Undertaking to the Essential Services Commission Minister

Given under section 49M of the Port Management Act 1995 (Vic)
By Port of Melbourne Operations Pty Ltd (as trustee for the Port of Melbourne Unit Trust)
ABN 83 751 315 034

Person giving the Undertaking

1. This Undertaking is given to the Essential Services Commission Minister (**ESC Minister**) by Port of Melbourne Operations Pty Ltd (as trustee for the Port of Melbourne Unit Trust) ABN 83 751 315 034 (**PoM**) in accordance with section 49M of the Port Management Act 1995 (Vic) (**PMA**).

Background

2. In 2016, Lonsdale Asset Property Pty Limited as trustee for the Lonsdale Asset Property Trust was awarded a 50-year lease of the Port of Melbourne by the Victorian Government. The Trust subleased the Port of Melbourne to PoM to operate the Port. PoM is the port licence holder.

3. PoM operates under a regulatory framework which took effect on 1 July 2016. The regulatory framework is set out in the:

    a. PMA; and

    b. a pricing order issued by the Governor in Council on 24 June 2016 in accordance with section 49A of the PMA, as amended by the Governor in Council on 20 May 2020 (**Pricing Order**).

4. On 10 June 2021 the Essential Services Commission (**ESC**) commenced an inquiry into PoM's compliance with the Pricing Order as required by section 49I of the PMA in relation to the review period 1 July 2016 to 30 June 2021. On 28 January 2022, the ESC released the final report of the inquiry, which, as required by s 49I(4) of the PMA, identified non-compliance with the Pricing Order that was, in the ESC's view, non-compliance in a significant and sustained manner (**Adverse Compliance Report**).

5. Under section 49M(1) of the PMA, the ESC Minister may accept a written undertaking given by a provider of prescribed services who is the subject of an adverse compliance report in relation to the provider's non-compliance with a Pricing Order if the ESC Minister is satisfied that:

    a. the terms of the undertaking offered by the provider are appropriate to adequately address the provider's non-compliance with a Pricing Order; and

b. the provider is reasonably likely to comply with the terms of the undertaking.

6. PoM, as the provider of prescribed services who is the subject of the Adverse Compliance Report, has offered to provide this undertaking to the ESC Minister in accordance with section 49M of the PMA.

Operation of Undertaking

7. This Undertaking comes into effect when:

    a. this Undertaking is executed by PoM; and

    b. this Undertaking so executed is accepted by the ESC Minister (the **Commencement Date**).

8. This Undertaking has effect from the Commencement Date until 30 June 2027 or such earlier time as determined in accordance with clause 9 (the **Term**).

9. PoM may withdraw or vary this undertaking at any time with the consent of the ESC Minister.

Undertaking

Consultation Provisions

10. This Undertaking and the consultation provisions contained within it relate to the obligations which PoM has under the Pricing Order. PoM operates under a range of statutory and contractual arrangements with diverse Stakeholder interests and PoM engages with Stakeholders on a range of topics outside the Pricing Order consistent with those other arrangements. PoM is committed to ongoing improvements in its stakeholder engagement practice in relation to the commitments in this Undertaking and its broader stakeholder engagement processes to encourage Stakeholder confidence in the effectiveness of PoM's engagement process and therefore promote the efficient use of, and investment in, the provision of prescribed services..

11. By no later than 3 months after the Undertaking is signed, PoM will provide to the Minister for Ports and Freight a draft engagement protocol covering PoM’s approach to consulting on regulatory matters under the Pricing Order (**Pricing Order Engagement Protocol**).

12. The **Pricing Order Engagement Protocol** will apply to PoM's engagement with Port Users as defined in the Pricing Order. The Pricing Order Engagement Protocol is not intended to limit the range of Stakeholders that PoM will engage with, and the PoM will continue to engage with other Stakeholders who are not Port Users where appropriate having regard to the subject matter of the consultation and the legitimate interests of those Stakeholders.

13. The Pricing Order Engagement Protocol will set out the process by which PoM effectively consults with and has regard to comments provided by Port Users and will:

    a. describe PoM's commitment to ensure a reasonable opportunity for Port User engagement on matters arising under the Pricing Order;

    b. set out the way in which PoM will have regard to Port User feedback in decision making relevant to the Pricing Order;

    c. outline the steps of engagement PoM will undertake, which may include (but which will not be limited to) how PoM will:

        i. identify Port User engagement needs tailored to suit the topic on which it seeks to engage;

        ii. determine the appropriate engagement approach taking into account how it will identify priority matters relevant to the Pricing Order that might have a significant impact on Port Users;

        iii. plan engagement activities including the preparation of materials for engagement to provide appropriate information outlining the purpose, form and content of engagement so that Port Users can provide informed and meaningful feedback;

        iv. implement engagement and the determination of a reasonable time period for engagement to ensure Port Users are given a reasonable opportunity to participate taking account of their engagement requirements;

        v. encourage Port Users to provide written feedback, and will also allow alternative acceptable means of providing feedback;

        vi. use feedback obtained during its engagement activities and any written responses to inform decision making and ensure PoM has had regard to Port User feedback;

vii. provide for complaints on engagement matters to be directed to PoM in the first instance; and

viii. keep Government informed about any material feedback and how that feedback is to be addressed.

14. PoM will take into account all feedback received from the Minister for Ports and Freight on the draft **Pricing Order Engagement Protocol** and will by no later than 3 months after all feedback is received from the Minister publish a final **Pricing Order Engagement Protocol**.

15. The **Pricing Order Engagement Protocol** may be amended by PoM from time to time. PoM undertakes to engage with the Minister for Ports and Freight and take into account all feedback received prior to publishing updates to the **Pricing Order Engagement Protocol**. Any proposed changes to the Pricing Order Engagement Protocol will be consistent with the principles set out in this Undertaking.

16. PoM will undertake all consultations required under, or relating to compliance with the Pricing Order in a manner consistent with the **Pricing Order Engagement Protocol**.

WACC Commitments

17. PoM undertakes that for the Term, in determining a rate of return on capital commensurate with that which would be required by a benchmark efficient entity providing services with a similar degree of risk for the purposes of clause 4.1.1(a) (and 4.3) of the Pricing Order, PoM will:

    a. apply a well accepted approach to estimating the return on capital parameters in that:

        i. all parameter values will be calculated in an internally consistent manner that has regard to the interrelationships between parameters; and
        ii. the parameters will be estimated using methods and approaches applied by Australian and New Zealand regulators and courts for the purposes of calculating a revenue requirement; and

    b. apply the following formula when calculating the nominal pre-tax WACC:

$$Nominal\ pre\ tax\ WACC = \frac{1}{1 - Tax\ rate \times (1 - Gamma)} \times (1 - Gearing) \times R_e + Gearing \times R_d$$

where

R_e is the return on equity

R_d is the return on debt

c. apply the approaches set out in clauses 18 to 27, and, to the extent the PoM changes or adjusts the approach it applies, the PoM will detail the change and the reasons for that change in the relevant TCS.

18. When calculating cost of equity for the purpose of clause 17 of this undertaking, the only approach that PoM will use will be the Sharpe-Lintner Capital Asset Pricing Model (**SL CAPM**).

19. When calculating the return on debt for the purpose of clause 17 of this undertaking, the only approach that PoM will use is a transition to an arithmetic trailing average cost of debt, starting in 2017/18.

20. When calculating the risk free rate for the purpose of clause 17 of this undertaking, PoM will:

    a. estimate the risk free rate by reference to the effective annual yield on government bonds using a ten-year term;

    b. apply the following calculations to estimate the risk free rate:

        i. arithmetic average of the daily annualised yield on the 10-year Commonwealth Government Securities (CGS) over 20 business days ending 31 March in the year the TCS is submitted;
        ii. the 10 year yields are derived by interpolating CGS with maturity dates that straddle a 10-year term as published by the Reserve Bank of Australia (RBA); and
        iii. the 10-year CGS yields are reported on a semi-annual basis, PoM will convert the reported yield to an annualised yield by applying the following formula:

$$r_a = \left(1 + \frac{r_s}{2}\right)^2 - 1$$

where

r_a is the annualised yield on the 10 year CGS; and

r_s is the semi-annual yield on the 10 year CGS.

21. When calculating the market risk premium (MRP) for the purpose of clause 17 of this undertaking, PoM will:

    a. apply an estimate that is consistent with the estimated value for gamma as determined according to clause 22, in accordance with the approaches of Australian and New Zealand regulators and courts;

    b. not use the Wright method;

    c. have regard to forward looking and Historical Excess Returns (HER) estimates of the prevailing market risk premium in line with approaches well accepted by Australian and New Zealand regulators and courts;

    d. when estimating the forward looking estimates of the MRP, such as Dividend Discount Models (DDMs):

        i. use only a selection of forward looking approaches or estimates of the MRP that are used by Australian and New Zealand regulators and courts;

        ii. where possible implement those models in a manner, and using inputs, that is consistent with the approach used by the relevant regulator; and

    e. when implementing the HER approach will rely on approaches to estimating the HER that are adopted by Australian and New Zealand regulators and courts and, in doing so:

        i. rely equally on NERA-adjusted and Brailsford Handley Maheswaran-adjusted stock market data unless an alternative weighting is more appropriate having regard to the requirements of the Pricing Order; and

        ii. have regard to stock market data from the periods starting 1883, 1937, 1958, 1980 and 1988, using arithmetic averages to estimate the MRP.

22. When calculating gamma for the purpose of clause 17 of this undertaking:

a. PoM will adopt the utilisation approach based on an equity ownership methodology, and not use the market valuation or finance practitioner (zero-gamma) approaches; and

b. PoM will use well accepted approaches (and/or estimates) used by Australian and New Zealand regulators and courts for the distribution rate and utilisation rate.

23. When calculating gearing levels for the purpose of clauses 17 and 25 of this undertaking, PoM will determine gearing levels based on the average gearing of the comparator set. In doing so, PoM will first refer to the benchmark gearing that currently applies, and then refer to the average gearing of the comparator sample as cross checks.

24. When calculating credit rating for the purpose of clause 17 of this undertaking, PoM will determine credit rating based on the average credit rating of the comparator set. In doing so, PoM will first refer to the benchmark credit rating that currently applies, and then refer to the average credit rating of the comparator sample as cross checks

25. When selecting a suitable sample of comparator firms for the purpose of clause 17 of this undertaking:

    a. PoM will select a sample of comparators consistent with the general principles adopted by Australian and New Zealand regulators and courts;

    b. in selecting suitable comparator firms PoM will prioritise:

        i. obtaining a sample size that is sufficiently large to generate robust estimates that are not influenced excessively by individual observations, having regard to the comparability of businesses in the sample;

        ii. excluding comparators for which good quality data cannot be obtained, such as due to poor liquidity; and

        iii. including comparators with similar economic and systematic risk characteristics to PoM, ie, companies that own and operate container port and channel infrastructure; and

    c. PoM will select the sample of comparator firms using the following steps:

i. search Bloomberg’s equity screening function (EQS) to identify potential comparators according to the relevant industry classifications, such as the Bloomberg Industry Classification Systems (BICS) and the Global Industry Classification Standard (GICS);

ii. apply appropriate filters to exclude companies with insufficient data or illiquid data, or whose market capitalisations are too small to serve as appropriate comparators;

iii. analyse the remaining companies manually to remove those that are not appropriate comparators, including reviewing their Bloomberg descriptions and carrying out desktop research; and

iv. If the above process does not generate a sample of comparable firms of sufficient size, then PoM will repeat the steps using search criteria that are less restrictive.

26. When calculating the asset beta and leveraging beta for the purpose of clause 17 of this undertaking, PoM will:

a. apply Ordinary Least Squares (OLS) regression analysis to estimate all betas from market data;

b. use well accepted approaches adopted by Australian and New Zealand regulators and courts in assessing:

i. the frequency of beta estimates, for example, daily, weekly, four-weekly or monthly betas;

ii. the use of end of period beta (eg: weekly beta ending on Fridays) or average of each day of the period beta (eg: for the weekly beta, the average of weekly betas ending Monday, Tuesday, Wednesday, Thursday and Friday); and

iii. the mean, median and portfolio of the sample betas; and

c. adopt the Brealey-Myers formulae to de-lever and then re-lever betas, unless an alternative approach is more appropriate having regard to the requirements of the Pricing Order.

27. When calculating the return on debt for the purpose of clause 17 of this undertaking PoM will:

a. transition to use an arithmetic trailing average cost of debt and will adopt a ten-year debt term;

b. calculate the allowed return on debt using the following formulae:

i. for the period 2022/23 to 2026/27 using the following formula:

$$r_t^d = \frac{10-(t-2018)}{10} R_{FY18} + \frac{1}{10} \sum_{j=t_{FY18}+1}^{t} R_j$$

ii. for the period starting 2027/28 using the following formula:

$$r_t^d = \frac{1}{10} \sum_{j=t-9}^{t} R_j$$

where:

r_t^d	is the allowed return on debt for financial year *t;*
2018	is the financial year 2017/18 and is the first year of the transition period;
j	indexes a series of financial years for summation;
R_j	is the on-the-day cost of debt estimate in any financial year in the series *j*, where:

R_{FY18}	is the on-day cost of debt estimate for 2017/18 and is 5.45 per cent;
R_{FY19}	is the on-day cost of debt estimate for 2018/19 and is 4.58 per cent;
R_{FY20}	is the on-day cost of debt estimate for 2019/20 and is 4.21 per cent;

R_{FY21} is the on-day cost of debt estimate for 2020/21 and is 3.42 per cent;

R_{FY22} is the on-day cost of debt estimate for 2021/22 and is 3.12 per cent;

iii. the on-the-day cost of debt will be the arithmetic average of the 20 business days ending 31 March in financial year *t*; and

iv. the on-the-day cost of debt will be estimated as the average annualised yield on benchmark debt from the following third party data sources:

1. RBA published estimates of the Australian corporate debt yield;

2. Bloomberg AUD BVAL curve;

3. a benchmark credit rating of BBB+ will be calculated using 1/3 A rated bond yields and 2/3 BBB rated bond yields; and

4. a benchmark credit rating of A- will be calculated using 2/3 A rated bond yields and 1/3 BBB rated bond yields.

Acknowledgments

28. PoM acknowledges that:

a. the ESC Minister will make this Undertaking publicly available by causing it to be published on the Department of Transport website;

b. the ESC Minister may, from time to time, make public reference to this Undertaking, including in news media statements and in publications;

c. the ESC Minister may apply to the Supreme Court for an order under section 49N of the PMA if the ESC Minister considers that PoM has breached any of the terms of this undertaking; and

d. the terms “benchmark efficient entity” and “well accepted approach” used in this Undertaking are to be interpreted in accordance with the decisions of Australian Courts (which, for the purposes of this undertaking, includes the Australian

Competition Tribunal) and will be applied consistently with those decisions, and Australian and New Zealand regulatory practice, as applicable at the time.

29. PoM further acknowledges that the ESC will conduct and complete an inquiry into PoM's compliance with the Pricing Order as required by section 49I of the PMA in relation to the five-year review period commencing 1 July 2021.

Port of Melbourne Operations Pty Ltd (as trustee for the Port of Melbourne Unit Trust) ABN 83 751 315 034

Executed by

sign here ►

print name Saul Cannon

Essential Services Commission Minister

Accepted pursuant to section 49M of the Port Management Act 1995 (Vic) by

sign here ► Danny Pearson

print name **The Hon. Danny Pearson MP**

Commencement Date 20 May 2022

Issue and PO requirement	ESC finding	Summary of PoM response
Operating expenditure		
Pricing Order requirements 4.1.1(c) ...an allowance to recover its forecast operating expenses, commensurate with that which would be required by a prudent service provider acting efficiently 8.2.1 Information in the nature of an estimate or forecast must be supported by a statement of the basis of the forecast or estimate. 8.2.2 A forecast or estimate: a) must be arrived at on a reasonable basis; and b) must represent the best forecast or estimate possible in the circumstances.	The ESC's view was that: ▪ PoM did not comply with 4.1.1(c) because it has not demonstrated that its approach to establishing total opex for the review period is prudent and efficient (ESC final report, p.83) ▪ The opex forecasts for 2019-20 and 2020-21 did not comply with clause 8.2.2(a) and (b) (ESC final report, p.90) ▪ PoM's non-compliance is sustained because its approach to forecasting and governance processes remained consistent over the review period (ESC final report, p.83) ▪ The non-compliance is not significant because PoM's forecasts do not have a material impact on port users over the review period (ESC final report, p.83)	**Actions in response** Consistent with the guidance provided by the ESC in its final report (pp.89-90), PoM will: ▪ Identify and consider the reasons for variations between forecasts and actuals ▪ Review and seek to improve the opex forecasting methodology. The actions we will take are as follows: <u>Annually review forecast accuracy</u> For the 2022-23 TCS we will review the difference between forecast and actual opex for each year in the review period (and an estimate for 2021-22), examine the reasons for the differences, apply any changes to the forecast methodology to address material forecasting inaccuracies, and explain them in the TCS. This review process will be repeated on an annual basis. <u>Review and improve the forecasting methodology for the 2022-23 TCS</u> The bottom up forecasting approach will be augmented with a 'base, step, trend calculation, including an appropriate efficiency factor described below, to ensure the bottom up forecasts are prudent and efficient. The base, step, trend approach will involve: ▪ Establishing an efficient and prudent level of costs in a 'base year', by taking actual costs in the most recent regulatory year, and adjusting it for any one-off factors that are unlikely to occur going forward. PoM will document and explain the reasoning for adjusting for one-off factors. ▪ Identifying any one-off and material upward or downward 'steps' in opex, including changes in regulatory requirements, or any other significant impacts on costs. Each of these 'steps' will be clearly identified and justified. ▪ An annual 'trend', reflecting a combination of the change in opex due to changes in demand, plus an efficiency factor which reflects overall

Issue and PO requirement	ESC finding	Summary of PoM response
		improvements in productivity. In setting the efficiency factor, PoM will have regard to external benchmarks such as productivity improvement trends in the Australian economy produced by the Australian Bureau of Statistics. The outcome of the base, step trend calculation will be compared to the bottom-up approach, with adjustments made to the forecast adopted for the TCS where appropriate to address inconsistency between the bottom-up opex forecasts and the base, step trend calculation. The bottom-up approach will be enhanced with the following measures: ▪ Additional guidance provided to teams preparing forecasts from the finance group, including historic forecasts and actuals, and overarching efficiency expectations ▪ Requirement for teams to explicitly document assumptions that underlie their forecasts ▪ Documentation of the review process undertaken by senior management, shareholders and the Board. Include an annual review of labour costs as part of the forecasting process, drawing on benchmarking where available, where we will: ▪ Review existing levels of unit labour costs, and use independent forecasts of changes in real wages to forecast changes in underlying unit labour costs ▪ Review and clearly document and justify movements in FTE numbers ▪ Review incentive payments to ensure that incentive arrangements are consistent with good industry practice and assist in incentivising prudent and efficient expenditure Additional analysis and process improvements for the 2023-24 TCS These matters will be addressed as part of PoM's ongoing process improvements, however, given the need for external advice and analysis we will complete these actions for the 2023-24 TCS. We will:

Issue and PO requirement	ESC finding	Summary of PoM response
		▪ Review, and seek to quantify, the relationship between opex and demand. This will feed into further refinement of the base, step, trend approach and assist in explaining variances between actual and forecast opex. ▪ Benchmark our opex with other businesses to ensure our opex forecasts (bottom up and base, step, trend) are consistent with appropriate industry benchmarks. In the first instance, we will focus on benchmarking labour costs as these are the largest component of our opex. Cost benchmarking would have regard to appropriate normalisation factors, such as revenue, throughput, assets and capital expenditure, to assist with comparability. **Consideration of impact** PoM's opex levels are more than 40% below pre-lease levels and forecasts had no impact on port users during the review period because prices are set by the TAL. There will be no impact on future prices because opex forecasts did not affect the Regulatory Asset Base (RAB) due to the under-recovery of the revenue requirement under the TAL. After the TAL period, when prices are set using forecast opex, lower opex forecasts will result in lower prices (all else equal).
Cost allocation		
Pricing Order requirements 5.2.1 Costs of the Port Licence Holder must be allocated between Prescribed Services and all other services provided by the Port Licence Holder in a manner consistent with the following cost allocation principles: a) costs that are directly attributable to the provision of the Prescribed Service must be	The ESC's view was that PoM was non-compliant with clause 5.2.1 in the following ways: ▪ PoM did not allocate its directly attributable operating costs to individual prescribed services in the first three years of the review period (ESC final report, p.101) ▪ Road and rail asset costs unrelated to the Port Rail Transformation Project have not been allocated correctly (ESC final report,	**Actions in response** PoM has corrected the cost allocation issues as follows: ▪ PoM's cost allocation approach from 2019-20 onwards is based on revenue shares at the individual tariff level, in accordance with the Cost Allocation Model (now combined into a consolidated Regulatory Model) and deemed compliant by the (ESC final report, p.101, 196). ▪ PoM has made the following changes to the Regulatory Model to correct the errors (identified by PoM) in road and rail cost allocation: – Road assets and rail assets unrelated to the Port Rail Transformation Agreement have been mapped to 'wharfage' services and relevant 'other'

Issue and PO requirement	ESC finding	Summary of PoM response
attributed to that Prescribed Service; and b) costs that are not directly attributable to the provision of the Prescribed Service but which are incurred in the course of providing both one or more Prescribed Services and other services must be allocated to the Prescribed Service on the basis of its share of total revenue from all services provided by the Port Licence Holder	pp.102, 196) ▪ PoM allocated rail asset costs related to the Port Rail Transformation Project to tariffs other than the 'full-inward' wharfage fee. This means PoM's allocation approach could recover Port Rail Transformation Project capital costs twice if not corrected, once through increased 'full-inward' wharfage fee and again through the other tariffs. (ESC final report, p.196) The ESC's view was: ▪ The impact of the non-compliance is not significant because there is no price impact on port users during the review period due to the TAL. ▪ Since non-compliance is observed across the review period, it is considered sustained. (ESC final report, p.101)	services in addition to 'wharf access' – The allocation to 'slipway' services has been removed as a consequence of slipways not being provided under a prescribed service tariff (discussed below) – Rail assets related to the Port Rail Transformation Agreement are mapped only to 'Full – inward' Wharfage Fees – Port Rail Transformation Agreement costs have been separated from other rail costs in the Regulatory Model with a new asset class and new opex category. PoM has taken steps to improve its processes related to the application and review of Cost Allocation Principles, and has developed a Regulatory Cost Allocation Guideline which formalises and documents PoM's approach for applying the Cost Allocation Principles. The guideline sets out a process for annual reviews of cost allocation and of the guideline itself to ensure future compliance. **Consideration of impact** PoM's cost allocation had no impact on port users during the review period because prices are set by the TAL. There will be no impact on future prices because: ▪ The cost allocation issues identified by the ESC relate only to the notional allocation of prescribed services costs to individual tariffs. The current structure of Prescribed Services Tariffs is fixed by the Pricing Order under the Initial Prescribed Service Tariffs, which are deemed to be compliant with the Cost Allocation Principles.[1] ▪ PoM can only change from the Initial Prescribed Service Tariffs during the TAL period if the ESC approves a tariff rebalancing application (which requires the ESC to be satisfied that PoM is compliant with the Cost Allocation Principles).

[1] Pricing Order clause 11.

Issue and PO requirement	ESC finding	Summary of PoM response
Prescribed service tariffs		
Pricing Order requirements 2.1.1(a) Prescribed Service Tariffs must be set so as to allow PoM 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 ESC's view was that because PoM was not compliant with clause 4 of the Pricing Order (ARR), PoM will recover above the efficient cost of providing all prescribed service, and so is non-compliant with clause 2.1.1(a) (ESC final report, pp.110-111) The ESC's view was that the non-compliance was not significant because it did not significantly impact the objectives of the PMA (ESC final report, p.109) The ESC noted that PoM's prices were limited by clause 3.1.1 since the tariff adjustment limit applies. (ESC final report, p.111)	**Actions in response** PoM's actions in response to the non-compliance with clause 4 are set out in the undertaking in Attachment A. Addressing the non-compliance with clause 4 addresses the ESC's finding of non-compliance with clause 2.1.1(a). **Consideration of impact** PoM's non-compliance with clause 2.1.1(a) had no impact on port users during the review period because prices are set by the TAL.
14. Weighted Average Tariff Increase means, in respect of a Financial Year, the expected weighted average rate of increase in the Prescribed Service Tariffs using weightings based on historical revenues derived from the Prescribed Service Tariffs in the most recent Financial Year for which audited data are available or, if there is no historic audited data upon which to calculate the expected weighted average rate of increase on this basis, an alternative estimate of revenue for the purpose of calculating weightings on a basis determined by the Commission.	The ESC found PoM did not use audited revenue to calculate the WATI in 2018-19, 2019-20 and 2020-21 (ESC final report, p.111) and that the commission has not determined any other basis for an alternative estimate of revenue. (ESC final report, p.203) The ESC's view was that the difference between audited and unaudited revenue was immaterial during the review period, so it considers this non-compliance is not significant. (ESC final report, p.111)	**Actions in response** PoM's prescribed tariff revenue is currently audited at the category level (wharfage fees, channel fees, hire fees, and other fees) To address the requirement of clause 14, PoM will calculate the WATI so that the implied total revenue figure (calculating using the product of volume and price for each tariff) is reconciled to the audited revenue figure, at both a category and aggregate level. **Consideration of impact** PoM's WATI had no impact on port users during the review period because prices were set by the TAL, with prices going up uniformly by CPI in each year (i.e. the revenue share of each tariff under the WATI was not used in tariff setting). As PoM has resolved this issue, there will be no future impacts.

<table>
<tr><th>Issue and PO requirement</th><th>ESC finding</th><th>Summary of PoM response</th></tr>
<tr><td>3.2.3 The Port Licence Holder may not introduce a new Prescribed Service Tariff unless the proposed new Prescribed Service Tariff is the subject of a Final Rebalancing Application accepted by the Commission under clause 3.2.18</td><td>The ESC's view was that PoM did not comply with clause 3.2.3 when PoM introduced a tariff for Victoria Dock slipway in 2018-19. Slipway tariffs were not set out in the Pricing Order and PoM did not submit a rebalancing application to introduce a new prescribed service tariff.

The ESC stated PoM should treat slipway tariffs as contracts for prescribed services (ESC final report, p.111)</td><td>Actions in response

This error was immediately corrected in 2019-20 following engagement with the ESC, and was evidenced in the 2019-20, 2020-21 and 2021-22 TCS Regulatory Models.

Consideration of impact

All port users had access to the same service at the same price during the review period, so there was no impact on port users (as confirmed by footnote 454 on p.214 of the ESC final report).</td></tr>
<tr><td>Content of the tariff compliance statements</td><td></td><td></td></tr>
<tr><td>Pricing Order requirements

7.2.1 The Tariff Compliance Statement must:

d) set out the process by which the Port Licence Holder has effectively consulted and had regard to the comments provided by Port Users;

e) explain how the Prescribed Service Tariffs comply with this Order, including the Pricing Principles and Cost Allocation Principles;

f) contain any other sufficient supporting information determined by the Commission under clause 9; and</td><td>The ESC considered that non-compliances with 7.2.1 were:

▪ Not sustained, because the ESC has seen PoM improve its TCSs over time in response to feedback in the ESC interim commentaries

▪ Not significant because the TAL means any impacts on port users are immaterial (ESC final report, p.111)

The ESC's views on consultation (7.1.2(d))

▪ PoM's TCS did not always contain adequate content for the ESC to assess PoM's consultation against the pricing order. Although PoM set out its consultation processes for the last two years, it did not sufficiently address how these processes constitute effective</td><td>Actions in response

On consultation:

▪ The ESC's findings are addressed in the undertaking in Attachment A.

On expenditure:

▪ PoM is working on producing additional documentation on opex forecasts through the process described above, which will be included (as confidential attachments) in the next TCS.

▪ PoM will continue to improve the documentation provided in its annual TCS submissions, including:

– Additional detail on opex forecasting (as described above)

– Additional detail on capital projects (e.g. business case materials)

– The PDS Delivery Program (published in 2021) provides a pipeline of projects, and has received positive feedback from stakeholders. PoM will continue to update and publish the PDS Delivery Program regularly and respond to stakeholder needs and feedback on this document.</td></tr>
</table>

Issue and PO requirement	ESC finding	Summary of PoM response
g) comply with the requirements in clause 8.	consultation. (ESC final report, p.218-219) On expenditure (7.1.2(e)): ▪ PoM did not adequately explain how tariffs comply with the pricing order. The ESC agreed with FTI Consulting that PoM's annual TCS did not include sufficient information to assess the prudency and efficiency of operating and capital expenditure across the review period. (ESC final report, p.219-220) On forecasts (7.2.1(g)): ▪ The ESC considered PoM's forecast operating expenditure has not complied with clause 8.2.2 in its 2019-20 and 2020-21 TCS, because the forecasts were not arrived at on a reasonable basis and do not represent the best forecast possible in the circumstances. (ESC final report, p.220-221)	On forecasts: ▪ The ESC's finding is addressed in the response to the ESC's finding on Operating Expenditure. **Consideration of impact** ▪ Impacts on port users from the non-compliances during the review period were found by the ESC to be immaterial due to the TAL. ▪ The ESC has deemed the non-compliances in relation to expenditure to not be sustained. Therefore, they will have no impact in the future.