



25 August 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,

**ESC inquiry into Port of Melbourne Pricing Order compliance – Requirement to consider WDE Expansion Expenditure**

I am writing to confirm our previous submissions that the Port of Melbourne Groups' (PoM) acceleration of Webb Dock precinct developments and the inclusion of forecast capital expenditure related to the Webb Dock East Knuckle removal (**WDE Expansion Project**) in the capital base for the purposes of setting Prescribed Service Tariffs in their 2021-22 TCS published on 31 May 2021 is:

- within the scope of the ESC's current Inquiry into PoM's compliance with the 2016 Pricing Order (and 20 May 2020 amendment) (**compliance review**) under section 49I of the *Port Management Act 1995* (Vic) (**PMA**); and
- must be reviewed in the course of the current compliance review.

If there is any doubt as to the ability of the ESC to look at this issue under the current compliance review, the ESC has power to review this matter on its own initiative and/or at the request of the Minister. This review cannot wait until 2026 and must be properly reviewed now. It is hard to conceive of a capital expenditure project that could be more important to the long-term interests of port users and Victorian consumers than the commencement of development of the Webb Dock precinct.

Under section 49I of the PMA, the ESC is required to consider and report on PoM's compliance with the Pricing Order during the 5 yearly review period and the significant and sustained manner of any non-compliance.<sup>1</sup> The review period commences on the day in which the first Pricing Order takes effect (1 July 2016), and ends 5 years after that date (30 June 2021) (**review period**).<sup>2</sup>

The inclusion by PoM of forecast capital expenditure as part of the WDE Expansion Project in setting the published tariffs within the review period on 31 May 2021 clearly comes within the scope of this mandatory compliance review. We further note that this expenditure is not speculative with PoM announcing on 12 August 2021 its decision to proceed with the WDE Expansion Project.<sup>3</sup>

PoM itself also acknowledges that it is essential to the integrity of the ESC compliance review that the "ESC should consider the 2021-22 Prescribed Services Tariffs determined and published by PoM on 31 May 2021, and the contents of PoM's 2021-22 TCS submitted on 31 May 2021"<sup>4</sup> under the

<sup>1</sup> PMA s 49I(1).

<sup>2</sup> PMA s 49I(5).

<sup>3</sup> PoM Media Release "Port of Melbourne's Webb Dock East project focuses on operational efficiency" (12 August 2021).

<sup>4</sup> Letter from PoM to the ESC dated 7 July 2021.

compliance review, precisely because “those tariffs are required to comply with the Pricing Order and [were] set by PoM, published in the Reference Tariff Schedule and explained to the ESC (in the 2021-22 TCS), during the first review period (i.e. by 31 May 2021).”<sup>5</sup>

In setting Prescribed Service Tariffs during the review period, PoM included in the Aggregate Revenue Requirement (**ARR**) forecast prescribed capital expenditure relating to the WDE Expansion Project, noting that “capex is forecast to increase substantially from \$80.9m in 2020-21 to \$186.0m in 2021-22. The main driver of the increase in capex is the growth expenditure under the Port Rail Transformation Project and Webb Dock East Berth 4 & 5 Extension...”.<sup>6</sup> PoM states that it calculated its 2021-22 ARR using the Accrual Building Block Methodology (**ABBM**) in accordance with clauses 2.1.1 and 4 of the Pricing Order as set out in Appendix B. Appendix B is PoM’s Regulatory Model, which, under the tab titled “Data” at section 4.05 “Capital Expenditure” includes forecasted capex of \$30.5m for 2021 and \$84.8m for 2022 for “wharves”.<sup>7</sup>

The ESC is tasked, as part of its compliance review, with determining PoM’s compliance with the Pricing Order, including clause 2 (Pricing Principles: General) and clause 3 (Pricing Principles: Price Smoothing Mechanism). As such, the ESC is required to test PoM’s compliance with the requirement that it only include benchmark efficient capital costs and appropriately allocated prudent and efficient capital and operating expenditure in its ARR ABBM.

The decision to accelerate the development of the Webb Dock precinct is relevantly before the ESC under its compliance review as clause 4.2.1(c) of the Pricing Order requires both actual and forecast capital expenditure added to the capital base to be prudent and efficient.

To determine if accelerating the WDE Expansion Project and including it in the ARR is a significant and sustained non-compliance, the ESC must investigate it thoroughly in order to protect the long-term interests of port users and Victorian consumers. Once expenditure is in the capital base there is no clear mechanism to require it be taken out and once the Webb Dock East Knuckle is removed, its removal and the consequences of that removal for development, asset utilisation, efficiency and competition at the Port of Melbourne cannot be unwound.

In considering questions of prudence and efficiency, the ESC is not restricted to a narrow technical calculation of whether the quantum of costs included in the ABBM are, in and of themselves, efficient. It will be necessary for the ESC to carefully investigate, the adequacy of the port operations and development business practices set out by PoM in providing prescribed services and put forward as evidence of prudence and efficiency.<sup>8</sup> If the ESC finds that these practices are misstated or inconsistent with prudent and efficient capital and operating costs, having regard to the PMA regulatory objectives, then it can reasonably conclude that the inclusion of those costs in the ARR and their recovery through Prescribed Service Tariffs are non-compliant with the Pricing Order. It is for PoM to demonstrate compliance with the Pricing Order. Where the ESC is not satisfied of compliance on the material provided, and relied on, by PoM to support of the prudence and efficiency of its

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<sup>5</sup> Ibid.

<sup>6</sup> 2021-22 Tariff Compliance Statement (**TCS**), pp 64.

<sup>7</sup> See Appendix B at: [https://www.esc.vic.gov.au/sites/default/files/documents/port-of-melbourne-2021-22-tariff-compliance%20statement-regulatory-model-appendix-b-20210531\\_0.xlsx](https://www.esc.vic.gov.au/sites/default/files/documents/port-of-melbourne-2021-22-tariff-compliance%20statement-regulatory-model-appendix-b-20210531_0.xlsx).

<sup>8</sup> PoM, in seeking to justify how the prescribed service tariffs comply with the Pricing Order, submitted that their capex meets prudence and efficiency requirements as PoM “employ prudent capex governance, planning and stakeholder engagement arrangements... including asset management systems that have been independently audited”. See 2021-22 TCS, p. 71. See also for example the 2020-21 TCS p. 61.

provision of prescribed services in compliance with the Pricing Order, it is open to the ESC to reach the conclusion of non-compliance.

In addition, the ESC must undertake a substantive review of whether actual or forecast capital expenditure included in PoM's capital base is prudent and efficient having regard to the PMA regulatory objectives, effects on existing infrastructure and assets at the Port, and any other subsequent effects such as the acceleration of other projects. Taking this broader approach to the review is critical in determining whether there is non-compliance with this prudence and efficiency requirement, and to ensure that the actual and forecast capital expenditure meets the objectives of the regulatory regime.

It is important that the ESC carefully consider the implications of the WDE Expansion Project and the consequent broader Webb Dock precinct development timing implications against the regulatory objectives in section 48 of the PMA (including the long term interests of port users and consumers) that the ESC is required to have regard to.

The ESC has a broad responsibility for overseeing the Port regulatory framework as a regulated industry and has a critical role in ensuring the objectives of the regulatory regime are met, that role goes beyond (and is not constrained or limited by) the mandatory requirement to investigate and report on this issue under the compliance review.

The ESC also has a general responsibility to advise the Minister on matters relating to the economic regulation of regulated industries<sup>9</sup>, and the power 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 includes Part 3 of the PMA.<sup>10</sup> It must also have regard to these objectives in performing its functions and exercising its powers.<sup>11</sup> Ensuring that commencement of material development at Australia's largest container port is appropriately timed such that it is in the long-term interests of port users and Victorian consumers is fundamental to achieving the core objectives of the regime.

Accordingly, Patrick requests that the ESC confirms that:

- (a) PoM's inclusion of the forecast capital expenditure relating to the WDE Expansion Project in its ARR will be reviewed for compliance with the Pricing Order in the current Inquiry; and
- (b) it will more generally consider the impact of the WDE Expansion Project and the consequent accelerated timing of broader Webb Dock redevelopment for the purposes

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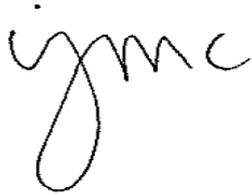
<sup>9</sup> Section 10(b) of the *Essential Services Commission Act 2001* (Vic) (**ESC Act**).

<sup>10</sup> Section 11 of the ESC Act.

<sup>11</sup> Under section 48A of the PMA.

of considering whether there are matters in respect of those developments that require advice to the Minister.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'VJM', with a large loop under the 'V'.

**Victoria Moore**  
General Counsel, Strategy and External Affairs  
Patrick Terminals