



THE PORT OF MELBOURNE REGULATORY REGIME

Overview of the Port of Melbourne and the Essential
Services Commission's Regulatory Roles

March 2017

An appropriate citation for this paper is:

Essential Services Commission 2017, *Overview of the Port of Melbourne and Essential Services Commission's Regulatory Roles*, March.

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GLOSSARY

Aggregate revenue requirement

A revenue requirement that will provide a reasonable opportunity for the port licence holder to recover the efficient cost of providing all prescribed services. The aggregate revenue requirement is determined by application of an accrual building block model.

Berth

The waterfront edge of a wharf in which a vessel is secured to load or discharge cargo.

Break bulk

Loose, non-containerised cargo stowed directly into a ship's hold. Typically steel and timber products, but also items too large to fit into a shipping container.

Buoy

An anchored float serving as a navigation aid for ships.

Competitively Neutral Pricing Principles Order

Made by the Governor in Council on 25 August 2016 under section 49ZC of the Port Management Act, the Competitively Neutral Pricing Principles Order specifies the manner in which service tariffs must be set by a state sponsored port operator engaging in international container handling.

Commission

The Essential Services Commission

Container

A steel or aluminium frame forming a box in which cargo can be stowed, meeting International Standard Organisation (ISO)-specified measurements, fitted with special castings on the corners for securing to lifting equipment, vessels, chassis, rail cars, or stacking on

other containers. Containers are measured in TEU.

CPI	Consumer Price Index
Dolphin	A bollard, or pile, that is not fixed to the berth and is used for mooring ships.
Dry bulk	Loose, mostly uniform cargo, such as bulk agricultural products, coal, fertiliser, and ores that are transported in bulk carriers.
Delivering Victorian Infrastructure Act	<i>Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Act 2016</i>
Essential Services Commission Act	<i>Essential Services Commission Act 2001</i>
ESC Minister	The Minister for Finance
Export pricing decision	The decision of the Port of Melbourne Corporation to enhance competitiveness with the Port of Botany and other Australian container ports by reducing prescribed service tariffs for full outbound container wharfage services by 2.5 per cent at the start of each financial year up to, and including, 2019-20; and thereafter to maintain the same or greater percentage discount relative to prescribed service tariffs for full inbound container wharfage services. (See the Pricing Order for the full definition).
Liquid bulk	Cargo that must be contained in its liquid form. This includes petroleum, LNG, gasoline, chemicals and liquid edibles.
Least Cost Capacity Expansion Principles Order	Made by the Governor in Council on 30 August 2016 under section 72 of the Delivering Victorian Infrastructure Act, the Least Cost Capacity Expansion Principles Order specifies the principles the

Commission must apply in deciding whether to certify a capacity expansion proposal by the port licence holder as being the least cost means of expanding capacity of existing infrastructure or developing new infrastructure to handle international containers in Port Phillip Bay or Western Port Bay.

Port Management Act	<i>Port Management Act 1995</i>
Port licence holder	The holder of a port licence issued under Division 5 of Part 3 of the Port Management Act
Port of Melbourne operator	A person declared under section 4A of the Port Management Act to be the port of Melbourne operator.
Port user	A person who requests or receives prescribed services, as per clause 14 of the Pricing Order.
Ports Minister	Minister for Ports
Prescribed services	The services subject to regulated prices for the purposes of the regime. These are defined in section 49(1)(c) of the Port Management Act.
Prescribed service tariffs	The prices charged for the provision of, or in connection with, prescribed services.
Price smoothing mechanism	A clause in the Pricing Order that will cease no less than 16 and no more than 21 years from the Pricing Order commencement date of 1 July 2016. This mechanism includes the tariffs adjustment limit and allows for rebalancing applications.
Pricing Order	The <i>Pricing Order</i> , Victorian Government Gazette, No S.201, Friday, 24 June 2016, made by the Governor in Council under section 49A of the Port Management Act. The Pricing Order specifies the regulatory framework for the Port Licence Holder's price setting for prescribed

services.

Rebalancing application	An application to the Commission under clause 3.2.4 of the Pricing Order that proposes to either vary certain prescribed service tariffs by different percentage adjustments, introduce a new prescribed service tariff or discontinue an existing prescribed service tariff.
Regime	Legislative and regulatory framework governing the leased functions of the port of Melbourne, including issues related to competition with other Victorian ports capable of handling international containers.
Reference tariff schedule	A published schedule of prescribed service tariffs for each Prescribed Service.
State sponsored port	A port located in Port Phillip Bay or Western Port Bay (other than the port of Melbourne), that is at least partially constructed, operated or funded by the public sector, with its main purpose being to handle international containers.
Tariffs adjustment limit	A pricing requirement that the weighted average tariff increase for prescribed services must not exceed the percentage change in CPI between the March quarter immediately preceding the relevant financial year and the March quarter in the financial year two years preceding the relevant financial year while the price smoothing mechanism is applicable.
Tariff compliance statement	A statement required to be provided by the port licence holder to the Commission no later than 31 May in each financial year. The tariff compliance statement must comply with clause 7.1.2 of the Pricing Order.
TEU	Twenty-foot equivalent unit, the standard shipping container unit of measurement.

Weighted average tariff increase

In respect of a financial year, the expected weighted average rate of increase in prescribed service tariffs using weightings based on historical audited revenues derived from prescribed service tariffs or, if there is no historic audited data, an alternative estimate calculated on a basis determined by the Commission.

Wharfage fees

A fee determined by the port of Melbourne operator under section 74 of the Port Management Act which may be calculated as a charge per unit of quantity, volume or weight of cargo. Wharfage fees are charged to provide a standard of landside facilities, systems and services including port facilities in the form of berths and storage facilities.

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FOREWORD

The Essential Services Commission (the Commission) is the independent regulator responsible for administering a number of new economic regulatory functions applying to the leased port of Melbourne.

This information paper describes the relevant aspects of the lease of the port of Melbourne and the Commission's roles in the new regulatory regime.

Questions about this paper may be directed to Dominic L'Huillier, Director - Transport Division, on 03 9032 1300.

1 INTRODUCTION

This section provides a short introduction to the port of Melbourne and the leasing of its commercial operations.

1.1 ABOUT THE PORT OF MELBOURNE

1.1.1 BASIC FACTS ABOUT THE PORT

The port of Melbourne (the port) is Australia's largest container, automotive and general cargo port. It handles around 36 per cent of national container trade and is one of the top 60 container ports in the world (based on 2015 throughput).¹

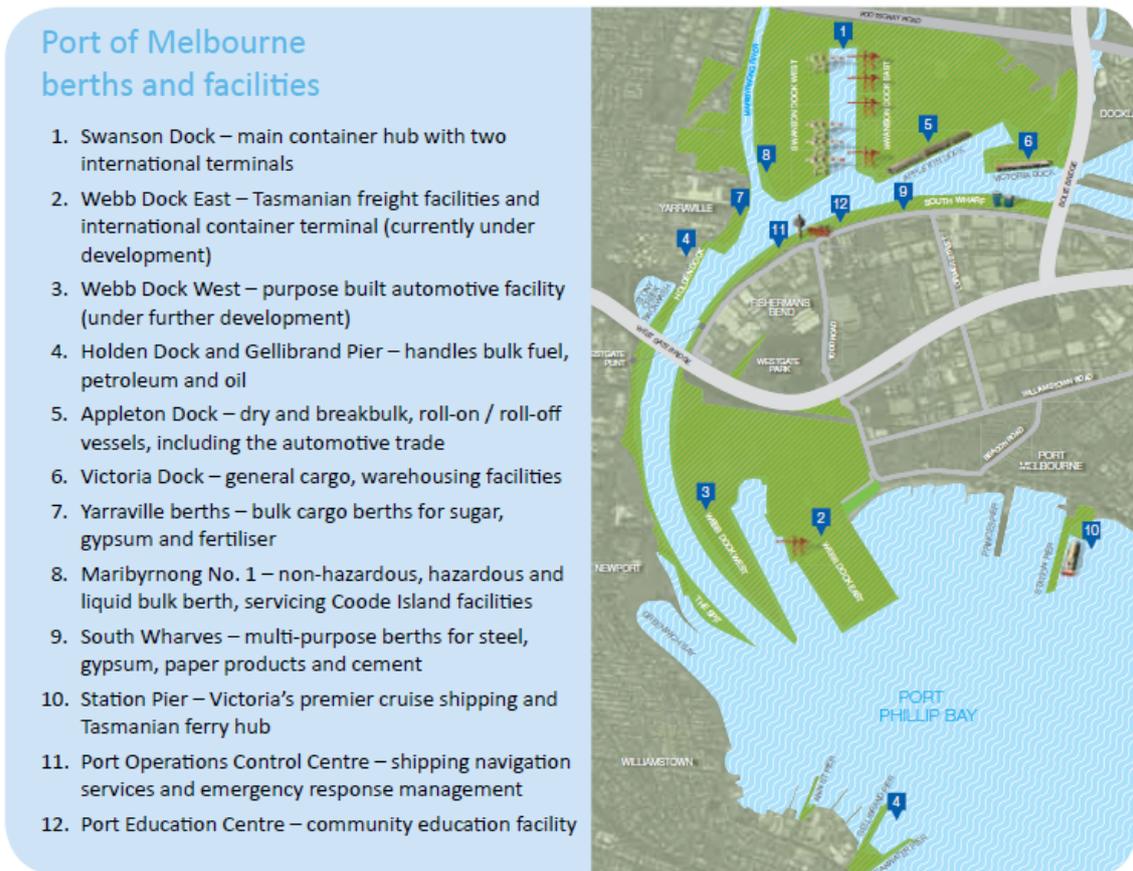
The port handles a variety of containerised and non-containerised cargoes, across 35 commercial berths, jetties and piers in nine separate port precincts.² Figure 1.1 identifies the land and key precincts of the port.³

¹ Port of Melbourne Corporation 2016, *Annual Report 2015-16*, October.

² Ibid. Station Pier will be transferred to the Victorian Ports Corporation (Melbourne).

³ Note that this figure includes land and assets leased to the new port licence holder and retained by the State.

FIGURE 1.1 PORT OF MELBOURNE LAND AND PORT PRECINCTS



Source: Port of Melbourne Corporation Annual Report, 2014-15, p. 25
 Note: The facilities in numbers 10 and 11 have been retained by the State
 The facilities in numbers 2 and 3 are now operational

The port received a total of 3044 ship visits in 2015-16, including 1095 container vessel visits. The port handled more than 2.6 million containers and 372 539 new motor vehicles.⁴

⁴ Port of Melbourne Corporation 2016, Annual Report 2015-16, October, p. 6.

1.1.2 FINANCIAL OVERVIEW OF THE PORT'S OPERATIONS PRIOR TO LEASE

Prior to the leasing of its commercial operations, the port of Melbourne was operated by the Port of Melbourne Corporation, a statutory authority established by the Victorian Government in 2003. The previous functions of the Port of Melbourne Corporation have now been divided across the new port licence holder and the Victorian Ports Corporation Melbourne (see section 1.2.1).

The Port of Melbourne Corporation's most recent annual report (2015-16) provides the following details on the port's commercial operations:

- revenue of \$394.2 million
- earnings before interest and tax of \$126.3 million
- operating profit after tax of \$95.8 million.⁵

In 2015-16, approximately 60 per cent of annual revenue (\$262 million) came from wharfage fees. Wharfage fees are charged for the use of berths and storage facilities on a quantity, volume or weight basis, depending on cargoes.⁶ For example, containers are charged in dollars per twenty-foot equivalent unit (TEU).

In 2015-16, the remaining 40 per cent of revenues came from channel fees, which were charged for accessing shipping channels (\$53 million), and from land rentals and other trade related revenue⁷ (\$79 million).

1.1.3 USERS OF THE PORT

There are two main types of port users at the port:

⁵ Port of Melbourne Corporation 2016, *Annual Report 2015-16*, October, p. 6.

⁶ Port of Melbourne (Port of Melbourne Operations Pty Ltd as the Trustee for the Port of Melbourne Unit Trust), Reference Tariff Schedule, Effective 1 July 2016.

⁷ Including area hire fees and land tax. See Port of Melbourne Corporation, *Annual Report 2015-16*, p. 69.

- stevedore and logistics operators use berths, pay rental fees for the use of land in and around the port, and are responsible for the day-to-day operation of their terminal facilities, including container terminals
- shipping lines use both shipping channels and berths to move cargo into and out of the port.

Three international container terminal operators are located at the port of Melbourne:

- DP World Australia (operates Swanson Dock West)
- Patrick Container Terminals⁸ (operates Swanson Dock East⁹)
- Victorian International Container Terminal Limited (VICT) (operates at Webb Dock East¹⁰).

Other terminals at the port are operated for general cargo and dry and liquid bulk cargo. Some of these terminals are multipurpose and handle a variety of non-containerised pack types and break bulk, while others are specialised and handle dry cargo (including cement, sugar, grain and gypsum) or bulk liquids (including petrochemicals, crude oil and molasses).¹¹

1.1.4 GROWTH OF THE PORT

The Port Capacity Project (PCP) was announced in April 2012 and is nearing completion. The PCP significantly expands the capacity of the port's container and automotive terminals. As shown in Figure 1.1, the PCP has included reconfiguration and redevelopment of Webb Dock East to include a new third international container handling facility (now operated by VICT) and a new automotive terminal.

⁸ Acquired by Qube, a large logistics provider, in 2016.

⁹ Patrick Container Terminals, Patrick Terminal Contacts, viewed at: http://enet.patrick.com.au/enet2/vbs/contacts.aspx?term_cd=OMSES

¹⁰ Victorian International Container Terminal Limited (VICT), commenced operating at Webb Dock East in December 2016

¹¹ Port of Melbourne, Port facilities overview, viewed at: <http://www.portofmelbourne.com/facilities-and-development/port-facilities-overview>

Further investment in the port of Melbourne's capacity has been foreshadowed over the medium to long term to meet expected growth in container and other port trades.¹²

1.1.5 THE BROADER VICTORIAN PORT CONTEXT

The port of Melbourne is Victoria's only international container port. Victoria's other commercial ports all handle a combination of dry bulk, break bulk, and liquid bulk. These ports are located at Hastings¹³, Geelong and Portland.

Future growth may mean that the port's maximum container capacity is exhausted before the end of the 50 year lease term. The timing and location of a second container port was a key issue raised by stakeholders during the lease process.¹⁴

To date, the Victorian Government has not taken a position on when a second container port will be needed or where it should be located, but ruled out providing the port licence holder with a right to develop a second container port in the lease agreement.¹⁵ The government did, however, include in the legislation the following mechanisms:

- a mechanism under which compensation is payable to the port licence holder in certain circumstances for investments in capacity at the port of Melbourne (within the first 15 years of the lease)¹⁶, and
- a mechanism to ensure that any competing state sponsored port prices in a 'competitively neutral' manner (see chapter 5 for further information).¹⁷

¹² Port of Melbourne Corporation 2009, *Port Development Strategy 2035 Vision*, August.

¹³ The ports of Geelong and Portland are privately owned. The Victorian Government established the Port of Hastings Development Authority to manage trade at the Port of Hastings. The Port of Hastings Development Authority manages the operations of the port through a port management agreement with Patrick Ports Hastings, which is in place until 30 June 2017 (source: Port of Hastings Development Authority 2016, *Annual Report 2015/16*, p. 5).

¹⁴ Parliament of Victoria - Port of Melbourne Select Committee 2015, *Inquiry into the proposed lease of the Port of Melbourne*, December, Chapter 3.

¹⁵ Department of Treasury and Finance, *Leasing the Port of Melbourne – Frequently Asked Questions*, viewed at; <http://www.dtf.vic.gov.au/Infrastructure-Delivery/Leasing-the-Port-of-Melbourne/Frequently-asked-questions#WillthePortofMelbourneleaseholderhaverightsinrelationtoasecondport>

¹⁶ Delivering Victorian Infrastructure Act 2016, Division 2 of Part 7

¹⁷ Port Management Act 1995, Division 2D of Part 3

In this context, competitive neutrality means that a private port (such as the port of Melbourne) is competing on a level playing field with a state sponsored port (for example, a second international container port in Victoria may be fully or

The Special Minister of State has asked Infrastructure Victoria to provide advice on the future capacity of Victoria's commercial ports with a focus on the timing of, need for, and location of, a second container port in Victoria. This advice is expected to be provided in May 2017.¹⁸

1.2 THE PORT OF MELBOURNE LEASE

In 2016, the Victorian Parliament passed legislation enabling the port's commercial operations to be leased to a private operator for 50 years. Prior to the lease commencing on 1 November 2016, the port was operated by the Port of Melbourne Corporation, a statutory body established by the Victorian Government in 2003.

1.2.1 WHAT WAS LEASED

The government leased the port of Melbourne's commercial operations. The lease term is 50 years, to allow the leaseholder to plan for the investment needed to expand capacity at the port, while providing the government with flexibility about developing port land after the lease term ends.¹⁹ The port land remains in state ownership.

The functions of the Port of Melbourne Corporation were divided across two entities, as outlined below and in Figure 1.2:

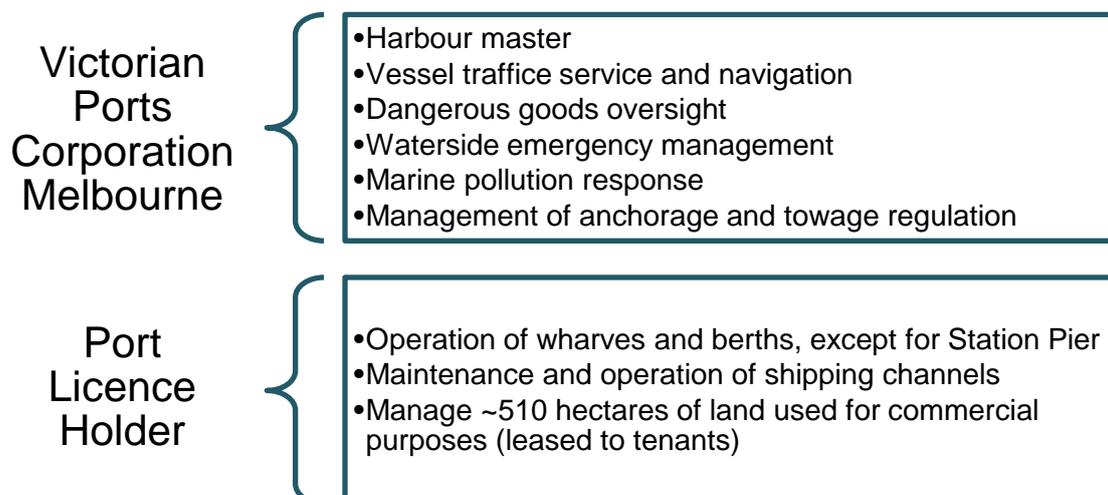
- the port licence holder – a private entity which assumes responsibility for the leased commercial operations
- the Victorian Ports Corporation Melbourne – a statutory authority responsible for marine safety and regulatory functions and the operation of Station Pier.

partially funded by the government). Without this mechanism, a state sponsored port would have competitive advantages, such as access to cheaper financing, which could be used to set prices below a competitive level.

¹⁸ Infrastructure Victoria 2016, *Preparing Advice On Victoria's Future Ports Capacity*, Discussion Paper, September.

¹⁹ Treasury and Finance, Victoria State Government, *Frequently asked questions*, <http://www.dtf.vic.gov.au/Infrastructure-Delivery/Leasing-the-Port-of-Melbourne/Frequently-asked-questions>, accessed on 24 February 2017.

FIGURE 1.2 THE FUNCTIONS OF THE VICTORIAN PORTS CORPORATION MELBOURNE AND PORT LICENCE HOLDER



1.2.2 THE NEW LEASEHOLDER

The government awarded the 50 year lease for the commercial operations of the port to the Lonsdale Consortium comprising Future Fund, QIC, Global Infrastructure Partners (GIP) and Ontario Municipal Employees Retirement Scheme (OMERS).²⁰

The consortium received clearance from Australia’s competition authority, the Australian Competition and Consumer Commission (ACCC), on 11 August 2016. The ACCC’s review focused primarily on the cross-ownership interests in the port of Melbourne, NSW Ports and the Port of Brisbane, and the vertical relationships with port services providers operating at the port of Melbourne.²¹ In particular, the members of the Lonsdale Consortium hold other interests in ports and other infrastructure around Australia. QIC has managing interests in the Port of Brisbane and GIP has managing

²⁰ We refer to this entity as the port licence holder in this paper.

²¹ Further information regarding the ACCC’s review is available: www.accc.gov.au/media-release/accc-will-not-oppose-proposals-for-port-of-melbourne-lease

interests in NSW Ports, as well as previously holding a stake in the Port of Brisbane. OMERS is an investor in overseas ports.²²

The Lonsdale Consortium commenced operations and became the port licence holder on 1 November 2016.

1.2.3 FINANCIAL ASPECTS OF THE SALE

The 50 year lease was sold for \$9.7 billion. The port licence holder is legislatively committed to:

- pay to the government an annual port licence fee²³ of approximately \$80 million, escalated by CPI²⁴
- abide by the 'export pricing decision', which commits to reducing the price of full outbound container wharfage fees by 2.5 per cent annually through to 2019-20, and then maintains the same or greater percentage discount relative to the price of full inbound containers from 2020-21 onwards.²⁵

²² Department of Treasury and Finance, *Leasing the Port of Melbourne – Frequently asked questions*, accessed at; <http://www.dtf.vic.gov.au/Infrastructure-Delivery/Leasing-the-Port-of-Melbourne/Frequently-asked-questions>

²³ Section 44HA of the Port Management Act 1995 provides for the Treasurer to require a one-off upfront licence fee of up to 15 years instead of annual licence fees for that period.

²⁴ Sections 44I and 44J of the Port Management Act 1995 outline that the amount of the port licence fee is \$75 million (1 July 2012) prices, escalated by CPI (All Groups Index, Melbourne).

²⁵ Pricing Order, clause 2.3

2 THE PORT OF MELBOURNE REGULATORY REGIME

This section describes the scope of the regulatory regime applying to the port licence holder, the objectives of the regime and the Commission's roles in administering the regime.

2.1 LEGISLATIVE FRAMEWORK

The regulatory regime applying to the port licence holder includes a number of Acts and legislative instruments. The two key Acts are:

- the *Essential Services Commission Act 2001*, the instrument that establishes the powers and functions of the Commission (Essential Services Commission Act)
- the *Port Management Act 1995*, which establishes the ports legislative framework (Port Management Act).

Both Acts were amended by the *Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Act 2016* to create specific regulatory functions for the Commission.

The Port Management Act contains a number of provisions which specify how it interacts with the Essential Services Commission Act. In particular:

- The Port Management Act designates that Part 3 of that Act is ‘relevant legislation’ for the purposes of the Essential Services Commission Act.²⁶
- The Essential Services Commission Act empowers the Commission to do all things necessary or convenient to be done for or in connection with the performance of its functions and to enable it to achieve its objectives under ‘relevant legislation’, which therefore includes Part 3 of the Port Management Act.²⁷
- The Port Management Act designates the port industry as a ‘regulated industry’ for the purposes of Part 3 of the Essential Services Commission Act and defines what are ‘prescribed services’.²⁸
- The Port Management Act requires that any inquiries the Commission conducts under section 49I of the Port Management Act (with respect to the compliance by the port licence holder with the Pricing Order) must be conducted in accordance with Part 5 of the Essential Services Commission Act (except sections 40 and 46²⁹ of the Essential Services Commission Act).³⁰

The legislative framework for the regime and associated functions of the port licence holder and the Commission are illustrated in figure 2.1. The framework establishes a number of economic regulatory roles for the Commission which are discussed in this paper, a key role being to monitor and report on the port licence holder’s compliance with the Pricing Order, which governs how the port licence holder is to set its prices for prescribed services.

²⁶ Port Management Act 1995, s 46.

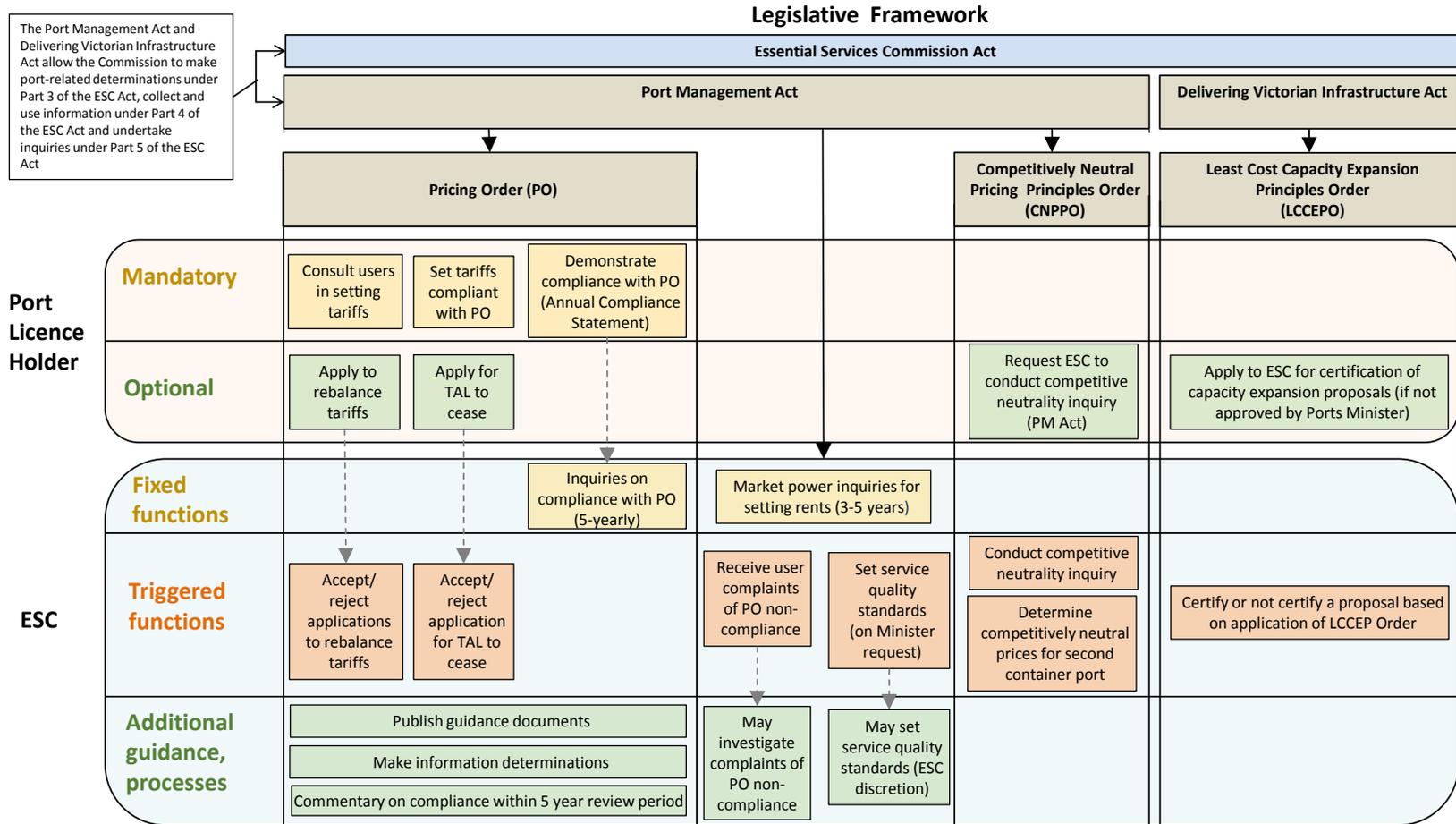
²⁷ Essential Services Commission Act 2001, s 11.

²⁸ Port Management Act 1995, s 49.

²⁹ Sections 40 and 46 of the Essential Services Commission Act 2001 relate to a requirement to consult with the Minister before conducting an inquiry and the Commission’s power to prepare a special report on another matter that arises in the course of an inquiry.

³⁰ Port Management Act 1995, s 49I(2) and (4).

FIGURE 2.1 THE LEGISLATIVE FRAMEWORK FOR THE PORT OF MELBOURNE REGULATORY REGIME
 Port licence holder and Commission's functions



2.2 THE OBJECTIVES OF THE REGULATORY REGIME

The objectives of the regulatory regime applying to the leased port of Melbourne are outlined in section 48 of the Port Management Act.

The Port Management Act specifies five objectives for the regime. These are:

- (a) to promote efficient use of, and investment in, the provision of prescribed services for the long-term interests of users and Victorian consumers; and*
- (b) to protect the interests of users of prescribed services by ensuring that prescribed prices are fair and reasonable whilst having regard to the level of competition in, and efficiency of, the regulated industry; and*
- (c) to allow a provider of prescribed services a reasonable opportunity to recover the efficient costs of providing prescribed services, including a return commensurate with the risks involved; and*
- (d) to facilitate and promote competition— (i) between ports; and (ii) between shippers; and (iii) between other persons conducting other commercial activities in ports; and*
- (e) to eliminate resource allocation distortions by prohibiting a State sponsored port operator from providing a relevant service at a price lower than the competitively neutral price for that service.*

Section 48A specifies that the Commission must have regard to these objectives in performing its functions or exercising its powers. In addition, the Commission must have regard to the objectives of section 8 of the Essential Services Commission Act, which states:

(1) *In performing its functions and exercising its powers, the objective of the Commission is to promote the long term interests of Victorian consumers.*

(2) *...the Commission must in seeking to achieve the objective specified in subsection (1) have regard to the price, quality and reliability of essential services.*

2.3 AN OVERVIEW OF THE REGULATORY REGIME

The regulatory regime has three aspects:

- the port licence holder's pricing and provision of prescribed services
- the port licence holder's setting of rents for port of Melbourne land
- functions relating to a second international container handling port in Victoria (should one be developed).

The regulatory arrangements for each are summarised in Table 2.1 and described in more detail in the remaining chapters of this paper.

TABLE 2.1 SUMMARY OF THE REGULATORY REGIME

Prescribed Services	Rent for port of Melbourne land	Functions related to a second container port
<ul style="list-style-type: none"> • PLH sets prices • Price setting requirements: <ul style="list-style-type: none"> – PLH must comply with Pricing Order – PLH must demonstrate compliance – PLH must consult port users • 5-yearly compliance reviews by ESC • Possibility of re-regulation of prices • Provision for user complaints • Options for service standards to be regulated by ESC 	<ul style="list-style-type: none"> • PLH sets rents for tenants (no pricing requirements) • ESC periodically reviews market power of PLH • Threat of regulation if market power exercised 	<ul style="list-style-type: none"> • PLH can submit capacity expansion proposals at port of Melbourne to the Minister and ESC to be approved for compensation purposes • Competitively neutral pricing obligations for a second port if it is state sponsored

Note: PLH – port licence holder, ESC – Essential Services Commission

2.4 APPEALS AND REVIEW MECHANISMS

In administering the ports regulatory regime, the Commission can make determinations and decisions that may be subject to appeal to the Essential Services Commission appeal panel or judicial review. These processes are briefly set out below.

2.4.1 ESC APPEAL PANEL

A party aggrieved by a decision or determination of the Commission may appeal to the Essential Services Commission appeal panel. The appeal panel comprises of three

members chosen by the Registrar³¹ from a pool of persons appointed by the Governor in Council. The grounds for appeal are limited and depend upon whether what is being appealed is a decision or a determination of the Commission. Section 55(2) of the Essential Services Commission Act sets out the permissible grounds of appeal. They are:

- the Commission's determinations (excluding those on competitively neutral prices) can be appealed on the basis of bias or error of fact³²
- if the Commission was to determine the competitively neutral price for the provision of a relevant service (see chapter 5) the determination can be appealed on the basis that it was not made in accordance with the law or is unreasonable having regard to all the relevant circumstances³³
- the Commission's decisions (listed below) can be appealed on the basis that the decision was not made in accordance with the law or is unreasonable having regard to all the relevant circumstances:
 - a requirement made under section 37 of the Essential Services Commission Act that a person provide the information or documents specified by the Commission in a written notice³⁴
 - a decision to disclose information given to the Commission in response to a written notice³⁵
 - a decision contained in a final published report³⁶ that a provider of prescribed services has not complied with a port Pricing Order in a significant and sustained manner³⁷
 - a Pricing Order decision (for example, to reject a tariff rebalancing application)³⁸

³¹ The Registrar is defined in regulation 11 of the Essential Services Commission Regulations 2011 as the principal registrar of the Victorian Civil and Administrative Tribunal.

³² Essential Services Commission Act 2001, s 55(2)(c)

³³ Essential Services Commission Act 2001, s 55(2)(g)

³⁴ Essential Services Commission Act 2001, s 55(2)(a)

³⁵ Essential Services Commission Act 2001, s 55(2)(b)

³⁶ A 'final published report' is defined in s 45 of the Port Management Act 1995 as 'a report on an inquiry under section 49I laid before each House of Parliament or made available for public inspection in accordance with section 45 of the Essential Services Commission Act 2001'.

³⁷ Essential Services Commission Act 2001, s 55(2)(d)

- a decision on whether to certify a capacity expansion proposal the port of Melbourne operator under section 69 of the *Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Act 2016*.³⁹

2.4.2 JUDICIAL REVIEW

A party may seek judicial review by the Supreme Court. Section 62 of the Essential Services Commission Act limits the grounds on which a party may seek judicial review. If a party seeks to review a determination, provisional order or final order of the Commission, they can only do so on the grounds that:

- there was no power to make the determination or provisional order or final order; or
- that the procedural requirements in relation to the making of the determination or provisional order or final order have not been complied with.

³⁸ Essential Services Commission Act 2001, s 55(2)(e)

³⁹ Essential Services Commission Act 2001, s 55(2)(f)

3 PRESCRIBED SERVICES

This section provides an overview of the regulation of services that are prescribed under the regulatory regime. It outlines the requirements the Pricing Order places on how the port licence holder sets its prescribed service tariffs, the Commission's role in monitoring compliance, the provision for port users to make complaints and options for regulation of service standards to be put in place.

3.1 REQUIREMENTS ON PRICES FOR PRESCRIBED SERVICES

Prescribed services are defined in section 49 of the Port Management Act. The Port Management Act states that prescribed services include the provision of channels for shipping in port of Melbourne waters; the provision of berths, buoys or dolphins in connection with the berthing of vessels; the provision of services in connection with cargo loading and unloading such as short-term storage and cargo marshalling; and the provision of access to, or use of, land or infrastructure for the purpose of providing services to port users.⁴⁰

The Pricing Order, made by the Governor in Council under section 49A of the Port Management Act, is the regulatory instrument which contains the details of how the port licence holder is required to set its prices for prescribed services.⁴¹ The Pricing Order is subordinate legislation and must therefore be read subject to and in accordance with the Port Management Act.⁴²

⁴⁰ Port Management Act 1995, s 49

⁴¹ Victoria Government Gazette, No. S 201, Friday 24 June 2016

⁴² Interpretation of Legislation Act 1984 (Vic), s 22

3.1.1 TWO OVERARCHING PRICING REQUIREMENTS

The Pricing Order imposes two key requirements on prices for prescribed services:

- 1. A tariffs adjustment limit** – a requirement that the weighted average tariff increase⁴³ for prescribed services must not exceed the tariffs adjustment limit. In short, average prices cannot rise faster than the Consumer Price Index (CPI).⁴⁴
- 2. An accrual building block methodology** – a requirement to set tariffs according to an accrual building block methodology which allows the port licence holder a reasonable opportunity to recover the efficient cost of providing prescribed services.⁴⁵

The tariffs adjustment limit applies for no less than 16 years and no more than 21 years from the Pricing Order commencement date of 1 July 2016.⁴⁶ The two requirements apply concurrently during this time. After the cessation of the tariffs adjustment limit, only the accrual building block requirement remains.⁴⁷

⁴³ A weighted average tariff increase is calculated by multiplying price changes on individual services with a service 'weight' reflecting its importance to the overall change. The Pricing Order specifies that weights are to be based on service revenues from a prior period.

⁴⁴ Pricing Order, clause 3.1

⁴⁵ Pricing Order, clause 4

The use of an accrual building block methodology – more commonly referred to as a building block model – is well established in regulatory settings across the energy, water, telecommunications and other infrastructure sectors.

Building block models are described by two equations: one for updating the value of regulated assets (known as a "roll forward" equation); and one for determining the revenue required to cover the efficient cost of providing services (known as the aggregate revenue requirement). The aggregate revenue requirement is then converted into prices using forecasts of demand. The Pricing Order specifies how the two equations are to be applied under this regime.

⁴⁶ The specific period depends on whether the Port Licence Holder applies for the tariffs adjustment limit to cease to apply, which can occur no earlier than 16 years into the regime. The tariffs adjustment limit provisions are in clause 3 of the Pricing Order. Clause 3.3.1 states *'the Port Licence Holder may, no earlier than 30 June in the Financial Year in which the fifteenth anniversary of the Commencement Date falls, make an application to the Commission for a determination that clause 3 ceases to apply'* (the 'Commencement Date' is the 1 July 2016 commencement date of the Pricing Order).

In the absence of a determination by the Commission that clause 3 ceases to apply, clause 3.3.5 states that the tariffs adjustment limit is to cease 'at the end of the Financial Year in which the twentieth anniversary of the Commencement Date falls' (that is, 21 years after the 1 July 2016 Pricing Order commencement date).

⁴⁷ Pricing Order, clauses 2.1.1 and clause 3.3

3.1.2 OTHER REQUIREMENTS ON PRICES

In addition to the two requirements discussed above, four other requirements apply to the port licence holder's setting of prescribed service prices. These are essentially sub requirements of the two main requirements, in that they affect the structure and level of *individual* prescribed service prices (or bundles of service revenues) without necessarily affecting the overall revenue able to be earned by the port licence holder.

- **Level and structure of tariffs:** prescribed service tariffs are required to be set having regard to the efficient costs caused by port users, transactions costs and the extent to which port users are likely or able to respond to price signals.⁴⁸
- **Upper and lower cost bounds:** apply to cargo-specific prescribed service bundles (for example wharfage services for containerised cargo, wharfage services for motor vehicle cargo etc.). Prescribed service tariffs must be set so that the revenues from cargo-specific prescribed service bundles must fall between:⁴⁹
 - a floor of the avoidable cost of providing the prescribed service bundles
 - a ceiling of the stand alone cost of providing the prescribed service bundles.
- **Tariff differentiation:** tariff differentiation for different users of the same prescribed services is permitted provided the differences are consistent with the objectives set out in section 48 of the Port Management Act.⁵⁰ For channels shared between the port of Melbourne and other ports, no discrimination between port users on the basis of port or berth is permitted.⁵¹
- **Cost allocation:** directly attributable costs must be attributed to each prescribed service, while costs incurred in providing both prescribed and non-prescribed services must be allocated to prescribed services on the basis of the revenue share of total revenue from all services provided by the port licence holder.⁵²

⁴⁸ Pricing Order, clause 2.1.3

⁴⁹ Pricing Order, clause 2.1.1(b)

⁵⁰ Pricing Order, clause 2.1.2

⁵¹ Pricing Order, clause 2.2

⁵² Pricing Order, clause 5

3.2 TARIFF COMPLIANCE STATEMENTS AND DEMONSTRATING COMPLIANCE WITH THE PRICING ORDER

The Commission's role is to monitor and report on the port licence holder's compliance with the Pricing Order. Except in limited circumstances (as discussed in section 3.3), the Commission does not have a role in determining or approving the port licence holder's prices or the building blocks used in setting those prices.⁵³ The onus is on the port licence holder to demonstrate that in setting prices it is compliant with the Pricing Order provisions.

The port licence holder must:

- publish its reference tariff schedule by 31 May each year⁵⁴
- provide tariff compliance statements to the Commission by 31 May each year. A tariff compliance statement must include details of the prescribed service tariffs, set out how any adjustments or additions have been made to prescribed service tariffs for the forthcoming year, set out how it has effectively consulted with port users and had regard to their comments, and explain how the prescribed service tariffs comply with the Pricing Order.⁵⁵ This also includes some specific requirements regarding the basis upon which the financial information is provided and how any forecasts or estimates have been used by the port licence holder.⁵⁶ The Commission also has powers to determine the form and content of supporting information relating to the port licence holder's demonstration of compliance with the Pricing Order.⁵⁷

⁵³ In some limited cases the Pricing Order provides for the Commission to determine certain things, such as replacement indices where an externally published index specified in the Pricing Order ceases to be published.

⁵⁴ Pricing Order, clause 6.1.1

⁵⁵ Pricing Order, clause 7

⁵⁶ Pricing Order, clause 8

⁵⁷ Pricing Order, clause 9

3.2.1 REFERENCE TARIFF SCHEDULE

A reference tariff schedule specifies the prescribed service tariffs for each of the port licence holder's prescribed services. The port licence holder must offer prescribed services to port users in accordance with the reference tariff schedule⁵⁸, and cannot require port users to acquire non-prescribed services in order to be supplied with prescribed services.⁵⁹

3.2.2 TARIFF COMPLIANCE STATEMENTS

Tariff compliance statements are important to the Commission's assessment of the port licence holder's compliance with the Pricing Order. Annually, the port licence holder must submit a statement to the Commission that sets out:⁶⁰

- the tariffs for prescribed services to apply in the following financial year
- information on the basis for tariff adjustments and new prescribed service tariffs, including how the cost building blocks have been applied
- how the port licence holder has effectively consulted port users about proposed prices, and how it has had regard to port user comments
- how the tariffs for prescribed services comply with the Pricing Order, including the pricing principles and cost allocation principles
- the supporting information that is required to be provided, as determined by the Commission under clause 9 of the Pricing Order.

Clause 8 of the Pricing Order requires the port licence holder to ensure that information supplied to the Commission must be adequately explained and that estimates and forecasts are reasonable and supported by a statement of the basis of the forecast or estimate.

⁵⁸ Port of Melbourne (Port of Melbourne Operations Pty Ltd as the Trustee for the Port of Melbourne Unit Trust), Reference Tariff Schedule, Effective 1 July 2016.

⁵⁹ Pricing Order, clause 6.1.7

⁶⁰ Pricing Order, clause 7.1.2.(a)-(g)

The Commission is not required to approve or reject the port licence holder's tariff compliance statements. Rather, tariff compliance statements inform the Commission's periodic inquiries into the port licence holder's compliance with the Pricing Order, which must be conducted every five years.⁶¹

In addition to these five-yearly inquiries, the Commission intends to regularly inform the port licence holder and port users about its view of the port licence holder's tariff compliance statements. However, the Commission is yet to decide on the form and timing of how it will express its views within the five year review periods (for example, on an annual or two-yearly basis) and will publicly consult further on this issue.

3.2.3 MANDATORY CONSULTATION WITH USERS

The Pricing Order requires the port licence holder to demonstrate how it has consulted with port users in relation to the pricing of prescribed services. Specifically, in its tariff compliance statement, the port licence holder must set out the process by which it has effectively consulted and had regard to the comments provided by port users.⁶²

3.2.4 INFORMATION DETERMINATIONS

Clause 9 of the Pricing Order gives the Commission the discretion to determine what constitutes the sufficient supporting information that it requires to:

- assess rebalancing applications (see section 3.3) and applications for the tariffs adjustment limit to cease to apply
- be satisfied that the port licence holder has complied with the Pricing Order (noting that clause 7.1.2(f) specifies that the tariff compliance statement must contain any other sufficient supporting information determined by the Commission).

⁶¹ Port Management Act 1995, s 49I

⁶² Pricing Order, clause 7.1.2(d)

The Commission will exercise its powers to specify the form and content of sufficient supporting information in order to aid its assessment of the port licence holder's ongoing compliance with the Pricing Order.

3.3 PRICES CAN BE 'REBALANCED' SUBJECT TO COMMISSION APPROVAL

During the initial period of the lease when the tariffs adjustment limit applies, the Pricing Order requires that annual price adjustments to prescribed service tariffs are of the same percentage magnitude for all prescribed services⁶³ unless the Commission approves a 'rebalancing application'.⁶⁴ The port licence holder must seek approval from the Commission to make non-uniform price adjustments.⁶⁵

A rebalancing application triggers an approval role for the Commission in what is otherwise predominantly a compliance monitoring regime.

Price rebalancing gives the port licence holder an opportunity to propose an alternative pricing structure within the overarching requirements of the tariffs adjustment limit and other pricing principles. To gain approval for its proposal, the port licence holder is required to demonstrate that, on a weighted average basis, tariffs continue to comply with the tariffs adjustment limit, as well as meeting other relevant Pricing Order clauses.⁶⁶

The same approval process is also required if the port licence holder proposes to introduce a new prescribed service tariff.⁶⁷

⁶³ Other than services subject to the Export Pricing Decision.

⁶⁴ Pricing Order, clause 3.2

⁶⁵ Pricing Order, clause 3.2. While approval is not required for non-uniform price adjustments resulting from complying with the Export Pricing Decision, the port licence holder should transparently set out changes to tariffs.

⁶⁶ Pricing Order, clause 3.2.7

⁶⁷ Pricing Order, clause 3.2.3

3.4 A FIVE-YEARLY REVIEW OF COMPLIANCE AND PROVISIONS FOR RE-REGULATION

Under the Port Management Act⁶⁸, the Commission must conduct a public review of the port licence holder's compliance with the Pricing Order every five years. Within six months after each five year review period, the Commission must report to the ESC Minister on whether the port licence holder has complied with the Pricing Order, and, if there has been non-compliance, whether that non-compliance is 'significant and sustained'.

The term 'significant and sustained' is not defined in the Port Management Act. The Commission will therefore determine what constitutes significant and sustained non-compliance, having due regard to the objectives of the Port Management Act and the Essential Services Commission Act.

3.4.1 CONSEQUENCES OF NON-COMPLIANCE WITH THE PRICING ORDER

If the Commission finds significant and sustained non-compliance by the port licence holder, further processes may then be triggered that could lead to 're-regulation' of prescribed service prices. If this were to occur, the Commission would be required to set prescribed service prices through a determination made in accordance with Part 3 of the Essential Services Commission Act.

The process for re-regulation of prescribed service prices is set out in the Port Management Act⁶⁹ and requires:

- the Commission's adverse compliance report has not been overturned by appeal by the port licence holder⁷⁰
- the ESC Minister has issued a 'show cause' notice to the port licence holder stating that the Minister is considering making a re-regulation recommendation

⁶⁸ Port Management Act 1995, s 49I

⁶⁹ Port Management Act 1995, s 49(I)-(P)

⁷⁰ Right of and grounds for appeal are provided for in section 55 of the Essential Services Commission Act.

- the port licence holder has not satisfied the ESC Minister that it has complied with the Pricing Order, or could become compliant via an acceptable undertaking that seeks to address the non-compliance
- the ESC Minister decides to recommend re-regulation having had regard to any information and undertakings provided by the port licence holder and whether re-regulation of prescribed service prices is in the public interest.
- The Governor in Council acts on the ESC Minister's re-regulation recommendation.⁷¹

3.5 PROVISION FOR USERS TO MAKE COMPLAINTS

Section 49Q of the Port Management Act provides for port users to submit complaints to the Commission if users consider the port licence holder has not complied with the Pricing Order.⁷²

The Commission has discretion to investigate complaints. The Commission can refer complaints to the ESC Minister if it considers the issues raised are not dealt with under the Pricing Order or the Port Management Act.

The Commission must also inform the complainant of the outcome of any investigation.

3.6 OPTIONS FOR SERVICE QUALITY REGULATION OF PRESCRIBED SERVICES

Under section 55(1)(a) of the Port Management Act, the Commission has the power to develop and determine the port licence holder's standards and conditions of service and supply in respect of prescribed services of its own motion.⁷³ The Commission may

⁷¹ Port Management Act 1995, s 45 – definition of 're-regulation recommendation'.

⁷² Port Management Act 1995, s 49Q

⁷³ Before exercising its power under section 55(1)(a), the Commission must first consult with the Director, Transport Safety (section 55(2) of the *Port Management Act 1995*).

also monitor and report on the port licence holder's compliance with the set standards and conditions.

The ESC Minister may also request the Commission to exercise its powers to develop and determine the port licence holder's standards and conditions of service and supply.⁷⁴ If the ESC Minister makes a request under section 54A of the Port Management Act, the Commission must comply within the timeframe specified in the request.

To date, the Minister has not requested the Commission to develop standards and conditions of service and supply nor has the Commission exercised its power under section 55(1)(a).

⁷⁴ Port Management Act 1995, s 54A

4 PORT OF MELBOURNE LAND RENTS

The port licence holder's process for setting of rents for port of Melbourne land will be reviewed periodically by the Commission.

4.1 MARKET POWER INQUIRIES FOR SETTING LAND RENTS

The port licence holder controls the leasing of port of Melbourne land, often on a long term basis, to third party operators including stevedoring companies and logistics operators. The port licence holder has taken over approximately 65 active leases across its 510 hectare site with contracts averaging 25 years in duration, and in some cases up to 50 years.⁷⁵ The rents from these leases and licences accounted for around 14 per cent of the Port of Melbourne Corporation's revenue in 2015-16.⁷⁶

The granting of certain leases is not a prescribed service under the Port Management Act. Thus, the rents under those leases are not regulated under the Pricing Order.⁷⁷ However, the Commission has been given a specific role under the Port Management Act to conduct regular inquiries into the port licence holder's process for setting rents.⁷⁸ The inquiries also cover subleases of port of Melbourne land by other port lessees.

⁷⁵ Parliament of Victoria - Port of Melbourne Select Committee 2015, *Inquiry into the proposed lease of the Port of Melbourne*, December, p. 60.

⁷⁶ Port of Melbourne Corporation 2016, *Annual Report 2015-16*, p. 69.

⁷⁷ Port Management Act 1995, s. 49(2).

⁷⁸ Port Management Act 1995. s. 53

The nature of these inquiries is to determine if:

- a port lessee or the port of Melbourne operator has power it may exercise in relation to the process of setting rents for port of Melbourne land; and
- if a port lessee or the port of Melbourne operator has exercised its market power in a way that has the effect of causing material detriment to the long term interests of Victorian consumers (defined in section 53(1)(a)(ii) of the Port Management Act as ‘misuse of market power’).

In conducting an inquiry, the Commission must have regard to:

- the processes used to establish or review rents or associated payments;
- whether the processes have been complied with in setting and reviewing rents or associated payments; and
- the extent to which rents or associated payments may be passed through by the tenant to users of the tenant’s services and ultimately, to Victorian consumers (section 53(3) of the Port Management Act).

If the Commission finds that a port lessee or the port licence holder has misused its market power, the Commission must make recommendations to the ESC Minister on whether and how access to the port of Melbourne land via a lease should be regulated.⁷⁹ This provides a potential for economic regulation, including price control, if market power is misused.

The Commission is required to commence an inquiry three years after the granting of the first port of Melbourne lease transaction and conduct inquiries every five years thereafter.⁸⁰

⁷⁹ Port Management Act 1995, s 53(1)(b)

⁸⁰ Port Management Act 1995, s 53(5)

5 FUNCTIONS RELATING TO A SECOND INTERNATIONAL CONTAINER PORT

This section outlines the Commission’s functions that can be triggered if a second international container port commences operating in Port Phillip Bay or Western Port Bay.

5.1 PORT OF MELBOURNE CAPACITY EXPANSION PROPOSALS

The port of Melbourne is currently the only port in Victoria handling international containers. Legislation enacted to provide for the 50 year lease includes a provision that compensation may be payable to the port licence holder if handling of international containers occurs at another Victorian port within 15 years of the lease commencement.⁸¹ The conditions on compensation payable, including the application of an annual cap, are outlined in Part 7 of the *Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Act 2016* (Delivering Victorian Infrastructure Act).

A compensation payment may only be made in respect of:⁸²

- existing port or terminal capacity, plus
- port or terminal capacity expansions that have had proposals approved or certified under the Delivering Victorian Infrastructure Act.

⁸¹ *Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Act 2016*, s 65

⁸² *Delivering Victorian Infrastructure Act 2016*, s 65(3)

The requirement for approval or certification means that if the port licence holder materially expands the port's container handling capacity in the first 15 years of the lease, and seeks to have the capacity expansion costs included in a compensation calculation, it will need to obtain either approval from the Ports Minister, or certification from the Commission.⁸³

5.1.1 APPROVAL BY THE PORTS MINISTER

The port licence holder may submit a capacity expansion proposal to the Ports Minister under section 66 of the Delivering Victorian Infrastructure Act. It may only submit a capacity expansion proposal for 'material' port or terminal capacity expansions. Section 64 of the Delivering Victorian Infrastructure Act enables the Ports Minister to issue guidelines about the form and content of capacity expansion proposals.

The Ports Minister may decide to approve or not approve the proposal within six months of receiving it and must provide written reasons for the decision.⁸⁴

5.1.2 CERTIFICATION BY THE COMMISSION

If the Ports Minister refuses to approve the capacity expansion proposal, or has not made a decision within six months of receiving the proposal, the port licence holder can apply to the Commission for certification of the proposal (within a further three months).⁸⁵

The Commission must conduct an inquiry⁸⁶ before deciding whether to certify a capacity expansion proposal and must make a certification decision within three months of receiving a proposal.⁸⁷

⁸³ Delivering Victorian Infrastructure Act 2016, s 65

⁸⁴ Delivering Victorian Infrastructure Act 2016, s 66(6) & s 66(7)

⁸⁵ Delivering Victorian Infrastructure Act 2016, s 67 & s 68

⁸⁶ Delivering Victorian Infrastructure Act 2016, s 70

⁸⁷ Delivering Victorian Infrastructure Act 2016, s 69

The first stage of an inquiry requires the Commission to satisfy itself that the port licence holder's proposal meets the 'eligibility criteria' in clause 2.1.1 of the Least Cost Capacity Expansion Principles Order⁸⁸, which require that the expansion is consistent with the port's development plan, will be operational within ten years and is a material capacity expansion.

If the port licence holder's proposal meets the eligibility criteria, the Commission must determine whether the proposal is the least cost means of a capacity expansion in Port Phillip Bay or Western Port Bay. If there are no alternative proposals, the port licence holder's proposal is taken to be the least cost means of capacity expansion and will be certified.⁸⁹

Before making a final decision on whether to approve or reject a certification proposal, section 71 of the Delivering Victorian Infrastructure Act requires the Commission to provide the port licence holder with a draft report and give the port licence holder an opportunity to make a written submission on the report.

5.2 COMPETITIVE NEUTRALITY OF A STATE SPONSORED PORT

As noted in section 1.1.5, the port of Melbourne is currently the only international container port in Victoria. If a second international container port is constructed or operated by either a public sector entity, or a private sector entity with financial support from a public sector entity grant, it will be considered to be a 'state sponsored port'⁹⁰.

The Port Management Act prevents a state sponsored port from providing its services at below a 'competitively neutral price'.⁹¹ The competitively neutral price for a service is defined in the Port Management Act⁹² as the lower of:

⁸⁸ *Least Cost Capacity Expansion Principles Order*, Victorian Government Gazette, No. S 272 Tuesday 30 August 2016.

⁸⁹ *Least Cost Capacity Expansion Principles Order*, clause 3.2

⁹⁰ Port Management Act 1995, s 49T

⁹¹ Port Management Act 1995, s 49V.

⁹² Port Management Act 1995, s 49R

- the price that is likely to allow the state sponsored port to recover its efficient costs in providing that service; and
- the price that the port licence holder charges for an economically substitutable service.⁹³

5.2.1 THE COMPETITIVELY NEUTRAL PRICING PRINCIPLES ORDER

The Competitively Neutral Pricing Principles Order, issued by the Governor in Council, outlines how the Commission is to determine if a state sponsored port is providing services below a competitively neutral price. The costs of the state sponsored port operator are determined using a building block methodology (including State cost contribution, if any), as outlined in the Competitively Neutral Pricing Principles Order.

The Competitively Neutral Pricing Principles Order also states that if a state sponsored port operator sets a price for a service below its costs on the basis that the price is still not lower than the port of Melbourne operator's price for a similar service, the state sponsored port operator must keep records identifying why it considers the two ports' services are economically substitutable.⁹⁴

5.2.2 COMPETITIVE NEUTRALITY INQUIRIES

If either the port licence holder or the ESC Minister is of the view that the state sponsored port is providing, or is likely to provide, its services below the competitively neutral price, they may request that the Commission conduct an inquiry into the prices of the state sponsored port.⁹⁵

Once the Commission has received a request for an inquiry into the state sponsored port's prices, it must complete the inquiry within three months.⁹⁶ The Commission may

⁹³ Port Management Act 1995, s 49R.

⁹⁴ Competitively Neutral Pricing Principles Order, clause 5.

⁹⁵ Port Management Act 1995, s 49Y

⁹⁶ Port Management Act 1995, s. 49Z(1).

refuse a request from the port licence holder if it is of the view that the request is frivolous, vexatious, without substance or has been made in bad faith.⁹⁷

If the Commission finds that the state sponsored port has been providing, or is likely to provide, its services below the competitively neutral price, it may make a determination that specifies minimum prices for those services.⁹⁸ The determination must also specify the duration for which the minimum competitively neutral prices apply, up to a maximum of five years.⁹⁹

⁹⁷ Port Management Act 1995, s. 49Z(2).

⁹⁸ Port Management Act 1995, s. 49ZA.

⁹⁹ Port Management Act, s 49ZA