DP World Australia Ltd
Level 21, 400 George St
Sydney NSW 2000
GPO Box 4084
Sydney NSW 2001
Tele: +61 2 9270 8800
Fax: +61 2 9270 8888
www.dpworld.com

11 September 2015

Mr Keir Delaney
Secretary, Port of Melbourne Select Committee
Parliament House, Spring Street
MELBOURNE VIC 3002

E: LCSC@parliament.vic.gov.au

Dear Mr Delaney

Submission to Inquiry into the Proposed Lease of the Port of Melbourne

Thank you for the opportunity to provide a submission and respond to the Committee about the proposed lease of the Port of Melbourne as contemplated by the *Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015* (**the Bill**).

DP World Australia (**DPWA**) is a container terminal operator and stevedore operating dedicated container terminals at various ports in Australia including at Swanson Dock West in the Port of Melbourne (the **Port**).

In principle, DPWA supports the privatisation of the Port, provided that appropriate regulation ensures that any efficiency gains are not overwhelmed by higher costs and unfair discrimination

DPWA does not object to the privatisation of the Port – and, to the contrary, we accept that this should deliver important benefits to Port users and Victorian taxpayers.

However, it is critical to the economy of Victoria – and Australia – that we get the privatisation and associated regulatory framework right. A failure to do so would mean the benefits of privatisation risk being more than offset by potential damage to the State and national economies resulting from the new incentives of a private operator, which will quite understandably be focused on maximising shareholder returns rather than promoting the national interest in maximising throughput and minimising supply chain costs at the Port.

As noted in the recent Australian Government Competition Policy Review Final Report, March 2015:

> *Where monopoly infrastructure is contracted out or privatised, it should be done in a way that promotes competition … maximising asset sale prices through restricting competition or allowing unregulated monopoly pricing post sale amounts to an inefficient, long-term tax on infrastructure and consumers.* [1]

[1] The Australian Government, Competition Policy Review Final Report, March 2015, at p196.

The Port is one of Victoria and Australia's key economic assets. During 2013-2014, this import and export gateway handled an estimated $91.9 billion worth of trade.[2] The Port handles over a third of Australia's container trade and is the largest container and general cargo port in Australasia handling more than 2.5 million TEU annually and around 1,000 motor vehicles per day on average.

In the process, the Port supports thousands of jobs and the prosperity of thousands of businesses and communities across Victoria and south-eastern Australia. For example, the Government of Tasmania stated that:

> *The Port of Melbourne is a critical link in the supply chain of moving products in and out of Tasmania with approximately 98 per cent of Tasmania's inbound and outbound container freight processed through this port.*[3]

DPWA is concerned that the proposed regulatory framework established under the Bill, in its current form, does not do enough to prevent a private port operator from potentially being able to use its control of the Port to distort competitive outcomes and undermine supply chain efficiency over the course of the 50 year (or potentially 70 year) lease term through vertical integration.[4]

This submission briefly outlines the key risks that arise from privatisation under the current drafting, before highlighting those aspects of the Bill that in our view require further development.

Monopoly Pricing

A monopoly provider of port services has both the incentive and ability to set tariffs at a level higher than would exist in a workably competitive market. This position exists even with a government owner of the Port. However, privatisation further intensifies the risk of such behaviour, as:

- pre-privatisation – the seller seeks to maximise the potential sale price; and
- post-privatisation – the new private operator seeks to maximise profits for shareholders.

The risks that privatisation presents to port costs both pre and post-privatisation are well known amongst industry and within the community. As an example, Shipping Australia Limited publicly aired its concerns that the situation at the Port of Melbourne was echoing other recent privatisations noting that:

- *Australian exporters and consumers have already suffered significant price increases surrounding privatisation of the Ports of Brisbane, Botany, Port Kembla and Newcastle.*[5]

There is also a high likelihood of further post-privatisation price increases given the high prices paid in recent Australian port privatisation processes (e.g. around 27 times EBITDA for the Port of Newcastle and 25 times EBITDA for Port Botany and Port Kembla) and the port operator's commercially required rate of return.

---

[2] Port of Melbourne Corporation Annual Report 2013-14, at p32.

[3] Tasmanian Government, *Options Paper: Approaches to Regulating Coastal Shipping in Australia, Tasmanian Government Submission,* June 2014 at p5.

[4] The Bill provides for the lease of the Port for a maximum period of 50 years, with the ability for regulations to permit an additional lease period of up to 20 years (see cl 11 of the Bill).

[5] Shipping Australia Limited, Shipping industry condemns money grab at Port of Melbourne, 4 March 2015. Available at: https://shippingaustralia.com.au/wp-content/uploads/2015/03/SAL15017-Media-Release-Shipping-Industry-condemns.pdf

Vertical Integration

A privatised port operator may also seek to expand their scope of operations, revenues and hence the available earnings/profit through vertical integration – with the risk that it leverages its monopoly position in port operations into other related (and contestable) port services.

The privatisation experience in South Australia highlights this risk. As a port operator, Flinders Ports has the unique ability to bundle port/terminal charges and stevedoring charges in competing with other port access seekers for customers. It also has access to commercially confidential information as a result of its position as port operator that could advantage its own downstream operations and has the ability to frustrate competitor access to the port through the way it manages and implements port operations.

A vertically integrated port operator is in a position to limit competition by:

- denying potential competitors access to port (or other essential) facilities or discriminating in the quality or price of services provided to competitors;
- providing access on less favourable/discriminatory terms and conditions (i.e. by restricting the quay length/yard space allocated to third party users);
- refusing to grant long-term leases of terminals to unaffiliated stevedores, which will have the effect of stevedores becoming unwilling to invest sufficiently in capital to provide a more efficient service for its customers as they cannot secure long-term leases;
- making port planning decisions such as relocating existing lessees who have made significant investments in their leased terminals to less favourable locations within the port in order to benefit its own downstream business;
- using commercially sensitive information gained in its role as port operator to unfairly advantage its own stevedoring activities;
- shifting costs from its competitive business to its regulated business to enable it to recover those costs through users/competitors; and
- investing in the port in a way that favours its own operations.

Due to these incentives, most Australian governments have unbundled integrated infrastructure monopolies before privatising them, as recommended in the Hilmer Report in the mid-1990s. For example, Victoria unbundled its integrated electricity monopoly before privatisation and legislated to prevent cross ownership of the competitive and monopoly components.

The Bill in its current form lacks transparency and fails to do enough to address these risks

The critical weakness of the regulatory regime provided in the Bill is that it does not sufficiently or transparently address the monopoly pricing and vertical integration risks described above.

To the extent that the Government has sought to reassure Port users that this will occur, this reassurance has not been actioned through the Bill itself. Instead it relies on future legislative instruments (such as Orders in Council) or contractual restrictions (in the Port lease) which are not sufficiently certain, transparent or able to be directly enforced by third party users.

While DPWA supports and respects the role of the State regulator, the Essential Services Commission (**ESC**), as a potential regulator for the privatised Port, the ESC needs to be given the ability to operate effectively by having a well-defined and understood transparent regulatory regime. The lack of detail and a clear framework (or legislative principles) guiding price regulation within the Bill creates uncertainty for Port users and for bidders.

In particular, the Bill does not:

- provide a mechanism for addressing discrimination at all (i.e. it does not prevent the new private operator from leveraging its monopoly position as Port operator and vertically integrating into other related (and contestable) port services or put in place a negotiate-arbitrate process as a basis for ensuring third parties can seek non-discriminatory access to the Port, consistent with longstanding COAG principles[6]) – the Bill is limited simply to price regulation of tariffs for a defined set of 'prescribed services';

- include adequate detail or certainty on the scope or content of the proposed price regulation regime (as discussed further below); and

- deal with separation of regulated operations or the protection of confidential information of users (i.e. separate accounting arrangements for the elements of a business covered by the access regime and ring-fencing of regulated activities from other parts of the new operator's business that may compete with users).[7]

The tariff framework for 'prescribed services' that is set out in the Bill is broad and discretionary and relies on being defined by the Minister through a future Pricing Order in Council.[8] This means that the Bill does not offer any certainty that regulated access prices will be set in the future consistent with COAG principles so as to:

- generate expected revenue for a regulated service or services to meet the efficient costs of providing access to the regulated service or services, including a risk-adjusted return on capital;

- not allow a vertically integrated access provider to set terms and conditions that discriminate in favour of its downstream operations, except to the extent that the cost of providing access to other operators is higher; and

- provide incentives to reduce costs or otherwise improve productivity.[9]

Put simply, the Bill does not put in place an access and tariff regulatory framework that is sufficient to satisfy the fundamental access principles established by COAG for monopoly infrastructure.

Moreover, the Bill does not even provide certainty around those more modest features which the Government has announced, notably:

- prices being set in accordance clear and transparent pricing principles contained in a Pricing Order; and

- an overriding CPI price cap for at least 15 years.

---

[6] Council of Australian Government, *Competition Principles Agreement* (11 April 1995), cl 6(4).

[7] Council of Australian Government, *Competition Principles Agreement* (11 April 1995), cl 6(4)(n).

[8] See cl 91 of the Bill.

[9] Council of Australian Government, *Competition Principles Agreement* (11 April 1995), cl 6(5)(b).

There is little or no detail of either element in the Bill. Instead, the Minister has wide powers to fix prices, establish price caps or to delegate pricing setting to the ESC, either directly or by establishing a tariff-setting methodology or model to be applied by the ESC. The Order may include setting an initial asset base but other more light-handed regulatory options could also be implemented such as price monitoring.

Strangely, the Bill also alters the statutory objectives governing regulation of services under the *Port Management Act 1995 (Vic).* In particular, it removes a reference to 'fair and reasonable' pricing as an objective of the regime.

As well as providing little detail on the content of tariff regulation, the Bill is unclear about the extent of future regulation. The Bill replaces the current list of three 'prescribed services', which are subject to price monitoring under the *Port Management Act 1995* (Vic). The new list of prescribed services includes the current three services together with two new categories:[10]

- the provision of access to places or infrastructure (including wharves, slipways, gangways, roads and rail infrastructure) on Port of Melbourne land for the provision of services to port users; and
- any other service that is prescribed by the regulations.

These new and uncertain limbs mean that a further uncertainty of the Bill is whether it is intended to extend price regulation at the Port to new 'prescribed services' such as the competitive market for terminal and stevedoring services. It would be strange indeed if the regulatory framework was used to regulate contestable elements of the supply chain (such as stevedoring) without adequately regulating the clear monopoly elements.

The Bill contemplates a number of new and significant upfront additional costs for Port users and the Victorian economy

DPWA notes that the Treasurer's stated intention to capitalise the Port Licence Fee as an up-front lump sum may also be of concern as it is a Government loan that will ultimately be paid for by Victorian exporters and consumers.

If the Port purchaser is allowed to recover interest on this amount and a return on investment for the premium that they pay for the future potential earning power of the asset this could impose an immediate and very substantial up front cost on Port users.[11]

The Bill also replaces the existing licence provisions (which contemplated only one licence to be held by PoMC) with provisions that clearly contemplate that other parties may need to be licensed in the future to provide a wider set of 'prescribed services' – which may then also become subject to annual or up front licence fees, imposing further costs on the Port supply chain.

---

[10] See cl 90 of the Bill which alters s 49 of the *Port Management Act 1995 (Vic).*

[11] The Bill creates an ability for the Treasurer to convert the current annual Port Licence Fee from an annual payment into a single, 'up front' payment (see cl 83, inserting s44HAA and 44HA into the *Port Management Act 1995 (Vic)*). This essentially enables the Government to "capitalise" this future income stream from the Port Licence Fee at the time of privatisation – through the purchase price – increasing the perceived headline value of the lease.

The compensation regime will restrict future competition between Ports

Finally, DPWA understands that the proposed 50 year lease term for the Port will have the effect of restricting the Government from developing a competing container terminal, by providing the lessee with a right to seek compensation if such a development goes ahead. Although little detail has been provided, such a regime would restrict future competition between Victorian container ports, entrench the monopoly pricing power of the Port operator and possibly restrict the timely development of a new container terminal and its associated infrastructure to the detriment of Australian trade.

It should be noted that DPWA does not have a strong policy view about the location and timeline for a future second container port for Victoria, as it will be a decision for the government of the day.

Conclusion – what needs to be done

As a principle, DPWA supports the privatisation of the Port, but recognises that it gives rise to substantial risks unless supported by an appropriate regulatory framework.

A workable regulatory framework for the Port needs to respond to the two key risks associated with the privatisation of any monopoly infrastructure: monopoly pricing and vertical integration/discrimination. In the opinion of DPWA, at present, neither is adequately addressed in the Bill.

Changes that should be adopted in order to better address these risks – and protect the value of the privatisation process for Victorians – include at least the following:

- either explicitly preventing vertical integration by the new Port operator or, alternatively, requiring any private operator to put in place and maintain a voluntary access undertaking under Part IIIA of the *Competition and Consumer Act 2010 (Cth)* to ensure non-discriminatory access in the future;
- expanding the tariff provisions of the Bill to enshrine a clearer tariff framework, with orthodox regulatory pricing principles overseen by the ESC and less reliance on arbitrary Ministerial discretion and future Orders in Council;
- removing the ability to capitalise licence fees or, if this remains, explicitly preventing recovery of interest or any return on capital associated with funding that capitalised amount; and
- removing the provision for potential compensation of the private lessee in the event of the development of a competing second container port within the lease period.

Yours Sincerely,

Jason Varsamidis
Chief Financial Officer
DP World Australia Ltd