

## Patrick Terminals

### Re Essential Services Commission Review into Compliance with Pricing Order

#### Joint Opinion

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#### Summary

1. We are instructed by Gilbert + Tobin on behalf of Patrick Terminals (**Patrick**).
2. We are asked to advise in relation to an ongoing review by the Essential Services Commission (**ESC**) under s 49I of the *Port Management Act 1995* (Vic) (**PMA**) into compliance by the Port of Melbourne (**PoM**) with the Pricing Order made under s 49A of the PMA: Victoria Government Gazette, No. S 201, 24 June 2016.
3. In particular, an issue has arisen about whether the review encompasses the prudence and efficiency of PoM's forecast capital expenditure associated with the Webb Dock East Expansion Project, which is included in the capital base for the purpose of setting Prescribed Service Tariffs for the period 1 July 2021 to 30 June 2022.
4. We have been briefed with an opinion of Peter Hanks QC and Catherine Dermody dated 13 September 2021, which records their view that that forecast capex is outside the scope of the current review because it does not give rise to any issue of compliance in the "review period" of 1 July 2016 to 30 June 2021.
5. We respectfully disagree with Mr Hanks and Ms Dermody. The issues of compliance concern PoM's obligation under the Pricing Order to "set" Prescribed Services Tariffs in accordance with the Pricing Order, which includes an obligation to "determine" an Aggregate Revenue Requirement and to do so by "applying" the method set out in the Pricing Order, which directs attention to efficient and prudent forecast capex. These obligations arise at the point of setting the tariffs, which occurred on 31 May 2021 within the review period. There are distinct obligations from 1 July 2021 onwards to offer to supply prescribed services in accordance with the tariffs as set. There is some risk that those obligations would not support an inquiry, in the next s 49I review, into the setting of the tariffs themselves.

## Consideration

6. We agree with Mr Hanks and Ms Dermody that the statutory function to be performed under s 49I of the PMA relevantly includes conducting and completing an inquiry and report to the ESC Minister as to whether PoM “has complied with the [Pricing Order] during the review period” (Hanks/Dermody at [20]). We also agree that the “review period”, calculated in accordance with s 49I(5), is 1 July 2016 to 30 June 2021 (Hanks/Dermody at [21]).
7. In principle, we also agree with Mr Hanks and Ms Dermody that the review therefore calls for a consideration of PoM’s compliance with its obligations under the Pricing Order in the review period (Hanks/Dermody at [23]).
8. Where we disagree with Mr Hanks and Ms Dermody is with their analysis of the relevant obligations that are engaged under the Pricing Order and the time at which they are engaged.
9. It is necessary to identify the obligations imposed by the Pricing Order as a matter of statutory construction, which must begin, and ultimately end, with the text: *Federal Commissioner of Taxation v Consolidated Media Holdings Limited* (2012) 250 CLR 503 at [39].
10. In our opinion, the following obligations are of particular relevance:
  - (a) cl 2.1.1: Prescribed Service Tariffs “**must be set**”...
  - (b) cl 2.1.1(a): Prescribed Service Tariffs must be set so as to allow PoM a reasonable opportunity to recover the efficient cost of providing all Prescribed Services “**determined by** application of an accrual building block methodology of the type described in clause 4 (Aggregate Revenue Requirement)”.
  - (c) cl 4.1.1: For the purposes of “**determining**” its Aggregate Revenue Requirement, PoM “**must apply**” an accrual building block methodology having the features spelled out in cl 4.1.1(a)–(d).
  - (d) cl 4.2.1: the capital base “**applied**” for the purpose of determining the Aggregate Revenue Requirement “**must be defined, at any particular time**”, on a roll

forward basis in accordance with cl 4.2.1(a)–(d), which includes adding efficient capital expenditure “when incurred, or to be incurred” during the relevant Financial Year by PoM acting prudently.

- (e) cl 6.1.1: **No later than 31 May in each Financial Year**, PoM “**must publish**” its Reference Tariff Schedule for the following Financial Year and “**provide**” the ESC with a copy.
  - (f) cl 7.1.1: **No later than 31 May in each Financial Year**, PoM “**must provide**” to the ESC a Tariff Compliance Statement.
  - (g) cl 7.1.2, the Tariff Compliance Statement must, among other things, “**explain**” how the Prescribed Service Tariffs comply with the Pricing Order and “**contain ... sufficient supporting information**”.
11. We note also the additional emphasis on the act of “setting” Prescribed Service Tariffs in cll 2.1.2, 2.1.3, 2.1.5, 2.2.1, 2.3.1. Clause 2.1.5 is of particular note, because it provides that PoM “will not be in breach of [the Pricing Order] if it **sets** actual tariffs for Prescribed Services at a level that is lower than permitted under clause 2.1.1.(a) in any relevant period”. This safe harbour provision is enacted on the assumption that PoM **may** be in breach of the Pricing Order if it **sets** tariffs otherwise.
  12. Apart from “setting” tariffs, there are also cognate obligations in relation to “revising” tariffs (cl 3.2.1).
  13. Quite distinctly from the setting or revising of tariffs, there are different obligations in relation to charging tariffs. In particular, PoM must “offer to provide Port Users with Prescribed Services in accordance with the Reference Tariff Schedule” (cl 6.1.6) and may enter into contracts on terms that differ from those specified in the Reference Tariff Schedule only under certain conditions (cl 6.2.1). There is no obligation to charge tariffs that comply with the pricing principles, only an obligation to charge tariffs in accordance with the Reference Tariff Schedule. The relevant obligation that renders the Reference Tariff Schedule an appropriate reference for the charging of tariffs is the obligation to “set” the tariffs compliantly with the pricing principles and related obligations listed above.

14. Thus, in our opinion, a proper construction of the Pricing Order identifies obligations imposed on PoM to “set” tariffs by “determining” an Aggregate Revenue Requirement in which it “applies” the specified principle of adding only efficient and prudent forecast capex. The obligation to “set” (and the associated obligations to “determine” an Aggregate Revenue Requirement and “apply” the pricing principle concerning efficient and prudent capex) is engaged as at 31 May in a Financial Year when the associated obligations to publish the Reference Tariff Schedule and Tariff Compliance Statement arise. That obligation was therefore relevantly engaged on 31 May 2021, within the review period, when PoM set tariffs in reliance on forecast capex associated with the Webb Dock East Expansion Project. PoM’s compliance with that obligation is therefore within the scope of the current review.
15. The fact that the tariffs so “set” apply to the provision of prescribed services from 1 July in the following Financial Year does not alter the analysis. The relevant obligation applying from 1 July is to charge in accordance with the tariffs as set. That obligation gives rise to range of potentially different species of non-compliance (e.g. charging tariffs otherwise than in accordance with the published tariffs).
16. Indeed, there would be some risk that the setting of tariffs on 31 May 2021 falls outside the scope of the next s 49I review, concerning a review period from 1 July 2021 to 30 June 2026. That review might be argued to be concerned only with PoM’s compliance with the obligation to charge tariffs from 1 July 2021 in accordance with the tariffs set before then. That risk must be taken seriously in circumstances where, as we understand it, PoM’s own position is that the setting of the 2021-22 tariffs falls within the scope of the current review (and perhaps, implicitly, not the next review).
17. Mr Hanks and Ms Dermody have anticipated the possibility that the “setting” of tariffs is an activity which occurred in the review period and which may be subject to scrutiny in the current review (Hanks/Dermody at [30]). They ultimately dismiss that possibility for the following reasons.

18. First, they say that, in their view (Hanks/Dermody at [30.2]):
- the relevant question of compliance is whether the Prescribed Service Tariffs that apply during the 1 July 2021 to 30 June 2022 Regulatory Period comply with the requirements of the Pricing Order, and the fact that those tariffs were set by the Port prior to 30 June 2021 does not alter the nature of that inquiry.
19. In our opinion, that reasoning does not grapple sufficiently with the terms of the Pricing Order, which, as we have sought to explain above, imposes obligations to “set” tariffs in a particular way and imposes quite different obligations in relation to applying those tariffs subsequently.
20. Mr Hanks and Ms Dermody appear to reason on the basis that the Aggregate Revenue Requirement is “for” the 2021-2022 Financial Year and that the forecast expenditure will be incurred after 30 June 2021 (Hanks/Dermody at [28]). They place reliance on the fact that cl 4.2.1 governs the definition of the capital base “applied for the purposes of clause 4.1.1(a) and 4.1.1(b)” (Hanks/Dermody at [27]). It is clear that PoM determines the capital base for the purpose of setting tariffs that will be applied from 1 July in the subsequent year. But this alone does not answer the critical question of whether the ESC is empowered to review PoM’s compliance with the obligation so to “set” tariffs or whether it is limited to reviewing the subsequent application of tariffs, after they have been set.
21. As we have said, the obligation imposed by the Pricing Order is relevantly to “set” tariffs. Mr Hanks and Ms Dermody do not identify the precise obligation compliance with which would be reviewable in the next review period.
22. Secondly, Mr Hanks and Ms Dermody say that (Hanks/Dermody at [30.3]-[30.4]):
- consistent with the regime established by the PMA, what is to be undertaken by the Commission is an ex-post assessment of the compliance of those tariffs with the requirements of the Pricing Order, which will form part of the subsequent 5-yearly review.
- To construe the Pricing Order otherwise would give rise to an illogical outcome – whereby the Commission’s 5-yearly review would be an ex-post review, considering the Port’s compliance with the Pricing Order over an historical five-year period and an ex-ante review for the first year of every succeeding five-year period, merely because of the obligation to provide a TCS to the Commission

by 31 May in each year, setting out the Prescribed Service Tariffs for the forthcoming Financial Year.

23. In our opinion, this reasoning adopts an incorrect approach to statutory construction. The reasoning depends entirely upon the notion of an “ex-post review” as distinct from an “ex-ante review”, but that distinction finds no support in the text of the PMA or Pricing Order. It is incorrect to construe the PMA on the footing of an “*a priori* assumption” about its intended reach: see, e.g., *Minister for Employment and Workplace Relations v Gribbles Radiology Pty Ltd* (2005) 222 CLR 194, 208 [21] (Gleeson CJ, Hayne, Callinan and Heydon JJ); *Certain Lloyd’s Underwriters v Cross* (2012) 248 CLR 378, 390 [26] (French CJ and Hayne J).
24. In any event, once the relevant obligation engaged by the Pricing Order is properly understood, there is on our preferred construction no “ex-ante” review, even if that were a concept precluded by the scheme of the PMA. In other words, there is nothing “illogical” in the review encompassing tariffs “set” during the review period. Indeed, the scheme of the PMA, having regard to the objectives set out in s 48, does not favour imposing artificial limitations on the ability of the ESC to oversee the provision of prescribed services and compliance with the Pricing Order.
25. We note that our disagreement with the view expressed by Mr Hanks and Ms Dermody has the result that we also disagree with their view about the relevance for the purposes of the current review of PoM’s approach to the WACC and depreciation in the 2021-2022 Tariff Compliance Statement (Hanks/Dermody at [32]-[34]).

#### **Availability of alternative avenues**

26. For completeness, we record our agreement with Mr Hanks and Ms Dermody that the ESC has available to it other avenues to consider PoM’s activities with respect to the WDE Expansion Project (Hanks/Dermody at [31]). Of course, the existence of other avenues does not favour either view of the scope of the review.
27. We would add to the avenues identified by Mr Hanks and Ms Dermody (s 49Q complaint and inquiry upon referral by the Minister) an inquiry on the ESC’s own motion after consultation with the Minister: ss 10(b) and 40 of the *Essential Services Commission Act 2001* (Vic).

28. These alternative avenues give the ESC a degree of flexibility to deal with the substance of the issue and manage the risk, which we have identified above, that the setting of tariffs on 31 May 2021 will fall outside the scope of the *next* s 49I review. We are conscious, however, that there are likely to be material differences in the effectiveness of these other approaches if they were to be treated as discrete pathways. In our view, the most focused and effective approach is likely to be an inquiry into the setting of tariffs on 31 May 2021 within the scope of the current s 49I review. There is no reason why the ESC could not couple this inquiry into the setting of tariffs under s 49I with other sources of power to the extent necessary, so as to review now the prudence and efficiency of PoM's forecast capital expenditure associated with the Webb Dock East Expansion Project.

### **Conclusion**

29. For the foregoing reasons, we disagree with the central conclusion of Mr Hanks and Ms Dermody. It is squarely within the scope of the current review to consider PoM's compliance with its obligation to set tariffs, which obligation was engaged on 31 May 2021 and is thus within the review period as defined.
30. No different obligation, arising after the review period, has been identified with such precision as would cause us to depart from the natural and ordinary meaning of the text of the Pricing Order. On the contrary, it would seem that, after 1 July 2021, the relevant obligation on PoM is to charge tariffs in accordance with the set tariffs, without any further obligation in relation to the actual setting of the tariffs.
31. There might thus be a risk that the setting of the tariffs on 31 May 2021 falls outside the next review period. That risk is a reason weighing in favour of our suggestion that the ESC, in reliance on all of its sources of power, now inquire into the setting of the 2021-22 tariffs and, in particular, into the prudence and efficiency of the forecast capex associated with the Webb Dock East Expansion Project.

32. We advise accordingly.

Date: 9 October 2021



**Neil Young QC**

Ninian Stephen Chambers



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