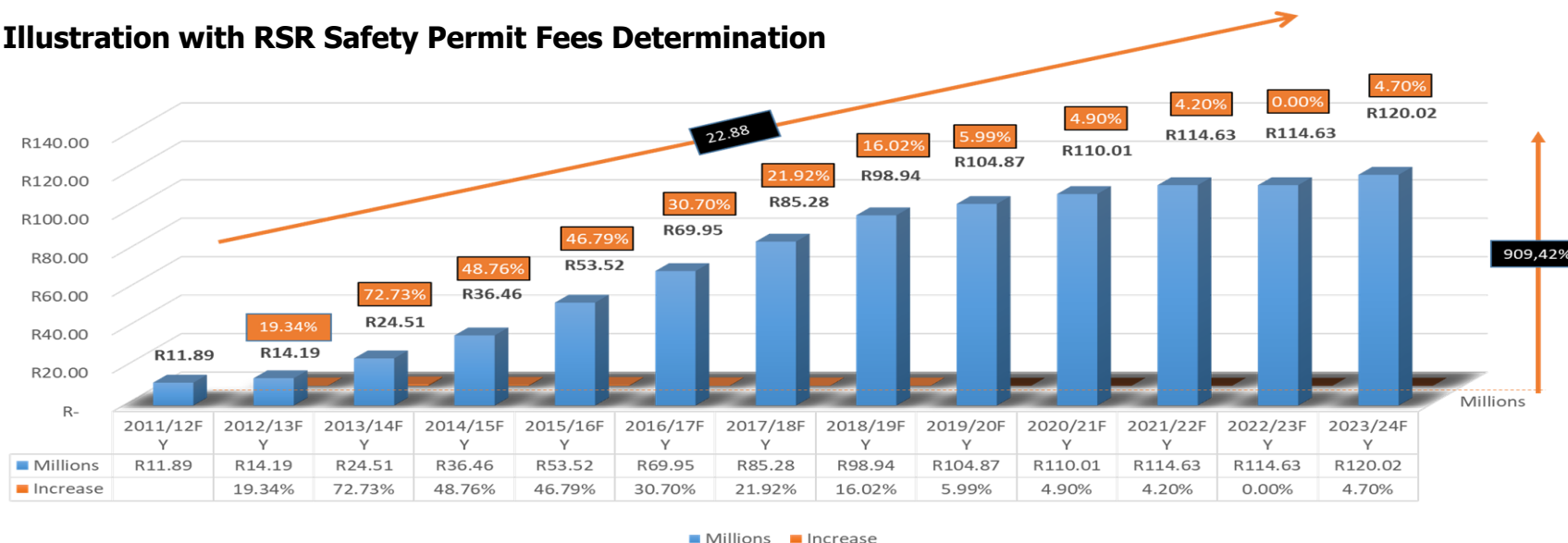
Need for sustainable funding plan for the Regulator:



Summary

- **Need for sustainable funding plan for the Regulator:**
 - Excessive fees results in burden on regulated entities; and
 - Cost pass-through to customers.
- **Illustration of the Rail Safety Permit Growth**
 - The compounded annual growth of 28% over 10 years from R11.8m in 2011/12 to R110m in 2020/21 is as a result of a lack of an appropriate pricing methodology to enable the cost of regulation to be distributed equitably between multiple licensees.
 - The Safety Permit fee Determination for 2023/2024 is R120,02m and the current compounded annual growth rate is 22.88.
 - The methodology for the calculation of the new RSR safety permit fee model was only published in March 2023 for public comment.
 - The ERT Bill needs to ensure that price setting is based on appropriate funding methodologies for regulators.

Illustration with RSR Safety Permit Fees Determination





Transnet Supports the Single Framework of Economic Regulation

The ERT Bill presents the opportunity for:

1. Regulatory principles across the different modes to be clearly established in the Bill and not be determined through regulation or rules by **the relevant** Minister and Regulator in an arbitrary manner.
2. The aforementioned is critical to ensure consistent application of Economic Regulatory methodologies that enable fairness to both customers and Operators with standardized approaches to elements of price setting, which include but are not limited to:
 - Asset valuation methodologies:
 - Discount rates-different beta, risk free rates - affect Transnet's WACC.
 - Provision for rehabilitation cost.
 - Asset maintenance regime and system design protection, for example, rail infrastructure upkeep.
 - Reserve Margin-investing ahead of demand.
 - Cost allocation methodologies.
 - Rate of return determination (profitability).
 - Regulation of quality of customer service.
 - Regulation of Maintenance and Investment Standards.
 - Regulation of information provision between Regulated entities and Regulators.
3. Reduction of the cost of regulation and enable improved learnings and focused capacity building as highlighted in Slide 7.
4. Delineation of functions to fully empower the Ports Regulator of South Africa by transferring all regulatory authority to the Ports Regulator which is vested with Transnet National Ports Authority (TNPA) by amending the National Ports Act, 2005. This change will remove the sometimes-controversial dualistic role of the TNPA and allow TNPA to focus on its role as developer unburdened by the regulatory functions.
5. The concurrent jurisdiction and potential conflict of principles between Economic Regulation and Competition Policy and Regulation to be clarified to avoid duplications with Regulators.

The ERT Bill must regulate for competitiveness of South Africa's transport sector.

If the above can be achieved through the ERT Bill Transnet fully supports, the enactment of the ERT Bill.

Overview of Transnet's Comments & Recommendations

ERT BILL	TRANSNET'S COMMENTS
<p>Access to Rail and Port Infrastructure</p> <p>Chapter 2 of the Bill deals exclusively with the proposed regulatory structure for the rail sector</p> <p>The following types of access requests may be regulated once the determination is concluded by the Minister - in terms of Clause 4 of the Bill:</p> <ul style="list-style-type: none"> • The use of rail infrastructure that has been determined to run trains; • Requests to physically interconnect infrastructure with infrastructure; or • Requests to make investments in order to increase the capacity of infrastructure that has been determined, where the owner of the said infrastructure has declined to make the requested investment to the requested specifications. <p>With regard to the port sector, amendments are proposed to the National Ports Act, per Schedule 1 of the ERT Bill, as regards the governance of infrastructure access in the ports sector.</p>	<ul style="list-style-type: none"> • It is not recommended that the economic regulation of rail infrastructure proceed in the absence of specific enabling legislation, e.g., the National Rail Act, which underlines the interactions and interoperability between rail infrastructure management and train operations. • There are risks associated with not doing the above as those aspects of the rail business that have been found to be more efficient and effective when managed as a single vertically integrated entity are lost. • The analysis of the National Rail Policy promotes a mixed model of a vertically integrated railway system with an accounting separation of infrastructure and operations. • It is also recommended that existing investigations into rail economic regulation be concluded ahead of implementing the economic regulation of rail infrastructure as contemplated. • Transnet recommends that the ERT Bill be structured around the regulatory instruments, i.e., access and access fee regulation, price regulation for transport services, quality of service regulation, provision of information, etc. and that it makes provision for and address how each regulatory instrument will be applied to each mode of transport. • It is recommended that definitions, notably of access and access arrangements to infrastructure, market, economic regulation, price control and transport sector to be distinct and clear in the ERT Bill. • Clarification is required on the application and implication of the ERT Bill on the current access arrangements and the required transitional requirements thereof, such as the role of the Regulator's in the prescribing of and receiving of fees to facilitate access arrangements. • It is further recommended that clarity on the Regulator's role in approving access agreements is fully set out in the regulatory framework and the basis for ratification. • It is recommended that the access arrangements for ports, including access to rail in ports, align with the requirements of the National Ports Act. • Transnet recommends that the ERT Bill must provide for the licensing of rail operators and consider the development of a licensing regime which will include, amongst other requirements, conditions to hold a license.

Overview of Transnet's Comments & Recommendations

ERT BILL	TRANSNET'S COMMENTS
<p>Price Regulation:</p> <p>Chapter 3 of the ERT Bill provides for economic regulation of transport facilities and services. Clause 11 of the Bill gives the Regulator powers to regulate prices in the transport sector and provides that price control of regulated entities may comprise of amongst others, a schedule of tariffs, charges, fees, tolls, or other amounts that may be imposed by the entity for the provision of transport services.</p>	<ul style="list-style-type: none"> • Whilst Transnet supports the economic regulation of access pricing, the company proposes that the economic regulation of pricing for rail haulage be reconsidered as a matter of last resort as it may have unintended consequences and further reduce the country's competitiveness in relation to commodities destined for global markets. • Given the different levels of competitive constraint experienced in the transportation of various commodities destined in both local and global markets, to avoid the inappropriate application of economic regulation, Transnet suggests that the risk and impact of price regulation should be investigated first. This is because rail is optimized when a network-pricing model is used. This will ensure that appropriate interventions are identified as there is a marked absence of appropriate regulatory models in the ERT Bill which will ensure recovery of operating costs, depreciation for asset renewal and reasonable return on investment. • Transnet recommends that the ERT Bill must provide clarity on how the different regulatory instruments of access, price, efficiencies, etc. will be applied for the different modes of transport; and how it will achieve consistency regarding asset backed cost recovery modes applicable to all transport modes/ infrastructure and facilities. • Transnet recommends policy and regulatory interventions should provide an enabling environment to address the road/rail imbalance and support the migration of traffic from road to rail instead of further constraining the competitiveness of rail. • It is Transnet's view that price regulation of rail and port operation services is not an appropriate regulatory instrument as these freight operations take place within local and global competitive markets, under these competitive circumstances, the monitoring of any excessive or discriminatory pricing could be undertaken by the Competition Commission. Further, the price regulation of railway services is not appropriate and will defeat the strategic objectives of moving rail friendly cargo from road to rail. • Transnet's view is that the ERT Bill must be clear on the regulation of all port terminal operators as this will affect the competitiveness of Transnet port terminal operations. • Transnet seeks clarity on the cost of funding the Regulator and the implications on customer affordability, as well as the associated impact on price determinations by the Regulator (Slide 7 is referenced). Transnet recommends that the Regulator is funded from the fiscus, as is the practice with other economic regulators, e.g., the economic council that regulates airports and the Ports Regulator.

Overview of Transnet's Comments & Recommendations



ERT BILL	TRANSNET'S COMMENTS
<p>Economic Regulation of Transport Facilities and Services:</p> <p>Chapter 3 of the ERT Bill presupposes that it will only apply to facilities and services offered by regulated entities. However, clause 11(1) states that "Every regulated entity that is subject to price regulation will be subject to price control determined by the Regulator.</p>	<ul style="list-style-type: none"> • Transnet recommends that the ERT Bill should endeavour to maintain the state of law applicable within the various Economic Regulators who are providing oversight to regulated entities in the current context and also simplify the statutory landscape. • It is recommended that whilst there is no overarching policy specifically targeted to all transport sectors (i.e., rail, road, civil aviation, and ports) to be regulated by the envisaged Act, a Preamble is required to declare the intent of this Bill and outline the broad principles contained in the particular legislation. • The ERT Bill should focus on implementing regulatory instruments in network industries ex ante (prior to implementation) whilst the Competition Commission applies these instruments ex post (after the conduct) in competitive markets. Whilst regulatory concurrence is possible, the economic regulatory approach must be consistent with the provisions of the Competition Act and circumstances of market intervention to avoid the risk of inconsistencies.
<p>Economic Oversight of Regulated Entities</p> <p>Chapter 4 & 5 of the ERT Bill: The ERT Bill requires from the regulated entities, submission of development plans for the facilities it operates, or has licensed others to operate, or the services that it provides or has licensed others to provide. The Transport Economic Regulator will regulate all areas of the market where competition is inadequate to ensure efficient market outcomes.</p>	<ul style="list-style-type: none"> • Transnet is concerned with the rising cost of economic regulation hence it is suggested that the Bill make as one of its objectives, reducing the cost of economic regulation whilst capitalising on existing regulatory regimes in place to avoid uncertainty and duplication. • Transnet also recommends that a cost sharing arrangement between regulated entities and government should be developed to provide an incentive for both parties to ensure that the costs of the economic regulator are optimized and that specific provisions are made in the Bill to ensure that the economic regulator's costs are subject to appropriate scrutiny and challenge. • Transnet recommends an appropriate methodology for determining the funding costs of the Regulator and it must also be borne in mind that these costs are passed through to customers. • Transnet suggests that the Regulator should strive to attain the principles of capital maintenance, which is premised on full cost recovery plus the cost of capital maintenance. Transnet is already struggling to sustainably maintain the cost of providing the railway network in a sustainable condition having regard to the current economic and financial climate. • Transnet recommends the transfer of certain regulatory powers of the National Ports Authority to the Ports Regulator of South Africa, in order to enhance the independence of decision making as is related to all terminal operators. To this extent, a proposal is under consideration wherein it is being proposed that the regulatory functions of TNPA per Sections 56, 57, 58, 59 and 79 of the National Ports Act, 2005 are transferred to the PRSA.

Overview of Transnet's Comments & Recommendations

ERT BILL	TRANSNET'S COMMENTS
<p>Constitutional Governance</p> <p>Section 4: Application of the Act</p> <ul style="list-style-type: none"> • Clause 4(2) of the Bill states that the Minister in consultation with the Regulator may declare that the ERT Bill can apply to any market. <p>Section 51: Minister to determine annual fees to be paid by regulated entities</p> <ul style="list-style-type: none"> • Clause 51(1) provides that the regulated entities will bear the cost of the Regulator and the Council. 	<ul style="list-style-type: none"> • Transnet is of the view that a sub-delegation of powers from the legislature to a Minister is unusual. The ERT Bill constitutes primary legislation and establishes the parameters of economic regulation for the transport sector. Any amendment to the envisaged Act must follow the prescripts relating to the amendment of primary legislation i.e., an Amendment Bill to be approved by Cabinet for submission to Parliament. In existing economic transport legislation, Parliament retains their authority and regulatory powers. Parliament has the original authority to regulate the ports and energy environment, however in the ERT Bill, Parliament is abdicating their role to the Minister. • Transnet is of the opinion that an annual fee is to be paid by regulated entities and will be used to fund the operational expenses of the Regulator and the Council, means that this is a tax that ought to be imposed by way of a 'Money Bill' as provided for in Section 77 of the Constitution. • Transnet's view is that the ERT Bill will impose a huge financial burden on the regulated entities, and this will further make it more difficult for regulated entities to reduce costs of doing business. In the case of the rail and the ports sector, any pass-through elements adding onto high cost will cause freight customers to choose a cheaper mode of transport, which will lead to the use of road transport as road is not regulated. • As stated in Slide 9, Transnet recommends that the ERT Bill must provide clarity on how the different regulatory instruments of access, price, efficiencies, etc. will be applied for the different modes of transport and how it will achieve consistency regarding asset backed cost recovery modes applicable to all transport modes/ infrastructure and facilities.

TRANSNET



delivering freight reliably

THANK YOU

