31 May 2024

2024-25 Tariff Compliance Statement

General Statement

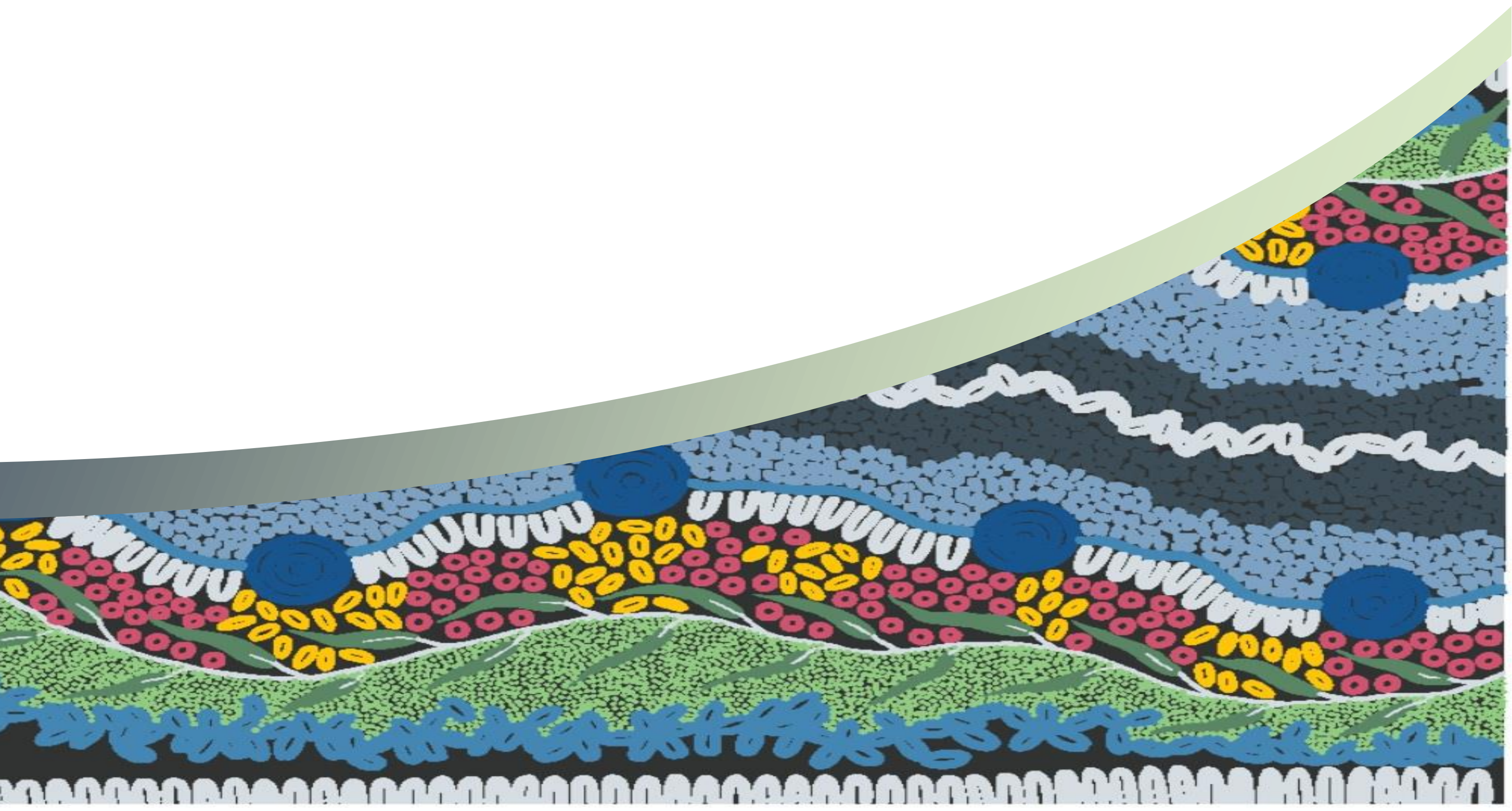
Port of Melbourne

Acknowledgement of Country

Port of Melbourne acknowledges Bunurong, Wadawurrung, and Wurundjeri Peoples of the Kulin Nation as the Traditional Custodians of the land and waters on which our business operates.

We recognise and value their unique cultural heritage, customs, spiritual beliefs and relationship with the land. We pay our respects to their Elders past, present and emerging, and to all Aboriginal and Torres Strait Islander peoples across the communities in which we work.

We acknowledge that we work on the unceded land of Aboriginal and Torres Strait Islander peoples. We recognise the past wrongdoings and injustices against Aboriginal and Torres Strait Islanders and the ongoing inequalities that continue today.



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CEO foreword

I am pleased to present Port of Melbourne's 2024-25 Tariff Compliance Statement.

As Australia's largest container and general cargo port, the Port of Melbourne plays an integral role in the lives of our community and the economy of south-eastern Australia. The port facilitates more than a third of Australia's container trade, making us a key driver of economic activity, with flow-on benefits that are delivered beyond the port gate.

Last year, at the start of the five-year regulatory period we committed to a capital expenditure program of over $700m to deliver projects that are in the long-term interests of Victorian consumers and the economy. This is the second year of our established five-year regulatory period and we continue to report annually to the Essential Services Commission.

This Tariff Compliance Statement includes details on tariffs, updates on stakeholder engagement, major projects and our performance against forecasts.

Over the next 12 months we're focused on ensuring we can accommodate future growth at the port and will start the refresh of our Port Development Strategy. We look forward to working with our tenants, government, the Essential Services Commission, and our broader stakeholder network to accommodate future growth at the port.

Saul Cannon

Chief Executive Officer

Port of Melbourne

Executive summary

Our 2024-25 Tariff Compliance Statement

This document forms part of our annual Tariff Compliance Statement (TCS) to the Essential Services Commission (ESC). It demonstrates how our tariffs for Prescribed Services for the next financial year within the current regulatory period comply with the Pricing Order. Prescribed Services include the provision of channels, berths, short-term storage and access to wharves, roads and rail.[1] Leasing of space and facilities on port land is classified as a non-prescribed service and is not covered by this TCS.[2]

This is the second year of our established five-year regulatory period, which runs from 1 July 2023 until 30 June 2028. This TCS includes details on tariffs for 2024-25 and provides updates on stakeholder engagement, major projects and our performance against forecasts.

Our prices are set to increase at the rate of inflation

In last year's TCS[3] we determined that our Prescribed Services Tariffs for the regulatory period from 2023-24 to 2027-28 would be subject to the Tariffs Adjustment Limit (TAL), which requires that our Weighted Average Tariff Increase (WATI) be no more than the annual change in the Consumer Price Index (CPI).

Accordingly, in 2024-25 all tariffs for Prescribed Services will increase by 3.62% (subject to rounding), which is the rate of increase in CPI over the year to 31 March 2024. We have not made a rebalancing application to the ESC for the tariffs to apply in 2024-25, so all tariffs have been increased by the same percentage amount (before rounding) and there are no new or discontinued tariffs.

Our 2024-25 tariffs are set out in the accompanying Reference Tariff Schedule (RTS) and are effective from 1 July 2024 (Appendix A).

Table E.1 WATI and TAL, 2023-24 to 2027-28 regulatory period

	2023-24	2024-25	2025-26	2026-27	2027-28
Weighted Average Tariff Increase	7.02%	3.62%	CPI - 0%	CPI - 0%	CPI - 0%
Tariffs Adjustment Limit	7.02%	3.62%	CPI (March 2024 to March 2025)	CPI (March 2025 to March 2026)	CPI (March 2026 to March 2027)

We continue to engage with our stakeholders and track our progress

As part of establishing the five-year regulatory period we undertook a significant engagement program that allowed us to identify our stakeholders' topics of interest. This has since informed planning for communications and engagement, and our annual reporting to the ESC on Prescribed Services engagement. We remain focused on developing project-specific, fit-for-purpose engagement programs across the organisation.

[1] Prescribed Services are defined in section 49(1)(c) of the *Port Management Act 1995* (Vic).
[2] The ESC undertakes periodic reviews of our rental agreements with port tenants in accordance with section 53 of the *Port Management Act* (Victoria) 1995.
[3] Our 2023-24 Tariff Compliance Statement is available on our website. Please refer to this document for further details on how Port of Melbourne's 2024-25 Prescribed Service Tariffs comply with the Pricing Principles and Cost Allocation Principles defined in the Pricing Order.

We recently conducted and published our second Stakeholder Pulse Survey to measure reputation, factors underpinning reputation, and performance across a range of attributes. The results show that stakeholders recognise our increased focus on engagement, with more than half of surveyed stakeholders acknowledging an improvement in engagement over the past year.

We remain committed to continuous refinement as we further embed our established internal process and engagement-focused culture.

We are continuing to invest in the port to deliver services to Port Users and progress the long-term interests of Victorian consumers

At the start of the five-year regulatory period we committed to a capital expenditure program of over $700m to deliver projects that are in the long-term interests of Victorian consumers:

- Maintaining services in accordance with our obligations under the Port Concession Deed, including the Swanson Dock West Remediation and periodic dredging
- Preparing for the next phase of investment in container capacity, including planning and design work for the Port Capacity Enhancement Program (PCEP)
- Closing out existing growth programs, including the Port Rail Transformation Project (PRTP), Webb Dock East 4&5 Berth Extension.

Of the nine major capital projects and programs that we planned to commence or deliver during the current regulatory period all remain on track, noting works continue to transition PRTP from manual to automated signalling.

Over the next 12 months, in addition to continuing to deliver on the five-year forecast, we will start the refresh of our Port Development Strategy.

Responding to the ESC's Interim Commentary

The ESC's Interim Commentary on our 2023-24 TCS noted an improvement on prior years' submissions. Further to this, the ESC acknowledged our efforts to improve stakeholder engagement, the enhancements we have made to our processes and methods to forecast demand, operating expenditure and capital expenditure.

The ESC's Interim Commentary also provided its preliminary views on the uncertainty mechanisms that we proposed to manage the risks of uncertain capital projects and unforeseen events on expenditure forecasts. The ESC observed that uncertainty mechanisms like these can play an important role in making longer regulatory periods sustainable and that they are a common feature in other frameworks, but expressed a preliminary view that they are not permitted under the Pricing Order.

We remain of the view that the uncertainty mechanisms we proposed for the current regulatory period would enhance the incentive properties of the regulatory regime and promote the long-term interests of Port Users and Victorian consumers. We also agree with the ESC that these uncertainty mechanisms are important in making longer regulatory periods sustainable.

However, having considered the ESC's Interim Commentary, we have decided that we will not implement the uncertainty mechanisms for uncertain capital projects and unforeseen events in the absence of further clarity as to their availability, or an amendment to the Pricing Order that provides for uncertainty mechanisms. This means we are taking on additional risks during the current regulatory period. If any changes in costs arise that would have triggered our uncertainty mechanisms, these will be borne by Port of Melbourne. In particular, if expenditure on PCEP exceeds the planning and design costs outlined in the 2023-24 TCS, we will incur a windfall loss (equal to the financing costs of expenditure above forecast) that is unable to be recovered.

The ESC also commented on components of the weighted average cost of capital (WACC). We remain of the view that our WACC for the current regulatory period was prepared using well accepted approaches. The approaches we used are consistent with approaches that the ESC identified as well accepted in its five-year Inquiry into compliance with the Pricing Order and in its Statement of Regulatory Approach. In response to the ESC's commentary, in this TCS we have considered whether there are other approaches that would also be well accepted and will give further consideration to these issues when preparing our Aggregate Revenue Requirement for the next regulatory period.

1 About this TCS

1.1 Purpose

Every year, the Port of Melbourne (PoM) is required to submit a Tariff Compliance Statement (TCS) to the ESC. In each TCS we demonstrate how tariffs for the upcoming financial year comply with the Pricing Order, a regulatory instrument issued by the Governor in Council under section 49A of the *Port Management Act 1995* (Vic) (PMA).

The Pricing Order regulates tariffs for Prescribed Services, which include the provision of channels, berths, short-term storage, and access to wharves, roads and rail.[4] Leasing of space and facilities on port land is not classified as a Prescribed Service and is not covered in this TCS.

In last year's TCS we adopted a five-year regulatory period for the first time since the beginning of the Pricing Order. The regulatory period is the span of time over which over which we forecast the revenue required to recover the prudent and efficient costs of providing Prescribed Services — the Aggregate Revenue Requirement (ARR). This is done in accordance with the Pricing Principles and Cost Allocation Principles set out in the Pricing Order.

This year's TCS covers tariffs for 2024-25, the second year of our five-year regulatory period. As the first 'within-period' TCS, the content differs from that of previous TCSs. Our rate of return and our forecasts of costs and trade volumes — which determined the ARR established at the beginning of the regulatory period — have been set for five years and have not been revisited.

This TCS focusses on elements of compliance that must be demonstrated annually, as well as other material to keep the ESC and Port Users informed about relevant matters. This includes:

- Setting out the Prescribed Service Tariffs for 2024-25 (**chapter 2**)
- Providing an update on engagement with stakeholders over the past 12 months (**chapter 3**)
- Summarising progress on major projects included in the five-year regulatory period forecast (**chapter 4**)
- Reviewing the performance of our expenditure and trade forecasts against the most recently available full-year actual data (2022-23) (**chapter 5**)
- Addressing issues concerning the rate of return on capital raised in the ESC's Interim Commentary on the 2023-24 TCS (**chapter 6**).

The content of this within-period TCS follows the approach previously presented to the ESC and is informed by the ESC's Interim Commentary (section 1.2).[5]

Accompanying this General Statement are several supporting appendices:

- The Reference Tariff Schedule for 2024-25 (**Appendix A**)
- A Tariff Compliance Model demonstrating how 2024-25 tariffs comply with key Pricing Order requirements (**Appendix B**)
- Details of our TCS governance and assurance processes (**Appendix C – confidential**)
- Further analysis comparing actual capital and operating expenditure to forecasts (**Appendices D** and **E – confidential**)
- Independent expert reports addressing issues concerning the rate of return on capital (**Appendices F** and **G**)

[4] Prescribed Services are defined in section 49(1)(c) of the *Port Management Act* 1995 (Vic).
[5] ESC, Interim Commentary on the 2023-24 TCS, 20 December 2023, p.15

- A summary of how this TCS complies with each clause of the Pricing Order (**Appendix H**)
- A register of other supporting documents provided to the ESC (**Appendix I – confidential**).

1.2 Our response to the ESC's Interim Commentary

On 20 December 2023 the ESC released its Interim Commentary on the Port of Melbourne's 2023-24 TCS. The Interim Commentary sets out the ESC's initial observations on our compliance with the Pricing Order with respect to the tariffs to apply in 2023-24 in advance of the next compliance inquiry due in 2026.

The ESC considered that our 2023-24 TCS was a further improvement on prior years and recognised that we have addressed a number of the issues it raised in previous commentaries.[6] The ESC was encouraged by our efforts to continually improve stakeholder engagement, and acknowledged the enhancements we have made to our processes and methods to forecast demand, operating expenditure and capital expenditure.[7] The ESC also reiterated its support for our adoption of a five-year regulatory period, which it considers serves the long-term interests of Port Users.

The ESC's Interim Commentary also provided its preliminary views on the uncertainty mechanisms that we set out in the 2023-24 TCS to manage the risks of uncertain capital projects and unforeseen events on expenditure forecasts.[8] We set out these mechanisms in the 2023-24 TCS to address the heightened expenditure forecast risk associated with moving from a one-year regulatory period (with expenditure forecasts set for one year) to a five-year regulatory period (with expenditure forecasts set for five years). The ESC observed that uncertainty mechanisms like these can play an important role in making longer regulatory periods sustainable and that they are a common feature in other similar economic regulatory frameworks, but expressed a preliminary view that such mechanisms are not permitted under the Pricing Order.[9]

We agree with the ESC that mechanisms to manage uncertain or unforeseen events are important for the sustainability of longer regulatory periods, and that such mechanisms promote the objectives of the regulatory regime and are in the long-term interests of Port Users and Victorian consumers. However, having considered the ESC's Interim Commentary, we have decided that we will not implement the uncertainty mechanisms for uncertain capital projects and unforeseen events in the absence of further clarity as to their availability, or an amendment to the Pricing Order that provides for uncertainty mechanisms. This means we are taking on additional risks during the current regulatory period. If any changes in costs arise that would have triggered our uncertainty mechanisms, these will be borne by PoM. In particular, if expenditure on PCEP exceeds the planning and design costs outlined in the 2023-24 TCS, we will incur a windfall loss (equal to the financing costs of expenditure above forecast) that is unable to be recovered.

The ESC's Interim Commentary also raised two issues related to our rate of return on capital. Namely, our proposed approach to 'true up' the trailing average cost of debt and our benchmark gearing. The ESC's preliminary views on these issues and our responses are set out in chapter 6.

1.3 Financial information and terminology

All financial information provided in this TCS is denominated in nominal dollars (referred to as "current price terms" in clause 8.1.1 of the Pricing Order), unless otherwise stated. Financial information for 2016-17

[6] Essential Services Commission 2023, [Interim Commentary on the 2023-24 TCS](), 20 December 2023, p. iv
[7] Essential Services Commission 2023, [Interim Commentary on the 2023-24 TCS](), 20 December 2023, pp. iv, xi, 22 & 26
[8] See pp. 48–49 of our [2023-24 TCS]() for further details of these mechanisms.
[9] Essential Services Commission 2023, [Interim Commentary on the 2023-24 TCS](), 20 December 2023, pp. vi-vii & 1

to 2022-23 are actual values and financial information for 2023-24 to 2027-28 reflect forecast values for the five-year regulatory period (as provided in the 2023-24 TCS), unless otherwise stated.

Numbers in tables may not sum due to rounding. All clause references relate to the Pricing Order, unless otherwise stated. Capitalised terms that are not otherwise defined have the meaning given in the Pricing Order.

2 Tariffs in 2024-25

In 2024-25 all tariffs for Prescribed Services will increase by 3.62% (subject to rounding). This increase is equal to the rate of increase in the Consumer Price Index (CPI) over the year to 31 March 2024. Our 2024-25 tariffs are set out in the accompanying Reference Tariff Schedule (RTS) and are effective from 1 July 2024 (Appendix A).

Tariffs have been set to comply with the requirements of the Pricing Order.[10] The Pricing Order defines a 'Pricing Order transition period' which runs until 2032 at earliest, or 2037 at latest.[11] During the Pricing Order transition period, a price smoothing mechanism limits tariffs to the lesser of two constraints:

- The Tariffs Adjustment Limit (TAL), which limits weighted average annual tariff increases to the rate of inflation (CPI)[12], or
- To recover no more than PoM's prudent and efficient costs of providing Prescribed Services, determined by the application of an accrual building block methodology over the regulatory period.[13]

In last year's TCS, in accordance with these requirements, we determined a weighted average tariff increase of 0% in real terms for each year of the five-year regulatory period (Table 2.1).[14] This means that the average tariff increase in each year of the regulatory period (2023-24 to 2027-28) cannot exceed the rate of inflation.

Consistent with the requirements of the Pricing Order, we confirm that, for 2024-25:

- All tariffs have been increased by the same percentage (before rounding)
- There are no new or discontinued tariffs
- The tariff for full outbound container wharfage services is set at the same percentage discount to the tariff for full inbound container wharfage services that was applicable in the 2020 Financial Year
- The Weighted Average Tariff Increase (WATI) does not exceed the TAL.[15]

Table 2.1 WATI and TAL, 2023-24 to 2027-28

	2023-24	2024-25	2025-26	2026-27	2027-28
Weighted Average Tariff Increase	7.02%	3.62%	CPI - 0%	CPI - 0%	CPI - 0%
Tariffs Adjustment Limit	7.02%	3.62%	CPI (March 2024 to March 2025)	CPI (March 2025 to March 2026)	CPI (March 2026 to March 2027)

[10] The Pricing Order and the *Port Management Act* are available on our website.
[11] Pricing Order, clause 3.4
[12] Pricing Order, clause 3.1
[13] Pricing Order, clause 2.1.1(a)
[14] See pp. 48–49 of our 2023-24 TCS for further details on how PoM's 2024-25 Prescribed Service Tariffs comply with the Pricing Principles and Cost Allocation Principles defined in the Pricing Order.
[15] Our calculations demonstrating that the Weighted Average Tariff Increase does not exceed the Tariffs Adjustment Limit are provided at Appendix B.

3 Stakeholder engagement update

3.1 Overview

This chapter describes how we have effectively engaged with stakeholders since the last TCS[16] and had regard to their feedback in our decision making.[17] The engagement discussed in this chapter builds on an extensive engagement program undertaken prior to the submission of last year's TCS in which we established a five-year regulatory period. The engagement methodology adopted as part of that program provided us with a platform to hear from stakeholders regarding their preferred topics of interest. Table 3.1 details the topics of interest and a high-level summary of related engagement activity.

In this TCS (and future within-period TCS submissions) we report on our stakeholder engagement against these topics. The reporting covers our engagement processes with Port Users, the issues they raised and the feedback we have received. It also outlines how we have considered the views of Port Users.

The ESC's Interim Commentary recognised that our engagement processes "continue to improve and build on the learnings" from previous engagement.[18] We remain committed to continuous refinement as we further embed our established internal process and engagement-focused culture.

Table 3.1 Engagement activities by topic in 2023-24

Port of Melbourne's role	Looking ahead	Rail	Sustainability	Engagement
Service provider, ambassador, business developer and strategic partner	Future industry trends and impacts	Future of port rail	Plans, initiatives, goals and our social licence to operate	What we heard and how we shared information
25 stakeholders informed regarding annual dredging activity	**18 formal submissions** received from PCEP stakeholders ——— **4 stevedore PCEP** workshops focused on future capacity	**8 rail stakeholders** consulted regarding procedures for rail operations within the port ———	MoU agreed with **7 stakeholders** to explore the feasibility of a green methanol hub at the Port ——— **57 participants** completed SECNewgate sustainability survey	Webb Dock East letterbox drop to **298 households** ——— **33 boat tours** attended by various industry people ——— **57 participants** completed Stakeholder Pulse Survey

[16] Specifically, this chapter covers stakeholder engagement activity which took place between 1 April 2023 and 31 March 2024.
[17] As required under clause 7.1.2(d) of the Pricing Order.
[18] Essential Services Commission 2023, Interim Commentary on the 2023-24 TCS, 20 December 2023, p. 25

3.2 Our process and regulatory requirements

When we develop our communications and engagement approach, we do so collaboratively with our internal teams to ensure we develop a project-specific, fit-for-purpose implementation plan. This includes the application of:

- Our Pricing Order Engagement Protocol (POEP), based on the requirements in the Pricing Order, which allows us to chart out our process and approach including stakeholder mapping
- The IAP2 Public Participation Spectrum to appropriately assign a relevant level of involvement to each identified stakeholder
- The ESC's Statement of Regulatory Approach (SoRA v3.0) which guides us to demonstrate how we have engaged effectively and identified what we heard, how we closed the loop, and how Port Users inform our decision making (Table 3.2).[19]

While the POEP, IAP2 and SoRA are key to how we develop, deliver and close out our engagement programs, we have commenced implementation of these key elements business wide in our everyday communications and engagement, including non-regulated activity, under the umbrella of our Stakeholder Engagement Framework principles.

Table 3.2 Process and regulatory requirements

<table>
<tr><th colspan="7">Stakeholder Engagement Framework
Our principles</th></tr>
<tr><th>Genuine</th><th colspan="2">Inclusive</th><th>Timely</th><th>Transparent</th><th>Accountable</th><th>Continuous Improvement</th></tr>
<tr><th colspan="7">Pricing Order Engagement Protocol</th></tr>
<tr><td colspan="2">Identify need</td><td colspan="2">Plan approach</td><td>Implement</td><td>Port user feedback</td><td>Consideration and decision making</td></tr>
<tr><th colspan="7">IAP2 Public Participation Spectrum</th></tr>
<tr><td colspan="2">Inform</td><td colspan="2">Consult</td><td>Involve</td><td>Collaborate</td><td>Empower</td></tr>
<tr><td colspan="2">We will provide balanced, objective, accurate and consistent information to support stakeholders to understand issues, opportunities, and solutions.</td><td colspan="2">We will seek feedback from stakeholders, listen to concerns and aspirations and inform them of the outcome of their feedback.</td><td>We will work directly with stakeholders to ensure their needs are directly and consistently understood and considered, and provide feedback on the outcome of their contribution.</td><td>We will partner with stakeholders, including: development of alternative plans, decision-making, and identifying preferred solutions.</td><td>We will engage with stakeholders to build networks, create opportunities and empower groups to lead the development of initiatives. Stakeholders are enabled / equipped to actively contribute to the achievement of outcomes.</td></tr>
<tr><th colspan="7">Statement of Regulatory Approach v3.0</th></tr>
<tr><td colspan="3">Details of consultation process with Port Users</td><td colspan="2">Issues raised and feedback provided by Port Users</td><td colspan="2">How the Port has taken into account the views of Port Users when making decisions</td></tr>
</table>

[19] Essential Services Commission 2022, Statement of Regulatory Approach — version 3.0: Port of Melbourne Pricing Order, 20 December.

3.3 Continuing our stakeholder engagement uplift

Our stakeholder engagement program is underpinned by continuing efforts to improve our engagement processes and embed engagement practices across our business. Over the last year we have developed an internal strategy and tested our newly developed internal process, tools and templates with key project managers across a range and scale of projects (Table 3.3).

We have established a dedicated stakeholder relations team and executive-level representation. This structure aims to ensure we have an umbrella view of our opportunities across all business functions, allowing for customisation and subsequently, more positive interface with external stakeholders, particularly as we progress and gain awareness within our surrounding communities.

Table 3.3 Stakeholder Engagement Uplift activities in 2023-24

- Achieved internal executive endorsement of the Port of Melbourne Stakeholder Engagement Uplift Strategy and rollout plan
- Established an internal process and use of templates, including within our project stage gate process (Enterprise Project Management Framework, or EPMF)
- Activated our new Stakeholder Relationship Management (SRM) tool and delivered training to support widespread adoption across the business
- Undertook formal IAP2 training sessions (July & September) for key internal people, including the Port Capacity Enhancement Program team members and project managers.
- Appointed dedicated stakeholder engagement leads for regulated and non-regulated engagement
- Commissioned our second annual pulse survey - Stakeholder Perceptions Research by SEC Newgate (January 2024) – detailed in section 3.4.3

3.4 Stakeholder engagement in 2023-24

3.4.1 Major projects engagement

In last year's TCS we outlined nine major capital projects and programs that we planned to commence or deliver during the regulatory period. Three of these projects were the subject of engagement programs in 2023-24, the details of which are described below. An update on the status of all major projects is provided in chapter 4.

3.4.1.1 Port Capacity Enhancement Program

In September 2023 we completed 12 months of engagement (Stage One) on PCEP. As highlighted in the 2023-24 TCS, engagement included public forums and written feedback (Round one). International Container Terminal Operator workshops (Round two) were underway, and engagement remained open.

We subsequently delivered a third round of engagement which concluded the Stage One engagement program. Round three was focused on formal submissions to achieve final versions of three expert technical reports.

The engagement program is highlighted below (Table 3.4).

Table 3.4 PCEP Stage One engagement program delivery outline

Engagement stage		Engagement source materials	Engagement period
Round one	Stakeholders and Community – Broad reaching engagement and formal submissions	• Trade Demand Forecasts prepared by BIS Oxford Economics (BISOE), *August 2022* • Ship Fleet Forecasts prepared by GHD Advisory, *September 2022* • Container Capacity Review prepared by Black Quay Consulting, *September 2022*	September 2022 to February 2023 Materials published 7 September 2022
Round two	Stevedore workshops	• Trade Demand Forecasts prepared by BIS Oxford Economics (BISOE), *December 2022* • Ship Fleet Forecasts prepared by GHD Advisory, *December 2022* • Container Capacity Review prepared by Black Quay Consulting, *January 2023*	March 2023 to July 2023 Materials published 13 February 2023
Round three	Stakeholders - Formal submissions	• Trade Demand Forecasts prepared by Deloitte, *June 2023* • Ship Fleet Forecasts prepared by GHD Advisory, *July 2023*	July 2023 to September 2023 Materials published 10 July 2023
Stage one complete		• Trade Demand Forecasts prepared by Deloitte, *September 2023* • Ship Fleet Forecasts prepared by GHD Advisory, *September 2023* • Container Capacity Review prepared by Black Quay Consulting, *September 2023*	21 September 2023

A comprehensive PCEP Stage One Engagement Summary Report, September 2023 is available on our website at Port Capacity Enhancement Program - Port of Melbourne.

The Stage One engagement program was delivered at the *inform, consult* and *involve* levels of the IAP2 Public Participation Spectrum. Given engagement at the *consult* and *involve* levels is designed to inform decision making, Table 3.5 provides a summary of alignment with Stage One engagement to the ESC's principles for assessing compliance as outlined in the SoRA v3.0.

Table 3.5 PCEP Stage One engagement delivery with regard to the SoRA v3.0

SoRA v3.0 principle	How we followed this principle
Start engagement early in its planning of projects, programs, and other initiatives.	PCEP is in the feasibility phase of a project lifecycle. Stage One engagement (September 2022 – September 2023) informed the forecasted future capacity of the Port, including stevedore investment as

The engagement should be ongoing, to keep testing proposals with Port Users and stakeholders.	part of establishing Scenario B4, which will be used as the basis of a Cost Benefit Analysis. As part of concluding Stage One, we acknowledged in our bespoke submission responses, that stakeholders identified other areas of interest. To ensure due diligence and as part of our continuous steps to gather data across engagement programs, in the future we will undertake work to understand heavy vehicle movements, the road and rail network, environmental, sustainability and safety elements. Development of the PCEP Stage Two engagement program is underway.
Ensure engagement process prioritises matters that have a significant impact on the Port's services and prices.	Delivery of the PCEP Stage One Engagement program responded to the needs of our stakeholders. We heard in Round one that stevedores wanted genuine and ongoing engagement, as such, the purpose of one-on-one stevedore workshops (Round two) was to: • Provide and discuss methodology and forecast inputs • Gain additional insights and data from stevedores that might inform the capacity analysis • Inform decision making and data to enhance the port capacity analysis. To reach a conclusion on trade, ship fleet and capacity forecasts, Round three engagement sought Port User feedback to determine final versions of the trade and ship fleet forecasts, and any additional feedback on capacity. We heard from 18 stakeholders including industry groups and associations, supply chain representatives, cargo owners, retail cargo owners, shipping lines, stevedores and the union.
Demonstrate that the engagement is genuine and clearly communicates the level of influence stakeholders will have on the decision.	Our engagement approach was communicated at the inform and consult level at commencement, and ultimately achieved the involve level through stevedore workshops. As demonstrated in Table 3.4 above, ongoing engagement regarding forecasts resulted in: • Four iterations of the Trade forecast • Four iterations of the Ship Fleet forecast; and • Three iterations of the Capacity forecast. Our engagement program was extended significantly and on more than one occasion following stakeholder feedback.
Tailor the form of engagement to suit the content on which it is seeking to engage, and to the circumstances facing Port Users and stakeholders.	Given the complexity of these topics, following Round one broad reaching engagement and formal submissions, workshops were held with each of the stevedores in March and in May 2023 to more suitably address capacity forecasting as it related to the operating assumptions of existing stevedores in a confidential manner and with subject matter experts in attendance.
Provide participants in its engagement process with appropriate information, given the purpose, form and the content of the engagement.	Engagement source materials are identified in Table 3.4 above. Adequate lead time was provided with materials published on the PCEP webpage and electronic Direct Mail (eDM) used to notify stakeholders of updates. Lines of enquiry for Stage One evolved and were refined from Round one to Round three to reflect updates in the analysis and feedback received.
Demonstrate how stakeholder feedback has influenced its decisions, including communicating to participants how their input influenced the decision.	Engagement has informed final reports on trade, ship fleet and capacity forecasts, and aided to identify next steps. PCEP Stage One Engagement Report – what we heard – Key technical themes discussed include: • Capacity modelling assumptions • Capacity modelling methodology • Cost Benefit Analysis scope and approach • Ship fleet • Stakeholder Engagement processes • Trade Demand.

3.4.1.2 Webb Dock East 4&5 Berth Extension

In December 2023 we reached practical completion of the Webb Dock East Extension project. The project involved demolishing a redundant section of concrete – 'the knuckle' – and extending the quay line by 71 metres to allow larger ships to offload as well as restoring the intended design capacity of the area to a two-berth operation.

In July 2023, we provided a project works notification to 298 households – engaging at the *inform* level of the IAP2 Public Participation Spectrum – with contact details for further information or enquiry. Information was provided in advance of extended work hours and overnight dredging, which was likely to result in ambient noise, and monitored as requested by the Environment Protection Authority.

We received no complaints or enquiries during or following the works period, and as such closed the loop at project completion via website and social media platforms.

3.4.1.3 Maintenance Dredging Program

We have ongoing obligations under the Port Concession Deed (PCD) to perform maintenance and capital dredging to maintain declared depths, to ensure the safety of Port Users and the safe navigability of vessels (clauses 5.1, 5.2 and Schedule 1).

The 2022-23 Dredging Program duration was shortened, and the cost reduced, by using a Trailing Suction Hopper Dredger (TSHD) Gateway, with approximately four times the capacity of typical dredgers used for maintenance campaigns. As a result, the 2023 dredging campaign ran for a period of seven weeks compared to approximately 20 weeks for a typical maintenance program of the same scope.

Based on low levels of interest and enquiry during and following the 2021-22 Dredging Program, engagement was predominantly delivered at the *inform* level of the IAP2 Public Participation Spectrum.

Stakeholder mapping identified many relevant stakeholders to notify of works, including Ports Victoria, service owners, special interest groups and bay tourism operators, government and local council, port customers and Port User stakeholders.

Prior to the commencement of works, notification was provided to these stakeholders, via letters and emails, directing to the PoM Dredging webpage as a single source of truth. This webpage was updated to include information on timing, areas of dredging, a fact sheet and a Notice to Mariners.

In addition to engagement with the Harbor Master, one recreational diving company was engaged at the *consult* level of the IAP2 Public Participation Spectrum. Where possible, dredging was timed to mitigate disruption and a direct line of communication established with this local operator with frequent updates on dredging locations.

3.4.1.4 2022-23 Backhoe Dredger (BHD) Scope Dredging Program

Further dredging across a smaller footprint was carried out from November 2023 to early February 2024. With a significantly smaller footprint and no complaints or enquiries following the 2022-23 Dredging Program, engagement was delivered at the *inform* level of the IAP2 Public Participation Spectrum to a reduced number of key stakeholders. We worked with Ports Victoria to on-communicate as the relationship owner around Station Pier.

An additional six-week program was completed in April 2024, with prior notification again delivered to identified stakeholders.

3.4.2 Sustainability engagement

Our sustainability engagement with tenants, while in its infancy, has evolved throughout the period 1 April 2023 to 31 March 2024. PoM commenced engagement with Port Users to:

- Understand port-wide climate risk and greenhouse gas emissions issues
- Identify port wide opportunities to lead and support decarbonisation
- Meet PoM's obligations for reporting on current and emerging regulations.

This engagement will continue through 2024-25.

In our Stakeholder Pulse Survey, we also identified stakeholders' interest in sustainability issues and sought feedback on our sustainability reporting mechanisms, as outlined in the following section.

3.4.3 Stakeholder Pulse Survey – what we heard

PoM's first Stakeholder Pulse Survey was delivered by SEC Newgate in 2022 and gave us valuable insights into the importance of being genuine, inclusive, timely, transparent, and accountable, highlighting the continuous need to enhance our engagement.

Our second Pulse Survey, undertaken between 30 May and 7 July 2023, was published in January 2024, and showed an uplift in stakeholder trust with an increase up from 6.6 to 7.1.[20] The results show that we maintain a healthy reputation bolstered by strengthened trust in the organisation, with approximately one-third of surveyed stakeholders acknowledging an improvement over the past year.

Notable findings demonstrate that:

- Stakeholders recognise our increased focus on engagement
- There is a perceived 'culture shift' at PoM, marked by a more proactive, open, and transparent approach to engagement
- The quality and effectiveness of our stakeholder engagement and overall reputation hinges on closing the loop on engagement and transparently sharing decision-making rationale.

The report also highlighted key areas of improvement that we are addressing as part of the development of future engagement methodology and communication programs, including:

- Increased engagement around the Port Development Strategy – identified as the most critical issue for ongoing engagement, particularly concerning sustainability issues
- More timely and consistent follow-up, supported by streamlined systems and processes
- Improved interaction across all stakeholder groups, including non-tenants and other Port Users.

[20] A summary of key findings from our second Stakeholder Pulse Survey is available on our website.

Survey participants also weighed in on the need for increased engagement on specific issues, such as green shipping initiatives, underscored by targeted engagement for different stakeholder groups.

We are committed to and are proud to be gaining positive traction on how we are perceived by our stakeholders and Port Users and will continue to use the Pulse Survey to inform how we plan for and deliver communications and engagement.

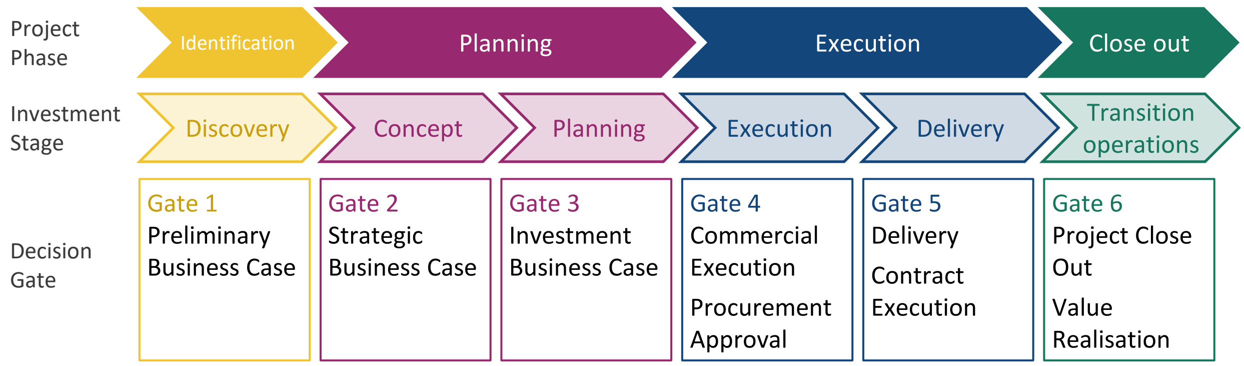
4 Major projects update

4.1 Our major projects and programs

In last year's TCS we outlined nine major capital projects and programs that we planned to commence or deliver during the regulatory period. These projects and programs account for 77% of the five-year capital expenditure forecast for the regulatory period.[21]

PoM's major projects are subject to a rigorous Enterprise Project Management Framework (EPMF) to ensure the successful delivery and effective management of capital projects consistent with prudent and efficient capital expenditure. A key element of the EPMF is our Project Lifecycle, Investment Stage and Decision Gate process (summarised in Figure 4.1) which sets out four project phases and six investment stages, supported by a decision gate approval process to provide a staged approach to expenditure approval with specific controls and considerations at each investment stage.

Figure 4.1 EPMF Project Lifecycle Phase, Investment Stage and Decision Gate



4.2 Progress in 2023-24

As of March 2024 five of the nine major projects and programs for the regulatory period had entered the delivery stage of the project lifecycle. Two of these projects, the Port Rail Transformation Project and the Webb Dock East 4 & 5 Berth Extension, are nearing close out. In both cases, practical completion has been achieved and only minor ancillary works remain. In 2023-24, PoM also completed a major campaign of maintenance dredging of channels and berth pockets. The first stage of the Beacon Pile Replacement Program is also expected to commence this financial year following the successful conclusion of the procurement process.

Table 4.1 provides an overview of each of the major projects and programs, and the progress that took place during 2023-24.

[21] Based on forecast capital expenditure as submitted in the 2023-24 TCS. Refer to chapter 5 of our 2023-24 TCS for further details of our five-year capital expenditure forecast.

Table 4.1 Major project updates

Swanson Dock West Remediation Project

EPMF Investment Stage as at March 2024:

Project type:
Renewal

Expected completion:
2027-28 (no change)[22]

About the project:

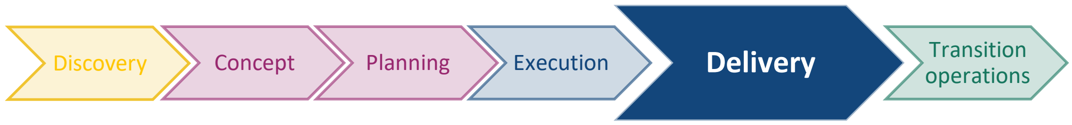
Swanson Dock West is an International Container Terminal comprising 944m of container handling berths, which were constructed in several stages between the 1960s and 1980s. This project involves remediation of wharves and retaining walls, and upgrades to bollards, to allow the terminal to continue to handle container vessels for the next 50 years.

Progress in 2023-24:

The project remains on schedule for completion in 2027-28. The first stage of the three-stage remediation program, focusing on Berth 1, is under way. Piling activities for Stage One have been successfully completed. Latent conditions, with some piles refusing to reach the required depth due to hard rock, necessitated rescheduling of some works to ensure the project remains on track.

Port Rail Transformation Project

EPMF Investment Stage as at March 2024:



Project type:
Growth

Expected completion:
2024-25 (originally 2023-24)

About the project:

This project involves the acquisition of existing rail assets and rail terminal land within the Port, the construction of a new Coode Road rail terminal interfacing with the Swanson Dock East International Container Terminal, and other improvements to rail and road access infrastructure.

Progress in 2023-24:

The project reached practical completion in August 2023 and was successfully handed over to PoM's tenants in the same month. The site is now fully operational. As such, the project practically achieved the original completion date. However, with remaining works to transition from manual rail signalling to automated rail signalling expected to be completed by December 2024, the completion date has been updated to 2024-25.

[22] Expected completion dates are compared against those provided in the 2023-24 TCS.

Webb Dock East 4 & 5 Berth Extension

EPMF Investment Stage as at March 2024:

Project type:
Growth

Expected completion:
2023-24 (no change)

About the project:

This project is designed to restore the operational capacity of Webb Dock East and allow it to accommodate two large vessels simultaneously. It involves demolition of a redundant section of concrete known as 'the knuckle', extraction and replacement of timber piles with steel, construction of a new wharf and hardstand, and dredging of the berth pocket.

Progress in 2023-24:

The extended berth has been successfully completed and transferred to PoM's tenant, the Victorian International Container Terminal (VICT). Some minor cathodic protection works remain to be completed during 2023-24.

South Wharf Berth 28-29 Rehabilitation

EPMF Investment Stage as at March 2024:

Project type:
Renewal

Expected completion:
2027-28 (no change)

About the project:

South Wharf berths 28-29 are commercial wharf facilities managed by PoM, located in the South Wharf precinct on the south bank of the Yarra River. This project consists of various rehabilitation works to allow customers to continue to use the berths and enable larger vessels to once again be serviced there, consistent with the original design expectations.

Progress in 2023-24:

We intend to initiate a feasibility assessment in 2024-25. Capital works are not expected to take place until later in the regulatory period. The results of the feasibility assessment may impact the expected completion date.

Stony Creek Pipe Bridge Replacement

EPMF Investment Stage as at March 2024:

Project type:
Renewal

Expected completion:
2025-26 (no change)

About the project:

- The Stony Creek Pipe Bridge is located underneath the West Gate Bridge and supports multiple petroleum pipelines. The bridge is at the end of its design life and in need of replacement.
- This project involves construction of a new bridge with pedestrian access, and piling within the existing structure footprint, to ensure that the pipeline operators can continue to operate, inspect, and maintain the product pipelines in accordance with current arrangements.

Progress in 2023-24:

In February 2024, a Preliminary Business Case for this project was approved enabling the project to enter the planning stage. Detailed cost analysis and design is underway to identify a fit for purpose remediation option. Construction works are expected to commence in 2025-26.

Port Capacity Enhancement Program

EPMF Investment Stage as at March 2024:

Project type:
Growth

Expected completion:
Targeting new capacity at Webb Dock North in 2036

About the project:

- This project involves the development of a container terminal at Webb Dock North to ensure that port capacity can meet the future demands of Victoria's growing economy, and the relocation of Tasmanian terminal operations to secure their future.
- The capital expenditure forecast included for this regulatory period included only the scope of works required for the planning and design activities necessary to enable the preparation of an Investment Business Case.

Progress in 2023-24:

In September 2023, PoM completed the PCEP Stage One engagement program. Over three rounds, stakeholders provided feedback on three technical reports on demand, ship fleet and capacity as the key drivers of the project. Final versions of the three technical reports, which incorporate feedback from stakeholders, have been published on our website at [Port Capacity Enhancement Program - Port of Melbourne].

Maintenance Dredging Program

EPMF Investment Stage as at March 2024:

Project type:
Dredging

Expected completion:
Ongoing

About the project:

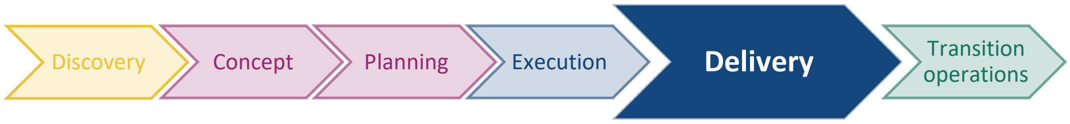
PoM has an ongoing program of periodic dredging campaigns to maintain channel depths and ensure that customers can continue to safely navigate the Port.

Progress in 2023-24:

As described in last year's TCS, PoM brought forward its 2023-24 maintenance dredging campaign to commence in 2022-23. We did this to take advantage of the availability of a large, high productivity dredge in Australian waters — the Gateway — which allowed for significant cost savings. This phase of maintenance dredging concluded in July 2023. Later in 2023-24, PoM procured a backhoe dredge to complete maintenance dredging in berth pockets inaccessible to the Gateway. This second phase of dredging is now also complete.

Beacon Pile Replacement Program

EPMF Investment Stage as at March 2024:



Project type:
Renewal

Expected completion:
2027-28 (no change)

About the project:

A program for the replacement and repair of Aids to Navigation which provide navigational assistance to vessel traffic while in Port waters.

Progress in 2023-24:

The Beacon Pile Replacement Program will take place in two stages. Following the conclusion of the procurement process and the selection of a preferred supplier, Stage One of the Beacon Pile Replacement Program has entered the delivery stage with works to commence by June 2024 and completion planned for March 2025.

Roads program

EPMF Investment Stage as at March 2024:

Project type:
Renewal

Expected completion:
Ongoing

About the project:

A rolling, ongoing and annual program of road remediation and reconstruction works. This program will allow for the continued access to the Port and places of infrastructure as heavy vehicles continue to grow in volume and, potentially, in axle loads over time.

Progress in 2023-24:

Following a road condition assessment undertaken in 2022, three projects were prioritised to commence in 2023-24: remediation of Mackenzie Road and Anderson Road, and upgrades to the Enterprise Road pedestrian crossing. These works are now expected to take place in 2024-25 due to site access issues and a longer-than-anticipated design process.

5 Comparison of actuals against forecasts

This chapter sets out actual outcomes for our trade and expenditure compared to forecasts for the most recent year in which full-year actual data is available (2022-23) and identifies the drivers of deviations between forecasts and actuals in that year.[23] The trade and expenditure forecasts in the 2022-23 TCS[24] have a one-year time horizon reflecting the timespan of the penultimate regulatory period (2022-23).

We will begin reporting on actual outcomes for the current regulatory period (2023-24 to 2027-28) in next year's TCS. As the ARR has been set for the five-year regulatory period, we will not publish new forecasts of trade and expenditure until the next regulatory period, commencing 1 July 2028. Our reviews of actuals against forecasts during the current regulatory period will inform refinements to our approaches to forecasting expenditure and trade in the next regulatory period.

5.1 Port trade

The port of Melbourne handles a variety of cargo types for import and export including containers, motor vehicles, liquid bulk and breakbulk. Containers are the most common type of cargo. Our most common containerised imports are consumer goods such as furniture and appliances, particularly from China. Our most common exports are agricultural commodities often originating from regional south-eastern Australia.

In 2022-23 the port handled:

- 3.1 million TEUs of containerised cargo, 0.2 million TEUs (6.7%) lower than forecast
- 24.0 million revenue tonnes of non-containerised cargo, 2.2m revenue tonnes (10.2%) above forecast (Table 5.1).

Variances between actual and forecast trade volumes were driven by the following:

- Containerised import volumes which were forecast to grow over the prior year, instead declined. This led to a difference between forecast and actual containerised imports of -0.11m TEUs (-7.9%). The difference was driven by a substantial decrease in spending on consumer goods. This was most evident in furniture, domestic appliances, toys, and miscellaneous manufactures.
- Containerised exports volumes, which were forecast to remain relatively stable, instead contracted from the prior year's level. This led to a difference between forecast and actual containerised exports of -0.11m TEUs (-14.0%). The difference was due to mixed performance in key commodities, which had an overall net negative impact on exports. Although wheat and cotton experienced strong demand; hay, fodder, pulp and wastepaper exports were down.
- Year-over-year forecasts for non-containerised trade were for double-digit growth for motor vehicles and dry bulk imports and exports, tempered by a decline in liquid bulk. Overall, actual non-containerised trade exceeded these forecasts, with higher-than-expected growth in:
    - New motor vehicles imports (reaching new record volumes)
    - Liquid bulk imports (on the back of strong demand for aviation fuel as post-COVID travel resumed)
    - Dry bulk exports (driven by a substantial increase in exports of canola seeds).

[23] Consistent with guidance provided in the ESC's Statement of Regulatory Approach v3.0 , pp. 26 & 36

[24] While the 2023-24 TCS reported updated forecasts of 2022-23, this chapter reports performance against the original 2022-23 TCS forecasts for 2022-23 as these forecasts were used to set the Aggregate Revenue Requirement in that year.

Table 5.1 Comparison of 2022-23 forecast and actual trade volumes

Trades	Units (Millions)	2022-23 (Forecast)	2022-23 (Actual)	Difference (Act – For)	Difference (%)
Containers – import	TEU	1.46	1.34	-0.11	-7.9%
Containers – export	TEU	0.82	0.70	-0.11	-14.0%
Containers – empty	TEU	0.75	0.78	0.03	4.4%
Containers – Bass Strait*	TEU	0.27	0.25	-0.02	-8.8%
Dry bulk	Revenue tonnes	4.96	5.12	0.17	3.4%
Liquid bulk	Revenue tonnes	5.21	5.75	0.54	10.4%
Motor vehicles	Revenue tonnes	7.77	8.51	0.74	9.6%
Breakbulk†	Revenue tonnes	3.82	4.59	0.77	20.1%
Channel – Melbourne	Gross tonnes	112.42	112.29	-0.13	-0.1%
Channel – Shared	Gross tonnes	135.79	137.63	1.84	1.4%

Note: All figures are inclusive of transhipments.
***Containers - Bass Strait excludes empty containers, which are not subject to a tariff.**
†Breakbulk includes Wheeled Unitised cargos.

5.2 Capital expenditure

Actual gross prescribed capex in 2022-23 was $214.3m, higher than in any year since the commencement of the Port Lease and $6.4m (3.1%) above forecast gross prescribed capex of $207.9m.[25]

Table 5.2 Comparison of 2022-23 forecast and actual capital expenditure
$m, nominal

Driver	2022-23 (Forecast)	2022-23 (Actual)	Difference (Act – For)
Dredging	1.0	16.0	15.0
Growth	152.2	139.0	-13.1
Renewal	54.8	59.2	4.4
Gross Prescribed Capex	**207.9***	**214.3**	**6.4**

Note: Capex is expressed in gross prescribed terms (i.e. before capital contributions and asset disposals are removed).
***Forecast capex has been adjusted as described in Appendix D.**

[25] Section 5.2 provides an overview of PoM's 2022-23 TCS capital expenditure forecast performance. Refer to Appendix D for further analysis and discussion.

While total actual expenditure was in line with the forecast, the following differences in delivery occurred in 2022-23:

- Actual costs for the Swanson Dock West Remediation project were higher than forecast mainly due to COVID-related labour and material supply disruptions in 2021-22 that pushed some expenditure into 2022-23.
- The Maintenance Dredging Program, originally expected to take place in 2023-24 was brought forward to 2022-23 to align with availability of a high efficiency large backhoe dredge in Australian waters, which reduced both unit rates and mobilisation costs.
- Reprioritisation and efficiencies in minor capital works to manage total expenditure and accommodate higher expenditure in the above major projects.

5.3 Operating expenditure

Actual total prescribed opex in 2022-23 was $148.0m, $2.9m (1.9%) below the 2022-23 TCS forecast of $150.9m.[26]

5.3.1 Non-controllable opex

The majority of PoM's 2022-23 actual prescribed opex related to three non-controllable costs:

- The Port Licence Fee
- The Cost Contribution Amount
- Port Rail Transformation Agreement (PRTA) costs.

Total non-controllable opex in 2022-23 was $112.5m versus a forecast of $112.4m. The difference of $0.1m (0.1%) was due to higher-than-expected inflation which impacted the calculation of the Cost Contribution Amount payable to Ports Victoria and lower than anticipated land tax outgoings included under Port Rail Transformation Agreement costs. The actual Port Licence Fee was known at the time of forecast.

Table 5.3 Comparison of 2022-23 forecast and actual non-controllable opex
$m, nominal

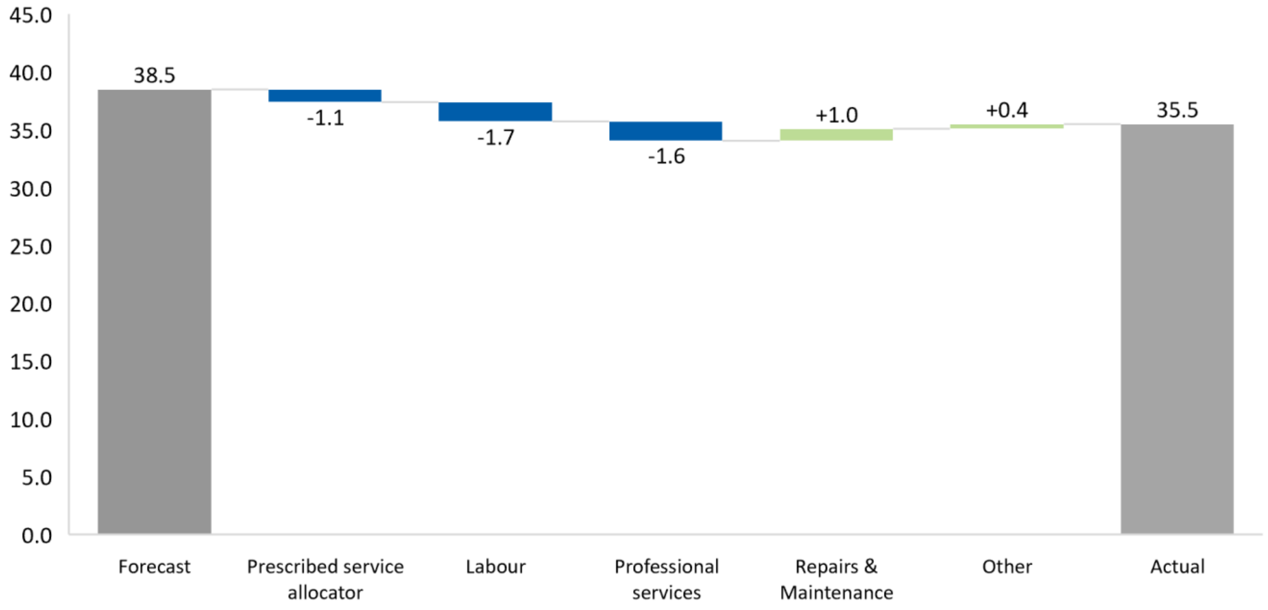
	2022-23 (Forecast)	**2022-23** (Actual)	**Difference** (Act – For)
Port Licence Fee	90.8	90.8	-
Cost Contribution Amount	17.1	17.4	0.3
PRTA costs	4.5	4.3	-0.2
Total non-controllable opex	**112.4**	**112.5**	**0.1**

5.3.2 Controllable prescribed opex

Actual controllable prescribed opex in 2022-23 was $35.5m, $3.0m (7.8%) below the 2022-23 TCS forecast of $38.5m. Figure 5.1 compares forecast to actual controllable prescribed opex for 2022-23. The main drivers of the difference between forecast and actual controllable prescribed opex are the prescribed opex revenue allocator, labour, professional services, and repairs and maintenance. The reasons for differences between forecast and actual outcomes for these items are set out below.

[26] Section 5.2 provides an overview of PoM's 2022-23 TCS capital expenditure forecast performance. Refer to Appendix E for further analysis and discussion.

Figure 5.1 Forecast versus actual controllable prescribed operating expenses, 2022-23
$m, nominal



5.3.2.1 Prescribed services allocator

The majority of our controllable opex is incurred while undertaking activities which support the provision of both prescribed and non-prescribed services. Consistent with the Pricing Order, we treat only a proportion of these 'shared' costs as prescribed costs recoverable through Prescribed Service Tariffs. This proportion is based on the share of PoM's total revenue which is recovered from Prescribed Services. In 2022-23, actual revenue from Prescribed Services was lower than forecast, while actual revenue from non-prescribed services exceeded the forecast. Consequently, the actual prescribed service revenue allocator of 65.9% is 2.9 percentage points lower than the forecast prescribed service allocator of 68.7%. The result is that $1.1m less in shared opex was allocated to Prescribed Services than originally forecast.

5.3.2.2 Labour and Professional Services

Controlling for the effect of the prescribed service allocator, prescribed expenditures for labour and professional services are both lower than forecast. The $1.7m difference in labour costs is mainly a function of a higher level of unplanned vacancies than originally forecast due to a tight labour market.

Prescribed expenditure for professional services is $1.6m below forecast. The primary driver of this difference is that the higher level of unplanned vacancies reduced PoM's capacity to complete all scheduled projects, reducing the demand for professional services support.

The lower than anticipated expenditures on labour and professional services are also partially attributable to ongoing efficiency improvements, as discussed in the 2023-24 TCS.[27]

5.3.2.3 Repairs & Maintenance

In 2022-23 there was a higher level of reactive maintenance than originally anticipated, as reflected in $1.0m higher expenditure than originally forecast. The higher level of repairs and maintenance costs is due to several factors, notably:

- Damage due to the flooding of the Maribyrnong River
- Higher than anticipated inflationary impacts on service contracts
- A higher than expected number of smaller reactive maintenance projects throughout the year.

[27] Refer to pp. 75-76 of the 2023-24 TCS for description of initiatives to deliver ongoing efficiency improvements

6 Rate of return on capital

In the 2023-24 TCS we adopted a pre-tax nominal Weighted Average Cost of Capital (WACC) of 9.34%, which was prepared by independent experts HoustonKemp using well accepted approaches.[28] This WACC was used to determine the allowance for the rate of return on capital for the purposes of determining the ARR for the current regulatory period.

The allowance for the rate of return on capital has been set for the five years of the current regulatory period and is not revised in this TCS. However, because the ESC included commentary on the WACC in its Interim Commentary on the 2023-24 TCS, we address the issues raised by the ESC in this chapter.

6.1 Equity beta and benchmark gearing

In our 2023-24 TCS, we amended our approach to filtering the comparator sample in response to the ESC's Interim Commentary. We adopted a country filter to remove developing countries when selecting the comparator sample, consistent with the ESC's views on well accepted approaches.[29]

This change had no impact on the asset beta, but reduced the benchmark gearing from 20% to 10% and therefore also reduced the equity beta and the WACC. We obtained a pre-tax nominal WACC of 9.34% from a sample of five firms, compared to a pre-tax nominal WACC of 9.49% obtained from a larger comparator sample that did not apply a country filter.

This mirrored the outcome of the ESC's analysis where it found that in applying a country filter the asset beta remained the same, but benchmark gearing would change from 20% to 10% (reducing the equity beta and the WACC). The ESC's view was that this was material.[30]

6.1.1 ESC Interim Commentary

In its Interim Commentary on the 2023-24 TCS, the ESC commented again on the benchmark gearing, with its preliminary view being that 10% gearing for a benchmark efficient firm "appears low"[31] and is "not intuitive or consistent with previously adopted values".[32]

While the ESC considered that it is well accepted for the gearing to reflect the average gearing of the comparator sample, the ESC considered it would also be well accepted to use a different comparator sample to estimate gearing and to only adjust the benchmark gearing used if there is sufficient evidence to indicate a change in the gearing of a benchmark efficient port.[33]

In relation to the comparator sample, the ESC noted that we used five comparators to estimate both gearing and beta, which the ESC considered was limited, and that up to 10 comparators were available. The ESC's preliminary view on the selection of comparators was that:

- To exclude the country filter would not be well accepted (as noted above, PoM's comparator sample was selected by applying a country filter)
- PoM could reconsider how it uses market capitalisation or liquidity filters to increase its sample.[34]

[28] Refer to chapter 9 of our 2023-24 TCS for a description of the approach to determining the WACC.
[29] Essential Services Commission 2023, Interim Commentary on the 2022-23 TCS, 20 December 2022, pp. 11
[30] Essential Services Commission 2023, Interim Commentary on the 2022-23 TCS, 20 December 2022, pp. 12-13
[31] Essential Services Commission 2023, Interim Commentary on the 2023-24 TCS, 20 December 2023, p. 15
[32] Essential Services Commission 2023, Interim Commentary on the 2023-24 TCS, 20 December 2023, p. x
[33] Essential Services Commission 2023, Interim Commentary on the 2023-24 TCS, 20 December 2023, p. 15
[34] Essential Services Commission 2023, Interim Commentary on the 2023-24 TCS, 20 December 2023, p. 15

In relation to adjusting the benchmark gearing, the ESC considered that it is well accepted to consider whether there is sufficient evidence that the gearing of a benchmark efficient port has changed, or whether changes in gearing estimates year-on-year primarily reflect short-term adjustments in gearing across the comparator sample. The ESC noted that PoM has previously adopted a gearing level of 20% (in the 2022-23 TCS) and 30% (in the five preceding TCSs), and that a broader assessment of the long-term capital structure of the benchmark efficient entity is required to justify the change to 10%.[35]

6.1.2 Our response to the ESC's Interim Commentary

We consider that the approach we adopted to obtain a comparator sample and determine the benchmark gearing for the current regulatory period was well accepted and compliant with the Pricing Order:

- The approach we adopted is the same as the approach described in the ESC's SoRA, where it states "The level of gearing – or debt – should be estimated by using observed gearing of an appropriate comparator sample to determine benchmark gearing."[36] The SoRA also states "We consider that if the Port applies these approaches, it will be compliant with our views of 'well accepted' approaches"[37]
- The Interim Commentary sets out the ESC's preliminary view that the use of five comparators is limited. However, in the five-year Inquiry, the ESC provided support for a sample of four or five comparators, where it noted that "there are several examples of Australian regulators forming their benchmark efficient entity with only four of five comparators"[38]. We also note that one of CEPA's samples prepared for the ESC's Interim Commentary (which it considers well accepted) contains six comparators.[39]

We sought an independent expert opinion from HoustonKemp on the ESC's comments in the Interim Commentary and whether there are any alternative approaches to estimating gearing that are also well accepted (Appendix F).

HoustonKemp considers that the method for estimating benchmark gearing for the current regulatory period remains well accepted, and found the ESC's preliminary view that we had not provided sufficient reasoning to support the benchmark gearing of 10% surprising, given:

- The methodology adopted to estimate benchmark gearing is unchanged from the approach applied in the previous (2022-23) TCS, where the benchmark gearing reflected the average gearing of the comparator sample used to determine the asset beta
- This approach is consistent with clause 23 of the Undertaking, and the ESC considered it to be well accepted in its Inquiry[40]
- CEPA also stated that "Australian regulatory precedent provides strong support for using the observed gearing of an appropriate comparator sample to set benchmark gearing".[41]

HoustonKemp noted the reason that the benchmark gearing falls to 10% in the 2023-24 TCS is the introduction of a country filter. They also note that the primary difference between the gearing estimate in

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[35] Essential Services Commission 2023, [Interim Commentary on the 2023-24 TCS](), 20 December 2023, p. 16
[36] Essential Services Commission, *Statement of Regulatory Approach – version 3.0*, 20 December 2022, p. 32
[37] Essential Services Commission, *Statement of Regulatory Approach – version 3.0*, 20 December 2022, p. 30
[38] Essential Services Commission, *Inquiry into the Port of Melbourne compliance with the pricing order*, 31 December 2021, p. 65
[39] CEPA includes China Container Terminal Corporation (CCTC) (gearing 48% to 65%) in all of its samples. HoustonKemp excluded this firm from the WACC estimate advice for the 2022-23 TCS (when there were 24 comparators in its preferred sample) because it derives a large proportion of revenue from stevedoring activities and continued to exclude it in its advice for the 2023-24 TCS (for the 2022 calendar year, CCTC derived 88% of its revenues from stevedoring)
[40] Essential Services Commission, *Inquiry into the Port of Melbourne compliance with the pricing order*, 31 December 2021, p. 65
[41] CEPA, *Port of Melbourne five-year review – WACC*, 17 December 2021, p 75

the 2023-24 TCS and that estimated by CEPA, is due to CEPA adding one additional firm, China Container Terminal Corporation, to the sample, with this change raising the sample average gearing to 18%.[42]

HoustonKemp considers that the liquidity and market cap filters from their 2023 report remain well accepted:

- HoustonKemp applied the liquidity and market capitalisation filters consistently when providing PoM with benchmark pre-tax WACC estimates for the 2022-23 TCS and 2023-24 TCS
- The liquidity and market capitalisation filters are identical to those that CEPA applied in its advice to the ESC's 2021 inquiry.

HoustonKemp also considers that adjusting the liquidity and market cap filters does not reflect a well accepted approach for estimating the WACC under clause 4.3.1 of the Pricing Order because:

- No regulator or court in Australia and New Zealand adjusts its liquidity filter for the purpose of expanding its comparator sample
- Loosening the liquidity filter to increase the sample of comparable companies used to calculate both beta and gearing results in inaccurate and imprecise beta estimates.

Finally, HoustonKemp considers that:

- Changing either the market capitalisation or liquidity filter at this point would reduce regulatory certainty to the detriment of PoM and Port Users
- Manipulating the bid-ask spread threshold in the liquidity filter (e.g. from 1% to 2%, as CEPA has done) to back-solve for a particular comparator sample with specific asset beta and gearing estimates does not reflect good regulatory practice
- It is well accepted to broaden the sample by omitting the country filter, as opposed to loosening the liquidity filter and/or market capitalisation filter.

In relation to alternative approaches to estimating gearing, HoustonKemp found that it would also be well accepted, and that the WACC parameter values would be calculated in an internally consistent manner, for PoM to adopt a benchmark gearing of 20% (while retaining the same sample). While noting that the current sample average gearing is lower than 20%, HoustonKemp considered that the range of deviation between the current sample average and a benchmark of 20% would be consistent with regulatory precedent.

In summary, HoustonKemp identified three approaches to determining the comparator sample, asset beta and gearing that they consider well accepted:

- PoM's adopted approach – apply a country filter and adopt the sample average gearing, i.e., 0.70 asset beta and 10% gearing
- HoustonKemp's preferred approach – omit a country filter and adopt sample average gearing, i.e., 0.71 asset beta and 20% gearing
- An alternative approach, which maintains gearing at 20% – apply a country filter and adopt the original benchmark gearing from PoM's 2022-23 TCS, i.e., 0.70 asset beta and 20% gearing.

The corresponding pre-tax nominal WACC estimates for the current regulatory period are set out in Table 6.1, below.

[42] We note that CEPA introduced China Container Terminal Corporation via its manual adjustment process, rather than the liquidity or market capitalisation filters. That is, the liquidity and market capitalisation filters do not have a material impact on the sample gearing.

Table 6.1 HoustonKemp well accepted beta, gearing and pre-tax nominal WACC estimates

	PoM adopted (country filter)	**HoustonKemp preferred** (no country filter)	**HoustonKemp alternative** (country filter, 20% gearing)
Asset beta	0.70	0.71	0.70
Gearing	10%	20%	20%
Equity beta	0.78	0.89	0.88
Pre-tax nominal WACC	**9.34%**	**9.49%**	**9.42%**

Having considered the issues raised by the ESC and the independent expert advice of HoustonKemp, our approach to addressing the comments made by the ESC is to leave the WACC and allowance for the return on capital for the current regulatory period (and previous, 2022-23 Regulatory Period) unchanged. As noted above, and set out in the 2023-24 TCS, we consider that the allowance for return on capital was determined using well accepted approaches and is compliant with the Pricing Order.

6.1.3 Alternative Aggregate Revenue Requirement calculations

We have not applied any adjustments to the ARR for the above issues. However, in this section we quantify the difference between the adopted and the alternative approaches to benchmark gearing to demonstrate the impact if the alternative approach had been adopted.

If the alternative approach of a gearing of 20% was used to calculate the WACC for the current and previous regulatory periods, we estimate that it would have had the effect of increasing the 2022-23 WACC from 8.81% to 8.99% and increasing the WACC for 2023-24 to 2027-28 from 9.34% to 9.42%.

Due to the operation of the TAL, the alternative approach to gearing would have no impact on tariffs during the prior or current regulatory periods. However, it would have altered the composition of the ARR by changing the amount of depreciation recovered during the respective regulatory period and the amount rolled forward into the capital base for recovery in later regulatory periods (changing the closing capital base).

As shown in Table 6.2, if PoM were to revise the ARR using the alternative benchmark gearing, the forecast closing capital base at the end of the current regulatory period (2027-28) would be $44.3m (0.6%) higher.

Table 6.2 Impact of alternative gearing on the forecast closing capital base
($m, nominal)

	Last Regulatory Period	**Current Regulatory Period**				
	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Closing capital base	5,450.3	5,784.6	6,140.7	6,482.2	6841.3	7,206.5
Closing capital base if alternative gearing (20%) was used	5,459.6	5,799.6	6,161.9	6,510.3	6,877.1	7,250.8
Impact of alternative gearing	+9.4	+14.9	+21.2	+28.1	+35.8	+44.3
Impact as a % of the capital base	**+0.2%**	**+0.3%**	**+0.3%**	**+0.4%**	**+0.5%**	**+0.6%**

6.2 Cost of debt

6.2.1 ESC Interim Commentary

In its Interim Commentary, consistent with its findings in the five-year Inquiry into Port of Melbourne compliance with the Pricing Order 2021, the ESC outlined its view that the trailing average approach used by PoM to estimate the cost of debt is well accepted.[43] However, the ESC also set out its preliminary view that it is 'not clear' that the Pricing Order permits between regulatory period true-ups to give effect to the trailing average cost of debt approach. [44]

6.2.2 Our response to the ESC's Interim Commentary

The cost of debt estimate for the current regulatory period was based on a trailing average approach, which was the same approach adopted in previous regulatory periods. The 2023-24 TCS included an on-the-day estimate of the cost of debt for the first year of the regulatory period and used the same estimate for each subsequent year, with the intent that the on-the-day estimate would be calculated for each subsequent year when available and then the WACC and ARR would be updated at the end of the Regulatory Period (i.e. 'trued up').[45]

We engaged HoustonKemp to calculate an updated 2024-25 cost of debt estimate using data up to 31 March 2024 (Appendix G). HoustonKemp calculate a benchmark BBB prevailing cost of debt of 5.82% as at 31 March 2024, excluding debt raising costs. This translates to a trailing average cost of debt of 4.93% (including debt raising costs). We note that:

- The updated trailing average cost of debt calculated by HoustonKemp is five basis points higher than the trailing average cost of debt from the 2023-24 TCS of 4.88%
- If we did update the trailing average cost of debt for the latest on-the-day estimate and subsequently update the WACC, the WACC would remain unchanged at 9.34% (pre-tax nominal).

We note that the trailing average approach may not be able to be given effect under the Pricing Order. Therefore, we have decided that we will not implement updates to the cost of debt in the absence of further clarity as to whether this approach is available under the Pricing Order, or an amendment is made to the Pricing Order that provides for this approach. That is, we will retain the cost of debt estimate from the 2023-24 TCS for the remainder of the regulatory period.

Notwithstanding the above, to further explore the issue, we also sought advice from HoustonKemp on whether there are alternative approaches for estimating the cost of debt that do not require updates and are also well accepted. HoustonKemp's advice is included as Appendix G to this TCS.

HoustonKemp has advised that four regulators and courts in Australia and New Zealand determine a cost of debt estimate that does not apply an annual update or a true-up: the ACCC, ESCOSA, OTTER and the Western Australian Supreme Court (WASC). HoustonKemp considers that all these approaches would be well accepted for calculating the benchmark cost of debt, although noted that only the ESCOSA approach appears to be consistent with the Undertaking.[46]

Given future on-the-day cost of debt outcomes are not certain, it is not possible to quantify the implications for the ARR if one of the alternative approaches identified by HoustonKemp had been adopted. However, any impact would be small because each on-the-day estimate comprises one tenth of the cost of debt component of the WACC and the total cost of debt comprises 10% of the WACC.

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[43] Essential Services Commission, *Interim Commentary on the 2023-24 TCS*, 20 December 2023, p.14
[44] Essential Services Commission, *Interim Commentary on the 2023-24 TCS*, 20 December 2023, p.7
[45] Refer to pp. 92–93 of the 2023-24 TCS General Statement for further description of the proposed approach.
[46] The Undertaking is available on our website: Regulatory Process | Port of Melbourne