

REGULATORY APPROACH TO THE PRICING ORDER — A CONSULTATION PAPER

Port of Melbourne Regulatory Regime

May 2017

An appropriate citation for this paper is:

Essential Services Commission 2017, *Regulatory approach to the Pricing Order — a consultation paper*, May.

Copyright notice

© Essential Services Commission 2017



This work, *Regulatory approach to the Pricing Order — a consultation paper*, is licensed under a Creative Commons Attribution 4.0 licence [creativecommons.org/licenses/by/4.0]. You are free to re-use the work under that licence, on the condition that you credit the Essential Services Commission as author, indicate if changes were made and comply with the other licence terms.

The licence does not apply to any brand logo, images or photographs within the publication.

GLOSSARY

Aggregate revenue requirement

A revenue requirement that will allow a reasonable opportunity for the port licence holder to recover the efficient cost of providing all prescribed services as determined by application of an accrual building block methodology of the type described in clause 4 of the Pricing Order.

Allocative efficiency

When firms produce goods and services at prices and quantities that align with their costs and consumers' willingness to pay.

Berth

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

Buoy

An anchored float serving as a navigation aid for ships.

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 twenty-foot equivalent units (TEUs).

CPI

Consumer Price Index

Dolphin

A bollard, or pile, that is not fixed to the berth and is

used for mooring ships.

**Essential Services
Commission Act**

Essential Services Commission Act 2001 (VIC)

ESC Minister

The Minister responsible for administering the Essential Services Commission Act (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 as that applicable in 2019-20. (See the Pricing Order for the full definition).

Port Management Act

Port Management Act 1995 (VIC)

Port licence holder

The holder of a port licence issued under Division 5 of Part 3 of the Port Management Act

**Port of Melbourne
Corporation**

A statutory authority established by the Victorian Government in 2003 responsible for operation of the port of Melbourne prior to the 2016 leasing of the port of Melbourne's commercial operations.

Port user

A person who requests or receives prescribed services, as per clause 14 of the Pricing Order.

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 published maximum prices charged for, or in connection with, the provision of prescribed services.

Price smoothing mechanism	A clause in the Pricing Order that will cease no less than 16 years 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, which regulates the manner in which the Port Licence Holder sets prices 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.
Reference tariff schedule	A published schedule of prescribed service tariffs for each Prescribed Service.
Tariffs adjustment limit	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.
WACC	Weighted average cost of capital. Used to estimate a return on capital for the port licence holder for the purposes of deriving the aggregate revenue requirement.

**Weighted average tariff
increase**

In respect of a financial year, the expected weighted average rate of increase in the 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 of revenue for the purpose of calculating weightings on a basis determined by the Commission.

ACRONYMS

CPI	Consumer Price Index
ESC	Essential Services Commission
WACC	Weighted average cost of capital

CONTENTS

GLOSSARY	II
ACRONYMS	VI
ABOUT THIS PAPER	IX
HOW TO MAKE A SUBMISSION	XII
1 THE PRICING ORDER	1
1.1 THE PRICING ORDER	1
1.2 PRICING REQUIREMENTS OF THE PRICING ORDER	3
1.3 THREE KEY PROCESSES IN THE COMPLIANCE FRAMEWORK	9
1.4 ONUS ON THE PORT LICENCE HOLDER TO DEMONSTRATE COMPLIANCE	11
1.5 THE PORT LICENCE HOLDER MUST EFFECTIVELY CONSULT WITH PORT USERS	11
2 OUR APPROACH TO KEY PROCESSES	12
2.1 THE COMMISSION'S APPROACH TO ITS ROLE	12
2.2 TARIFF COMPLIANCE STATEMENTS	13
2.3 FIVE-YEARLY REVIEWS OF COMPLIANCE WITH THE PRICING ORDER	15
2.4 TARIFF REBALANCING APPLICATIONS	21
3 THE BUILDING BLOCK METHODOLOGY	26
3.1 INTRODUCTION	26
3.2 THE CAPITAL BASE	29
3.3 CAPITAL EXPENDITURE	35

3.4	RETURN ON CAPITAL	38
3.5	RETURN OF CAPITAL (DEPRECIATION)	42
3.6	OPERATING EXPENSES	45
3.7	INDEXATION ALLOWANCE	46
3.8	CHOICE OF REGULATORY PERIOD	48
3.9	COST ALLOCATION	49
4	SUMMARY OF QUESTIONS FOR CONSULTATION	51
	APPENDIX A: ILLUSTRATION OF THE TWO PRICING REQUIREMENTS	54
	APPENDIX B: PRICING ORDER	57

ABOUT THIS PAPER

THE PORT OF MELBOURNE LEASE AND THE PRICING ORDER

The port of Melbourne 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 In 2016, the Victorian Parliament passed legislation enabling the port's commercial operations to be leased to a private operator (the port licence holder) for 50 years. The port licence holder commenced operations on 1 November 2016.

A number of services provided by the port licence holder are 'prescribed services' for the purposes of the *Port Management Act 1995* (the Port Management Act). These include the provision of shipping channels, berthing facilities and other services defined in section 49 of the Port Management Act.

In setting its prices for prescribed services, the port licence holder is required to comply with requirements in the Pricing Order – a regulatory instrument made by the Governor in Council under section 49A of the Port Management Act.²

ABOUT THIS PAPER

The Essential Services Commission (the Commission) is responsible for assessing and reporting on the port licence holder's compliance with the Pricing Order. The Commission is also responsible for ensuring compliance with the Port Management Act and the *Essential Services Commission Act 2001* (the Essential Services Commission

¹ Port of Melbourne Corporation, Annual Report, October 2016

² The Pricing Order was designed and developed by the Department of Treasury and Finance.

Act) and for performing its functions under both Acts. This paper consults on the key aspects of the Commission's approach to its role.

The Commission is seeking feedback from stakeholders on its proposed approach before publishing a 'statement of regulatory approach' in late 2017. The statement of regulatory approach paper will aim to provide the port licence holder and port users with some guidance as to how the Commission will approach its roles in administering the Pricing Order.

Given this is a new regulatory regime, it is likely the Commission will make subsequent updates to its statement of regulatory approach paper over time. This will allow the Commission's approach to remain relevant to key issues as they arise.

STRUCTURE OF THIS REPORT

This consultation paper is arranged as follows:

- Chapter 1 describes the pricing compliance framework under the Pricing Order.
- Chapter 2 outlines our proposed approach to administering key processes of the pricing compliance framework.
- Chapter 3 examines the accrual building block method for setting allowed revenues that is described in the Pricing Order. It also raises questions for consultation on our approach to assessing compliance with this method.
- Chapter 4 summarises questions for consultation and sets out our next steps.

QUESTIONS AND ISSUES FOR CONSULTATION

The Commission is seeking submissions from interested stakeholders on its proposed regulatory approach to administering the Pricing Order. Box 1 summarises the questions posed within this paper and on which the Commission is seeking stakeholder input. Stakeholders' submissions may also address other matters relevant to the Commission's development of its regulatory approach to the Pricing Order

The Commission will assess all stakeholder submissions before finalising its first statement of regulatory approach paper to be released in late 2017.

BOX 1 SUMMARY OF QUESTIONS AND ISSUES FOR CONSULTATION

- Q1. The Commission welcomes stakeholder views on which aspects of the Pricing Order the Commission should develop and publish guidance on.
- Q2. The Commission seeks stakeholder feedback on its proposal to provide interim commentary within the five year inquiry period on the port licence holder's compliance with the Pricing Order.
- Q3. Stakeholder feedback is sought on the Commission's proposed considerations in relation to assessing whether any non-compliance with the Pricing Order is 'significant and sustained'.
- Q4. The Commission is interested in stakeholder views on the Commission's expectation of the port licence holder to consult on and publish a tariff rebalancing strategy should it seek to rebalance tariffs. If so, what types of issues would port users expect the strategy and engagement to cover?
- Q5. What forecast and historical service performance information should the port licence holder provide to demonstrate that its capital expenditure complies with the relevant Pricing Order requirements?
- Q6. The Commission welcomes feedback on the suitability of common expenditure assessment tools and information requirements outlined in this consultation paper for assessing compliance with the Pricing Order requirement for capital expenditure to be prudently and efficiently incurred.
- Q7. The Commission seeks stakeholder feedback on the extent to which capital contributions from non-public sector entities and asset disposals are likely to occur in the Port of Melbourne context, and whether these should be accounted for via the normal regulatory practice of deducting them from the capital base.
- Q8. What other characteristics, considerations or trade-offs should be taken into account when selecting an appropriate sample of benchmarking comparators for the Port of Melbourne, for the purposes of calculating return on capital?
- Q9. Are there any reasons why the Pricing Order terminology 'well accepted' is not to be interpreted as the common methods used by Australian regulators to set the cost of capital? Well accepted approaches would be:
- the Sharp-Lintner capital asset pricing model to estimate the prevailing return on equity
 - the trailing average method to estimate the cost of debt.

HOW TO MAKE A SUBMISSION

SUBMISSIONS

Submissions to this consultation paper close on 2 June 2017.

Please email submissions to **ports@esc.vic.gov.au** with subject title: '**Submission to regulatory approach consultation paper**'

You may also send submissions via fax to 03 9032 1303 or by mail, marked:

Attention: Transport Division
Essential Services Commission
Level 37, 2 Lonsdale Street
Melbourne VIC 3000

Any questions regarding this consultation paper may be directed to Dominic L'Huillier Director, Transport Division on 03 9032 1300.

PUBLICATION OF SUBMISSIONS

To promote transparency, we will make all submissions publicly available on our website unless clearly instructed otherwise in the submission.

If your submission contains confidential or commercially sensitive information that you do not wish to be disclosed publicly, please clearly identify the specific information in the submission.

1 THE PRICING ORDER

This chapter describes the pricing compliance framework set out in the Port Management Act and the Pricing Order that applies to the port licence holder's pricing of prescribed services. It also outlines key regulatory processes that form part of the framework and highlights the obligations of the port licence holder to demonstrate its compliance with the Pricing Order and effectively engage with port users.

1.1 THE PRICING ORDER

The Pricing Order is a regulatory instrument made under the *Port Management Act 1995* (the Port Management Act) which sets out the requirements the port licence holder must comply with in setting its prices for prescribed services.³ A copy of the Pricing Order is at appendix B.

Prescribed services

Section 49 of the Port Management Act sets out that the following are prescribed services subject to economic regulation by the Commission:

- the provision of channels (except anchorages) for use by shipping in port of Melbourne waters, including the shared channels used by vessels bound either for the port of Melbourne or the port of Geelong and the dedicated channels used by vessels bound for the port of Melbourne
- the provision of berths, buoys or dolphins in connection with the berthing of vessels in the port of Melbourne

³ The Pricing Order was made by the Governor in Council under section 49A of the Port Management Act. See Victoria Government Gazette, No. S 201, Friday 24 June 2016.

- the provision of short term storage or cargo marshalling facilities in connection with the loading or unloading of vessels at berths, buoys or dolphins in the port of Melbourne
- the provision of access to, or allowing the use of, places or infrastructure (including wharves, slipways, gangways, roads and rail infrastructure) on port of Melbourne land for the provision of services to port users
- any other service that is prescribed by the regulations.

Form of regulation

The port licence holder is required to submit annual compliance statements to the Commission demonstrating how it has complied with the Pricing Order in setting its tariffs.⁴ The Commission's role is to assess the port licence holder's compliance with the Pricing Order. To aid this function, the Commission may determine the form and content of information that must be included in the port licence holder's compliance statements.⁵

As part of its compliance assessment role, the Commission is required to conduct a public review (referred to as an inquiry) 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 during the review period, and, if there was non-compliance, whether that non-compliance was 'significant and sustained' in the Commission's view.⁶

An adverse compliance finding by the Commission can lead to the ESC Minister recommending to the Governor in Council that the Pricing Order be revoked or amended in order for prescribed service tariffs to be determined by the Commission.

⁴ Clause 7 of the Pricing Order requires the port licence holder to provide the Commission a tariff compliance statement each year that sets out its prices for the forthcoming financial year and information that explains how these prices comply with the Pricing Order.

⁵ Clause 9 of the Pricing Order enables the Commission to determine the form and content of supporting information to be provided in the port licence holder's tariff compliance statements, applications to rebalance tariffs (see section 1.3 of this paper) and application for the cessation of the tariffs adjustment limit (see section 1.2.1 of this paper).

⁶ The term 'significant and sustained' is not defined in the Port Management Act.

On the spectrum of economic regulation (see table 1.1) this framework is a unique form of regulation best described as a price compliance regime. It represents a more heavy handed form of regulation than a typical price monitoring regime, but is lighter handed than a price determination regime.

TABLE 1.1 SPECTRUM OF ECONOMIC REGULATORY REGIMES
Examples of Australian regimes

	Characteristics	Examples
Price monitoring	<p>Regulator administers information disclosure usually on prices, costs and profits</p> <p>Analysis of information enables the regulator and others to ascertain if the regulated business may have misused its market power.</p> <p>If monitoring indicates that further investigation is required, there may be processes established that may lead to increased regulation.</p>	<p>Australian and New Zealand airports regimes</p> <p>Former Port of Melbourne regime</p>
Price negotiation and arbitration	<p>Parties negotiate access terms with provision for binding arbitration by the regulator.</p>	<p>Former Australian telecommunications regime</p>
Price compliance	<p>The provider is obliged to explain how the proposed pricing complies with prescribed requirements for allowed revenues and pricing principles.</p> <p>Defined escalation process for deemed significant and sustained non-compliance.</p>	<p>Port of Melbourne Pricing Order regulation</p>
Price determination	<p>Provider makes a pricing submission and the regulator determines price arrangements that it considers comply with the prescribed rules for allowed revenues and pricing principles, and supports the regime objectives.</p>	<p>Victorian water businesses</p> <p>Australian electricity networks</p>

1.2 PRICING REQUIREMENTS OF THE PRICING ORDER

The current prices that apply to port of Melbourne prescribed services are referred to in the Pricing Order as ‘initial prescribed service tariffs’. They are set out in a schedule to

the Pricing Order. These are legacy prices rolled over from the Port of Melbourne Corporation's⁷ previous reference tariff schedule.

The Pricing Order imposes two key requirements on subsequent changes to initial prescribed service tariffs:

1. **A tariffs adjustment limit (TAL)** – a requirement that the weighted average tariff increase⁸ for prescribed services must not exceed the percentage change in the Consumer Price Index (CPI) between the March quarter in the preceding financial year and the March quarter in the financial year two years prior. In short, average prices cannot rise faster than CPI.⁹
2. **An accrual building block methodology** — a requirement to set tariffs according to an accrual building block methodology of the type set out in the Pricing Order. The methodology involves determining an amount of revenue required to give the port licence holder a reasonable opportunity to recover the efficient cost of providing all prescribed services.¹⁰

The tariffs adjustment limit applies for up to 21 years from the Pricing Order commencement date of 1 July 2016.¹¹ The two requirements apply concurrently during this time, meaning the port licence holder is required to comply with both. After the cessation of the tariffs adjustment limit, only the accrual building block methodology requirement remains and this methodology will determine prices for prescribed services.¹²

⁷ The Port of Melbourne Corporation was a statutory authority established by the Victorian Government in 2003, responsible for operating the port of Melbourne prior to the leasing of the port's commercial operations in 2016.

⁸ 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 historical audited revenues derived from prescribed service tariffs in the most recent financial year or, if there is no historic audited data, an alternative estimate of revenue for the purpose of calculating weightings on a basis determined by the Commission.

⁹ Pricing Order, clause 3.1

¹⁰ Pricing Order, clauses 2.1.1(a) and 4

¹¹ Pricing Order, clause 3.3 – from 16 years after the Pricing Order commencement date the port licence holder may seek the Commission's approval for the tariffs adjustment limit to cease to apply, otherwise it ceases to apply after 21 years.

¹² Pricing Order, clauses 2.1.1 and clause 3.3

The following sections provide more detail on the tariffs adjustment limit, the accrual building block methodology and how these two requirements interact during the period in which they apply concurrently.

1.2.1 TARIFFS ADJUSTMENT LIMIT

The tariffs adjustment limit applies to subsequent changes to the initial prescribed service tariffs. It caps annual percentage price changes at the rate of inflation, as measured by the CPI published by the Australian Bureau of Statistics.¹³ More specifically, the rate of inflation is defined as the percentage change in CPI between the March quarter before the financial year that prices will apply in, and the March quarter in the financial year two years prior.¹⁴

The tariffs adjustment limit continues to apply for price adjustments made during the initial period of the lease, which is up to 21 years in length (expiring on 30 June 2037). However, the port licence holder may apply to the Commission any time after 30 June 2032 (16 years after the Pricing Order commencement date) to approve an earlier cessation of the tariffs adjustment limit.

The Commission must approve an earlier cessation if it is satisfied that applying the accrual building block methodology (described in the following section 1.2.2) would result in lower prescribed service tariffs for the current and subsequent two financial years, as compared with the application of the tariffs adjustment limit.¹⁵

1.2.2 ACCRUAL BUILDING BLOCK METHODOLOGY

Accrual building block methodologies (also commonly referred to as building block models) are used in regulatory regimes across the energy, water, telecommunications and other infrastructure sectors. They allow regulated firms to forecast an amount of revenue required to recover the component elements (building blocks) of the efficient

¹³ The CPI is defined in the Pricing Order as the 'Consumer Price Index: All Groups Index Number, weighted average of eight capital cities'.

¹⁴ Pricing Order, clause 14

¹⁵ Pricing Order, clause 3.3

costs of supplying the regulated services. This forecast revenue is referred to as the 'aggregate revenue requirement'.

The Pricing Order mandates the use of a particular accrual building block methodology for the port licence holder's determination of its aggregate revenue requirement. It specifies the building blocks used to calculate the aggregate revenue requirement as comprising:

- return on the capital base to cover nominal pre-tax debt and equity financing costs;
- return of the capital base to recover depreciation of the asset; and
- forecast operating expenses to fund operating and maintenance activities; less
- an indexation adjustment to account for the impact of inflation on the capital base.¹⁶

The Pricing Order sets out the initial capital asset values to be used for the purposes of applying the building block method. It also sets out the method by which the value of the capital base is to be updated over time, which involves adding allowances for indexation and efficient capital expenditure, and deducting an allowance for depreciation.

Chapter 3 provides more detail regarding the building block methodology as it applies to the port of Melbourne.

1.2.3 INTERACTION OF THE TWO PRICING REQUIREMENTS

The two pricing requirements place different kinds of limitations on the port licence holder's pricing of prescribed services. The tariffs adjustment limit directly caps price increases, whereas the application of the accrual building block methodology limits the amount of forecast revenue the port licence holder can earn in any given financial year.

The two requirements apply concurrently while the tariffs adjustment limit is in operation.¹⁷ This means that during the first 16 to 21 years of the lease while the tariffs adjustment limit applies, the port licence holder must set prices that:

¹⁶ Pricing Order, clause 4.1.1

¹⁷ Pricing Order, clause 3.1.1

- do not increase by more than CPI, on a weighted average basis; and
- do not result in forecast revenues exceeding the aggregate revenue requirement.

In order to satisfy both requirements, and prove which results in lower prescribed service tariffs, the port licence holder must calculate the forecast aggregate revenue requirement according to the building block methodology specified in the Pricing Order from the commencement of the regime.

In the early years of the regime while the tariffs adjustment limit applies, the Commission expects the aggregate revenue requirement calculated according to the building block methodology specified in the Pricing Order will exceed the revenue earned from escalating prescribed service tariffs at the rate of the tariffs adjustment limit.¹⁸ In other words, we expect the tariffs adjustment limit to be the binding constraint on prices in the early years of the lease. If this is the case, it may result in a shortfall between the port licence holder's aggregate revenue requirement and the revenues it actually earns.

The Pricing Order recognises the potential for shortfalls in the recovery of the aggregate revenue requirement while the tariffs adjustment limit is in place. It allows for mitigation of such shortfalls to an extent by allowing the port licence holder to use an alternative to straight line depreciation to reduce the value of the aggregate revenue requirement in financial years while the tariffs adjustment limit is in place.¹⁹ This effectively allows the port licence holder to defer its recovery of depreciation to later years in the lease. The Pricing Order also clarifies that the depreciation allowance must not be below zero in any financial year, which means that the port licence holder can reduce its depreciation to any positive or zero value and recover that deferred depreciation in later years.²⁰

The Pricing Order requirement for depreciation not to be negative, and the absence of any other provision for residual revenue shortfalls to be recovered, effectively limits the amount of any shortfall in the aggregate revenue requirement that can be recovered

¹⁸ This expectation is based on Government modelling produced for the sale process, which was designed to be indicative only.

¹⁹ Pricing Order, clause 4.4.2(a)

²⁰ Pricing Order, clause 4.4.3

after the tariffs adjustment limit ceases to apply. Appendix A of this paper illustrates example scenarios of the interaction between the two pricing requirements and the extent to which depreciation allowances can be deferred.

1.2.4 OTHER PRICING REQUIREMENTS

In addition to the two pricing requirements discussed above, four other pricing requirements apply to the port licence holder's setting of prescribed service tariffs. These are essentially sub requirements of the two main price setting requirements, in that they affect the structure and level of individual prescribed service tariffs (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, transaction costs and the extent to which port users are likely or able to respond to price signals.²¹
- **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:
 - a floor of the avoidable cost of not providing the prescribed service bundles; and
 - a ceiling of the stand alone cost of providing the prescribed service bundles.²²
- **Tariff differentiation** — setting different tariffs for different users of the same prescribed service is permitted provided the differences are consistent with the objectives set out in section 48 of the Port Management Act and certain provisions in the Pricing Order.²³ For the provision of channels shared between the port of Melbourne and other ports, discrimination between port users on the basis of port or berth is not permitted.²⁴

²¹ Pricing Order, clause 2.1.3

²² Pricing Order, clause 2.1.1(b)

²³ Pricing Order, clause 2.1.2

²⁴ Pricing Order, clause 2.2

- **Cost allocation** — directly attributable costs must be attributed to each prescribed service, while costs that are not directly attributable to the provision of a prescribed service, but which are incurred in providing both prescribed and non-prescribed services, must be allocated to the prescribed services on the basis of the revenue share of total revenue from all services provided by the port licence holder.²⁵

The port licence holder must also abide by the ‘export pricing decision’, which commits to reducing the prescribed service tariffs for full outbound containers by 2.5 per cent annually through to 2019-20, and then maintain the discount relative to the price of full inbound container wharfage services from 2020-21 onwards. This reflects a decision made by the Port of Melbourne Corporation to enhance competitiveness with the Port of Botany and other Australian container ports.²⁶

1.3 THREE KEY PROCESSES IN THE COMPLIANCE FRAMEWORK

There are three key processes associated with the pricing compliance framework:

- The port licence holder must submit a tariff compliance statement to the Commission by 31 May in each year, which sets out its prescribed service tariffs for the upcoming financial year and demonstrates how it has complied with the Pricing Order (**tariff compliance statement**).
- The Commission must conduct an inquiry into the port licence holder’s compliance with the Pricing Order every five years (**five-yearly inquiry**).
- The port licence holder may seek approval from the Commission to make non-uniform percentage adjustments to its prescribed service tariffs, to add a new prescribed service tariff, or discontinue an existing prescribed service tariff (**tariff rebalancing application**).

The port licence holder, port users and the Commission all have roles in these three processes, as summarised in table 1.2. In chapter 2 we outline these processes in

²⁵ Pricing Order, clause 5

²⁶ Pricing Order, clause 2.3.1

more detail and discuss the Commission's proposed approach to administering its roles in relation to each.

TABLE 1.2 SUMMARY OF ROLES IN RELATION TO KEY PROCESSES

Stakeholder	Three key processes		
	Tariff compliance statement	Five-yearly compliance review	Rebalancing applications
Port licence holder	<ul style="list-style-type: none"> Consult with users on tariffs prior to submission Annually submit tariff compliance statement to the Commission by 31 May Apply tariffs from 1 July 	<ul style="list-style-type: none"> May make a written submission in response to the draft report 	<ul style="list-style-type: none"> Consult with users on rebalanced tariffs prior to submission <ul style="list-style-type: none"> Submit tariff rebalancing application to the Commission by 1 January Apply tariffs from 1 July (if accepted)
Port users	<ul style="list-style-type: none"> Engage with port licence holder 	<ul style="list-style-type: none"> Engage in the review process 	<ul style="list-style-type: none"> Engage with port licence holder
Essential Services Commission	<ul style="list-style-type: none"> Receive annual tariff compliance statement 	<ul style="list-style-type: none"> Conduct inquiry of port licence holder's compliance with Pricing Order Provide a draft report to the port licence holder <ul style="list-style-type: none"> Produce a final report, which may find significant and sustained non-compliance 	<ul style="list-style-type: none"> Accept or reject the application

Clause 3.3 of the Pricing Order also outlines a process whereby, from 16 years after the Pricing Order's commencement, the port licence holder may apply to the Commission for the early cessation of the tariffs adjustment limit. As this process is not immediately relevant to the Commission's regulatory approach we do not discuss it further in this paper.

1.4 ONUS ON THE PORT LICENCE HOLDER TO DEMONSTRATE COMPLIANCE

The Pricing Order places the onus on the port licence holder to demonstrate that in setting prescribed service tariffs it is compliant with the Pricing Order provisions. Compliance demonstration is facilitated by the submission of tariff compliance statements and tariff rebalancing applications, as described in section 1.3 above.

As the Commission's role is to assess the port licence holder's compliance, we outline our proposed approach to administering these processes in chapter 2. We also discuss our expectations of the port licence holder's compliance demonstration with the building block model provisions of the Pricing Order in chapter 3.

1.5 THE PORT LICENCE HOLDER MUST EFFECTIVELY CONSULT WITH PORT USERS

The Pricing Order requires the port licence holder to effectively consult port users in setting its prescribed service tariffs and to have regard to their comments. This applies to its tariff compliance statement submission process.²⁷

In addition, the Pricing Order requires the port licence holder to provide port users with a reasonable opportunity to express their views on any tariff rebalancing application prior to the application being made.²⁸

The Commission considers effective consultation and engagement by the port licence holder with port users will be important to the port licence holder's compliance with the Pricing Order. The Commission also notes port users are generally large and well-resourced commercial firms. We therefore expect they will have the means and incentive to engage with the port licence holder.

²⁷ Pricing Order, clause 7.1.2(d)

²⁸ Pricing Order, clause 3.2.5

2 OUR APPROACH TO KEY PROCESSES

In this chapter, the Commission outlines and consults on the three key processes associated with the pricing compliance framework. We set out our proposed approach to administering these three processes and seek feedback from stakeholders.

2.1 THE COMMISSION'S APPROACH TO ITS ROLE

In administering its roles in relation to the Pricing Order the Commission aims, to the extent possible, to adopt a transparent, consistent and predictable approach. As this is a new regulatory regime, it is likely that unforeseen issues will arise and the Commission must therefore balance its aim for predictability and consistency with the need to maintain flexibility in its compliance assessment roles.

To aid the development of our approach, in this chapter we consult on specific aspects of our role relating to three key processes of the compliance framework:

- the port licence holder's requirement to demonstrate compliance through submission of annual **tariff compliance statements** to the Commission (section 2.2)
- the Commission's **five-yearly reviews** of the port licence holder's compliance with the Pricing Order (section 2.3)
- the port licence holder's requirement to obtain the Commission's approval should it seek to **rebalance tariffs** (section 2.4).

2.2 TARIFF COMPLIANCE STATEMENTS

2.2.1 THE PROCESS

Clause 7 of the Pricing Order requires the port licence holder to provide tariff compliance statements to the Commission by 31 May each year detailing how its prescribed service prices for the upcoming financial year have been set in compliance with the Pricing Order.

Clause 7.1.2 lists the required contents of the tariff compliance statement. These include: demonstration of compliance with the pricing principles including the tariffs adjustment limit and accrual building block methodology; compliance with cost allocation principles; information on contracts with port users; and explanation of how the port licence holder has effectively consulted with port users and had regard to their comments.

Clause 7.1.2(f) and clause 9 also provide for the Commission to determine the form and content of information the port licence holder must submit to support its tariff compliance statements.

2.2.2 THE COMMISSION'S PROPOSED APPROACH

The Commission seeks to administer the tariff compliance statement process in accordance with its aim to provide transparency, predictability and consistency in its approach. To do so, we:

- intend to issue information requirements to support effective tariff compliance statements
- may, overtime, publish guidance on our expectations of demonstrating compliance with key issues in the Pricing Order.

Issuing supporting information requirements

The Commission intends to issue the port licence holder with specific requirements relating to the form and content of supporting information for tariff compliance statements (as provided for in clause 7.1.2(f) of the Pricing Order). The Commission

considers that outlining the information it requires to assess the port licence holder's compliance will promote predictability and transparency in how we administer our compliance assessment role. Throughout this consultation paper, we pose questions for stakeholders about what information should be required to aid this process.

We intend to issue a supporting information determination for tariff compliance statements in time for the port licence holder's submission of its second statement by 31 May 2018. The Commission also intends to require the port licence holder to provide a version of its tariff compliance statement that would be suitable for publication.

Publishing guidance on key compliance issues in the Pricing Order

The Commission considers that issuing guidance as to what it would likely consider compliant (or non-compliant) on key compliance issues will provide clarity and support the tariff compliance process. Such guidance could cover specific technical provisions in the Pricing Order (for example, relating to weighted average cost of capital). In addition to signalling the Commission's views on what would be compliant or non-compliant, guidance would also cover our expectations of how compliance is to be demonstrated by the port licence holder.

FOR CONSULTATION

1. The Commission welcomes stakeholder views on which aspects of the Pricing Order the Commission should develop and publish guidance on.

A key requirement of tariff compliance statements is for the port licence holder to demonstrate it has effectively consulted port users and had regard to their comments.²⁹ The port licence holder's engagement with port users affords users the opportunity to be engaged on the drivers and levels of the port licence holder's costs of providing prescribed services – including its proposed service levels – as well as its proposed price setting and the adequacy of its compliance demonstration.

²⁹ Pricing Order, clause 7.1.2(d)

Given the requirement in the Pricing Order for the port licence holder to effectively consult port users, the Commission expects the port licence holder to provide the following as part of its tariff compliance statement:

- details of its consultation process with port users
- issues raised and feedback provided by port users
- whether, where, how and why outcomes of engagement have or have not been reflected in the tariff compliance statement.

Another key requirement of the tariff compliance statement is for the port licence holder to demonstrate compliance with the accrual building block methodology in clause 4 of the Pricing Order. We discuss this in more detail in chapter 3 with a view to developing initial guidance for inclusion in our statement of regulatory approach.

2.3 FIVE-YEARLY REVIEWS OF COMPLIANCE WITH THE PRICING ORDER

2.3.1 THE PROCESS

The Commission must, at five-yearly intervals, conduct an inquiry and report to the ESC Minister:

- as to whether the port licence holder has complied with the Pricing Order during the five year period; and
- 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'.³⁰

The Commission's five-yearly inquiry must be conducted in accordance with Part 5 of the Essential Services Commission Act (except for sections 40 and 46), which sets out general provisions relating to inquiries and reports.³¹

³⁰ Port Management Act 1995, s. 49I(1)

³¹ Port Management Act 1995, s. 49I(2)

The Port Management Act sets out that in its five-yearly inquiries the Commission may take into account any findings it has made in previous inquiries and the nature and details of any instance of non-compliance with the Pricing Order reported in those inquiries.³² This does not limit the Commission from taking account of any other matters it considers relevant to its inquiries.

Before preparing a final report, the Commission must provide a draft report to the port licence holder and provide the port licence holder an opportunity to make a written submission.³³ If the Commission finds in its final report that the port licence holder has been non-compliant with the Pricing Order in a significant and sustained manner, the port licence holder may appeal the decision under section 55 of the Essential Services Commission Act. The only grounds for appeal are that the decision was not made in accordance with the law, or was unreasonable having regard to all the relevant circumstances.³⁴ The appeal will be heard by an ESC appeal panel, which comprises of three members chosen by the Registrar³⁵ from a pool of persons appointed by the Governor in Council. The appeal panel may affirm the decision of the Commission, vary the decision of the Commission, or set aside the decision and remit to the Commission for amendment.³⁶

If the Commission provides an adverse compliance report to the ESC Minister (that is, a final report that the port licence holder has not complied with the Pricing Order in a 'significant and sustained' manner), it triggers a process that may lead to 're-regulation', whereby the Commission (rather than the port licence holder) would be responsible for determining prescribed service tariffs. If the ESC Minister, after having considered the Commission's final report, concludes that the port licence holder has not complied with the Pricing Order in a significant and sustained manner, they may issue the port licence holder a 'show cause notice'. The show cause notice must include the nature and details of the non-compliance, specify the steps the provider may take to remedy the non-compliance and invite the port licence holder to make written submissions as to

³² Port Management Act 1995, s. 49I(3)

³³ Port Management Act 1995, s. 49J

³⁴ Essential Services Commission Act, section 55(e)

³⁵ 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.

³⁶ Essential Services Commission Act 2001, s. 56

why the ESC Minister should not make a re-regulation recommendation to the Governor in Council.³⁷

Before making a re-regulation recommendation, the ESC Minister must consult with the Ports Minister and have regard to a range of matters outlined in section 49L of the Port Management Act. As an alternative to a re-regulation recommendation, the ESC Minister may accept an enforceable undertaking from the provider as a basis for providing assurances as to future compliance with the Pricing Order.³⁸

2.3.2 THE COMMISSION'S PROPOSED APPROACH TO FIVE YEARLY INQUIRIES

The Commission will undertake its five-yearly inquiries in accordance with the processes outlined in its charter of consultation.³⁹ This process includes notifying stakeholders of the inquiry, inviting submissions, publishing a draft report, inviting submissions on the draft report, and then providing the final report to the ESC Minister.

In addition, we propose to provide interim commentary on the port licence holder's compliance statements within the five year review periods – that is, prior to and between our formal inquiries.

We also outline in this section some considerations the Commission may take into account in interpreting the terms 'significant and sustained' in relation to non-compliance with the Pricing Order.

Providing our views during five year review periods

The Pricing Order requires the port licence holder to submit annual tariff compliance statements to the Commission. However, there is no obligation for the Commission to take any further action until its formal requirement to undertake an inquiry and report on the port licence holder's compliance at five year intervals.

³⁷ Port Management Act, section 49K(2)

³⁸ Port Management Act 1995, sections 49K to 49M

³⁹ <http://www.esc.vic.gov.au/wp-content/uploads/esc/d1/d1757189-87ce-4af5-b24e-2e460030d75e.pdf>

To promote transparency and predictability in our approach, we propose to provide our interim views on the port licence holder's compliance on a more regular basis by publishing commentary during the five year review periods. This will benefit the formal five-yearly review process by providing opportunities for stakeholders, including the port licence holder, to be aware of key issues or concerns in advance of formal inquiries.

The Commission is considering publishing its interim commentary on the port licence holder's compliance on an annual or two yearly basis (by the end of the calendar year, following receipt of tariff compliance statements in May). In conjunction with our commentary, we would also seek to publish and refer to a non-confidential version of the port licence holder's tariff compliance statement.

The scope and extent of our commentary will be informed by the calibre of the port licence holder's tariff compliance statements, the quality of information provided by the port licence holder and materiality of any compliance considerations arising from our interim assessments of compliance.

Our key focus areas for the provision of interim commentary may include:

- compliance with the Pricing Order provisions for applying the building block methodology
- the effectiveness of the port licence holder's consultation with port users
- the prescribed service tariffs and compliance with the CPI tariffs adjustment limit
- confirmation of compliance with other provisions of clause 7.1.2 including:
 - information on contracts (clause 7.1.2 (b))
 - how the prescribed service tariffs comply with the Pricing Order, including the pricing principles and cost allocation principles (clause 7.1.2 (e))
 - information requirements (clause 7.1.2 (f)).

Our interim commentary will not be an exhaustive compliance assessment, nor will it seek to make findings as to whether any non-compliance is 'significant and sustained'. We provide our initial considerations in relation to 'significant and sustained' non-compliance below in this section.

The scope of issues we consider in our five-yearly reviews will therefore not necessarily be limited to issues we have previously raised in annual commentary. However, by raising issues of actual or potential non-compliance in our interim commentary we will signal our views and provide opportunity for the port licence holder to address compliance issues ahead of the formal inquiry. This will in turn support the Commission's consideration of whether compliance is considered 'sustained'.

The Commission expects that over the next five years this approach should facilitate a common understanding of compliance among stakeholders. It is possible that the Commission, the port licence holder and port users may develop differing interpretations of compliance over certain Pricing Order provisions. The Commission expects that by the time the inquiry is undertaken under section 491(1) of the Port Management Act that any such differences will have become clear, and if these were material they would be a central area of focus in the inquiry.

FOR CONSULTATION

2. The Commission seeks stakeholder feedback on its proposal to provide interim commentary within the five year inquiry period on the port licence holder's compliance with the Pricing Order.

'Significant and sustained' non-compliance

Overall, the Commission will assess whether there is non-compliance with the Pricing Order 'in a significant and sustained manner' having regard to the context of the Pricing Order and the purpose and objects of the regulatory framework – which include protecting prescribed services users and promoting economic efficiency and the long-term interests of Victorian consumers. However, stakeholders must also recognise our considerations outlined in this section must be balanced and qualified with the need for the Commission to maintain discretion around its interpretation, as the nature of non-compliance may not be clearly foreseeable.

Without limiting the Commission's future exercise of its discretion, we outline the following considerations we may take into account in assessing whether non-compliance is 'significant and sustained':

- The Commission may consider the materiality of the harm to port users or consumers associated with any non-compliance. This will be assessed by

considering the extent to which any non-compliance is contrary to achieving the purpose and objects of the price compliance framework, including the Port Management Act and the Essential Services Commission Act.

- The Commission may consider whether the non-compliance has the potential to undermine stakeholder confidence in the integrity of the regulatory framework.
- The Commission may consider whether the port licence holder has established and adhered to effective processes to support compliance and to monitor and review remediation of identified non-compliance. Failure to implement adequate processes to prevent recurrent non-compliance will, combined with initial non-compliance, be more likely to be regarded as significant and sustained.
- The Commission may consider the adequacy and timeliness of the port licence holder's responses to any non-compliances that the Commission has identified or raised (including but not limited to non-compliances raised as part of five-yearly reviews).
- The Commission may consider whether harm to port users or Victorian consumers is ongoing or whether the harm can be reversed (at all or retrospectively).⁴⁰
- If non-compliance is likely to have a lasting effect going forward, the Commission may consider a non-compliance to be significant and sustained at the point in time at which it occurs, especially if a future action by the port licence holder could not reverse harm to port users or Victorian consumers. That is, our identification and review of any non-compliance may include considering future effects of that non-compliance, not just past impacts.
- If non-compliance with a requirement of the Pricing Order will or may affect future prescribed service prices, the Commission may consider that non-compliance to be significant and sustained even if it does not affect current prices.

⁴⁰ For example, the port licence holder may set future tariffs lower to specifically offset additional revenue it gained through previously non-compliant tariffs. This may reverse the impact on the port licence holder's revenue. However, the action may not equally reverse the harm to the users and consumers previously affected by non-compliant tariffs, as future users and consumers may be different to previous users and consumers.

FOR CONSULTATION

3. Stakeholder feedback is sought on the Commission's proposed considerations in relation to assessing whether any non-compliance with the Pricing Order is 'significant and sustained'.

The Commission reiterates that while we aim to promote transparency, predictability and consistency through the above ex-ante guidance, not every instance of significant and sustained non-compliance will necessarily be able to be anticipated or immediately identified. We therefore provide this information as guidance only and maintain our discretion to assess any non-compliance as we become aware of that non-compliance, and in light of any relevant facts and circumstances.

2.4 TARIFF REBALANCING APPLICATIONS

Clause 3.2.1 specifies that during the initial 16 to 21 year period in which the tariffs adjustment limit applies, unless the Commission approves a tariff rebalancing application, the port licence holder must make uniform percentage adjustments to its prescribed service tariffs.⁴¹

Tariff rebalancing gives the port licence holder an opportunity to propose an alternative pricing structure. 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 and other Pricing Order requirements, including the building block methodology, general pricing principles and cost allocation principles.⁴² The same approval process is required if the port licence holder proposes to introduce a new prescribed service tariff.⁴³

⁴¹ With the exception of prescribed service tariffs subject to annual reductions under the export pricing decision

⁴² Specifically, clause 3.2.2 requires that compliance with clauses 2, 3.1.1, 4 and 5 must be demonstrated. Clause 3.2.5 also requires the port licence holder to consult port users about its rebalancing proposal and provide a reasonable opportunity for port users to express their views to the port licence holder.

⁴³ Pricing Order, clause 3.2.3

A rebalancing application approved by the Commission means that, provided that the weighted average tariff increase in a financial year does not exceed the tariffs adjustment limit, the port licence holder can:

- revise certain prescribed service tariffs for the upcoming financial year by different percentage adjustments
- introduce a new prescribed service tariff, and/or
- discontinue an existing prescribed service tariff.⁴⁴

2.4.1 THE PROCESS

The Pricing Order is prescriptive on the process requirements for the port licence holder's submission of the application, and the process for the Commission's decision.

Clause 3.2.5 of the Pricing Order requires the port licence holder to consult port users about its tariff rebalancing proposal prior to submitting its application to the Commission. As noted above, the port licence holder is also required to give port users a reasonable opportunity to express their views.

Clause 3.2.7 requires the port licence holder to submit sufficient supporting information to enable the Commission to verify it complies with: the pricing principles in clause 2, the tariffs adjustment limit in clause 3.1.1, the accrual building block methodology in clause 4 and the cost allocation principles in clause 5.

Clause 9 of the Pricing Order gives the Commission power to determine the form and content of information the port licence holder must submit to support its compliance demonstration in a rebalancing application.

A rebalancing application must be submitted to the Commission by 31 December in relation to tariffs to apply from 1 July for the following year. The proposed tariffs in the rebalancing application due by 31 December are required to comply with the tariffs adjustment limit for the following financial year. The calculation of that tariffs adjustment requires the March quarter CPI figure, which is typically released by the Australian

⁴⁴ Pricing Order, clause 3.2.4

Bureau of Statistics in late April, and therefore not available in time for the December rebalancing application. The port licence holder is therefore required to adopt a reasonable estimate for the upcoming March quarter CPI in its rebalancing application.⁴⁵

After receiving a rebalancing application by 31 December, the Commission must notify the port licence holder of its intention to accept or reject the application before 1 March. This is referred to in the Pricing Order as an ‘interim decision’. In the event of an interim decision to reject the application, the port licence holder may submit an amended rebalancing application within 30 days.⁴⁶

Within seven days of the Australian Bureau of Statistics’ release of the March quarter CPI figure, the port licence holder is required to update and submit to the Commission its rebalancing application with the actual CPI figure.⁴⁷ The Commission is then required to issue its decision on the final rebalancing application within seven days of receiving it.⁴⁸

2.4.2 COMMISSION’S APPROACH

A key difference of the tariff rebalancing application process as compared with the tariff compliance statement and inquiry processes, is that it involves an approval by the Commission before the port licence holder can change its prices.

In deciding whether or not to accept a rebalancing application the Commission must assess the application’s compliance with the relevant Pricing Order provisions. Given there are fixed timelines for the application submission and approval process, the Commission recognises it is important to clarify what it expects the application to contain to enable the Commission to make its assessment. As such, the Commission proposes to:

⁴⁵ Pricing Order, clause 3.2.6

⁴⁶ Pricing Order, clause 3.2.8

⁴⁷ Pricing Order, clause 3.2.15

⁴⁸ Pricing Order, clause 3.2.18

- make clear that it expects to see evidence of the port licence holder's comprehensive consultation with users about its rebalancing proposals
- issue a determination detailing the form and content of supporting information required to be submitted as part of the rebalancing application.

Tariff rebalancing strategy to support consultation with port users

In order for port users to be given a reasonable opportunity to express their views on the port licence holder's tariff rebalancing proposals (as required by clause 3.2.5), the Commission expects the port licence holder to consult port users on its proposals in a comprehensive manner and well in advance of its application submission.

Port users are significant businesses and have incentives, information and access to resources to help them engage with the port licence holder in relation to rebalancing. As such, we expect and encourage port users to inform the port licence holder during consultation of any concerns that rebalanced tariffs may result in non-compliance with the Pricing Order.

To promote an appropriate level of engagement and support compliance demonstration, we consider the port licence holder should consult on and publish a tariff rebalancing strategy prior to submitting an application to the Commission. This would set out how it plans to rebalance prescribed service tariffs over the short and medium term. The Commission would expect that a final (post-consultation) version of the tariff rebalancing strategy would then be submitted as supporting information with any tariff rebalancing application.

The tariff rebalancing strategy should provide sufficient information to port users and the Commission to understand how the structure of prescribed service tariffs would change and demonstrate how rebalancing will comply with the Pricing Order requirements including:

- compliance with the upper and lower bound pricing rules (clause 2.1.1(b))
- if different tariffs are to be charged to different users for the same or similar services, how these would comply with the objectives set out in section 48 of the Port Management Act and the relevant clauses of the Pricing Order (clause 2.1.2)
- how, in setting the level and structure of prescribed service tariffs, the port licence holder has had regard to the efficient costs caused by port users, transaction costs,

and the extent to which port users are able or likely to respond to price signals (clause 2.1.3).

The port licence holder's engagement on the tariff rebalancing strategy would provide an opportunity for port users to understand and give feedback on the port licence holder's practical application of the clause 2 pricing principles and other aspects of the Pricing Order. For example, port users could engage on:

- how the port licence holder has estimated its standalone and avoidable costs
- how transaction costs have been considered
- the extent to which port users will be able to respond to price signals
- any other relevant aspects of the Pricing Order.

FOR CONSULTATION

4. The Commission is interested in stakeholder views on the Commission's expectation of the port licence holder to consult on and publish a tariff rebalancing strategy should it seek to rebalance tariffs. If so, what types of issues would port users expect the strategy and engagement to cover?

Information determination for tariff rebalancing applications

The port licence holder's tariff rebalancing applications must demonstrate compliance with a range of Pricing Order requirements – including general pricing principles, the tariffs adjustment limit, the building block methodology and cost allocation principles. As such, the Commission considers it may be beneficial to clearly outline, to the extent possible, the form and content of the information it requires to assess compliance with these provisions. This would be done through an information determination made pursuant to clause 9 of the Pricing Order.

3 THE BUILDING BLOCK METHODOLOGY

In this chapter, the Commission outlines the Pricing Order requirements for the application of the accrual building block methodology and raises key questions for stakeholder feedback.

3.1 INTRODUCTION

This section provides a brief overview of the building block methodology and the Pricing Order requirements for how it is to be applied by the port licence holder. It covers matters relevant to the port licence holder's compliance with the applicable building block methodology set out in clause 4 of the Pricing Order, how the port licence holder is to demonstrate compliance, and how the Commission might assess compliance. We discuss each of the building blocks in turn and raise questions for stakeholder feedback.

3.1.1 OVERVIEW OF BUILDING BLOCK METHODOLOGY

The accrual building block methodology – more commonly called a building block method or model – is an approach for calculating the maximum revenue a regulated business may recover for providing regulated services over a specified period of time. The methodology is currently used to set prices for monopoly providers in electricity, water, gas and telecommunications industries across Australia. The way the methodology is applied and the process and assumptions underpinning the model

inputs varies considerably between industries. However, the Pricing Order sets out the specific methodology to be used by the port licence holder.⁴⁹

Generally, the building block model calculates the total regulated revenue a business may earn by building up the cost components required for providing regulated services. This revenue is referred to as the 'aggregate revenue requirement'. The cost components or blocks that make up the aggregate revenue requirement typically include:

- a return on capital to provide financing of debt and a return to equity holders, including allowance for tax
- a return of capital to recover depreciation of assets
- operating and maintenance costs.

Building up the cost components requires information on the assets used to supply services, forecasts of volumes of services (demand), the service levels proposed or required for the regulated services, and any operating obligations and technical regulations that affect costs.

An aggregate revenue requirement is a forecast over a specified period of time known as the 'regulatory period'. Prices for prescribed services can then be set by dividing the aggregate revenue requirement for the regulatory period, by the forecast demand for regulated services over that period.

In other Australian regulatory regimes that apply building block methods, the length of the regulatory period is typically around five years in length, and is set in regulation or determined by a regulator. For the Port of Melbourne regulatory regime, the Pricing Order specifies that the port licence holder may set the regulatory period and may adopt different lengths over the term of the port lease.

The length of the regulatory period the port licence holder chooses will affect the operation of the regime, the port licence holder's incentives and the interests of port users. We explain this further in section 3.8.

⁴⁹ Pricing Order, clause 4

3.1.2 THE TWO EQUATIONS OF BUILDING BLOCK MODELS

Building block models involve two equations:

1. an equation to calculate the revenue required to provide regulated services (**the aggregate revenue requirement equation**)
2. an equation to calculate the value of the capital base over time (**the roll forward equation**).

The aggregate revenue requirement is generally calculated as the sum of a return on capital (cost of capital multiplied by the capital base), a return of capital (depreciation) and operating expenses.

The roll forward equation is for updating the value of regulated assets each year. Over the regulatory periods, the capital base is updated to reflect:

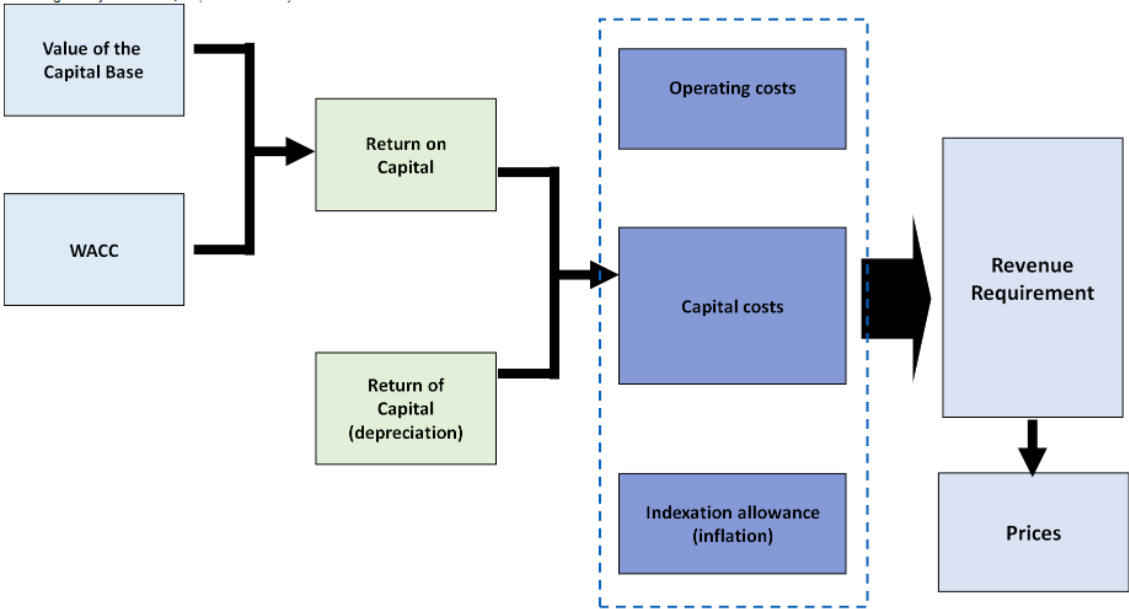
- the value of the capital base that is recovered through regulated revenue (through the return of capital allowance for depreciation)
- any additions to the capital base through new capital expenditure
- any deductions for capital contributions, such as those from government to sponsor port expansions
- the impact of inflation.

The roll forward equation consists of the closing value of the capital base in a given year, which is determined by: the opening value at the start of the year, plus new capital expenditure, less depreciation. An indexation allowance is also provided to maintain the value of the asset in real terms

The building block equations establish a cost recovery model that allows an opportunity for a regulated business to recover its efficient costs and to recover and receive a return on its investment over the life of the regulated assets (or, in the case of the Port of Melbourne, the port lease period if shorter). The particular building block equations that must be used by the port licence holder are specified in clause 4 of the Pricing Order. Under the Pricing Order, the tariffs adjustment limit may affect this recovery as the port licence holder is required to comply with both the building block methodology and the tariffs adjustment limit.

Figure 3.1 illustrates how the building block components and inputs integrate for calculating revenues.

FIGURE 3.1 BUILDING BLOCK MODEL



The following sections discuss each of the building blocks in turn as they relate to the Pricing Order.

3.2 THE CAPITAL BASE

The capital base is the primary mechanism by which the port licence holder recovers its investment in the port assets. It captures the value of efficient historical investment, maintains this in real terms by adjusting for inflation, and depreciates it over time as the asset is repaid by users through the return of capital (i.e. depreciation) building block.

The opening value of the capital base has been set by the Victorian Government in the Pricing Order as:

- \$592 million in nominal dollars as at 1 July 2016 for shared channel services
- \$2913 million in nominal dollars as at 1 July 2016 for bundled services.⁵⁰

3.2.1 PRICING ORDER REQUIREMENTS

The value of the capital base will change over time through the application of the accrual building block methodology, including the roll forward equation. The port licence holder is required to define the capital base on a 'roll forward basis' as specified in clause 4.2.1 of the Pricing Order. Specifically, the port licence holder is required to define its capital base at any particular time by:

- taking the commencement value of the capital base at the beginning of a financial year⁵¹
- adding an indexation allowance for that financial year⁵²
- adding efficient capital expenditure that has been, or will be, prudently incurred during that financial year:
 - efficient capital expenditure is deemed to be incurred as at the mid-point of that financial year and adjusted by an indexation allowance, which is half of the percentage change in CPI for that financial year⁵³
 - capital expenditure associated with the port capacity project (PCP)⁵⁴ may be added if it has been incurred efficiently (this expenditure has been deemed prudent under the Pricing Order)⁵⁵
 - public sector capital contributions must not be included in the capital base⁵⁶
- deducting depreciation expenses.⁵⁷

⁵⁰ Pricing Order, clause 4.7.1

⁵¹ Pricing Order, clause 4.2.1(a)

⁵² The indexation allowance is the percentage change, or forecast percentage change, in the CPI for that financial year multiplied by the value of the capital base at the beginning of that year. Pricing Order, clause 4.2.1(b) and 4.6.1 (a)

⁵³ Pricing Order, clause 4.2.1(c)

⁵⁴ The PCP significantly expands the capacity of the port's container and automotive terminals. The PCP includes a 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.

⁵⁵ Pricing Order, clause 4.2.3 to 4.2.5

⁵⁶ Pricing Order, clause 4.2.6

In any given regulatory period the capital base will reflect the historical capital base up to, and the forecast capital base over, that regulatory period. At the commencement of a regulatory period, the capital base is rolled forward such that the opening capital base is updated with actual information (replacing previous forecasts)⁵⁸, and the forecast capital base over the regulatory period adopts new forecasts. Box 3.1 demonstrates the roll forward calculations.

⁵⁷ Pricing Order, clause 4.2.1(d)

⁵⁸ The roll forward methodology in the Pricing Order requires the port licence holder to update the capital base with actual figures for capital expenditure (prudently and efficiently incurred) and indexation. It allows for either actual or forecast depreciation to be rolled forward.

BOX 3.1 ROLL FORWARD EQUATIONS

Calculation of opening capital base at start of regulatory period

- Opening capital base (first regulatory period commencing 1 July 2016) =
\$3.505 billion (nominal dollars, set in Pricing Order clause 4.7.1)
- Opening capital base (all subsequent regulatory periods) =
(opening capital base of previous period \times actual inflation)
+ (actual capital expenditure[#] \times $\frac{1}{2}$ actual inflation)
- (forecast or actual depreciation^{##})

Calculation of forecast capital base over a regulatory period

- Forecast capital base =
(opening capital base \times forecast inflation)
+ (forecast capital expenditure \times $\frac{1}{2}$ forecast inflation)
- (forecast depreciation)

[#] Capital expenditure must be prudently and efficiently incurred and must exclude any value attributable to capital contributions made by a public sector entity.

^{##} The Pricing Order allows for forecast or actual depreciation to be rolled forward.

3.2.2 DEMONSTRATING AND ASSESSING COMPLIANCE

A roll forward calculation template

Clause 9 of the Pricing Order enables the Commission to determine the form and content of information supporting the port licence holder's tariff compliance statements and tariff rebalancing applications, both of which require demonstration of compliance with the Pricing Order's roll forward calculation requirements.

In other regulatory regimes, compliance with roll forward equations is often administered through use of a prescribed or agreed roll forward model. This aids all stakeholders by confirming the calculations accord with the regime requirements, and avoids duplicated effort in replicating and verifying the roll forward calculations submitted by the regulated firm. It is common practice in the Commission's current approach to water industry regulation and its former approach to energy industry regulation.

The Commission proposes to produce a roll forward model template in spreadsheet form for the port licence holder to complete as part of its compliance demonstration process. This will aid transparency of the port licence holder's roll forward calculations and efficiency of the compliance demonstration and assessment process. We will commence developing a roll forward model in time for the May 2018 tariff compliance statement.

Nominating use of actual or forecast depreciation

The Commission notes that the Pricing Order does not specify whether actual or forecast depreciation is to be used when rolling forward the capital base. The use of one or the other involves different incentive properties for the port licence holder. If actual depreciation is rolled forward, the port licence holder will have a greater incentive to outperform the capital expenditure forecasts it sets at the beginning of a regulatory period. It will also bear greater risk if it underperforms against its capital expenditure forecasts. Box 3.2 provides an example to explain this.

BOX 3.2 INCENTIVE EFFECTS OF ROLLING FORWARD ACTUAL OR FORECAST DEPRECIATION

Assume the port licence holder forecasts it will spend \$100 million on new capital infrastructure in a regulatory period, and forecasts \$10 million of depreciation of that infrastructure over the same period.

Assume then that the port licence holder only ended up spending \$80 million over the regulatory period and actual depreciation was \$8 million.

In the Pricing Order's roll forward methodology, only the actual expenditure of \$80 million can be added to the capital base (provided it was prudently and efficiently incurred). However, the port licence holder can choose a methodology to deduct either actual or forecast depreciation in the roll forward equation.

In this example, where the port licence holder has outperformed its capital expenditure forecast, the value of the opening capital base for the next regulatory period will be \$2 million higher if it deducts the actual depreciation of \$8 million, instead of the forecast depreciation of \$10 million.

Equally, by choosing the methodology of deducting actual depreciation, the port licence holder bears the risk of roll forward calculation resulting in a lower capital base value if it overspends on capital expenditure compared to its forecast.

The choice of actual or forecast depreciation affords the port licence holder some control over the level of risk and reward it takes on in relation to its endeavour to ensure its capital expenditure is incurred efficiently. To align with the objective of the Port Management Act to promote efficient investment in the provision of prescribed services, the Commission considers that the port licence holder should nominate at the beginning of a regulatory period whether it will use forecast or actual depreciation in its roll forward calculation for the next regulatory period.

3.3 CAPITAL EXPENDITURE

The Pricing Order requires, and the port licence holder must demonstrate, that actual or forecast capital expenditure added to the capital base be efficient, and reflects prudent actions:⁵⁹

...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 Services [emphasis added]

In other regulatory regimes, the tests for prudence and efficiency of capital expenditure generally require the regulator to be satisfied that the expenditure would be incurred (or would have been incurred) by a prudent service provider acting efficiently, having regard to applicable service standards, regulatory obligations and expected levels of demand.

3.3.1 DEMONSTRATING AND ASSESSING COMPLIANCE

The Commission's considerations relevant to the port licence holder's demonstration, and the Commission's assessment, of compliance with this provision, include that:

- assessing capital expenditure assessment after it has been incurred can adversely affect investment incentives if the prospects of recovery are uncertain
- the 'efficient' and 'prudent' terminology in the Pricing Order is common to a number of Australian regulatory regimes for which guidance has been published and regulatory precedents exist.⁶⁰

These considerations suggest there is value in the Commission providing guidance on the types of information relevant to demonstrating compliance, and the various regulatory compliance assessment techniques the Commission may employ. Subject to feedback from stakeholders, we will consider preparing a technical paper on this aspect of compliance, and developing requirements for our information determination.

⁵⁹ Pricing Order, clause 4.2.1(c)

⁶⁰ See for example, NER clauses 6.5.7(c) capex criteria: '(2) the costs that a prudent operator would require to achieve the capex objectives', and the associated Australian Energy Regulator Expenditure Assessment Guideline (2013).

Demonstrating capital expenditure compliance

How the port licence holder demonstrates compliance of its capital expenditure will be informed by the nature of the expenditure category or activity, and the circumstances in which it is being incurred. Demonstrating compliance may include, among other things:

- providing evidence of the prudence of its investment governance and asset management processes
- providing director attestation that the forecasts comply with the requirement in clause 8.2.2 of the Pricing Order that the forecasts are '*arrived at on a reasonable basis*' and '*represent the best forecast or estimate possible in the circumstances*', as is commonly required in other regulatory regimes, including the Commission's approach to water regulation
- explaining how its procurement, project management and labour practices are consistent with efficient cost outcomes
- explaining expenditure forecasts and outcomes by reference to historical levels and trends
- providing benchmarking and/or productivity assessment of its capital expenditure
- for actual capital expenditure, explain how and why the actual expenditure has differed from the forecasts provided at the prior roll-forward of the capital base.

The scope of prescribed services to be provided is relevant to both the capital expenditure and operating expenditure building block inputs. We cannot assess compliance with the Pricing Order efficiency and prudence tests without knowing:

- the forecast service levels those expenditure forecasts are intended to deliver
- the actual service levels that actual expenditure did deliver.

This means forecast and actual service performance data will be a minimum information requirement for the port licence holder when demonstrating compliance.

FOR CONSULTATION

5. What forecast and historical service performance information should the port licence holder provide to demonstrate that its capital expenditure complies with the relevant Pricing Order requirements?

Assessing capital expenditure compliance

The Commission has previously used a range of tools when assessing the forecast and actual capital expenditure in other regulatory regimes. These include:

- expert engineering assessment — where an independent engineering firm reviews the historical and forecast expenditure for efficiency and prudence
- trend and productivity assessment — where economic benchmarking techniques are used to look at a regulated firm's own productivity changes over time, and also compare this to other like firms where sufficient data is available
- benchmarking, activity based costing and unit rate analysis — where a firm's costs at a category, activity or unit rate level are compared with other comparable firms, or with the outcomes of market testing processes
- independent forecasts of forecasting inputs such as demand and input price escalation — where key forecasting assumptions are prepared by independent expert forecasters such as for wage, commodity and materials price growth or demand forecasts
- actual costs revealed by a service provider that faces incentives to spend efficiently (e.g. because it faces an explicit incentive mechanism that rewards efficient spend or penalises inefficient spend).

The Commission will consider which of these, or other, forms of evidence or tools will be appropriate for administering the Pricing Order based on the nature and circumstances of that capital expenditure at the time of assessment. We expect the port licence holder's tariff compliance statement to provide the forms of evidence relevant to the capital expenditure it is submitting, with the above examples being illustrative of common practice by regulated firms. We welcome stakeholder feedback on these common ways of demonstrating and assessing compliance.

FOR CONSULTATION

6. The Commission welcomes feedback on the suitability of common expenditure assessment tools and information requirements outlined in this consultation paper for assessing compliance with the Pricing Order requirement for capital expenditure to be prudently and efficiently incurred.

3.3.2 USER CONTRIBUTIONS AND ASSET DISPOSALS

Common regulatory practice in the capital base roll forward process involves deducting both capital contributions and asset disposals from the capital base, where these are part of the commercial practices of the industry. The Pricing Order contemplates contributions from the public sector entities and requires these to be deducted from the capital base.⁶¹ However, it does not expressly contemplate contributions from non-public sector entities or asset disposals.

FOR CONSULTATION

7. The Commission seeks stakeholder feedback on the extent to which capital contributions from non-public sector entities and asset disposals are likely to occur in the Port of Melbourne context, and whether these should be accounted for via the normal regulatory practice of deducting them from the capital base.

3.4 RETURN ON CAPITAL

Two main forms of capital are typically required in order to fund a business:

- equity (e.g. shares and retained earnings), and
- debt (e.g. bonds, bank loans and other forms of interest-bearing borrowing).

The return on capital building block represents the return that the regulated business would need to offer investors to attract necessary capital to fund the business. The return on capital is also called the 'cost of capital', since the return required by lenders

⁶¹ Clause 4.2.6 of the Pricing Order

and investors is a cost to the business. More specifically it is the weighted average of the two forms of capital — referred to as weighted average cost of capital (WACC).

The return on capital provides funding for the debt and equity financing costs the port licence holder will incur to fund the capital base and any new capital investment over a given regulatory period. Regulatory regimes, including the Pricing Order, provide an allowance for these funding costs to be financed at a rate commensurate with a benchmark efficient entity that provides services with a similar degree of risk. This provides an incentive for the port licence holder to fund its operations at a lower cost than the benchmark entity.

For most of the port lease period, the return on capital will be the single largest building block cost item, so it will have the greatest effect on port licence holder's aggregate revenue requirement.

3.4.1 PRICING ORDER REQUIREMENTS

Clause 4.1.1(a) of the Pricing Order requires that the port licence holder's aggregate revenue requirement includes an allowance to recover a return on its capital base that is:

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 Licence Holder in respect of the provision of the Prescribed Services.

Clause 4.3 further specifies that in determining a rate of return on capital, the port licence holder 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.

The Pricing Order specifies the rate of return to be determined on a pre tax, nominal basis.⁶²

⁶² Pricing Order, clause 4.3.2

Clauses 4.1.1(a) and 4.3.1 places two notable requirements on the port licence holder:

- to demonstrate that it has determined what return a **benchmark efficient entity** would require to provide services with a similar degree of risk to the port licence holder's prescribed services
- to demonstrate that it has used a weighted average cost of capital (WACC) to derive its return (that is, financing using a combination of equity and debt), and that, moreover, its approach **is one or a combination of well accepted approaches to determining a return on capital.**

3.4.2 BENCHMARK EFFICIENT ENTITY

The Pricing Order directs that the rate of return should be based on the return required by a benchmark efficient entity providing services with a similar degree of risk to those of the port's prescribed services. This is consistent with standard Australian regulatory practice of estimating benchmarks for rate of return parameters (for example, the equity beta and gearing) with reference to a sample of comparator firms that reflect relevant risk characteristics of the regulated service.

Relevant risk characteristics of the services provided by the port include that the prescribed services:

- relate primarily to the provision of wharfage and channel access services
- are provided by a port that predominantly derives revenue from services to container cargo, with a smaller share of bulk and non-bulk cargo
- are provided by a port in Australia.

There are no publicly-listed ports in Australia. Consequently, the port will have to determine a comparator set by considering other characteristics of the port's prescribed services, and by making trade-offs between elements of comparability. For example, by including other firms (not ports) that provide similarly risky services or to include overseas ports in the comparator set. Whichever approach is adopted, it is important that a systematic approach to comparator selection be used to avoid 'cherry picking' comparators in each regulatory period.

FOR CONSULTATION

8. What other characteristics, considerations or trade-offs should be taken into account when selecting an appropriate sample of benchmarking comparators for the Port of Melbourne, for the purposes of calculating return on capital?

3.4.3 DEMONSTRATING AND ASSESSING COMPLIANCE

WACC is the single largest driver of revenue outcomes for the port licence holder, and determining WACC estimates for use in regulated infrastructure is often highly contentious. This means this aspect of Pricing Order application is likely to have the most material impact on the extent to which the objectives of the Port Management Act are achieved.

The standard equation used to calculate the nominal pre-tax WACC is:⁶³

$$\text{WACC} = \left[\frac{\text{Cost of equity}}{1 - \text{effective tax rate} \times (1 - \text{gamma})} \times (1 - \text{Gearing}) \right] + [\text{Cost of debt} \times \text{Gearing}]$$

Various approaches exist for estimating the cost of equity, cost of debt and level of gearing for a benchmarking efficient entity. However, not all are well accepted in Australian regulatory practice. Some approaches used in academia or by finance practitioners are not well accepted in Australian regulatory practice and their application can be difficult in practice due to data quality and availability issues or methodological choices.

The Commission interprets the Pricing Order terminology 'well accepted' as the approaches commonly used in Australian regulatory practice. For example:

- the Commission and all other Australian economic regulators currently use the Sharpe-Lintner capital asset pricing model⁶⁴ to estimate the prevailing cost of equity

⁶³ This is often referred to as the *Officer* pre-tax cost of capital formula: see Officer R.R. 1994, *The cost of capital of a company under an imputation tax system*, Accounting and Finance, 34 1, May.

⁶⁴ Applying this model involves taking the prevailing rate on long-term government bonds and adding a premium for the risk borne by equity investors in the type of asset being looked at (in this case the Port of Melbourne). The premium is typically estimated as the product of a 'market risk premium' and the sensitivity of returns on that asset to the market (referred to as 'beta').

- the Commission has recently adopted a trailing average approach⁶⁵ to calculating the cost of debt, as has the Australian Energy Regulator and our jurisdictional counterparts in NSW and SA.

The Commission considers both these approaches are well accepted.

FOR CONSULTATION

9. Are there any reasons why the Pricing Order terminology ‘well accepted’ is not to be interpreted as the common methods used by Australian regulators to set the cost of capital? Well accepted approaches would therefore be:
 - the Sharp-Lintner capital asset pricing model to estimate the prevailing return on equity
 - the trailing average method to estimate the cost of debt.

To aid the compliance demonstration and assessment process, the Commission considers it may be instructive to provide guidance on the interpretation of some key Pricing Order rate of return concepts. We are considering publishing a technical paper on this aspect of compliance, and may seek stakeholder views to inform this work.

3.5 RETURN OF CAPITAL (DEPRECIATION)

The depreciation building block (referred to as the ‘return of capital’) allows the port licence holder to recover the value of the capital base over the life of those assets, or the lease period where this is shorter.

Depreciation is most commonly calculated on a ‘straight line’ basis. Straight line depreciation implies that the amount of depreciation included in the building block

⁶⁵ The trailing average approach involves estimating the average cost of debt incurred over a fixed historical period, usually matching the assumed term of debt (i.e. often 10 years for long-lived asset such as ports), for debt with a benchmark credit rating. The return on debt estimated using the trailing average approach can be updated each year within a regulatory period by adding one new year of data to the average and removing the oldest year of data. Earlier approaches involved applying the same estimate technique but over a much shorter (and relatively recent) historical period – such as 10 to 40 business days just prior to the start of the regulatory period – and holding the estimated return on debt constant for the duration of the regulatory period.

model in any year is equal to the value of the relevant assets at the commencement of that year divided by their remaining life.

Although straight line depreciation is the most common approach, other approaches to calculating the depreciation building block are available. These approaches differ from the straight-line approach by shifting the profile of depreciation either forwards or backwards over the asset's life.

Toward the end of the port lease period, the return of capital building block will become the largest contributor to prices, but it may initially be very low due to both:

- indexation of the asset base, which pushes backwards the recovery of depreciation relative to an unindexed approach, and
- alternative approaches to depreciation being applied because of the operation of the tariffs adjustment limit.

As outlined in section 1.2.3, the tariffs adjustment limit may cause the port licence holder to earn less than the aggregate revenue requirement in the years it applies. In these circumstances, some of the under-recovered aggregate revenue requirement may be deferred for recovery later in the lease period by adopting an alternative depreciation approach. The Pricing Order caps the extent of deferral by prohibiting negative values for return of capital in any financial year.⁶⁶

3.5.1 PRICING ORDER REQUIREMENTS

The Pricing Order provides for both default and alternative approaches to determining the return of capital allowance.

Clause 4.4 defines a default approach for depreciation – straight-line depreciation. Straight-line depreciation allocates an equal amount of depreciation to each year of an asset's life. Asset lives are determined by whichever is shorter of the economic lives of the assets, and the remaining term of the port lease (clause 4.4.1).

⁶⁶ Pricing Order, clause 4.4.3

Clause 4.4.2 allows for the port licence holder to adopt alternative depreciation approaches in circumstances where either:

- the tariffs adjustment limit prevents recovery of the return of capital amount that would otherwise be recoverable in that financial year (clause 4.4.2(a)), or
- an alternative method would reduce the variance in the expected annual percentage changes in prescribed service tariffs through to the end of the port lease (clause 4.4.2(b)).

3.5.2 DEMONSTRATING AND ASSESSING COMPLIANCE

Default approach (straight-line depreciation)

The Commission expects the port licence holder to provide information on:

- the remaining economic asset lives of existing assets and the economic lives for new assets, how these compare to the accounting lives the port licence holder has adopted for the same assets, and an explanation for any divergence
- the value attributable to assets (from which depreciation is calculated)
- the amount of depreciation applicable to each type of asset on a straight-line basis.

This information is necessary to both apply the default approach, and to calculate the unrecoverable value in instances where an alternative approach is proposed.

Alternative approaches

If the port licence holder uses an alternative to the default straight-line depreciation pursuant to clause 4.4.2(a) of the Pricing Order, it is necessary for it to provide information showing that the return of capital component derived using a straight-line depreciation methodology is not capable of being recovered in the applicable year. This can be demonstrated by calculating:

- an aggregate revenue requirement under the straight line depreciation method; and
- the revenues able to be earned by applying the tariffs adjustment limit.

If the port licence holder uses an alternative to straight-line depreciation pursuant to clause 4.4.3(b), the port licence holder must demonstrate the alternative method will

reduce the variance in the expected annual percentage changes in prescribed services tariffs through to the end of the port lease.

In either case, the port licence holder must also demonstrate that the alternative method ensures that assets are only depreciated once, meaning they may not be depreciated by more than their value at the time of their inclusion in the capital base.

3.6 OPERATING EXPENSES

The building block model includes an operating cost allowance to reflect ongoing operating, maintenance and administration costs for providing prescribed services. It allows the port licence holder to recover the forecast cost of its operating activities over a given regulatory period.

Unlike capital expenditure which is recovered via the return on and return of capital over its life, operating expenditure is funded on a dollar-for-dollar basis in the year in which it is forecast to be incurred.

3.6.1 PRICING ORDER REQUIREMENTS

Clause 4.1.1 of the Pricing Order allows the port licence holder to recover forecast operating expenses, commensurate with those required by a prudent service provider acting efficiently.⁶⁷

It does not require that any under or over expenditure relative to these forecasts for a given regulatory period is adjusted for at the end of the period. This creates an incentive for the port licence holder to outperform expenditure forecasts and minimise costs both generally and when unforeseen events occur that push its actual expenditure above forecast levels.

⁶⁷ Clauses 4.5.1 and 4.5.2 provides specific guidance for the Commission and the port licence holder on certain items on which expenditure is deemed prudent and efficient.

3.6.2 DEMONSTRATING AND ASSESSING COMPLIANCE

Demonstrating compliance for forecast operating expenditure will be similar to capital expenditure. In addition to the evidence types and assessment tools discussed in section 3.3 for assessing the forecast capital expenditure, the port licence holder may also seek to demonstrate operating expenditure compliance by:

- providing its asset management and maintenance processes and showing they are followed in practice
- explaining expenditure forecasts and outcomes by reference to historical levels and trends, and providing business case justifications for any step changes
- providing benchmarking and/or productivity assessment of its expenditure.

The Commission will consider which forms of evidence and tools will be appropriate for administering the Pricing Order based on the nature and circumstances of that operating expenditure at the time of assessment. We expect the port licence holder's tariff compliance statement to provide the forms of evidence relevant to the operating expenditure it is submitting.

3.7 INDEXATION ALLOWANCE

The indexation allowance preserves the financial value of the capital base in real terms over its life (or the lease period) by accounting for the effects of inflation.

3.7.1 PRICING ORDER REQUIREMENTS

The Pricing Order specifies that indexation of the capital base is to be applied such that, for a given financial year:⁶⁸

- the value of the capital base at the beginning of the year is indexed by the percentage change in CPI for that year

⁶⁸ Pricing Order, clause 4.6.1

- new capital expenditure incurred during the year is indexed by half the percentage change in CPI for that year (the expenditure is deemed to be incurred at the midpoint of the financial year).

The Pricing Order requires that indexation of the capital base is to use actual CPI figures for the historical capital base, and a reasonable forecast CPI figure for the forecast capital base. It defines CPI to mean the Consumer Price Index: All Groups Index Number, weighted average of eight capital cities published by the Australian Bureau of Statistics.

For the purpose of the aggregate revenue requirement, the indexed capital base is to be used for calculating:

- the return on capital allowance using a nominal (inclusive of inflation) weighted average cost of capital (clause 4.1.1(a))
- the return of capital allowance (clause 4.1.1(b))
- a deduction in the aggregate revenue requirement equal to the value of the indexation of the capital base (to avoid double counting) (clause 4.1.1(d)).

3.7.2 DEMONSTRATING AND ASSESSING COMPLIANCE

Consistent choice of CPI publication date

While the Pricing Order's definition of CPI clearly explains which series is to be used, for the indexation allowance it does not prescribe which quarterly index value is to be used.

The Commission considers that the port licence holder should nominate which quarter it will adopt for the CPI value for the purpose of indexing the capital base, and apply the same quarter value consistently over the port lease period. Use of inconsistent CPI quarters could distort the calculation of the revenue required to recover efficient costs. If, for any reason, the port licence holder changes the CPI quarter it uses for the

purpose of indexation, the Commission expects the port licence holder would adjust for the change.⁶⁹

Clause 4.7.1 of the Pricing Order defines the opening capital bases for shared channel services and bundled services in 1 July 2016 dollars. Should the port licence holder adopt a March CPI for the indexation allowance, this would imply a three-month CPI lag. Lags of three, six and nine months are common in regulatory practice for indexation due to the lead times between the date from which a financial value needs to be escalated (in this case 1 July) and the date at which the chosen CPI escalator is published.

3.8 CHOICE OF REGULATORY PERIOD

The Pricing Order provides that the length of the regulatory period is a choice for the port licence holder, and that the port licence holder may adopt different regulatory period lengths over the life of the lease.

The Commission considers that it is in the interest of port users and Victorian consumers to:

- clearly understand the basis for the port licence holder's choice of the length of regulatory periods
- encourage a consistent and principled approach to determining the length of the regulatory period in future.

The choice of the length of the regulatory period affects:

- the incentives for efficiency provided by the opportunity to outperform forecast building block allowances
- the incentives for the port licence holder to overstate forecast building block allowances

⁶⁹ For example, use of a five quarter CPI adjustment if the indexation moved from past use of a March quarter CPI to future use of a June Quarter CPI.

- the management of cost uncertainty
- opportunities for beneficial management of cost cycles.

The Commission therefore proposes to determine under clause 9 of the Pricing Order that the port licence holder provide in its tariff compliance statement:

- the factors that the port licence holder has considered in determining the length of the forthcoming regulatory period and proposes to consider for determining future regulatory periods
- the process by which the port licence holder has effectively consulted and had regard to the comments provided by port users⁷⁰
- the nominated length of the current regulatory period
- the nominated length of the next regulatory period where the current regulatory period will cease before the next tariff compliance statement is submitted.

3.9 COST ALLOCATION

The port licence holder will incur costs that are directly related to a prescribed service or other service, as well as costs that are shared across one or more of such services. The allocation of costs to services for the purpose of pricing those services can affect the efficient use of those services (allocative efficiency) and thus the extent to which the Port Management Act objectives are supported.

3.9.1 PRICING ORDER REQUIREMENTS

The Pricing Order requires the port licence holder to allocate its costs between prescribed services and all other services in a manner consistent with the following cost allocation principles:

- costs that are directly attributable to the provision of the prescribed service must be attributed to that prescribed service⁷¹

⁷⁰ Clause 7.1.2 (d) of the Pricing Order

- costs that are not directly attributable to the provision of the prescribed service but which are incurred in the course of providing both one or more prescribed services and other services must be allocated to the prescribed service on the basis of its share of total revenue from all services provided by the port licence holder.⁷²

3.9.2 DEMONSTRATING AND ASSESSING COMPLIANCE

This provision is consistent with the treatment of shared costs in a number of regulatory regimes. However, it is helpful to outline what may be sufficient information to demonstrate compliance.

The Commission considers it will be necessary for the port licence holder to provide the underlying cost and revenue data, and supporting calculations used to apply the allocation of the prescribed service share of indirect costs across prescribed services.

⁷¹ Pricing Order, clause 5.2.1(a)

⁷² Pricing Order, clause 5.2.1(b)

4 SUMMARY OF QUESTIONS FOR CONSULTATION

Stakeholder feedback on this consultation paper will inform the Commission's development of its first statement of regulatory approach to the Pricing Order. The Commission intends to publish its statement of regulatory approach in late 2017.

Table 4.1 summarises the questions for consultation posed throughout this paper. Stakeholders may also wish to make submissions on other matters relevant to the Commission's development of its regulatory approach to the Pricing Order.

Submissions to this consultation paper close on 2 June 2017.

TABLE 4.1 SUMMARY OF QUESTIONS FOR CONSULTATION

Q1.	The Commission welcomes stakeholder views on which aspects of the Pricing Order the Commission should develop and publish guidance on.
Q2.	The Commission seeks stakeholder feedback on its proposal to provide interim commentary within the five year inquiry period on the port licence holder's compliance with the Pricing Order.
Q3.	Stakeholder feedback is sought on the Commission's proposed considerations in relation to assessing whether any non-compliance with the Pricing Order is 'significant and sustained'.
Q4.	The Commission is interested in stakeholder views on the Commission's expectation of the port licence holder to consult on and publish a tariff rebalancing strategy should it seek to rebalance tariffs. If so, what types of issues would port users expect the strategy and engagement to cover?
Q5.	What forecast and historical service performance information should the port licence holder provide to demonstrate that its capital expenditure complies with the relevant Pricing Order requirements?

- Q6. The Commission welcomes feedback on the suitability of common expenditure assessment tools and information requirements outlined in this consultation paper for assessing compliance with the Pricing Order requirement for capital expenditure to be prudently and efficiently incurred.
- Q7. The Commission seeks stakeholder feedback on the extent to which capital contributions from non-public sector entities and asset disposals are likely to occur in the Port of Melbourne context, and whether these should be accounted for via the normal regulatory practice of deducting them from the capital base.
- Q8. What other characteristics, considerations or trade-offs should be taken into account when selecting an appropriate sample of benchmarking comparators for the Port of Melbourne, for the purposes of calculating return on capital?
- Q9. Are there any reasons why the Pricing Order terminology ‘well accepted’ is not to be interpreted as the common methods used by Australian regulators to set the cost of capital? Well accepted approaches would be:
- the Sharp-Lintner capital asset pricing model to estimate the prevailing return on equity
 - the trailing average method to estimate the cost of debt.

APPENDIX A: ILLUSTRATION OF THE TWO PRICING REQUIREMENTS

BOX A.1 ILLUSTRATION OF TWO REQUIREMENTS

Scenario 1

Consider a simplified scenario where the **default straight-line depreciation method** is used in calculating the aggregate revenue requirement (ARR_D):

- Return on capital (R) is 60
- Return of capital using the default straight-line method (D_D) is 30
- Operating costs (O) are 50
- Indexation allowance (I) is 10

The resulting aggregate revenue requirement (ARR_D) = $R + D_D + O - I = 130$

Consider also that the forecast revenue under the tariffs adjustment limit is 100 (call this TAL_R), as calculated by multiplying: tariff increases within the tariffs adjustment limit, by forecast demand.

Here there will be a shortfall in revenue of 30: $ARR_D - TAL_R = 130 - 100 = 30$

Scenario 2

Consider another scenario with similar values, but where the port licence holder chooses to adopt an **alternative depreciation method** that sets the return of capital allowance to zero in this year ($D_A = 0$).

The resulting aggregate revenue requirement (ARR_A) is calculated as:

$$ARR_A = R + D_A + O - I = 60 + 0 + 50 - 10 = 100$$

Forecast revenue under the tariffs adjustment limit, TAL_R , is still 100; and now the aggregate revenue requirement $ARR_A = TAL_R = 100$.

In this scenario there is no shortfall caused by the application of the tariffs adjustment limit, and the depreciation allowance of 30 (had straight-line depreciation been used) is deferred by remaining in the capital base for recovery in later periods.

Scenario 3

Now consider a third scenario where all values remain the same as in scenario 2, except that operating costs are higher by 10 ($O_{S3} = 60$).

The resulting aggregate revenue requirement is now 110:

$$ARR = R + D_A + O_{S3} - I = 60 + 0 + 60 - 10 = 110.$$

In this scenario, despite using an alternative depreciation method, there will be a shortfall in revenue of 10: $ARR - TAL_R = 110 - 100 = 10$.

Since depreciation cannot be negative, this scenario demonstrates an example of a revenue shortfall from the operation of the tariffs adjustment limit that cannot be recovered.

Incentives

It is possible that the tariffs adjustment limit will result in the port licence holder not recovering its efficient costs using the building block method in the early years of the pricing regime, as scenario 3 demonstrates. This increases incentives for the port licence holder to:

- grow demand for port services to earn more revenue
- seek cost efficiencies in early years of the lease

- defer expenditures and depreciation costs until after the tariffs adjustment limit constraint ceases to apply (i.e. after 16 to 21 years).

Return of capital compliance

Recognising the impact of the tariffs adjustment limit on recovery of the building block revenues, the Pricing Order provides for depreciation allowances to be deferred for recovery in later periods.

In order to give itself a reasonable opportunity to recover its efficient costs over the life of the lease, the port licence holder could adopt a depreciation approach that minimises the rate at which its assets are depreciated (for regulatory pricing purposes) in the years in which the tariffs adjustment limit is the binding constraint, and depreciate those assets at a greater rate in the years after it ceases. This would mean a lower return of capital cost block (and therefore lower aggregate revenue requirement) in the earlier years and a higher return of capital cost block (and aggregate revenue requirement) in the later years.

While permitted, the Pricing Order limits the extent of this depreciation shifting by prohibiting below zero (negative) depreciation allowances. This means that, unlike in some other regimes, 'losses' calculated as the difference between actual revenues and the aggregate revenue requirement cannot be 'rolled forward' or 'capitalised' using negative depreciation.⁷³ Using the example above, the depreciation allowance could be set to zero to lower the ARR to 110. However, it could not be set to -10 to bring its aggregate revenue requirement in line with the forecast revenue under the tariffs adjustment limit.

It is important for the Commission to consider this interaction of the two constraints and the incentives it creates when making its information disclosure determination and assessing Pricing Order compliance. This is because the total income the port licence holder earns over the lease will vary materially depending upon how the building block model and depreciation deferral provision are applied.

⁷³ For clarity, if depreciation is set to zero in a period and there is still a deficit between actual revenues (determined by the *tariff adjustment limit*) and the aggregate revenue requirement (calculated as return on capital plus operating costs less indexation), this deficit cannot be recovered in future periods.

APPENDIX B: PRICING ORDER



Victoria Government Gazette

No. S 201 Friday 24 June 2016
By Authority of Victorian Government Printer

Port Management Act 1995 (Vic.)

PRICING ORDER

The Governor in Council, under section 49A of the **Port Management Act 1995** (Vic.), makes the following Order:

1. COMMENCEMENT AND APPLICATION

1.1.1 This Order takes effect on 1 July 2016 (**Commencement Date**).

1.1.2 Pursuant to section 49A(2) of the Act it is declared that:

- (a) Divisions 2A and 2B of Part 3 of the Act together with the provisions of this Order apply to the provision of Prescribed Services; and
- (b) Division 3 of Part 3 of the Act does not apply to the provision of Prescribed Services.

2. PRICING PRINCIPLES: GENERAL

2.1 Prescribed Service Tariffs Pricing Principles

2.1.1 Prescribed Service Tariffs must be set so as:

- (a) to allow the Port Licence Holder 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**); and
- (b) subject to clauses 2.1.1(a), 2.2, 2.3.1 and 3, to allow the Port Licence Holder a reasonable opportunity to recover, for each Prescribed Service Bundle, revenue that:
 - (i) does not exceed an upper bound representing the stand alone cost of providing the Prescribed Service Bundle; and
 - (ii) does not fall below a lower bound representing the avoidable cost of not providing the Prescribed Service Bundle.

2.1.2 The Port Licence Holder may set different Prescribed Service Tariffs for different users of the same or similar Prescribed Service, provided that such differences are consistent with the objectives set out in section 48 of the Act and clauses 2.1.3, 2.2.1 and 2.3.1.

2.1.3 The Port Licence Holder must set the level and structure of Prescribed Service Tariffs having regard to:

- (a) the efficient costs caused by Port Users of the relevant Prescribed Service;
- (b) transaction costs; and
- (c) the extent to which Port Users are able or likely to respond to price signals.

2.1.4 The principle in clause 2.1.1(b) does not apply to the extent that the Port Licence Holder expects to derive revenue from:

- (a) any applicable Initial Prescribed Service Tariff; or
- (b) during the period in which clause 3.1.1 applies, any subsequent increase to any Initial Prescribed Service Tariff (as may be varied from time to time due to the acceptance of a Final Rebalancing Application under clause 3.2.18) that does not exceed the Tariffs Adjustment Limit; or
- (c) in any period in which clause 3.1.1 no longer applies, any subsequent increase to any Initial Prescribed Service Tariff that does not exceed the rate of change in the Aggregate Revenue Requirement over a corresponding period,

that would exceed the stand alone cost of providing the Prescribed Service Bundle.

2.1.5 For the avoidance of doubt, other than as provided in clause 2.1.1(b), or as may be required to comply with the principles in clauses 2.1.2 and 2.1.3, this Order establishes maximum tariffs for Prescribed Services and a Port Licence Holder will not be in breach of this Order if it sets actual tariffs for Prescribed Services at a level that is lower than permitted under clause 2.1.1(a) in any relevant period.

SPECIAL

2.2 Specific Shared Channel Tariffs Pricing Principles

2.2.1 In addition to complying with the principles set out in clauses 2.1, 2.3.1 and 3.1.1, the Port Licence Holder must set Prescribed Service Tariffs for the use of the Shared Channels:

- (a) by application of the same accrual building block methodology and parameters that are utilised in determining Prescribed Service Tariffs for the Dedicated Channels, including without limitation in relation to establishing:
 - (i) an allowance to recover return on the applicable capital base;
 - (ii) an allowance to recover return of the applicable capital base; and
 - (iii) an allowance to recover its forecast of applicable operating expenses, (see clause 4); and
- (b) so as not to otherwise discriminate between Port Users on the basis of port or berth.

2.3 Port of Melbourne Corporation container export pricing decision

2.3.1 Notwithstanding any other provision of this Order, the Port Licence Holder must maintain and comply with the Export Pricing Decision when setting Prescribed Service tariffs for full outbound container wharfage services.

3. PRICING PRINCIPLES: PRICE SMOOTHING MECHANISM**3.1 Tariffs Adjustment Limit**

3.1.1 In addition to complying with clause 2, the Weighted Average Tariff Increase implied by the Prescribed Service Tariffs set by the Port Licence Holder in respect of any Financial Year commencing on or after 1 July 2017 must not exceed the Tariffs Adjustment Limit.

3.2 Rebalancing

3.2.1 Subject to the Commission's acceptance of a Final Rebalancing Application under clause 3.2.18 (or pursuant to an appeal under Part 7 of the **Essential Services Commission Act 2001** (Vic)), the Port Licence Holder may only revise each Prescribed Service Tariff (other than, in the period prior to the start of the 2020 Financial Year, Prescribed Service Tariffs that are subject to the Export Pricing Decision) in respect of a Financial Year by the same percentage adjustment.

3.2.2 The Commission must accept a Final Rebalancing Application under clause 3.2.18 if it is satisfied that the proposed Prescribed Service Tariffs the subject of the Final Rebalancing Application comply with clauses 2, 3.1.1, 4 and 5.

3.2.3 The Port Licence Holder may not introduce a new Prescribed Service Tariff unless the proposed new Prescribed Service Tariff is the subject of a Final Rebalancing Application accepted by the Commission under clause 3.2.18.

Making a Rebalancing Application

3.2.4 Except in relation to Prescribed Service Tariffs that are subject to the Export Pricing Decision, prior to 1 January of any Financial Year commencing on or after 1 July 2017, the Port Licence Holder may make a written application to the Commission which proposes that, subject to compliance with clauses 2, 3.1.1, 4 and 5:

- (a) certain Prescribed Service Tariffs for the upcoming Financial Year be revised by different percentage adjustments;
- (b) that a new Prescribed Service Tariff be introduced; and/or
- (c) that an existing Prescribed Service Tariff be discontinued,

(Rebalancing Application).

3.2.5 Prior to making a Rebalancing Application, the Port Licence Holder must consult Port Users about its proposal to do so and provide a reasonable opportunity for Port Users to express their views to the Port Licence Holder.

- 3.2.6 The Port Licence Holder must utilise a reasonable estimate of the upcoming March CPI for the purpose of calculating the Tariffs Adjustment Limit in a Rebalancing Application submitted prior to the March CPI Release Date.
- 3.2.7 The Rebalancing Application must contain sufficient supporting information to enable the Commission to verify that the proposed Prescribed Service Tariffs comply with clauses 2, 3.1.1, 4 and 5.

Interim Decision by the Commission

- 3.2.8 Subject to compliance with clause 3.2.7, the Commission must notify the Port Licence Holder in writing of either its:
- (a) interim acceptance of the Rebalancing Application; or
 - (b) intention to reject the Rebalancing Application,
- before 1 March of the Financial Year preceding the Financial Year to which the Rebalancing Application relates (**Interim Decision**). If notification has not been given within that timeframe, the Commission shall be deemed to have given its interim acceptance to the Rebalancing Application.
- 3.2.9 Where the Commission has not received sufficient supporting documentation from the Port Licence Holder in accordance with any relevant determination made under clause 9, the timeframe specified in clause 3.2.8 may be extended at the Commission's discretion by any period starting on the day the Commission requests further information from the Port Licence Holder and ending on the day that the Port Licence Holder complies with that request.
- 3.2.10 The Commission must grant interim acceptance to a Rebalancing Application under clause 3.2.8 if it is satisfied that the proposed Prescribed Service Tariffs the subject of the Rebalancing Application comply with clauses 2, 3.1.1, 4 and 5.
- 3.2.11 Where the Commission notifies the Port Licence Holder under clause 3.2.8 of the Commission's intention to reject the Rebalancing Application, the Commission must provide in that notification reasons for its intended rejection.
- 3.2.12 Where the Commission is required to utilise the upcoming March CPI prior to the March CPI Release Date as part of making its Interim Decision, the Commission must adopt a reasonable estimate of the March CPI.

Amended Rebalancing Application

- 3.2.13 Where the Commission notifies the Port Licence Holder under clause 3.2.8 of the Commission's intention to reject the Rebalancing Application, the Port Licence Holder may submit to the Commission an amended Rebalancing Application (**Amended Rebalancing Application**) within thirty (30) days of receipt of that notification.
- 3.2.14 An Amended Rebalancing Application submitted to the Commission under clause 3.2.13 must comply with clause 3.2.7.

Final Rebalancing Application

- 3.2.15 The Port Licence Holder must submit to the Commission an updated version of its Rebalancing Application or Amended Rebalancing Application (as applicable), utilising the actual March CPI released on the March CPI Release Date (**Final Rebalancing Application**), within seven days after the March CPI Release Date.
- 3.2.16 Subject to clause 3.2.17, where the Commission has not received the Final Rebalancing Application within the timeframe specified in clause 3.2.15, the Commission shall be deemed to have finally rejected the Rebalancing Application or Amended Rebalancing Application (as applicable).
- 3.2.17 The deadline in clause 3.2.15 may be extended at the Commission's discretion.

Final decision by the Commission

- 3.2.18 Subject to compliance with clause 3.2.7, the Commission must notify the Port Licence Holder in writing of its final acceptance or rejection of the Final Rebalancing Application within seven days after receiving the Final Rebalancing Application. If notification has not been given within that timeframe, the Commission shall be deemed to have accepted the Final Rebalancing Application.
- 3.2.19 Where the Commission has not received sufficient supporting documentation from the Port Licence Holder in accordance with any relevant determination made under clause 9, the timeframe specified in clause 3.2.18 may be extended at the Commission's discretion by any period starting on the day the Commission requests further information from the Port Licence Holder and ending on the day that the Port Licence Holder complies with that request.
- 3.2.20 Where the Commission notifies the Port Licence Holder under clause 3.2.18 of the Commission's rejection of the Final Rebalancing Application, the Commission must provide in that notification reasons for its rejection.

3.3 Duration of application of clause 3

- 3.3.1 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.
- 3.3.2 An application under clause 3.3.1 must contain sufficient supporting information to enable the Commission to be satisfied of the matters specified in clause 3.3.3.
- 3.3.3 The Commission must issue a determination that clause 3 ceases to apply if satisfied that the application of the principles in clause 2.1.1 would result in Prescribed Service Tariffs for the Financial Year in which the application is made and the two Financial Years immediately following that are likely to be lower than would be permitted under clause 3.1.1.
- 3.3.4 The Commission must in writing notify the Port Licence Holder of the outcome of an application under clause 3.3.1 within ninety (90) days of receipt of the application.
- 3.3.5 In the absence of a determination by the Commission under clause 3.3.3, clause 3 ceases to apply at the end of the Financial Year in which the twentieth anniversary of the Commencement Date falls.

3.4 Specification of Pricing Order transition period

- 3.4.1 For the purposes of the Act, the 'Pricing order transition period' is the period commencing on the Commencement Date and ending on the date on which, pursuant to clause 3.3, clause 3 ceases to apply.

4. PRICING PRINCIPLES: COST BASE FOR SETTING PRESCRIBED SERVICE TARIFFS**4.1 General – Accrual Building Block Methodology**

- 4.1.1 For the purposes of determining its Aggregate Revenue Requirement, the Port Licence Holder must apply an accrual building block methodology over the Regulatory Period comprising:
- (a) 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 Licence Holder in respect of the provision of the Prescribed Services (see clauses 4.2 and 4.3);
 - (b) an allowance to recover the return of its capital base (see clause 4.4); and
 - (c) an allowance to recover its forecast operating expenses, commensurate with that which would be required by a prudent service provider acting efficiently (see clause 4.5); less
 - (d) an indexation allowance (see clause 4.6).

4.2 Capital Base

- 4.2.1 Subject to clause 4.2.2, 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:
- (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 Licence Holder, 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.
- 4.2.2 The initial capital base is to be determined by applying the asset values specified in clause 4.7.
- 4.2.3 PCP Capital Expenditure is to be added to the capital base in accordance with the principles in clause 4.2.1.
- 4.2.4 The act of completing the Port Capacity Project and the act of undertaking capital works so as to comply with a term of the Port Lease or any other obligation arising under a Transaction Arrangement are to be taken to be prudent acts for the purposes of clause 4.2.1.
- 4.2.5 For the avoidance of doubt, clause 4.2.4 does not preclude an assessment as to whether capital expenditure undertaken so as to comply with a term of the Port Lease or any other obligation under a Transaction Arrangement has been incurred efficiently.
- 4.2.6 For the avoidance of doubt, the capital base of the Port Licence Holder must not include any value attributable to capital contributions made by a Public Sector Entity to assets used to provide Prescribed Services after the date of the completion of the first Authorised Transaction.

4.3 Return on Capital

- 4.3.1 Subject to clause 4.3.2, in determining a rate of return on capital for the purposes of clause 4.1.1(a) the Port Licence Holder 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.
- 4.3.2 The rate of return to be calculated for the purposes of clause 4.1.1(a) must be determined on a pre tax, nominal basis.

4.4 Return of Capital

- 4.4.1 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.
- 4.4.2 The Port Licence Holder 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 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 Services Tariffs through to the end of the Port Lease.

4.4.3 The return of capital allowance in any Financial Year must not be below zero.

4.5 Operating Expenses

4.5.1 For the avoidance of doubt, the allowance referred to in clause 4.1.1(c) is to include an amount equal to the Port Licence Fee and any Cost Contribution Amount payable under the Port Concession Deed in respect of the relevant Financial Year in which those expenses are incurred and such amounts are deemed to be commensurate with that which would be required by a prudent service provider acting efficiently.

4.5.2 Actions reasonably required to comply with the obligations of the Port Licence Holder under the Port Concession Deed are taken to be prudent acts for the purposes of clause 4.1.1(c).

4.6 Indexation Allowance

4.6.1 For each relevant Financial Year, the indexation allowance referred to in clause 4.1.1(d) is an amount equal to the sum of:

- (a) for the purposes of clause 4.2.1(b), the percentage change, or forecast percentage change, in the CPI for the relevant Financial Year, multiplied by the value of the capital base at the commencement of the relevant Financial Year; and
- (b) for the purposes of clause 4.2.1(c), one half of the percentage change, or forecast percentage change, in the CPI for the relevant Financial Year, multiplied by the efficient capital expenditure when incurred, or to be incurred during that Financial Year.

4.7 Initial Capital Asset Values

4.7.1 Despite any other clause of this Order, the initial capital asset values to be utilised to provide the Shared Channel Services and the Bundled Services are deemed to be as set out in the table below:

Service	Asset Value (A\$000,000's)	Date
Shared Channel Services	592	1 July 2016
Bundled Services	2,913	1 July 2016
Total	3,505	1 July 2016

4.7.2 For the avoidance of doubt, the initial capital asset values in the table in clause 4.7.1 exclude PCP Capital Expenditure, which is to be added to the capital base in accordance with the principles in clause 4.2.3.

5. COST ALLOCATION PRINCIPLES

5.1 Cost Allocation Principles Objectives

5.1.1 The objective of the Cost Allocation Principles is to provide a transparent and consistent methodology for allocating and monitoring costs for the purpose of setting Prescribed Service Tariffs.

5.2 Principles for allocating costs for the purpose of setting Prescribed Service Tariffs

5.2.1 Costs of the Port Licence Holder must be allocated between Prescribed Services and all other services provided by the Port Licence Holder in a manner consistent with the following cost allocation principles:

- (a) costs that are directly attributable to the provision of the Prescribed Service must be attributed to that Prescribed Service; and

- (b) costs that are not directly attributable to the provision of the Prescribed Service but which are incurred in the course of providing both one or more Prescribed Services and other services must be allocated to the Prescribed Service on the basis of its share of total revenue from all services provided by the Port Licence Holder,

(Cost Allocation Principles).

6. REFERENCE TARIFF SCHEDULE

6.1 Provision/Publication of Reference Tariff Schedule

- 6.1.1 No later than 31 May in each Financial Year, the Port Licence Holder must:
 - (a) publish its Reference Tariff Schedule for the following Financial Year;
 - (b) provide the Commission with a copy of its Reference Tariff Schedule for the following Financial Year; and
 - (c) provide the Commission with a copy of any contracts with Port Users of the kind described in clause 6.2.1 under which Prescribed Services are to be supplied in the following Financial Year.
- 6.1.2 The Port Licence Holder will satisfy the publication obligation in clause 6.1.1(a) if it publishes its Reference Tariff Schedule on its website.
- 6.1.3 The Port Licence Holder must provide its Reference Tariff Schedule, as published under clause 6.1.1(a), in writing to any Port User who requests it, within five (5) Business Days of receiving the request.
- 6.1.4 The Reference Tariff Schedule must specify:
 - (a) the Prescribed Service Tariff for each Prescribed Service offered by the Port Licence Holder; and
 - (b) a description of the Prescribed Service to which the Prescribed Service Tariff applies.
- 6.1.5 Prescribed Service Tariffs that are specified in the Reference Tariff Schedule must:
 - (a) not include charges or fees for services that are not Prescribed Services; and
 - (b) separately identify the Prescribed Service Tariffs for Shared Channel Services.
- 6.1.6 The Port Licence Holder must offer to provide Port Users with Prescribed Services in accordance with the Reference Tariff Schedule.
- 6.1.7 The Port Licence Holder must not require a Port User to acquire services that are not Prescribed Services in order for that Port User to be supplied with Prescribed Services.

6.2 Contracts for Prescribed Services

- 6.2.1 The Port Licence Holder may enter into a contract with a Port User for the supply of Prescribed Services on terms and conditions that:
 - (a) differ from those specified in the Reference Tariff Schedule; or
 - (b) do not satisfy the requirements in clause 6.1.5,but only if:
 - (c) the Port Licence Holder has first offered to provide those Prescribed Services to that Port User in accordance with the Reference Tariff Schedule (as required by clause 6.1.6); and
 - (d) the contracted terms and conditions comply with the principles set out in clauses 2.1.1, 2.1.2, 2.1.3 and 2.3.1.
- 6.2.2 For the avoidance of doubt, despite the entry into a contract with a Port User as contemplated by clause 6.2.1:
 - (a) the services provided under the contract remain Prescribed Services; and
 - (b) revenue from the Prescribed Services provided under all such contracts must be included in the Port Licence Holder's calculation of its Aggregate Revenue Requirement under clause 2.1.1.

6.3 Changes to Prescribed Service Tariffs

- 6.3.1 During a Financial Year and in addition to the requirements in clause 2.3.1, if the Port Licence Holder seeks to amend its Reference Tariff Schedule in order to charge for a new or additional service as part of a Prescribed Service, or for any other reason, it must:
- (a) notify Port Users and the Commission of its intention to do so by providing its proposed amendments to the Reference Tariff Schedule sixty (60) days prior to its earliest date of effect; and
 - (b) provide Port Users and the Commission with thirty (30) days notice of the final version of the amended Reference Tariff Schedule.
- 6.3.2 For the avoidance of doubt, if the Port Licence Holder amends its Reference Tariff Schedule in accordance with clause 6.3.1, from the date the amendments come into effect:
- (a) the new Reference Tariff Schedule will replace the previous Reference Tariff Schedule; and
 - (b) the obligations in clauses 6.1.3 to 6.1.7 and in clause 6.2 will apply in respect of the new Reference Tariff Schedule.

7. TARIFF COMPLIANCE STATEMENT

- 7.1.1 The Port Licence Holder must provide to the Commission a Tariff Compliance Statement:
- (a) no later than 31 May in each Financial Year; and
 - (b) where Prescribed Service Tariffs are to be varied or a new Prescribed Service Tariff is to be introduced, at the same time as it notifies Port Users and the Commission under clause 6.3.1(b).
- 7.1.2 The Tariff Compliance Statement must:
- (a) set out the Prescribed Service Tariffs for the forthcoming Financial Year (where clause 7.1.1(a) applies) or for the remainder of the Financial Year (where clauses 7.1.1(b) applies);
 - (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;
 - (d) set out the process by which the Port Licence Holder has effectively consulted and had regard to the comments provided by Port Users;
 - (e) explain how the Prescribed Service Tariffs comply with this 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.

8. INFORMATION REQUIREMENTS**8.1 Basis on which financial information is to be provided**

- 8.1.1 Subject to requirements for application of the accrual building block methodology in clause 4, any financial information provided in a Tariff Compliance Statement must specify whether it is denominated in constant or current price terms.

8.2 Forecasts and estimates

- 8.2.1 Information in the nature of an estimate or forecast must be supported by a statement of the basis of the forecast or estimate.

8.2.2 A forecast or estimate:

- (a) must be arrived at on a reasonable basis; and
- (b) must represent the best forecast or estimate possible in the circumstances.

8.3 Inferred or derivative information

8.3.1 Information in the nature of an extrapolation or inference must be supported by the primary information on which the extrapolation or inference is based.

9. COMMISSION MAY DETERMINE FORM AND CONTENT OF SUPPORTING DOCUMENTATION

9.1.1 The Commission may, from time to time, determine what constitutes ‘sufficient supporting information’ for the purposes of clauses 3.2.7, 3.3.2 and 7.1.2(f).

9.1.2 A determination under clause 9.1.1 may specify the form and content of information to be provided.

9.1.3 A determination under clause 9.1.1 must be published on the Commission’s website.

10. COMMISSION MAY DETERMINE INDICES TO BE USED

10.1.1 If any index or other externally published statistic or set of statistics referred to in this Order ceases to be published, changes in title or is otherwise amended in a material respect, the Commission may determine the appropriate replacement to be used.

11. INITIAL PRESCRIBED SERVICE TARIFFS

11.1.1 The Prescribed Service Tariffs that apply on and from the Commencement Date are those set out in the Schedule to this Order (**Initial Prescribed Service Tariffs**).

11.1.2 In the Initial Financial Year, the Port Licence Holder must not charge an amount for any Prescribed Service other than in accordance with the Schedule to this Order.

11.1.3 Despite any other provision of this Order, the Initial Prescribed Service Tariffs established under clause 11.1.1 are deemed to comply with the Pricing Principles and Cost Allocation Principles in the Initial Financial Year.

12. PROTECTED PROVISIONS

12.1.1 The following clauses of this Order are ‘protected provisions’ for the purposes of the Act:

- (a) clause 4.2.3 (Port Capacity Project);
- (b) clause 4.2.4 (efficient capital expenditure);
- (c) clause 4.4.1 (Depreciation Period);
- (d) clause 4.5.1 (Port Licence Fee); and
- (e) clause 4.7 (initial capital asset values).

13. REGULATORY PERIOD

13.1.1 The Port Licence Holder may determine the period of time over which to apply the Pricing Principles and Cost Allocation Principles (**Regulatory Period**). For the avoidance of doubt, the Port Licence Holder may adopt Regulatory Periods of different lengths over the term of the Port Lease.

14. DEFINITIONS

In this Order:

Act means the **Port Management Act 1995** (Vic.).

Aggregate Revenue Requirement has the meaning set out in clause 2.1.1(a).

Amended Rebalancing Application has the meaning set out in clause 3.2.13.

Annual Licence Fee has the same meaning as in the Act.

Authorised Transaction has the same meaning as in the **Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Act 2016** (Vic.).

Bundled Services means the Prescribed Services other than the Shared Channel Services.

Commencement Date has the meaning set out in clause 1.1.1.

Commission means the Essential Services Commission of Victoria established under Part 2 of the **Essential Services Commission Act 2001** (Vic.).

Cost Allocation Principles has the meaning set out in clause 5.2.1.

Cost Contribution Amount means the amounts payable by the Port Licence Holder under clause 27.1 of the Port Concession Deed.

CPI means the Consumer Price Index: All Groups Index Number, weighted average of eight capital cities published by the Australian Bureau of Statistics.

Dedicated Channels has the same meaning as in the Act.

Dedicated Channel Services means the provision of the Dedicated Channels.

Depreciation Period has the meaning set out in clause 4.4.1.

Export Pricing Decision means the decision of the Port of Melbourne Corporation to enhance competitiveness with the Port of Botany and other Australian container ports by:

- (a) reducing Prescribed Service Tariffs for full outbound container wharfage services by 2.5% from the price applicable at the start of the preceding Financial Year, at the start of each of the 2017, 2018, 2019 and 2020 Financial Years; and
- (b) from the start of the 2021 Financial Year and thereafter, setting prices for Prescribed Service Tariffs for full outbound container wharfage services at a percentage discount to the equivalent Prescribed Service Tariffs for full inbound container wharfage services that, expressed as a percentage, is the same or a greater percentage discount than was applicable in the 2020 Financial Year.

Final Rebalancing Application has the meaning given in clause 3.2.15.

Financial Year means a year commencing on 1 July in any calendar year and ending on 30 June of the immediately following calendar year.

Initial Financial Year means the Financial Year in which the Commencement Date occurs.

Initial Prescribed Service Tariffs has the meaning given in clause 11.1.1.

Interim Decision has the meaning given in clause 3.2.8.

March CPI means the CPI for the March quarter.

March CPI Release Date means the date the Australian Bureau of Statistics publishes the March CPI that enables the actual Tariff Adjustment Limit relevant to the Rebalancing Application, Amended Rebalancing Application or Final Rebalancing Application (as applicable) to be calculated.

PCP Capital Expenditure means:

- (a) as at 30 June 2016, A\$637 million; plus
- (b) expenditure on assets and services related to the Port Capacity Project incurred by either the Port of Melbourne Corporation or the Port Licence Holder after 30 June 2016.

PCP Completion means the date on which a final certificate of practical completion has been received by the Port Licence Holder in relation to both the roads and services package and the maritime works package for the Port Capacity Project.

Port Capacity Project means the development declared in the nomination order under the **Project Development and Construction Management Act 1994** (Vic.) dated 4 September 2012 and published in the Government Gazette on 7 September 2012.

Port Concession Deed means the Transaction Arrangement bearing that name.

Port Lease means the document of that name entered into pursuant to authorisation under the **Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Act 2016** (Vic.).

Port Licence Fee means the Annual Licence Fee.

Port Licence Holder has the same meaning as in the Act.

Port of Melbourne Waters means any waters which by Order in Council made under section 5(2) of the Act are declared to be port waters of the port of Melbourne.

Port User means a person who requests or receives Prescribed Services.

Prescribed Services has the same meaning as in the Act.

Prescribed Service Bundle means each of the following:

- (a) wharfage services for containerised cargo;
- (b) wharfage services for non-containerised/general cargo;
- (c) wharfage services for motor vehicle cargo;
- (d) wharfage services for liquid bulk cargo;
- (e) wharfage services for dry bulk cargo;
- (f) Shared Channel Services;
- (g) Dedicated Channel Services; and
- (h) any other Prescribed Services, or component or combination thereof, in respect of which the Port Licence Holder introduces new Prescribed Service Tariffs after the Commencement Date and which the Commission determines to be a Prescribed Service Bundle by notice in writing to the Port Licence Holder.

For the avoidance of doubt, each of items (a)–(g) above is a Prescribed Service Bundle. By way of example, ‘wharfage services for containerised cargo’ is a Prescribed Service Bundle and ‘Shared Channel Services’ is another Prescribed Services Bundle.

Prescribed Service Tariffs means the prices charged for the provision of, or in connection with, Prescribed Services.

Pricing Principles means the principles and requirements contained in clauses 2, 2.3.1 and 4.

Public Sector Entity has the same meaning as in the **Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Act 2016** (Vic.).

Rebalancing Application has the meaning set out in clause 3.2.4.

Reference Tariff Schedule means a schedule of Prescribed Service Tariffs that contains the information specified in clause 6.1.4.

Regulatory Period has the meaning set out in clause 13.1.1.

Shared Channels has the same meaning as in the Act.

Shared Channel Services means the provision of the Shared Channels.

Shared Channel Tariffs means the prices charged for the provision of Shared Channel Services.

Tariffs Adjustment Limit means 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.

Tariff Compliance Statement means the statement required to be provided by the Port Licence Holder to the Commission in accordance with clause 7 of this Order.

Transaction Arrangement has the same meaning as in the **Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Act 2016**.

Weighted Average Tariff Increase means, in respect of a Financial Year, the expected weighted average rate of increase in the Prescribed Service Tariffs using weightings based on historical revenues derived from the Prescribed Service Tariffs in the most recent Financial Year for which audited data are available or, if there is no historic audited data upon which to calculate the expected weighted average rate of increase on this basis, an alternative estimate of revenue for the purpose of calculating weightings on a basis determined by the Commission.

Dated 21 June 2016

Responsible Minister:
ROBIN SCOTT MP
Minster for Finance

ANDREW ROBINSON
Clerk of the Executive Council

SCHEDULE – INITIAL PRESCRIBED SERVICE TARIFFS[#][#]Applicable from the Commencement Date**WHARFAGE FEES**

Wharfage fees are charged per unit of quantity, volume or weight of cargo for all cargoes, including empty containers, loaded on or discharged from vessels or between vessels in the Port of Melbourne. Transhipment port fee rates are applicable in respect of cargo which is transhipped from the Port within 90 days of being discharged. The appropriate transhipment port fee rate is separately charged on both the inward and outward movements. Beyond 90 days, normal rates apply for both inward and outward cargo movements. Goods must be transhipped in the same cargo carrying unit for the transhipment port fee rates to apply.

	Until 30 June 2017 (inclusive)			From 1 July 2017 ¹		
	GST exclusive	GST	GST inclusive	GST exclusive	GST	GST inclusive
Containerised² – \$ per TEU³						
Full – outward	63.28	6.33	69.61	98.26	9.83	108.09
Full – inward	67.54	6.75	74.29	105.04	10.50	115.54
Full Bass Strait ⁴	70.14	7.01	77.15	70.14	7.01	77.15
Empty (including nested units) ⁵	16.76	1.68	18.44	16.76	1.68	18.44
Empty returns ^{5 & 6}	33.50	3.35	36.85	33.50	3.35	36.85
Infrastructure Fee⁷ – \$ per TEU³						
Full – outward and inward	37.50	3.75	41.25	–	–	–
Full Bass Strait ⁴	0.00	0.00	0.00	–	–	–
Non-containerised/general – \$ per tonne or cubic metre⁸	2.71	0.27	2.98	2.71	0.27	2.98
Accompanied passenger vehicles – \$ per tonne or cubic metre⁸	1.81	0.18	1.99	1.81	0.18	1.99
Motor vehicles⁹ – \$ per tonne or cubic metre⁸	3.06	0.31	3.37	3.06	0.31	3.37

¹ These prices are subject to escalation in accordance with clause 3 of this Order.

² Tautliners, Tassieliners and Straightliners up to and including 2.9 m in height are charged as containerised. Cargo carrying units in excess of 2.9 m in height are charged as non-containerised cargo.

³ TEU = Twenty-foot equivalent unit (6.1 m). Non-standard length containers are calculated on a pro rata basis.

⁴ Bass Strait cargo is defined as cargo that is loaded/unloaded from a port in Tasmania.

⁵ Except those on dedicated Bass Strait services.

⁶ Cargo carrying unit that only contains reusable packaging or dunnage.

⁷ The infrastructure fee is levied to recover the costs of the Channel Deepening Project.

⁸ Charges are based on the greater of weight or volume of the cargo.

⁹ Motor vehicles include all vehicles new and second-hand primarily designed for the transportation of passengers or goods. It includes special purpose vehicles such as ambulances, fire fighting, police and breakdown vehicles, mobile cranes, road sweepers and concrete mixers.

Motor vehicles exclude:

- (i) all agricultural, earthmoving and construction machinery including tractors, cultivators, harvesters, balers, mowers, rollers, bulldozers, scrapers, excavators and shovel loaders; and
- (ii) accompanied passenger vehicles.

WHARFAGE FEES						
Liquid bulk – \$ per tonne or cubic metre	4.07	0.41	4.48	4.07	0.41	4.48
Dry bulk – \$ per tonne						
Inwards – overseas and coastal ¹⁰	3.25	0.33	3.58	3.25	0.33	3.58
Outwards – overseas and coastal ¹⁰	2.35	0.24	2.59	2.35	0.24	2.59
Transhipment¹¹						
Standard charge	35% of the published rate			–		
Full – outward – \$ per TEU ¹²	–			39.87	3.99	43.86
Full – inward – \$ per TEU ¹²	–			42.39	4.24	46.63
Other	–			35% of the published rate		
Infrastructure Fee ⁷	For the infrastructure fee the following specific transhipment rule applies: (i) transhipment cargo is charged at 50% of the standard infrastructure rate except where a transhipment includes a Bass Strait movement, then the full infrastructure fee will be charged on the non-Bass Strait movement.			–		

CHANNEL FEES

Channel fees are charged for the provision of channels for use by vessels in Port of Melbourne waters and the provision of associated services. Channel fees are levied once per ship visit on the gross tons (GT) of vessels using the channels or in other manners specified for the provision of channel related services.

	GST exclusive	GST	GST inclusive
Vessels up to and including maximum summer draught¹³ of 12.10 m			
Shared channels – \$ per GT	0.1814	0.0181	0.1995
Dedicated channels – \$ per GT	0.3546	0.0355	0.3901
Vessels exceeding maximum summer draught¹³ of 12.10 m			
Shared channels – \$ per GT	0.1935	0.0194	0.2129
Dedicated channels – \$ per GT	0.4140	0.0414	0.4554
Reduced channel fees are applicable to the following (percentage of full charge)			
Pure car carrier ¹⁴			75%

¹⁰ Coastal cargo is defined as cargo that is loaded/unloaded from an Australian port (including Bass Strait).

¹¹ Transhipment cargo is defined as cargo that is unloaded from one vessel in the port and reloaded for export on another vessel.

¹² This rate is based on the infrastructure fee-inclusive transhipment price that applied until 30 June 2017.

¹³ The maximum summer draught is the vertical distance in metres measured from the lowest point of a ship's hull to the summer load line. The maximum summer draught is as detailed in Lloyds Register or similar.

¹⁴ Applies only to vessels with GT: Dead weight tonnage ratio equal to or greater than 2:1 and which are carrying not less than 70% motor vehicles. Motor vehicles include all vehicles new and second-hand primarily designed for the transportation of passengers or goods. It includes special purpose vehicles such as ambulances, fire fighting, police and breakdown vehicles, mobile cranes, road sweepers and concrete mixers.

Passenger cruise vessel	90%
Coastal liner vessel ¹⁵	60%
Vessels using Dedicated and Geelong channels on the same entry to Port Phillip Bay ¹⁶	75%
Exempt vessels (no channel fee)	
<i>Tugs and barges based in Melbourne</i>	
<i>Tugs and barges based in Geelong are exempt from shared channel fees</i>	
<i>Vessels less than 200 GT</i>	
<i>Royal Australian Navy (RAN) and the approved guests of the RAN, cadet and training vessels</i>	
<i>Other vessels under special circumstances¹⁷</i>	

BERTH HIRE FEES

Berth hire is a time based fee charged for the provision of berths for the purpose of loading or discharging specialised cargo and lay-up or other approved purpose.

Berth hire does not apply to the Royal Australian Navy (RAN) and approved guests of the RAN.

Full charge

The full charge is calculated on total time of the vessel at berth from the first line ashore to last line cast-off. Cost is calculated to the nearest one-tenth of an hour, rounded upwards.

Lay-up charge

Lay-up use includes:

- mooring at a berth for a period greater than four hours before cargo operations;
- mooring at a berth for a period greater than two hours after completion of cargo operations; and
- mooring at a berth by vessels not intending to transfer cargoes.

Use of a berth for lay-up is solely at the discretion of the Port Licence Holder.

Any berth use designated by the Port Licence Holder for lay-up use will be charged at the hourly rate calculated on total time of the vessel at berth from the first line ashore to last line cast-off. Cost will be calculated to the nearest one-tenth of an hour, rounded upwards.

Motor vehicles exclude: (i) all agricultural, earthmoving and construction machinery including tractors, cultivators, harvesters, balers, mowers, rollers, bulldozers, scrapers, excavators and shovel loaders; and (ii) accompanied passenger vehicles.

¹⁵ Applies only to vessels operating as a 'common carrier' with a fixed schedule of greater than two visits per week between Melbourne and at least one fixed interstate destination that is published in advance.

¹⁶ Applies only to Dedicated channel charges.

¹⁷ Subject to the specific approval of the Port Licence Holder in advance.

¹⁸ Cargo operations is defined as the time taken for actual cargo transfer only, at all applicable lay-up berths (excluding Maribyrnong No.1 and Holden Dock).

Concessions

The Port Licence Holder is to consider applications for concessions to these charges in the event that vessels are delayed in unmooring or required to moor early at the request of the Harbour Master.

The Port Licence Holder is also to consider applications to waive full charge berth hire for the time cargo operations did not occur on the gazetted Victorian public holidays of Good Friday, ANZAC Day and Christmas Day.

Concessions are to be calculated to the nearest one-tenth of an hour, rounded upwards.

	GST exclusive	GST	GST inclusive
Full charge – \$ per hour			
Maribyrnong No. 1	351.80	35.18	386.98
Holden Dock	466.20	46.62	512.82
Passenger cruise ships at a berth other than Station Pier ¹⁹	580.00	58.00	638.00
Lay-up charge²⁰ – \$ per hour	123.00	12.30	135.30

WHARF ACCESS FEES

Wharf access is a fee for the provision of facilities at common user areas within the Port of Melbourne for the purpose of loading/unloading dry bulk and breakbulk cargo directly to or from a vehicle. This charge is in lieu of an area hire charge.

Wharf access is charged:

- at 6 Yarraville and F Appleton Dock;
- when breakbulk and/or dry bulk cargo is loaded directly to or from a vehicle; and
- when no area hire charge is applicable.

	GST exclusive	GST	GST inclusive
Cargo – \$ per tonne	0.93	0.09	1.02

¹⁹ To apply only when vessels can not be accommodated at Station Pier.

²⁰ Lay-up charges are applicable at the following berths: 24 Victoria Dock; Holden Dock; Maribyrnong No. 1; 24, 27, 28, 29 & 33 South Wharf; 6 Yarraville and F Appleton Dock.

AREA HIRE FEES

Area hire is a fee charged for the provision of a common user area within the Port of Melbourne for the purpose of storage of cargo discharged from, or to be loaded on to, a vessel.

The area hire charge is calculated on total time from the earlier of the start of storage of export cargo before the arrival of the vessel, or start of storage of import cargo, until the later of the finish of storage of import and/or export cargo.

Area hire charges do not apply on the gazetted Victorian public holidays of Good Friday, ANZAC Day and Christmas Day.

Area hire is charged at double rate for periods of use earlier than three days (72 chargeable hours) before vessel arrival and for periods of use later than three days (72 chargeable hours) after finish of vessel discharge. Cost is calculated to the nearest one-tenth of an hour, rounded upwards.

	GST exclusive	GST	GST inclusive
Area hire – \$ per hour			
Standard rate – 6 Yarraville	69.40	6.94	76.34
Standard rate – F Appleton Dock	45.10	4.51	49.61

TANKER INSPECTION FEES

Tanker inspection charges are fees charged for the necessary or mandatory safety and compliance inspection of tankers berthing at the following facilities:

- Holden Dock;
- Maribyrnong No. 1 (hazardous tankers only); and
- 6 Yarraville (hazardous tankers only).

	GST exclusive	GST	GST inclusive
Inspection – \$ per inspection	700.13	70.01	770.14

OTHER GANGWAY HIRE FEES

Other gangway hire is a charge for the provision of non-passenger gangways to ships.

Hirers are responsible for the transfer of gangways to/from the wharf (if applicable) and the placement of the gangway on and off the vessel. The Master of the vessel is responsible for the proper placement of a gangway, including the installation of a gangway net and all other Australian Maritime Safety Authority requirements. Other gangway hire is applicable at all wharves (special arrangements apply at Maribyrnong No. 1 and 33 South Wharf).

	GST exclusive	GST	GST inclusive
Other gangway hire – \$ per day or part thereof (minimum charge 24 hours)	211.20	21.12	232.32

WHARF INSPECTION FEES

Wharf inspection (if required) is a fee to inspect the wharf before the vessel arrives and after the vessel departs.

	GST exclusive	GST	GST inclusive
Pre-vessel arrival inspection – \$ per each inspection	934.10	93.41	1027.51
Post-vessel departure inspection – \$ per each inspection	934.10	93.41	1027.51

This page was left blank intentionally

bluestar*PRINT

The *Victoria Government Gazette* is published by Blue Star Print with the authority of the Government Printer for the State of Victoria

© State of Victoria 2016

This publication is copyright. No part may be reproduced by any process except in accordance with the provisions of the Copyright Act.

Address all enquiries to the Government Printer for the State of Victoria

Level 2, 1 Macarthur Street

Melbourne 3002

Victoria Australia

How To Order**Retail &
Mail Sales****Victoria Government Gazette**

Level 5, 460 Bourke Street
Melbourne 3000

PO Box 1957 Melbourne 3001

DX 106 Melbourne

**Telephone**

(03) 8523 4601

**Fax**

(03) 9600 0478

email

gazette@bluestargroup.com.au

Price Code B