NERSA ANALYSIS OF THE PUBLIC COMMENTS ON THE PRELIMINARY GAS TRANSMISSION TARIFF FOR TRANSNET PIPELINES (LILY PIPELINE) FOR THE PERIOD 01 JANUARY TO 31 DECEMBER 2010

Name of Company	Section	Comments	NERSA Analysis
1. Transnet	1. Applicable Law	The National Energy Regulator of South Africa ("NERSA") is mandated in terms of the National Energy Regulator Act, 2004 (Act No. 40 of 2004) to regulate the piped-gas industry. In terms of Section 4(h) of the Gas act, 2001 (Act No. 48 of 2001) NERSA must "monitor and approve and, if necessary, regulate" transmission and storage tariffs.	Agreed
2. SASOL GAS		As set out in paragraph 2 of the Consultation Document Section 4(h) of the Gas Act, 2001 (Act No 48 of 2001) (Gas Act), provides that the Gas Regulator must "monitor and approve and, if necessary regulate" transmission tariffs. From the Consultation Document there appears to be difference between the calculation of the transmission tariff as calculated by NERSA and the tariff calculated by Transnet in accordance with the existing agreement between Transnet Pipelines and Sasol Gas. It is however not clear from the Consultation Document, whether the Regulator intends to prescribe the transmission tariffs as calculated by NERSA as a regulated tariff or whether NERSA intends to only monitor and approve the tariff as agreed between Transnet and Sasol Gas in accordance with the agreement in question. It is submitted that if NERSA intends to prescribe the tariff as a regulated tariff, NERSA only has the jurisdiction to do so in the event that there are clear reasons why it is necessary to regulate the tariff as opposed to monitor and approve the	As part of its "monitoring and approval" mandate, the Energy Regulator performs an independent verification of the tariff so as to check for reasonableness. The main purpose of NERSA's independent determination is to check whether the tariff conforms to the Gas Act.

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		tariff. It is further submitted that in both the Transnet application as well as the NERSA Consultation Document, no such necessity for a regulated tariff in respect of the transmission facility in question has been set out and no such necessity exists.	
		The current Gas Transportation Agreement in terms of which Transnet Pipelines transports gas for Sasol Gas to the market in KwaZulu-Natal through the Lilly pipeline was negotiated during 2004 and the first half of 2005. The agreement was signed on 22 June 2005. This agreement came into effect prior to the Gas Act becoming effective On 1 November 2005. As such, this agreement constitutes an existing agreement as referred to in paragraph 2.3 of the Guidelines for the Monitoring and Approving of Piped Gas Transmission and Storage Tariffs in South Africa (NERSA Tariff Methodology) dated 1 May 2009.	It is an existing agreement, however the Gas Act was promulgated in 2001.As such the Act was already on the public domain by 22 June 2005 when the GTA was signed (as evidenced by references made to the Gas Act in some sections of the GTA). Furthermore, all existing agreements, including agreements that were in force prior to the enactment of the Gas Act are subject to monitoring and approval and if necessary regulation by the Energy Regulator. It should be noted that in order to attract investment and promote the development of the piped-gas sector, the Energy Regulator is acutely aware of the need to provide regulatory certainty and predictability and would approach existing contracts with prudence.

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			In light of the above, the Energy Regulator can prescribe a tariff in a pre-existing agreement if the tariff applied for does not meet the objects of the Gas Act and if the tariff is not cost effective and non-discriminatory as contemplated in Section 22 of the Gas Act.
1. Transnet	2. Tariff Application	In its 2010/11 tariff application, Transnet Limited ("Transnet") applied for an increase of 1.47% on its block tariff, from R7.49/GJ in 2010 based on the weighted escalation formula in the Gas Transportation Agreement ("GTA"). Transnet is not applying for a R7.49/GJ across the board tariff but for the following tariff structure: 0-12 MGJ/a 7.60 12.1-18 MGJ/a 4.36 18.1-23MGJ/a 3.84	The Energy Regulator has considered the main tariff of R7.60/GJ. Any volume discounts applied on tariffs are at the discretion of the licensee but should be applied in a non-discriminatory manner as contemplated in section 22 of the Gas Act.

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1. Transnet	3. Elements of Allowable Revenue	Transnet is in broad agreement with NERSA applying a Rate of Return (“RoR”) methodology in assessing the current gas tariffs. The methodology stated as follows: AR = (RAB x WACC) + E +T +D + C	Agreed
	3.1 Starting RAB	Transnet notes that NERSA applied the Starting Regulatory Asset Base (“SRAB”) of R566m as approved by the Energy Regulator on 25 March 2010. At the time of submission this value was not available and the 2005 MEAV value of R592m was applied as this is the value that formed the basis of the GTA.	Section (4.4.1) of the Tariff Guidelines states that the regulatory asset base is derived from the inflation-adjusted historical cost or trended original cost (TOC) value of assets. As such, the TOC value of R566m should be used as the SARB as opposed to the modern equivalent asset value (MEAV) of R592m.
	3.2 Depreciation	It should be noted that while PricewaterhouseCoopers (“PwC”) used an average useful life of 42 years when establishing the SRAB as at March 2006, actual useful lives need to be incorporated into the post 2006 trending of assets. For example the Lilly gas pipeline (actual pipeline and not associated assets) has a useful life of 75 years, of which 43 years remain as at 1 April 2010. NERSA in applying PwC average life of 42 has therefore understated the asset life by asserting 21 years remain as at 1 April 2010. As the PwC SRAB has not yet been rolled out at an individual asset level, it appears appropriate for NERSA to use the average as they have for now, but should however bear in mind the likely	NERSA is in agreement with Transnet’s assertion that the actual remaining useful lives should be used going forward once Pwc’s SARB exercise has been rolled out at an individual asset level. The adjustments would be done when the exercise is fully completed.

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		possibility of future asset adjustments once the exercise has been fully completed and the SRAB rolled out at individual asset level.	
	3.3 Tax	NERSA's approach has been to use the pass through method, which is in contrast to the petroleum methodology which reflects a notional tax approach. As both gas and petroleum products are transported by Transnet Pipelines ("TPL"), both gas and petroleum Regulatory Reporting Manuals ("RRMs") need to be implemented at TPL. In order to ensure complete, reliable and accurate data we need to make sure that the sum of the parts equal the whole. The only way that this can be achieved is to apply consistent methodologies. We therefore request that NERSA consistently apply notional tax method as elected by Transnet for the Petroleum Pipeline 2011 tariff application. The notional tax formula is: NPBT = (RAB x WACC) + total depreciation (trended plus historic) – historic depreciation + Clawback And Tax = NPBT / (1 – tax rate) x tax rate If notional tax is to be used in the AR calculation, then deferred tax should be deducted from the RAB. As per the petroleum pipelines methodology, the opening deferred tax balance should be used. As the 2010/11 gas tariff application is the first submission to NERSA, deferred tax prior to 2010/211 should be excluded.	The flow-through tax approach is the Energy Regulator's preferred tax methodology for the piped gas transmission and storage tariff application. However, the Energy Regulator may upon request allow a licensee to use the normalized tax approach under the following conditions: 1. *Where a licensee has been using a normalized tax approach in the past and has obtained approval from the Energy Regulator to continue using this approach.* 2. *Any other licensee wishing to use the normalized tax approach must motivate to the Energy Regulator before using the normalized approach and provide sufficient undertakings that detailed records must be kept as indicated as well as proof that sufficient funds will*

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			be set aside to be available in the later years to pay taxes when the deferred taxes start reversing. In light of the above, the Energy Regulator used the flow-through tax approach in the Lilly pipeline gas tariff determination as Transnet did not seek regulatory approval for the notional tax approach to be used in its 2010 gas transmission tariff application.
1. SASOL GAS	4. Existing Contracts	Paragraph 2.3 of the NERSA Tariff Methodology states that "the Energy Regulator is Acutely aware of the need to provide regulatory certainty and predictability and would approach existing contracts with prudence" (page 4 of the document). The Transnet Gas Transportation Agreement it is expressly listed as an existing agreement in the NERSA Tariff Methodology. In respect of this agreement the Regulator states in the NERSA Tariff Methodology that this agreement as any other existing agreement is subject to Section 4(h) of the Gas Act and that it is envisaged that the current tariff will be on monitored and approved in the short term. The Gas Act does not establish an express authority or jurisdiction for NERSA to supersede or cancel existing agreements in place in the piped gas industry. As other regulatory legislation expressly legislate the effect of regulation on pre-existing agreements it has to be inferred that the absence of such provisions in the Gas Act clearly indicates an intention on the part of the legislature not to afford NERSA such jurisdiction. It is therefore submitted that in	All existing agreements, including agreements that were in force prior to the enactment of the Gas Act are subject to monitoring and approval and if necessary regulation by the Energy Regulator. NERSA will not set tariffs but will review tariffs prepared by licensees or applicants for transmission and storage facilities. Furthermore, NERSA applies a reasonableness test to each tariff application to verify whether it meets the requirements of the Gas Act. It should be noted that in order to attract investment and promote the development of the piped-gas sector, the Energy Regulator is acutely aware of the need to provide regulatory certainty

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		the event of the existence of a pre-existing agreement, NERSA does not have the power to change the tariffs determined between the owner of the transmission facility and its customers without the agreement of the parties affected. In the context of the absence of a express statutory authority to over rule the existing agreement without the approval of the contract parties, the absence of clear and imperative reasons for the necessity for the regulation of the transportation tariff (as opposed to the monitoring and approving thereof) read with the published intention of NERSA to monitor and approve the tariffs (paragraph 2.3 of the NERSA Tariff Methodology) provided for in the existing agreement, it is submitted that a decision by NERSA to replace the contractually agreed gas transportation tariff in respect of the Lilly Pipeline for Sasol Gas by a regulated prescribed tariff may constitute an ultra vires decision by the Regulator.	and predictability and would approach existing contracts with prudence. In light of the above, the Energy Regulator can prescribe a tariff in a pre-existing agreement if the tariff applied for does not meet the objects of the Gas Act and if the tariff is not cost effective and non-discriminatory as contemplated in Section 22 of the Gas Act.