INFRASTRUCTURE PARTNERSHIPS AUSTRALIA
BUILDING AUSTRALIA TOGETHER

INFRASTRUCTURE PARTNERSHIPS AUSTRALIA'S SUBMISSION TO THE VICTORIAN PARLIAMENT'S PORT OF MELBOURNE SELECT COMMITTEE

SEPTEMBER 2015

ABOUT IPA

Infrastructure Partnerships Australia is the nation's peak infrastructure body – formed in 2005 as a genuine and enduring policy partnership between Australia's governments and industry.

IPA's formation recognises that through innovation and reform, Australia can extract more from the infrastructure it has, and invest more in the infrastructure it needs.

Through our research and deep engagement with policymakers and industry, IPA seeks to capture best practice and advance complex reform options to drive up national economic prosperity and competitiveness.

Infrastructure is about more than balance sheets and building sites. Infrastructure is the key to how Australia does business, how we meet the needs of a prosperous economy and growing population and how we sustain a cohesive and inclusive society.

Infrastructure Partnerships Australia draws together the public and private sectors in a genuine partnership to debate the policy reforms and priority projects that will build Australia for the challenges ahead.

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EXECUTIVE SUMMARY

The lease of the Port of Melbourne is a matter of rare political consensus, having underpinned the funding and spending policies of both the Government and the Opposition at the last election.

With the benefit of in-principle support for recycling taxpayer funds from the Port, our submission considers that there are just three areas of material policy divergence between the Government and Opposition, which we understand to be:

1. The term of the lease;
2. The mechanism to control port charges under private management; and
3. The best way for the lease to contemplate future competing port capacity to service Melbourne and Victoria more broadly.

These are material and important areas – however, we submit that each of these areas can be resolved in the interest of taxpayers and consumers through the Committee's deliberations and report.

In terms of these matters, we submit that:

Term of the lease:

On balance, the term of the lease should be 50 years, with no option.

Pricing control:

The price control recommended in the legislation reflects national best-practice, and should be supported.

Future port capacity:

This technical aspect of the transaction should be resolved through expert advice, balancing the interest of the taxpayer against the long-run efficiency of Victoria's freight and logistics sector.

This Committee presents an important opportunity to reach broad political consensus about the best timing and structure of the lease transaction.

This Committee's role in developing proper political consensus is all the more important, noting the unwelcome spectre of sovereign-type risks created by the cancellation of the East West Link.

For this reason, we respectfully submit that the Committee's deliberations and report are important in their own right.

Noting the need to restore confidence in Victoria's Greenfield and Brownfield infrastructure programmes, failure to pass legislation this calendar year would see the transaction unable to reach the market when expected. This is not in the taxpayer interest.

For this reason, we respectfully recommend that the Committee accelerate its reporting timeframe to **1 November**, providing the Parliament with additional time to consider the (ideally bipartisan) amendments and pass the legislation by year's end.

KEY POINTS

Leasing the port is a consensus issue in principle – and is required to fund infrastructure activity:

While Victoria enjoys a stronger fiscal position than most other states, it still faces an infrastructure investment task beyond the capacities of the budget alone.

The lease of public assets liberates existing taxpayer funds, which can then be used to fund new infrastructure without charging users – or increasing taxes.

We submit that the Committee should consider the levels of investment and activity in NSW, which is now able to deploy a record level of public infrastructure investment. By retiring existing port, water and electricity assets New South Wales will increase its share of Australia-wide civil construction from 32 per cent to 39 per cent over the next five years (BIS Shrapnel, 2015).

Committee reporting timeframe:

We note the importance of this Committee in driving agreement on key aspects of the Port transaction; but also note that the taxpayer interest will be ill-served by continued political volatility over the Greenfield and Brownfield infrastructure programme.

Victoria needs to remove the spectre of sovereign-type risks posed by the cancellation of the East West Link motorway.

For this reason, we submit that the Committee should report by **1 November** – not the end of November as currently planned; in turn allowing the Parliament time to review and pass the legislation in time for the Port's expected sale.

We submit that Victoria can ill-afford further reflections of political uncertainty in its Greenfield or Brownfield infrastructure programme.

Lease term:

On balance, we submit that the 20 year lease option should be removed.

While accepting the basis of structure, our analysis suggests little taxpayer value in offering a contingent extension. Rather, the lease should be set at circa 50 years reflecting government and opposition support for a medium term (which we understand to be circa 40-50 years) lease.

Price protections:

Leasing core economic assets with effective-monopoly traits, like the Port of Melbourne, requires prudent consideration of how prices are controlled, after the Port becomes solely commercial in its focus.

While noting the various options that have been advanced – including the option of national price regulation by the ACCC – the price protections and regulatory structure advanced in the legislation reflects national best-practice. Indeed, the lack of an identifiable market failure in terms of pricing behaviours by other leased ports (with lower levels of price regulation) sees the argument for ACCC regulation poorly explained or justified.

Contemplating a future second port:

There are various ways in which the structure of the planned lease could deal with the requirement for future development of additional and potentially, competing, port capacity.

The Government's model will see bidders nominate the level of trade after which the State could develop a new facility. Bidders will also be asked to specify the amount of refund they would expect, if the State decided to build a new port before the agreed level of trade is met at the existing port.

Another option could see Victoria specify a year from which the State retains the right to develop a new port facility, with or without a monetary refund. For example, the lease could specify that a new port could be built anytime from say 2035.

An alternative option could be to provide the lessee with a 'first right of refusal' to develop a new facility as needed – with Sydney Airport providing a current and live example.

Each of these three broad approaches seek to balance investor's need for certainty, against the public policy requirement for flexibility in meeting the economy's requirements.

We submit that resolving the best option for this transaction is beyond the expertise of this submission – and likely beyond the individual expertise of the Committee's members.

For this reason we respectfully submit that the Committee agree an independent advisor to review the options and provide the Committee with clear advice on the best approach.

1 LEASE DURATION

We submit that the lease option should be removed. Our analysis suggests little taxpayer value in offering a contingent extension. Rather, the lease should be set at circa 50 years reflecting government and opposition support for a medium term (which we understand to be circa 40-50 year) lease.

The term of the lease is in our view, the easiest of the three issues to resolve.

We agree with the Opposition that there is little value to be gained from including a contingent 20 year optional extension, exercised at the sole discretion of a future government.

We accept the arguments that have been used to explain the 20 year potential extension, gathered around flexibility for the public sector, removing the risk of a competitor port and creating an ongoing signal for investment in the Port of Melbourne facility in the latter years of the lease. We believe these issues can be dealt with in other ways.

We submit that the 20 year extension is unlikely to increase the sale price. Our understanding is that investors will logically value the first circa 30-35 years of the cash flow, and will ascribe some value through to year 50.

Even with a longer fixed term, investors are unlikely to attribute much value beyond this point, because it is so far distant and therefore, uncertain.

On balance, we therefore submit that the Committee should recommend amendment to the legislation to remove the option, with a fixed term of 50 years.

2 PRICE PROTECTIONS

Leasing core economic assets with effective-monopoly traits, like the Port of Melbourne, requires prudent consideration of how prices are controlled, after the Port becomes solely commercial in its focus.

While noting the various options that have been advanced – including the option of national price regulation by the ACCC – the price protections and regulatory structure advanced in the legislation reflects national best-practice. Indeed, the lack of an identifiable market failure in terms of pricing behaviours by other leased ports (with lower levels of price regulation) sees the argument for ACCC regulation poorly explained or justified.

Existing Regulatory Safeguards

State based protections

Current arrangements see the Port of Melbourne regulated under two principal acts - the *Port Management Act* 1995 (Vic) and the *Essential Services Commission Act* 2001 (Vic). These existing arrangements see core key port infrastructure services subject to the scrutiny of the Essential Services Commission's (ESC) price regulation powers.

These "Prescribed Services" under the ESC's oversight include:

- the provision of channels for use by shipping in Port of Melbourne waters;
- the provision of berths, buoys or dolphins; and
- the provision of short-term storage or cargo marshalling facilities

The ESC conducts a review every five years and releases Price Monitoring Determinations which govern the level of regulation of Prescribed Services. The current determination requires the Port of Melbourne to:

- prepare "Pricing Policy Statements" which set out its pricing principles;
- publish Reference Tariff Schedules; and
- provide business and financial information to the ESC for monitoring purposes.

While the ESC has taken a light handed approach to date, it does retain a latent power to intervene if necessary, namely, by making new determinations which:

- fix the price or the rate of increase or decrease in price for a service
- fix the maximum price or maximum rate of increase in the maximum price for a service
- fix an average price for a service or an average rate of increase in the price
- specify pricing policies or principles

Commonwealth protections, and the role of the Australian Competition and Consumer Commission (ACCC)

State price controls are complemented by existing Commonwealth statutory safeguards – which already allow the ACCC to obtain price control powers over the Port of Melbourne, if the Commonwealth Treasurer makes a declaration under part 3a of the *Competition & Consumer Act* 1990 (Cth).

We note a number of submissions argue for the ACCC to take a more direct role in Port of Melbourne's price regulation.

We submit to the Committee that these submissions do not appear to make a cogent case that there has been a market failure in other jurisdictions that have leased their ports, often with lower levels of price regulation than is contemplated in the legislation. Rather, port charge increases observed in recent years have largely reflected market corrections following periods of below-market rates.

IPA supports many of the arguments advanced in the ACCC's own submission – and we annexe our 2007 research report on the structure of the national freight market. This paper's central recommendation was for national economic regulation of the freight sector.

We note that the intervening period has seen essentially all capital city container ports move from public to private operation. In some ways, the contemporary argument for national price regulation of the port of Melbourne appears to be made too late in the process – it makes little sense to have only the Port of Melbourne subject to additional direct national regulation – versus the existing step-in power, if the asset is declared under part 3a of the *Competition & Consumer Act* 1990 (Cth).

Indeed, with the ACCC not regulating any other sea port, the Committee should carefully consider how the State's interest would be advanced by ceding price regulation to a remote national regulator with no experience in port regulation.

We therefore submit that the prospect of expanded ACCC direct regulation of the Port of Melbourne does not appear to have a strong underpinning case and should not be adopted.

Proposed Legislative Mechanisms

The *Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015* retains the Victorian Government's existing regulatory powers described above, and provides additional safeguards.

This includes the power to issue "Pricing Orders" to regulate the price of prescribed services. Pricing Orders have a wide array of functions, key among which include:

- specifying pricing policies or principles;
- fixing the price or rate of increase in price;
- fixing the maximum revenue or rate of increase in revenue; and
- providing for a return on, or return of capital.

The scope of "Prescribed Services" is also expanded under the proposed legislation to cover all port services (see Figure 1 below).

Figure 1 – Expanded scope of prescribed services under legislation

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

Source: Victorian Government, 2015

It is important to note that lease charges will not be regulated and will be commercially negotiated between the parties. As outlined in Figure 2, this is consistent with port operating regimes in other Australian jurisdictions.

Furthermore, the proposed legislation will introduce a CPI cap for 15 years on the annual increase in Prescribed Services charges – providing further reassurance to end consumers.

Comparison with other jurisdictions

Victoria's port regulatory framework is in many cases stronger than in other jurisdictions, both in terms of the coverage of charges monitored and the power of the monitoring body (in Victoria's case the ESC). Figure 2 provides a detailed comparison of the differences across jurisdictions.

Figure 2: Cross State Comparison

Source: Victorian Government, 2015

3 RESOLVING THE ISSUE OF A SECOND PORT

There are various ways in which the structure of the lease can deal with the requirement for future potentially competing port capacity. The first right of refusal for Sydney's second airport provides one example.

The Port legislation provides an alternative approach, by which bidders specify in their submissions the arrangements, if the Government procures a new port which competes for international trade before the Port of Melbourne reaches a pre-agreed cap.

Another approach could see the public sector specify a particular year from which new port capacity can be brought online.

All of these approaches are seeking to balance the need for certainty for lease bidders, against the requirement for new port capacity to come on-line when needed.

We submit that one of these broad approaches will offer the best outcome for taxpayers and long-run efficiency of the Victorian economy.

Noting both the complexity and importance of this aspect of the transaction, we recommend that the Committee engage an agreed, appropriately qualified transaction consultant to advise on the best approach.

This would allow the Committee to recommend the best value solution for taxpayers and for consumers, and recognises that this transactional issue is beyond the direct expertise of this submission and the Committee.

There is wide agreement that a second container port will be needed at some point in the future, noting Victoria's projected population and economic growth.

In this, timing is paramount given that both early and late delivery of new capacity will pose downside economic costs (which are ultimately funded by the community).

This section considers three broad options to deal with this issue – and recommends

- The Government's current proposal establishing a "Port Growth Regime", under which a "capacity cap" for the Port of Melbourne will be established;
- Setting a time period during which the Government will be precluded from building a second port; and
- Providing the successful private sector bidder with a "first right of refusal" to develop the second port (the Sydney Airport model).

We submit that this is a technical, transactional issue which could be resolved through expert advice and assessment of the options, rather than through reliance on the political process alone.

In exploring the range of options, our overarching recommendation is that this aspect be resolved through expert, independent advice to the Committee.

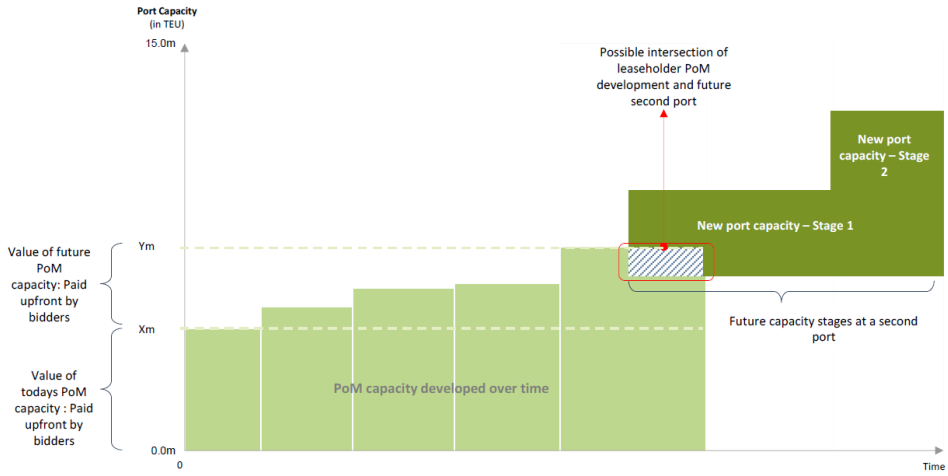
We also recommend that *Infrastructure Victoria* be required to produce an updated strategic freight plan, each five years alongside the ESC's price monitoring. This requirement reflects the need to ensure efficient long-term capacity – and to ensure independent oversight of the future need and timing of additional port capacity.

The Current Proposal (Government Proposal)

Under the proposed "*Port Growth Regime*", the State retains the right to build and operate a second container port, once the Port of Melbourne reaches an agreed level of capacity. The legislation proposes to retain an additional degree of flexibility, which would allow the State to bring a competing facility online in advance of reaching the cap, with a pre-agreed amount to be refunded to the lessee, if that happens. The degree of refund due, and the cap, are both subject to market negotiations as a component of each bid.

This approach is outlined in Figure 3, below.

Figure 3: Second container port



Source: Victorian Government

We submit that this approach appears to have merit, given that it seeks to make explicit the arrangements by which a new port will be developed – and seeks to make explicit the responsibilities of the lessee and the State if a second port is needed sooner.

Alternative options

Defined time period

An alternative approach to deal with the need to balance lessor certainty with the state's flexibility to develop a second port would be for the public sector to forecast the likely time in which new capacity will be needed, and to make that explicit in the structure of the lease. For example, the public sector could specify that at any point from say 2035, the lessee of the Port of Melbourne should expect a competing port facility.

This approach, which we understand had been contemplated as an aspect of the former Government's lease strategy, provides a greater level of certainty for the lessee about when competition can be expected. However, we note that this approach relies on accurate forecasting and could serve to limit the public sector's flexibility if demand is greater than forecast, and a port is needed sooner.

First right of refusal

Another alternative option is to offer the lessee a right of first refusal to develop and operate the new port. This reflects the approach used in the relatable lease of Sydney's airport, which gave the incumbent operator the first right to develop a second airport for Sydney, subject to achieving

commercial agreement. The deed also ensures that the Commonwealth can only offer the market a deal as good as the final offer rejected by Sydney Airport.

This approach mitigates the uncertainties posed by new capacity and offers some benefits through system-wide integration – but also serves to limit competition over the cost of the new port in the future.

Resolving new capacity

We submit that this issue of how new capacity is contemplated and dealt with is critical, because it will materially affect the asset price and also dictate the long-term shape of Melbourne's freight sector.

Noting again that this matter is transactional, we respectfully submit that the Committee should engage an appropriately qualified independent expert, to guide the Committee's recommendation on this aspect of the Port lease.

A five yearly review of port and freight system efficiency

Freight plays an obvious and fundamental role in the growth of the Victorian economy, and has significant impacts on the demands across the wider transport network.

Indeed, future decisions about when and where to locate new port capacity will force attendant consideration of how supporting landside road, rail and intermodal facilities are planned, funded and delivered. This consideration will also need to include the wider benefits, costs and opportunities to make Victoria's transport and logistics sector more efficient and capable of accommodating growth.

It is important that there is also a recognition of the significant economic costs for consumers, and the broader economy, if the investment decision to trigger a second port and supporting landside infrastructure is brought on too early or too late to meet economic need.

This means that opportunities to extract more from the existing port will need to be an ongoing consideration, alongside planning for a second port.

For this reason, we submit that the Committee should consider tasking Infrastructure Victoria to undertake a detailed assessment and release an updated plan for Victoria's future requirements for efficient freight capacity.

This will ensure that the optimal capacity of the Port of Melbourne is realised, and will aid the bringing on-line of a second port a way that minimises any duplication of assets, or lag. It will also allow the private sector to plan and invest in line with the State's requirements.

Critically, it would also provide the private operator, freight and logistics companies as well as other stakeholders with an ongoing, transparent mechanism to shape freight planning – assisting to ensure the various components of the supply chain are working in sync.