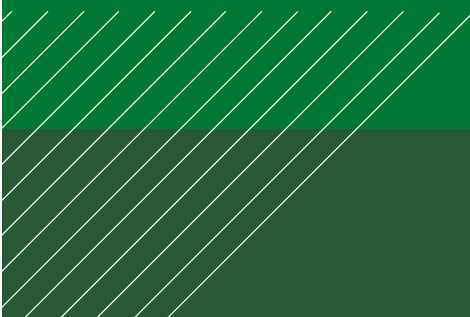


Select Committee Inquiry

Submission

September 2015



Authorised by the Victorian Government
1 Treasury Place, Melbourne, 3002

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Glossary

Term	Definition
2010 PMD	Price Monitoring Determination in place since 2010 under the current economic regulatory regime
ACCC	Australian Competition and Consumer Commission
Bill	<i>Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015</i>
BITRE	Bureau of Infrastructure, Transport and Regional Economics
CAGR	Compound Annual Growth Rate (per cent)
CDP	Channel Deepening Project
COAG	Council of Australian Governments
CPI	Consumer Price Index
DEDJTR	Department of Economic Development, Jobs, Transport and Resources
DELWP	Department of Environment, Land, Water and Planning
DTF	Department of Treasury and Finance
EPA	Environment Protection Authority
ESC	Essential Services Commission
FEU	Forty-foot Equivalent Unit
Force Majeure	Legal term frequently used to refer to events outside the control of the parties, such as natural disasters
Leaseholder	The private sector entity entering into the Transaction documentation with the State and acquiring the commercial operations of PoM residing in PortCo
MSA	<i>Marine Safety Act 2010</i>
PCP	Port Capacity Project
PDACM Act	<i>Project Development and Construction Management Act 1994</i>
PGR	Port Growth Regime
PMA	<i>Port Management Act 1995</i>
PMD	Price Monitoring Determination
PoM	Port of Melbourne
PoMC	Port of Melbourne Corporation
PoMPS	Port of Melbourne Planning Scheme
PortCo	The operating entity to be transferred to the private sector as part of Transaction; initially established as a subsidiary of PoMC
Port Lessor	The State entity holding the PoM land during the lease term, initially established as a subsidiary of PoMC
SOE Act	<i>State Owned Enterprises Act 1992</i>
StateCo	The State entity operating the State retained functions, legacy Port of Melbourne Corporation entity to be renamed Victorian Ports Corporation (Melbourne)
SUZ	Special Use Zone
RTS	Reference Tariff Schedule
TEU	Twenty-foot Equivalent Unit
TAL	Tariffs Adjustment Limit
TIA	<i>Transport Integration Act 2010</i>
TOR	Terms of the Reference for the Select Committee Inquiry
Transaction	has the meaning given to it in section 1.1
TSV	Transport Safety Victoria
VPC (Melbourne)	Victorian Ports Corporation (Melbourne) is PoMC's new name following completion of the Transaction
VTF	Victorian Transport Fund

1. Executive summary

1.1 Introduction

The Government introduced the *Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015* (the Bill) into the Legislative Assembly in May 2015. The Bill provides the authorising framework for the Port of Melbourne Lease Transaction (the Transaction).

The Legislative Assembly passed the Bill in June 2015. It was then debated in the Legislative Council in August 2015. The Legislative Council referred the Bill to a Select Committee Inquiry (Inquiry) in August 2015.

This Whole of Victorian Government submission responds to the Terms of Reference (TOR) for the Inquiry. While the submission responds to each specific TOR, it is important to reflect on the overall context of the Transaction design and the Bill rather than review specific sections in isolation.

1.2 Objectives

The Treasurer's second reading speech for the Bill outlined the Government's objectives for the Transaction:

- a. regulating Port of Melbourne (PoM) to ensure it continues to operate competitively and efficiently to support Victoria's freight and logistics network;
- b. requiring that the transaction delivers the optimal overall long-term economic benefit to Victorians and Victorian businesses;
- c. treating employees fairly and equitably;
- d. maximising the financial return to the state from the transaction within overall policy settings, while minimising the ongoing financial risks and liabilities to the State;
- e. ensuring that appropriate activities, including marine, environmental and safety functions, remain with the State and are managed in an efficient manner;
- f. completing the transaction efficiently with appropriate probity, transparency and accountability standards; and
- g. securing Victoria's role as the freight and logistics capital of Australia.

1.3 Legislation

While the Transaction can be completed without transaction specific legislation, the Government considers legislation best achieves the Transaction objectives, including optimal long-term economic outcomes for Victoria, and is consistent with recent market precedents for government assets.

The Bill enables the transaction to be efficiently implemented and modifies current legislative frameworks to allow assets and functions to be separated between the State and the leaseholder. Some specific provisions of existing legislation, including the *Transport Integration Act 2010* (TIA), *Port Management Act 1995* (PMA) and *Marine Safety Act 2010* (MSA) are proposed to be modified accordingly.

The Bill:

- a. authorises the transfer of the Port of Melbourne Corporation (PoMC)'s assets and liabilities to the leaseholder;
- b. grants a head of power to issue Crown leases and licences;
- c. authorises a 50-year lease, and under regulation, the ability to grant an additional term of up to 20 years to a leaseholder;
- d. authorises and facilitates an efficient and timely restructure of PoMC's assets and liabilities and the transfer of the commercial port operations to the private sector;
- e. authorises a strengthened economic regulatory regime to provide enhanced protection for port users for the 50-year lease term; and
- f. enables the transfer of employees, preserves employee entitlements and provides a two year employment guarantee for permanent non-executive employees.

The Bill establishes the Victorian Transport Fund (VTF) and directs proceeds into the VTF. The Bill requires the use of proceeds in the VTF for the Level Crossing Removal Program and infrastructure projects for public transport, roads, rail, the movement of freight, ports or other infrastructure.

In the absence of Transaction specific legislation, a transaction can still be implemented. The most likely form of alternative transaction is using contracts and existing legislation such as the *State Owned Enterprises Act 1992* (SOE Act).

While the Government has commenced planning to implement this approach should it be required, this is not the preferred approach. This approach substitutes contractual for legislative certainty and compromises timeliness, value and overall economic outcomes. By contrast, Transaction specific legislation delivers a timely and more comprehensive, certain and transparent authorisation for the Transaction as well as a range of statutory safeguards and benefits such as a strengthened economic regulatory regime.

1.4 Transaction highlights

The authorising framework in legislation and the detail of the Transaction structure are discussed in later sections. In summary, the highlights are:

- a. 50-year lease;
- b. commercial operations generally being transferred to a future leaseholder and a range of assets and functions being retained by the State;
- c. strengthened economic regulatory arrangements during the lease term;
- d. Port Growth Regime (PGR) – payment regime dealing with a limited set of circumstances where international container trade moves through a State sponsored second port; and
- e. State retains strategic flexibility to develop new port capacity – there is no right for the leaseholder to develop a second container port included in the Transaction.

1.5 Victoria's economy

1.5.1 Context

The Victorian population is estimated to reach 10.0 million by 2051, up from 5.5 million in 2011.¹

This population growth will feed demand for goods and services and ultimately trade growth. Growth in regions and economies using PoM, such as South Australia, southern New South Wales and Tasmania, will also drive trade growth.

An efficient port is a critical gateway for Victoria's economy. Increasing container trade, and trade more broadly, needs to be accommodated to support this population growth and anticipated demand.

PoM's physical container capacity after the Port Capacity Project (PCP) is completed is around 5.0 million+ Twenty-foot Equivalent Unit (TEU) per annum. Once demand approaches this capacity, the options to meet trade demand are:

- a. further expand PoM – noting natural capacity within the existing port footprint has been generally considered to be between 7.0 to 8.0 million TEU per annum, subject to the relevant approvals;
- b. build new capacity at a second container port; and/or
- c. land bridge, i.e. goods transported overland from another capital city port.

Expanding the PoM further, at least over the medium term, is likely to be the best economic outcome because:

- a. the costs of expanding the PoM and supporting infrastructure ('brownfield costs') are expected to be materially lower than new port infrastructure and any landside connections ('greenfield costs') for a second container port location, particularly considering the relative environmental and amenity impacts of both options;
- b. PoM is strategically important to the existing supply chain, which is oriented around the PoM and located within an integrated transport network;
- c. existing land supply and development opportunities mean it is unlikely that PoM land would have a higher and better alternative use than port land over the lease term; and
- d. overland transport costs to another capital city port are greater than using a local existing sea port (i.e. PoM) with its established supply chain.

The significant capital costs for a second container port, wherever it is located, and associated landside infrastructure capital and supply chain costs should only be incurred when required.

The optimal economic outcome for the State is considered to be for a second container port to be largely complementary to PoM until the port land is required for alternative purposes, such as to support urban renewal close to the Melbourne CBD over time.

1.5.2 Government objectives

Under the direction of the Premier and the Treasurer, the Department of Treasury and Finance (DTF) is preparing the Transaction to meet the Government's objectives as set out in section 1.2.

¹ *Victoria in Future 2015*, August 2015, DELWP

While the Transaction has a number of objectives, a main overarching principle is managing long-term policy needs and preserving the State's strategic flexibility to ensure the Transaction delivers the optimal overall long-term economic benefit to Victorians and Victorian businesses.

The TOR set out by the Select Committee have direct parallels with the Government's objectives; the Government appreciates the opportunity to set out in more detail how the Bill and the key parameters of the Transaction are designed to meet the needs of Victorians into the future.

1.5.3 State policy management post Transaction close

The State will have a number of policy and governance levers to ensure the PoM is managed in the Victorian public interest post Transaction, including:

- a. the Bill provides greater transparency of the role of the State and leaseholder and a comprehensive authorising environment for the Transaction, including a range of broader community safeguards;
- b. the Bill makes transparent and enshrines the strengthened economic regulatory regime;
- c. the State interface and oversight will continue during the lease term through a number of Ministers, portfolio departments (DEDJTR, DELWP), agencies such as the Environment Protection Authority (EPA) and regulatory bodies such as the Essential Services Commission (ESC);
- d. the Ministers for Environment, Planning and Ports remain responsible for port policy planning, and enforcing planning and environmental performance and protections;
- e. Commonwealth and State laws continue to apply across the relevant portfolio areas such as ports, transport, environment and planning;
- f. providing regular reporting and visibility over PoM development through legislation and Transaction documentation, including a Port Development Plan (PDP), asset condition and maintenance reports, environment reporting and a range of other information reporting and requirements; and
- g. protections for the State and community including the capability for re-regulation, State step in for non-performance and ultimately termination of the lease arrangements.

1.6 Terms of Reference (TOR)

1.6.1 TOR (a) – Structure and duration

The State's primary focus is for a transaction design that protects and promotes the long-term economic interests of the State ahead of lease proceeds.

The Transaction's key structural and duration features are:

- a. **Structure:**
 - i. the leaseholder is responsible for PoM's commercial operations, except for Station Pier and West Finger Pier, and use of channels for commercial shipping;
 - ii. the State retains marine and regulatory functions including the Harbour Master, Vessel Traffic Service (navigation in PoM waters), Dangerous Goods oversight, waterside emergency management, marine pollution response, management of PoM anchorage and towage regulation because the public interest is better served through State retention enabling consistent management and response;

- iii. port land remains in State ownership;
- iv. no right for the leaseholder to develop a second container port is included in the Transaction;

b. Duration:

- i. 50 years; and
- ii. head of power in the Bill to allow Government, under regulation, to authorise a leaseholder to lease the PoM for up to another 20 years.

The Government considered lease terms ranging from 40 years through to 99 years. The recent NSW port transactions are for up to 99 years. The option of 50 years plus the capacity for up to an additional 20 years provides the best blend of preserving State strategic flexibility and policy needs, and provides sufficient time to promote efficient capital investment by the leaseholder and tenants.

Allowing for up to an additional 20 years provides the State with flexibility to exercise policy levers and manage timing and staging of a second container port development and associated landside and supply chain infrastructure and future existing or alternative use of PoM land. It may also be used to assist in mitigating the prospect of the leaseholder, tenants, ports users and the supply chain not investing towards the end of the 50-year lease term because of being unable to recover costs and leading to lower productivity through the PoM.

The regulation to allow for an additional 20 year term can be made by government at any time. However, this is designed to future proof for State needs towards the end of the lease term. This ability to grant an additional term is not expected to be used in the near future for a range of reasons, including it being inconsistent with preserving strategic flexibility.

1.6.2 TOR (b) – Second container port

There are many factors influencing the rate and type of trade (import and export) growth in the Victorian economy. The underlying key driver will be population growth, which translates into economic development and trade growth, an increased freight task and broader infrastructure needs to service this growth and respond to demand for goods.

The natural container capacity of the PoM within the existing footprint is consistently estimated to be between 7.0 to 8.0 million TEU per annum, subject to the relevant approvals. PoM will be an efficient, low cost source of container capacity for some time and even though trade forecasts do vary from period to period, PoM's natural capacity is expected to be sufficient for container and trade growth over the medium term.

However, under most realistic scenarios, PoM's natural container capacity is likely to be exhausted before the end of the 50-year lease term. Environment and amenity impacts in and around the PoM as it develops will also be relevant considerations for the government of the day.

Given the inherent uncertainty in how trade growth might manifest in the long-term, appropriate timing of a second container port is highly uncertain. The Government does not believe it is in the State's interests to commit to that timing now. The Transaction will therefore preserve the State's flexibility to respond to a wide range of possible future outcomes. Consistent with preserving this strategic flexibility, there is also no right for the leaseholder to develop a second container port included in the Transaction.

The uncertainty that the State might build a second container port during the lease term, and uncertainty over what capacity might be built and the extent of State support, is challenging for infrastructure investors to price. Without mitigation of this uncertainty, Transaction proceeds will be adversely impacted.

The Port Growth Regime (PGR) addresses this uncertainty. It also aligns the State's interest to build and commence operating a second container port in response to demand, in the absence of other policy considerations. It allows investors in PoM to fully, efficiently and reasonably price assuming this commercial behaviour. It also allows investors to expand PoM container capacity – providing the most efficient form of extra capacity – by mitigating the prospect their investment will be 'stranded' by a competing State sponsored container port.

There are a number of thresholds to be satisfied prior to triggering any annual payment under the PGR for actual diverted trade and recovery is not 100 per cent of trade revenue, but is calibrated to ensure appropriate incentives to mitigate impacts.

The leaseholder bears all other material commercial risks associated with running a landlord port, including obtaining approvals for PoM capacity expansion, actual capital costs and timing of trade revenues (i.e. demand risk) and of competing private sector sponsored ports.

The State has complete flexibility on how to stage and start operating a second container port and where it is built. The State effectively determines the payments under the PGR through these decisions. A competing State sponsored second port will derive revenues, and will represent an offsetting revenue to any PGR payments.

A more detailed explanation of the PGR and its operation is set out in section 4.

1.6.3 TOR (c) – PoM expansion: environmental impact considerations

The Transaction will not change any existing environmental or planning statutory approval requirements. The PoM today, in public hands, operates within an existing statutory framework at both a Commonwealth and State level for environmental and planning matters. This will remain unchanged for the PoM whether in the hands of the State or a leaseholder.

Environmental and planning accountability and performance is embedded in existing law and the Ministers for Environment, Planning and Ports remain responsible for planning and environmental performance and accountability.

All statutory approval processes will continue to provide assurance on any future PoM expansion and impact assessments. In no way does the Transaction provide any pre-emptive or assumed approval of PoM expansion.

The leaseholder will bear the commercial risk of obtaining the relevant approvals within the environmental, planning and approval framework of the day. For example, any request to change channel depth and width for shipping channels in Port Phillip Bay and at the Entrance (also referred to as the Heads) will be subject to all the applicable environmental and statutory approvals required.

The Transaction does not constrain, nor commit, the State to any specific road or rail investment around the PoM, or in the broader transport network. The State retains the ability to manage landside issues as and when they arise and it is currently considering a range of projects for road network enhancements to address traffic movements on inner city roads.

Consistent with maintaining strategic flexibility, the State will protect the capability for rail modal outcomes through maintaining planning controls over existing rail reservations for

any future needs (e.g. Webb Dock Rail) and also requiring the leaseholder to maintain PoMC's currently owned rail assets in the PoM lease area.

The State will remain actively engaged with the leaseholder for the lease term. The leaseholder will be required to provide plans that allow the State sufficient lead time to anticipate and manage future needs and investment.

Although port-related traffic on the broader transport network is a very small proportion of overall traffic, it is recognised there may be localised near-port impacts around the PoM. The State will maintain visibility of the leaseholder's development plans through the Transaction documentation and legislation so it can manage landside issues as and when they arise.

1.6.4 TOR (d) – PoM competitiveness, supply chain and cost effect on goods

PoM is the largest container port in Australia. The Victorian freight and logistics sector is supported by natural comparative advantages of the PoM in terms of location, transport network and the supply chain oriented around it.

PoM's import charges are currently between Port Botany and Port of Brisbane charges, its export charges are currently higher than Port of Brisbane and Port Botany.

While the Government cannot predict the trajectory of Port Botany or Port of Brisbane pricing, the proposed economic regulatory regime including the recently announced export pricing discount, maintains PoM's port access pricing competitiveness over the lease term for port users and ultimately Victorian exporters and consumers.

PoM remains a low cost alternative for trade when taking into account port charges and the net additional landside costs to transport from alternative locations such as a second container port and/or overland via Port Botany.

As part of the Transaction design, the PGR also supports competitive port access pricing for the Victorian freight and logistics sector by incentivising low cost PoM capacity development at the right time.

1.6.5 TOR (e) – Proposed economic regulatory framework

The Bill establishes the proposed economic regulatory regime, which is strengthened compared to the current regime through features such as:

- a. broadening the prescribed services subject to independent Essential Services Commission (ESC) oversight;
- b. ensuring prices reflect underlying efficient costs;
- c. capping price increases at the Consumer Price Index (CPI) for 15 years; and
- d. enhancing ESC oversight.

By proposing a more stringent and prescriptive economic regulatory regime compared to other privately operated Australian ports, the Government is seeking to ensure port users and Victorian consumers are safeguarded from unexpected price increases and that the PoM continues to support the long-term competitiveness of the Victorian economy, while providing the leaseholder with regulatory certainty.

The strengthened economic regulatory regime, enshrined in legislation, provides for efficient cost pricing principles to be embedded for the lease term including the safeguard of a 'building block' approach that will underpin price setting.

The number of services captured by the framework has increased to include all current and future port services, except for land and improvements rent. In effect, 86 per cent of existing PoM revenues will be captured by the framework.

The Government, on the recommendation of the ESC, has the ultimate ability to re-regulate if there is significant and sustained non-compliance with the Pricing Order. The Pricing Order will be established by Governor-in-Council as set out in the Bill.

A CPI price cap for 15 years provides certainty and predictability for port users and the supply chain. The PoMC also recently announced an export price discount initiative which will be preserved in the Pricing Order.

Land rent remains a market based, contractual arrangement between willing parties, typically with an independent valuer review process where the parties are unable to agree.

1.6.6 TOR (f) – Balancing short-term and long-term objectives

A central focus for Government in implementing the Transaction is optimising the State's overall long-term economic outcome, while balancing flexibility, capacity growth incentives, efficiency, economic competitiveness and the response by the investor market. Key features which ensure this balance include:

- a. 50-year lease reflects need for longer-term strategic flexibility compared to achieving more upfront value today through a longer, less flexible arrangement (e.g. 99 years);
- b. strengthening the proposed economic regulatory regime to facilitate low cost port access pricing through efficient costs and capital investment compared to a private sector bidding market preference for less regulation;
- c. establishing a PGR to align the interests of the State and leaseholder in efficient and timely development of PoM container capacity; and
- d. setting up a Transaction design which is neutral to a second container port location and enables the State to determine if, and when, second container port capacity is developed.

The Transaction facilitates a broad range of Victorian transport infrastructure including the Level Crossing Removal Program and infrastructure projects for public transport, roads, rail, the movement of freight, ports or other infrastructure. The Transaction proceeds also provide for additional budget capacity to support the recently announced \$200 million Agriculture Infrastructure and Jobs Fund. It does this by paying Transaction proceeds into the Victorian Transport Fund (VTF).

1.6.7 TOR (g) – Other relevant matters

While not specifically addressed in the TOR, the Government has had regard to a number of other significant matters including:

- a. **Employees:** there are a number of protections in the Bill for PoMC employees allocated to assets and functions transferring to the leaseholder:
 - i. transfers are voluntary – even though staff are allocated to remain with PoMC (State) or to be transferred to the leaseholder, once a preferred bidder is known, employees do not have to accept a position with the leaseholder;
 - ii. no less favourable terms and conditions – the State protects employment conditions in the Bill and in a range of obligations in the Transaction documentation, including entitlements and superannuation arrangements. Enterprise Agreements in place continue to apply;
 - iii. two year employment guarantee – the Bill sets out a two year employment guarantee for permanent non-executive staff; and

- iv. PoMC retained employees continue to have the benefit of their existing employment terms and conditions and Enterprise Agreements in place continue to apply.
- b. **Bidding market considerations:**
 - i. certainty – legislation provides greater certainty for bidders, allows for more timely restructuring and delivers a better overall economic outcome for the State in a more comprehensive and transparent manner with a range of safeguards and protections for the Victorian community. However, a transaction can be implemented without specific legislation, if required, most likely through a combination of contracts and existing legislation such as the SOE Act and TIA; and
 - ii. timing – the transaction must proceed without further delay. There are a number of competing infrastructure transactions in other states and territories and timeliness is relevant to the depth of the bidding field, resources, advisers and funding. All these factors impact the competitiveness of the bidding field and therefore impact the relative value achieved for PoM.
- c. **Broader community benefits:** public access to port land and amenities is to be maintained by the leaseholder – e.g. Perce White Reserve, foreshore areas and the provision of non-core commercial services.
- d. **Asset recycling initiative:** bringing the PoM to market now provides Victoria with the opportunity to receive an additional 15 per cent on proceeds from the Commonwealth Government to be utilised by the State for other priorities and needs for the community. Further delay in the Transaction may see Victoria miss out on its fair share of these funds. This places close to \$1 billion in funding at risk.

1.6.8 Transaction documentation

As is usual for this type of transaction, many aspects will be implemented and administered by contract.

This is similar to other existing arrangements where projects have specific legislation (e.g. CityLink and EastLink) or are facilitated under other legislation such as the *Project Development and Construction Management Act 1994*, but the detailed arrangements are set out in a range of contracts.

It is not considered in the public interest to disclose any commercially sensitive material, including Transaction documents, prior to Transaction close as this may prejudice the State's outcome in a competitive tender process. The Transaction is also being prepared with probity advice on the management of confidential information and approach to market. Any document disclosure will be in accordance with the relevant State policy.

Section 10 provides more information on the proposed Transaction documentation to assist the understanding of the relationship between the Bill and the Transaction documents.

2. Proposed legislation

KEY POINTS:

1. Legislation best achieves Government's objectives and is consistent with market precedents.
2. Provides for efficient implementation and modifies the current legislative framework for a leaseholder.
3. Provides transparency, certainty, timeliness and optimal economic outcomes and a range of statutory community safeguards, including protecting employees transferring to the leaseholder.
4. The alternative approach to legislation is achievable, but substitutes contractual for legislative certainty and transparency, and diminishes timeliness and economic outcomes.

2.1 *Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015*

2.1.1 Rationale

The use of Transaction specific legislation best achieves the State's transaction objectives as it enshrines in law the broader community safeguards described below and facilitates efficient and timely transaction implementation. The use of legislation also provides transparency of the proposed structure for the lease of the PoM.

In addition, the legislation provides certainty to bidders for the PoM on the Transaction package and is consistent with recent market practice. This is likely to enhance the value of the proposed lease.

2.1.2 Transaction implementation

The proposed legislation enables efficient Transaction implementation. Its features include:

- a. giving statutory authority for the Transaction by authorising the transfer of PoMC's assets and liabilities (and other designated public sector port assets and liabilities) to the private sector and within the public sector;
- b. the ability to effect a timely restructure of PoMC's assets and liabilities that enables an optimal transaction package to be presented to market. This restructure is conducted by statutory vesting instruments and the legislation provides that third party consents are not required;
- c. providing for statutory directions to be given to the State transaction entities and their directors to facilitate transaction implementation;
- d. protecting the directors of the State transaction entities from liability for anything done or not done in complying with a direction issued under the Bill;
- e. a head of power for the grant of a lease or licence of Crown land for the purposes of the Transaction. This power is to be used to give the leaseholder appropriate shipping channel and port waters access rights for the term of the port lease to support its port operations;

- f. permitting disclosure to bidders of third party confidential information as part of the sale process (noting that disclosure will be subject to confidentiality arrangements being in place);
- g. providing the Transaction itself does not trigger third party consent requirements;
- h. giving the leaseholder landside clean up and cost recovery powers, the power to direct the movement of goods vehicles or people for safety and security purposes and the power to collect information of port users for limited purposes;
- i. supporting the PGR by removing any uncertainty as to the application of Part IV of the *Competition and Consumer Act 2010 (Cth)* to the regime; and
- j. amending existing legislation to provide for the change of name of the Port of Melbourne Corporation to Victorian Ports Corporation (Melbourne) on completion. The Port of Melbourne brand is to be part of the transaction package transferred to the leaseholder.

2.1.3 Broader community safeguards

2.1.3.1 Establishes maximum lease term

The legislation limits the maximum term of any lease or licence of port land to the private sector to 50 years. The legislation also includes a regulation making power to authorise an additional term for all or part of the port lands by up to 20 years beyond the initial 50-year lease.

This regulation making power does not provide for an automatic extension of the lease term, it merely authorises the government of the day to agree a further lease. The commercial terms of any such additional lease term, including any consideration, would need to be negotiated between the government of the day and a leaseholder at the time.

This regulation making power is intended to give a future Government the flexibility (but no obligation) to extend the lease term if considered appropriate at the time. For example, it may make sense to extend the lease to cater for a new capital expansion at PoM towards the end of the 50-year term that would otherwise be uneconomic, or to align the lease term with the commencement of new container capacity at a second port.

2.1.3.2 Express requirement that port land be maintained in State ownership

Authorisation for the Transaction in the legislation is subject to an express condition that the Transaction does not transfer ownership of the port land to the private sector. At the end of the lease term the land will be handed back to the State for continuing use as a port, or to be developed in a different way as the State determines at the time.

2.1.3.3 Protects employees

The legislation enshrines a number of protections for employees whose employment transfers to the leaseholder:

- a. employment terms must be no less favourable overall compared to the terms that applied to their employment with PoMC;
- b. permanent non-executive employees have the benefit of a two year employment guarantee during which time their employment cannot be terminated or their employment terms varied (other than by agreement with the employee, following the proper application of reasonable disciplinary procedures or in the case of termination, for serious misconduct);
- c. temporary employees have the same employment guarantee for the remaining term of their contract up to a maximum of two years;

- d. continuity of service and entitlements; and
- e. existing superannuation entitlements are to be maintained.

2.1.3.4 Greater transparency of roles and responsibilities of the State and the leaseholder

The legislation amends existing legislation so that there is transparency as to the future role and responsibilities of both PoMC (State retained assets and functions) and the leaseholder. For example:

- a. PoMC's objects and functions are narrowed to align with its reduced post transaction role largely focused on waterside control and management, harbour master and safety functions, emergency management and its ongoing ownership and management of Station Pier and West Finger Pier;
- b. the leaseholder is given statutory power to charge wharfage and channel fees;
- c. the leaseholder takes over PoMC's statutory obligation to pay the port licence fee; and
- d. various amendments are made to the *Port Management Act 1995* (PMA) reflecting the separation of marine and landside responsibilities and operations between PoMC and the leaseholder as part of the Transaction.

2.1.3.5 Leaseholder statutory obligations

The legislation creates a statutory obligation for the leaseholder to prepare a safety and environmental management plan in relation to its landside and marine functions, consistent with PoMC's obligations today.

The leaseholder will be responsible for port development during the port lease. Accordingly, to give the State sufficient visibility of future port developments, the legislation imposes an obligation on the leaseholder to prepare and submit to the State a port development strategy every five years.

Statutory marine safety obligations are also imposed on the leaseholder in relation to its marine safety infrastructure operations. For example, when it is dredging or maintaining navigational aids.

2.1.3.6 Strengthened economic regulatory regime

The legislation implements the strengthened economic regulatory regime described in section 7.

2.1.3.7 Requires lease proceeds to be used for developing State transport infrastructure

The legislation establishes the Victorian Transport Fund (VTF) and requires the payment of the transaction proceeds into that fund. Any money in the fund must only be used as authorised by the Treasurer to meet the costs of the Level Crossing Removal Program and infrastructure projects for public transport, roads, rail, the movement of freight, ports or other infrastructure.

2.2 Contract approach is sub-optimal

Transaction structures not using transaction specific legislation will result in the transaction largely being implemented through contract and are likely to also involve the exercise of powers under the *State Owned Enterprises Act 1992* (SOE Act) or the *Transport Integration Act 2010* (TIA).

These alternate transaction structures are sub-optimal as it is likely that:

- a. the State will seek to obtain similar community safeguards set out in section 2.1.3 through contract, though this is not as robust as imposing these obligations through legislative means upfront;
- b. implementation largely through contract reduces transparency of the transaction structure and the ongoing role and responsibilities of PoMC and the leaseholder;
- c. the State will receive less proceeds from the Transaction due to less bidder certainty on transaction structure and implementation, a reduced bidder pool, given the likely change of the nature of the asset being transacted, and a changed investment profile;
- d. the Transaction will result in an increased risk profile for the State and in most cases increased ongoing administration costs and complexity;
- e. the Transaction will take longer and be more costly to complete;
- f. there are less transparent safeguards for employees; and
- g. the State will seek to obtain equivalent economic regulatory regime outcomes in contract, but this is not as robust or transparent compared to the use of legislation and instruments such as the Pricing Order and the underlying pricing principles.

3. TOR (a) – Structure and duration

KEY POINTS:

1. Structure:

- a. the leaseholder will have responsibility for PoM's commercial operations, except for Station Pier and West Finger Pier, and use of channels for commercial shipping;
- b. State retains marine and regulatory functions including the Harbour Master, Vessel Traffic Service (navigation in PoM waters), Dangerous Goods oversight, waterside emergency management, marine pollution response and towage regulation and PoM anchorage management; and
- c. port land remains in State ownership.

2. Duration:

- a. 50 years; and
- b. head of power in the Bill to allow the government of the day, under regulation, to authorise a further lease of the PoM for up to another 20 years.

3.1 Structure

3.1.1 Overview of allocation process

PoMC's assets, liabilities, people and functions are to be separated into two going concerns referred to as 'PortCo' and 'StateCo'. The leaseholder will acquire PortCo, the entity holding PoM's commercial operations. StateCo has the State retained assets and functions of the PoMC, to be renamed Victorian Ports Corporation (Melbourne), also referred to as VPC (Melbourne), in the Bill.

A range of government policy objectives, including an effective maritime safety regime and co-ordinated emergency response management, informed the allocation process between PortCo and StateCo.

State retained assets, functions and employees remain with StateCo. The functions and assets of PortCo form part of the Transaction subject to the 50-year lease offered by the State. Note the reference to StateCo includes State retained assets and functions which reside in the legacy PoMC entity, or else transferred to another State entity or agency, subject to policy and Government preferences.

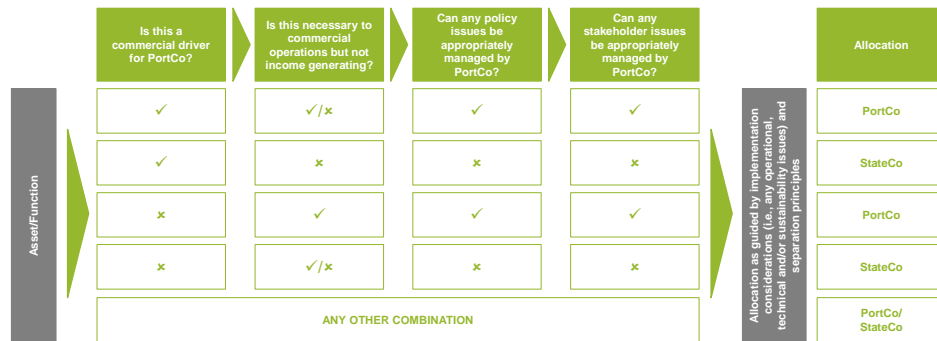
The specific allocation of each function and/or asset to PortCo or StateCo was guided by approaches in other jurisdictions, and four key criteria developed in consultation with key portfolio agencies being (multi-factor criteria, not order relevant):

- Is this function/asset a commercial driver for the port and therefore will naturally sit with PortCo who seeks to maximise return to its shareholders?
- Is this function/asset required in the commercial operation of the port, but does not itself directly generate income for the port (for example, security function)?
- Can any policy issues be appropriately managed by PortCo (e.g. issuing fines)?
- Can any stakeholder issues be appropriately managed by PortCo?

These criteria are consistent with allocating commercial and landlord port functions to a private operator (leaseholder in this instance) and also reflect where State-side control is considered more appropriate due to the nature of the asset or function.

The resulting allocation for an asset or function based on answering the four criteria is set out below. Detailed consultation with the PoMC (as operator), stakeholders such as the Department of Economic Development, Jobs, Transport and Resources (DEDJTR) and Transport Safety Victoria (TSV) was undertaken throughout this process.

Separation allocation framework



Appendix 2 outlines each function/asset category against the above criteria and the outcomes of the separation allocation process reflected in the Transaction design.

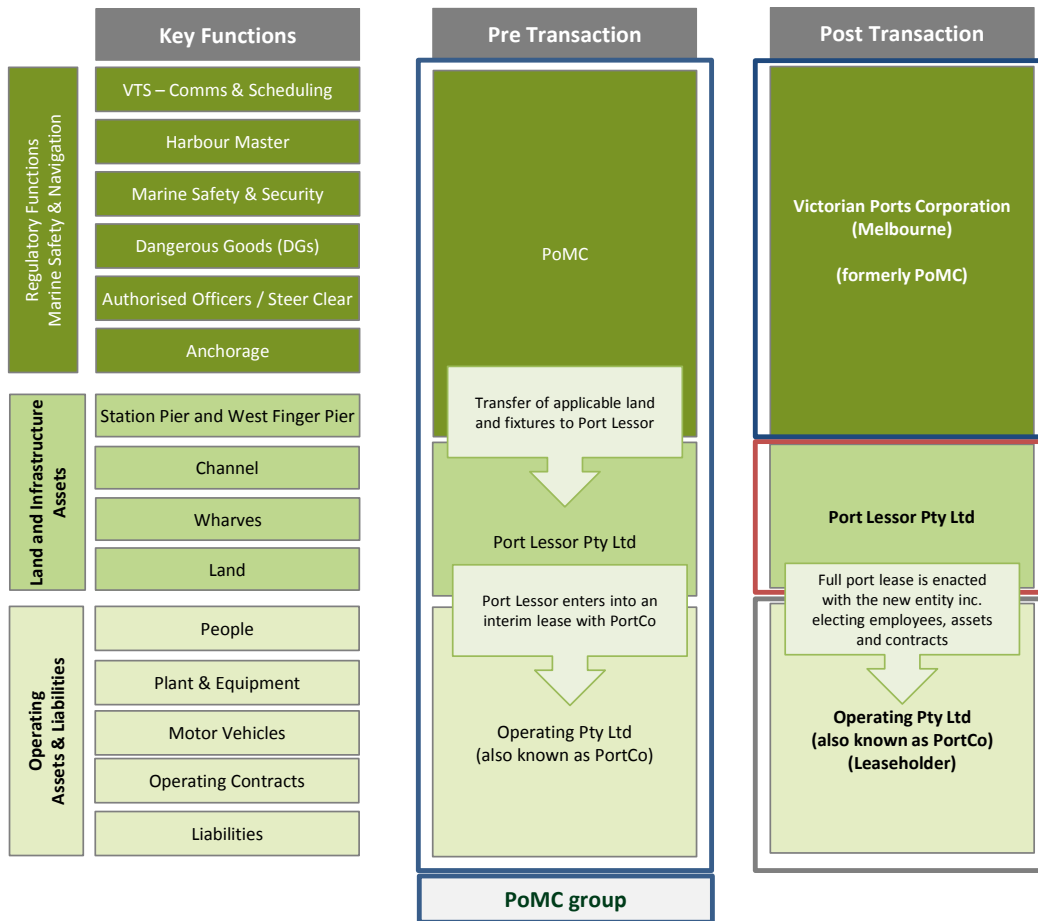
3.1.2 Transaction structure

3.1.2.1 Assets and functions

The following summarises how PoMC’s assets and functions are divided and will transition in preparation for the Transaction between the two entities to be created, subject to the Bill being enacted.

Port Lessor Pty Ltd (Port Lessor) and Operating Pty Ltd (PortCo) are to be created as subsidiaries of PoMC as part of restructuring ahead of a Transaction. PortCo will be the entity acquired by the leaseholder. Port Lessor will be the freehold landholder for the State, other than for Station Pier and West Finger Pier remaining with PoMC.

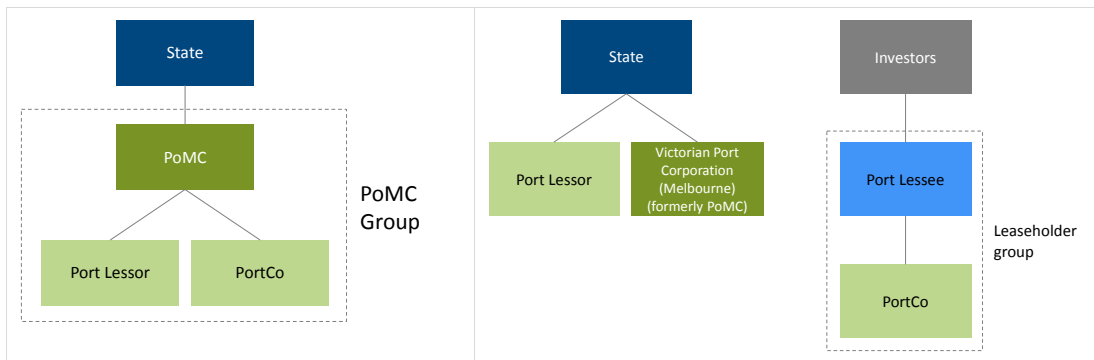
PoMC assets and functions allocations and transition over time



The above sets out how the PoMC assets and functions will be restructured ahead of the Transaction. Prior to Transaction close, the entities set up to facilitate the Transaction will be subsidiaries of PoMC, i.e. Operating Pty Ltd and Port Lessor Pty Ltd. PoMC and these subsidiaries will operate as a corporate group until Transaction close and be governed by the PoMC Board and their boards.

Restructure in preparation for Transaction

Post Transaction close



After Transaction close, Port Lessor will cease to be a subsidiary of PoMC and be held within Government by an appropriate department.

Separating Port Lessor and PoMC (both State entities) enables the day to day operating concerns of PoMC to be separated from the different skills and personnel required for contract management, monitoring and enforcement under the Transaction documentation and specific legislation.

PoMC will retain the current management, governance and emergency management responsibilities of transport entities established through the *Transport Integration Act 2010*. Port Lessor will retain all of the land and fixtures, except for Station Pier and West Finger Pier.

Other State entities may also have specific non-operational land transferred to them, reflecting Government policy positions.

3.1.2.2 StateCo and PortCo

StateCo will be providing services to PortCo, specifically the necessary marine and safety functions such as the Harbour Master and Vessel Traffic Service (VTS).

To reflect the services PortCo will receive from StateCo, a cost contribution model has been developed to reflect a series of principles being (in summary):

- alignment of StateCo's safety marine obligations and PortCo's commercial interests;
- efficient costs, subject to a transition period; and
- contributions reflect functions relating to provision of services to PortCo for operations at PoM.

The cost contribution is proposed to be set at a level for a short period of time, followed by a percentage of channel revenue. This will ensure that StateCo's safety marine interests are aligned with PortCo's commercial interest. In addition, the StateCo cost contribution is being deemed an efficient cost under the Pricing Order in the proposed economic regulatory pricing regime.

3.1.3 State-side management

The Bill and Transaction documents will provide a number of safeguards to ensure the State is able to effectively exercise its functions and to provide a degree of oversight of port land and operations.

Under the Transaction documents, PortCo will regularly report specified matters to the State, as owner of the port land. This will provide the State visibility over PoM development. Reporting requirements include a five yearly Port Development Plan, asset condition and maintenance reporting and environmental reporting.

The Transaction documents will govern the ongoing operation of the port and arrangements between the State retained functions and PortCo. This includes PortCo's obligations surrounding maintenance dredging, hydrographic surveys, asset condition and handback and providing emergency service personnel to assist the State.

To provide visibility over safety and environmental functions, and ensure the leaseholder is subject to the same laws as PoMC is today, it is proposed the leaseholder will have statutory obligations to prepare Safety and Environmental Management Plans and Port Development Strategies.

Furthermore, there are various protections in the Transaction documents for the State and the community in the event of a failure by the leaseholder. This includes step-in rights for non-performance and termination of the lease arrangements.

3.2 Duration

The lease term has significant implications for future State policy objectives and overall economic outcomes and for the viability and attractiveness of the Transaction.

There are a number of possible options for the PoM lease term, ranging from 40 years to 99 years, including scenarios where the lease term varies for different port precincts.

There are a number of critical policy and commercial decisions impacting the optimal PoM lease term, while preserving the State's strategic flexibility and optimising overall economic outcomes, including Transaction proceeds.

3.2.1 Expected operating life of PoM

The optimal operating life of PoM is driven by:

- a. expected capacity;
- b. the timing, staging of, transition to, and operation of a second container port;
- c. whether or when possible alternative uses (e.g. urban development) of PoM represent highest and best use of the land; and
- d. whether PoM is required to operate in parallel with a second container port due to capacity constraints at the second port and/or size of the trade demand.

The expected natural capacity of the PoM within its existing footprint as indicated in a number of PoMC port development strategies, is in the range of 7.0 to 8.0 million TEU, subject to the relevant approvals. Therefore, there is significant capacity remaining in the PoM. Not allowing the PoM to grow to its natural capacity will impose unnecessary and avoidable higher costs to industry, Victorians and government earlier than necessary.

3.2.2 Future possible alternative land use

The length of the lease will need to balance the impact on proceeds against the State's option in having port land available for possible higher and better use, such as urban development at some point in the future. However, predicting when, and if, port land might have higher and better alternative use is difficult and depends on a number of factors including population growth and availability of land outside the port.

There are significant areas of land around the port and the CBD which can be developed prior to port land. Initial analysis shows there is no demand driven requirement for urban development of port land for perhaps another 60 years due to significant land available in inner Melbourne (this capacity is in Docklands, E-Gate, Fishermen's Bend and North Dyon). Furthermore given poor ground quality and high environmental remediation costs, most PoM land will be the least commercially attractive of those available for possible urban development.

3.2.3 Capital expenditure incentives

Within the 50-year lease term, the leaseholder should be incentivised to facilitate additional container or other trade capacity growth and ensure PoM's assets are maintained appropriately. A shorter lease provides a diminishing amount of time that the leaseholder has to recoup its investment (given the long-life nature of the port's assets). This either reduces incentives for the leaseholder to spend the optimal capital expenditure as it approaches the term of the lease or alternatively effectively recovers the expenditure through the regulatory regime over a short period to the end of the lease, either of which may not be to the optimal benefit of the port users or the State.

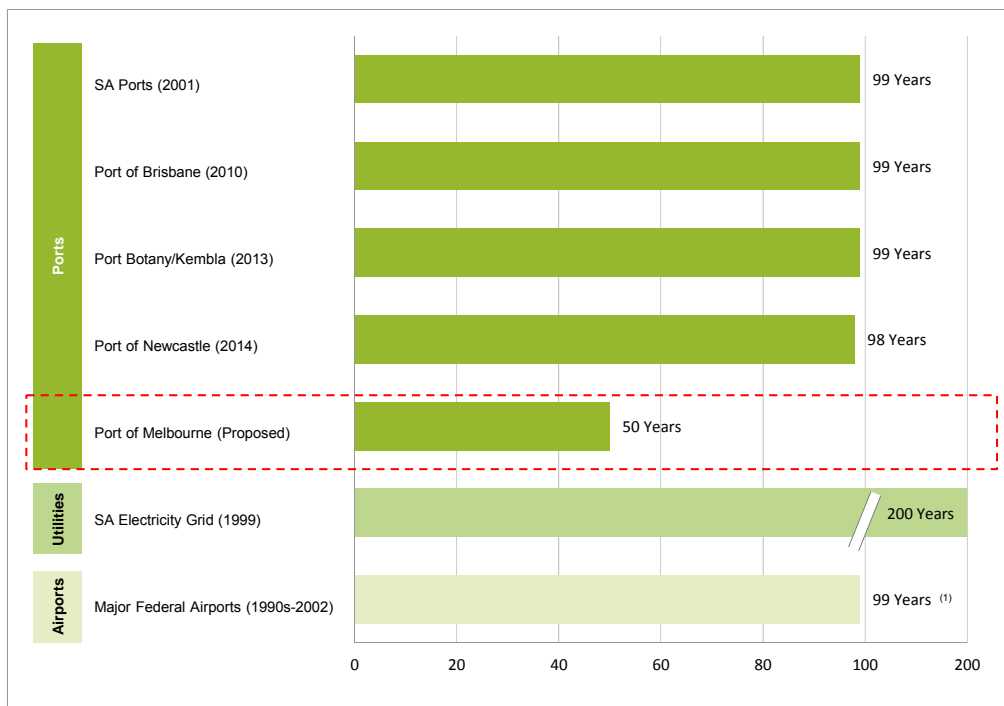
To optimise the flexibility for the leaseholder to have the incentive to optimise the PoM’s operations, the State has proposed an ability for an additional term of up to 20 years to the private sector. This preserves the State’s flexibility on land use while also providing the leaseholder with an incentive to invest if an additional term is negotiated and agreed.

3.2.4 Bidding market considerations

Bidders value a longer lease as it provides for a greater period to receive cash flows and more flexibility in operations and opportunities to optimise financing.

The majority of infrastructure asset bidders will have a preference for a longer investment life. Accordingly, a lease term of less than 50 years is likely to result in somewhat diminished bidder appetite translating into less overall competitiveness, reducing potential Transaction proceeds. As illustrated below, most infrastructure assets have been transacted under a lease greater than 50 years. In addition, Victorian regional ports were transacted on a freehold basis.

Comparative concession life overview



Notes:

1. 50-year lease; with an option for the operator to extend for a further 49 years

3.2.5 Bill – head of power for up to additional 20 years

Allowing for up to an additional 20 years provides the State with flexibility to exercise policy levers and manage timing of second container port development and future PoM land use.

A capacity to grant an additional term of up to 20 years to the private sector future proofs the arrangements and allows the government of the day flexibility. For example, a future government may need to manage for the following situations:

- a. an orderly and progressive transition of part or all of the PoM operations to a new second container port location, which is better served through a short extension of all or part of the PoM lease, and for which there is little value in competing a short lease extension at the time;
- b. where the State believes that it is appropriate to do so, grant additional time in the event of a Force Majeure event (e.g. catastrophic damage to the asset) to enable the leaseholder and tenants sufficient time to recover and allow a reset of the investment cycle;
- c. provides strategic flexibility for the State to determine when the second port will be built, particularly in situations where, for example, container growth is slower than expected and a short extension better aligns with physical built capacity being optimised at PoM; or
- d. provides strategic flexibility for the State to determine at the appropriate time in the future what the land use for some or all of the port land will be; if the decision for best use is development of commercial and residential buildings, then the State will not have locked in a longer term arrangement that prevents the option of urban development.

The regulation to allow for an additional 20 year term can be made by government at any time. However, this is not expected to be used until later in the lease term or in response to the type of situations described above.

Using the head of power in the near term is unlikely for a number of reasons including:

- a. a 50-year lease term is designed to preserve the State’s strategic flexibility – granting an additional term in the near future is inconsistent with this approach as the Government will not have any better understanding of what the State needs will be beyond 50 years;
- b. the expected value for an additional term beyond year 50 is relatively low in net present value terms, so it is not a compelling near term driver to sacrifice policy options to achieve this incremental value outcome upfront;
- c. furthermore, the value of an additional term is likely to be further dampened by the lack of certainty as to tenant and supply chain investment in years 51–70 where a second container port is likely to be operating; and
- d. the Transaction and economic regulatory regime is based on a 50 year recovery, so providing for an additional term in the near term will require a range of amendments to the economic regulatory regime and contractual arrangements.

3.2.6 Lease term options considered

The Government’s considerations in determining the preferred lease term for the Transaction, reflects a balance of State policy and strategic needs, sufficient capital investment cycles for leaseholder, tenants and port users and bidding market considerations.

Option	Considerations
40 years	<ul style="list-style-type: none"> • Insufficient investment cycle to incentivise development
50 years	<ul style="list-style-type: none"> • Sufficient to incentivise leaseholder and tenants to invest to optimise PoM's capacity • Proceeds for the State capture the ability of this new container investment • Preserves State's strategic flexibility – container trade needs versus port land use
50 years plus up to 20 years	<ul style="list-style-type: none"> • Additional flexibility for State towards lease term end, if required
60-75 years	<ul style="list-style-type: none"> • Reduces flexibility around use for urban development • Greater period of likely overlap with second container port
99 years	<ul style="list-style-type: none"> • Upfront value today versus the loss of strategic flexibility – insufficient overall economic benefit

3.2.7 Preserving strategic flexibility

Given the above considerations, the Government has proceeded on the basis of a 50-year lease with the government of the day having the authorising capacity, under regulation, to negotiate a lease extension of up to 20 years, at the appropriate time in the future.

The option of 50 years plus the capacity for up to an additional 20 years is considered to provide the best blend of meeting State strategic flexibility and policy needs and providing sufficient time to promote efficient capital investment from the leaseholder and tenants.

4. TOR (b) – Second container port

KEY POINTS:

1. **Second container port:**
 - a. There are many drivers of container trade growth affecting second container port timing.
 - b. State retains strategic flexibility to develop when required – no right for the leaseholder to develop a second container port is included in the Transaction.
 - c. State retains the ability to develop capacity at any time.
2. **Port Growth Regime:**
 - a. aligns State and leaseholder interests by supporting low cost efficient PoM capacity development alongside the proposed economic regulatory regime;
 - b. delivers best economic outcome through a State regime contested in a competitive tender process; and
 - c. is designed to recognise the leaseholder's investment in their upfront bid value - effectively provide a 'refund' of lost international container trade and reducing the likelihood of investors pricing a greater discount to value than is warranted.

4.1 Second container port

4.1.1 Timing

There are many factors influencing the rate and form of trade growth through the Victorian economy. With the population of Victoria forecast to grow to 10.0 million by 2051² (5.5 million in 2011), there will be a commensurate increase in the demand for goods to meet the needs of the population.

The form of trade, container and non-containerised, is also influenced by a range of factors including technological change, changes in Victorian manufacturing, agriculture and industry and consumer trends.

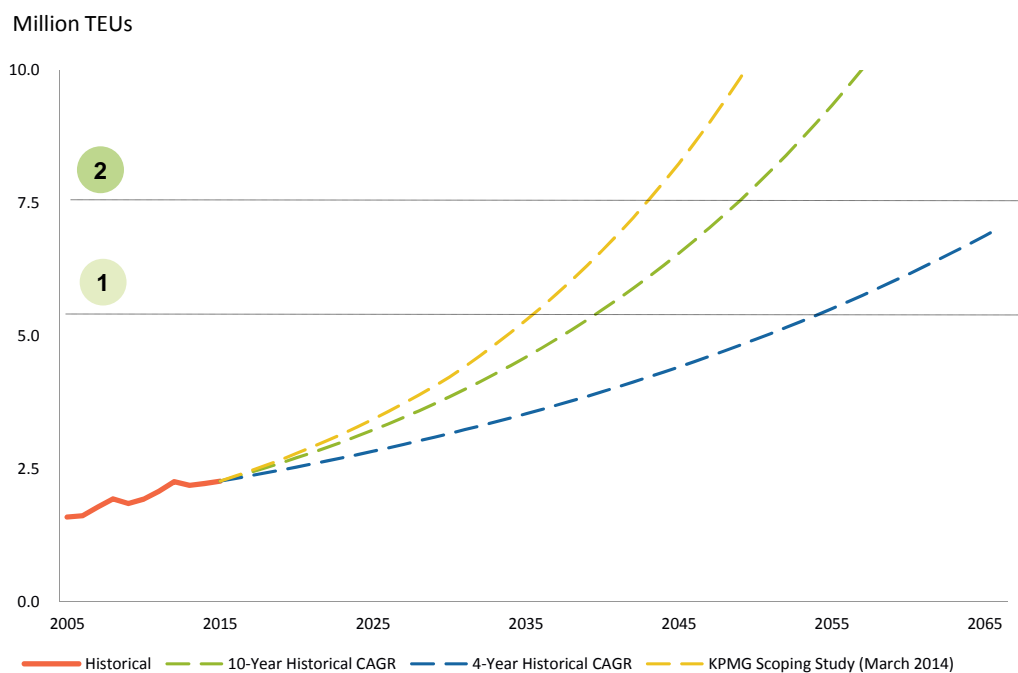
An efficient port sector is a critical gateway to facilitate economic development for Victoria.

However, given the inherent uncertainty in how trade growth might manifest in the long-term, appropriate timing of a second container port is highly uncertain. The Transaction design ensures the State's flexibility is preserved to respond to a wide range of possible future outcomes.

The following chart illustrates the potential spectrum and variability in trade based on different scenarios on long-term growth.

² *Victoria in Future 2015*, August 2015, DELWP

Total Port of Melbourne container demand



- 1 Capacity post Port Capacity Project (Webb Dock)
- 2 Indicative future PoM capacity estimate: 'natural capacity'

Under most realistic scenarios, natural capacity is likely to be exhausted before the end of the 50-year lease term. Further, environment and amenity considerations in and around the PoM will also be relevant considerations for the government of the day. However, it is worth noting the environmental conditions are well documented and understood at PoM compared with other expansion locations.

The natural capacity of the PoM is consistently estimated to be between 7.0 to 8.0 million TEU per annum, subject to the relevant approvals. Even though trade forecasts do vary from period to period, PoM's natural capacity is expected to cater for container and trade growth over the medium term.

4.1.2 Overall economic outcome

When, and how, the State might need to meet future container trade demand with a second container port is uncertain. However, the PGR supports lowest cost incremental port capacity development, while preserving strategic flexibility for the State to develop capacity as required and delivering confidence to investors to underpin their investment. Consistent with preserving strategic flexibility, there is no right for the leaseholder to develop a second container port included in the Transaction.

The PGR and proposed economic regulatory regime (sections 4 and 7 respectively) are designed to align State and leaseholder interests in efficient incremental capacity development at the PoM while it remains the lowest cost option, having regard to both capital costs and overall economic impacts. The Government considers this is the best overall economic outcome for Victoria as it defers the need for a higher cost greenfield port ahead of actual need.

4.2 Port Growth Regime

4.2.1 Bidding market considerations

The State retains full strategic flexibility to build and start operating a second container port at any time.

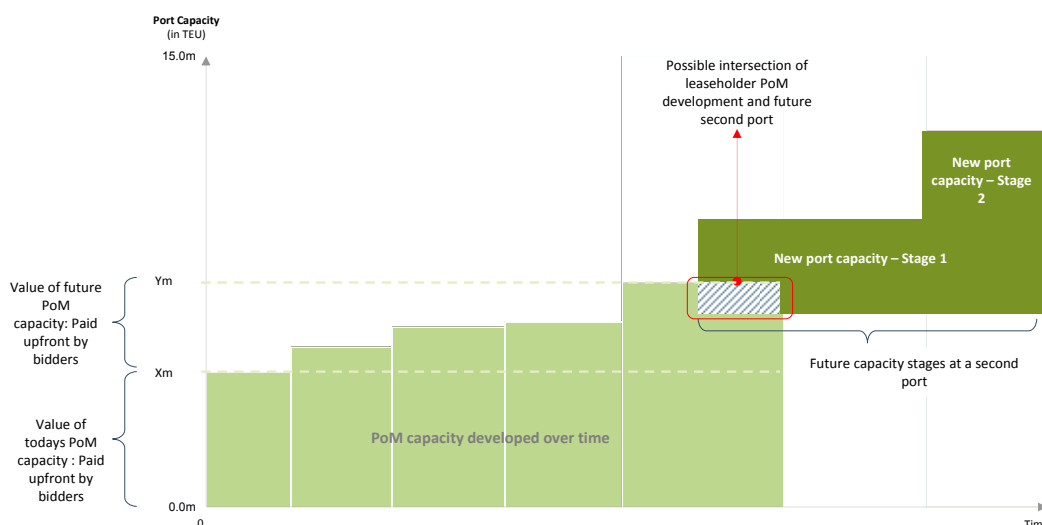
However, this potential for a second port of unknown timing, size, significance of State support or investment and competitiveness with PoM will impact the bidders' assessment of value. A regime such as the Port Growth Regime (PGR) has been raised by a number of prospective bidders, advisers and in the KPMG scoping study³.

Given the nature of PoM, its location and the various policy perspectives on the location and timing of a second container port, bidders are expected to be particularly mindful of the State need to respond to trade needs and exercise its discretion to develop a new competing second container port which impacts the revenues from the PoM.

While the potential impact of a second port may be greater under some lease term and capacity scenarios than others, under all scenarios the commercial advice to the State is it can expect bidders to apply a significant discount to their valuation in the absence of any mitigation of this uncertainty.

This discount for expected losses in upfront value is anticipated to be much greater than any actual payments under the PGR. It is expected to be substantially greater than any expected strategic benefits the State derives from not having the PGR.

Illustrative overlap of PoM capacity development and second container port timing



Although there is potential for overlap, it is in effect an option the State can exercise at the time and is traded off against a higher upfront value today.

The commercial advice to the State is there is greater value to the State to incentivise ongoing investment in brownfield capacity at PoM. This is also consistent with achieving the best overall economic outcome by supporting a low cost port pricing outcome at PoM and deferring greenfield port capacity and landside investment for as long as possible.

³ KPMG was commissioned in late 2013 to undertake a scoping study; a version is available on www.portofmelbournelease.vic.gov.au

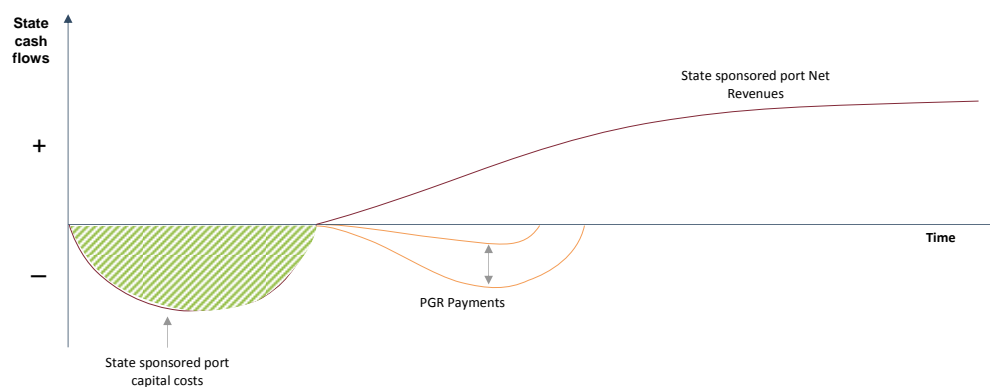
Infrastructure investors are used to taking demand risk, i.e. revenue being variable as a consequence of volume, and responding to private sector competitors behaving commercially. However, the State's discretion to build a second container port is difficult for investors to assess, including what might trigger this decision and the scale and competitiveness of what Government may build. Without the incentives a PGR regime provides, the State can expect proceeds for the Transaction to be reduced.

The State has full control over if, and how much, might be paid under the PGR through its decisions on the timing and scale of second port staging and commencement of operations. The State is better able to manage the uncertainty of a second port impacting the leaseholder and reflect this in a regime. Investors can more efficiently price this uncertainty on this basis and more fully reflect the inherent value of the PoM.

Furthermore, in the absence of a State based regime, bidders are likely to construct their own regimes to respond to the uncertainty. This likely bidder response will be difficult to transparently assess in value for money terms in the absence of a State based benchmark.

PGR payments will only be made where a State sponsored second port derives revenues from international container throughput which is otherwise capable of being handled at PoM. Importantly, therefore, the State receives revenues at the State sponsored second port, providing an offsetting cash flow to fund any PGR payments which are based on the underlying 'lost' volume (illustrated below).

Illustrative flows for the State in second container port scenario



A range of alternatives to the PGR were considered, but were discarded as being less transparent, difficult to quantify and enforce or inconsistent with the underlying demand risk nature of the asset.

Having regard to these considerations, the PGR is designed to align the leaseholder's interests with the State and provides confidence to bidders through:

- a PGR which allows the leaseholder to efficiently price uncertainty of the timing and extent of a second container port, providing for optimal economic outcome for State and bidder;
- providing a strong market signal the State understands the uncertainty of second container port development to bidders;
- incentivising the leaseholder to invest in capacity to efficiently meet State needs, i.e. the leaseholder's interests are to drive commercially feasible growth in a timely manner rather than have the State come over the top of it with new container capacity;

- d. providing a prescribed framework for when the State wishes to develop a second container port as well as a form of assurance to the leaseholder, while capturing upfront value and reducing the likelihood of investors pricing a greater discount to value than is warranted; and
- e. being consistent with the demand risk transfer profile of the asset and the investment proposition being offered to the market.

4.2.2 Principles

In developing a regime, the type of mechanism suitable to meet both the State and a future leaseholder's needs was informed by the following principles:

- a. have regard to the Government's objectives, including the right to develop a second container port at any time;
- b. facilitate ongoing investment by the leaseholder in the desired efficient cost and container capacity outcomes for port users and the Victorian economy;
- c. assign risk to the party best able to manage and control the risk;
- d. optimise predictability of cash flows for bidders to support transaction values;
- e. be as simple as possible to interpret and administer;
- f. not create perverse incentives for the leaseholder;
- g. minimise the potential for gaming and over-compensation; and
- h. be consistent with the economic regulation model chosen.

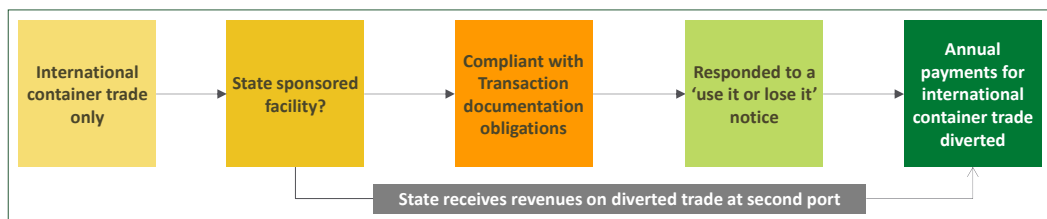
4.2.3 Indicative risk allocation

The following table sets out the indicative risk allocation for the PGR.

Risk	Allocation
Container market grows more quickly or slower than expected (i.e. demand risk)	Leaseholder
Non-container trades relocate from PoM	Leaseholder
Container market share lost to a privately sponsored port or remote Victorian port	Leaseholder
Costs of new expansions at PoM are greater than expected	Leaseholder
Capacity fails to materialise as expected when developed or is less efficient	Leaseholder
Standard planning, environmental and other approvals for new container capacity	Leaseholder
Force majeure events	Leaseholder
Leaseholder fails to build new capacity and State is required to invest	Leaseholder
General changes in State laws not specific to PoM, including planning and environmental	Leaseholder
International containers able to be accommodated at PoM diverted to State-sponsored port	State

4.2.4 Multiple thresholds

The PGR design sets out a series of thresholds required to be met before the leaseholder is eligible for any potential PGR payment.



Threshold	Comments
International container trade	<ul style="list-style-type: none"> The PGR only applies to the diversion of international container trade Does not apply to other trades – e.g. bulk liquid, break bulk, automotive, Bass Strait trade
State sponsored facility	<ul style="list-style-type: none"> A State sponsored facility is a container facility where the State provides specific support in competition to PoM, whether in capital contribution or through specific benefits (e.g. subsidies) Excludes port facilities sponsored by private operators
Compliant with Transaction documentation obligations	<ul style="list-style-type: none"> Leaseholder must be in compliance with transaction documentation To be eligible for payments, the leaseholder needs to be meeting its obligations and not frustrating the PoM's operations
Responded to a 'use it or lose it' notice	<ul style="list-style-type: none"> To incentivise the leaseholder to meet demand when commercially feasible, the State will have the ability to serve a notice on the leaseholder to build capacity Where the State has served such a notice, then if the leaseholder has not responded then the State can build capacity that will not be captured by PGR
Payments	<ul style="list-style-type: none"> Payments are annual and are calibrated to meet some, but not 100 per cent of trade revenue lost These payment features are designed to incentivise the leaseholder to mitigate losses and to prevent claims for small losses The State will be receiving offsetting revenues at a State sponsored second container port for the diverted international trade

4.3 Supporting low cost PoM capacity development and operation

In summary, the Transaction structure, including the PGR and economic regulatory regime is fundamentally premised on preserving the State's right to build and start operating capacity whenever it believes appropriate. The Transaction structure and economic regulatory regime incentivises low cost PoM capacity in the long-term interest of the Victorian economy.

5. TOR (c) – PoM expansion: environmental impact considerations

KEY POINTS:

1. No change to environmental and other statutory approval requirements.
2. Environmental accountability is embedded in existing law.
3. Enforcement and environmental performance and planning outcomes continue to reside with the Ministers for Environment, Planning and Ports.
4. No change in any of the environmental or statutory controls over the condition and performance of Port Phillip Bay, including the Heads (Entrance).
5. No pre-approval of PoM capacity expansion; the leaseholder continues to bear the commercial risk of obtaining all relevant approvals.
6. PoM environmental conditions are well documented and understood compared with expansion locations.

5.1 Regulatory frameworks

5.1.1 Existing regulatory framework

The PoMC and the operation of PoM are subject to a range of transport, property, environmental, planning, safety and employment-related Victorian legislation, among other laws and in particular, the TIA, PMA and MSA.

PoMC is also subject to a range of Commonwealth laws relating to maritime safety, security, the environment and customs and quarantine, which are administered by various Commonwealth agencies, including the Department of Infrastructure and Transport.

In particular, internal and external compliance audits of the maritime security plans at the Port are required to be conducted in accordance with the *Maritime Transport and Offshore Facilities Security Regulations 2003 (Cth)*.

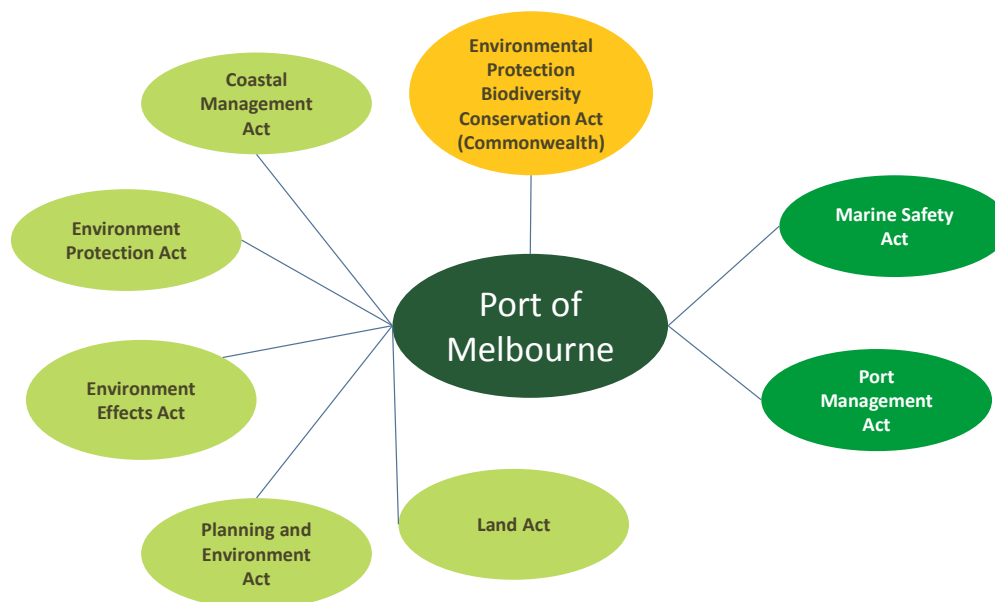
Broadly speaking, the legislative environment governing PoMC can be divided into the following categories:

- a. a range of laws conferring powers and imposing obligations and responsibilities on PoMC in its semi-governmental or regulatory capacity, such as powers and obligations relating to towage regulation and safety, including the functions of the Harbour Master under the marine legislation;
- b. laws imposing environmental and marine safety and other port related obligations on PoMC;
- c. specific laws providing PoMC with particular rights, functions and powers to assist PoMC in performing its obligations, operating its business and imposing fees and charges on port users; and
- d. general laws imposing obligations and responsibilities on PoMC in its own right as a body corporate, landowner or commercial enterprise, or in respect of certain activities undertaken by PoMC.

The Bill does not alter this framework except for specific amendments to appropriately reflect the division and responsibilities between the State and the leaseholder.

5.1.2 Environment and planning frameworks

The following diagram summarises the main environmental and planning frameworks governing the PoM. These frameworks continue to operate unchanged, except for specific Transaction amendments to legislation such as the MSA and PMA to reflect the appropriate allocation of roles and responsibilities between the State and the leaseholder.



5.1.2.1 Planning

The Minister for Planning is the Responsible Authority for the Port of Melbourne Planning Scheme (PoMPS). The previous Minister for Planning introduced a new Port Zone over the ports of Geelong and Portland and to a limited area of the Port of Hastings. The Port Zone has not yet been applied to the PoMPS, which remains within one of four Special Use Zone (SUZ) schedules.

Consolidation of planning controls is important for consistent management of State-side planning matters under a single responsible authority. To give effect to this, it is expected the PoMPS will be updated to align to the PoMC controlled land subject to the lease. The PoMPS was last updated in 2008 and a range of proposed changes have been discussed between PoMC, local council stakeholders and DELWP to agree a common understanding and reflect this consistency.

The planning regime will continue to offer the relevant protections, e.g. buffer management through the Port Environs Overlay, in the overall planning framework to manage the interface between the community and port operations servicing the Victorian economy.

5.1.2.2 Environment

Environmental accountability is embedded in existing law. Enforcement and environmental performance and planning outcomes continue to reside with the Ministers for Environment, Planning and Ports and their respective portfolios and agencies.

The Transaction does not change any of the environmental or statutory controls over the condition and performance of Port Phillip Bay, including the Heads. The leaseholder, as PoMC would today, must conduct any dredging within permit approvals. The Transaction also does not change the nature of access and use of Port Phillip Bay for recreational purposes.

The leaseholder will bear the commercial risk of obtaining the appropriate approvals, including environmental approvals, within the framework of the day. For example, any request to change channel depth or width for shipping channels in Port Phillip Bay and at the Entrance (also referred to as the Heads) will be subject to all the relevant approvals required.

5.1.2.3 Landside

Efficiently moving traffic and freight is an important factor in the productivity of the Victorian economy, industry and the supply chain. The State retains the ability and responsibility to manage landside issues as and when they arise, and it is currently considering a range of projects for road network enhancements to address traffic movements on inner city roads.

Consistent with maintaining strategic flexibility, the State will be preserving rail modal outcomes through maintaining planning controls over existing rail corridors for any future needs (e.g. Webb Dock Rail) and also requiring the leaseholder to maintain PoMC currently owned rail assets in the PoM lease area. Bidders will also be required to pursue a rail modal outcome as agreed with the State.

Although port-related traffic on the broader transport network is a very small proportion of overall traffic, it is recognised there may be localised near-port impacts around the PoM. The State will maintain visibility of the leaseholder's development plans through the Transaction documentation and legislation so it can manage landside issues as and when they arise.

5.1.3 PoM expansion

There is no pre-approval of PoM capacity expansion included in the Transaction; as noted earlier, the leaseholder continues to bear the commercial risk of obtaining all of the appropriate approvals.

However, PoM environmental conditions are well documented and understood compared with expansion locations, which further supports low cost expansion at PoM. Extensive environmental assessment was completed as part of the Channel Deepening Project (CDP) and the more recent PCP.

6. TOR (d) – PoM competitiveness, supply chain and cost effect on goods

KEY POINTS:

1. PoM charges are currently competitive with the two other eastern seaboard container ports, Port Botany and Port of Brisbane.
2. While Government cannot predict pricing trajectory at the other two container eastern seaboard ports, the proposed economic regulatory regime including the recently announced export pricing discount, fosters efficient underlying costs and promotes PoM's port access pricing competitiveness for PoM users and Victorian consumers.
3. PoM is strategically important to the Victorian freight and logistics sector – it has natural location and cost advantages as an existing brownfield port with an integrated transport network and supply chain oriented around it.
4. PoM charges are not a major contributor to overall supply chain costs compared to road transport and terminal and freight costs and are an even smaller percentage of the total cost of goods.
5. PoM remains a low cost outcome for imports to alternatives such as a second container port location or overland from other major eastern seaboard container ports.
6. As part of the Transaction design, the PGR also supports competitive port access pricing for the Victorian freight and logistics sector by incentivising low cost PoM capacity development at the right time.

6.1 Introduction

The National Ports Strategy 2011, as adopted by COAG, recognises much of the future investment and operation of ports will rely on the private sector and that ports and freight supply chains involve long-life assets. Policy decisions about the timing and level of investment in ports are necessarily complex and involve a range of considerations.

There have been numerous previous assessments of potential port capacity options in Victoria. While there is naturally some variation over long term port options, the consistent conclusion of these assessments is the most economically optimal outcome option is to leverage existing investment in PoM.

The Government's Transaction features are designed to support low cost capacity development at the PoM, for as long as possible.

6.2 PoM's relative competitive position

PoM's import charges are currently between Port Botany and Port of Brisbane, and its export charges are currently higher than Port of Brisbane and Port Botany. The recent export pricing freeze announcement for FY16 and subsequent 2.5 per cent per annum discount for the following four years supports PoM's competitive position on export pricing.

While the Government cannot predict the pricing trajectory at Port Botany or Port of Brisbane, the proposed economic regulatory regime maintains PoM’s price competitiveness through capping prices for 15 years and transitioning to a ‘building block’ approach price path. This strengthened economic regulatory regime, enshrined in legislation, ensures efficiency of port access pricing costs to the supply chain.

See section 7 for further information on the proposed economic regulatory regime.

6.3 PoM’s strategic significance

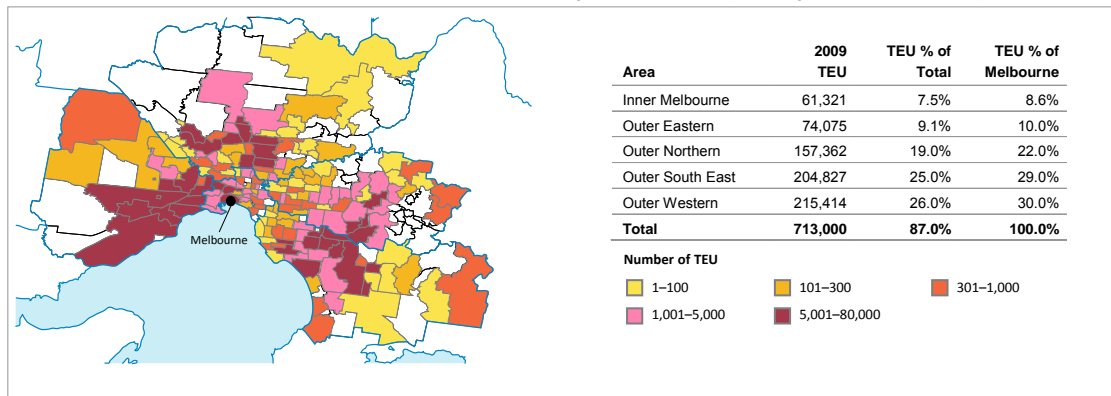
PoM is centrally located for Melbourne’s key import trades and is located within a large, diversified catchment area making it the export gateway for trade from Victoria, eastern South Australia, Tasmania and southern New South Wales. An extensive commercial supply chain has been built around the PoM which serves a diverse and efficient freight system:

- 87 per cent of import containers are destined for the Melbourne metropolitan area;
- 61 per cent of import containers are destined for the inner, outer-western or outer-northern Melbourne metropolitan area; and
- 43 per cent of export containers come from regional Victoria and the broader PoM catchment.

The following diagrams show the detailed break down origin and destination of full import and export containers as well as the regional container flows through the PoM.

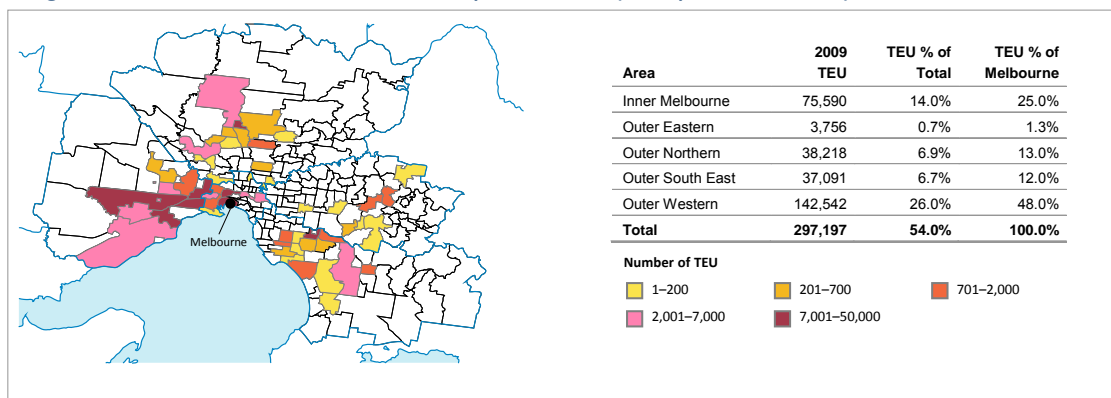
These illustrate the significance of the PoM to the supply chain and its critical position as a gateway for imports and exports.

Destination for full international and mainland coastal import containers (metropolitan Melbourne)



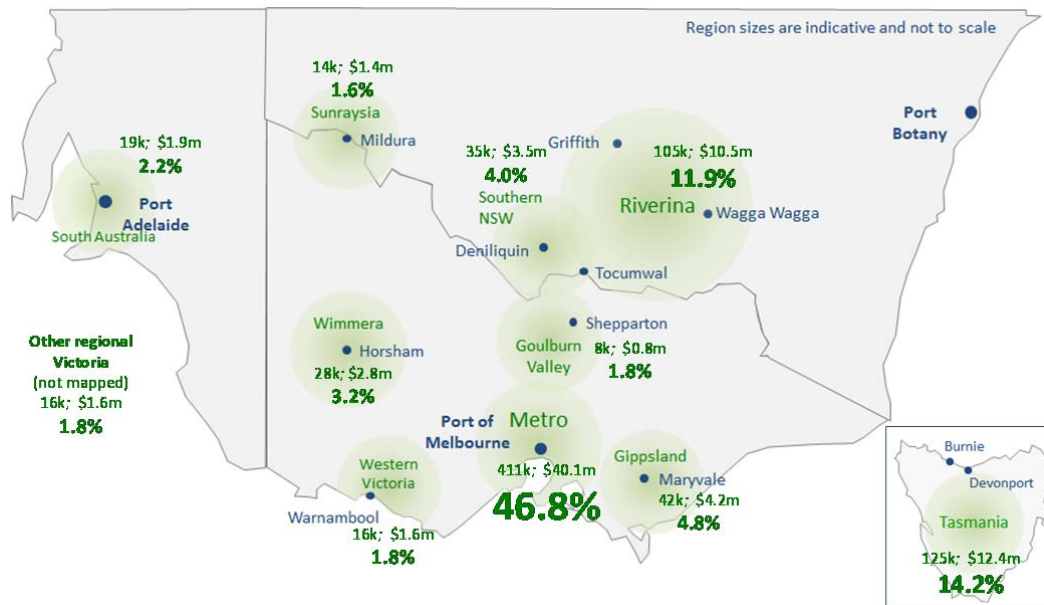
Source Port of Melbourne Study (2010)

Origin of Full International and Mainland Coastal Export Containers (Metropolitan Melbourne)



Source Port of Melbourne Study (2010)

Trade catchment areas - export volumes (TEU), revenue for 2013-14 and relative proportion of total export volume via PoM



Source: Port of Melbourne Corporation, 2015

6.4 PoM and the supply chain

6.4.1 Background

Landlord port costs are part of the overall supply chain costs and cost of goods sold. However, port costs comprise only a small proportion of the total supply chain costs given the number of cost components and parties involved in transporting containers.

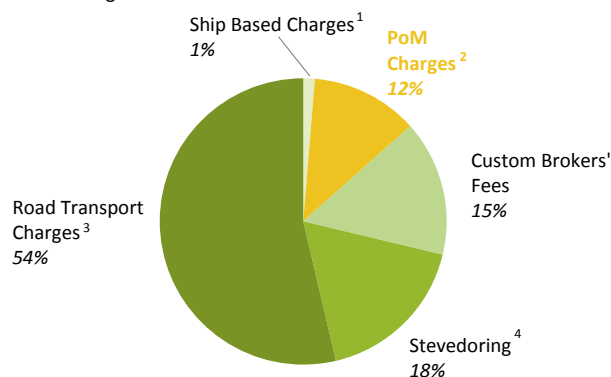
A summary of the typical supply chain is set out in Appendix 3.

6.4.2 Road to port supply chain charges

A historical analysis of container charge components was undertaken by BITRE for mainland capital city ports. This analysis was undertaken for ‘shore-based’ charges, i.e. that part of the charges paid by importers and exporters of containers that are directly related to the activity which occurs in the port or on the wharf, excluding shipping transportation costs.

The analysis shows landlord port charges, including wharfage, channel fees, pilotage, mooring and berth hire, comprise only approximately 12 per cent of total road to port supply chain charges (even less of the total international transfer cost).

FY14 Import Charges
35,000 to 40,000 GT Ships
% of total charges



Source: BITRE

Notes:

1. Includes pilotage, mooring and berth hire; PoM does levy berth hire charges on a select few berths.
2. Indicative PoM charges include wharfage, channel fees and other port charges; these are the major port charges levied by PoM.
3. Based on an estimate of what transport companies charge for transporting a container to or from the wharf from/to the metropolitan area of the capital city in which the port is situated. These charges are estimated for a representative distance.
4. Includes stevedore ground rent costs as estimated at \$9/TEU by the ACCC for all major capital city stevedores.

6.4.3 Total supply chain charges

The State commissioned advice on the competitiveness and capacity for growth of PoM as part of the preparations for the Transaction. This analysis illustrated PoM charges in total amounted to a very small proportion of total landed cost of a product.

Using an indicative containerised commodity with a value of approximately \$20,000 per TEU, it was estimated PoM charges are approximately 0.5 per cent to 1.0 per cent of total landed value of a container.

Over the 2014 calendar year, the daily movement in the AUD/USD exchange rate was approximately 0.5 per cent. In other words, in a typical day, the impact of the fluctuation in exchange rates is approximately the same magnitude as the total contribution of PoM charges to the landed price of a container of goods priced in USD. Therefore, movements in landlord port charges are unlikely to have a perceptible impact on port container volumes or PoM's competitiveness.

6.5 Comparative port costs

As mentioned above, PoM is the gateway for trade in Victoria, eastern South Australia, Tasmania and southern New South Wales. A large proportion of trade through PoM is destined to the Melbourne metropolitan area, particularly to the industrial warehouses in north west Melbourne, where a large proportion of the growth is expected to be.

Therefore, containers through a second or alternate port, which is located further from the container's likely origin or destination, is expected to incur additional transportation costs due to its greater distance and potentially new landside infrastructure required. This is aside from the capital costs associated with developing a greenfield second container port.

In terms of an overland option, the additional cost of directing trade through the closest alternative container port (Port Botany) is material given the transport costs associated with the distance and higher port charges at Port Botany.

6.6 Overall economic outcome

Capacity expansions do not occur often and it is therefore in the State's interests to provide for the appropriate Transaction design and economic regulatory settings for the long-term benefit of the Victorian economy.

The Government is implementing a strengthened economic regulatory framework, which provides a direct relationship between port pricing and underlying efficient and prudent expenditure. This setting will promote low cost port access pricing for the use of PoM by port users and ultimately Victorian consumers.

As part of the Transaction design, the PGR also supports competitive port access pricing for the Victorian freight and logistics sector by incentivising low cost PoM capacity development at the right time.

7. TOR (e) – proposed economic regulatory regime

KEY POINTS:

1. The proposed economic regulatory regime is strengthened through:
 - a. broadening the prescribed services subject to independent Essential Services Commission (ESC) oversight;
 - b. ensuring prices reflect underlying efficient costs;
 - c. capping price increases at the Consumer Price Index (CPI) for 15 years; and
 - d. enhancing ESC oversight.
2. The recently announced export price discount by PoMC will be preserved.
3. There are a number of additional safeguards and controls for port users, Victorian consumers and the State in the proposed economic regulatory regime, including the ability for the State to re-regulate.
4. Land (and improvements) rent remains a market-based, contractual arrangement between willing parties, typically with an independent valuer review process where the parties are unable to agree.

7.1 Economic regulation at PoM

7.1.1 Overview of current arrangements

The ESC is responsible for the economic regulation of PoM under the *Port Management Act 1995 (Vic)* (PMA) and the *Essential Services Commission Act 2001 (Vic)* (ESC Act).

The PMA currently prescribes that the ESC regulates the following services (Prescribed Services):

- a. provision of channels for use by shipping in PoM, including shared channels used by ships bound either for PoM or for Geelong Port;
- b. provision of berths, buoys or dolphins in connection with the berthing of vessels carrying container or motor vehicle cargoes in PoM; and
- c. provision of short-term storage or cargo marshalling facilities in connection with the loading or unloading of vessels carrying container or motor vehicle cargoes in PoM.

The ESC has price regulation powers in respect of the Prescribed Services under the ESC Act and PMA, subject to Ministerial approval. The PMA requires the ESC to review the regulatory regime for the Prescribed Services at five yearly intervals and make recommendations to the State on whether continued regulation of the Prescribed Services is appropriate, and if so, the form of economic regulation to be adopted.

7.1.2 Current economic regulatory regime

The 2010 Price Monitoring Determination (2010 PMD) is the current regulatory instrument imposing obligations on PoM relating to the pricing and financial reporting of the Prescribed Services. Given the current lease transaction considerations, the current 2010 PMD has been extended by one year to 30 June 2016. Consultation with stakeholders and users by the PoMC occurred in March 2015 as part of a regular cycle.

Under the current price monitoring regime, the PoM is required to:

- a. prepare a pricing policy statement (PPS) every five years at the start of the regulatory period, setting out its pricing approach, including how it will calculate its reference tariffs and how it applies the 'pricing principles' and other economic or commercial principles;
- b. publish reference tariff schedules (RTS) setting out its prices for the Prescribed Services on an annual basis; and
- c. provide specified business and financial information to the ESC for monitoring purposes.

The 'pricing principles' in the PPS referred to above are set out in the 2010 PMD and comprise general and shared channel pricing principles. These principles are consistent with the pricing principles established in the Competition Infrastructure Reform Agreement (CIRA), agreed by COAG in February 2006 and to which the State is a party, as well as regulatory practice in Australia more generally. The general pricing principles in the 2010 PMD state that PoM should have regard to the following principles when establishing its reference tariffs and that PoM:

- a. should generate expected revenue that is sufficient to meet the expected efficient long-run costs of providing regulated prescribed services, including a return on assets commensurate with risk;
- b. should not provide a sustained level of revenue that is significantly above that which would be or would have been sufficient to meet the efficient long-run costs of providing the regulated prescribed services, including a return on assets commensurate with risk;
- c. should not be structured to advantage the operations of PoM over those of a competitor in a related market, except on the basis of costs of supply;
- d. should not discriminate between users of equivalent services where those users compete in a related market, other than on the basis of differences in the costs of supply;
- e. may reflect efficient forms of price discrimination as follows:
 - i. multi-part pricing and price discrimination should be employed when these will promote efficient outcomes; and
 - ii. the expected revenue raised from the prices applying to a particular service should be no lower than the forward-looking avoidable cost of providing that service and no higher than that required to support the provision of that service on a stand-alone basis.

7.1.3 Comparison of PoM regulation with other Australian ports

NSW ports are subject to a price monitoring regime. In Queensland, there is no formal price oversight although, under certain circumstances, the relevant Minister is able to 'declare' services at the Port of Brisbane, effectively bringing them under access price regulation administered by the Queensland Competition Authority (QCA).

The historical trend of economic regulation of ports demonstrates a shift to a more 'light-handed' regulatory approach. However, compared to the approach taken in other Australian jurisdictions with privatised ports, such as the Port of Botany, Port Kembla and the Port of Brisbane, the current Victorian regime is more stringent, primarily due to the mandated five year review, providing a potential trigger for more heavy-handed re-regulation of PoM's Prescribed Services.

Some Queensland coal exporting facilities, such as Dalrymple Bay and Abbott Point, are also subject to particular forms of price control, either by contract or through access

undertakings to the QCA. The table below compares current regulatory models applying to different Australian ports.

Comparison of current regulatory models in Australian ports

	Victoria	NSW	Queensland	South Australia
Relevant entities	PoM	All designated NSW ports - i.e. Sydney Harbour, Botany Bay, Newcastle, Port Kembla, Yamba and Eden)	Port of Brisbane	Port Adelaide, Port Giles, Wallaroo, Port Pirie, Port Lincoln and Thevenard
Regime type	Price monitoring	Light-handed price-monitoring regime	No formal price oversight; leaseholder subject to cross-ownership limitations and obligations to publish certain information	Price-monitoring
Charges monitored	<ul style="list-style-type: none"> Provision of channels for shipping use Provision of berths and buoys, short-term storage and cargo marshalling facilities in relation to vessels carrying container or motor vehicle cargoes in the PoM Pilotage services are not regulated 	<p>Most charges under Part 5 of the <i>Ports and Maritime Administration Act 1995</i> (NSW):</p> <ul style="list-style-type: none"> navigation service charges pilotage charges port cargo access charges site occupation charges wharfage charges berthing charges port infrastructure charges 	<ul style="list-style-type: none"> None: prices for all port services provided by the Port of Brisbane are set on a commercial basis Queensland Government provides pilotage and sets prices for those services, and also applies conservancy charges 	<ul style="list-style-type: none"> 'Essential maritime services' including allowing vessels access to the port, port facilities for loading and unloading, and berths for vessels A pilotage service provider must maintain a schedule of charges and provide a copy to members of the public on request
Role of monitoring body	<ul style="list-style-type: none"> ESC also makes a price determination every five years. This includes Pricing Principles to guide a port operator in setting the price of the services on a standing offer basis ESC publishes an annual report on port prices, activities and service standards ESC can determine the form of regulation which is then subject to Ministerial approval 	<ul style="list-style-type: none"> The Minister for Roads and Freight receives information about prices, revenues and price variations and is able to request specified further information Minister has the discretion to make a public statement or report Government agency has no express power to determine or expand the form or coverage of regulation 	<ul style="list-style-type: none"> N/A 	<ul style="list-style-type: none"> Essential Services Commission of South Australia (ESCOSA) makes a price determination every five years and monitors the extent to which the relevant charges have increased in excess of CPI ESCOSA publishes annual price monitoring report Can determine the form and coverage of regulation
Information operator must provide	<ul style="list-style-type: none"> The port operator must prepare and publish a Pricing Policy Statement, and must provide audited financial statements and cost allocation, revenue and port usage information each year The port operator must in effect give 30 days' notice to ESC of prices to apply from the start of a new financial year, and give 60 days' notice of any price variations during the year 	<ul style="list-style-type: none"> Port operators must publish a list of charges. They must publish and provide reasons to the Minister prior to any price variation. If they propose to include a new charge, they must explain the purpose and function of the charge, the basis for its calculation, and which users will be obliged to pay it. For a new infrastructure charge, port operators will be required to submit further information about the Transaction and the period of time for which the charge will be imposed Port operators must report annually to the Minister on various matters including the types of service charges charged and the revenue obtained during the previous financial year 	<ul style="list-style-type: none"> Under the lease, the port operator must publish on its website: <ul style="list-style-type: none"> Within 30 days after each quarter, current port charges and aggregate volumes of trade by major cargo type; and Within 120 days after a financial year, prescribed high-level financial information on maritime services for that year and the prior year 	<ul style="list-style-type: none"> Port operators must publish prices for the relevant services. ESCOSA also requires port operators to submit annual audited regulatory accounts. The accounts are used in ESCOSA's roles as port access regulator and monitoring body The port operator must notify ESCOSA within 10 business days of any changes to the published prices

7.2 Overview of the proposed economic regulatory framework

7.2.1 Rationale

In preparing for the Transaction, the Government reviewed the existing ESC arrangements for PoM and considered what amendments (if any) might be required in order to strengthen the ESC regime and provide greater certainty and predictability for both the leaseholder and port users regarding prescribed service pricing. From a Government policy perspective, it is important that PoM's pricing strikes the appropriate balance in:

- a. promoting the efficient use of, and investment in, regulated port services for the long-term benefit of users, consumers and the Victorian economy;
- b. allowing the leaseholder to recover the cost of providing regulated port services, including a return on the assets employed and commensurate with the risks involved; and
- c. facilitating and promoting competition between ports, shippers, and third party operators.

Consequently, the regulatory framework for PoM's prices needs to:

- a. provide a relationship between prices and underlying costs;
- b. address concerns for the potential for anti-competitive pricing of shared channel services;
- c. provide arrangements to ensure efficient future capacity expansion;
- d. provide a mechanism to enforce compliance with regulatory pricing principles without needing to implement direct price control;
- e. provide flexibility to the leaseholder with appropriate oversight, and mechanisms for the State to make future regulatory changes, if needed; and
- f. minimise the regulatory burden.

7.2.2 How the framework is being strengthened

The proposed regulatory framework is designed to provide confidence that prescribed services tariffs at PoM reflect efficient costs, while ensuring that prudent and efficient investment at the PoM is not compromised over the 50-year lease term.

The key enhancements under the strengthened framework include:

- a. setting future PoM prices against more clearly established pricing principles, including a one-time power for the Governor-in-Council to make a 'Pricing Order' to establish the regulatory regime, and the requirement for the leaseholder to comply with pricing and cost allocation principles utilising a 'building block' methodology;
- b. expanding prescribed services to cover all port services, accounting for approximately 86 per cent of the PoMC's revenue, except leasing of space and facilities (i.e. land and improvements based rent commercially negotiated between the landlord and tenant);

Prescribed Services	Current	Proposed
Shared channel	Yes	Yes
Port of Melbourne channel	Yes	Yes
Anchorage	No	No
Wharfage – including the use of berths, buoys and dolphins	Only for container and motor vehicle charges	For all cargo types
Short-term storage and cargo marshalling facilities for the loading and unloading of cargos	Only for container and motor vehicle charges	For all cargo types
Slipway	No	Yes
Licence and right of access for all third party port service providers	No	Yes
Other port services – wharf inspection, tanker inspection, gangway hire	No	Yes

- c. establishing an opening asset base for PoM's channel and wharf assets, which underpins the 'building block' methodology;
- d. the leaseholder being responsible for setting tariffs for prescribed services in accordance with the Pricing Order and providing specified information to the ESC to support compliance monitoring;
- e. the ESC continuing as the independent economic regulator, providing ongoing compliance monitoring of the leaseholder with the Pricing Order;
- f. non-discrimination provisions will be explicitly set out to protect Geelong Port or any other future Port Phillip Bay port users requiring the use of shared channels; and
- g. a reserve power for the relevant Minister, currently the Minister for Finance, after consultation with the Minister for Ports, to refer the regulatory framework to the ESC for review.

The proposed strengthened ESC regime will mean future PoM prices are set against more clearly established pricing principles, thereby:

- a. providing certainty for the State and investors;
- b. ensuring incentives for timely future investment in new container capacity to meet demand by the Victorian economy and population;
- c. providing predictable and relatively smooth price trajectory for port users;
- d. providing pricing protections for Victorian consumers; and
- e. providing flexibility to the leaseholder to respond to changing conditions over the lease term.

7.2.3 Pricing Order

Under the proposed economic regulatory arrangements, the Governor in Council is required to issue a 'once-off' Pricing Order. The Pricing Order will set out the pricing and cost allocation principles to apply to prescribed services provided by the leaseholder and requires the leaseholder to apply a 'building block' methodology as the basis for setting tariffs.

The Pricing Order will set out the following matters relating to price setting:

- a. Prescribed Service Tariffs Pricing Principles, i.e. utilising the 'building block' approach;
- b. Specific Shared Channel Tariffs Pricing Principles, i.e. no discrimination between the common channel for the Port of Melbourne and Geelong Port;

- c. Port of Melbourne Corporation container export pricing decision, i.e. the leaseholder must ensure the export discounts for the next four years are applied when setting wharfage tariffs for container exports, with the export pricing differential applying in perpetuity;
- d. Tariff Adjustment Limit (TAL) - tariffs can only increase at the lower of CPI and the maximum allowable revenue. It is expected tariffs will increase by CPI for the next 15 years, but no longer than 20 years;
- e. Re-balancing - the leaseholder can re-balance charges provided they do not exceed the TAL;
- f. Capital Base - the opening asset base for channel and port assets are specified upfront;
- g. Return of Capital - The asset life is to be no shorter than the reasonable economic life of the asset, and no longer than the remaining term of the lease. This ensures that any capital expenditure incurred over the course of the lease is recovered by the leaseholder over the term of the lease;
- h. provision/publication of Reference Tariff Schedule, i.e. the leaseholder is obliged to publish and provide to the ESC its Reference Tariff Schedule, which sets out the prices that are to be charged for prescribed services. This must be done no later than the 31 May prior to the commencement of each new financial year;
- i. Tariff Compliance Statement, i.e. requires the leaseholder to provide information to ESC in the form of an annual Tariff Compliance Statement, no later than 31 May; and
- j. Regulatory Period, i.e. allows the leaseholder to determine the length of the regulatory period).

7.2.4 Export pricing discount preserved

The PoMC recently announced an export pricing discount being:

- a. a freeze on loaded international container export charges in 2015-16; and
- b. recommending a progressive 2.5 per cent price reduction for these export charges for the four years thereafter.

This recommended approach will increase export competitiveness and the Government will give effect to this PoMC decision through the Pricing Order.

7.2.5 Land and improvements rents are excluded

Land and improvements rents paid by tenants under their respective leases with the port landlord, i.e. for space and facilities, are not regulated by the ESC under the existing regime, and are not to be regulated by the ESC under the proposed amended regime. This approach is not unique; it is consistent with the approach adopted across the three comparable eastern seaboard international container ports. Neither Port Botany nor Port of Brisbane include tenant leases in services prescribed by the economic regulatory framework.

Regulation of a service is relevant for a uniform and commoditised service, whereas the nature of the PoM tenant leases is a broad range of tenure, conditions, rent setting and uses. The nature of the commercial arrangements are struck between willing parties and/or in competitive tender processes to meet the needs of both the landlord and tenant at the time.

Furthermore, a number of leases at the port contain periodic market rent review provisions, which:

- a. are common in industrial property leases;
- b. reflect a commercial practice where the landlord makes the land available at commercial, 'market rates';
- c. at each rent review period, the landlord will first issue a notice of what it considers market rent to be, with which the tenant can disagree;
- d. the parties then negotiate and/or refer the rent to independent determination by a third party valuer.

The majority of individual leases at the PoM provide for an independent, suitably qualified valuer, to determine a market rent should the port landlord and tenant fail to agree a commercial outcome. This periodic third party determination of market rent ensures tenant rents at the PoM reflect market rates.

7.2.6 Proposed regulatory regime

The proposed economic regulatory framework is designed by Government to reflect its preference to better protect port users and Victorian consumers, while still providing certainty to the leaseholder. The proposed economic regulatory framework is stronger than the current framework at PoM in a number of key respects. Namely it:

- a. applies to a broader set of prescribed services, covering approximately 86 per cent of PoMC revenues;
- b. specifies the initial capital values for assets required to provide the prescribed services, underpinning the orthodox 'building block' approach which:
 - i. allows the leaseholder to recover a return on its capital base commensurate with that which would be required for a benchmark efficient entity providing services with a similar degree of risk;
 - ii. allows the leaseholder to recover the return of its capital base, i.e. depreciation; and
 - iii. allows the leaseholder to recover its forecast efficient operating expenses.
- c. provides improved incentives for efficient investment by establishing expenditure criteria for expenditure allowed to be captured by the regulatory regime;
- d. improves price certainty for users by setting out principles for price setting (tariffs) for prescribed services;
- e. places a CPI cap for 15 years on the year-on-year changes in prescribed service tariffs; and
- f. explicitly defines circumstances that must be satisfied prior to any changes being made to the framework.

Comparison of proposed and current regulatory regime

Key features	Proposed regime	Current regime
Form of regulation	<ul style="list-style-type: none"> One-off power for Governor in Council to make 'Pricing Order' 'Pricing Order' to establish modified price monitoring regime requiring compliance with pricing and cost allocation principles 	<ul style="list-style-type: none"> ESC has power to determine form of regulation every five years Current regime established under ESC's 2010 PMD
Coverage	<ul style="list-style-type: none"> Broader than current scope Covers all port services to vessels regardless of cargo type 	<ul style="list-style-type: none"> Access to channels Provision of berths, short-term storage and cargo marshalling facilities in relation to vessels carrying container and motor vehicle cargoes
Pricing principles	<ul style="list-style-type: none"> Prices to be determined by applying an accrual 'building block' methodology Prices implied by 'building block' approach subject to a transitional cap on annual price increases Non-discrimination principle in respect of shared channel pricing Specification of deemed initial asset values and depreciation period being the term of the Port Lease ('protected provisions') Port Licence Fee left in place and part of allowable cost base under the 'building block' methodology Publication of pricing schedules and provision of tariff compliance statements to ESC 	<ul style="list-style-type: none"> No requirements to set prices by reference to an accrual building block methodology Lacks transparency in relation to revenue and cost relationship for individual services Publication of pricing schedules and provision of one-off pricing policy statement to ESC Port Licence Fee passed through
Compliance	<ul style="list-style-type: none"> ESC to conduct an ex-post review of compliance with Pricing Order at five yearly intervals ESC compliance review report to be published 	<ul style="list-style-type: none"> ESC has discretion to prepare and publish Annual Monitoring Reports and other ad-hoc reports
Power to re-regulate	<ul style="list-style-type: none"> Governor in Council has reserve powers to modify, replace or revoke the Pricing Order in the following limited circumstances: <ol style="list-style-type: none"> Significant and sustained non-compliance with the Pricing Order; The commencement of a second container port in Victoria; or With the agreement of PortCo. In the case of 2, power is limited to revoking regulatory requirements imposed on PortCo 	<ul style="list-style-type: none"> ESC undertakes five yearly inquiries as to whether the prescribed services should continue to be subject to price regulation and the form of such regulation

The proposed regulatory regime is more prescriptive and stringent compared with other regulated eastern seaboard Australian container ports such as in New South Wales and Queensland.

7.2.7 State oversight and enforcement

The Minister for Finance (Minister) retains a residual power to direct the ESC to undertake a review of the leaseholder, including relating to Pricing Order compliance. This power may be exercised outside of the periodic five yearly reviews conducted by the ESC.

The ESC will report to the Minister its findings on the leaseholder's compliance with the Pricing Order. The report will state whether, in the ESC's opinion, there has been significant and sustained non-compliance by the leaseholder.

If, upon receipt of a finding by the ESC to the effect the leaseholder is in significant and sustained non-compliance with the Pricing Order, the Minister, in consultation with the Minister for Ports, will have the power to issue a 'show-cause' notice to the leaseholder. The leaseholder will be provided with an opportunity to respond to any such 'show cause' notice, including explaining why it believes it has not been in significant and sustained non-compliance with the Pricing Order.

The Minister may recommend the Governor in Council exercise its reserve powers to modify the Pricing Order. The Minister can only make this recommendation if each of the following conditions are met being the:

- a. ESC has made a finding of significant and sustained non-compliance with the Pricing Order in its five yearly compliance review;
- b. ESC's findings have not been overturned by the existing appeal rights available to the leaseholder under the ESC Act;
- c. Minister has issued a 'show cause' notice to the leaseholder;
- d. leaseholder has not satisfied the Minister, in consultation with the Minister for Ports, it is complying with the Pricing Order, or will be after complying with an accepted undertaking; and
- e. Minister, in consultation with the Minister for Ports, is satisfied, having regard to the objectives of the regulatory regime, it will be in the public interest to modify the Pricing Order.

7.2.8 Safeguards and benefits for port users, Victorian consumers and the State

There are a number of features of the proposed economic regulatory regime designed to provide safeguards and assurance to port users, Victorian consumers and the State, and provide confidence that the PoM will continue to support long-term Victorian economic growth as efficiently as possible. Strengthening the economic regulatory regime, as enshrined in the legislation, provides for efficient cost pricing principles to be embedded for the lease term including the safeguard of a 'building block' approach underpinning price setting.

The ESC's role is enhanced and Government has the ultimate ability to require re-regulation if there is significant and sustained non-compliance with the Pricing Order, subject to the procedural steps described above.

A CPI price cap for 15 years also provides for certainty and predictability for port users and their impact on the supply chain and cost of goods at PoM. Preservation of the PoM's export pricing discount also encourages and supports the export activities of Victorian industry and interstate trade utilising the PoM as an export gateway.

The ESC's continuing role as an independent regulator of the PoM and the CPI price cap will provide confidence to Victorian consumers that the cost of goods coming through the PoM will remain competitive.

In proposing a more stringent and prescriptive economic regulatory regime compared to other privately operated Australian ports, the Government is seeking to ensure port users and Victorian consumers are safeguarded, and PoM continues to support the long-term competitiveness of the Victorian economy while providing regulatory certainty for the leaseholder.

8. TOR (f) – balancing short-term and longer-term objectives

KEY POINTS:

1. A central focus for Government is optimising the State's overall long-term economic outcome.
2. The Transaction has a number of features more heavily influenced by State policy needs (i.e. longer-term objectives) than bidding market preferences (short-term objective of maximising proceeds).

8.1 Longer-term objective

A central focus for Government in implementing the Transaction is optimising the State's overall long-term economic outcome.

This involves balancing flexibility and optionality, capacity growth incentives, efficiency and economic competitiveness and the response by the investor market.

8.2 Transaction features

The table below sets out a selection of Transaction parameters where longer-term or short-term objectives are relevant in the design, demonstrating how the State is balancing these various needs. As the table indicates, the majority of the features are weighted towards the long-term objective of optimising overall economic outcomes rather than maximising Transaction proceeds.

Key transaction feature	Description	Short-term objective	Long-term objective
50 year lease	<ul style="list-style-type: none"> • Reflects the need for longer term strategic flexibility compared to achieving more upfront value today for a longer arrangement (say 99 years) 	✘	✓
Capacity to grant an additional lease term for up to 20 years	<ul style="list-style-type: none"> • Provides strategic flexibility for the government of the day: <ul style="list-style-type: none"> – an orderly transition of PoM operations to a second port – determine timing of a second port – respond to land use requirements – may assist to mitigate prospect of leaseholder or tenant not investing 	✘	✓
Strengthened economic regulatory regime	<ul style="list-style-type: none"> • Facilitates low cost port access pricing through efficient costs to ensure that PoM continues to support the long term competitiveness of the Victorian economy 	✓	✓

Key transaction feature	Description	Short-term objective	Long-term objective
CPI cap for 15 years	<ul style="list-style-type: none"> Provides certainty and predictability for port users and the supply chain, and ensures PoM remains competitive 	✓	✗
PGR	<ul style="list-style-type: none"> Aligns the interests of the State and leaseholder in the efficient and timely development of PoM Enhances the State's overall economic outcome by growing PoM capacity for as long as it remains the least cost incremental capacity, including environmental and amenity considerations 	✓	✓
No pre-determined timing, capacity and configuration of a second port and no right for the leaseholder to develop a second container port included in Transaction	<ul style="list-style-type: none"> Enables the State to determine if, and when, to develop a second container port 	✗	✓
Allocation of marine and regulatory functions to StateCo, and commercial functions to PortCo (with the exception of Station Pier)	<ul style="list-style-type: none"> Reflects the important policy consideration that the public interest is better served by the marine, emergency management and regulatory functions being retained within the State 	✓	✓
Protection of community benefits provided by PoMC today	<ul style="list-style-type: none"> Leaseholder will be obliged to continue to maintain and provide public access to port land and amenities currently publicly accessible, such as Perce White Reserve, foreshore areas and the provision of non-core commercial services 	✓	✓
No change to environmental or planning statutory requirements	<ul style="list-style-type: none"> The Transaction does not provide any pre-emptive or assumed approval of PoM expansion The leaseholder will bear the commercial risk of obtaining the appropriate approvals within the environmental, planning and approval framework of the day 	✓	✓
Commonwealth assistance	<ul style="list-style-type: none"> Transaction is timed for Victoria to take advantage of the 15 per cent Commonwealth asset recycling initiative while it is still available 	✓	✗
Timing	<ul style="list-style-type: none"> Transaction is timed to access strong demand for infrastructure assets 	✓	✗

8.3 Funding infrastructure

The Bill also prescribes paying Transaction proceeds into the Victorian Transport Fund (VTF) and their use for Victorian transport infrastructure, delivering long-term benefits to the State, including the Level Crossing Removal Program and infrastructure projects for public transport, roads, rail, the movement of freight, ports or other infrastructure.

The Transaction proceeds also provide for additional budget capacity to support the recently announced \$200 million Agriculture Infrastructure and Jobs Fund.

9. TOR (g) – other relevant matters

KEY POINTS:

1. There are a number of other significant matters the Government has focused on in preparing the Bill to implement the Transaction including:
 - a. **employee protections** – protections for employees allocated to the commercial operations to transfer, including voluntarily transfer on no less favourable terms and a two year employment guarantee for permanent non-executive personnel;
 - b. **bidding market considerations** – certainty for investors to confidently bid and the potential timing impacts of implementation as well as competing infrastructure and privatisation transactions;
 - c. **broader community benefits** – public access and amenities maintained and the provision of non-core commercial services; and
 - d. **asset recycling initiative** – optimising the opportunity for Victoria to access the Commonwealth government’s initiative on 15 per cent on proceeds.

9.1 Relevant matters

While not specifically called out in the TOR, the Government has had regard to a number of other significant matters and considerations including employees, bidding market considerations, broader community benefits and the Commonwealth Government’s asset recycling initiative.

9.1.1 Employees

There are a number of protections in the Bill for PoMC employees allocated to assets and functions transferring to the leaseholder including:

- a. transfers are voluntary – even though staff are allocated to remain with the State (PoMC) or to transfer to the leaseholder, once a preferred bidder is known, employees do not have to accept a position;
- b. no less favourable terms and conditions – the State protects these conditions in the Bill and in a range of obligations in the Transaction documentation, including entitlements and superannuation arrangements. Enterprise Agreements in place today continue to apply;
- c. two year employment guarantee – the Bill sets out a two year employment guarantee for permanent non-executive staff; and
- d. State retained employees – continue to have the benefit of their existing employment terms and conditions and Enterprise Agreements in place today continue to apply.

9.1.2 Bidding market considerations

A transaction can be implemented without specific legislation, most likely through a combination of contracts and existing legislation such as the SOE Act and TIA. However, legislation provides greater certainty for bidders, allows for more timely restructuring and delivers a better overall economic outcome for the State in a more comprehensive and transparent matter with a range of safeguards and protections for the Victorian community.

In terms of timing, there are a number of competing infrastructure transactions in other states/territories and timeliness is relevant to the depth of the bidding field, resources, advisers and funding. All these factors impact the competitiveness of the bidding field and therefore impact the value achieved for PoM.

9.1.3 Broader community benefits

The Transaction will convey a range of broader community benefits such as:

- a. requiring current public access to PoM lease land to be maintained;
- b. the leaseholder will also be required to maintain other public amenities such as Perce White Reserve and foreshore areas (e.g. The Spit, Newport foreshore and Spotswood foreshore);
- c. access will also be maintained for other community access points such as the Westgate Punt; and
- d. the leaseholder is also required to provide slipway functionality used by many vessels using the waterways (e.g. ferries), which is a non-core commercial activity.

9.1.4 Asset recycling initiative

Bringing the PoM to market now provides Victoria with the opportunity to receive an additional 15 per cent on Transaction proceeds from the Commonwealth Government, which can then be used by the State for other priorities and community needs.

10. Transaction documentation

KEY POINTS:

1. As is usual for this type of transaction, many aspects will be implemented and administered by contract.
2. While not included within the TOR, this section provides information on the broad nature of the proposed Transaction documentation.

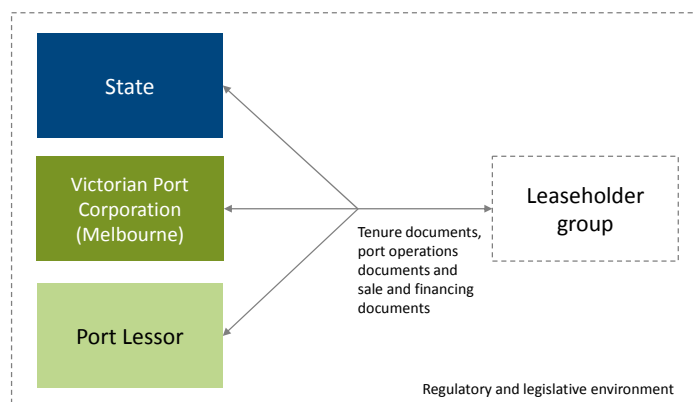
10.1 Introduction

The Bill authorises the Transaction, and as is usual for this type of transaction, many aspects will be implemented and administered by contract.

This is similar to other existing arrangements where projects have specific legislation (e.g. CityLink and EastLink) or are facilitated under other legislation such as the PDACM Act. However, the detailed arrangements are set out in a range of contracts. Prior to Transaction close, it is not considered in the public interest to provide any detailed commercially sensitive information, including Transaction documents, as this may prejudice the State's outcomes in a competitive tender. Any disclosure will be in accordance with relevant State policy.

A simplified illustration of the proposed structure is set out below.

Illustrative transaction legal structure



A draft set of Transaction documentation has been developed reflecting the proposed structure. The Transaction documents will be finalised in light of the prevailing legislative environment, the Government's preferred commercial position and negotiations as part of a confidential competitive tender process.

The final documentation will be substantial as is typical for infrastructure transactions of this nature. The description of the operation of these documents are necessarily illustrative only and subject to updating due to ongoing due diligence, documentation, approvals and discussions with bidders during the confidential bidding process.

For the most part these descriptions reflect precedent documentation for transactions of this type, as the Transaction is likely to reflect similar commercial positions in many areas, but will be customised for the PoM as an asset and reflecting Victorian Government preferences.

The proposed documents governing the legal relationship between the State and the private sector generally sit in one of the following four categories:

- a. **tenure documents:** land focused documents under which the port land and channel seabed is leased to the private sector, including the Port Lease and the Seabed Lease;
- b. **port operations documents:** govern the ongoing operation of the port business by the leaseholder, including the Port Concession Deed, Dredged Material Ground Licence, Port Waters Licence, Port Operations Service Agreement and Transitional Services Agreement;
- c. **sale and financing documents:** govern the transfer of port assets to the private sector and support the funding for the proceeds, including the Sale and Purchase Agreement, Financier Deed and Port Growth Regime Deed; and
- d. **supporting plans and documents:** assist the State to manage the asset and to give it appropriate visibility of port operations throughout the lease term including the Port Development Plan, Asset Management Plan and Environmental Management Plan.

10.2 Outline of key Transaction documents

The two key Transaction documents governing the 50-year lease and the PoM operations are the Port Lease and Port Concession Deed. These documents are complemented by legislative requirements set out in the Bill and proposed amendments to existing legislation such as the TIA, PMA and MSA.

10.2.1 Port Lease

The Port Lease is expected to be the key tenure-related Transaction Document. An indicative outline of its content is set out below.

Heading	Illustrative Content
Permitted use and port stewardship obligations	<ul style="list-style-type: none"> • Leaseholder generally must use the leased land only for port-related uses and other lawful purposes as approved by the State. • Leaseholder must at all times during the term: <ul style="list-style-type: none"> – manage, operate and maintain the Port in accordance with good operating practice; – ensure the PoM is capable of providing access to intrastate, interstate and international shipping; – ensure that port land is no less capable of providing access to the PoM for intrastate and interstate rail and road transport than at the commencement of the Port Lease; – provide for access to the PoM by all safety and security vessels employed in the service of a State agency; and – provide for access to the port by vessels employed in the service of Defence. • Leaseholder must not use any part of the port land for a range of specific non-port uses or developments (i.e. those of a kind that might increase traffic movements or create amenity issues). For example, hotels, residential developments, retail shopping facilities etc.
No vertical integration	<ul style="list-style-type: none"> • Prohibition on leaseholder or its controlling entities or its associates being a 'Prohibited Port Operator', i.e. a stevedore or motor vehicle terminal operator. (Note that while not contained in the Transaction Documents themselves, the

Heading	Illustrative Content
	Government has already announced that stevedores will not be permitted to bid in the Transaction.)
General obligation on port development	<ul style="list-style-type: none"> Leaseholder must develop port land and facilities from time to time at its cost having regard to a number of factors including: <ul style="list-style-type: none"> the actual and reasonably anticipated future growth in, and demand for, port facilities and port services; the quality and efficiency standards reasonably expected of a major port in Australia; good operating practice; applicable laws and government legal requirements; and the objective that the Port be managed, operated, maintained and developed so as to be a major seaborne trade gateway for Victoria. Leaseholder's obligations are subject to availability of development approvals, availability of finance on reasonable terms and the development being consistent with leaseholder obtaining a reasonable commercial return on any required investment.
Amenity	<ul style="list-style-type: none"> Leaseholder must use its reasonable endeavours to plan and control use and development of the port land to: <ul style="list-style-type: none"> maintain a high level of residential amenity in any residential areas, having regard to traffic, noise, dust, odour, light and other relevant impacts; and minimise the impact of traffic, noise, dust, odour, and light on any school, pre-school, community care facility or hospital. Leaseholder must provide for public access and maintenance of amenities as prescribed.
Rail corridors	<ul style="list-style-type: none"> Leaseholder must not without the prior written consent of the State: <ul style="list-style-type: none"> use or permit the use of the rail corridor for any purpose other than the provision of a railway corridor; or use or permit the use of land adjacent to the rail corridor for a purpose inconsistent with or likely to interfere with the use of the rail corridor. Leaseholder must not remove or relocate, or permit the removal or relocation of, rail infrastructure from the rail corridor unless those facilities are immediately relocated or replaced.
Rail modal outcomes	<ul style="list-style-type: none"> Leaseholder must pursue a rail modal outcome as agreed with the State. Leaseholder will not be required to pursue any rail modal outcome that will prejudice leaseholder's ability to commercially recover the costs of the outcome from port users.

10.2.2 Port Concession Deed

The Port Concession Deed is expected to be the main 'operational' Transaction document. An indicative outline of its content is set out below.

Key parameter	Comments
Key operational matters	<ul style="list-style-type: none"> Port Capacity Project to be completed by the leaseholder Asset condition and maintenance regime Performance of hydrographic surveys Leaseholder emergency response obligations Maintenance of navigation aids Provision of slipway functionality Access for Defence vessels Dredging responsibilities

Key parameter	Comments
	<ul style="list-style-type: none">• Reporting obligations• Restrictions on transfer and change of control• Leaseholder must assist with 'handover' of port assets and port operations at the end of the lease if requested by the State• Use of the Port of Melbourne name and logo• StateCo cost contribution

Appendix 1 – Terms of Reference

A Select Committee of eight members has been appointed to inquire into and report on the proposed lease of the Port of Melbourne as contemplated by the Bill and, in particular:

- a. the structure and duration of the proposed lease;
- b. the potential impacts of the proposed lease on the development of a second container port in Victoria;
- c. the potential impacts on the environment of the further expansion of the Port of Melbourne;
- d. the potential impacts of the proposed arrangements on the competitiveness of the Port of Melbourne, the supply chains that depend on it and cost effects on goods passing through the Port of Melbourne;
- e. the effectiveness of the proposed regulatory framework in dealing with the transfer of a monopoly asset from the public sector to the private sector;
- f. how the proposed lease balances the short-term objective of maximising the proceeds of the lease with the longer-term objective of maximising the economic benefits to Victoria of container trade; and
- g. any other relevant matters.

Appendix 2 – Separation allocation outcomes

Allocation outcomes

The outcomes from the application of the separation allocation framework are summarised below.

Item	Precedent Treatment	Is this a commercial driver for PortCo?	Is this necessary to commercial operations, but not income generating?	Can any policy issues be appropriately managed by PortCo?	Can any stakeholder issues be appropriately managed by PortCo?	Separation allocation
Pricing						
Port charging powers	PortCo	✓	✗	✓	✓	PortCo
Channel revenue	PortCo	✓	✗	✓	✓	PortCo
Navigation Function						
VTS	StateCo	✓	✓	✗	✗	StateCo
Harbour Master	StateCo	✗	✓	✗	✗	StateCo
Hydrographic survey	PortCo/State Co	✗	✓	✓	✓	PortCo
Channel & Dredging						
Dredge Material Ground (DMG) management	N/A	✓	✓	✓	✓	PortCo
Channel maintenance and dredging	PortCo	✓	✓	✓	✓	PortCo
Provision of Port Infrastructure Function						
Navigational aids	PortCo (majority)	✗	✓	✓	✓	PortCo (majority)
Physical security	PortCo	✗	✓	✓	✓	PortCo
Cth security plans	PortCo/State Co	✗	✓	✓	✓	PortCo
Authorised officers	StateCo	✗	✓	✗	✗	StateCo
Property & Planning						
Property management	PortCo	✓	✗	✓	✓	PortCo
Provision of utilities	PortCo	✓	✗	✓	✓	PortCo
PCP – People, Contracts, Funding, Obligations	N/A	✓	✗	✓	✓	PortCo
Commercial operating land (Webb Dock, Swanson Dock, Appleton/Victoria Docks, Yarraville/Holden Bulk Liquid, Maribyrnong 1/Coode Island, Gellibrand Pier, Breakwater Pier)	PortCo	✓	✗	✓	✓	PortCo
Non-Operational Port Land (e.g., Port Education Centre, Perce White Reserve, other buffer land)	PortCo	✗	✓	✓	✓	PortCo
Other Land/Assets						
Head Office	PortCo/State Co	✗	✓	✓	✓	PortCo / StateCo (office split)
Control Tower	StateCo	✗	✓	✗	✗	StateCo
Slipway	PortCo	✗	✗	✓	✓	PortCo
Station Pier (Cruise Precinct)	StateCo	✗	✗	✗	✗	StateCo

Item	Precedent Treatment	Is this a commercial driver for PortCo?	Is this necessary to commercial operations, but not income generating?	Can any policy issues be appropriately managed by PortCo?	Can any stakeholder issues be appropriately managed by PortCo?	Separation allocation
Road ownership and usage	PortCo	x	✓	✓	✓	PortCo
Rail Infrastructure	PortCo	x	✓	✓	✓	PortCo
Safety & Environment						
Emergency management/Marine pollution	StateCo	x	✓	✓/x	✓	StateCo (Waterside) PortCo (Landside)
Dangerous Goods Function	StateCo	x	✓	x	x	StateCo
Emergency response equipment	StateCo	x	✓	x	x	As per Emergency Management Allocation above
Marketing						
Trade statistics	PortCo/State Co	x	✓	✓	✓	PortCo/StateCo
Trade promotion function	PortCo	x	✓	✓	✓	PortCo
Other						
IT	PortCo/State Co	x	✓	✓	✓	PortCo/StateCo (depending on function)
Hydrographic Vessels	PortCo	x	✓	✓	✓	PortCo

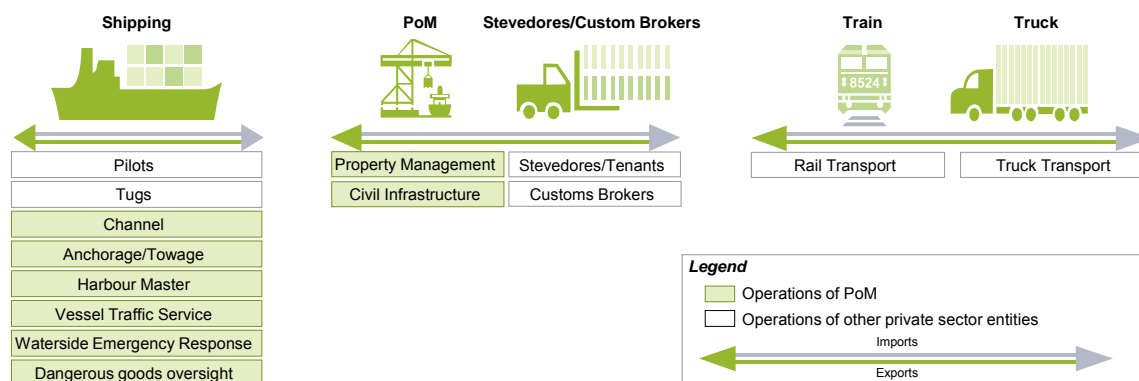
Appendix 3 – Overview of typical supply chain

The full container logistics supply chain costs for users, i.e. from the warehouse to the end user, is comprised of the following components:

- cost of goods sold;
- warehouse storage costs;
- transportation costs from the warehouse to the port, either by truck or train;
- landlord port charges, which includes wharfage charges, channel fees;
- stevedore loading fees;
- shipping costs, which includes the costs of navigation within the port and shipping transportation costs (e.g., fuel) from/to the origin/destination; and
- other fees and charges such as customs and freight forwarder fees.

An overview of a typical supply chain for the import and export of containers from port to/from the warehouse (excluding shipping transportation) is shown below and how they intersect with PoM operations.

Overview of typical supply chain



There are a large number of parties involved in the delivery/supply of goods including:

Parties	Comments
Importers/exporters	<ul style="list-style-type: none"> • Those who take delivery of cargo or deliver cargo
Freight forwarders	<ul style="list-style-type: none"> • Those who arrange the international transport of freight on behalf of importers and exporters
Customs brokers	<ul style="list-style-type: none"> • Authorised by importers to act on their behalf to arrange clearance of cargo by the Australian Customs and Border Protection Service
Container terminals (stevedores)	<ul style="list-style-type: none"> • Container terminals are under contract to shipping lines • Stevedores load and unload containers from ships and arrange for containers to be received from, and delivered to, transport operators
Shipping lines	<ul style="list-style-type: none"> • Shipping lines operate vessels solely or in partnership with other lines, own or lease the majority of containers, arrange berthing/un-berthing and stevedoring, and contract empty container parks to handle empty containers

Parties	Comments
Empty container parks (ECPs)	<ul style="list-style-type: none"> • Empty container parks are contracted by shipping lines to store empty containers and to provide empty container dehire (import) and hire (export) services as well as container repairs, upgrades and reefer services
Road transport providers	<ul style="list-style-type: none"> • Transport containers between the container terminals, pack/unpack locations, ECPs and any staging or interim depots
Rail operators	<ul style="list-style-type: none"> • Transport containers to/from rail terminals
Landlord port operator	<ul style="list-style-type: none"> • Provides civil infrastructure (wharf) to shipping lines to berth, lease port land to service providers such as stevedores, and provide safe navigation for shipping lines to berth

Important notice

This submission has been prepared by the Department of Treasury and Finance solely for the purpose of responding to the terms of reference of the Legislative Council Select Committee Inquiry into the Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) 2015 Bill. Parliamentary privilege applies to this submission.

The information in this submission does not constitute financial, legal, tax or investment advice and no third party is entitled to or should rely on this information including in relation to any potential future transaction of the State relating to the Port of Melbourne (Port of Melbourne transaction).

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