//Agile Economics

Independent Price Expert Determination

MIRRAT's Price Increase For 2018-19

July 2018

Final

1. Introduction

This report constitutes my Independent Price Expert determination in respect to the proposed increases in MIRRAT's Reference Tariffs for 2018-19.

I have been required to make this determination following the receipt of Objection Notices to the proposed price increases for 2018-19 announced by MIRRAT on 2 May 2018.

In making this determination I am obliged to have regard to the requirements of Schedule 6 of MIRRAT's 87B Undertaking as approved by the ACCC.

2. Background

MIRRAT proposed increases to its Reference Tariffs for 2018-19 as detailed in an updated tariff schedule published on its website and originally dated 27 April 2018.

These were intended to take effect from 1 July 2018, but due to MIRRAT missing the deadline for notifying terminal users of these proposed increases, they are due to take effect from 1 August 2018. This delay in notification of the increases resulted in an extension of the time for providing objections until 31 May 2018 and an extension of the time available for me to make my determination.[1]

In making the price determination on the price increases, it is necessary for me to take account of the existing Reference Tariffs. For this purpose, I have used MIRRAT's published Reference Tariffs that have applied from 1 January 2018. The use of these tariffs as the existing Reference Tariffs was confirmed to me as valid by the ACCC on 30 July 2018.[2]

Under the activation clause of MIRRAT's 87B Undertaking (clause 3.1) and the terms of Schedule 6 of the Undertaking, my role as Independent Price Expert, is to determine whether MIRRAT's proposed price increases for 2018-19 are reasonable and appropriate; and there is no role for me to make a determination on price increases prior to this time.[3]

Nevertheless, in considering the reasonableness of the price increases for 2018-19, I am required under clause 3.4 of Schedule 6 of the Undertaking to among other things, have regard to the reasonableness and appropriateness of, and justification for the existing Reference Tariffs for the supply of the Terminal Services. I am, however, advised by the ACCC, that my assessment in this regard does not provide me with the power to re-determine the existing Reference Tariffs.[4]

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1 These revised arrangements were agreed to by the ACCC in an e-mail to MIRRAT on 18 May 2018 that was copied to me.

2 Confirmed via e-mail to me from the ACCC, 30 July 2018.

3 Confirmed via e-mail to me from the ACCC, 30 July 2018.

4 E-mail to me from the ACCC, 13 June 2018.

3. Objection Notices

Summaries of the Objection Notices received in respect to MIRRAT's proposed price increases for 2018-19 are provided in Table 1 below.

Table1: Summaries of Objection Notices

Date	Objector	Issues raised
9 May 2018	K Line	• Notice not provided at least 60 days before end of financial year. • Absence of detailed reasons for the price increase. • Concern about 4.5% increase in FAC relative to increase in the SAC of 1%. • Concern about the level of increases given annual CPI of 1.9% to end of March Quarter 2018.
15 May 2018	Federal Chamber of Automotive Industries (FCAI)	• MIRRAT introduced a price rise for key cost components of 24% on 1 January 2018 that should be considered in the context of considering the reasonableness, appropriateness of justification of existing reference tariffs under Schedule 6. • The volume of trade through the terminal is more than likely to increase as vehicles are no longer manufactured in Australia and the FCAI expects modest growth in the overall market in 2018. • The FCAI expects growth in project cargoes outside the RORO trade due to significant infrastructure investment in Victoria. • There are no new initiatives that are providing efficiencies to offset the 1 January and subsequently proposed increase in the FAC and SAC. • CPI has increased by only 2.2% in the 12 month period ending March 2018 and should have already been taken into account in the 1 January price increase. • Disputes that there has been any PoM rent increase that underpins the 1 January and 1 July price increases. • FCAI members yet to see any benefits from the over 25% price increase that must be passed directly on to consumers.

18 May 2018	LINX Cargo Care	• MIRRAT did not provide 60 days' notice of the proposed price increase. • MIRRAT has failed to provide detailed reasons of the proposed price increase.
31 May 2018	Qube (via Gilbert and Tobin)	• Disputes the validity of the proposed and earlier tariff increases and the appointment of the Price Expert to review them. • Without prejudice to the above view, disputes the increase in the SAC for 2018-19, noting that: ▪ The appropriate starting point for the SAC increase is the price paid under its SLA of $10.50. ▪ The services, equipment and facilities to which the SAC applied were unchanged throughout the period from April 2017 to the present, and the 1 January 2018 tariffs were not a new tariff for Qube but an increased SAC for an existing service provided under its SLA. The increase that must be assessed is the 51% increase in the SAC from $10.50 to $15.82. ▪ Any increase in costs associated wtih taking control of berths and the laydown area are not referable to the SAC, but rather to the FAC. ▪ The $10.50 SAC was negotiated in the context of substantially lower volumes than are now handled through MIRRAT's operations at the PoM. ▪ MIRRAT has not provided sufficient information to enable Qube and other stakeholders to respond to the increase in charges, and the Price Expert should make available to Qube and other stakeholders a fully populated tarrif model and various details and justifications of inputs and assumptions.

The issues surrounding the timing of the notice of the price increase and the adequacy of reasons have been addressed by the ACCC guidance provided to MIRRAT on 18 May 2018 and MIRRAT's response to this guidance. MIRRAT's response has included extending the period for Objection Notices, the delay of the price increase until 1 August 2018 and the publication of further reasoning on its website.

Where I have had insufficient information to make my determination based on MIRRAT's published reasons, I have sought additional detailed information from MIRRAT. This has included MIRRAT's original business case, the Frontier Economics financial model prepared for MIRRAT and associated report, documentation of MIRRAT's leases with the Port of

Melbourne Corporation (PoM) and other information provided by MIRRAT in response to specific questions by me.

I note that the price related dispute resolution process of the undertaking does not require, nor provide for, a process where this additional information can be shared with terminal users. Further, the commercial-in-confidence nature of much of this information means it would be inappropriate for me to share it with terminal users or to ask MIRRAT to do so.

My assessment of the other issues raised in the Objection Notices is provided in section 5. This follows my assessment of the proposed price increase in accordance with the required considerations in section 4 below.

4. Relevant considerations

In determining whether a price increase proposed by MIRRAT is reasonable and appropriate, clause 3.3(a)(i) of Schedule 6 of the Undertaking requires me to have regard to a number of principles contained in clause 3.4. These principles concern the basis on which a Reference Tariff can be determined as reasonable and justified.

Accordingly, in this section of my report I assess MIRRAT's proposed price increase against these principles (listed as headings in bold text). Following this, I assess the matters raised in objections in section 5, including with reference to this assessment as required.

Reference Tariffs should:

(i) be set to generate expected revenue for Terminal Services that is at least sufficient to meet the efficient costs of providing the terminal services; and

(ii) include a return on investment commensurate with the commercial risks involved

MIRRAT has developed a business case for the Terminal Services that is directed at ensuring that the expected revenues from its prices recover the expected costs of providing the terminal services, including allowance for a return on investment.

This business case is supplemented by financial model it commissioned from Frontier Economics (Frontier) that combines key business case inputs and its own parameters to determine annual revenue requirements with the aim of ensuring that over the course of the undertaking, MIRRAT's prices and revenues increase relatively smoothly and are just sufficient to recover its operating and capital costs, including a return on investment.

I note that the Frontier financial model has not been used to determine the actual price increases in 2018-19, Rather, it provides a framework under which they can be considered and assessed.

I consider the Frontier model to be a helpful means of tracking MIRRAT's adherence to the pricing principles to which it is to have regard in setting Reference Tariffs over the course of the undertaking. Accordingly, I have made use of the Frontier model in making my determination, including for making or seeking changes to input assumptions.

In relation to questions of cost efficiency, I note that MIRRAT's facility is entirely new so is unlikely to have legacy costs inefficiencies, the facility was built following a competitive tender process and it faces some competition from other terminal services in other States that can be expected to exercise some constraint on its costs and prices.[5]

Reference Tariffs should be set taking into account:

(i) Terminal lease costs and all efficient input costs;

(ii) an appropriate allocation of MIRRAT's relevant overhead costs;

(iii) expected volumes over the period MIRRAT has used to calculate the proposed price increase;

(iv) depreciation of, and a return on, the prudent level of capital invested by MIRRAT at the Terminal, where

a. depreciation is based on a straight line methodology (or a reasonable alternative methodology) and reasonably anticipated asset lives; and

b. the rate of return is based on MIRRAT's weighted average cost of capital;

(v) the interests of all users of the Terminal Services for which the proposed Reference Tariff relates

(vi) the reasonableness and appropriateness of, and justification for the existing Reference Tariffs for the supply of the Terminal Services

MIRRAT's business case, and the Reference Tariffs include allowance for the recovery of terminal lease costs and other inputs costs. I have examined the lease documentation with the Port of Melbourne and confirm that the terminal leases had staged increases as described by MIRRAT in its documentation in support of its proposed price increases for 2018-19.[6]

MIRRAT's costs include allowance for overhead costs. Based on Frontier analysis, these costs represent less than 8 per cent of operating expenses[7] and are not a major contributor to changes in MIRRAT's prices.

Expected volumes have a major bearing on MIRRAT's ability to meet its annual revenue requirement, and by extension the prices that it must charge. The key volume variable is the level of vehicle imports. MIRRAT's forecast growth of vehicle imports has been compared with historical trends shown by ABS and Port of Melbourne data by Frontier.[8] These comparisons suggest that MIRRAT's expectations of vehicle import growth are reasonable, and which I have confirmed by reviewing more recent public data on motor vehicle annual sales growth.

In relation to the depreciation and return on capital, the Frontier financial model generates a depreciation profile that is designed to smooth prices over the course of the undertaking while allowing for the full recovery of capital invested. The model also includes a WACC for the purpose of determining MIRRAT's allowed return on a capital. This WACC was last

5 Frontier Economics, *Tariffs for RORO automotive terminal services*, A report prepared for MIRRAT, October 2017, pp. 3, 11.

6 MIRRAT, Additional background to MIRRAT's 2019 financial year tariff review, 24 May 2018.

7 Frontier Economics, *op. cit.* p. 14.

8 *Ibid.*.pp. 14-15

updated at my request on 20 June 2018 and is per cent (nominal, pre-tax). I consider the depreciation method adopted and the WACC to be reasonable.

In relation to the interest of different users of the terminal services, I note that the price increases for a given service are uniform, so do not discriminate between different users of these services. This meets a major objective of MIRRAT's 87B Undertaking. A further consideration, however, is whether the price rises for particular services used by different users take account the interests of the respective users. This has been raised in objections in relation to the differential rise in the FAC and SAC, and which MIRRAT has justified by the differential impact of the 1 July 2018 rental increase on these services. I examine this further in the next section of the report where I respond to issues raised in objections.

Although MIRRAT has not provided a specific explanation for the price increases in its other services, given that there have been no objections raised by users, the relatively small contributions these services make to overall revenue and the fact that overall revenues for 2018-19 are below anticipated costs, I have not interrogated these increases in detail.

The existing Reference Tariffs are underpinned by the MIRRAT business case and incorporated into the Frontier financial model. It is noted in particular that a key driver of the increase in the existing reference tariffs on 1 January 2018 was the large rise in the rent charged by the PoM at that date, which I have confirmed by reviewing the relevant lease documentation.

On the basis of the development of the Frontier model to set an assessment framework for the price increases, I consider the existing Reference Tariffs to be broadly reasonable and appropriate. By this I mean they are set so that, overall, they recover no more than MIRRATs anticipated costs.

MIRRAT has informed me that the SAC specified under the existing Reference Tariff and the prior Reference Tariff, was not paid by Qube and LINX as both these stevedores would only agree to pay MIRRAT lower tariffs. MIRRAT has further informed me that it will seek to recover the amount of ɔm the stevedores since 1 January 2018 rather than the existing Reference Tariff amount of $15.66.

I consider that these underpayments in relation to the existing Reference Tariff are relevant for assessing the reasonableness and appropriateness of the proposed price increases for 2018-19. I have calculated that these underpayments mean that there is a shortfall in revenue that MIRRAT otherwise expected of approximately ɔr 2017-18 under the existing Reference Tariff. This amount could itself justify 40 per cent of the revenue gain from the proposed increase in reference tariffs in 2018-19 of approximate! (including allowance for adjustment of other modelling assumptions).

The structure of the Reference Tariffs may allow multi-part pricing and price discrimination only if, and to the extent that:

(i) the costs of providing the service is higher, or

(ii) it aids efficiency; and

any multi-part pricing or price discrimination should be transparent.

There are some instances of multi-part pricing for some of the more minor services provided by MIRRAT. These take the form of a minimum charge applicable to some fees determined on an hourly basis. These would appear to be driven by cost or efficiency considerations, but given the very small share of these tariffs in overall revenue I have not determined the degree to which this is the case. These instances of multi-part pricing are made transparent in MIRRAT's proposed tariff schedule.

There is no price discrimination (that is charging different users different prices for the same or similar service) contained within MIRRAT's proposed Reference Tariffs.

5. Assessment of issues raised in objections

In this section I provide an assessment of the matters raised in objection notices (see summary of these in Table 1 in section 3 above), and other matters identified by me.

Applicable existing Reference Tariff

In line with final ACCC advice provided to me on 30 July 2018, I have used MIRRAT's 1 January 2018 tariffs as the existing Reference Tariff for the purposes of making my determination on MIRRAT's proposed price increase for 2018-19.

Reasonableness, appropriateness and justification for the existing Reference Tariff

As detailed in section 4 above, I have considered the reasonableness, appropriateness and justification for the existing Reference Tariff as one of the factors in considering whether the proposed increase for 2018-19 is reasonable and appropriate. I consider the existing Reference Tariffs to be broadly appropriate for the reasons stated in that section. A related consideration is the underpayment of the existing SAC by stevedores, which I consider should be taken into account in assessing the proposed increase in 2018-19.

Rental increases

I requested and was provided with lease documentation between MIRRAT and the PoM. This documentation enabled me to confirm the historical and prospective rent payable by MIRRAT, the dates at which increases take effect and the rates/formulae by which the rental increases are determined. I further confirmed that this information is subject to confidentiality provisions that do not allow me to divulge this information.

I can confirm that the rental amounts, dates of increase and rates of increase that MIRRAT has used for the purpose of determining its Reference Tariffs, including the 2018-19 price increase, are consistent with the relevant provisions of this lease documentation. I am advised that the rent and concession cost item in the business case also includes land tax and rates.

Forecasts of vehicle volumes

MIRRAT's forecasts of vehicle volumes for 2018-19 in its business case reflect that it is the first year which it fully controls automotive import and exports from the port. Consequently, a very large increase (in the order of 60 per cent) is expected in 2018-19 compared to 2017-18.

I have confirmed with MIRRAT that there is some continuing export volume unrelated to motor vehicle manufacturing in Australia. Exports account for only around 2 per cent of MIRRAT's vehicle movements.

In subsequent years, vehicle volume growth seems to be broadly consistent with trends revealed by other recent public information on vehicle market growth.[9] Specifically,

[9] The ABS reports growth in new motor vehicle sales of 2.8 per cent in the year to December 2017. ABS, *Sales of New Motor Vehicles, Australia*, Cat. No. 9314.0.

MIRRAT's forecasts have vehicle imports increasing modestly (by 2.5 per cent per annum) and exports remaining flat (i.e. 0 per cent), which I consider to be reasonable assumptions.

CPI increases

The objections from K Line and the FCAI raised whether MIRRAT's proposed increase were reasonable in light of recent relatively lower rates of increase in the CPI.

It can be expected that increases in MIRRAT's prices will be governed by forecast increases in MIRRAT's input costs in combination with volume changes, and that these may result in price increases unrelated to CPI growth. Nevertheless, forecast CPI is an input into some of MIRRATs forecast input costs.

In its business plan MIRRAT has assumed a forecast CPI increase of 2.9 per cent for 2018-19 in its forecasts of the growth of non-labour opex costs. In view of recent rates of CPI increase and the forecast of CPI for 2018-19 by the Australian Treasury of 2.25 per cent[10], this is not a reasonable assumption.

I have therefore varied the increase in opex costs for 2018-19 in the Frontier financial model to take account of this lower inflation forecast.[11] While this serves to slightly reduce the revenue requirement for 2018-19, its impact is not material to the proposed price increases. This is because MIRRAT's price increases for 2018-19 are justified by MIRRAT on the basis of the rise in rent costs alone (that have a price escalation for this year not tied to the CPI figure), and which, in any case, are significantly below what is required to recover the revenue shortfall cause by the non-payment of the increased SAC in 2017-18.

Difference between the increase in the FAC and SAC

MIRRAT has indicated that the differential rise in the FAC and SAC charges for 2018-19 is driven by the differential impact of the rise in rent across the terminal of It has further provided me with data to indicate that the share of site rental and related charges attributable to stevedoring services based on the amount of the site used is 0.5 per cent, with other services (primarily related to the FAC) accounting for the remaining 99.5 per cent.

I have confirmed that based on these percentages, the rise in rental costs for 2018-19 would justify an approximate 7.6 per cent rise in the FAC (assuming it was to bear all of the rest of the rent increase[12]) and a 0.11 per cent rise in the SAC. This indicates to me that MIRRAT's proposed 4.5 per cent increase in the FAC is reasonable. The proposed 1 per cent rise in the SAC does not seem to be justifiable based on the rent increase in 2018-19, but can be more than justified based on the prior under payment of the existing SAC by the stevedores.

Nevertheless, these findings also rest on the assumption that the allocations of site costs between the services in question are reasonable. MIRRAT's allocation methodology, does seem to be a defensible means of allocation. I also take comfort, moreover, that both charges are passed on to the shipping lines and their customers, so the allocation should not make much difference to the use of the facility. In any case I do not have the power to raise

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10 Treasury, *Budget Strategy and Outlook*, Budget Paper No 1, 2018-19, p. 1-10, Table 2.

11 This is achieved by dividing MIRRAT's opex forecast for 2018-09 by 1.0064, to adjust for the impact of the difference between the MIRRAT inflation forecast and the Treasury inflation forecast (1.0064=1.029/1.0225).

12 If it were to only bear the rental increase in proportion to its pre-1 July 2018 revenue share (based on existing Reference Tariffs) among all non-SAC services, the increase in the FAC justified by the rent increase would be 6.3 per cent. The increase justified in the other services in this case would be 6.5 per cent.

a charge (i.e the SAC in this case) by more than the increase proposed if I thought that a substantially different allocation was warranted.

6. Determination on price increases for 2018-19

In light of the considerations detailed above, my decision is to accept the price increases to the Reference Tariffs as proposed by MIRRAT and reflected in its published tariff schedule for 2018-19 updated on 27 April 2018.

I note that contrary to the advice provided by MIRRAT, these increases result in an approximate overall increase of 3.1 per cent on a weighted average basis.

7. Date of effect

In line with MIRRAT's proposal to delay its proposed price increases until 1 August 2018 due to delayed notification, and the ACCC's assent to this, I determine that the price increases should take effect from 1 August 2018.

Stephen Farago
Independent Price Expert
31 July 2018