



25 October 2019

Price Monitoring and Regulation Division - Transport
Essential Services Commission
Level 37, 2 Lonsdale Street
MELBOURNE VIC 3000

Via email: transport@esc.vic.gov.au

Re: Port of Melbourne – Market Rent Inquiry 2020, Scope and Process Paper

Thank you for the opportunity to make a submission to the Essential Services Commission's (ESC) Scope and Process Paper.

Port of Melbourne (PoM) is generally supportive of the scope and process for the inquiry as set out in the ESC's paper, and looks forward to working with the ESC on the inquiry. Below, we offer some comments on some of the key issues raised in the ESC's scope and process paper.

Definition of the market

As noted by the ESC, the 'relevant market' that is the subject of the inquiry is 'the market for access to leased port of Melbourne land by means of an applicable lease'.¹

PoM notes that it may also be relevant to consider product and geographic dimensions of the market when defining the market that is the subject of the inquiry, and in particular, the availability of substitutes. For example, some tenants may have a specific operational need for access to leased port of Melbourne land (for which there may be limited substitutes), whereas some tenants may value proximity to the port for commercial reasons (e.g. to reduce supply chain costs), for which there are many available substitutes.

Definition of market power

The Scope and Approach Paper refers to a widely used definition of market power, being the ability of a firm to profitably sustain prices above competitive levels, which the ESC equates to marginal costs.²

While PoM does not dispute this definition of market power (as it is widely applied in competition analysis), we note that competitive price levels for land rentals will not necessarily be equivalent to marginal costs. PoM recognises that the ESC's Scope and Process paper also generally refers to

¹ Port Management Act 1995, Section 53.

² ESC Scope and Process Paper, p.7

prices in the context of valuations of market rents.³ As such, PoM suggests that in considering competitive price levels for land rentals, the ESC also has regard to the concept of 'market value'. Market value is used by valuers of real property, the International Valuation Standards Council and business valuers in Australia, and is set out by the Australia Taxation Office (ATO) as follows⁴:

...the price that would be negotiated in an open and unrestricted market between a knowledgeable, willing but not anxious buyer and a knowledgeable, willing but not anxious seller acting at arm's length

Importantly, market value is distinct from cost, which the ATO notes is the result of a historic transaction, whereas market value can vary through time and circumstances and will not necessarily be consistent with cost.⁵

Assessment of market power

PoM supports the main factors identified by the ESC as likely to be relevant to the assessment of market power, being:

- The existence of barriers to entry
- Whether tenants' have any countervailing market power, and
- The potential for tenants to find substitute land in other ports.⁶

With respect to countervailing market power, PoM notes that most tenants are large businesses of significant size and commercial significance, with strong bargaining power.

In relation to substitute land, PoM suggests that in addition to considering whether tenants are able to find substitute land in other ports, it will be relevant to consider whether tenants can substitute to other land in general. Many tenants have the option or ability to locate their operations on land that is not within a port boundary, but have made a commercial decision to operate in or near to the port rather than an alternative location.

The ESC notes that it will consider any other factors which may indicate the Port of Melbourne has market power in the land rental market.⁷ PoM considers that the regulatory environment is an important consideration in an assessment of market power. As noted in Appendix A of the Scope and Process Paper, in conducting the inquiry under section 53 of the *Port Management Act 1995* (Vic) (PMA), the ESC must have regard to PoM's compliance with any processes for setting and reviewing rents required under a port of Melbourne lease.⁸

The Port Concession Deed (PCD) sets out the requirements around terms and timeframes for market rent reviews and also conditions around new leases established by PoM. In its Scope and Approach Paper, the ESC correctly defines these arrangements as a negotiate-arbitrate regime.⁹

Process for setting and reviewing rents

The ESC notes that in its initial desktop review, the process for setting and reviewing rents does not appear to be well documented in the public domain. The ESC suggests some parties may be put at a

³ ESC Scope and Process Paper, p.13

⁴ See ATO website on market valuations for tax purposes <https://www.ato.gov.au/General/Capital-gains-tax/In-detail/Market-valuations/Market-valuation-for-tax-purposes/?anchor=Meaningofmarketvalue>

⁵ Ibid.

⁶ ESC Scope and Process Paper, p.8

⁷ ESC Scope and Process Paper, p.8

⁸ Port Management Act 1995, Section 53.

⁹ ESC Scope and Process Paper, p.11

disadvantage if they are not able to access this information, although it also recognises that this may not be a cause for concern.¹⁰

The port was leased on the basis of an established negotiate-arbitrate model that has been in place in all of the Australian landlord ports for many years, and, as such, port-related tenants and the industry more broadly will be familiar with the process. The specifics of the negotiate-arbitrate regime are set out in the PCD, which is a confidential agreement between the Government and PoM. In general, it is not common practice for the steps in commercial negotiations to be publically available. However, in so far as individual tenants are concerned, PoM considers that sufficient information on setting and reviewing rents is readily available in individual lease agreements.

While PoM is required to abide by the rent setting and reviewing procedures in the PCD, the leases all contain their own provisions concerning market rent reviews, and the specific terms that apply to each tenant are confidential.

Notwithstanding the above, PoM would welcome further discussions with the ESC on the availability of information on the negotiate-arbitrate regime that applies to access to leased Port of Melbourne land.

Contact

If you have any questions about this submission, or for further information requests relating to the inquiry, please contact Michael Black, Head of Regulation, on 0438 394 274.

A handwritten signature in black ink, appearing to read 'D Mutzelburg', written over a horizontal line.

Darryl Mutzelburg
Chief Financial Officer

¹⁰ ESC Scope and Process Paper, p.10

