

TITLE: Submission to Essential Services Commission – Port of Melbourne 5-year review

DATE: 3 September 2021

This submission is prepared by QIC Private Capital on behalf of its managed funds and clients, Global Infrastructure Partners on behalf of its managed funds and clients, and OMERS, as shareholders in the Port of Melbourne Group (“PoM”) (together, the “Shareholder Group”). Further details are in Appendix A.

The Shareholder Group has wide-ranging experience and expertise in managing significant infrastructure assets globally. In aggregate it manages over A\$160bn¹ in infrastructure investments. We have significant experience in managing the complexity of private landlord ports both in Australia and globally with multiple port investments.

The Shareholder Group supports the long-term approach to managing assets responsibly through PoM’s board and management to serve the interests of shareholders, employees, customers, tenants and broader stakeholders. As long-term investors, the Shareholder Group is committed to supporting the overarching stewardship commitments of PoM through a strong governance regime.

Our fiduciary duty to our ultimate beneficiaries (who are largely retirees), is to earn a reasonable return on investment. We are fully aware that long-term returns are reliant on a constructive relationship with the regulator and continued compliance with the regime. We welcome the opportunity for PoM and the Essential Services Commission (“ESC”) to continue to work together in a constructive and open way.

We are privileged to be owners of the Port and look forward to continuing to invest, along with industry and government, to support the efficiency and growth of the port of Melbourne (the “Port”) and its supply chain. This is critical to the community as it underpins over 19,600 jobs, contributes over \$6bn to the Victorian economy and fundamentally facilitates a significant volume of trade in Victoria.

Regulatory compliance

The Shareholder Group takes the responsibilities of PoM to act in compliance with the Port Management Act and the 2016 Pricing Order (as amended from time to time) since the privatisation of the Port very seriously.

The Shareholder Group believes that each Tariff Compliance Statement (“TCS”) submission was diligently compiled and based on the best information available at the time. This included third-party expert advice provided to PoM and the interim views provided by the ESC up to the point of each submission, as the operationalisation of this new and bespoke regulatory regime was progressed.

The annual TCS process has enabled all stakeholders, including PoM and the ESC, to evolve their understanding of the application of the regime. Throughout this period, PoM’s Board has continued to ensure PoM remained in compliance with the regulatory regime and its broader obligations to the State of Victoria.

Throughout its ongoing regulatory process, PoM has procured expert advice on all key areas of compliance to ensure each TCS is based upon appropriate advice and balanced estimates at the time of submission. The Board has continually sought to appropriately balance the various views of the advice received by PoM and the ESC’s evolving thinking, as demonstrated in PoM’s 2021-2022 TCS with the WACC parameter values now being in line with the ranges in the ESC’s December 2020 Interim Commentary.

Given that the regime remains new for PoM and the ESC, the annual guidance from the ESC via its Interim Commentaries and evolution of its thinking on the regulatory regime is greatly appreciated. This is evidenced by PoM’s continued efforts to address the comments raised in the ESC’s Interim Commentaries and the guidance provided within the revised Statement of Regulatory Approach.

¹ As at 30 June 2021

The feedback has assisted with PoM's and our understanding of the ESC's interpretation of the regulatory framework with respect to appropriate cost of capital methodology and best practice engagement amongst other matters, ultimately reflected in the 2021-2022 TCS. We believe that the 2021-2022 TCS demonstrates material alignment with the ESC's current positions, and we would encourage the ESC to give regard to this TCS in the 5-year review.

Regulatory process to support investment

The Shareholder Group made its investment in PoM based on the nature of the regulatory regime put forward at the time of privatisation, which is a backwards looking compliance monitoring regime. It was and remains clear in the legislation that it is not intended to be a heavy-handed or deterministic regulatory regime.

PoM has invested approximately \$340 million² across the Port for prescribed services during the first 5 years of the lease as part of its commitment to support the continued economic growth of Victoria and to meet PoM's legislative objectives and requirements. This investment has included wharf remediation, developing rail infrastructure, and enabling larger vessels to access the Port.

There is no pre-approval requirement by the ESC for capital expenditure undertaken by PoM under the regulatory regime. To meet its stewardship obligations under the Port Lease, PoM must determine which projects are prudent and efficient and proceed with projects it believes are in the best interests of consumers and producers following appropriate engagement with stakeholders. The Shareholders established a strong governance regime at PoM which, through the Board, provides checks and balances to ensure these stewardship obligations are being satisfied.

The Shareholders have no incentive to over-invest. Under the Pricing Order, PoM must ensure its investments are prudent and efficient, since the cost base used to set tariffs must include only prudent and efficient costs. To do otherwise would put at risk PoM's opportunity to recover its costs, including a return commensurate with the risks involved.

Given the Tariffs Adjustment Limit ("TAL") will be in effect until at least 2032, and most likely to 2037, the annual weighted average increase in tariffs can be no more than CPI during this time. Whilst this provides a high level of certainty to Port users, it restricts PoM from adjusting pricing to accommodate for varying investment needs or responding to industry changes and creates a back-ended return profile which defers returns from any investment, thereby creating significant investment risk not seen in other regulatory regimes. This dynamic provides a strong disincentive for the Shareholder Group to support PoM "gold plating" the Port.

There is also a developing need to address climate change risk and emissions targets in the port supply chain beyond what was envisaged in the Port Lease at the time of privatisation. In this respect, the Shareholder Groups expects PoM to work with the Victorian Government and other stakeholders to ultimately achieve significant reductions in scope 1, 2 and 3 emissions. This important initiative will most likely require additional investment and will provide additional benefits to the Port community and Victorian economy.

As the ESC is aware, under the backward-looking compliance monitoring regime, PoM is empowered to make decisions and invest prudently and efficiently as required. The review of compliance by the ESC then focusses on proof of robust processes by the Port to ensure that capex is prudent and efficient, which we are confident the ESC will confirm as part of the 5-year review. The certainty in the regulatory process and assessment of capital investments is necessary to provide stability for the Shareholder Group to commit the approximately

² Actual capex for FY17 to FY20, forecast capex for FY21.

\$1.5Bn³ of future capital investment needed over the next 20 years to ensure efficient future capacity expansion at the Port.

Conclusion

The Shareholder Group strongly believes PoM has acted in compliance with the Port Management Act and the 2016 Pricing Order (as amended from time to time) since the privatisation of the Port. PoM and its shareholders are firmly committed to continuing and strengthening the existing relationship with the ESC and will work collaboratively to allow the Port to have capital invested efficiently so that the Port can continue to support trade, jobs, the Victorian economy and consumers.

³ Port Development Strategy 2020

Appendix: Port of Melbourne shareholders



QIC is a long-term specialist investment manager in alternatives offering infrastructure, real estate, private capital, liquid strategies and multi-asset investments. It is one of the largest institutional investment managers in Australia, with A\$85bn (US\$65bn) in funds under management⁴. QIC has over 800 employees and serves more than 115 clients. Headquartered in Brisbane, Australia, QIC also has offices in Sydney, Melbourne, New York, Los Angeles, San Francisco, London and Copenhagen.

futurefund

Australia's Sovereign Wealth Fund

Established in 2006, the Future Fund is Australia's sovereign wealth fund responsible for investing for the benefit of future generations of Australians. The Future Fund was established to strengthen the Australian Government's long-term financial position. The Future Fund's stake in the Port of Melbourne is managed by QIC.



Global Infrastructure Management, LLC (GIP) is an independent and experienced infrastructure fund manager that specialises in infrastructure investments in the energy, transport and water/waste sectors in OECD countries and select emerging market countries. GIP's core business is managing and investing funds and it currently manages approximately US\$75 billion for its investors.

GIP is headquartered in New York and has offices in Hong Kong, London, Mumbai, Sydney and Stamford, Connecticut. GIP's portfolio companies have combined annual revenues of approximately US\$41 billion and approximately 58,000 employees.

OMERS

Founded in 1962, OMERS is one of Canada's largest defined benefit pension plans. OMERS invests and administers pensions for members from municipalities, school boards, emergency services and local agencies across the province of Ontario.

⁴ As at 31 December 2020