



3 September 2021

By email: [REDACTED]

Marcus Crudden
Executive Director, Price Monitoring and Regulation at the Essential Services Commission Victoria
Level 8, 570 Bourke Street
Melbourne VIC 3000

Dear Mr Crudden,

Submission to the ESC inquiry into Port of Melbourne compliance with the Pricing Order

As you are aware, the Port of Melbourne (**Port**) was privatised by the Victorian Government with a regulatory framework unlike most large monopoly infrastructure assets (e.g., water, electricity). Under this framework, Port of Melbourne Group (**PoM**) was given freedoms around rent setting and how to develop the port over the 50-year lease term, with an expectation by the Victorian Government that these freedoms would be exercised responsibly. In fact, PoM has given clear and formal stewardship commitments to the State as the custodian of Australia's largest gateway port asset.¹

To provide port tenants and other stakeholders with visibility of PoM's plans for developing the Port, PoM also has a statutory obligation to publish a Port Development Strategy (**PDS**) every five years with the purpose of creating economic value through supporting industry understanding, confidence and investment.² Under the Pricing Order, PoM has a range of obligations, including that PoM must only include actual or forecast capital expenditure in its regulatory asset base if it is 'prudent and efficient' and PoM must demonstrate that it has consulted effectively with port users and stakeholders.³

PoM paid \$9.7 billion for the 50 year lease for the commercial operations of the port - an estimated EBITDA multiple of 25 times earnings and, at the time, the highest price paid for an Australian port.⁴ As a private operator and monopoly landlord, there is a considerable risk for conflicted motivations to drive inefficient port development investment decisions, which are potentially directly inconsistent with the objectives of the regulatory regime.⁵ In particular, PoM receives largely unconstrained commercial benefits from increasing its rental revenues at the Port because property revenues are excluded from the regulatory regime.⁶ As rents are unregulated, PoM has a significant incentive to start to receive new rental revenue streams as soon as possible. The Webb Dock precinct is the last major part of the port yet to be developed for container terminal operations. It is clear that PoM has the incentive to accelerate this development in order to bring those revenue streams online, especially as it can do so without loss in rentals from inefficiencies caused to existing leases, as PoM's standard lease contains ratchet rent review mechanisms. PoM also benefits from increasing the capital base over which it gets a return sooner through bringing forward Webb Dock developments.

Given this landscape and noting the Essential Service Commission's (**ESC**) recent findings that PoM has used its significant power to the material detriment of Victorian Consumers in setting and

¹ Port Lease between Melbourne Port Lessor Pty Ltd and Lonsdale Asset Property Pty Limited as trustee for the Port of Melbourne Property Trust.

² *Port Management Act 1995 (Vic)*, s 91K; 2017 Ministerial Port Development Strategy Guidelines, p. 3.

³ Victoria, *Gazette* No S201, 24 June 2016 clauses 3.2.5, 4.2.1, 7.1.2(d).

⁴ Australian Financial Review, *Record \$11b Port of Melbourne sale rides infrastructure boom*, Patrick Durkin, Jenny Wiggins, Sarah Thompson and Anthony Macdonald: <https://www.afr.com/companies/transport/port-of-melbourne-reaps-97-billion-for-victoria-20160919-grj9l6>.

⁵ *Port Management Act 1995 (Vic)*, s 48(1).

⁶ *Port Management Act 1995 (Vic)*, 49(2)(a).

reviewing rents,⁷ the ESC's inaugural five yearly inquiry into PoM's compliance with the Pricing Order and the regulatory regime more broadly is of utmost importance.

The purpose of this letter is to provide details of Patrick's own direct experiences, which indicate significant and sustained non-compliance by PoM with the Pricing Order and the regulatory regime.

Patrick's role at the Port of Melbourne

Patrick is a port user,⁸ a user of prescribed services and a key stakeholder in port development planning and capacity investment decisions. Patrick is a long-term tenant at the Port of Melbourne with material sunk capital, labour and other investments made in reliance on PoM acting in accordance with the principles, objectives, and requirements of the regulatory regime.

As one of three container stevedores at the Port, Patrick plays a critical role in the Victorian supply chain supporting importers, exporters, port users and Victorian consumers more generally.

Concerns about non-compliances related to WDE Expansion Project

The accelerated capacity development at Webb Dock East (**WDE Expansion Project**) is relevantly before the ESC for consideration in the current compliance review. Expenditure for the WDE Expansion Project was included in PoM's regulatory asset base in the tariff schedule set within the review period, planning decisions were undertaken during the review period and 'consultation', such as it was, occurred during the review period.

Patrick is particularly concerned by the circumstances of PoM's plan to significantly accelerate the proposed WDE Expansion Project, leading to the likely associated acceleration of future developments of the Webb Dock precinct (including the development of Webb Dock North and the Webb Dock Freight Link).

There are serious inferences about PoM's conduct that can be drawn from the timing of events related to the WDE Expansion Project, particularly given the existence of clear incentives as a monopoly landlord and the absence of any genuine consultation with Patrick. Patrick and PoM entered into long term leases and committed capital to the Port Rail Transformation Project in September 2020. On 6 October 2020, PoM published the final 2050 PDS, which consistent with prior consultation and the draft 2050 PDS published on the PoM website on 12 November 2019:

- noted that PoM was committed to actions that optimised existing capacity and productivity before delivering new infrastructure⁹;
- identified the WDE Expansion Project as a project to be delivered by 2035¹⁰; and
- represented that the shortest project delivery period for all projects was 4 years¹¹.

The WDE Expansion Project was not identified as a project that was 'in progress' unlike other projects in the planning phase¹² and forecast demand did not support delivery of this project in the short term. On the same day, 6 October 2020, PoM notified Patrick, for the first time, of PoM's proposal to significantly bring forward the WDE Expansion Project. On the same day, 6 October 2020, PoM notified Patrick of PoM's proposal to significantly bring forward the WDE Expansion Project.

⁷ Essential Service Commission, Port of Melbourne – Market Rent Inquiry 2020 Public Report, 14 August 2020, pp. viii, 50-51.

⁸ As previously submitted to the ESC, Patrick is a port user for the purposes of clause 14 of the Pricing Order as it 'requests or receives' the prescribed service of accessing or using 'places or infrastructure...on port of Melbourne land for the provision of services to port users.' In particular, PoM grants a wharf licence and other licences at the port so that container terminal operators, such as Patrick, have provision of access to, and are allowed use of, places and infrastructure on port land for the provision of services to port users (for example shipping lines or land transport operators). This licence granted to container terminal stevedores, such as Patrick, is clearly permitting a use of a 'requested or received' prescribed service.

⁹ 2050 PDS, p 1.

¹⁰ 2050 PDS, p 51.

¹¹ 2050 PDS, p 5.

¹² 2050 PDS, p 51.

This issue has significant ramifications for supply chain participants, as well as the long-term interests of Victorian consumers. This issue has also been before the ESC since PoM lodged the Tariff Rebalancing Application in December 2020. As several stakeholders, including Patrick, have raised concerns with the ESC on multiple occasions, we assume it has been, and is being, thoroughly interrogated.

A failure to take steps now to address these concerns, either as part of the current compliance review or using other avenues open to the ESC, will undermine achievement of the objectives of the *Port Management Act 1995* (Vic) (**PMA**) and credibility of the regulatory regime itself. By 2026, it is highly likely that PoM will already have made commitments to develop the overall Webb Dock precinct and the potential consequences for port users and consumers will have been set in motion. This development is expected to cost several billion dollars and clearly should be subject to proper oversight and scrutiny given the current level of concerns about inefficient port development raised by several key stakeholders.

Opinion of Neil Young QC and Brendan Lim regarding non-compliance

Patrick specifically draws attention to the opinion of Neil Young QC and Brendan Lim dated 25 May 2021 which clearly sets out that:

- not only has the PDS not been complied with, it is also misleading and deceptive;
- PoM has not complied with the Ministerial Guidelines issued pursuant to section 91M of the PMA; and
- PoM's decision to significantly accelerate the development of Webb Dock (inconsistent with PoM's published PDS) is contrary to:
 - the objectives for the operation and development of the Port as set out in section 48(1) of the PMA; and
 - the principles and requirements set out in the Pricing Order.

Patrick's key concerns in relation to PoM's non-compliance

Patrick's own direct experience indicates significant and sustained non-compliance by PoM with the Pricing Order, particularly in respect of the consultation and prudence and efficiency requirements.¹³

No genuine consultation

In Patrick's view, PoM has completely failed to engage in genuine consultation with stakeholders in relation to the significantly accelerated WDE Expansion Project which:

- (i) is non-compliant with the Pricing Order;¹⁴
- (ii) leads to a presumption against the investment and its acceleration being prudent and efficient, especially as the stated rationale for that investment and its timing has been inconsistent; and
- (iii) is reinforced by PoM's announcement that it is proceeding with the WDE Expansion Project and that it is now in the implementation phase despite material concerns raised by a range of stakeholders and without those concerns having been addressed or properly responded to.

¹³ Victoria, *Gazette* No S201, 24 June 2016, clauses 3.2.5, 4.2.1, 7.1.2(d).

¹⁴ Victoria, *Gazette* No S201, 24 June 2016, clauses 3.2.5 and clause 7.1.2(d) of the Pricing Order.

The fact that Patrick has taken the serious step to commence proceedings against PoM for misleading and deceptive conduct and unconscionable conduct, based on the misrepresentations made by PoM during long term lease negotiations with Patrick and in publishing the PDS, should provide a very strong indication that adequate consultation did not take place regarding the acceleration of the WDE Expansion Project.

PoM has not demonstrated 'prudence and efficiency'

In Patrick's view, PoM has also failed to clearly and transparently demonstrate that accelerating the WDE Expansion Project by some 10 years earlier than communicated to industry in the 2050 PDS is prudent and efficient. Not only is there currently material excess capacity, existing capacity is likely to be adequate to meet demand for the medium term on both Patrick's and PoM's market growth forecasts¹⁵ – well beyond the accelerated timeline for the WDE Expansion Project.

Investment ahead of market demand will have broad utilisation effects on a range of operators in the Swanson Dock precinct, not just stevedores. The effect on stevedores will be more pronounced given their material sunk investments and very significant long term lease commitments. There is a real cost associated with underutilisation and this must be factored into any assessment of the appropriateness of further investment in Webb Dock capacity being brought forward.

As required in other regulated industries where the investment decisions of a monopoly provider impact the investment decisions and efficient operation and utilisation of sunk investments of downstream suppliers, Patrick would expect to see a formal cost benefit analysis undertaken for all material capacity capex proposals and for the benefits to outweigh the costs in order to show they are prudent and efficient. Clearly such a benefits analysis must be undertaken to ensure the party receiving the benefits is in line with the objectives of the regulatory regime, which emphasises the long-term interests of Victorian consumers.¹⁶

If "competition benefits" or "competitive detriments" are claimed, it is expected that these would be explicitly quantitatively modelled and set against the other costs and benefits of the investment.

PoM has not done this, or if it has, it has not shared any such information with stakeholders through consultation. Patrick submits that if such analysis were applied to the accelerated development of Webb Dock the cost benefit assessment for prudence and efficiency would fail. This makes it difficult to see how the investment could be considered to be prudent and efficient as required under the Pricing Order.

Potential for consumer harm and competitive detriment

The timing of investment by PoM has a direct impact on the potential for, and degree of, future price shocks once the limit on tariff adjustments by PoM ends.¹⁷ Future pricing decisions by PoM are relevant for a range of stakeholders, including for example, port tenants with significant sunk assets and ultimately Victorian consumers. Inefficient material capacity investment decisions by PoM will increase total supply chain costs and have adverse flow-on effects by manifesting pricing pressures on other supply chain participants. It is also feasible that these decisions will affect the competitiveness of the Port for certain regional freight and in turn reduce the competitiveness of Victorian exporters.

As conveyed on multiple occasions, Patrick will make itself available to respond to the ESC if there is any way it can assist the ESC in its continued consideration of these significant issues and the approach to material capacity development at the Port both now and in the future. Material capacity developments require the largest capital contributions and hence have the most significant impact on the regulatory asset base, depreciation and pricing, and the greatest potential to result in inefficiency, competitive detriment, and consumer harm. They need to occur in line with the regulatory regime

¹⁵ See PoM's assumptions on 2050 PDS p. 23.

¹⁶ *Port Management Act 1995* (Vic), s 48(1).

¹⁷ The TAL only applies until at least 30 June 2032 and at the latest 30 June 2037 (Pricing Order, cl. 3.3), and after this point PoM can increase tariffs to recover any unrecovered capital base without restriction.

(including the PDS) and with appropriate checks and balances in place to address the conflicting incentives of a private monopoly port landlord.

We reiterate our willingness to consider any requests to make confidential information available to PoM or Government on request where this would enhance the outcome of the ESC's review.

Michael Jovicic
CEO
Patrick Terminals