

RESPONSE TO THE DOCUMENT ENTITLED:

Possible Reforms to the fiscal regime applicable to windfall profits in South Africa's liquid fuel energy sector, with particular reference to the synthetic fuel industry.

1. Introduction

Transnet is affected by the discussions on windfall profits in the liquid fuels industry in the following ways:

- As large user of fuels in its operations – largest user is traction fuel in Diesel Locomotives in Spoornet and SAPO – marine diesel;
- As carrier of fuel via its pipeline infrastructure owned and operated by Petronet;
- As transporter of fuel via rail tank cars by Spoornet;
- As transporter of fuel via road tank lorries by Freightdynamics;
- As owner of a large vehicle fleet;

The commentary in this document refers in the main to the discussion document for public comment issued by the Task Team appointed by the Minister of Finance to look into possible reforms.

The comments and conclusions in the discussion document, which is available publicly may influence the perceptions about Transnet in general, but Petronet and Spoornet in particular. If these comments are inaccurate or ambiguous it could impact these businesses via regulatory environment and customer relationship management. The comments contained herein are intended to correct inaccuracies and provide inputs on certain aspects.

2. Responses to specific paragraphs in the Discussion Document

2.1 Comments on Chapter 4: Answers to questions posed in 4.6

First Question:

Transnet agrees with these terms and definitions. The application of the reforms have to be done in a non-disruptive way to the industry at large. A phased program of introducing change should be employed.

Second Question:

Transnet agrees that economic rent qualifies for taxation. This is especially true since the South African government has previously heavily invested in the synfuels industry, with the mainstay of benefits going to private shareholders. It may be argued that some degree of retrospective correction may appropriate, but there are significant risks to be considered, for example to investment into the country, etc. Transnet would not endorse

retrospective taxation of windfall profits, given our current understanding that the likely risks outweigh the benefits and our belief that a mechanism to calculate the degree of windfalls can be very complex.

Third Question

Transnet agrees that there are the two aspects. Please read our comments in the second question above.

Fifth Question

Conceptually, yes... but reality has proven that there is always been windfall profits instead of losses in the SFI.

Sixth Question

Transnet suggests that the following key considerations need to be added:

- There needs to be consideration of the drivers of decision making – political vs. economic drivers. This should inform policy going into the future to ensure that the decisions balance all the imperatives.
- There should be strong focus on SFI as a strategic enabler to the SA economy, from the point of view of:
 - Greater degree of self sufficiency and beneficiation of coal/gas
 - An exportable technology
 - Means of driving down domestic production costs and improving competitiveness
 - Effect of fuel price on inflation, etc.

2.2 Comments on Chapter 5:

Section 5.5

Infrastructure was developed within the regulatory framework of the day as part of the total fuel delivery system. Part of the regulatory framework was to give priority to Synfuels (by means of the SASOL Supply Agreement) this did give priority to SASOL, but it was not a choice exercised by Petronet.

Under normal circumstances the focus would have been on Network Optimization. The concept of “locational advantage” was a natural attribute of the system. This is because the location of primary inputs (raw materials and coal) and the National Security issues around ‘inland’ as opposed to ‘coastal’ zoning of refineries resulted in the geographic position of SASOL, which in turn benefited from reduced logistics costs.

The perception expressed in the discussion document needs to be corrected:

- competition amongst oil companies does not translate into benefit for business or motorists, since Petrol prices are regulated, and as such SASOL's infrastructure benefit is of no consequence to this discussion;
- there exists a degree of benefit to large commercial users of diesel, if they negotiate with fuel suppliers. It cannot be assumed that the pipeline infrastructure benefit that SASOL has influences this at all, since it is mitigated by the network 'sharing systems' in place ('back to back', 'borrow loan', 'product exchange'), at different locations.
- we suppose that the existence of such "product exchange" agreements in the industry was the reason why the pipeline fell into disuse for many years, since the "system" as a whole had enough distribution capacity.
- we need to add that the contribution to the current pipeline infrastructure constraint is a failure of the market and the regulatory environment in the determination of fair pricing in the market.

Section 5.7.3 – last paragraph

Transnet does not believe that there is any foundation in the conclusion that the "scheduling of pipeline deliveries is biased to Sasol's requirements". In fact, Petronet's liquid fuel pipelines operate on the "common carrier" principle, which ensures that all carriers are subject to the same conditions.

Section 5.8.4

For the case of Transnet as state owned enterprise, this is true insofar Petronet is part of Transnet. By virtue of this relationship all profits and losses of all operating divisions and entities in Transnet accrue to a single bottom line. There is no policy or deliberate framework of cross subsidizing and adjusting pricing regimes to ensure that enough profits are made to "carry" other divisions.

Section 5.8.5 – bullets 24 to 25

These statements imply that there was a collusive arrangement between SASOL and Petronet, to the exclusion of the rest of the oil industry. This is a fallacy. All decisions were made on the basis of sound business principles, given the constraints applicable at the time. No special or additional resources was expended from Petronet in order to benefit SASOL.

2.3 Comments on Chapter 6:

None.

2.4 Comments on Chapter 7:

Section 7.3 Table item 2

Definite windfalls exists – typically ‘stock profits’ – for example the period March to July 2006, was extremely high due to a R1.243 increase in BFP. Stock Profits relate to ‘stock on hand’ when price adjustments are imminent – the typical response by the fuel industry to an expected price increase is to ‘stock pile’ reserves at the ruling price prior to the increase. The minimal stock holding is calculated at 14 days as per the Supply Managers’ Oil Industry Forum. The Industry has been typified by high stock windfall gains. Transnet believes that a policy response needs to be considered, especially since the fuel industry does not pass any of these benefits on to the consumer.

Section 7.3 Table item 5

There is a question around whether the “rents were windfalls” : This should be a definite “No”. The “no” is not due to policy, but by consequence of the ‘locational advantage’. SASOL does not have the transportation element (zone differential) and as such experiences a windfall. Due to this we believe that past windfall profits should reflect a “Yes” – since this situation has been in place historically.

Section 7.3 Table item 6

There is a question around whether the “rents were windfalls” : This should be a definite “Yes”. As above – SASOL benefits from the zone differential. Hence past windfall profits should also be a “Yes”.

Section 7.4.4

Transnet agrees with this, but would like to add that the government policy around infrastructure was the main driver for the transportation of fuel. This had nothing to do with actions taken by Petronet to necessarily advantage one supplier over another.

Section 7.4.7

Normal business processes were followed – there was no sympathetic stance taken by Petronet towards SASOL and Total. The engagements were done on pure business principals that took into account all factors pertaining to good business decision making. Petronet welcomes any further detailed engagement by the Task Team on this matter.

Section 7.5

We would like to add the following:

- Consideration should be given to incorporating a process for review, and
- A watchdog mechanism (like an ombudsman) which allows for “complaints” and issues around compliance to be heard.

2.5 Comments on Chapter 8:

None.

2.6 Comments on Chapter 9:

Section 9.1

No comment on both Royalty Bills for Gas and Coal.

Section 9.2 bullet item 1

No comment

Section 9.2 bullet item 2

No comment

Section 9.2 bullet item 3

Transnet has embarked on an ongoing process of upgrading our diesel Traction Sites, which stores fuel for the diesel locomotives. The upgrades are in line with our Safety, Health, Environmental and Risk (SHERQ) Policy.

Section 9.2 bullet item 4

Transnet considers biodiesel as very important to its future plans, especially for the operation of diesel locomotives. The expectation is that biodiesel is a very significant environmental and governmental imperative and we would suggest that a tax relief mechanism should be considered to encourage usage/production of biodiesel.

Section 9.3 bullet item 1

We agree with your comments

Section 9.3 bullet item 2

We agree the conditions as set out – however we believe economic rent should qualify for taxation when the windfalls accrue to a limited number of private shareholders and not SA society at large.

Section 9.3 bullet item 3 and 4

We agree with these statements.

Section 9.3 bullet item 5

The document is sufficiently comprehensive.

Section 9.3 bullet item 6 & 7

We are satisfied with your interpretation.

Section 9.4 bullet items 1 and 2

Transnet is not in a position to validate the information in the 'history section'. We will also not comment on the logistics infrastructure, since Petronet as the 'carrier' acts on pipeline orders received from the Oil Industry.

Section 9.4

No comment on OOC's, Government, CEF, IDC and PetroSA

Section 9.5

No comment

Section 9.6

No comment

Section 9.7

No comment on the fiscal measures suggested. We support the use of a common, transparent and equitable mechanism, and welcome any relief forthcoming.

3. Conclusion

Transnet appreciates the opportunity to be part of this process and would like to be invited to the public hearings on this matter. If there is any detail required by the Task Team on any aspects that are related to Transnet, we invite further dialogue. We will indicate when information and views are regarded as sensitive and not for public knowledge or scrutiny.

Thank You,

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Transnet