

REVIEW, BY THE ESSENTIAL SERVICES COMMISSION OF VICTORIA, OF COMPLIANCE BY THE PORT OF MELBOURNE WITH THE PRICING ORDER AND THE 2021-22 TARIFF COMPLIANCE STATEMENT

A. Request for advice and summary of advice

1. We have been asked to advise the Essential Services Commission (the **Commission**) on a series of questions arising out of:
 - 1.1 the review presently being undertaken by the Commission pursuant to s 49I of the *Port Management Act 1995* (Vic) (the **PMA**), relating to the period 1 July 2016 to 30 June 2021 (the **5-yearly inquiry**); and
 - 1.2 the Tariff Compliance Statement (the **TCS**) relating to the period 1 July 2021 to 30 June 2022, submitted to the Commission by the Port of Melbourne (the **Port**) on 31 May 2021.
2. We are instructed that an issue has arisen about the scope of the 5-yearly inquiry to be conducted by the Commission pursuant to s 49I of the PMA.
 - 2.1 The issue relates generally to the extent to which the preparation of, and matters addressed in, the 2021-22 TCS are matters that properly come within the scope of the Commission's 5-yearly inquiry.
 - 2.2 A specific issue has arisen in connection with forecast capital expenditure related to the Webb Dock East Knuckle removal (the **WDE Expansion Project**) in the capital base of the Port's 2021-22 TCS for the purposes of setting the Prescribed Service Tariffs for the period 1 July 2021 to 30 June 2022.
 - 2.3 The Commission is also seeking advice on whether other particular matters, involving the Port's approach to the weighted average cost of capital (**WACC**) and depreciation in the 2021-22 TCS, are within the scope of the Commission's 5-yearly inquiry.
3. The Commission has received submissions from a number of stakeholders addressing the WDE Expansion Project, the Port's approach to WACC and depreciation in the 2021-22 TCS and how those matters are considered by stakeholders to be relevant to the Commission's 5-yearly inquiry. Specifically in relation to the WDE Expansion Project, we have been provided with a letter from Patrick Terminals, which claims to be a person

who is provided with prescribed services by the Port, to the Commission dated 25 August 2021. In that letter, Patrick Terminals sets out how it considers the WDE Expansion Project comes within the scope of the 5-yearly inquiry. We set out the details of that position in this memorandum, and have addressed the issue it raises directly, as we are instructed that Patrick Terminals has not claimed confidentiality over the letter and we understand the letter is generally representative of the issues being raised by stakeholders as to the relevance of the 2021-22 TCS to the 5-yearly inquiry.

4. In summary:

4.1 The “terms of reference” for the Commission’s review are set out in s 49I of the PMA. The Commission is charged with undertaking an inquiry into whether the Port has complied with the Pricing Order during the review period, which is the period from 1 July 2016 to 30 June 2021; and, if not, whether the non-compliance was, in the Commission’s view, non-compliance in a significant and sustained manner. Only matters that inform an assessment as to the Port’s compliance with the Pricing Order during the review period, and whether any non-compliance was significant and sustained, are relevant to the Commission’s inquiry.

4.2 When considering whether any particular matter is relevant to the Commission’s inquiry, it is necessary, first, to identify with some precision the aspect of the Pricing Order against which compliance is being assessed; and, then, to determine whether the particular matter assists in determining whether there has been compliance in the review period.

4.3 Looking specifically at forecast capital expenditure for the WDE Expansion Project included in the capital base of the Port’s 2021-22 TCS for the purposes of setting the Prescribed Service Tariffs for 1 July 2021 to 30 June 2022, we do not consider this to be a matter relevant to the Commission’s current 5-yearly inquiry. The proposed expenditure will properly fall for consideration in the next review period. Alternatively, the WDE Expansion Project could be the subject of an:

- (a) investigation pursuant to s 49Q of the PMA in the event of a complaint that the Port has not complied with the Pricing Order; or
- (b) inquiry under Part 5 of the *Essential Services Commission Act 2001* (the **ESC Act**).

- 4.4 We do not consider the approaches the Port has taken to the WACC and depreciation in the 2021-22 TCS to be relevant matters for the purposes of the current 5-yearly inquiry. That is because those matters do not assist in determining whether the Port has complied with a relevant aspect of the Pricing Order in the review period.
- 4.5 There are some aspects of the activities that the Port has undertaken in connection with the 2021-22 TCS that are relevant to the Commission's assessment of the Port's compliance with the Pricing Order in the review period.
- (a) That is because they are activities that have been undertaken during the review period and the obligation to comply with particular provisions of the Pricing Order was an obligation that existed during the review period.
 - (b) For example, the requirement to provide to the Commission a TCS no later than 31 May 2021 was a requirement that applied to the Port during the review period; and the Port's compliance with that requirement can only be assessed in the current 5-yearly inquiry.
 - (c) Similarly, the Port's compliance with the requirement that the TCS address various matters properly falls for assessment in the current 5-yearly inquiry. That includes the requirement that the TCS set out the process, by which the Port has effectively consulted and had regard to the comments provided by Port Users. In undertaking its assessment of the Port's compliance with that aspect of the Pricing Order, the Commission is permitted to look beyond merely whether the Port's TCS set out the process by which the Port consulted with, and had regard to the comments provided by, Port Users, and is entitled to look at whether the Port has in fact effectively consulted and had regard to the comments provided by Port Users in the current review period.

B. Relevant legal framework

Port Management Act

5. Part 3 of the PMA provides for the regulation of port services.

- 5.1 Part 3 applies to a person who is a provider of "prescribed services": PMA, s 47(1).

- 5.2 The content of prescribed services is set out in s 49(1)(c)(i). It includes:
- (a) the provision of channels for use by shipping in port of Melbourne waters, including the Shared Channels (as that term is defined in s 45) used by vessels bound either for the port of Melbourne or for the port of Geelong and the Dedicated Channels (as that term is defined in s 45) used by vessels bound for the port of Melbourne;
 - (b) the provision of berths, buoys or dolphins in connection with the berthing of vessels in the port of Melbourne; and
 - (c) the provision of access to, or allowing the use of, places or infrastructure (including wharves, roads and rail infrastructure) on port of Melbourne land for the provision of services to port users.
- 5.3 The Port provides prescribed services pursuant to a 50-year lease of the commercial operations and assets at the port of Melbourne and is therefore subject to the provisions of Part 3 of the PMA.
- 5.4 Section 49A(1) of the PMA provides that the Governor in Council may make an Order:
- (a) for or with respect to the provision of prescribed services; and
 - (b) for the regulation, in such manner as the Governor in Council thinks fit, of the prices for the provision of prescribed services (a **Pricing Order**).
- 5.5 Section 49A(2) and (3) of the PMA provide that an Order may, without limiting the generality of s 49A(1):
- (a) specify pricing policies or principles: s 49A(3)(b);
 - (b) specify the treatment of capital expenditure: s 49A(3)(e);
 - (c) fix the price or the rate of increase or decrease in a price: s 49A(3)(f);
 - (d) fix a maximum revenue or maximum rate of increase or minimum rate of decrease in the maximum revenue in relation to prescribed services or any component of prescribed services: s 49A(3)(k).

6. The Commission is charged, pursuant to s 49I of the PMA, to conduct reviews into compliance with a Pricing Order. Section 49I(1) provides that the Commission must, not later than 6 months after a review period, conduct and complete an inquiry under the *Essential Services Commission Act 2001 (ESC Act)* and report to the ESC Minister (defined in s 45 as meaning the Minister administering the ESC Act):
 - 6.1 as to whether a provider of prescribed services to whom a Pricing Order applies has complied with the Pricing Order during the review period; and
 - 6.2 if there was non-compliance with the Pricing Order, whether that non-compliance was, in the Commission's view, non-compliance in a significant and sustained manner.
 - 6.3 A "review period" for the purposes of s 49I is defined in s 49I(5) to mean:
 - (a) the period commencing on the day on which the first Pricing Order made under s 49A takes effect and ending 5 years after that day; and
 - (b) every subsequent period of 5 years commencing on the day after the day on which the previous period ends.
7. A Pricing Order applying to the Port was made on 21 June 2016, and published in the Victoria Government Gazette on 24 June 2016. It commenced on 1 July 2016.
 - 7.1 Therefore, pursuant to s 49I, the Commission must, not later than 6 months after the review period 1 July 2016 to 30 June 2021, report to the ESC Minister as to whether the Port has complied with the Pricing Order during that review period and, if there was non-compliance, whether that non-compliance was, in the Commission's view, non-compliance in a significant and sustained manner.
 - 7.2 The Commission commenced an inquiry under s 49I on 10 June 2021.

Pricing Order

8. The Pricing Order provides for the regulation of Prescribed Services Tariffs.¹
9. The Pricing Order sets out Prescribed Service Tariffs Pricing Principles, which include that Prescribed Service Tariffs must be set so as to allow the Port 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**): Pricing Order, clause 2.1.1(a).
10. Clause 4.1.1 of the Pricing Order sets out details of the method, by which the Port is to determine its Aggregate Revenue Requirement. It provides that the Port must apply an accrual building block methodology over the Regulatory Period, comprising:
 - 10.1 an allowance to recover a return on its capital base, commensurate with that which would be required by a benchmark efficient entity providing services with a similar degree of risk as that which applies to the Port in respect of the provision of the Prescribed Services: clause 4.1.1(a);
 - 10.2 an allowance to recover the return of its capital base: clause 4.1.1(b); and
 - 10.3 an allowance to recover its forecast operating expenses, commensurate with that which would be required by a prudent service provider acting efficiently: clause 4.1.1(c); less
 - 10.4 an indexation allowance: clause 4.1.1(d).
11. Further prescription as to each of the various building blocks described in clause 4.1.1 is provided in subsequent clauses.
 - 11.1 Clause 4.2 deals with the capital base. It provides that subject to clause 4.2.2 (which provides that the initial capital base is to be determined by applying the asset values specified in clause 4.7), the capital base applied for the purposes of clause 4.1.1(a) and 4.1.1(b) must be defined, at any particular time, on a roll forward basis, by:

¹ The Pricing Order defines “Prescribed Services Tariffs” as meaning the prices charged for the provision of, or in connection with, Prescribed Services. The term “Prescribed Services” in the Pricing Order is defined to have the same meaning as in the PMA. Pricing Order, clause 14.

- (a) taking the value at the commencement of any Financial Year;
- (b) adding an indexation allowance for that Financial Year in accordance with clause 4.6.1(a);
- (c) adding efficient capital expenditure when incurred or to be incurred during that Financial Year, by the Port, acting prudently, in the provision of the Prescribed Services (in each instance, deemed to be incurred as at the mid-point of that Financial Year and adjusted by an indexation allowance in accordance with clause 4.6.1(b) for that Financial Year); and
- (d) deducting an allowance for the return of capital.

11.2 Return on capital is dealt with in clause 4.3. It provides that, subject to clause 4.3.2 (that the rate of return be determined on a pre-tax, nominal basis), in determining a rate of return on capital for the purposes of clause 4.1.1(a), the Port must use one or a combination of well accepted approaches that distinguish the cost of equity and debt, and so derive a weighted average cost of capital, or WACC.

11.3 Clause 4.4 addresses the return of capital. Clause 4.4.1 provides that, subject to clauses 4.4.2 and 4.4.3, for the purposes of clauses 4.1.1(b) depreciation must be determined so that each asset or group of assets used to provide the Prescribed Services is depreciated using a straight-line methodology over a period that is:

- (a) no shorter than the reasonable economic life of the relevant asset or the remaining term of the Port Lease (whichever is shorter); and
- (b) no longer than the remaining term of the Port Lease;

(Depreciation Period); and

- (c) only once, meaning that the amount by which the asset or group of assets is depreciated over the Depreciation Period does not exceed the value of the asset or group of assets at the time of its or their inclusion in the capital base.

11.4 Clause 4.4.2 provides that the Port may only use an alternative to the straight-line methodology to be applied under clause 4.4.1 if:

- (a) the application of clause 3.1.1 (which relates to the Tariff Adjustment Limit) means that the return of capital derived using a straight-line depreciation methodology is not capable of being recovered in the applicable Financial Year; or
- (b) the alternative depreciation methodology is reasonably likely to reduce the variance in the expected annual percentage changes in the level of Prescribed Service Tariffs through to the end of the Port Lease.

11.5 Further prescription on the operating expenditure block is dealt with in clause 4.5.

11.6 Clause 4.6 provides further detail on the method for calculating the indexation allowance referred to in clause 4.1.1(d).

11.7 Finally, clause 4.7 sets out the initial capital asset values to be used to provide the Shared Channel Services² and the Bundled Services³.

12. Clause 7 of the Pricing Order deals with the Tariff Compliance Statement, which the Port is required to provide to the Commission.

12.1 Relevantly, clause 7.1.1 provides that the Port must provide to the Commission a Tariff Compliance Statement no later than 31 May in each Financial Year.

12.2 Relevantly, clause 7.1.2 provides that the Tariff Compliance Statement must:

- (a) set out the Prescribed Service Tariffs for the forthcoming Financial Year;
- (b) provide information detailing the basis by which adjustments to, or introduction of new, Prescribed Service Tariffs have been made, including the cost building blocks that have been applied and the basis on which the rate of return has been determined;
- (c) provide information on all contracts with Port Users of the kind described in clause 6.2.1 and the basis on which they comply with clause 6.2.1;

² The term “Shared Channel Services” is defined in clause 14 of the Pricing Order to mean the provision of the “Shared Channels”. The term “Shared Channels” is defined to have the same meaning as in the PMA, which is, according to s 45 of the PMA: “that part of port of Melbourne waters extending from the seaward limit to Point Richards in the direction of Geelong and Fawkner Beacon in the direction of Melbourne, including the channels known as the Great Ship Channel and adjacent channels and the South Channel” (s 45).

³ The term “Bundled Services” is defined in clause 14 of the Pricing Order to mean the Prescribed Services other than the Shared Channel Services.

- (d) set out the process by which the Port has effectively consulted and had regard to the comments provided by Port Users;
- (e) explain how the Prescribed Service Tariffs comply with the Pricing Order, including the Pricing Principles and Cost Allocation Principles;
- (f) contain any other sufficient supporting information determined by the Commission under clause 9; and
- (g) comply with the requirements in clause 8.

12.3 Clause 8 sets out a number of information requirements.

- (a) Clause 8.1.1 provides that any financial information provided in a Tariff Compliance Statement must specify whether it is denominated in constant or current price terms.
- (b) Clause 8.2.1 provides that information in the nature of an estimate or forecast must be supported by a statement of the basis of the forecast or estimate.
- (c) Clause 8.2.2 provides that a forecast or estimate must be arrived at on a reasonable basis and must represent the best forecast or estimate possible in the circumstances.
- (d) Clause 8.3.1 provides that information in the nature of an extrapolation or inference must be supported by the primary information on which the extrapolation or inference is based.

13. The length of the regulatory period is dealt with in clause 13. Clause 13.1.1 provides that the Port may determine the period of time over which to apply the Pricing Principles and Cost Allocation Principles (**Regulatory Period**). It further provides that, for the avoidance of doubt, the Port may adopt Regulatory Periods of different lengths over the term of the Port Lease.

C. 2021-22 TCS

14. The 2021-22 TCS was submitted by the Port to the Commission on 31 May 2021. Relevant to the questions that we have been asked, the 2021-22 TCS:

- 14.1 addresses the Port's 2020-21 stakeholder engagement program;⁴
- 14.2 adopts a one-year regulatory period for the 2021-22 financial year;⁵
- 14.3 sets out the Port's calculation of the 2021-22 Aggregate Revenue Requirement using the Accrual Building Block Methodology,⁶ the inputs to which include:
 - (a) an opening capital base as at 1 July 2021 of \$4,911.6m and a closing asset base as at 30 June 2022 of \$5,153.4m—which included forecast capital expenditure over that period of \$186.0m, of which \$28m comprised forecast capital expenditure associated with berth extension at Webb Dock East;⁷ and
 - (b) a pre-tax nominal WACC of 8.23%;⁸ and
- 14.4 set out a depreciation methodology, which involves:
 - (a) for the next regulatory period (and the remainder of the Tariff Adjustment Limit period), applying straight-line depreciation with an unrecovered depreciation account, with uncharged depreciation recorded as a separate asset with a life equal to the remaining lease term; and
 - (b) after the Tariff Adjustment Limit period ends, applying a tilted annuity depreciation method, with the tilt factor designed to reduce the variance in the expected annual percentage change in the level of tariffs until the end of the Port Lease.⁹
- 15. Attachment 2 to the 21-22 TCS provides more detail on the Port's 2021-22 forecast capital expenditure for Prescribed Services. Of particular relevance to this advice is the proposed WDE Expansion Project.
 - 15.1 The 2021-22 TCS identifies the proposed WDE Expansion Project as one main driver of the increase in capital expenditure. The project is described as extending the current quay line by 71m to the north with the additional Southern

⁴ 2021-22 TCS, pp 17–21 and Appendices I and J.

⁵ 2021-22 TCS, p 21.

⁶ 2021-22 TCS, pp 34–54.

⁷ 2021-22 TCS, p 35.

⁸ 2021-22 TCS, p 38.

⁹ 2021-22 TCS, p 46.

Mooring Dolphin providing a further 15m of usable quay line. The Port says that the project is intended to “address the artificial and unintended capacity constraint being caused by larger vessels, with insufficient quay line to service two vessels concurrently”.¹⁰

15.2 The Port says that, with respect to larger vessels, its strategy has focussed on “first maximising the use of the existing infrastructure through new technology and operational controls, and then targeted, incremental capital investments to accommodate large vessels”.¹¹ In that connection, the Port identifies a range of work done to date, including:

- (a) vessel simulations program, hydrodynamic modelling, vessel interaction studies and berth structural assessment;
- (b) Yarra river channel and Swanston Dock Swing Basin selected deepening;
- (c) Swanson Dock Berths 3 (East and West) Mooring Bollards upgrade;
- (d) detailed designs for Swanston Dock East and Swanson Dock West Berths 2 Mooring Bollards upgrade (scheduled for completion in 2021);
- (e) rehabilitation of Swanson Dock East Berths 1 and 2 (completed in December 2020);
- (f) detailed planning and design for Swanson Dock West rehabilitation underway (works scheduled to commence in 2021);
- (g) commencement of Webb Dock East – Southern Mooring Dolphin (complete); and
- (h) detailed design and planning for the Webb Dock East Berth 4 & 5 extension.¹²

15.3 The Port says that the WDE Expansion Project forms a component of its planned investment program to provide services to larger vessels and was first consulted on in 2018 as part of its consultations on the Port Development Strategy.¹³

¹⁰ 2021-22 TCS, p 64.

¹¹ 2021-22 TCS, p 65.

¹² 2021-22 TCS, p 65.

¹³ 2021-22 TCS, p 65.

The Port says that in its 2021 industry consultation it set out its view that construction of the proposed WDE Expansion Project should proceed and provided its forecast expenditure for 2021-22 which included the project.¹⁴

15.4 The Port describes the WDE Expansion Project as comprising:

- (a) demolition of the Webb Dock East berth 3 structure the “knuckle”, and extension of Webb Dock East Berth 4 by 71m to the north, supported by a mooring dolphin to the south to provide an operational berth length of 746m; and
- (b) increased terminal area for Victoria International Container Terminal (**VICT**) of approximately 2%, to enable the safe operation of cranes (including safe service vehicle access) behind the extended berth.¹⁵

15.5 In terms of project timing, the Port notes that it has included the WDE Expansion Project in its forecast expenditure for 2021-22. With the construction phase expected to run for 18-24 months, this timing would result in commissioning of the project in 2023-24.¹⁶

15.6 In connection with project funding, the Port notes that it considers Prescribed Service Tariffs to be the appropriate mechanism for recovery of the investment.¹⁷

Correspondence from Patrick Terminals in relation to the 2021-22 TCS and the WDE Expansion Project

16. On 25 August 2021, the Commission received a letter from Patrick Terminals in connection with the WDE Expansion Project (the **Patrick Letter**).

17. The Patrick Letter stated that the Port’s acceleration of Webb Dock precinct developments and the inclusion of forecast capital expenditure related to the WDE Expansion Project in the capital base, for the purposes of setting Prescribed Service Tariffs in the Port’s 2021-22 TCS, “is [sic] within the scope of the” 5-yearly inquiry and “must be reviewed in the course of the current compliance review”. The Patrick Letter put its position in the manner set out below.

¹⁴ 2021-22 TCS, p 65.

¹⁵ 2021-22 TCS, p 66.

¹⁶ 2021-22 TCS, p 70.

¹⁷ 2021-22 TCS, p 70.

- 17.1 Under s 49I of the PMA, the Commission is required to consider and report on the Port's compliance with the Pricing Order during the 5 yearly review period.
- 17.2 The inclusion by the Port of forecast capital expenditure as part of the WDE Expansion Project in setting the published tariffs within the review period on 31 May 2021 comes within the scope of the Commission's mandatory compliance review.
- 17.3 In setting Prescribed Service Tariffs during the review period, the Port included in the Aggregate Revenue Requirement 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...".
- 17.4 The Port states that it calculated its 2021-22 Aggregate Revenue Requirement using the Accrual Building Block Methodology in accordance with clauses 2.1.1 and 4 of the Pricing Order, and the Port's regulatory model includes forecast capital expenditure of \$30.5m for 2021 and \$84.8m for 2022 for "wharves".
- 17.5 The Commission is tasked, as part of its compliance review, with determining the Port's compliance with the Pricing Order and, as such, the Commission is required to test the Port'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 Aggregate Revenue Requirement Accrual Building Block Methodology.
- 17.6 The decision to accelerate the development of the Webb Dock precinct is relevantly before the Commission 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.

D. Questions and advice

18. The questions we have been asked and our advice on each of those questions are set out below.

Question 1

Is the Port's forecast capital expenditure related to the WDE Expansion Project, which has been included in the capital base in the Port's 2021-22 TCS for the purposes of setting Prescribed Service Tariffs for the regulatory year 1 July 2021 to 30 June 2022, a relevant matter for the purposes of the current inquiry? In answering this question, please consider in particular clause 4.2.1 of the Pricing Order, which relates to the capital base applied for the purposes of clause 4.1.1(a).

Short answer: The Port's forecast capital expenditure related to the WDE Expansion Project, which has been included in the capital base in the 2021-22 TCS for the purposes of setting Prescribed Service Tariffs for the period 1 July 2021 to 30 June 2022, is not a relevant matter for the purposes of the current inquiry. The scope of the inquiry is limited by s 49I of the PMA, and that scope extends to an examination of matters that are relevant to the Commission's assessment of whether the Port has complied with the Pricing Order during the review period, being 1 July 2016 to 30 June 2021. To the extent the Port proposes to add to the capital base expenditure associated with the WDE Expansion Project for the purposes of determining its Aggregate Revenue Requirement for 2021-22, that proposed addition properly falls for consideration in the next review period, being 1 July 2021 to 30 June 2026.

Discussion

19. The terms of reference that apply to the 5-yearly inquiry are set out in s 49I of the PMA.
20. As noted above, s 49I(1) of the PMA provides that the Commission must, not later than 6 months after a review period, conduct and complete an inquiry under the ESC Act and report to the ESC Minister (defined in s 45 as the Minister administering the ESC Act):
 - 20.1 as to whether a provider of prescribed services, to whom a Pricing Order applies (in this case, the Port), has complied with the Order during the review period; and
 - 20.2 if there was non-compliance with the Pricing Order, whether that non-compliance was, in the Commission's view, non-compliance in a significant and sustained manner.
21. As also noted above, the review period is defined in s 49I(5) of the PMA.
 - 21.1 Section 49I(5) provides that the "review period" means:

- (a) the period commencing on the day on which the first Pricing Order made under s 49A takes effect and ending 5 years after that day; and
- (b) every subsequent period of 5 years commencing on the day after the day on which the previous period ends.

21.2 In the present case, the first Pricing Order took effect on 1 July 2016: see Pricing Order, clause 1.1.1. Therefore the review period is 1 July 2016 to 30 June 2021.

22. The terms of reference for the Commission's 5-yearly inquiry are therefore:

22.1 whether the Port has complied with the Pricing Order during the period 1 July 2016 to 30 June 2021; and

22.2 if there was non-compliance with the Pricing order, whether that non-compliance was, in the Commission's view, non-compliance in a significant and sustained manner.

23. As a general proposition, the only matters that are relevant to the Commission's 5-yearly inquiry are matters that go to the Commission's assessment of whether the Port has complied with a requirement in the Pricing Order during the review period. As such it is necessary to identify:

23.1 the particular aspect of the Pricing Order against which compliance is being assessed; and

23.2 the manner in which the particular matter or thing contributes to the assessment of whether there has been compliance or otherwise with that particular aspect of the Pricing Order.

24. In the case of forecast capital expenditure, the Commission only needs to (and is only permitted to) consider forecast capital expenditure in the 2021-22 TCS in the event that such forecast capital expenditure is relevant to the terms of reference for the Commission's 5-yearly inquiry. The question is: how, if at all, is the forecast capital expenditure in the 2021-22 TCS relevant to assessing the Port's compliance with the Pricing Order during the review period?

25. In its 25 August 2021 letter, Patrick Terminals relies in particular on clause 4.2.1(c) of the Pricing Order as the basis on which it says the Port's decision to accelerate the

development of the Webb Dock precinct comes within the 5-yearly inquiry (see paragraph 17.6 above).

26. Clause 4.2.1 of the Pricing Order provides that, subject to clause 4.2.2 (which is not presently relevant), the capital base applied for the purposes of clause 4.1.1(a) and 4.1.1(b) must be defined at any particular time, on a roll forward basis, by:

26.1 taking the value at the commencement of any Financial Year;

26.2 adding an indexation allowance for that Financial Year in accordance with clause 4.6.1(a);

26.3 adding efficient capital expenditure when incurred, or to be incurred during that Financial Year, by the Port Licence Holder, acting prudently, in the provision of the Prescribed Service (in each instance, deemed to be incurred as at the mid-point of that Financial Year and adjusted by an indexation allowance in accordance with clause 4.6.1(b) for that Financial Year); and

26.4 deducting an allowance for the return of capital.

27. Importantly, clause 4.2.1 sets out how the value of the capital base applied for the purposes of clause 4.1.1(a) and 4.1.1(b) must be defined. As set out in clause 4.1.1, the capital base is applied for the purposes of determining the Port's Aggregate Revenue Requirement by applying an accrual building block methodology over the Regulatory Period, relevantly comprising:

27.1 an allowance to recover a return on the Port's capital base; and

27.2 an allowance to recover the return of its capital base.

28. To the extent that forecast capital expenditure in connection with the WDE Expansion Project has been included in the 2021-22 TCS and in the capital base used for the purposes of determining the Port's Aggregate Revenue Requirement for the Regulatory Period 2021-22, that capital expenditure falls for consideration in the next 5-year review period. That forecast capital expenditure has not been used to determine the Port's Aggregate Review Requirement in the current review period and there is no basis on which to assess that forecast expenditure in the current 5-yearly inquiry in the event that expenditure on that project falls entirely outside of the 1 July 2016 to 30 June 2021 review period.

29. It might be that a particular capital project spans two review periods before and after 30 June 2021 (for example, some expenditure on the WDE Expansion Project might have been incurred in the period 1 July 2016 to 30 June 2021, as appears to be the case from the 2021-22 TCS: see paragraph 15.2 above). In that situation, the Commission would be authorised and required to examine the efficiency and prudence of that expenditure as part of its current review – because that would be part of assessing the Port’s compliance with the Pricing Order in the current review period.
30. We note that a position could be put that, although the relevant Prescribed Service Tariffs are based on capital expenditure in respect of the WDE Expansion Project forecast to be incurred after 30 June 2021, the Port, in the 2021-22 TCS has undertaken the activity of “setting” the Prescribed Service Tariffs in the current 5-year review period, and it is open to the Commission to assess compliance of that activity in the current 5-yearly inquiry.
- 30.1 For example, clause 2.1.1 of the Pricing Order provides that “Prescribed Service Tariffs must be set” so as to allow the Port a reasonable opportunity to recover the efficient cost of providing all Prescribed Services determined by application of an Aggregate Revenue Requirement.
- 30.2 However, in our view, 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.
- 30.3 That is, 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.
- 30.4 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.

31. There are other avenues, through which the Port's activities with respect to the WDE Expansion Project could be considered by the Commission prior to next 5-yearly review, which relates to the period 1 July 2021 to 30 June 2026.

31.1 First, a person who is provided prescribed services may complain to the Commission if that person considers that the Port has not complied with the Pricing Order. On receipt of such a complaint, the Commission may investigate the complaint pursuant to s 49Q of the PMA Act.

31.2 Secondly, the Minister could refer the matter to the Commission for an inquiry pursuant to s 41 of the ESC Act.

Question 2

Are the approaches that the Port takes to the WACC and depreciation in the 2021-22 TCS relevant matters for the purposes of the current inquiry?

Short answer: The approaches that the Port takes to the WACC and depreciation in the 2021-22 TCS are not relevant matters for the purposes of the current inquiry.

Discussion

32. For the reasons set out above in connection with forecast capital expenditure relating to the WDE Expansion Project proposed to be undertaken in 2021-22, the approaches that the Port takes to the WACC and depreciation in the 2021-22 TCS are not relevant matters for the purposes of the current 5-yearly inquiry.

33. The terms of reference require the Commission to answer the question as to whether the Port has complied with the Pricing Order during the period 1 July 2016 to 30 June 2021 and, if there has been non-compliance, whether that non-compliance was in a significant and sustained manner. The WACC and the depreciation method adopted by the Port in the 1 July 2016 to 30 June 2021 period, and their compliance or otherwise with the Pricing Order, fall for consideration within that timeframe. What is proposed to happen in 2021-22, as a general proposition, is irrelevant to that ex-post assessment.

34. We have considered whether it might be appropriate to consider depreciation over a more extended period – for example, where the Port has set the depreciation building block to \$0, with the intention of deferring recovery of substantial amounts of depreciation until the Tariff Adjustment Limit ceases to apply in 2031. We note that clause 4.2.2(b) of

the Pricing Order permits an alternative to straight-line depreciation where the alternative is reasonably likely to reduce the variance in the expected annual percentage changes in the level of Prescribed Services Tariffs through to the end of the Port Lease. However, that is different to having regard to future TCSs: it is an assessment of a methodology for the purpose of determining compliance in the review period, in which that methodology is applied.

Question 3

To the extent that the Port has undertaken, during the 5-year review period, activities connected with the 2021-22 TCS, are those activities a relevant matter for the purposes of the current inquiry? In answering this question, please consider in particular:

- (a) clause 7.1.2(d) of the Pricing Order, which requires that the TCS must set out the process by which the Port has effectively consulted and had regard to the comments provided by Port Users; and*
- (b) the scope of any Commission consideration of that activity.*

Short answer: The Commission does need to consider the consultation undertaken by the Port in relation to its 2021-22 TCS as part of the Commission's 5-yearly inquiry, together with any other activities that are relevant to the Commission's assessment of compliance by the Port with a particular requirement of the Pricing Order in the current review period.

Discussion

35. Relevantly, clause 7.1.1 of the Pricing Order requires the Port to provide to the Commission a TCS no later than 31 May in each Financial Year.

35.1 Clause 7.1.2 provides that a TCS must, amongst other things:

35.2 set out the Prescribed Service Tariffs for the forthcoming Financial Year: clause 7.1.2(a);

35.3 provide information detailing the basis by which adjustments to, or introduction of new, Prescribed Service Tariffs have been made, including the cost building blocks that have been applied and the basis on which the rate of return has been determined: clause 7.1.2(b);

- 35.4 provide information on all contracts with Port Users of the kind described in clause 6.2.1 (namely, contracts for the supply of prescribed services on terms and conditions that differ from those specified in the Reference Tariff Schedule or do not satisfy the requirements in clause 6.1.5) and the basis on which those contracts comply with clause 6.2.1: clause 7.1.2(c);
- 35.5 set out the process by which the Port has effectively consulted and had regard to the comments provided by Port Users: clause 7.1.2(d);
- 35.6 explain how the Prescribed Service Tariffs comply with the Pricing Order, including the Pricing Principles and Cost Allocation Principles: clause 7.1.2(e);
- 35.7 contain any other sufficient supporting information determined by the Commission under clause 9: clause 7.1.2(f); and
- 35.8 comply with the requirements of clause 8, which include that:
- (a) information in the nature of an estimate or forecast must be supported by a statement of the basis of the forecast or estimate; and
 - (b) a forecast or estimate must be arrived at on a reasonable basis and must represent the best forecast or estimate possible in the circumstances: clause 7.1.2(g).
36. A number of the obligations set out above applied during the review period and, in respect of which, compliance or otherwise by the Port properly forms part of the Commission's current 5-yearly review. For example, the obligation in clause 7.1.1 (that the Port provide to the Commission a TCS no later than 31 May 2021 that sets out the Prescribed Service Tariffs for the 2021-22 Financial Year) is an obligation that existed in the review period and against which compliance can only be assessed as part of the current 5-yearly review.
37. A number of the requirements in clause 7.1.2 are of a procedural nature and the Port's compliance with them will likely be straightforward to determine. That is, the TCS either will or will not:
- 37.1 provide information detailing the basis by which adjustments to, or introduction of new, Prescribed Service Tariffs have been made: clause 7.1.2(b);

- 37.2 provide information on all contracts with Port Users for Prescribed Services and the basis on which they comply with clause 6.2.1: clause 7.1.2(c); and
- 37.3 explain how the Prescribed Service Tariffs comply with the Pricing Order: clause 7.1.2(e).
38. That said, the Commission’s consideration of whether the Port has complied with the above matters is not merely a “tick the box” exercise—the Commission may also enquire into the sufficiency of the information provided. For example, if in the TCS the Port provides some explanation as to how it says the Prescribed Service Tariffs comply with the Pricing Order, but that information is insufficient properly to understand how it is the Port says those tariffs comply, the Commission may determine that the Port has not in fact complied with a requirement of the Pricing Order.
39. Although clause 7.2.1(e) requires the Commission to assess whether the Port has explained how the Prescribed Service Tariffs comply with the Pricing Order, the Commission is not required by that clause to assess whether those tariffs in fact comply with the Pricing Order. That assessment, as set out above, properly occurs as part of the Commission’s subsequent 5-yearly review, relating to the period 1 July 2021 to 30 June 2026.
40. We consider that the requirement in clause 7.1.2(d), that the 2021-22 TCS set out the process by which the Port has effectively consulted and had regard to the comments provided by Port Users, permits the Commission to assess, as part of the 1 July 2016 to 30 June 2021 5-yearly review, whether the Port has in fact effectively consulted and had regard to the comments provided by Port Users. That is an activity that the Port is required to cover in the 2021-22 TCS submitted on 31 May 2021, and relates to consultation that would have commenced and concluded prior to 31 May 2021, in order for the Port to submit the TCS to the Commission as required by clause 7.1.1.
41. Although clause 7.1.2(d) is stated as a procedural requirement—insofar as the obligation is that the TCS must set out the process by which the Port has effectively consulted with, and had regard to the comments provided by, Port Users—we consider that a Court would construe this provision as placing a substantive obligation on the Port to consult effectively with, and have regard to the comments provided by, Port Users. That is, the Port cannot demonstrate compliance with clause 7.1.2(d) merely by setting out in a TCS the process by which the Port says it has effectively consulted and had regard to the comments provided by Port Users; in order to satisfy the requirements of clause 7.1.2(d),

the Port must in fact have effectively consulted and had regard to the comments provided by Port Users.

42. Returning to the Commission's terms of reference under s 49I of the PMA, the Commission may legitimately assess what the Port says about its consultation process in the 2021-22 TCS and inquire into whether in fact that consultation represents effective consultation and whether the Port has had regard to the comments provided by Port Users. That assessment would then enable the Commission to make a finding as to whether the TCS sets out a process of effective consultation which has had regard to the comments provided by Port Users.
43. In terms of the content of the obligation to consult, some guidance may be drawn in particular from the area of administrative law, in which compliance with a duty to consult is frequently considered. Guidance is also available from cases where there exists a statutory duty to consult, which is common in planning and environment legislation as well as in industrial relations. Some instructive commentary that has emerged from cases in those areas is set out below.
 - 43.1 Consultation is no empty term and the requirement is never to be treated perfunctorily or as a mere formality.¹⁸
 - 43.2 A responsibility to consult carries a responsibility to give those consulted an opportunity to be heard and to express their views so that they may be taken into account.¹⁹
 - 43.3 To be a proper consultation, the consultation must be "undertaken at a time when proposals are still at a formative stage; it must include sufficient reasons for particular proposals to allow those consulted to give intelligent consideration and an intelligent response; adequate time must be given for this purpose; and the product of consultation must be conscientiously taken into account when the ultimate decision is taken".²⁰

¹⁸ See, for example, *TVW Enterprises Ltd v Duffy (No 2)* (1985) 7 FCR 172 at 178, citing *Port Louis Corporation v Attorney-General of Mauritius* [1965] AC 1111 at 1124.

¹⁹ See for example: *TVW Enterprises Ltd v Duffy (No 2)* (1985) 7 FCR 172 at 178 citing *Port Louis Corporation v Attorney-General of Mauritius* [1965] AC 1111 at 1124; *Rollo v Minister of Town and Country Planning* [1948] 1 All ER 13 at 17; *Sinfield v London Transport Executive* [1970] 1 Ch 550 at 558.

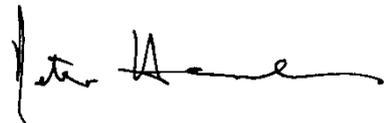
²⁰ See, for example, *R v North & East Devon Health Authority; Ex parte Coughlan* [2001] QB 213 at 258 [108].

- 43.4 Sufficient material must be provided to those being consulted and a reasonable opportunity given to respond, including to new material that may become available after consultation has occurred.²¹
- 43.5 A right to be consulted is not a right of veto.²²
- 43.6 The case of *Wellington International Airport Ltd v Air New Zealand* [1993] 1 NZLR 671 at 675 provides a convenient summary of the principles of consultation as follows:

Consultation must be allowed sufficient time, and genuine effort must be made. It is to be a reality, not a charade ... To “consult” is not merely to tell or present. Nor, at the other extreme, is it to agree ... Consultation is an intermediate situation involving meaningful discussion ...” Consultation involves the statement of a proposal not yet finally decided upon, listening to what others have to say, considering their responses and then deciding what will be done”.

Implicit in the concept is a requirement that the party consulted will be (or will be made) adequately informed so as to be able to make intelligent and useful responses. It is also implicit that the party obliged to consult, while quite entitled to have a working plan already in mind, must keep its mind open and be ready to change and even start afresh.

13 September 2021



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²¹ See, for example, *Leichhardt Municipal Council v Minister for Planning* (1992) 78 LGERA 306 at 338.

²² See, for example, *Communications, Electrical, Electronic, Energy, Information, Postal, Plumbing and Allied Services Union of Australia v QR Limited* [2010] FCA 591 at [44].