NATIONAL ENERGY REGULATOR OF SOUTH AFRICA

TARIFF DECISION FOR ROYALE ENERGY (PTY) LTD'S PETROLEUM STORAGE FACILITY IN KLERKSDORP

6 MARCH 2018

TABLE OF CONTENTS

LIST OF TABLES

THE NATIONAL ENERGY REGULATOR OF SOUTH AFRICA

In the matter regarding

THE APPLICATION FOR APPROVAL OF A TARIFF FOR A LICENCED PETROLEUM STORAGE FACILITY IN KLERKSDORP

By

ROYALE ENERGY TERMINALS (PTY) LTD

THE DECISION

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1. On 6 March 2018, the National Energy Regulator of South Africa (NERSA) **approved,** as a condition of the operation licence of Royale Energy Terminals (Pty) Ltd ('Royale') (licence number:PPL.sf.F3/321/1/2017), the tariff for its petroleum storage facility located at 4 Mahogany Avenue, Klerksdorp in the North West Province.

2. The tariff approved by NERSA for petroleum storage is a maximum tariff and is exclusive of VAT. The tariff for the petroleum storage facility is shown in Table 1.

Table 1: Tariff approved for the storage facility

	1 March 2018 to 28 February 2019
Tariff (cents per litre)	18.10

3. The approved tariff will remain in force until NERSA takes a decision to approve a new tariff.

4. Royale is requested to comply with Regulation 9 of the Regulations made in terms of the Petroleum Pipelines Act, 2003 (Act No. 60 of 2003) by submitting a report on its plans for the rehabilitation of land.

5. Furthermore, Royale is requested to comply with condition 13 of its operational licence by submitting its Regulatory Reporting Manuals (RRMs) to NERSA.

REASONS FOR DECISION

INTRODUCTION

6. On 3 November 2017, Royale Energy Terminals (Pty) Ltd (hereinafter referred to as 'Royale') submitted a tariff application for the period of 1 March 2018 to 28 February 2019.

7. Royale sought approval for a tariff of 18.10 cents per litre (cpl). The National Energy Regulator of South Africa (NERSA), using its Methodology, calculated a tariff of 18.09 cpl.

8. This is the first tariff application approved by NERSA and the tariff is based on the total Allowable Revenue (AR) divided by the total volume. The AR is calculated based on the Trended Original Cost (TOC) Methodology.

BACKGROUND

9. Royale is a private company registered in terms of the company laws of South Africa, with company registration number 2005/000802/07 and it was established in 2004. Royale is a 100% black-owned company and is a level four contributor in terms of the Broad-Based Black Economic Empowerment Act, 2003 (Act No. 53 of 2003).

10. The tariff application was submitted based on the Tariff Methodology for the Approval of Tariffs for the Petroleum Loading and Storage Facilities Version 4, approved on 24 August 2017 ('the TOC Tariff Methodology Version 4'). The Methodology requires that assets be valued using the TOC.

APPLICABLE LAW

11. The legal basis for NERSA to approve tariffs for petroleum loading and storage facilities is derived from the National Energy Regulator Act, 2004 (Act No. 40 of 2004) ('NERSA Act'), read with the Petroleum Pipelines Act, 2003 (Act No. 60 of 2003) ('the Act')[1].

[1] Available at www.nersa.org.za

THE METHODOLOGY

12. NERSA is required by Section 28(2)(a)(i) of the Act to approve tariffs based on a systematic methodology applicable on a consistent and comparable basis[2]. To this end, NERSA published the Tariff Methodology for the Approval of Tariffs for Petroleum Loading and Petroleum Storage Facilities, Version 4, approved on 24 August 2017[3], which outlines the approach taken in this decision.

13. Section 1 of the Methodology provides that:

    Licensees may submit their tariff applications using their own methodologies or use this methodology as a guide, however, NERSA will use this tariff methodology to evaluate tariff applications and approve tariffs. Therefore, the Licensees must provide in their applications all the information necessary to apply this methodology.

DECISION-MAKING PROCESS

14. As part of the public consultation process, NERSA published the non-confidential version of the tariff application on its website for comments on 18 December 2017. Notices inviting the public to comment were published in the *Business Day* newspapers and the *Beeld* newspaper on 19 January 2018.

15. The closing date for public comments was 18 January 2018. No comments were received from interested or affected stakeholders or members of the public.

16. The Public Hearing to consider the tariff application was scheduled for 1 February 2018, but did not take place as no members of the public or affected stakeholders registered to make presentations.

ASSESSMENT OF THE APPLICATION

Basis of the tariff application

17. In assessing this application, NERSA used the TOC Tariff Methodology to assess the outcome of the tariff applied for by Royale for its storage facility.

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[2] Section 28(2)(a)(i) of the Act
[3] Available at www.nersa.org.za

18. Data supplied by Royale was used for most of the calculations performed in this evaluation. Where this is not the case, the reasons for not using Royale's supplied data are provided.

Calculation of the Allowable Revenue (AR)

19. Royale calculated its AR based on the Rate of Return (ROR) approach as prescribed by the TOC Tariff Methodology.

20. In accordance with the TOC Tariff Methodology, the following formula was used to determine Royale's AR:

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

Where:

RAB	=	Regulatory Asset Base
WACC	=	Weighted Average Cost of Capital
E	=	Expenses: Operating and Maintenance expenses for the tariff period under review
D	=	Depreciation expense for the tariff period under review
C	=	Clawback adjustment: to correct for differences between actual and forecasts in formula elements from a preceding tariff period in relation to the actual estimates for that tariff period
T	=	Tax: estimated tax expense for the tariff period under review.

21. The elements of the AR are discussed in more detail in the paragraphs below.

Regulatory Asset Base (RAB)

22. According to the TOC Tariff Methodology, RAB is to be determined by applying the following formula:

$$\mathbf{RAB = (V - d) + w \pm dtax}$$

Where:

V	=	Value of Operating Property, Plant, Vehicles and Equipment
d	=	Accumulated Depreciation and Accumulated Amortisation of inflation write-up for the period up to the commencement of the tariff period under review
w	=	Net Working Capital
dtax	=	Deferred Tax

Property, Plant, Vehicles and Equipment (PPE)

23. Royale states that the RAB value is based on the TOC method which requires that the original cost of the assets be indexed annually using the Consumer Price Index (CPI) value over the economic useful life of the assets.

24. Royale applied the TOC method correctly and arrived at a Property, Plant, Vehicles and Equipment (PPE) value of [redacted].

25. NERSA determined the value of PPE by using the asset values submitted by Royale. The assets were trended using the CPI values and Depreciated on a straight line basis. NERSA arrived at a PPE value of [redacted].

26. NERSA accepted the PPE value of [redacted] in the calculation of RAB and reserves its right to verify the PPE value provided by Royale. Any difference between the PPE value submitted for this tariff application and the verified PPE value will be subject to a clawback in the next tariff period.

Net Working Capital (w)

27. The following formula from the TOC Tariff Methodology was used to determine the Net Working Capital.

Net Working Capital = Inventory + Receivables + Operating Cash – Trade Payables

28. Royale states that its Trade Receivables are based on 30 days of AR, Operating Cash on 45 days of Operating Expenditure (OPEX) and Trade Payables on 45 days of AR as prescribed by the TOC Tariff Methodology. However, the calculation by Royale resulted in Trade Receivables of 30 days of AR, Trade Payables of 45 days of AR and

Operating Cash of 45 days of OPEX. This resulted in a Net Working Capital of [redacted].

29. NERSA followed its TOC Tariff Methodology in determining the Trade Receivables and Trade Payables. NERSA calculated the Trade Receivables based on 30 days of AR, Operating Cash on 45 days of OPEX and Trade Payables on 45 days of AR. NERSA calculated the Net Working Capital to be [redacted].

30. A comparison of the Net Working Capital values of Royale and NERSA is presented in Table 2.

Table 2: Calculation of Net Working Capital

	2018/19	
	Royale	NERSA
	R	R
Inventory	[redacted]	[redacted]
Trade Receivables	[redacted]	[redacted]
Operating cash	[redacted]	[redacted]
Trade Payables	[redacted]	[redacted]
Net working capital	[redacted]	[redacted]

31. Table 2 shows that there is a slight difference between the Net Working Capital calculated by Royale and that calculated by NERSA due to the different AR values used by both parties.

32. The Net Working Capital was then added to the PPE value to arrive at the RAB value on which a return should be earned.

Deferred Tax (Dtax)

33. No Deferred Tax was provided by Royale. Therefore, the RAB value does not include any Deferred Tax calculation.

34. A comparison of RAB values between Royale and NERSA including the Net Working Capital is shown in Table 3.

Table 3: Comparison of RAB values between Royale and NERSA

	2018/19	
	Royale	NERSA
	R	R
PPE	[redacted]	[redacted]
W	[redacted]	[redacted]
Total RAB	[redacted]	[redacted]

35. Table 3 shows that there is a difference in the RAB value applied for by Royale and that calculated by NERSA due to the different Net Working Capital values calculated by both parties.

Weighted Average Cost of Capital (WACC)

36. Section 5 of the TOC Tariff Methodology stipulates that the following formula must be used to determine the WACC:

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

Where:

Eq	=	Shareholders equity
Dt	=	Interest bearing debt
Ke	=	Post-tax, real cost of equity derived from the CAPM
Kd	=	Post-tax, real[4] cost of debt

37. In determining the WACC value, the TOC Tariff Methodology requires that data used to calculate the Cost of Equity be that of 12 months prior to the commencement of the tariff period under review. In this regard, NERSA used the data of 28 February 2017 to determine the Cost of Equity value. There is no difference between the data used by Royale and NERSA. Royale arrived at the Cost of Equity value of [redacted] and NERSA arrived at the same Cost of Equity value of [redacted].

38. Royale used a nominal Cost of Debt of [redacted] and used a Consumer Price Index forecast (CPIf) of 5.70% as a conversion factor to calculate the real Cost of Debt of [redacted]. NERSA also used the same data and arrived at the same real Cost of Debt of [redacted]. This therefore, resulted in the same WACC value of [redacted] being calculated by Royale and NERSA.

39. The WACC calculation by Royale and NERSA is depicted in Table 4.

[4] First convert from pre- to post-tax and then from nominal to real.

Table 4: Comparison of WACC calculation

	2018/19	
	Applicant	**NERSA**
Risk free rate	4.65%	4.65%
Market risk premium (real)	5.40%	5.40%
Beta	[redacted]	[redacted]
Liquidity Premium (LP)	[redacted]	[redacted]
Cost of Equity (real)	[redacted]	[redacted]
Nominal cost of debt	[redacted]	[redacted]
CPI forecast	5.70%	5.70%
Corporate tax rate	28%	28%
Cost of Debt (post-tax real)	[redacted]	[redacted]
Capital Structure:		
Debt ratio	[redacted]	[redacted]
Equity ratio	[redacted]	[redacted]
WACC	[redacted]	[redacted]

Operation Expenses (E)

40. Regulation 5(2) read with Regulation 4(2)(a) made in terms of the Petroleum Pipelines Act, 2003 (Act No.60 of 2003) ('the Act') provides that the tariffs approved by NERSA must enable an efficient licensee to recover reasonable Operational and Maintenance expenses in the year in which they are incurred.

41. Royale submitted its forecast expenses for this storage facility to be [redacted].

42. NERSA used Royale's forecast expenses in its tariff calculation. NERSA accepts Royale's forecast expenses. Any difference between the expenses provided in this tariff application and actual expenses incurred will be subject to a clawback in the next tariff application.

Land Rehabilitation Costs

43. Royale provided its Land Rehabilitation costs of [redacted] in its tariff calculation. However, Royale is requested to submit a report on its plans for the rehabilitation of land in accordance with Regulation 9 of the Regulations made in terms of the Act.

Depreciation (D)

44. Section 8.1 of the TOC Tariff Methodology prescribes that Depreciation is calculated on a straight line basis over the service life of each of the assets or classes of assets. Royale calculated its Depreciation using a straight line basis. The Depreciation calculated by Royale is [redacted].

45. NERSA also used a straight line basis to calculate the Depreciation as prescribed in the TOC Tariff Methodology. NERSA calculated the Depreciation to be [redacted].

46. NERSA accepts the Depreciation as calculated by Royale and reserves the right to verify the RAB values submitted by Royale as this would have an impact on the Depreciation. Any difference between this Depreciation and the verified Depreciation will be subject to a clawback in the next tariff period.

Clawbacks (C)

47. Royale did not determine the clawback for this tariff application. This is Royale's first tariff application and any impact on clawback will be considered in future tariff applications.

Tax Allowance (T)

48. Royale has opted to use the Notional Tax payment approach in determining its Tax Allowance. Section 7 of the TOC Tariff Methodology prescribes the following formula for calculating the notional Tax Allowance:

Tax	**=**	**{(NRBTA)/ (1-t)*t}**

Where:

NRBTA = Net revenue before tax allowance

= {(RAB*WACC) + E + D (historic & write up) ±C} - {E + Depreciation (historic))}

t = Prevailing corporate tax rate of the licensee.

49. NERSA interprets a Notional Tax Allowance to mean the Tax due according to accounting requirements rather than the actual Tax payable in the period under review. Table 5 shows the Tax Allowance calculated by NERSA and Royale.

50. A Comparison of the Tax Allowance calculated by Royale and that calculated by NERSA is shown in Table 5.

Table 5: Tax comparison between the Royale and NERSA

	2018/19	
	Royale	NERSA
	R	R
Corporate Tax	28%	28%
RAB	[redacted]	[redacted]
WACC	[redacted]	[redacted]
Return on investment	[redacted]	[redacted]
Added: OPEX costs	[redacted]	[redacted]
Less: OPEX costs	[redacted]	[redacted]
Total allowance before tax	[redacted]	[redacted]
Tax	[redacted]	[redacted]

51. Table 5 shows that there is a difference in Tax Allowance due to different RAB values and ultimately different AR values between Royale and NERSA.

52. NERSA reserves its right to verify the Tax Allowance value provided by Royale. Any difference between the Tax Allowance value submitted for this tariff application and the verified Tax Allowance value will be subject to a clawback in the next tariff period.

Allowable Revenue (AR)

53. In calculating the AR the following formula is used:

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

54. Royale calculated its AR based on the ROR approach. This is in accordance with the TOC Tariff Methodology.

55. NERSA also performed its calculations of AR based on the ROR method. A comparison of AR values between Royale and NERSA is shown in Table 6.

Table 6: Comparison of AR values between Royale and NERSA

	2018/19	
	Royale	NERSA
	R	R
Assets value (PPE)	[redacted]	[redacted]
Net Working capital	[redacted]	[redacted]
RAB	[redacted]	[redacted]
WACC	[redacted]	[redacted]
Return on RAB	[redacted]	[redacted]
Total OPEX	[redacted]	[redacted]
Taxation	[redacted]	[redacted]
AR	[redacted]	[redacted]
% difference in AR values	**0.03%**	

56. Table 6 shows that there is a difference in AR due to the different Tax Allowance values calculated by Royale and NERSA.

57. NERSA reserves its right to verify the AR value provided by Royale. Any difference between the AR value submitted for this tariff application and the verified AR value will be subject to a clawback in the next tariff period.

Volumes

58. In the tariff application, Royale submitted its forecast throughput volumes of [redacted] litres for the 2018/19 tariff period. NERSA accepts the forecast volumes as submitted by Royale, subject to clawback in the next tariff period.

Tariff design

59. In calculating the tariff, Royale took the total AR divided by the total throughput volume. The tariffs are expressed in cents per litre and are exclusive of VAT.

60. The tariffs calculated by Royale and NERSA are shown in Table 7.

Table 7: Tariffs calculated by Royale and NERSA

	2018/19	
	Applicant	**NERSA**
	R	**R**
AR	[redacted]	[redacted]
Volumes		
Tariff	**18.10**	**18.09**
% difference in tariffs	0.03%	

61. Table 7 shows that there is a difference of 0.03% in the tariffs calculated by Royale and those determined by NERSA. This is due to the difference in Net Working Capital and RAB values, which ultimately result in the AR values being different.

Conclusion

62. On the conspectus of the facts and evidence, it is appropriate and in compliance with the requirements of the National Energy Regulator Act, 2004 (Act No. 40 of 2004) to make the decision set out above. The decision finds a reasonable balance between the interests of customers on the one hand and the interests of investors on the other.