



Annexure B

BACKGROUND

The current gas pipeline, commonly referred to as the "Lilly pipeline" is a result of a conversion of sections of the crude oil pipeline ("COP") and the Durban Witwatersrand pipeline ("DWP"). The DWP was constructed in 1975 but was underutilised due to the commissioning of the Secunda refinery. The severe underutilisation persisted until the then Petronet (now Transnet Pipelines ("TPL")) divisional Board's decision in 1994 to effect changes to the pipeline network to optimise the usage of assets.

The primary purpose of the conversion was, amongst others, to:

- Achieve better utilisation of assets; and
- Diversify into gas pipeline transportation.

In trying to minimise risk, various clauses around tariffs were included in the "Gas Transportation Agreement" between the Sasol Gas Limited ("Sasol Gas") and Petronet, a Division of Transnet Limited ("Petronet"). These included commitments regarding:

- Capital expenditure;
- "Ship or pay" obligations related to minimum volumes;
- Validity of agreement – only until Sasol is sole supplier of gas;
- Termination period; and
- Shared obligations of parties arising from the discontinuance of the conversion initiative.

NEED FOR LIQUID PETROLEUM PIPELINE CAPACITY

In 2005, as soon as TPL realised that there was a need for additional liquid pipeline capacity, it invoked the termination clause to ensure that the Lilly pipeline was part of the evaluation of options for additional liquid petroleum pipeline capacity for the inland market. Once the Lilly pipeline was discarded as a feasible option, renegotiation regarding tariffs and conditions of contract ensued with Sasol Gas.

RENEGOTIATION OF CONTRACT

Based on the termination and the resultant uncertainty, Sasol Gas required a long term commitment from TPL to develop the gas business as its customers also required long term commitments to convert to gas usage. This provided an opportunity for TPL to renegotiate the tariff. Sasol Gas then gave a commitment to utilise the pipeline for the remainder of its economic life.

TARRIF ASSUMPTIONS

The starting tariff was derived after applying a "basic" allowable revenue calculation and considering the forecasted volumes to be transported for the year.

Arthur D Little ("ADL"), undertook an independent valuation of the Lilly pipeline's modern equivalent asset value ("MEAV") and depreciation as well as operating costs. These costs, together with the Transnet weighted average cost of capital ("WACC" were used to determine the allowable revenue.

The allowable revenue calculation, at the time, is likely to have been on the high side, based on current experience. The key assumptions were as follows:

- Gas asset value (2004): R 592m
- Operating costs: R 16m
- Depreciation: R 22m
- WACC: 14. 5% (Nominal value should be real)
- Resulting Allowable Revenue = R 124m

The R 124m divided by the forecasted volumes resulted in a tariff that was not acceptable to the market and hence would have constrained the market, rather than facilitate growth. Therefore, negotiations took place around this initial proposed allowable revenue. Some of the factors considered during the negotiation were:

- Pricing had to fit in with what the market could afford at the time;
- Pricing bands reflected levels at which the market could absorb the transport cost; and
- The higher price bands were for the markets which had high price alternatives, whilst the lower price bands were for those using electricity and had greater difficulty in converting to gas.

It was therefore agreed to discount the "allowable revenue" and thus the tariff to address the above issues. To counter this discount and to mitigate the risk from a TPL perspective, TPL insisted on a "ship or pay" clause. A phased take or pay level was introduced at 80% of the market projections over a 5 year period, when it was expected for the line to be at full capacity.

The initial gas contract had a minimum ship or pay of 4.5 million gigajoules per annum ("mGJ/annum"). This was increased to 12 mGJ/annum in the new contract.

The ship or pay schedule was structured as follows:

Year	Ship or Pay volume: MGJ/a
2005	11.8
2006	11.9
2007	11.9
2008	14.0
2009	18.0
2010	18.0

Furthermore, a top-up mechanism that would compensate TPL up to the minimum allowable revenue level by a certain date if volumes did not transpire was included. This level was R105m at commencement of contract, escalated annually.

The price escalation clause agreed on was based on a weighted escalation formula. A combination of 20% of the price remains fixed whilst 80% increases are informed by the produce price index ("PPI"). Sasol Gas required a tariff phase to allow for the movement from current levels to any new levels. A 4 year phase in period was agreed on whereafter escalation would continue.

It was also agreed that any future capacity enhancements will be subject to a new contract for the additional throughputs.

RECOMMENDATION

Transnet is of the view that, based on the above, the contractual arrangements between the two willing parties remain fair and appropriate and that there exist no grounds for the disregard of the sanctity of this contract. However, as is evident from the express terms of this contract, both parties recognised from the onset that this contract would be subject to regulation under the Gas Act.

Transnet thus submits its tariffs for the period 1 January 2010 to 31 December 2010 (to follow the calendar year as opposed to TPL's financial year) the calculation of which is as follows:

ANNEXURE 1

	Producer Price Index	Average PPI for the year	
Nov-06	149.5	155.9	
Dec-06	149.1		
Jan-07	149.3		
Feb-07	150.2		
Mar-07	152.5		
Apr-07	154.9		
May-07	157.0		
Jun-07	160.5		
Jul-07	161.9		
Aug-07	162.5		
Sep-07	160.9	177.7	1.140
Oct-07	162.3		
Nov-07	162.9		
Dec-07	163.3		
Jan-08	164.9		
Feb-08	167.2		
Mar-08	170.6		
Apr-08	174.1		
May-08	182.7		
Jun-08	187.5		
Jul-08	192.5	180.9	1.018
Aug-08	193.6		
Sep-08	186.7		
Oct-08	185.8		
Nov-08	183.4		
Dec-08	181.3		
Jan-09	180.0		
Feb-09	179.4		
Mar-09	179.6		
Apr-09	179.2		
May-09	177.2		
Jun-09	179.9		
Jul-09	185.2		
Aug-09	185.8		
Sep-09	179.8		
Oct-09	179.7		

TARIFFS

0 - 12m GJ/a			12.1m - 18m GJ/a	18.1m - 23m GJ/a
6.30	6.74		3.87	3.41
6.30	6.74		3.87	3.41
6.30	6.74		3.87	3.41
6.30	6.74		3.87	3.41
6.30	6.74		3.87	3.41
6.30	6.74		3.87	3.41
6.30	6.74		3.87	3.41
6.30	6.74		3.87	3.41
6.30	6.74		3.87	3.41
6.30	6.74		3.87	3.41
6.30	6.74		3.87	3.41
→	7.49		4.30	3.79
	7.49		4.30	3.79
	7.49		4.30	3.79
	7.49		4.30	3.79
	7.49		4.30	3.79
	7.49		4.30	3.79
	7.49		4.30	3.79
	7.49		4.30	3.79
	7.49		4.30	3.79
	7.49		4.30	3.79
	7.49		4.30	3.79
→	7.60		4.36	3.84

1. CALCULATION OF TARIFF APPLICABLE FROM JANUARY 2009 TO DECEMBER 2009 FOR VOLUMES UP TO 12 MGJ

Average PPI for 2007 = Average of PPI from November 2006 to October 2007

$$= 155.9$$

Average PPI for 2008 = Average of PPI from November 2007 to October 2008

$$= 177.7$$

$$\begin{aligned} \text{PPI Differential} &= 1 + \frac{(177.7 - 155.9)}{155.9} \\ &= 1.140 \end{aligned}$$

Transport tariff 2009 = (Jan 2008 tariff X PPI Differential X 80%) + (Jan 2008 tariff X 20%)

$$= (\text{R}6.74/\text{GJ} \times 1.140 \times 80\%) + (\text{R}6.74/\text{GJ} \times 20\%)$$

$$= \text{R}7.49$$

NB: The same method of calculation is used to derive the tariffs for volumes exceeding 12 MGJ

2. CALCULATION OF TARIFF APPLICABLE FROM JANUARY 2010 TO DECEMBER 2010 FOR VOLUMES UP TO 12 MGJ

Average PPI for 2008 = Average of PPI from November 2007 to October 2008

$$= 177.7$$

Average PPI for 2009 = Average of PPI from November 2008 to October 2009

$$= 180.9$$

$$\begin{aligned} \text{PPI Differential} &= 1 + \frac{(180.9 - 177.7)}{177.7} \\ &= 1.018 \end{aligned}$$

Transport tariff 2010 = (Jan 2009 tariff X PPI Differential X 80%) + (Jan 2009 tariff X 20%)

$$= (\text{R}7.49/\text{GJ} \times 1.018 \times 80\%) + (\text{R}7.49/\text{GJ} \times 20\%)$$

$$= \text{R}7.60$$

NB: The same method of calculation is used to derive the tariffs for volumes exceeding 12 MGJ