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ECONOMIC IMPACT AND PORT ASSET PACKAGING STUDY

FINAL REPORT (MILESTONE 6)

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MARKETS
GROUP

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Prepared by:
CPCS Transcom

In association with:
The Cornell Group
Shipping and Transport College/Dynamar Consultancy
Expeditor Management Services
Phathani Consulting (Pty) Ltd

Under contract to:
Emerging Markets Group, Ltd.
(f/k/a Deloitte Touche Tohmatsu Emerging Markets, Ltd.)

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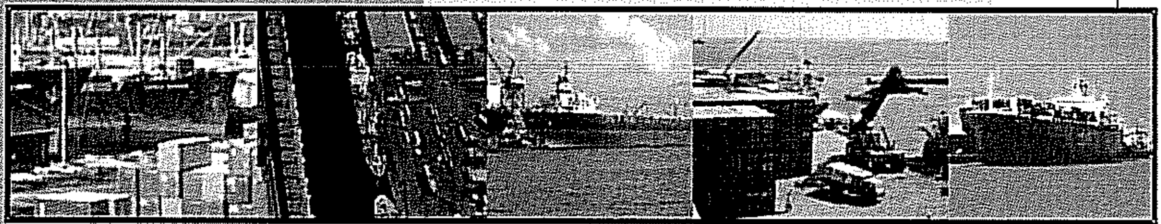

FINAL REPORT
(MILESTONE 6)

Economic Impact and Port Asset Packaging Study

prepared for:

Department of Public Enterprises, Government of South Africa
U.S. Agency for International Development
U.K. Department for International Development

under contract to

Deloitte Touche Tohmatsu Emerging Markets Limited

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1 Introduction

The Government of South Africa set out a new policy framework to restructure the South African port system in the *White Paper on National Commercial Ports Policy*, issued in March 2002. That policy has continued to evolve, in part as a direct result of extensive discussions between Government and labour under the NFA framework during 2003. It is our understanding that the following major policies have been confirmed as of late 2003:

- The mixture of Government and private management of terminals within the ports managed by *NPA* will continue.[1] In order to maximize options for competition both within and between South African ports, the end-state of the process of increasing private sector involvement in port operations will be a situation where the number of terminals operated by *SAPO* is likely to be less than the thirteen but more than zero;
- The guarantee to labour that no jobs will be lost during the first three years of concessioning, initially applied only to DCT, will be extended to other terminals where private sector operation is to be encouraged[2];
- The *NPA Act*, withdrawn in mid-2003 but shortly to be again placed before Parliament, will continue to provide for the possible future separation of *NPA* from *Transnet*. However it will not include a firm timetable for this action, which is to be re-considered at a later date.

The *Department of Public Enterprises* (*DPE*) is leading the government team to implement the restructuring objectives set down in the *National Commercial Ports Policy*. The restructuring process has to date also involved *Transnet*, *National Port Authority* (*NPA*, presently a division of *Transnet*) and *South Africa Port Operations* (*SAPO*, also a division of *Transnet*), and key ministries, including *Trade and Industry*, *National Transport* and *National Treasury*, all represented on the *Ports Restructuring Steering Committee* (*PRSC*).

Following an open tender and competitive process, *DPE* retained the services of a consortium led by *CPCS Transcom* to provide technical support to the development of strategies for the packaging and the sequencing of the various facilities to be concessioned and to assess the implications of the concessioning options on *NPA* and its port branches (***EIAPPS Project***). Ports that are under *NPA* authority but that do not presently contain commercial operations were not included, since they do not provide any immediate potential for private sector involvement in operation of commercial port activities. This study therefore was limited to terminals within existing and planned South African national ports under *NPA*, excluding Port Nolloth and Mossel Bay because they do not presently provide commercial operations. It therefore includes: Richards Bay, Durban, East London, Port Elizabeth, Cape Town, and Saldanha Bay, plus the port presently under development at

[1] The private sector has always been active in the management of select terminals within the NPA port system, including most of the Maydon wharf in Durban and the major coal terminal in Richards Bay. The current restructuring initiative is therefore aimed at increasing the involvement of the private sector in terminals currently operated by *SAPO*, not at introducing private sector operation to South African ports.

[2] In May 2002 the Minister stated (with respect to DCT): "Labour will be given job security by the new concessionaire for a minimum period of 3 years that reflect current conditions, pension funds, and other social security arrangements". This statement does not make clear whether the guarantee applies to the total number of workers at a point in time, or to each individual in the position he or she occupies on the day of handover. The distinction will prove critical; potential terminal operators indicated that they are willing to deal with on imposed freeze on number of employees for an initial period, so long as they can retain flexibility in re-assignment of individuals.

Ngqura (Coega). This ***Final Report*** summarizes the work that was completed during the project, including reports prepared, interaction with the *PRSC*, BEE skills development and Government Capacity Building.

The Consortium lead by *CPCS Transcom* included *The Cornell Group* (USA), *Shipping and Transport College/Dynamar Consultancy* (Netherlands) and two BEE firms from Africa - (*Pathani Consulting (Pty) Ltd.* and *Expeditor Management Services*. The contract between *Deloitte Touche Tohmatsu Emerging Markets Limited – DTT* (on behalf of Department of Public Enterprises – *DPE*, U.S. Agency for International Development – USAID, and U.K. Department for International Development – DFID) and *CPCS Transcom Ltd.* (on behalf of the Consortium) was signed on 30 September 2003, and the Team began work at the *DPE* offices in Pretoria on October 22, 2003[3]. This ***Final Report*** (Milestone 6) is being submitted in January 2004.

Figure 1.1 summarizes the outputs of this ***EIAPPS Project*** as defined in the Work Plan provided in our ***Inception Report***. This includes the planned and actual date of submission of each contract milestone report specified in our contract with DTT, as well as other key activities such as Working Papers.

Figure 1.1

Output	Target Submission Date	Actual Submission Date	Review with *PRSC*	Final Revision
Milestone 1: Inception Report	15 November 2002	15 November 2002	6 December 2002	-
Working Paper 1: Implications of Existing Private Sector Participation in SA Ports		24 December 2002	-	-
Milestone 2: Concession Strategy	15 January 2003	27 January	4 February	February 2003
Working Paper 4A: Operations and Facilities: DCT		15 January 2003	-	-
Working Paper 2: Labour Mitigation Strategies		30 January 2003	-	March 2003
Public Workshops	January 2003	January 22 (Gauteng) January 23 (Durban)	-	-
Working Paper 3: Review of *NPA* Traffic Forecasts		3 March 2003	-	-
Milestone 3: DCT Concession Plan	15 March	15 March 2003	25 March 2003	May 2003
Port Reform Toolkit workshop	22-24 March	22-24 March	-	-
Working Paper 6: Financial Model		24 January 2003	-	April 2003
Milestone 4: Economic impact Analysis	11 April	24 March	15 May	June 2003
Working Papers 4b, 4c: Operations and Facilities:		May-July 32003		
Milestone 5: Transaction Strategy	11 April	28 November 2003	-	December 2003
Final Report	June 17 2003	5 December 2003	-	January 2004

[3] At the time of signing of the contract with the CPCS Transcom consortium, it was envisaged that *SAPO* would cease to exist once all 13 *SAPO* terminals had been concessioned to private operators.

The *PRSC* agreed with the consortium's observation, expressed at a meeting held December 5 2002 in Pretoria to review our ***Inception Report***, that a macro-economic impact analysis would not provide data at a level that could assist in intra-port or even inter-port comparisons of terminals. Such analysis therefore could not serve as a "driver" for a formal concessioning sequencing and packaging model at the level of individual terminals. Since the measurement of the potential overall macro-economic impact of terminal restructuring was regarded as the prime output of the "Economic Impact" task (***Milestone 4***), it was therefore agreed that work on the economic impact task would be limited to development of those macro-economic measures.

Comments on the various *Working Papers,* provided by members of the *PRSC* in writing or in the course of formal and informal meetings, were incorporated in our key strategic Milestone Reports (2,3 and 5), as were comments on Milestone 1 and Milestone 4. ***Milestone 5*** thus takes specific account of all feedback received on prior milestones and working papers, and therefore should therefore be read as our final recommendations for restructuring (concessioning of the thirteen terminals within the original policy framework). Under that framework, as specified in late 2002, *SAPO* would cease to exist as an operating entity once all terminals had been concessioned, and *NPA* would eventually be separated from TRANSNET.

In mid-March of 2003 we were advised that completion of Milestone 3 (***DCT Concession Plan***) and subsequent Milestones should be delayed, pending Government policy decisions on the "guiding principles" that would govern port concessioning. In June 2003, after acceptance by the *PRSC* of the ***Milestone 3*** and ***Milestone 4*** reports, we were advised that **Milestone 5** (***Transaction Strategy Report)*** should be further delayed, pending key Government policy decisions. In September 2003 we were advised that the Government had decided to proceed with port restructuring under a different model than envisaged in 2002, with *SAPO* continuing to operate in direct competition with concessioned terminal facilities where possible. In late 2003 we were provided with a sketch of the evolving policy, permitting us to complete both the ***Milestone 5*** Report and the present one. While ***Milestone 5*** makes only passing reference to recent policy evolution, in Section 3 of this ***Final Report*** we specifically consider the impact of these policy change on issues that have been critical since this technical assistance began and on new issues arising as a direct result of that revised policy.

Between October 2002 and June 2003 the Study Team Leader worked in the *DPE* offices (and with *NPA* and *SAPO* staff in Johannesburg and Durban) for more than three months. In total, team members worked well over 12 man-months in South Africa. Team members participated in meetings of the *Ports Restructuring Steering Committee* in Pretoria in October and December of 2002, in February, March, April, May, and June of 2003, and in meetings of the *Port Reform Communication Group* (which also *SAPO, NPA, DPE* and *DTT*) between February and June of 2003.

2 Capacity Building

2.1 Government Capacity Building

The objectively verifiable output for this component was "Execution of two Seminars including the delivery of papers of various issues of concern by the consultants."

In January 2003 the *CPCS Transcom Consortium* organized two one-day public workshops – one at the ESKOM Centre in Gauteng and one in Durban. More than 50 representatives of Government, the port unions and port users attended each session. The sessions provided a broad overview of recent worldwide experience in port reform, and included extended discussion between attendees and the presenters on the implications of this experience for South Africa.

The agenda for the two public workshops was as follows:

- **Introductory remarks by *DPE***
- **World Trends in Port Reform**

(Peter Kieran, President, CPCS Transcom Ltd., Canada)

- **Transport Sector Reform: A Political Perspective**

(Hon. Douglas Young, former Federal Minister of Transport, Canada)

- **Best Practices for Restructuring Ports**
    - India and Sri Lanka (Pamy Arora, Executive vice-President, The Cornell Group, USA)
    - Canada (David Bellefontaine, past President, Halifax Port Authority, Canada
    - Europe (Marc Evertse, Port of Rotterdam
- **Panel Discussion/Questions from the Floor**

In March 2003, with co-funding by *CIDA Inc* (Government of Canada), *CPCS Transcom* undertook an intensive three-day workshop for a smaller group, principally members of the *Port Restructuring Steering Committee*, our BEE partners, and representatives of one of the key port unions.[4] This workshop involved a presentation and discussion of key elements of the *World Bank Port Reform Toolkit*, plus a detailed presentation of both the process of concessioning of the container terminal in Dar es Salaam[5] and the lessons learned from that experience, regarded by the Government of Tanzania, the World Bank and the operator as a major success. The early success of this terminal concession led the Government of Tanzania to proceed with concessioning of the balance of cargo handling in the port.

2.2 BEE Capacity Building

The objectively verifiable output for this component was "Participation of the BEE team members in the successful execution of 'their' project components." All components in which BEE partners participated were satisfactorily completed. In addition, CPCS Transcom

[4] At the request of the representatives from UTATU who participated in the 3-day workshop, a special one-day session was conducted later in the month at UTATU headquarters in Johannesburg, attended by representatives of all three key port sector unions.

[5] The terminal concessioning process in Tanzania was managed by *CPCS Transcom.*

conducted a one-day workshop on project management with our BEE partners, in conjunction with the March "Port Reform Toolkit" workshop, in which they also participated.

3 Key Issues

Our November 2002 ***Inception Report*** identified a number of key issues directly impacting on port restructuring strategy, on which policy decisions were still pending. These remained important policy concerns throughout our extensive interaction with the *PRSC* between October 2002 and June 2003. Most of them remain critical today, despite ongoing changes in the policy environment for increasing private sector involvement in port operations. In addition, the new policy framework, with *SAPO* continuing to play a role as terminal operator, raises a number of new issues that were not considered in our previous analysis.

3.1 Labour Issues

There are two key labour issues in any major port restructuring endeavour – how to deal with surplus labour (if any) and how to ensure that an adequately trained labour force will be available to the terminal operator as the labour force ages and skill requirements increase over time.

As noted above, prior to the beginning of this *PEIPPS Project* the Government of South Africa announced a decision to require bidders for the DCT concession to guarantee no lay-offs during the initial 3 years of the concession. As a result of extensive discussions between Government and the key port unions during the first half of 2003, it has been decided to extend a similar guarantee to other terminals presently operated by *SAPO*, whether they continue to be operated by *SAPO*, are concessioned to a private operator, or are divided between *SAPO* and a private operator to provide direct intra-port competition. Staff can be reduced during this period only by natural attrition or strictly voluntary early retirement.

We analyzed the age distribution of the existing labour in detail only for DCT. At that terminal, which in late 2002 accounted for 1,020 people, or 18% of *SAPO*'s overall employment, 476 employees were over 45, 335 over 50 and 121 were over 55. For the other ports, preliminary analysis suggests a broadly similar structure, with 32-35% of the labour force is over 50. The annual rate of natural attrition, currently 4%, is likely to increase substantially as the average age of employees continues to rise.

The employment guarantee period, while it may be extended beyond 3 years, will certainly be much less than the 20 to 30 year term of a concession agreement. Thus the longer term and more critical issue for new operators not be surplus labour, but rather development of an immediate and ongoing program to recruit and train new workers, before key skilled workers are lost to natural attrition or retirement. This should therefore be identified in the initial call for proposals as a critical item, to be considered explicitly in bid evaluation.

While excess labour is not likely to be a serious issue for DCT, preliminary analysis indicates that over-staffing may be more common in other terminals, at least during a relatively short initial period. Our discussions with a number of potential bidders during 2003 suggests that being required to retain labour beyond their perceived initial requirements will reduce the amount bidders are willing to pay as a concession fee, but was generally not perceived to be a "deal-killer", in the sense of changing the decision of a bidder whether or not to make a bid for a particular terminal.

3.2 Port Reform Legislation

In reviewing the *Draft NPA Bill* in October 2002, we noted a number of apparent anomalies. The detailed commentary we provided in November 2002 has been superceded by the revised draft, which was returned to the legislative committee in mid-2003. Although the Bill was withdrawn shortly after, it is expected to be retabled shortly. However a number of the broader issues raised by the 2002 and 2003 drafts remain relevant in 2004.

As a general comment, the *Act* concentrates more on the relationship between the *NPA* and the regulator than on the role of the *NPA* (or the Regulator) in terms of monitoring the performance of concession agreements, or of the regulator in adjudicating disputes between *NPA* and concessionaires or other port users. In our discussions with *NPA* it has not been clear that *NPA* fully accepts the concept of the distinction between "managing the concession(s)" (or concessionaire(s) and "managing the concession contract(s)". Except for the setting of tariff ceilings etc, *NPA*'s day-to-day interaction with terminal operators holding long-term concessions will in fact be formally limited to the reporting specified in the concession contract. Operators whose performance in terms of specified indicators fully meets their contracted targets will in effect be protected by their concession agreement from demands for additional information etc. from *NPA*.

It will be essential to ensure that the final *NPA* bill provides an explicit 'last resort' provision for *NPA* to take over existing leases by paying appropriate compensation, where negotiation fails. This could take the form of a provision similar to that included in all new leases (see Section 3.4 below). In the absence of such a provision, existing lease agreements with port tenants that cannot be renegotiated, if they adversely affect the operating layout and operational efficiency of a new operator, may make certain restructuring transactions 'un-doable".

3.3 Development of the new Port of Ngqura at Coega

The *Port of Ngqura Establishment Act 77* (1998) specifies that *Transnet Limited* shall have the power to:

> "construct, equip, control, manage possess and maintain approach, entrance and navigational channels and turning basins with accompanying buoying, wharves, docks, basins, jetties, piers, signal stations, navigational aids, breakwaters, yards, railway lines, sidings, road and services, storage areas, buildings, and other facilities or appurtenances or additional works necessary for or incidental to the proper working of the port". (Article 2(4))

That *Act* also specifies that:

> "The costs of construction, equipping, control, operation, management, possession and maintenance of the port shall be financed by the Company". (Article 5)

NPA, a division of *Transnet,* has been designated by *TransNet* as the entity responsible for construction and development of the new port. Two key elements of the proposals for Ngqura relate directly to the concessioning of DCT and other established container terminals in South Africa:

- It was proposed that *P&O Nedlloyd/TCI Infrastructure* develop and operate a container terminal. This agreement was being negotiated directly between *NPA* and *P&O Nedlloyd/TCI Infrastructure.* The negotiation process has been managed directly by *NPA* (as part of their mandate to develop and operate or arrange for the operation of the overall port), without direct involvement of those who are dealing with both overall strategy or individual transactions (the *PRSC* and its successors).
- *NPA* will initially construct at least one purpose-built terminal within the port, designed to serve a single user.

Since *P&O Nedlloyd/TCI Infrastructure* is not in fact a terminal operator, it is not clear who will actually operate the container terminal under the arrangement being negotiated. While Ngqura is designated as a national port under *NPA*, it is also not clear whether after the Phase 1 marine infrastructure has been finished whether additional terminals are to be developed and financed by the private sector or by *NPA*.

The following issues therefore require consideration by *DPE* and the *Ports Restructuring Steering Committee* (or its successors):

- Will additional berths/terminals at Coega be developed directly by *NPA*, or by private sector port operators under some form of BOT agreement?
- If additional berths/terminals are developed by *NPA*, how will the operators be selected?
- If additional berths/terminals are developed under one or more BOT agreements, how will these concessions be awarded?

While detailed information was not made available to the CPCS Consortium Team, press reports and other sources indicate that during initial discussions *P&O Nedlloyd/TCI Infrastructure* tabled the following proposed conditions:

- Rail tariff equalization for Gauteng-Ngqura and Gauteng-Durban, despite the substantially greater rail distance to Ngqura, implying an ongoing direct or indirect subsidy by the Government of South Africa to all cargo using this corridor;
- A commitment to add rail capacity as required, and to eventually develop a new and more direct rail corridor between Gauteng and Ngqura[6];
- Integration of Port Elizabeth into the Ngqura container terminal concession, with a plan to phase out container operations at Port Elizabeth;
- Restrictions on capacity expansion at other container terminals in South Africa for a number of years, to ensure that the container terminal at Ngqura is full utilized before additional capacity is added elsewhere.

It must be kept in mind that the container terminal concession presently being negotiated at Ngqura arises from a bid to develop and operate a container terminal, in response to a very broadly worded announcement related to development of an industrial park/free zone. Because *NPA* has a statutory responsibility for the planning and construction of all port infrastructure, negotiation of the terminal concession within the port being developed by *NPA* passed from CDC to *NPA*. However the above conditions would not appear to be

[6] Such a subsidy would certainly provide an advantage to Gauteng producers and consumers through stimulating interport competition between Durban and Ngqura. However it could be regarded as encouraging inland industrial growth at the expense of the less-developed coastal regions of the country. This is not fully consistent with the strategy of the CDC industrial zone at Coega, which is intended to encourage industrial development in the Eastern Cape.

entirely consistent with the *National Commercial Ports Policy* (*White Paper*) or with the guidelines for dealing with unsolicited proposals included in the *Public-Private Partnerships Manual*, as issued by National Treasury in May 2001. The latter states that:

> "Proposals should conform with governmental aims, be in the public interest, avoid the creation of monopolistic practices, not seek to place onerous conditions upon Government, and reflect environmental, social and economic sustainability" (Section I, p. 3)

The *National Commercial Ports Policy* states that:

> "Greater private sector involvement in operations will be sought through leases and concessions;
>
> The allocation of leases or concessions will be open to competitive bidding;
>
> The bidding process will be transparent and based on a set of clearly stated objectives/targets." (Section 3.1)

Granting of a concession that includes special conditions for the Ngqura container terminal that are substantially different from the conditions to be applied to other terminals to be concessioned (or to be operated by SAPOO) would of course impact significantly (and negatively) on the "concessionability" of all other container-handling terminals in South Africa. Acceptance of these conditions would not only be inconsistent with the policy documents cited above, and probably preclude the concessioning of the Port Elizabeth container terminal, but would also limit the freedom of *NPA*, *SAPO* or new concessionaires to develop future container handling capacity at Durban or elsewhere. There is no provision for such conditions, a number of which would involve agencies of Government other than *NPA*, within the current pro forma *NPA* lease, discussed further in the following section. In November 2003 we therefore recommended as follows:

> "...As soon as the Concessioning Architecture/guiding principles framework receives final endorsement from the Departments and Ministries involved in the Ports Restructuring Steering Committee, steps be taken to ensure that further negotiations regarding the container terminal at Ngqura proceed under that framework. While this may lead to some delay in finalizing that agreement (the reported target date for signature of an MOU is early 2003) failure to do so is likely to seriously prejudice the implementation of an open and transparent process for the concessioning of other terminals within the South African port system, including Durban Container Terminal."

Although the approach to increased private sector terminal management now envisages both *SAPO* and private sector operation within DCT and other terminals rather than a handover from *SAPO* to a private operator of each of the 13 terminals, the problem remains of the uniqueness of the Coega/Ngqura container terminal remains within an environment where the Government of South Africa seeks increased private sector involvement within terminals that may compete directly or indirectly with Coega/Ngqura for traffic.

3.4 Existing *NPA* Leases

NPA currently manages more than 400 leases, including 108 on the Maydon wharf. Most of these are long term, with an average remaining life of more than 30 years. Many of these, dating from the early 20th century, fail to provide for price escalation over time. One of the existing leases is perpetual, with no termination date. Few include a "no sub-lease" clause, so an active secondary market in these leases has emerged.

NPA is already proceeding with renegotiation of these leases on two fronts. In the absence of specific funding that would permit the "buy-out" of existing leases, *NPA* has been seeking to negotiate new leases one by one, based on a modern market-oriented pro forma agreement. While a small number of such leases have been renegotiated, these have been limited to cases where *NPA* is in a position to provide a "carrot", such as deeper water alongside the key or better landside access. *NPA* undertook a detailed analysis of existing leases analysis, which indicates that the present annual gap between market-based rents (assumed to be 10% of the market value of the land) and current rents is in excess of Rand 35 million.[7] One effort to unilaterally change the terms of an existing lease was challenged in the Courts, where a decision was pending in mid-2003. The new standard-form lease agreement includes a number of key elements to address historic problems:

- Twenty year life, with renewal during the final 2 years of the lease subject to mutual agreement;
- Annual escalation of lease payments, related to market conditions;
- A "no sub-let" clause;
- A clause permitting *NPA* to give notice of intent to terminate the lease for reasons of port planning. *NPA* would be obliged to provide suitable alternate space and to pay the cost of leasehold improvements that cannot be moved. In the event of disagreement, a mediation process is foreseen, but the entire process is expected to provide *NPA* with access to land occupied under a revised lease within 24 months.

Since *NPA* has not been provided with the financial resources to buy out leases directly or to consolidate existing leases through the secondary market, it is actively encouraging existing leaseholders to do so. While the number of outstanding leases will be unchanged after consolidation through the secondary market, the number of leaseholders will be substantially reduced. *NPA* has prepared a plan for a "rationalized" Maydon wharf, involving six terminals. *NPA* believes that consolidation by existing leaseholders will significantly simplify both the process of re-negotiation and the ongoing work of property management, since a number of existing leases, under different terms, will be consolidated into a single new lease.

In at least one case, an existing operator who is consolidating existing leases within the *NPA* plan for the Maydon wharf is reported to have given notice that it intends to apply to *NPA* for approval to operate a new container terminal under the consolidated lease. While not expressly precluded (or foreseen) by the *White Paper* or the current policy prescriptions, this consolidation process is of course open only to those who are aware of its existence – effectively to those who are presently leaseholders. As with the proposed container terminal at Ngqura, we believe that it is essential that all such "concession" proposals be evaluated and awarded within the same framework, to avoid giving potential bidders for other facilities, including Durban Container Terminal, the impression that there is more than one set of rules in South Africa for the granting of terminal concessions.

[7] This preliminary analysis does not take into account the cost to *NPA* of providing the "carrots" needed to encourage current leaseholders to sign revised leases.

3.5 Continued Involvement of *SAPO* in Terminal Operations at DCT

One of the reasons for deciding that there will be an ongoing role for SAPO is to provide for the possibility of direct competition between the public and private terminal operations. The immediate application will be container handling in Durban. Two terminals will be created as part of the initial restructuring, not necessarily within the current boundaries of DCT. While this was not our initial recommendation[8], it is certainly physically possible to make such a split. However experience in both Sri Lanka and India with the model of direct competition between public and private operation of terminals (or ports) suggests that if there is a "level playing field" the public operator fairly quickly lose market share. In Colombo this led within a few years to a decision to concession the 2nd container facility, which had continued to be operated by the port authority after the first concession took place. In Dar es Salaam, where only the container terminal was concessioned initially, the success of that concession led Government to concession the handling of non-contaierized cargo to a private operator

In the South African situation, care must be taken to decide on a number of technical issues (and to communicate those decisions to *SAPO* and bidders) in advance, to avoid either short-term or long-term conflicts between *SAPO* and the private-sector operator:

Short-term issues include:

- the need to provide an "equitable" but functional division of storage area, berths and office space, which will be operationally viable for both operators;
- the need to provide an "equitable" division of moveable assets (particularly port cranes and straddle carriers). While *SAPO* will probably wish to continue to use straddle carriers, certain private operators will almost certainly prefer to use an alternate approach to container handling within the yard, based on their own operating experience elsewhere.
- The need to provide an equitable division of the existing labour force. The "standard" approach of allowing the concessionaire to select from among the existing labour force (after the end of the guarantee period specified by Government) is not workable in an environment where *SAPO* will continue to operate. As the current manager of the existing labour force *SAPO* would clearly be at an advantage in a "competitive" partition of that labour force, in terms of knowledge of individual performance.
- The need to define a new tariff-setting structure for terminal operations. Tariffs for terminal operation are presently set nation-wide, discouraging any competition between ports. *SAPO*'s September 2003 observations on a mixed public-private model for port operations appears to continue this vision of an integrated or centrally planned port system, rather than encouraging competition between ports. As discussed in our ***Milestone 5*** Report, the potential for direct competition between ports in South Africa (or indeed competition between ports in South Africa and other southern Africa ports) is limited by the inland transport system, which creates "semi-unique"

[8] It is also not entirely consistent with the *NPA* preference for a single concession, as expressed to the *PRSC* in early 2003. NPA proposed that this initial concession could be expanded spatially by NPA in future at the request of the concessionaire. The *CPCS Transcom Consortium* proposed that a second concession be granted when expansion was required.

hinterlands for each port. It is further limited at present by the policy of common port charges, including terminal charges throughout the country. However, competition does exist for certain classes of traffic – particularly for transshipment traffic – and will continue to exist. The issue is whether to explicitly encourage (or discourage) increased competition. Effective inter-port or intra-port competition will rely on a price-setting mechanism that permits – indeed encourages – both intra-port and inter-port price competition.

- The need to define a revised division of revenue between *NPA* as landlord and *SAPO* (or private operators) as terminal operator. The present structure evolved during the era when vessel charges and terminal charges were collected by a single entity (*PortNet*). The structure emphasized revenue from cargo dues, with explicit terminal charges accounting for less than 30% of total revenue. This revenue structure was unrelated to the level of terminal and "harbour services" costs incurred. *NPA* began a process of "rebalancing" of the tariff structure after *PortNet* was divided (essentially through a reduction in the level of cargo dues, formerly collected as an *ad valorem* charge called wharfage). However the planned progressive reduction was halted after the first year, apparently because of *TransNet* concerns about the corporate impact of reduced revenues from *NPA*. If concessionaires are required to make substantial investment, the current terminal charges are unlikely to permit them to obtain a return on new investment.

  While *SAPO* and private sector operators will be free to increase terminal charges, in the absence of further "rebalancing" by *NPA* the sum of terminal charges and payments to *NPA* would exceed present total direct charges for the use of South African ports. This would not only be politically unacceptable but would also risk diverting traffic from South African ports to other ports of the region. While increased cargo-handling competition in any form is desirable from the point-of-view of South African cargo owners, it is unlikely to be in the national interest to divert South African traffic away from South African ports.

The key long-term issues include:

- The unequal expansion potential of the two portions of DCT. This is not dependent on whether or not Pier 1 (the former multi-purpose terminal, currently being redeveloped by *NPA* to provide additional container handling berths and storage area) is included with the present DCT.

  However the terminal is split initially, potential expansion toward the inside of the bay is extremely limited, both by environmental concerns and by the existing lease for the container storage area, which was recently renewed for a term in excess of 20 years. Expansion toward the entrance channel and the sea, whether through incorporation of Pier 1 or beyond Pier 1 by a combination of landfill and development of the area presently controlled by the South African Navy, can be continued for some years. Therefore even after an "equitable" division of the current terminal area is agreed upon, the potential for expansion will remain "inequitable". In a strategic sense this could be dealt with by linking the concession for the "fixed land area" terminal to the potential for development of a third container terminal, to be located at the new harbour being considered for future development by *NPA*. Since the timing of development of this new harbour is much less certain than expansion within the existing harbour, the key decision will be whether *SAPO* should be assigned the "limited expansion" portion or the "readily expandable" one, or whether that allocation should be made via a competitive (bidding) mechanism rather than as a policy decision.

- Concerns by private concessionaires arising from the fact that at least initially both *SAPO* (as a direct competitor) and *NPA* (as the landlord for both *SAPO* and the private operator) will continue to operate as "ring-fenced divisions" of *TransNet*. Once the port tariff structure has been rebalanced (through a reduction of the charges made by *NPA*) it might be desirable to separate *SAPO* from TransNet, either as a single entity or via creation of a separate operating entity for each terminal to continue to be operated.

3.6 Continued Involvement of *SAPO* in Terminal Operations at other Terminals in South Africa

After all or part of the container handling operations in Durban have been concessioned, it will be desirable to proceed as quickly as possible to concessioning of other container terminals in South Africa, and in due course to a process of deciding how to deal with each of the other terminals presently operated by *SAPO*. The timetable should to be announced in advance of the concessioning of DCT, at least for other container terminals, so that bidders are aware both of the speed with which inter-port competition will be introduced and with whether or not the successful bidder in Durban will be permitted to bid for other container terminals. If a decision is made to provide rate equalization for land transport between Gauteng and Durban or Coega/Ngqura, this should also be announced in advance of the call for bids for DCT (whether as one or two terminals).

Some of the terminals presently operated by *SAPO* cannot readily be split between two operators, either because of scale factors (such as the Port Elizabeth container terminal) or because of their essentially unitary operation (such as the Saldanha iron ore terminal or the Port Elizabeth ore plant). In each of these cases it will therefore be necessary to make a decision to either leave the facility with *SAPO*, to cease *SAPO* operation and hand the terminal over to a private operator, or to create a strategic partnership between *SAPO* and a private operator. Key decision criteria for this decision include:

- **Single Commodity Terminals**

  Smaller producers face risks to the export transport chain if a key element of that chain such as the terminal, is handed over over to one of the exporters (usually the largest). This has become a public issue for the export of coal from smaller mines through the private coal-handling facility at Richards Bay. A similar problem could well occur for manganese at Port Elizabeth or even iron ore at Saldanha. In such a circumstance the public interest may be better served by continuing to have terminal operation in the hands of a public entity such as SAPO.

- **Multi-Purpose Terminals**

  This business has been in overall decline worldwide for some years, as containerization of general cargo. Each such terminal can be thought of as a cluster of small single-purpose terminals, handling a shifting mix of commodities classified as "general cargo". The details of the mix will differ between ports, and can change fierily rapidly over time. However there are a number of specialized operators of particular components usually handled by such facilities, for components that continue to grow (bulk sugar, cement, granite, logs edible oils, etc). Some of these operators are already active in South Africa, handling granite or sugar, for example. For other commodities, specialized South African experience is not yet available outside *SAPO*. A strategic decision will therefore need to be taken about the benefits and costs of concessioning out a larger number of small facilities, each serving a local market for a particular commodity, resulting in a comparatively high "tranaction cost" for each concession, but leading to little or no increase in competition[9]. It is likely to be difficult to find an experienced operator, inside or outside of South Africa, to handle a changing mix of commodities within one "multi-purpose terminal", where the overall volume shows little or no overall growth potential.

[9] Each terminal in effect handles a single commodity with a unique hinterland, so there is no potential for either inter-terminal or inter-port competition.