Tariff Rebalancing consultation draft

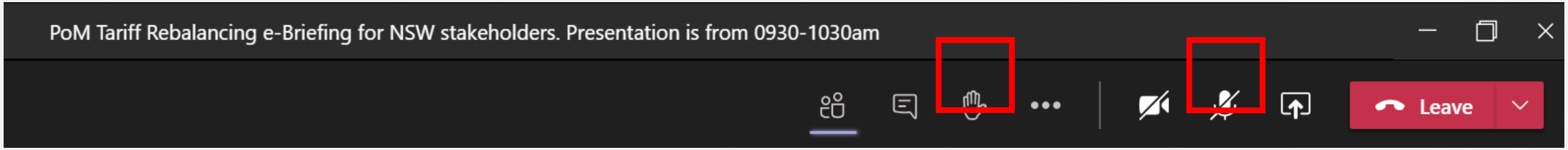
November 2020

Port of Melbourne

Session details

Please note, in order to facilitate a productive session:

- All participants will be muted (audio and video) whilst the presenter is talking
- We will unmute audio and allow for Q&A
  - Please use the 'Raise your hand' function to communicate with the presenter



- At the end of the presentation, we will have a further Q&A
- Written responses can also be made to **rts@portofmelbourne.com**

Agenda

1. Purpose of the second phase of stakeholder engagement
2. Context – why rebalance tariffs?
3. Overview of the rebalancing proposal
4. Summary of the first phase of stakeholder engagement
5. Feedback from stakeholders to-date
6. Compliance with the Pricing Order
7. Feedback and next steps

1. Purpose of the second phase of stakeholder engagement

In the **first phase** of stakeholder engagement (Sept-Oct), PoM sought to:

- Explain the drivers of rebalancing
- Test the relative demand from different Port Users for the investments driving the need to rebalance
- Test options for tariff structure and levels

The purpose of this **second phase** (Nov-Dec) is to ensure stakeholders:

- Understand our proposal and how it will affect them
- Can test and clarify that PoM has correctly understood their feedback
- Can provide feedback on PoM's compliance evidence

Consultation material

- Consultation drafts of the Rebalancing Application are on PoM's website:
  - Rebalancing application
  - Reference Tariff Schedule
  - Regulatory models
- PoM is seeking feedback by **11 December 2020** by email to rts@portofmelbourne.com

2. Context – why rebalance tariffs?

Larger vessels are changing the service needs of Port Users

- Larger vessels have only recently begun to visit the port, but the potential for significant and rapid change is clear
- Big ships investment program ($80-$90M) is designed to meet this trend

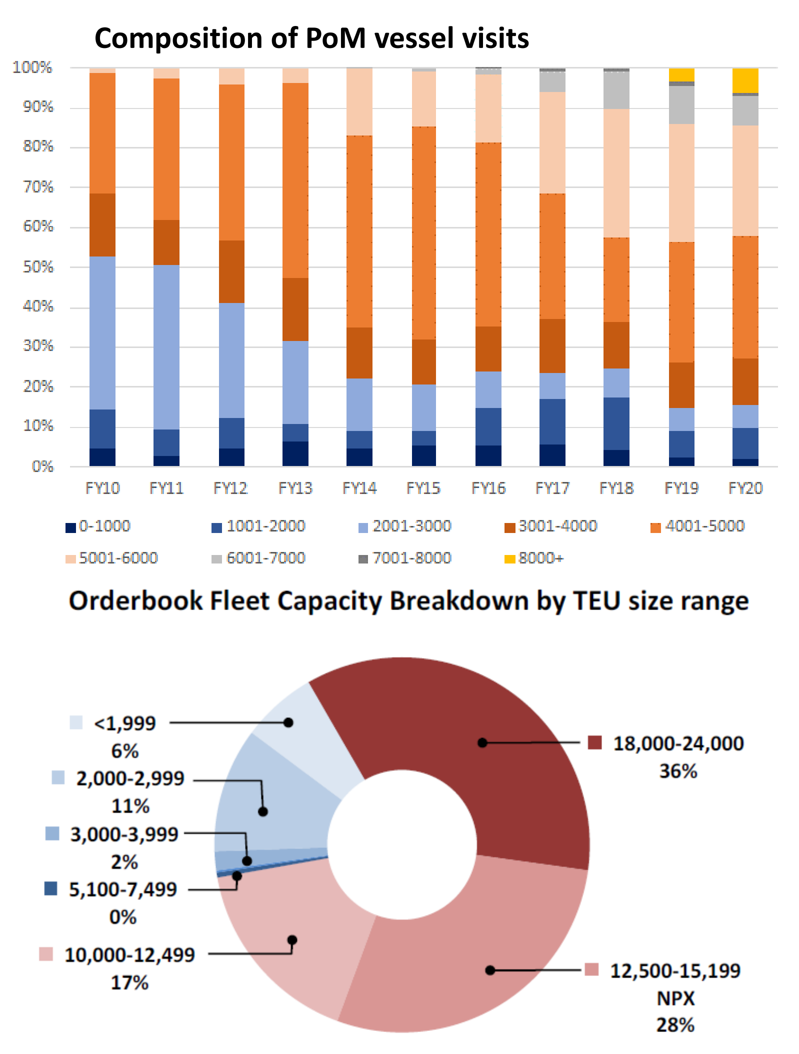
However, there are challenges

- PoM is already not recovering its efficient costs, and has adequate capacity to meet forecast TEU throughput in the near term
- Some stakeholders will benefit from future investments under the big ships investment program and support it, and some stakeholders will not benefit and do not support future investment
- PoM's ability to fund investment in new services that do not materially impact trade volumes during the TAL period is limited

The purposes of rebalancing tariffs are twofold

- To better align tariff signals with marginal investment costs for larger vessels that some Port Users are driving
- To support improved port utilisation by Port Users who are not driving these marginal investment costs

Figure 1: vessel visits and new builds



3. Overview of the rebalancing proposal

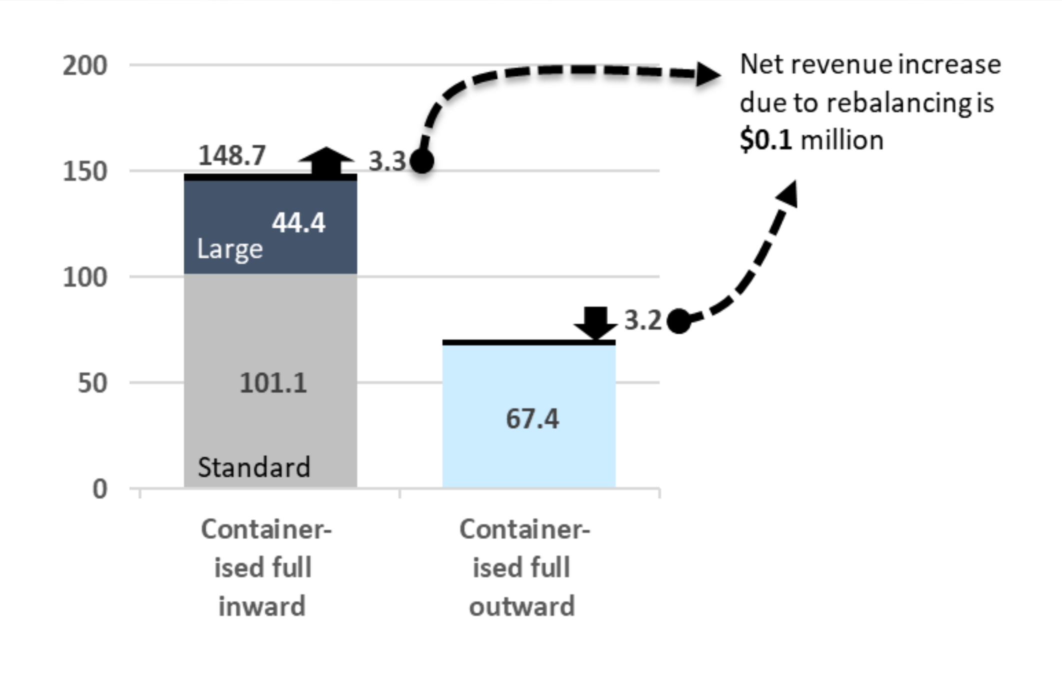
Rebalancing proposal

The tariff rebalancing generates an incremental price signal to larger vessels, signalling the additional cost impost on the port of providing services:

1. The current wharfage fee for full – inward containers ($/TEU) will be discontinued and replaced with:
    - a wharfage tariff for full import containers that is **$10/TEU higher** than the current rate, applying to vessels that exceed either 300m LOA or 40m beam; and
    - a wharfage tariff **at the historical rate (adjusted for CPI)**, for ships that do not exceed the design threshold (effectively a continuation of the current tariff)
2. The wharfage fee for full – outward containers would be **decreased by $3.77/TEU** to support export trade growth

The net effect of PoM's rebalancing is a $100,000 revenue increase in 2021-22 compared to the default revenue outcome (calculated under the WATI) if there was no tariff rebalancing.

Figure 2: Forecast revenue movement 2021-22



Actual tariff and revenue movements will be subject to changes in CPI, data on historical actual revenues (i.e. the weights in the WATI), and demand.

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4. Summary of the first phase of stakeholder engagement

- **11 forums and meetings** with Port Users and other stakeholders identified as being impacted by, or likely to have an interest in, the Tariff Rebalancing Application
- Around **980 stakeholders** were invited, and around **200 stakeholders** participated in these engagement activities
- Presentation materials were sent to all invitees (i.e. 980 recipients), and stakeholders were provided with four weeks from the date that materials were circulated to respond.

We received **12 submissions** from:

- Shipping lines and their representatives
- Cargo owners and their representatives
- International Container Terminal Operators
- Industry/academia

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5. Feedback from stakeholders to-date

Issue	Feedback	PoM response
Investment need	• Most stakeholders support the need to invest to provide services to larger vessels • Some stakeholders objected to the Webb Dock East components of the investment on the grounds of excess capacity at Swanson Dock	• The rebalancing proposal is intended to accommodate those who want the investment, while accounting for the concerns of those who do not • PoM's targeted rebalancing to split the inbound wharfage fee into standard and large vessels will have much less impact on Port Users that use Swanson Dock

Objectives
Cost recovery, efficient pricing signals, growth and competitiveness
	• While supporting the investment in services to larger vessels, shipping lines raised concerns about cost recovery:
	  ○ Cost recovery should only apply to new investment not considered as part of the purchase of the port
	  ○ Investing to support larger vessels was known at the time of the Port Lease and so not new
	• An exporter noted all companies invest and aren't always able to change tariffs to meet expenses.
	• Stakeholders also raised concerns about competitiveness of pricing in the Australian market
		• Cost recovery is one of the key principles of the regulatory framework established by the Victorian Government for the lease of the port.
		• This principle applies to both:
		  ○ Assets in place at the time the port lease was granted (via the Initial Capital Asset Values set by the Government in the Pricing Order) and
		  ○ all subsequent prudent and efficient investment, regardless of whether it was foreseen at the time of the port lease transaction or not.
		• PoM has proposed a small rebalancing adjustment at the lower end of those under consideration, so PoM's tariffs remain competitive with Port Botany

Explainer – cost recovery under the Regulatory Framework

The Pricing Order requires efficient cost recovery, cl.2.1.1(a):

> *Prescribed Service Tariffs must be set so as 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)*

The amount paid for the Port Lease has no impact on prices.

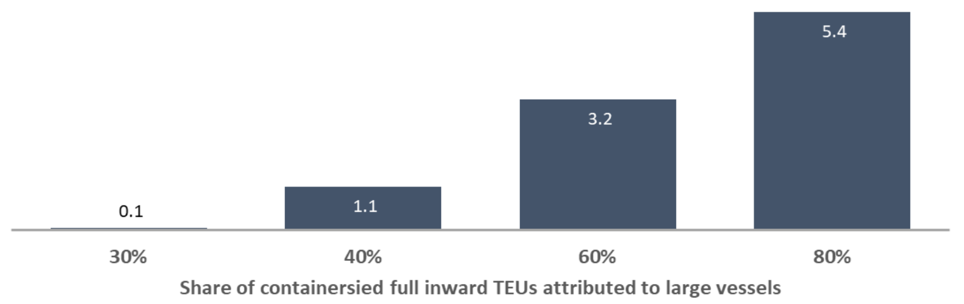
Prices are based on a regulated revenue allowance calculated using the Building Block approach, comprising:

- Existing asset values determined by the Government ($4.1bn as per the Pricing Order), in place before the Port Lease
- Prudent and efficient investments incurred, or to be incurred, by PoM, since the Port Lease
- Prudent and efficient operating expenses.

PoM is not entitled to recover more than its efficient costs

- If it is projected that growth in trade would cause tariffs to over-recover PoM's efficient costs, tariffs must be reduced to remain within the total regulated revenue allowance
- PoM's projected under-recovery in 2021-22 is ~$160M
- Even under dramatic increases in the proportion of containers imported on large vessels, it will be many years before PoM is recovering its costs

Figure 3: Impact on annual revenue if share of containers on large ships increases ($ Million)



5. Feedback from stakeholders to-date (continued)

Issue	Feedback	PoM response

Tariff structure and design
User pays
	• Most stakeholders support the principle of user pays
	• Some support for the large vessel threshold, however Shipping lines proposed alternative constructions, including vessels that exceed:
	  o 300m LOA <u>and</u> 40m beam
	  o the current Swanson Dock limits
	• IFCBAA disagreed with the approach to recovering costs from imports only
		• Absent rebalancing, the costs of investments to support larger vessels would be spread more broadly across tariffs levied on all Port Users, including smaller vessels, automotive, liquid bulk operators, and the Tasmanian trades, who do not use or benefit from the infrastructure in question.
		• The draft proposal retains the threshold of 300m LOA or 40m beam, on the basis that:
		  o Increases in length or beam can increase weight, which requires investment to support safe berthing
		  o The current limits have been achieved with investment under the big ships strategy
		• The head-haul direction of trade (imports) determines the required level of capacity investment. On this basis, we consider that an increase to the import tariff is consistent with user pays principles.

Tariff structure and design Wharfage fees or channel fees	• Most stakeholders supported wharfage fees as transparent and efficient • Some stakeholders preferred channel fees on the basis that the benefits of investments accrue to vessel owners.	• Both wharfage and channel fees are levied on vessels. However, as the main costs relate to wharves for container ships, wharfage fees for containers are the appropriate cost recovery mechanism. To the extent that costs are passed through the supply chain, TEU-based charges appear more transparent.

5. Feedback from stakeholders to-date (continued)

Issue	Feedback	PoM response
Tariff structure and design Indicative tariff levels	• Most stakeholders recognised that large vessels offered significant savings (approx. USD100/TEU), but also raised concerns about the level of tariff increase and potential impacts on competition • Stakeholders generally recognised that while exports are cost sensitive and reductions will assist trade growth, other costs are more significant.	• PoM consulted on tariff increases of $10-$20/TEU. • Stakeholder feedback suggested smaller tariff adjustments would be preferred. Therefore, we settled on the lowest of the options consulted on, which is a $10 increase in the inward tariff. • Stakeholder feedback suggests that access to scale efficiencies will more than offset this increase. • Reducing the costs of exports to grow trade is aligned with the policy of reducing export prices
Tariff structure and design Transaction costs and port user response	• Limited feedback was provided on transaction costs, although some shipping lines noted that differentiated wharfage charges would increase complexity in rate setting • Some stakeholders suggested that the tariff rebalancing would deter shipping lines from deploying larger vessels, while some stakeholders suggested that it would not.	• PoM's noted the rebalanced tariffs rely on existing billing systems and vessel size data, as such are unlikely to create material new costs. • PoM considers it unlikely that the size of the tariff adjustment would unduly impact shipping lines' decisions to deploy larger vessels, particularly in light of the savings identified. • However, we note the concerns raised by some stakeholders, and uncertainty around savings (which rely on utilisation, trade vessel availability, etc.). Therefore, the draft proposal is to adopt an increase in the wharfage fee at the lower end of the range ($10/TEU).

6. Compliance with the Pricing Order

The rebalanced tariffs comply with the Tariffs Adjustment Limit (March-March CPI) (clause 3.1.1)

- The estimated March20-March21 change in CPI is 0.66%, which will be updated for actual March Quarter data
- The draft Weighted Average Tariff Increase (WATI) for Prescribed Services is 0.66% for 2021-22

Verified in the Regulatory Model, available on PoM's website

The rebalanced tariffs have regard to pricing efficiency (clause 2.1.3)

- The efficient costs caused by different Port Users (clause 2.1.3.i)
- Transaction costs of its tariff structures (clause 2.1.3.ii)
- Possible Port User response to the rebalanced tariffs (clause 2.1.3.iii)

Sections 4 and 5 in the Consultation Draft Rebalancing Application

6. Compliance with the Pricing Order (continued)

The price differentials for different users of containerised wharfage services are consistent with the objectives in the Port Management Act (clause 2.1.2)

Objective	Compliance evidence – see section 4 and 5 in the Rebalancing Application
Efficiency | to promote efficient use of, and investment in, the provision of prescribed services for the long-term interests of users and Victorian consumers	• Port Users driving investment to accommodate large ships pay a greater contribution to the costs than those who are not driving new investment
Fairness | to protect the interests of users of prescribed services by ensuring that prescribed prices are fair and reasonable whilst having regard to the level of competition in, and efficiency of, the regulated industry;	• Aligned with the user pays principles supported by most stakeholders • Absent rebalancing the costs would be spread more broadly across other Port Users, including smaller vessels, automotive, liquid bulk operators, and the Tasmanian trades.
Cost recovery | to allow a provider of prescribed services a reasonable opportunity to recover the efficient costs of providing prescribed services, including a return commensurate with the risks involved	• Absent rebalancing, PoM is not likely to have a reasonable opportunity to recover the costs of the investments. The rebalancing is expected to provide a net improvement in cost recovery, but not exceed it • PoM is not entitled to over-recover it costs, and must to demonstrate this to the ESC annually in its Tariff Compliance Statements
Competition | to facilitate and promote competition— (i) between ports; and (ii) between shippers; and (iii) between other persons conducting other commercial activities in ports	• Competition between shipping lines will be supported by enabling shipping lines to differentiate their prices based on vessel sizes they employ • Splitting the inbound wharfage into standard and large vessels will have less impact on Port Users that use Swanson Dock and mean that on average, vessels visiting Swanson Dock will pay lower tariffs for regulated services than Port Users that use Webb Dock

6. Compliance with the Pricing Order (continued)

Forecast revenues comply with clause 4 and clause 5 of the Pricing Order

- Forecast revenues are less than the efficient regulated cost base determined using the Accrual Building Block Method (clause 4), determined in compliance with the cost allocation principles (clause 5)
- Forecast revenues fall within the efficient cost bounds of standalone cost and avoidable cost (clause 2.1.1(b))

Figure 4: Forecast revenue under-recovery 2021-22 ($M)

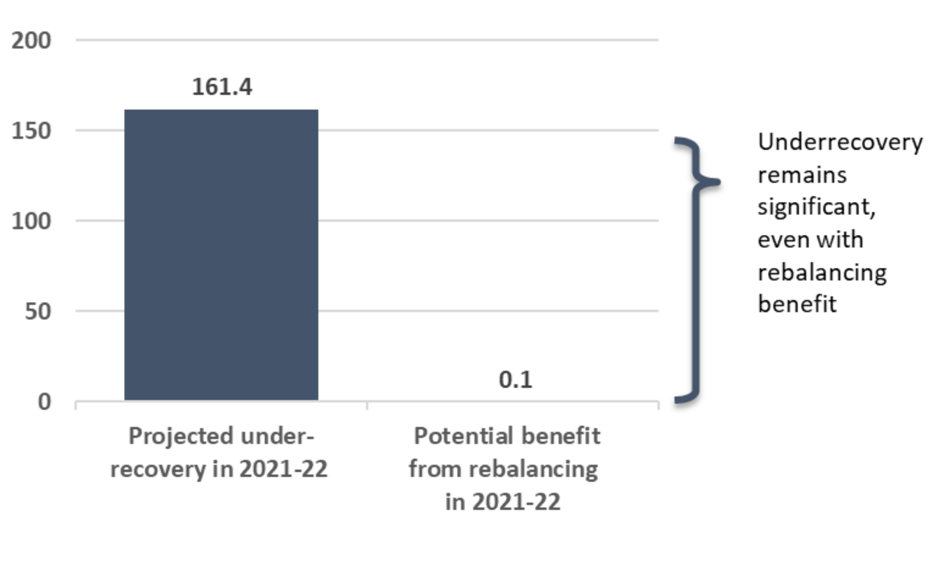
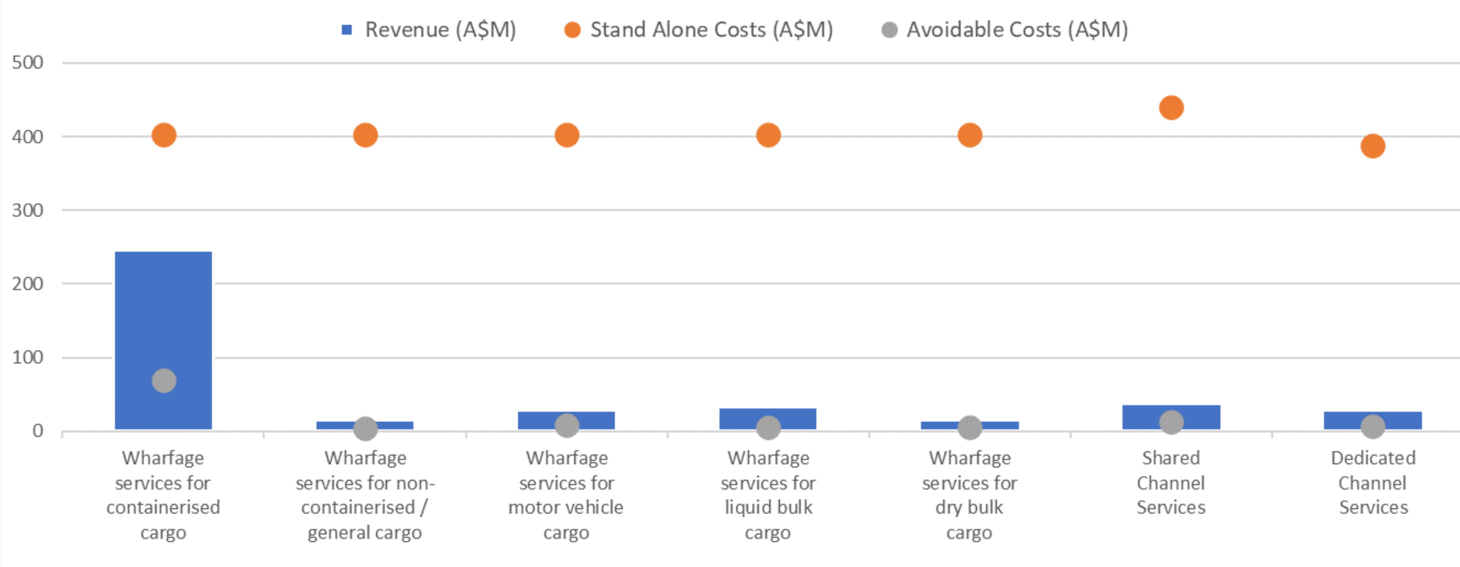


Figure 5: Revenue compared to efficient cost bounds 2021-22 ($ Million)



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7. Feedback and next steps

- **November:** Phase 2 engagement with Port Users and other stakeholders consultations to obtain feedback on the draft proposal
- **11 December 2020**: Port User and other stakeholder consultations to obtain feedback
- **End-December 2020**: Rebalancing Application submission to the ESC
- **March 2021**: ESC Interim Decision on Rebalancing Application
- **July 2021**: if the Rebalancing Application is approved by the ESC, rebalanced tariffs will commence from 1 July 2021.

Feedback by 11 December

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