C O R R E C T E D T R A N S C R I P T

PORT OF MELBOURNE SELECT COMMITTEE

Inquiry into the proposed lease of the port of Melbourne

Melbourne — 4 November 2015

Members

Mr Gordon Rich-Phillips — Chair
Mr Daniel Mulino — Deputy Chair
Mr Greg Barber
Mr Damian Drum
Mr Craig Ondarchie
Mr James Purcell
Ms Harriet Shing
Ms Gayle Tierney

Staff

Secretary: Mr Keir Delaney
Research officer: Mr Anthony Walsh

Witnesses

Mr David Martine, Secretary,
Mr David Webster, Deputy Secretary, Commercial, and
Mr Nick Rizos, Director, Port Transaction Unit, Department of Treasury and Finance;
Mr Peter Block and
Mr Geoff Carter, Minter Ellison;
Mr Tony Burgess, Chief Executive Officer, Flagstaff Partners;
Mr Julian Peck, Managing Director, Morgan Stanley; and
Mr Nick Easy, Chief Executive Officer, Port of Melbourne Corporation.

The CHAIR — I declare open the Legislative Council Port of Melbourne Select Committee public hearing. This hearing is in relation to the inquiry into the proposed lease of the port of Melbourne. I ask that all mobile telephones now be switched off as they do interfere with the Hansard recording equipment. This hearing is a resumption of an earlier hearing with the Department of Treasury and Finance and the Port of Melbourne Corporation. I welcome back for this hearing Mr David Martine, the Secretary of the Department of Treasury and Finance; Mr David Webster, deputy secretary, commercial; Mr Nick Rizos, director of the port transaction unit; and from the government's legal representatives, Mr Peter Block from Minter Ellison and Mr Geoff Carter from Minter Ellison. We also have the government's financial advisers for this transaction — Mr Tony Burgess, chief executive officer, Flagstaff Partners, and Mr Julian Peck, managing director, Morgan Stanley. From the Port of Melbourne Corporation we again welcome Mr Nick Easy, the chief executive officer.

The committee does not require witnesses to be sworn, but questions must be answered fully, accurately and truthfully. Witnesses found to be giving false or misleading evidence may be in contempt of Parliament and subject to penalty. All evidence taken at this hearing is protected by parliamentary privilege as provided by the Constitution Act 1975 and further subject to the provisions of the Legislative Council standing orders. Therefore the information provided today in the hearing is protected by law. However, any comments made outside the precincts of the hearing may not be so protected. All evidence is being recorded, and witnesses will be provided with a proof version of the transcript in the next couple of days for any corrections.

The committee has allocated an open period for this hearing on the basis of dispatching any remaining questions that committee members may have with respect to this transaction. It has been conveyed to the committee that witnesses may request some matters be dealt with in camera. It is the Parliament's preference, the committee's preference, that as much material as possible be dealt with in public session, and any consideration of matters in camera would have to be done on a case-by-case basis. Obviously if that is the desire with particular matters, I ask that that be flagged at the outset. It would be my intention to consider matters in public first, and any matters that need to be taken in camera are to be done later in the day at a closed session.

Mr Martine, I invite you to make an opening statement if you wish and the committee will then proceed to questions. Thank you for your attendance once again.

Mr MARTINE — Thank you, Chair, and thank you, committee, for inviting us back here today. Chair, you have already run through the introductions of who is here today so I will not cover that again. I just wanted to briefly, for the benefit of the committee, do a quick recap on the material that we have sent through since we last appeared. Since we last appeared on 8 September the department has provided a copy of the draft pricing order, which was on 9 September; on 1 October a detailed draft outline of the transaction documents; on 16 October a letter from the Treasurer to the ACCC was provided; and then of course the responses to the 20 questions that the committee sent through, and those were provided to the committee on last Friday. As I mentioned, Chair, we are more than happy for those answers to be published.

I certainly understand the issues around committees and in camera, so we will certainly endeavour from this side of the table to try to deal with as much as we can in the open hearings, and I think we can pretty much deal with most of the issues in the normal way. If there are matters, I will certainly raise that with you as we go. That is all I was planning to mention up-front. Our diaries are clear, so we are at the committee's disposal to basically answer questions that you may wish to ask.

The CHAIR — Thank you, Mr Martine. I will open the batting, and I suspect some of these first questions you may wish to take in camera, but I will start. I just want to do some scene setting around the transaction to understand the magnitude of the transaction and some of the metrics that go with it. My first question relates to the provision the government has made in the forward estimates for the proceeds of this transaction, being the expected sale price and also the port licence fee.

Mr MARTINE — Okay, Chair. We have, as you no doubt appreciate, factored in the expected proceeds from the sale of the port of Melbourne. Obviously given the commercial sensitivities that number is not disclosed. It has been in the budget papers for, from memory, the last two budgets. It is factored into the forward estimates in one particular year, but it is not something that we would be prepared to disclose, given the commercial nature and the market sensitivities of signalling, I guess, an expectation based on the current information we have of what the government might consider would be an appropriate sale price.

The CHAIR — Is that something to be considered in an in camera session?

Mr MARTINE — I think it is difficult even in camera to disclose the expected sale price.

The CHAIR — It is fairly material to some of the subsequent considerations around the viability of the transaction and this committee's consideration of the legislation.

Mr MARTINE — I think at the moment, Chair, probably all I could do is take that question on notice and raise it with the Treasurer. There are obviously sensitivities around the expected sale price.

The CHAIR — Thank you, Mr Martine. I will move on from that and come back later in the day to that matter. Related to that I have some questions, and again I expect you may want to take these in camera, as to your advisers' views of the WACC — the weighted average cost of capital — that bidders would expect for a transaction of this nature, which obviously also will be material to understanding the pricing structure and the implications of that pricing structure on the operation of the port.

The next matter I would like to ask you about is the port licence fee. The legislation provides for the port licence fee to be collected up-front in aggregate. Can you outline the government's intentions with respect to the port licence fee and this transaction?

Mr MARTINE — I might ask Mr Rizos to run through that.

Mr RIZOS — Chair, effectively there is no policy change in relation to the port licence fee. The port licence fee continues on foot, consistent with the facilitating legislation to the port licence fee. The legislation, or the bill before the Parliament, provides for the port licence fee to effectively be paid up-front should that be the preference of the transaction and the government. Insofar as the port licence fee goes to prices paid by users as port charges for prescribed services, it has no impact on whether that is paid up-front or not. The underlying building block methodology provides for — and we may get to this later, of course — effectively the underlying regulated asset base with a WACC return, together with the depreciation and the operating expenditure.

The accounting for the port licence fee will be captured as part of that framework and has no material impact — in fact has no impact — on the prices that would ultimately be paid by users. The port licence fee will be captured as part of that framework and, as we have outlined in our submission, the framework provides for a CPI price cap for a minimum of 15 years, potentially as much as 20 years, and the ESC will ensure that underlying costs as part of that building block methodology reflect prudent and efficient expenditure. The port licence fee, as far as that is concerned, has no impact.

The CHAIR — Is it the government's intention to collect the port licence fee up-front?

Mr RIZOS — That decision has not been made as yet.

The CHAIR — It has not been made?

Mr RIZOS — There is flexibility under the legislation to provide for that.

The CHAIR — Will that be a decision made by the Treasurer ahead of the transaction or will it be subject to negotiation in the transaction?

Mr WEBSTER — That decision will be made prior to the transaction documents going out, I would imagine. I suspect that would go to a subcommittee of cabinet.

The CHAIR — If the port licence fee was to be brought forward, on what basis would it be calculated? On what basis would a lump sum port licence fee be calculated? It is currently approximately $80 million per annum.

Mr RIZOS — Yes.

The CHAIR — On what basis would you calculate a lump sum?

Mr RIZOS — That will be effectively the roll forward of that amount.

The CHAIR — Discounted?

Mr RIZOS — It will be.

The CHAIR — What would it be discounted at?

Mr RIZOS — That is a matter for the transaction.

The CHAIR — For the transaction or for the Treasurer?

Mr RIZOS — It goes to value and, I think, as the secretary has already alluded to, there is some sensitivity around any discussion that goes to transaction value.

Mr WEBSTER — That will effectively be wrapped up in part of a consortium's bid, so it will be whatever is bid back from the market. That is true of cash flows.

The CHAIR — So it will not be a decision of government before you go to market?

Mr WEBSTER — Whether to have it paid up-front or through time will be in terms of what value bidders ascribe to that. How that comes through in the transaction price will be part of the bid.

The CHAIR — Has there been a clear policy articulated by government that the port licence fee will be based on the current approximately $80 million per annum, given the legislation allows the Treasurer to base it on whatever considerations the Treasurer wants?

Mr RIZOS — The internal calculations have obviously had to make assumptions, by definition, on the port licence fee; and, yes, that has been assumed as part of various calculations. But given the commercial sensitivity for what bidders will bid ultimately, we need to be very careful in terms of what we disclose in the public domain.

Mr WEBSTER — But there is no policy change as far as the port licence fee goes.

The CHAIR — Going back to the issue I raised before around budget estimates, has the port licence fee been brought into the forward estimates as a lump sum?

Mr MARTINE — Sorry, Chair, I am just checking the actual treatment. Perhaps if we can take that on notice now and get to an answer during the course of the session.

I think we will need to come back to that to provide the committee with the information. We just need to double-check exactly the treatment. I think I know what it is, but I do not want to mislead the committee, so I will come back to you on that one.

The CHAIR — Okay, we will return to that a bit later in the day. Thank you, Mr Martine. Can I also ask you, with respect to the legislation, 461 provides for the Premier to grant relief from state taxes and fees — a blanket capacity for the Premier to effectively grant relief to the Duties Act, Land Tax Act et cetera. Is it the government's intention to grant any relief under that provision?

Mr MARTINE — I might get Mr Rizos to just run through the clause.

Mr RIZOS — Peter Block can cover the legal implications of that.

Mr BLOCK — Flexibility is allowed in the transaction in relation to this because the process will be taken or decided before we go out to bid as to whether or not the bidders will bid a price inclusive or exclusive of paying tax. It will depend on the treatment that the bidders have of that item. It might be that for certainty reasons and to drive a better value for the transaction there may be an exemption given. Otherwise, conversely it may be decided that the bidders will pay tax and they will have to make up their own mind as to what the amount of tax will be. Essentially there will usually be a net result — either the bidders will pay the tax, it will be collected, so it is actually a lump sum, or it is exempted. So it will be a net result for the state.

The CHAIR — Which taxes are contemplated in that potential relief or consideration?

Mr PECK — It is a bit of round robin, because the state is the vendor of a property asset whether you take it through some of it in stamp duty or in lump sum and do not quote the stamp duty, so given that it is a round robin from the state's perspective, I think that is flexibility —

Mr MARTINE — Just provides the flexibility for government.

Mr PECK — whether you want to book it through the normal means and not create any particular precedent the state might not want to create or just take it as a lump sum into the — —

Mr MARTINE — I understand in New South Wales — —

Mr PECK — In New South Wales similar things are done, so it is quite a common thing to do. I think it is just reflecting some flexibility for the state to decide which pocket of the state P and L it wants to take the stamp duty revenue stream.

The CHAIR — Is it only with respect to stamp duty that this consideration will be given?

Mr PECK — I think that is the only material tax that would apply.

The CHAIR — Land tax?

Mr PECK — That is the commercial answer. We will defer to the lawyers if they want to override me, but — —

Mr BLOCK — The discussions we have been having are about stamp duty at present.

The CHAIR — Obviously port of Melbourne currently pays land tax. That would not be considered? So when would a decision be made in respect of whether relief would be given to stamp duty on this transaction?

Mr WEBSTER — We would expect that approval to be given by government as part of signing off the documents. With stamp duty as well there may be an indirect impact in terms of the asset recycling payments as well — in terms of purchase price versus stamp duty and how you take the value of those proceeds.

The CHAIR — So the asset recycling only applying to the proceeds?

Mr WEBSTER — To the purchase price, yes.

The CHAIR — So it would be advantageous to the government to forego the stamp duty and have a higher purchase price?

Mr WEBSTER — Potentially.

Mr MARTINE — If you got sufficient value. You obviously would not sacrifice the stamp duty receipts if the change in the purchase price was not sufficient to cover that. It is really just to provide the government with that flexibility.

The CHAIR — Will that be a decision made by government and applied consistently across all bids or will it be something subject to a negotiation with individual bidders?

Mr WEBSTER — It will be consistent across all bids.

Mr PECK — That is a typical process with these sorts of matters is that you would have a very common instruction to all bidders through the transaction documents and that would be done on that basis.

The CHAIR — Is it your expectation that you will proceed on the basis of forgoing stamp duty?

Mr MARTINE — I do not think that decision has been made at this point. When you say, Chair, 'forgo stamp duty', it is really just a different way of collecting the same amount.

The CHAIR — When will that be finalised, Mr Martine?

Mr WEBSTER — We will need to give bidders certainty in terms of what they are bidding on.

The CHAIR — So when will that be done? When will that decision have been made?

Mr WEBSTER — We are slightly in your hands because until the legislation is passed we cannot finalise a timetable in advance of the transaction documents going out.

The CHAIR — I guess, Mr Webster, we are slightly in your hands because until you can give us clarity about this transaction, it is hard to recommend the legislation.

Mr PECK — If I can perhaps add from a commercial perspective again — I am happy to be overruled — typically by the time we get into a final bid round you would give the final bid instructions to the bidders on what they are doing and what they are getting approvals for and how they are allocating the purchase price. That would be the latest time. It could be decided earlier, but at some point during that final bid round you would need to say, 'Here is how we want you to present your bid costs to us', the state, and therefore how they should allocate those funds. That would be a typical treatment in these sorts of transactions.

The CHAIR — Thank you, Mr Peck. I want to move on to another area now. Mr Mulino, would you like to open some questions?

Mr MULINO — Yes, I will start with a couple of questions. I just wanted to ask a couple of high-level questions to start with. We have heard from both yourselves and from a number of other witnesses about potential policy rationales for this kind of transaction: one is that a private operator might be able to improve operational efficiency potentially under the right circumstances; another is the broad rationale for asset recycling. Is it fair to say that the broad policy rationale and the way that it affects the transaction structure has remained unchanged since the beginning of the process?

Mr MARTINE — I think that is correct. You have identified two of the key policy rationales embedded in your question — certainly efficiency at the port and also a future investment in the port. That really then becomes the responsibility of the private sector. You do see over time in various jurisdictions that government-owned assets in tight fiscal situations do not always necessarily get the right sort of investment allocations made to them. Certainly one of the key rationales for this type of transaction is very much on the efficiency and appropriate investment side and then, as you mentioned in your question as well, just in terms of asset recycling and making better use of the government's balance sheet in terms of releasing those funds for other purposes by government.

Mr MULINO — Thanks. Another question relates I suppose to the way one might describe the broad nature of the transaction, and that is that some aspects of the transaction we can be clear about now, we see those set out in the bill, and there are other aspects of the transaction that remain to be decided, and we have touched on a couple of those already — for example, whether or not some elements or all of the stamp duty will be taken up-front or collected over time. Is it fair to say that it is pretty standard in transactions like this for some aspects to be clarified early in the legislation but for some aspects to be left to the negotiations of the market, because one cannot know in advance, in a sense, what market conditions will be at the pointy end, how much competition there will be and what might reflect fair value for taxpayers?

Mr MARTINE — That is certainly the case, and there will be a range of matters that will be sorted through the bidding process. But it might be useful if I ask one of our financial advisers just to give a perspective on other transactions that they have been involved in and how similar this one is to those large transactions.

Mr PECK — I am happy to lead off and then pass to Tony. Certainly typically in these transactions — we were involved in the New South Wales ports and Queensland was done in a similar way in that there were some legislative changes made in order to set the overall framework for the transaction and certain powers et cetera need to be clarified — unsurprisingly with how things are set up in government ownership it is not necessarily a smooth transition to a private leaseholder and therefore there are normally some things to be tidied up in that regard. That is not unusual for not only a port transaction but any other transaction — the New South Wales poles and wires transactions that are on at the moment likewise had some legislative changes to facilitate those transactions.

Obviously not everything is in legislation — a range of things are best dealt with by contracts, and whilst the state will then design and set out its preferred commercial and policy objectives in those agreements, they are then subject to a process and a bidding arrangement. Part of our job obviously is to make sure we get the right

people there, do the right due diligence and get the right competition to get the best risk-adjusted result for the state, which you cannot always do if you set up everything on day one and lock it in — you then therefore do not get the benefits of competition in some respects.

Me BURGESS — I would agree with that, and we have just completed the lease of the port of Darwin the other week. The process is quite similar: you need to establish the broad framework of the package of assets that you are putting to the marketplace, probably before the first-round bid, to be clear, so people can start getting their mind around what it is that is actually on the table for them to transact. During the actual process of first round and second round, if you have a very competitive field, bidders will look to differentiate themselves, and that differentiation can take a whole variety of forms, including commitments, for example, for extra investment in the actual facilities, which would be in the interests of the particular jurisdiction. You need the flexibility to allow that to play out during the bidding process.

Mr WEBSTER — I would just add to that there is a third and fourth mover advantage here in terms of a lot of the contractual positions: we can see what has been done in other port transactions — Brisbane, Sydney, Darwin — and typically during these processes things move towards the vendor in terms of being able to get better risk allocation, so it is not as though we are starting from a clean sheet of paper here, there are some pretty good precedents which we are building on.

Mr MULINO — The final question, and this might be for the commercial advisers: in your experience is the balance between what is provided for with absolute clarity in the framework versus leaving a few things to be negotiated fairly typical?

Mr PECK — Yes, for my part it is very typical.

Me BURGESS — I would concur with that.

Mr PURCELL — I have just a couple at this stage. I will go back to the question the Chair asked earlier in regard to the expected sale price. As I understand it, there is a price in the forward estimates of the budget, and I understand that it is confidential at this stage. Would it be fair to argue, though, that if the price were similar to that, you would be confident in saying that it was included in the budget and to basically look at the budget? If it were significantly lower, you would change the budget in the forward estimates. Would it be fair if I take that logic to its conclusion to say that what you believe would be the sale price would be far in excess of what is in the budget at the moment?

Mr MARTINE — We have tried to reflect expected proceeds based on the advice of the experts here at the table into the forward estimates. There are a broad range of figures that get thrown around publicly. The best way to describe it is that we have taken a prudent, conservative kind of approach to our value evaluation, but it does try to reflect our expectation based on the expert advice that has been provided by the experts advising government.

Mr PURCELL — But is the logic that I have just put forward a reasonable logic?

Mr MARTINE — If we receive some additional advice from our experts to say that for whatever reason we now think the value is different — whether that is higher or lower — then we would reflect that in the next available update of the estimates.

Mr PURCELL — I will take that as a yes. We have been told through the process that the lease of 50 years, and if you put another 20 onto it, it does not affect the sale price significantly. Why is the 20 years included in the agreement, the legislation?

Mr WEBSTER — It is there purely to give some flexibility out the back end in terms of what might happen. If the second port is up and operating, there may be a desire to transition down to a second port. It is probably easier to do that in keeping the existing leaseholder in. There may be a desire to free up some of the land at the port of Melbourne for other activities but keep the port's operations ongoing. So it is there effectively to give a future government maximum flexibility and optionality in terms of what is the best outcome for the state at the time.

Mr PURCELL — So you would not expect that to be implemented at the early stage of a lease?

Mr WEBSTER — That is not contemplated at the moment.

Mr PURCELL — Even though the option is there that it could be.

Mr WEBSTER — Theoretically.

Mr MARTINE — You just would not receive appropriate value. So a bidder looking 50 years out, given uncertainty, would bid a very low amount. So it would be much, much better for the government of the day to be contemplating that closer to the end of the 50-year term, because that is when you would actually extract sufficient value for that option.

Mr WEBSTER — And you have got much better visibility in terms of what that option might look like.

Mr MARTINE — Yes.

Mr DRUM — I wonder if somebody could talk to me a little bit about this periodic review by the ESC of the rents that are likely to be ongoing. How is this review going to actually manifest itself?

Mr MARTINE — I might get Mr Rizos to run through the details of the ESC process.

Mr RIZOS — Thank you for the question. The process that we have outlined and I think that communication has been shared that was provided to the ACCC from the government outlining the general approach that will be adopted. I think we have provided certainly some material to you in our response to the questions that were provided to us — the 20 questions. That outlines that we would propose to deal with it through an amendment to the bill to provide authority to the ESC to undertake a five-yearly review into whether market power — assuming it exists in the first instance — has been misused in any way in the rent review process undertaken by the port of Melbourne in relation to the various tenants that occupy the port. There are standing powers in the ESC legislation that provide for periodic inquiries to be undertaken.

Mr DRUM — Sorry, I missed that last bit.

Mr RIZOS — In the ESC legislation, it has the ability to undertake inquiries as directed by government. There is a general outline of the process they would adopt. We would not suggest that we would direct the ESC in terms of how it would undertake this inquiry. That is a matter for the ESC to undertake and to determine the appropriate frame it would use in assessing whether there has been a misuse of market power by the port.

Mr DRUM — Then what happens?

Mr RIZOS — The ESC would then report back to government — in fact, I think it might be the Parliament formally — but that is a matter then for the government to determine on the advice of the ESC what additional steps it could take.

Mr DRUM — So when would those details be available for us to be able to look at and actually see how that is going to work?

Mr RIZOS — In terms of what would appear in the bill that is before you, and what we are suggesting would be an amendment to the bill, that is something we are working up internally. We do not have a final set of drafting instructions within government at the moment. That is being developed both internally and externally with legal advisers. Ultimately, though, in terms of how the ESC would give effect to that, that is very much a matter for the ESC. We do not want in any way to suggest that we are fettering the ESC's ability to undertake that review as it sees fit.

The CHAIR — I will just jump in there, Mr Drum. Are you able to provide those drafting instructions to the committee when they are completed?

Mr RIZOS — I think that is a matter for government.

Mr MARTINE — I will take that on notice, but I would have thought that ultimately the committee and the Parliament will need to see the amendments to the bill that you are being asked to consider.

The CHAIR — It would obviously be helpful to the committee to see those before we report.

Mr DRUM — That is where I was going. We will need to see these before we can comment on where we sit with it. Will the ESC report to the government or do they report to the Parliament?

Mr RIZOS — I understand that it will be tabled in Parliament.

Mr DRUM — So any misuse of market power would be reported and tabled in Parliament?

Mr RIZOS — That is our understanding about the report the ESC would conduct, yes.

Mr DRUM — Okay. Thank you. I also have some other issues about the growth regime.

Ms TIERNEY — My question is really a point of clarification. It arose from an answer that was given in relation to the first question, which was around the proceeds of the sale. In your answer you mentioned that in the last two budgets and forward estimates the proceeds of the sale have been incorporated. I simply ask: did the previous government put a money amount in the forward estimates for the sale price?

Mr MARTINE — That is correct.

The CHAIR — Mr Martine, can I just take you back to that issue, given that Ms Tierney has raised it. Is it the case that that estimate has been increased in the most recent budget?

Mr MARTINE — It has been amended marginally, from memory.

The CHAIR — Only marginally?

Mr WEBSTER — The transaction previously was booked assuming a 40-year lease term. Obviously moving to a 50-year lease term does have some impact on value.

Mr MARTINE — Yes. It has been updated for some policy changes, and then, I think, in the absence of that it has been reasonably consistent with the underlying amounts that were put in previously.

The CHAIR — Does the figure that is in the budget — and we will come back to that later — reflect the financial advisers' current assessment?

Mr MARTINE — Yes. Based on the government's current policy settings, which, as Mr Webster indicated, changed slightly between the new government and the former government.

The CHAIR — I would like to take you to the issue of the price regulation framework. The committee has received the draft — or a draft — pricing order. Can I firstly ask: is there an update on that draft pricing order that was received by the committee from the Treasurer in early September? Has that pricing order changed?

Mr RIZOS — No.

The CHAIR — Okay. Can you — I assume Mr Rizos will take these questions — talk the committee through the process for setting the prescribed services tariffs — the actual process that will be followed by the operator?

Mr RIZOS — It is a building block methodology, so they will need to satisfy — —

I think we need to take a step back. The pricing order provides for — and these numbers have been redacted, given the commercial sensitivity — a regulated asset base to be incorporated into the pricing order. You will see that, but it is redacted, as I said, for commercial purposes. The regulated asset base, together with operating expenditure and a return on that asset base, as well as depreciation, is what is provided for as part of the building block methodology.

I should point out that the building block methodology, for those who do not play in that space often, has been a tested methodology adopted by regulators, both at state and federal level, for a number of years. In fact it is a methodology that has been applied since the Hilmer reforms were introduced and we went through a phase of reform and privatisation in the energy sector in particular, so the model itself is not a novel approach; it is tried and tested.

Following discussions with the ESC, who we did consult with prior to finalising the pricing order, the order itself provides flexibility for the ESC to determine what information it considers it will require from the operator to satisfy itself that the expenditure the operator is choosing to pass through, and is reflected in prices, truly reflects the underlying efficient and prudent expenditure, and that is a matter for the ESC to determine ultimately. It will do that at five-yearly intervals, and the ESC will be able to determine whether there has been significant and sustained non-compliance with that pricing order.

The CHAIR — I am wondering a bit more fundamentally than that, Mr Rizos, if you could actually talk the committee through the process that the port operator will need to follow to put in place a tariff schedule. I understand the building block methodology, but what is the actual process that is required to get to a completed prescribed service tariff?

Mr RIZOS — In our response to the committee, question 19, which talks about the process that is to be followed, talks about three phases. We can walk through that if you like.

The CHAIR — If you could, please.

Mr RIZOS — The initial phase, as outlined — and this is in relation to, just for the record, question 19 of the questions we received — is that in the first instance there is an initial set of tariffs, which are obviously the tariffs as they apply at the moment by the Port of Melbourne Corporation. From 1 July 2016 what is referred to as the price smoothing mechanism or the CPI cap, as we have also referred to it, would kick in, and that would apply for a minimum of 15 years out to a maximum of 20 years.

I need to be clear that the CPI mechanism is a CPI cap; it is not a CPI price path. So the ultimate analysis that the ESC will do is that the underlying building block methodology will still have to be undertaken by the port operator to the satisfaction of the ESC, and it will be the lower of the CPI cap or the maximum allowable revenue that comes out of the building block methodology that would apply, even for that 15 to 20-year period. Then post that 15 or 20-year period, when the price smoothing mechanism ends, prices would need to reflect the underlying building block methodology, which will throw up a maximum allowable revenue. So users can be satisfied that the independent umpire will have the ability to ensure that ultimate prices reflect prudent and efficient expenditure, and the ESC will determine what form of information it will require from the operator to satisfy itself that the operator has met those tests.

The CHAIR — You indicated that the initial tariff schedule, which is not specified in the draft pricing order — it was referred to, but the details are not provided — will be the current port of Melbourne tariff schedule.

Mr RIZOS — Correct. As per the answer to question 19, until 30 June 2016 the prices will be as per the port of Melbourne's current reference tariff schedule.

The CHAIR — So the current schedule will be reflected in the addendum to the pricing order that will be signed off by the minister in due course. Is that pricing order going to be made before the transaction is completed?

Mr RIZOS — Subject to the legislation passing and giving us the authority, or giving government the authority, to issue the pricing, that is the intention.

The CHAIR — So those asset bases, which will be published in the order, will be disclosed before the transaction.

Mr RIZOS — They will not be disclosed while we are in the bid phase of the transaction; they will be disclosed post the conclusion of the transaction. I guess we are talking about a number of phases, without wanting to confuse the issue. We are talking about an initial phase, where tariffs are as per what is published by the Port of Melbourne Corporation for the year 2015–16; I think we are agreed that does not change. We are then talking about a phase that has the price smoothing mechanism in there with the CPI cap, which I referred to, and then post year 15 or year 20 we revert back to the underlying building block methodology. They are the broad three phases. When those regulatory asset bases are disclosed, they will be disclosed in a data room, so bidders will have the ability to see those regulatory asset bases and form a view. They need to have full information, but we are obviously not going to disclose that information ahead of the bid process.

The CHAIR — Why?

Mr RIZOS — It is sensitive information.

The CHAIR — Why is it sensitive?

Mr RIZOS — The JFAs may have a view about the commercial sensitivity of disclosing regulated asset bases ahead of time.

Mr PECK — I just think the same general approach applies here: we did not want to be getting into disclosing partial valuation information regardless of what it was at this stage of the transaction. Obviously when you normally put an asset to market, bidders see a package of information and they can understand the full package as a package, and this is a slightly unusual process where this process is effectively asking for pieces of information without the benefit of the full package.

The CHAIR — We would be happy to take the full package, Mr Peck, but it seems that that is not yet concluded or valid, if I understand various evidence over the course of this inquiry. Just to be clear, from Mr Rizos's evidence, when the order is made the legislation requires the order to be published in the *Government Gazette*, which will disclose those two asset base numbers, and that is to take place before the transaction is concluded, if I understood Rizos's evidence correctly.

Mr RIZOS — The order will be published following gazettal**.** That is the intention. What I would like — —

The CHAIR — And that is before the transaction is concluded?

Mr RIZOS — There is an issue there about when the transaction is concluded. There are various phases as we go through the transaction. There is an EOI phase, an indicative bid phase and a binding bid phase. As you would appreciate, it is standard process for a transaction of this nature. Can I take on notice when we would actually publish, because there are discrete issues there around the various phases of the transaction that I would like to take on notice and come back to the committee.

The CHAIR — Clearly part of making the order is the obligation to publish the order.

Mr WEBSTER — Yes.

The CHAIR — Mr Barber, do you have a follow-up on that particular matter?

Mr BARBER — Just on the regulator.

The CHAIR — I thought we might spend some more time on that.

Mr BARBER — So how will the regulated asset base be set?

Mr RIZOS — Thank you for that question. I will take that one as well. Question 13 in our response provides an outline for how the regulated asset base will be determined, and again you will see there that we have got an outline of the approach. The approach again is a fairly standard approach, which refers to a depreciated optimised replacement cost, or DORC, methodology. That incorporates technical advice and economic regulatory advice and is again a fairly standard process.

Mr BARBER — It is kind of like 'replacement value'. Is that what that is saying in that answer?

Mr RIZOS — It is.

Mr CARTER — It is similar to a replacement value.

Mr BARBER — You refer to replacement value as a hypothetical new entrant. Am I on the right track?

Mr RIZOS — Yes.

Mr BARBER — Who and what is a hypothetical new entrant in this situation we are in here in Victoria?

Mr RIZOS — Geoff Carter can explain.

Mr CARTER — I will keep it short, but it is someone that needs to re-establish the asset base of the port using, I guess, the best available mechanisms for doing that today, and that is what the engineering consultants have done in calculating those numbers.

Mr BARBER — Is that if the current port collapsed in an earthquake and had to be rebuilt, or is it a hypothetical new entrant at a new site?

Mr RIZOS — It is not in relation to a new site. It is in relation to the port.

Mr WEBSTER — It is effectively replacing the assets at the port of Melbourne, which are necessary for the port use if they did not exist today, and it is indifferent to the ownership structure of that. It is an engineering-led calculation.

Mr BARBER — The regulatory asset base, then, is all the assets that have been kind of plonked on the site: buildings, roads, those things that lift containers — what are they called?

Mr RIZOS — It is the port's civil infrastructure. I think there is a distinction to be made. Given it is a landlord port, a number of the superstructures that are on the port obviously belong to tenants rather than the port, so it is in relation to the port's assets.

Mr BARBER — What are those? It is not the channels in the bay, is it?

Mr RIZOS — I think there is a pricing order in the schedule, which I will turn to. Section 4.5 talks about the initial capital asset values, and you will see it refers to shared channel services and bundled services. The port provides its services both by facilitating entry to the port by maintaining the channel — so the channel is relevant — and other infrastructure. Civil infrastructure, including landside infrastructure that the port provides is also relevant, and that forms the underlying basis of the services the port provides, which ultimately gets rolled up into the prescribed or regulated services that we have referred to previously.

Mr BARBER — So by definition the assets are the services. Is that what that is saying? You refer to channel services as an asset, but what you are really saying is the assets that provide the services come to define the port — all those assets.

Mr RIZOS — With respect, the services cannot be provided without the assets being maintained and being made available.

Mr BARBER — Absolutely. In the order it talks about the services. The assets are defined as the services.

Mr CARTER — That is not quite technically correct. It is the services provided by means of those assets being available to port users, if you like.

Mr BARBER — But Port Phillip Bay is part of the assets in the way that the services require ships to come in and out. I am not sure that that bit in the pricing order is necessarily as clear as what I am seeking, but maybe that is just the way that — —

Mr RIZOS — Just to be clear, the channel is relevant for obvious reasons, and hence why the maintenance of the channel is relevant. To state the obvious, if the channel was not maintained, the ability to get ships in and out of the port becomes an issue. Hopefully that is clear.

Mr BARBER — Obviously, as you say, it is not the tenants' asset base, because they are tenants. What does that leave on the land side of the port?

Mr EASY — Perhaps I could provide some additional information. The port obviously values its assets, which include channels, land, property, plant and equipment, and a good example is the wharfs and the berths. They are owned by the corporation and maintained by the corporation. They have a value and they enable services to be provided by the private operators, but that is an example regarding an asset that would be a regulated asset under the pricing order.

Mr BARBER — The thing about your building block model — and we have learnt this over the years — is that the more assets they have the more they can charge. There are even instances where another person has

provided to them an asset, and they have insisted on that asset — which they did not pay for; they just got as a gift — then forming part of their regulatory asset base, and they start charging us accordingly. It is important to understand exactly what is the asset base, even though we are not going to find out what the number is until somewhere down the line.

The CHAIR — Thanks, Mr Barber. We might explore those numbers a bit more closely in closed session. I would like to return to the issue of the process around establishing the prescribed services tariff structure and ask: how will individual tariffs be established for individual services? You referred to the building block methodology setting the overall price limit, the aggregate price limit. How, for example, will tariffs be set for wharfage versus channel services using the building block methodology?

Mr RIZOS — I will refer that question to Geoff Carter.

Mr CARTER — In the first instance, they will be set the same way that the port currently sets them, because that gets rolled over. In the first 15 years if the lessee wishes to change any of those other than by increasing them by CPI, it would need to apply to the ESC to rebalance those within a weighted average tariff bundle meeting no greater than CPI increase. Afterwards it would need to again provide the ESC with a tariff compliance statement supporting any change to show that it had met with both its aggregate revenue requirement, which is set out in the pricing order, as well as sitting between the upper bound of the stand-alone cost of providing the particular prescribed service bundle and the avoidable cost of providing it as the lower boundary. That is a fairly standard economic regulatory approach, which was recommended by the transactions economic expert advisers. That is the answer to that question.

The CHAIR — You referred to if they want to exceed CPI, but on Mr Rizos's evidence, irrespective of whether they want to exceed CPI they will still have to go through this exercise to justify a price level even below current plus CPI.

Mr CARTER — That is correct. They would need to satisfy the ESC in the tariff compliance statement each year at all times that they comply with both.

The CHAIR — To go back to the question — Mr Easy may wish to contribute here — using the building block methodology, how will prices be set separately for individual service bundles?

Mr CARTER — I am not 100 per cent sure I understand your question, Chair. Initially they will be set as they are now — —

The CHAIR — Okay, I will re-ask the question: how are they set now?

Mr CARTER — I might defer to Mr Easy to respond to that.

Mr EASY — It is set in our prices. We have a total asset base and we have a weighted average cost of capital on that asset base, so there is a model that we have internally that we use from our finance area that looks at the value of the asset, the expenses and the revenue and what our weighted average cost of capital is for those assets, and we set an overall pricing tariff in order to achieve that outcome and take into account the business environment and other economic drivers that influence our pricing in terms of competition, trade and volumes through the port of Melbourne. So it is a systemic approach in terms of looking at overall economic drivers, achieving our weighted average cost of capital and our total asset base, and achieving that return on those assets in setting our prices.

The CHAIR — So the distinction between your wharfage charges and your channel charges, that has regard to the individual asset base, channel assets versus — —

Mr EASY — It takes into account, obviously, the individual asset value and the revenue and the expenses attached to that, and then we look at it in globo as well, across our total asset base. Our pricing will look at the total charges across each of our assets based on, yes, their value, expenses and return on those assets over the financial year.

The CHAIR — You said 'revenue', but of course revenue will be a function of your tariff schedule across the individual assets?

Mr EASY — Yes. So obviously in setting the prices we take into account and make assumptions around revenue, volume and trade, whether it is shipping through the port, the cargo, the charges on wharfage or rental fees and licences or other income we receive, and we look at that in total in terms of our return on that asset base.

The CHAIR — Under the pricing order, how will the rebalancing mechanism work if the new operator wants to shift from the relativities that are currently in place between wharfage and channel services?

Mr CARTER — It would need to make an application to the ESC. It would need to convince the ESC that in rebalancing it both met the weighted average tariff limit of CPI and also that it met those upper and lower bounds for individual prescribed service bundles. So it would need to meet both tests. If it did not, a default would apply, which is that it could only increase individually prescribed tariffs by CPI.

The CHAIR — So assuming the overall constraint was met, the only constraint would be the upper and lower bounds for individual service bundles?

Mr CARTER — That is correct.

The CHAIR — And that rebalancing does require specific ESC approval?

Mr CARTER — Absolutely.

Mr PECK — Just to add to that, obviously if a brand-new trade started that does not currently have a trade charge for that charge in the current pricing schedule, you would need to apply a new charge and therefore you would go to the ESC and say, 'We've got this brand-new trade X. We don't currently have that at the port. Here's how we are intending to charge it. Therefore, we need to rebalance, to keep it in our overall metrics, some other charge'. If that happened, which obviously would be a good thing, you would need to go through a process to rebalance, because you have got a new revenue stream that you are bringing in because you have got a new trade, and therefore you are rebalancing away from some other trades.

Mr RIZOS — Chair, if I could, the explanatory memorandum that was provided to you with our response on Friday under 3.2, 'Rebalancing', provides a bit of an outline, I guess in lay terms to some extent, of how that process would work. I draw your attention to the fact that the licence holder must consult with port users prior to making any rebalancing application. This is not something that happens behind closed doors or lacks transparency; this will be something that will have transparency throughout the process, and the ESC and users will have visibility of any rebalancing that takes place or is proposed to take place.

The CHAIR — Thank you, Mr Rizos. Shifting away from rebalancing to the setting of the tariff schedule, ultimately the setting of the prices under the schedule is a matter for the port operator. It is not approved by the ESC.

Mr CARTER — Yes, that is correct.

The CHAIR — What exactly is the mechanism for the role the ESC will play when it receives the reference tariff schedule?

Mr CARTER — If I can just clarify the question, this is in circumstances where a rebalancing application is not being requested — we are talking about the ordinary sort.

The CHAIR — Correct.

Mr CARTER — In the ordinary course this is what has been described as an enhanced price-monitoring regime, so the purpose of the tariff compliance schedule, which requires the licensee to provide all of the information justifying the basis on which it has set its tariffs, and any other information that the ESC requires has to be provided annually at the same time as it provides and publishes its reference tariff schedule. The purpose of that is to provide the ESC with a history of cost, revenues, pricing and other relevant data so that when it comes to conducting its five-yearly review it is in a good position to do so.

I might also say that in the 15-year transitional period where the CPI price-smoothing mechanism applies, that information can also be used to enliven the direct enforcement power which the minister has to take action in

the Supreme Court under division 2B to seek remedies against the licensee if it has not complied with the pricing order in that period. The information is able to be made available to the government for that purpose as well.

The CHAIR — What are the ESC's obligations with respect to the information they will receive with an annual schedule? What are they obliged to do with that?

Mr CARTER — I think their formal obligation arises at the five-year mark, Chair, at which point obviously they have to provide the compliance report to the minister. Until that point they would pursue, I assume — that is perhaps a question for the ESC — their normal statutory functions and objectives and obviously, I would suggest, have the discretion to make that information available for the government. But their main responsibility is to monitor and then review at five-yearly intervals.

The CHAIR — So when the port operator provides the annual schedule — it is determined what the prices are going to be under what it says is consistent with the building block approach — there is no obligation on the ESC to verify the port's claimed expense base on an annual basis as part of that exercise.

Mr CARTER — If it is not a rebalancing application —

The CHAIR — Not a rebalancing application.

Mr CARTER — then I would say that is correct, Chair, because it is a price monitoring regime with an ex-post five-yearly review. It collects information, but you are correct in saying that it is the responsibility of the lessee in the first instance to ensure that it is complying, obviously subject to the sanctions that are available to the ESC and the government of the day if it is found to be non-compliant in a significant, sustained manner at the five-yearly review.

Mr RIZOS — Chair, I also draw your attention to question 19 in our response to that. You will see there that we refer to the fact that the ESC, as part of the annual process, particularly over the price-smoothing period, has the ability to ensure that it can verify — the annual verifications process undertaken by the ESC. That is point 4 on page 21. I know there is a lot of detail there, but I think that response to question 19 provides a fairly comprehensive outline of the process.

Mr PECK — If I can just add commercially to that answer from Geoff, I think the reality is, coming into the next financial year, the leaseholder will be providing its pricing schedule by 31 May for the forthcoming financial year. So the prices that they are putting forward and the estimates will be exactly that, and it will be based on volumes and other things in terms of overall returns and the other information that is there in question 19. At that point you are verifying a process, and the ESC would no doubt check on the process, which is up to them, but you would expect them to do that. But the ex-post five-year review is looking backward at how things have turned out, because obviously if there is a downturn, volumes will be lower than the leaseholder expected in its forecast, therefore it will under-earn. If volume has jumped up unexpectedly, then it might slightly out-earn that year because, again, the prices have been set volumetrically on a forward-looking basis.

When you come to verifying a forward-looking, all you can do is verify a process point, and that is why the regime has a forward-looking provision of information so that the ESC has perfect visibility on an annual basis. Again, this is assuming the price cap is not applying here. Looking backwards, the ESC can look at how that worked in practice, were they over-earning as a result of the way they had forecast. It is not unusual in regulated assets — ports aside, looking at electricity, gas et cetera — that the proponent put forward their estimates because they have to provide pricing schedules on a forward-looking basis and they do that on an estimated basis. The regulator will do an ex-post review at a point in time and look at how that performance has turned out. That is how it is set up here. It is not an unusual process. I think the slightly unusual transitional piece here is the price cap for the first 15 to 20 years.

Mr DRUM — When you bring up electricity distribution, with the concept that we currently have where the ESC oversee the gold plating of the poles and wires, Victorians still pay. It is all regulated and it is all above board, but it is difficult for mums and dads when the prices go through the roof. The owner of the asset continues to build their asset. It is all regulated and it is all legal, but mums and dads still pay through the nose.

Mr PECK — It is a complex area. We could spend a lot of time on this. I think that if you go down the building block regulatory model, I think as the chair of the ACCC said — maybe it is not perfect, but it is the best we have — it obviously has a return-on-capital model to it, and so if you invest capital, you get a return, which is what you are saying. I think the reality is that if you look at how privately owned transmission and distribution assets have performed in Victoria and South Australia vis-a-vis state-owned assets in New South Wales and Queensland, it is very clear now. With the benefit of looking at those assets that are all homogenous, it is very clear that the private sector has delivered lower prices for the privatised networks in those states against New South Wales and Queensland networks.

Mr RIZOS — I think the other point to note here is the relativity of port cost. We are talking about port costs here in terms of the landlord operator of the port; we are not talking about the costs of the entire supply chain. I think as our submission indicates on page 35 — this is our original submission in early September — BITRE estimates suggest that port costs are in the order of 12 per cent of the overall supply chain cost, and estimates that we have made are therefore of a 1 per cent increase on port charges, or a 2 per cent increase. I guess you can do the maths on that yourselves, but it is 0.12 if it is 1 per cent or double that if it is 2 per cent. So I think we need to keep orders of magnitude in context here. We are not talking about a CPI impost on the entire supply chain; we are talking about 12 per cent of the entire supply chain cost that relates to port services, and even then we are ensuring that it is regulated, and only prudent and efficient expenditure is allowed to be passed through.

The CHAIR — With respect to the rebalancing scenario, if the operator seeks to rebalance the tariffs and does so without ESC approval, what mechanism would come into play? It has either made an application and it has been rejected, or it has not made an application and it has simply rebalanced the tariffs.

Mr CARTER — It would seem to me, Chair, in that circumstance by definition it is going to be in breach of the CPI price-smoothing mechanism, and that would enliven a direct enforcement power in the hands of the Minister for Finance to apply to the Supreme Court for an order to injunct that behaviour, to seek compensation for users or to seek an amount to be paid to the state.

The CHAIR — What if it does not breach the CPI cap, if it is a rebalancing within the CPI cap, but a major shift from one stream to the other?

Mr CARTER — If it is doing that, Chair, I think by definition it is reducing prices.

The CHAIR — But a shift from one to another — from wharfage to channel services, for example — and it was within the aggregate CPI cap.

Mr CARTER — Chair, I would need to ask for clarification of the question, because in the absence of a rebalancing application, it can only increase any particular prescribed service bundle by CPI.

The CHAIR — But I am saying, it either has applied and been rejected or it has not applied, but what it has done is an increase under the CPI cap.

Mr CARTER — Well it can do that up to the CPI price cap.

The CHAIR — But it is a rebalancing.

Mr CARTER — It would be in its interests to increase its individual prescribed service tariffs by CPI, so if it did not then by definition I would have thought it is not increasing one of its prescribed service tariffs by less than the CPI.

Mr RIZOS — And again, Chair, I draw your attention to the rebalancing provisions both as outlined in the pricing order and the explanatory memorandum, which does require the ESC to review that, so it is actually an application to the ESC that is required. Doing it unilaterally without applying to the ESC will beg the obvious question — that they would be in non-compliance with the pricing order — so it is highly unlikely they would seek to do that, given the potential ramifications that Mr Carter has just outlined.

The CHAIR — But the intervention there would be an application by the minister to the Supreme Court.

Mr CARTER — Until the five-yearly review, Chair, at which point it could well mean in that scenario that the ESC recommends significant sustained non-compliance because it is a very, very clear breach. Of course I am hypothesising about what the ESC might do, Chair, but in those circumstances, yes, it could bring on the re-regulation scenario earlier if there were such a flagrant breach.

The CHAIR — Can I ask about the scope of the regulated services? Are land rents the only thing which are excluded from the scope of so-called regulated services?

Mr CARTER — That is a fair summary.

The CHAIR — The committee has heard extensively through the evidence that 86 per cent of revenue from the port will be subject to ESC oversight. Are you able to give the committee an estimate — perhaps Mr Easy — of the current extent of ESC oversight versus that 86 per cent?

Mr EASY — Currently the ESC has oversight for wharfage on containers and motor vehicles and then also on channel fees. Revenue from wharfage in the last financial year was $241 million, and on channel fees it was about $50 million, so I would suggest it is probably somewhere in the order of 50 to 60 per cent, because what we are seeing with the pricing order is that it applies to a broader range of services and all of our fees, with the exception of rental and licence fees.

The CHAIR — What are rental — —

Mr EASY — Rental in the last financial year was $54 million.

The CHAIR — So that was roughly $290 million out of about three hundred and — —

Mr EASY — Three hundred and eighty-one million in the last financial year.

The CHAIR — In respect of the building block approach to price setting, how does that work with those functions which are not subject to the oversight, the rents? How would it be applied to those revenue items which are subject to building block and exclude those which are not subject to oversight in a practical sense?

Mr RIZOS — To be clear, the rents are not —

The CHAIR — The rents are not covered. The rents are not regulated.

Mr RIZOS — under the pricing order.

The CHAIR — Under the pricing order.

Mr RIZOS — What we are proposing is that the ESC will have a periodic review of those rents utilising its inquiry powers.

The CHAIR — But in terms of setting prices using the building block method, how are matters related to rents excluded from falling within the calculation of the building block?

Mr RIZOS — They are not one of the prescribed services —

The CHAIR — I understand they are not.

Mr RIZOS — and therefore they are not captured by the pricing order and therefore they are not captured by the building block methodology.

The CHAIR — How are they excluded?

Mr WEBSTER — They are excluded from the revenue which goes to count to the regulated return and maximum allowable revenue.

The CHAIR — Excluded from the asset base?

Mr WEBSTER — The revenues are excluded from the calculation against the asset base.

The CHAIR — Is the asset base reduced — —

Mr PECK — And the assets?

Mr WEBSTER — Yes.

Mr PECK — If your question is: is it like for like, yes.

The CHAIR — So if the land assets were $1 billion of the asset base, that would be $1 billion taken out of the asset base for the purposes of calculating the WACC or calculating the return?

Mr PECK — Yes. There is no double count, if that is the question. You are not getting your rents and then getting the asset base covered again in the regulatory model, if that is the question.

The CHAIR — On an annual basis, to what extent is it reasonable to expect the ESC to offer a view as to whether the port operator is complying with the pricing order? Can we expect that that will be part of, on an annual basis, what the ESC does after it receives the reference schedule?

Mr RIZOS — I think, Chair, that is clearly a matter for the ESC. The ESC will have full visibility in terms of how prices have been set. Again, without wanting to labour the point, our response to question 19 and question 20 provides an outline of how that process would work. It is definitely a matter for the ESC in terms how it decides to deal with this.

The CHAIR — It does not provide an outline on what happens if the ESC is of the view that the pricing order has not been complied with and what capacity it has on an annual basis to intervene if it is of the view the pricing order has not been complied with.

Mr RIZOS — I think it does, Chair.

Mr CARTER — Certainly there is no limitation on the ESC referring concerns that it has to government and for the Minister for Finance to take action prior to the five-yearly review. But it is not an up-front price-setting regime. As we have discussed, it is an enhanced price monitoring regime with significant sanctions at the five-year review. I hope that answers your question.

The CHAIR — So the only mechanism would be the ESC raises concerns with the minister; the minister decides whether to intervene by a Supreme Court action on an annual basis?

Mr CARTER — In that five-year period, that is correct, yes.

The CHAIR — Has the ESC or has the government determined how the ESC should pursue a dispute with the port operator if it is of the view that the pricing order has not been complied with? Is there a mechanism to resolve between the ESC and the port operator?

Mr CARTER — Is your question, Chair, in relation to the five-year period?

The CHAIR — No. Again on an annual basis.

Mr CARTER — On an annual basis?

The CHAIR — Yes.

Mr CARTER — No. That is a matter for the regulator's discretion, as to how much informal guidance it provides. Again, I believe it is properly a matter for the ESC to advise the committee.

Mr RIZOS — I just point again, in response to question 20 we do refer to the residual power — option 3 on page 24 of 25. You will see there that the Minister for Finance clearly retains a residual power to direct the ESC to undertake a review at any time. If anything is brought to the attention of the government, the Minister for Finance reserves the right to ask for an inquiry to be undertaken within the five-year period, so it is not as if government's hands are tied at all here. In fact government has the ability to direct the ESC to undertake an inquiry if it considers, on the advice of the ESC or others, that there is a risk of or there has been some non-compliance.

The CHAIR — Has the government undertaken any policy consideration to under what circumstances it would seek to intervene or would advise the Minister for Finance to intervene?

Mr RIZOS — No, not explicitly. That is a matter for individual circumstances as they prevail at the time.

The CHAIR — If in the second year of operation the port, in the view of the ESC, was not compliant with the pricing order, it would be flying blind as to what type of intervention it should take or what type of action it should recommend to government?

Mr RIZOS — I think on the contrary. The government in the first instance will have the ability to ask the ESC to undertake an inquiry if it was to receive such information and then it is a matter for the government to determine a course of action thereafter. The risk is then of course on the operator, who potentially is non-compliant. We are speculating here, of course, but if they are non-compliant the risk is with them in terms of courses of action government may take. I suggest it is in the operator's own interests to ensure they comply with the pricing order rather than run the risk of government exercising other powers it may have.

Mr PECK — Can I just add, the way this transaction is designed, if the lease was ever terminated because someone did something egregious to the point where — obviously there are the regulatory sanctions and re-regulation, but if someone did something egregious, they would actually put the whole equity investment at risk and there would be no compensation for that if the lease was terminated. If you are asking questions around would someone were to enter into transactions that blatantly disregard a pricing order and put themselves in that situation where they are going to get some consequences, I think that is highly unlikely to occur. That would be a novel proposition for the superannuation funds, pension funds, those sorts of people who provide the lowest cost to capital and invest in these sorts of assets to go out a year or two into a transaction where the long-term investors blatantly disregard a regulatory instrument and put their whole equity investment at risk, which we all hope is a sizeable number for the Victorian taxpayers. That would be unusual behaviour.

The CHAIR — It would be highly unusual for the state to terminate an agreement on that basis, too.

Mr PECK — It would, but the reason these things are set up this way is that obviously that would be the benefit, whatever small amount of money they might get from breaching a regulatory order, versus the consequences of losing billions of dollars of equity. I think the balance is right.

Mr MULINO — I just wanted to clarify, and I think this has already been answered. We have talked about the 86-14 split, but the way the regulatory framework has been set up, new charges will by default fit into the prescribed services category.

Mr WEBSTER — Correct.

Mr MULINO — Then, as Mr Peck indicated, that may require rebalancing, which will ultimately be to the advantage of people being charged other services, but that will be the default.

Mr WEBSTER — If there is a new charge that comes in, if they are at the limit of their allowable return, then other charges would have to go down so they do not breach their overall returns.

Mr RIZOS — Just further to that, the benefit of the port of Melbourne lease transaction following recent transactions in other jurisdictions is that a number of lessons have been learnt coming out of those transactions. The ability for new charges to be imposed on users of the port is something we have been acutely aware of, and we are ensuring that that is captured by the regulatory framework. I would direct the committee to review section 90(iv), where the definition of prescribed services also extends to the provision of access to, or allowing the use of, places or infrastructure. That is really anticipating any new charges that may be sought to be imposed by an operator that go to accessing the port. We have been acutely aware of the potential risks of that from other transactions and have provided for that. We have also provided in (v) in that same section any other service that is prescribed by the regulations, so we are being very conservative in our approach as far as that is concerned.

Mr MULINO — Post the 15 or 20-year period it is envisaged, is it not, that there will be a 5-year program of review? Is it fair to say that is a fairly commonly adopted time frame so as to allow balance between driving efficiency gains but allowing the right incentives for operators to capture some benefits of any new innovations?

Mr RIZOS — Indeed, that is correct. A number of regulated sectors have five-yearly intervals where regulators will undertake their periodic reviews to satisfy themselves that the appropriate regulatory tests have been satisfied. This is not unusual in that regard. The other thing to note here is significant capital expenditure at the port will happen in significant lumps, so we have clearly taken that into account in thinking about how we frame the framework. It is not as if we are going to have significant capital expenditure happening on an annual basis, but even then what gets rolled into the asset base still needs to meet the prudent and efficient test. So the regulator will have the ability to satisfy themselves of that.

Mr PURCELL — My question is probably to Mr Easy, and it is in relation to the bigger, global picture rather than the more detailed one. It comes out of the ESC and 86 per cent being regulated and everything. The question relates to the sale price. In getting a return on that sale price, whether it be 6 billion or 8 billion or whatever, when I look at the annual report of the Port of Melbourne and the return it currently achieves, I have difficulty calculating how you actually get — whoever is going to invest this significant amount of money — a rate of return plus the return on the capital over the 50-year period that is going to satisfy the owners of their business. My question really is: if you were in that situation, considering the regulations on price increases and other costs, how would you see yourself getting a return? What changes would you make to get a return on that investment?

Mr EASY — I think a similar question was put to me last time I was before the committee. I am not sure I can answer a question around the behaviour or the decisions of a new operator moving forward, so that question is a bit difficult for me to answer. Clearly, you have looked at our annual report, and that indicates the financial outcomes for the last financial year. This is a long-term lease with an investment over a long period of time, so I am not sure the behaviours will be different to what we see today. As I said, it is difficult for me to answer on behalf of what the new operator may do moving forward.

Mr WEBSTER — If I can just pick up from there, in terms of the projections going forward, obviously Webb Dock North comes in. That has an impact in terms of future profitability, but the valuation is effectively done on a discounted cash flow basis. There is a substantial portion of fixed costs, so to the extent that volumes go up, that does play through to the whole cost base. But in terms of the types of owners, we are expecting very similar owners or bidders to north of the border. Their return requirements, their gearing requirements, are reasonably well known, so in terms of arriving at a value we have used demonstrable benchmarks to come up with what we think is good value — appropriate value.

Mr PURCELL — That partially answered my next question to Treasury. When you have done your modelling to come up with a sale price —

Mr WEBSTER — Estimate.

Mr PURCELL — have you actually taken the current position into account and therefore included some price increases, cost savings and volume increases and then put a multiplier on that to come up with a sale price?

Mr WEBSTER — It is not a multiplier approach. It is a detailed financial model — inputting a capital structure there, inputting trade growth, inputting growth around costs et cetera, and how we think those costs are going to grow. Then it is effectively an WPV calculation based on the return requirements that equity want and what sort of gearing we think the capital markets will allow an owner to achieve.

Mr PURCELL — When you do those calculations, they are based on the discounted cash flow rather than looking at the multipliers that other ports have been sold for or any of those aspects?

Mr WEBSTER — Correct. The other ports are also 99 years, so while a simple EBITDA multiple. A useful rule of thumb for people in the marketplace, this is a 50-year term and typically buyers use a highly detailed, sophisticated financial model.

Mr PURCELL — Just the final part of that, if I may, Chair: do you include cost savings in those — you know, if they are detailed calculations? Because, as I say, looking at the annual report it does not obviously jump out at me — and I have spent a lifetime looking at these things — it does not obviously jump out to say, 'This is where you would have some significant price increases, cost reductions, efficiency changes or changes

in the structure of the business' — or any other factors, synergies of business or whatever, that says that it is going to be a significant discounted cash flow and return on your investment.

Mr WEBSTER — We use what we think are prudent assumptions going forward for both future operating expenses and capital expenses.

Mr PURCELL — Thank you.

Mr DRUM — Earlier on, I think in a response to Ms Tierney's question about the proceeds of the sale, it was effectively along the lines that, 'It is roughly the same as what it was previously with a bit of an increase due to the extended term of the lease'. But one of the other aspects that is quite different is the compensation clause. That was only put in place early this year. Would that also have been a reason why you have now got an increased forecast from the proceeds?

Mr WEBSTER — I think if you look at the KPMG study that was released, that contemplated a need for a mechanism similar to the port growth regime, so I do not think fundamentally there has been a change in the underlying sort of assumptions around protections for a second port.

Mr DRUM — But that is a significant change in policy.

Mr WEBSTER — There is not a significant change in policy. The KPMG report and the previous assumptions were that there would be a similar regime in place to achieve a similar outcome.

Mr DRUM — Okay.

Ms TIERNEY — I just wanted to pick up further on lessons learnt from similar transactions and ask whether other examples can be given, other than the new charges question that Mr Mulino put forward.

Mr RIZOS — I think it is one thing for us to reflect on that. The more sage view may come from joint financial advisers who have been involved in previous transactions and their ability to share some of that input with us and the transaction team, so perhaps if I defer to Julian and Tony.

Mr PECK — Sure. I will lead off if you like. In other transactions, in the modern port leases, if you will, 2010 was the first one, the port of Brisbane, and then more recently in the last two to three years the New South Wales ports have been leased as well. If I look across those transactions and generalise, I think overall the private sector has over time taken some costs out of those businesses and found some cost savings and made those businesses more efficient. That is a matter of public record. If you look back at head count numbers et cetera over time, they have generally found some efficiencies. Part of those is also to do with the fact that within a separation of the leaseholder from the state-owned model each state has different models in terms of what is residual and what is left behind, and so the new organisation has to redefine itself. Generally they have done that.

I think the track records are also quite good in terms of looking at new developments and signing up new developments, particularly in Brisbane, which has had the longest history, has looked at increased use of land for motor vehicle storage to accommodate demand. It has been developing new facilities around the port gate facility, which is at the mouth of the port of Brisbane, and leasing new lands for distribution centres. It is continuing to reclaim and fill in the site there for future terminal development. It is looking at cruise terminal developments and oil terminal developments. The private sector there has been quite active in terms of developing and attracting new trade. Likewise the port of Kembla, even though it has only been leased for a relatively short period of time, has signs of new developments in terms of grain terminals and liquids terminals.

So we have efficiencies in those businesses over time, I think, being found. The private sector has, given time and given the opportunity, also shown itself to be quite capable and quite willing to bring new trade through the port. Obviously from a government perspective you would like to see that new trades are being accommodated. I think there were various comments from some of the commercial parties that have submitted to the committee about their experiences with the private sector ports, and I think they have found them quite proactive and receptive to new ideas.

Ms TIERNEY — I appreciate that, but my question was more in terms of: what has the state learnt? From a state government perspective, regardless of who is in power, what has the state learnt that takes us forward in this transaction as opposed to other transactions that have occurred in other jurisdictions?

Mr RIZOS — I think it is fair to say that from a state government perspective we have ensured that the state retains sufficient strategic flexibility for future policymakers to make appropriate decisions at the appropriate time over the 50-year life of the lease. Our priority has been on ensuring we protect the economic interests of the state. It is not about the gross sale proceeds being given primacy ahead of other outcomes; it is about the economic interests of the state. We have ensured that the transaction is structured in a way that allows for an active engagement between the state and the new operator over the 50-year journey, so there will be at five-yearly intervals port development plans in place. They will ensure that the state retains sufficient flexibility and visibility, in particular, of demand projections and capacity commitments at the port to ensure that the state's and the operators' interests are aligned throughout. Our expectations are that the incentives are aligned.

It is in the interests of the operator to ensure they manage their facility efficiently and maximise throughput. Indeed it is also the state's interest to ensure that the facility is as efficient as possible, given what we were talking about earlier on price regulation, but also that throughput is maximised. So we have ensured that the transaction provides for that strategic flexibility, and ultimately we have also taken into account that a 50-year lease provides the right term to ensure the state can exercise whatever judgement it needs to exercise as it gets to the end of that 50-year lease. Indeed that is why we have also provided for the potential for a 20-year extension, as David Martine and David Webster alluded to earlier.

Mr BURGESS — Just to reinforce the emphasis on long-term planning, it is interesting to note that the consortium that runs Botany and Kembla released last Friday a 30-year master plan for development of the port, setting out some projections on trade and therefore what the issues are around accommodating that trade on the most efficient basis. That was really a document designed to be a consultative document with all the relevant stakeholders — the users, the stevedores, the state government — and we have designed our apparatus here in terms of every five years requiring the leaseholder to put forward a port development plan considering all of those issues, so we are going to be in a similar situation to have thorough advanced planning to ensure that the port can continue to meet the state's freight and logistics needs for the next 50 years.

The CHAIR — I would like to continue on the issue of price regulation for the time being and go back to the pricing order and the obligation on the operator under the pricing order. One of the key drivers of price setting — and Mr Peck referred to this before in his comments — is volume forecast of volume through the port. Obviously if the operator consistently forecasts a lower volume than has actually passed through the port, they will receive additional revenue. How will that be managed through the pricing order structure if there is a consistent underestimation of port volumes and consequently higher unit prices?

Mr CARTER — Again, formally it is a matter for the ESC, but the ESC is an experienced regulator, and I would expect that that would be the sort of thing they would report as potentially being non-compliance. If it were significant and sustained, it would lead to the re-regulation power being enlivened. The ESC has full power to ascertain the underlying basis on which that forecast information is provided to it. It can specify the form and the content of the underlying information about volume forecasts, which are obviously used to determine forward-looking prices.

The CHAIR — But from a practical point of view, if you look back over the 2006 port plan, the 2009 document, the KPMG document, the BITRE work, all those forecasts are wrong — inevitably wrong: some by small margins, some by a substantial margin — so the port operator arguing, 'The forecasts we used were our best estimate at the time', where does that give ESC recourse to take action against it or recommend action to the government?

Mr CARTER — Again, at the risk of answering a question that might be directed to the ESC, the decisions that the regulator is reviewing go to the reasonableness, the consistency and the robustness of the forecasts at the time. It is not a look back to say whether or not those forecasts turned out to be correct — sometimes they will, sometimes they will not — but it would certainly be my view that the regulator has discretion to call out any inconsistency in approach or, if your concern is cherry picking, cherry picking of favourable volume forecasts to that effect. There is absolutely no doubt in my view that that is the sort of thing the ESC would be obliged to look at having regard to its functions and powers.

The CHAIR — How would the ESC undertake that function with the five-year review? It is not looking forward — what the forecasts are being set at for the next five years to ascertain whether they are reasonable for the next five years — it is simply looking back at what happened over the last five years. What is the mechanism there, and what would be the — —

Mr CARTER — I feel some degree of discomfort in answering questions directed to the ESC. Again, I would just say — —

The CHAIR — I guess the frustration from our perspective is that Ron Ben-David has appeared and given evidence to this inquiry, and he indicated quite clearly that the ESC has not been involved in the development of this oversight framework and that it was a matter for Treasury and its advisers.

Mr CARTER — Perhaps I will do my best to answer the question with the caveat that I am not standing in the regulator's shoes, and that is that clearly a regulator in that circumstance has the ability to specify the various indices and sources of volume forecasts that are used and the methodology that should be used and to accumulate that data on an annual basis as part of the tariff compliance statement. If there were any significant divergence between forecast and actual on-average outcomes over time as a result of inappropriate sources of data or methodologies being used, that is precisely the sort of thing that I imagine would be reported as part of a five-yearly review. Perhaps the financial advisers may have a comment in relation to the actual sources of data that are used for those sorts of trade volume forecasts. There are a number of different sources, so in a practical sense they may be able to add more colour to the answer.

Mr RIZOS — Chair, if I can step in just ahead of the financial advisers on that, it is important to note that the ESC was consulted in relation to the pricing order. It was on the back of that consultation that the information requirements in the pricing order were framed, which goes to the very question you ask and goes to Mr Carter's response. We have sought to provide the ESC with as much flexibility as it has asked in relation to the information requirements it will impose on the port operator and therefore to allow the ESC to source whatever information it requires from the operator to satisfy itself of the very questions you ask.

The CHAIR — I guess the gap here is understanding what the ESC will do with that information and how it will satisfy itself. I take it from your series of answers that Treasury is not in a position to give that information.

Mr RIZOS — I think, Chair, with respect, you will find that regulators — independent regulators — like to form their own view about the detail they would like to receive and the form in which they would like to receive it. That is not unusual — regulatory accounts have been developed for the energy sector from time to time by regulators without government specifying the form of those regulatory accounts. A number of other information-gathering powers — whether it go to KPIs, qualitative or quantitative — have been left to the regulator to determine rather than being imposed centrally by government. That has merit because the regulator, frankly, is closer to the detail and is the day-to-day expert on applying the framework. It applies the framework or similar frameworks in other sectors and it takes lessons from those. So far be it for us to try to limit the ability of the ESC to source whatever information it considers appropriate. Indeed, if you look at clause 8 of the pricing order, that is in effect what was requested by the ESC.

Mr CARTER — If I may, if it would assist the committee, I draw your attention to clause 9 of the pricing order, which says in clause 9.1 that the ESC may from time to time determine what constitutes what is called 'sufficient supporting information', including in relation to a tariff compliance statement that is required under clause 7. So in effect, Chair, whatever the ESC believes is required to support things such as volume forecasts, in what form and from what source, are within the control of the ESC to determine at any time, not just at the five-yearly interval.

The CHAIR — Yes, I do not think there is any dispute that they can ask for whatever information they want. The question is: what do they do with it once they have got it, and what action can they take five years after the event in addressing wildly inaccurate forecasts?

I will move on to another matter, being the Treasurer's announcement of 30 September around the role the ESC will play in looking at the exercise or misuse of market power in the setting of port rents. Can you outline how that mechanism is proposed to work, please?

Mr RIZOS — I think we touched on that a little earlier in one of the earlier questions. As we have indicated, we are working out the detailed provisions to provide for that amendment to the bill. I think in the question we received from the committee, the committee appeared to be suggesting that it would be dealt with in the pricing order. I think our response makes it clear that our expectation is that that would be dealt with in the bill.

The CHAIR — Yes.

Mr RIZOS — And hence we are working up drafting instructions. They are not, frankly, in a form that is to be shared, but as we agreed earlier through the secretary, that is something we will come back to you on.

The CHAIR — Can you talk about the mechanism that is proposed, though?

Mr RIZOS — It will be the standard inquiry mechanism, but Geoff can talk to the detail if you want.

Mr CARTER — It might be of assistance to the committee if I refer it back to the powers the ESC has historically had in relation to undertaking reviews of the appropriateness of the scope and the form of price regulation of port services. So it has undertaken that role historically on, I think, at least three occasions, certainly two. We would envisage that the review it would undertake in relation to rent setting would be a similar power, so it would be asked to look into whether there has been an exercise or misuse of market power in relation to rent setting and to provide a report as to whether regulation of the rent book was justified and, if so, what the regulatory form should be — the form of that price regulation. In doing so, it would have its full inquiry powers to consult widely with affected stakeholders and to report back to government, and I believe that would be a report that would be tabled in Parliament, Chair.

The CHAIR — So there would be no mechanism for the ESC to intervene if it determined that there had been a misuse of market power; it would simply be a recommendation to government to regulate or not to regulate.

Mr CARTER — That is what my instructions are and what is currently proposed. I should note, Chair, that the ACCC, of course, has a standing power under section 46 of the Competition and Consumer Act and the ability to take enforcement action at any time in relation to a misuse of market power at the port. So in developing these regulatory settings, we have had regard to the existing economic, regulatory and competition law framework at both the state and the federal level.

The CHAIR — Thank you. With respect to the issue of the setting of port rents, would you expect there to be a difference or a material difference between rents that are set having regard to a building block approach and rents that are set via a market mechanism in a port environment?

Mr CARTER — I am afraid I do not have a view on that.

The CHAIR — Mr Easy or one of the financial advisers may have a view.

Mr PECK — If you like. The reality is that we do not have any precedent for what that might look like. I think the annual report of the port makes it clear that there are a range of different leases in place. Each site has a different size, a different topography, different environmental conditions, different uses, is leased at different times under different conditions with different KPIs et cetera. So it is really an assembly of a range of different contracts that have their own terms and conditions, as I said, all entered into at different times. How a regulator would go about developing — if they did — a single unitary price for that land would be challenging, given all those differences. I do not know how a regulator would go about developing different regulatory prices for those lands, given all those differences, rather than leaving it to the commercial parties to work through, which is the current model obviously. I do not know how they would do that, frankly, without putting themselves in the shoes of port management. Port management may from time to time lease land short term because it is going to redevelop a bigger parcel later for different uses. How a regulator would think about all those commercial dynamics, I think, is problematic.

The CHAIR — But ultimately, if rents were subject to the building block approach, it would be the port operator that would need to determine what those rents were, having regard to the building block approach, and would have the knowledge of those unique factors related to individual parcels that you spoke about.

Mr PECK — Yes, all I am pointing to is that in order to apply a building block approach, you first have to determine what the building block can be and what the pricing law should be and then, as you would know from the legislation for the pricing order, the other trade charges, which the port has the power to determine — therefore they are not under contract; they are determined under power — are applied uniformly. What you are doing is talking about a building block model where no two sites are exactly the same and you are trying to put a regulatory oversight over something that currently is left to a market test. Obviously the benefit of that is that the reason that tenants seek to do market-based deals rather than fixed-price rents — apart from accounting reasons — is that they have some broad comfort from time to time if they are on a market rent and their competitors are more broadly on a similar type of trajectory. I think if you are applying a building block approach at different points in time, and then applying some discretion within that building block under rules that are obviously hypothetical, I think that is pretty complicated. I do not know how that would operate. I do not know whether tenants would be better or worse off. Some tenants may be better off and some tenants may be substantially worse off.

The CHAIR — But there is no obligation — —

Mr RIZOS — Chair, I was just going to add to that, if I can. We need to take a step back, I think, and consider the services we are talking about being captured by the regulatory framework as proposed through the transaction and the legislation. They are generic services provided to a number of users, hence the application of the regulatory framework and the approach we are adopting.

Individual leases for individual sites have a whole lot of unique circumstances attached to them that do not lend themselves to the sort of general regulatory framework that we are applying here. A particular tenant on a particular site may have a particular use for that site. They may want to enter into direct negotiations — in fact they all do — clearly with the port about options for that site and how they want to use that site and flexibility. A generic regulatory framework which is really aimed at a broad number of users who access the port for the provision of services from the port does not naturally fit with the characteristics of individual tenancies on port land.

Mr WEBSTER — If I can just pick up from that, if you think about the underlying economics for the tenants, the economics for break bulk or cement are very different to international containers, so in terms of a one-size-fits-all regulatory regime which comes up with X dollars per square metre, it does not take into account all of those unique circumstances that the previous two speakers spoke about, including the underlying profitability of the operations on that site.

The CHAIR — But it is the case, though, is it not, with the prescribed services that the port operator is not obliged to offer those services at the same price to every user of those services?

Mr CARTER — That is correct within the other bounds that we talked about earlier today, Chair, bearing in mind that that is desirable from an efficiency perspective but that it should not change the overall aggregate revenue requirement.

The CHAIR — But just as they have flexibility with prescribed services under an extension of the oversight model, they would still maintain flexibility with rents, if the model was extended to rents, as to different tenants on different sites?

Mr CARTER — The view has certainly been formed by the transaction team and its advisers that the disadvantages of seeking to regulate the rent book far outweigh the possible advantages and therefore we have not developed a detailed model.

Mr RIZOS — Chair, I think importantly on that point, if we think about where the framework is today, both in terms of the framework and the pricing order and what has been proposed in relation to the periodic reviews of rents and whether there is a risk of misuse of market power, our view is that it strikes the appropriate balance between ensuring we protect users in relation to reference of prescribed services but also provide for independent oversight by the ESC on a periodic basis of rents and whether there has been a misuse of market power.

We think that all else being equal, and taking into account the regulatory burden that may be created as well, that strikes the appropriate balance and provides the appropriate visibility. Ultimately government will have the

ability on the back of an ESC review at a five-yearly interview into whether there has or has not been a misuse of market power in relation to rents to determine a course of action at that point, so we have not tied government's hands at all; in fact if anything we have taken on board the concerns that have been raised and the issues that have been raised and sought to accommodate that in a balanced way.

Mr PECK — Nick, you might want to comment, but I think the practical reality of port charges for wharfage and channels et cetera is that they are basically homogenous across all users and obviously the shared infrastructure, so if you were pricing down one user, you would be pricing up another user that may be using the same service; they might be competitors. Given the shared infrastructure that would be quite difficult to justify, and obviously given the disadvantage they would be not happy. I think individual sites have their own characteristics and therefore there is good reason why they might be differently priced for all the reasons we have talked about — the connection to infrastructure, size, site conditions, timing et cetera. I do not know, Nick, if you want to add to that comment?

Mr EASY — Yes, I mean that is correct. The only other thing I would add is in relation to the conventions around rents — they were obviously established by a contract under the leases between the port manager and the tenants in the port of Melbourne. I think there are well-set conventions. A change in that methodology is complicated, and as we have said before, there are opportunities for third-party review under well-set structures in terms of establishing value, and there are well-set structures in terms of the independent review of those processes, and that can certainly be undertaken by a third party. With respect to the prices, yes, they are set. They apply across the grouping of services and activities across the port of Melbourne, so I would agree with that comment.

The CHAIR — I just seek clarification, Mr Easy. Approximately how many leases do you have at the port of Melbourne?

Mr EASY — Just over 50.

The CHAIR — And the average duration?

Mr EASY — The average duration? I mean they do vary, but what we would see with leases requiring investment and returns over long periods of time is that it is not unusual for those to be generally in excess of 20 years. Some of those have been 30 years.

The CHAIR — Some are 50?

Mr EASY — I would say between 20 and 25 years.

The CHAIR — On average across the 50?

Mr EASY — On average, yes.

Mr PECK — I think the weighted average lease life, if I can use that term, is in between 20 and 25 years, which is similar to other ports, if you think about it in those terms.

The CHAIR — With respect to the changes the Treasurer announced on 30 September, when were they first contemplated by government?

Mr MARTINE — Presumably, Chair, you are talking about the Treasurer's press release dated 30 September?

The CHAIR — Indeed, yes.

Mr MARTINE — Obviously those are matters that the government considered over a period of time. It is a bit hard to put a specific time frame on that.

Mr BARBER — Chair, are we going to give these guys a break at some point? I know I would appreciate one.

The CHAIR — Yes, Mr Barber, we will. Given the numbers that want a break, we will break until 11.15, give a 15-minute break to everyone and then continue until about 12.30.

Hearing suspended.

The CHAIR — We will resume the session. Before the break I was asking Mr Martine about the development of the changes which were announced by the Treasurer on 30 September of this year, just the background to those changes.

Mr MARTINE — Chair, the port transaction team led by Mr Rizos had been in constant discussions with the ACCC for pretty much the whole period of the consideration of the transaction, so there have been numerous discussions with the ACCC about a whole range of matters, which include the issues that were touched on in the Treasurer's press release of 30 September. Those discussions occurred over an extended period of time between the transaction unit and the ACCC.

The CHAIR — Those proposals or changes that were announced by the Treasurer were developed within the department after consultation with the ACCC?

Mr MARTINE — Certainly we provided the advice to the Treasurer and government on the issues that are covered in the press release; that is correct.

The CHAIR — You recommended those proposals to the Treasurer?

Mr MARTINE — Chair, I cannot really go through and disclose the nature of our advice to the Treasurer, but we certainly provided the advice to the Treasurer.

The CHAIR — Some advice to the Treasurer?

Mr MARTINE — Very fulsome advice to the Treasurer, as we always do.

The CHAIR — Thank you, Mr Martine. I will move on. Has the department received advice or undertaken any modelling as to efficiencies that reasonably could be expected to be achieved by a port operator in that first 15-year window when they are operating under the CPI cap?

Mr WEBSTER — Not specifically.

The CHAIR — Why not? In establishing a framework that allows a CPI increase in port charges, why did you not seek to understand what efficiencies could be gained in that period?

Mr WEBSTER — I think if we think about how the regulatory regime works in the role of the ESC in determining efficient pricing and efficient costs, there are two incentives in that regime to drive out efficient cost behaviour in terms of the impact on price. Ultimately that will be up to bidders to determine what their forecasts are going forward and how that impacts on the price they are willing to pay.

The CHAIR — So how was the CPI cap derived as the capping model?

Mr WEBSTER — Nick, do you want to pick that one up?

Mr RIZOS — Sorry, Chair; I did not catch that.

The CHAIR — How was the CPI cap determined as the preferred model for price capping? Why is it CPI and not CPI minus an X factor for a real decline in real prices?

Mr RIZOS — I think we took into account the current methodology and framework adopted by the port, which provides up to CPI plus 1.5, as I understand it. We formed a view, based on modelling on a no-change basis and an understanding of what additional capital expenditure may be required at various points in time, that it was appropriate to provide for a price-smoothing mechanism — I think we referred to it as a price-smoothing mechanism — for a period of time that would not cut across the operator's ability to invest and be incentivised to invest at the right time. We did not speculate, given that various operators will have different views — indeed that is the benefit of getting the private sector's input in running the port — on what opportunities they may see for efficiencies going forward, particularly in partnering with any one of a number of users of the port or tenants of the port.

The CHAIR — Just on your point about capital investment, doesn't the pricing order allow new capital investment to take into account an increased asset base in any case?

Mr RIZOS — It does.

The CHAIR — So a CPI cap there as opposed to a CPI minus X factor would come into play?

Mr RIZOS — Yes. We felt comfortable that we had good visibility on a no-change basis of the underlying costs of the port, and it is the underlying efficient cost that would comprise the building block methodology. We were keen to ensure there would be a price-smoothing effect to ensure that there would not be significant blips, if you like, in terms of prices. We felt a 15 to 20-year period was about appropriate. There would not be any need for substantial capital expenditure within that period, so that the application of a CPI price cap would not frustrate investment. We are confident, based on the analysis that has been done, that if any significant capital investment is required, it will be required post the 15-year period.

The CHAIR — But how would that price cap frustrate investment anyway, given that the investment will be reflected in the asset price?

Mr RIZOS — Indeed, and it has to be prudent and efficient and recoverable. We want to ensure that the CPI price cap is not perceived by bidders as something that constrains them undertaking the investment and being effectively capped at CPI if that requires additional charges to be passed through, given the nature of the investment.

The CHAIR — You have referred to the CPI cap as a minimum 15 up to 20-year period. Can you just clarify the process after the ESC agrees to the removal of the CPI cap — it could be for 15 years — and the mechanism that will apply for price monitoring beyond the capped period?

Mr RIZOS — Sure. The methodology that is to be adopted will be, as we alluded to earlier, a building block metholodogy, so I will not labour that point. The ESC will undertake building block analysis with the port operator to ensure a good visibility of underlying efficient and prudent costs. That will happen from the first review. So irrespective of the application of the CPI price cap, they will be done in parallel. The ESC needs to be satisfied that it is still seeing prices that reflect the lower of the CPI price cap rolling into the building block methodology. The moment the CPI price cap moves away, the ESC needs to be satisfied that the future charges will be less than they would have been with the application of a CPI price cap, so there is that test. Going forward, the building block methodology will continue to be applied to ensure that only prudent and efficient charges, costs, are reflected in prices. So it will still be a building block methodology; it will just be that the CPI price cap is not there.

The CHAIR — So the process will be identical, pre and post the 15 or 20 year removal of — —

Mr RIZOS — Yes, it will still be a building block methodology.

The CHAIR — Can I go now to the issue of the port licence fee, assuming it is collected up-front, and the impact it will have on price? The response that the committee received from the department on Friday indicated that there will be no impact on the setting of prices from the up-front charging of a port licence fee. Can you expand on how that will be the case? Say hypothetically the port licence fee is currently in the order of $80 million, applied over 50 years, $4 billion, if you discount it, it might come back to $2 billion. If the operator is required to pay a lump sum of $2 billion for the port licence fee upon receiving the lease, how can that not impact on its costs in terms of subsequently setting prices?

Mr RIZOS — Chair, I think if you look at question 17 in our response, there is no change to the treatment of the port licence fee. From our perspective the port licence fee continues to be charged and is charged by the port through the charging mechanism and is deemed to be efficient. So in terms of what the users ultimately see, users will still see a port licence fee as it is today, rolled up into reference tariffs. The ESC will have the ability to ensure that the licence fee is what should have been applied. How that is factored in by bidders in paying for that port licence fee up-front — I think we alluded to earlier in one of the earlier answers today [inaudible] — so from the user perspective it will be no different. The port licence fee continues to be charged. It is charged as part of the prescribed services that are deemed to be efficient.

Mr BURGESS — If I can just clarify, from the bidder's point of view, instead of remitting it annually in each of the 50 years, they will provide it up-front. Should the decision be made to ask the bidder to pay for it up-front, they will pay an up-front amount.

The CHAIR — Yes, and therefore there will be a carrying cost to the bidder if it is a $2 billion lump sum as the discounted amount. Obviously there is a servicing cost to the bidder of paying that $2 billion up-front — or $200 million, maybe 10 per cent plus the capital — which will need to be recovered.

Mr BURGESS — But you will recover that by not having to remit annually the port licence fee that is collected, which also I understand inflates with CPI under current legislation.

The CHAIR — Currently it is, in round numbers, $80 million, so you incur a $200 million financing cost versus an $80 million annual licence fee, which is an extra $120 million in costs to the operator if the fee is capitalised. What I am seeking to understand is how that is going to be reflected in the pricing that is subsequently charged to users.

Mr WEBSTER — The price needs to allow for an annual port licence fee and an efficient cost. Geoff, you might be able to expand.

Mr CARTER — That would be the current annual licence fee escalated. If the amount is deemed to be efficient in each year, that can be then translated into prices and recovered. So it is not what the winning lessee pays, Chair, it is the amount that is set out in the legislation and is deemed to be efficient.

Mr RIZOS — So, Chair, hence our point that there is no policy change. The legislation provides for a port licence fee escalated, and that is what we are assuming and what is deemed to be efficient. I think in our response to you again in question 17 we make reference to that. If that is not clear, we can elaborate on it. How a bidder chooses to fund their bid is a matter for them. That does not mean that it is considered to be efficient for regulatory purposes.

The CHAIR — The pricing order refers to recovering expenditure in the year in which it is incurred. Why would that not extend to a lump sum for a licence fee?

Mr PECK — The port licence fees are in schedules in legislation, which — —

Hearing suspended.

The CHAIR — Apologies, gentlemen. We are now back on line.

Mr Peck, you were making some commentary with respect to the impact or otherwise of the port licence fee on pricing.

Mr PECK — Yes, that is right. I was just clarifying that the amounts visibly pass through and the allowed amount is the annual amount, which is what the ESC currently does — it passes through the annual amount. This was made clear in the pricing order, so it was clear for all parties — the state and the bidder — as to what was proposed. If that is funded differently or how they fund it, there is no provision in the pricing order for individual, discrete funding costs to be passed through. It should be very clear on the face of the pricing order that the annual cost passed through is the annual cost that is specified in the legislation.

The CHAIR — I take you to a couple of other issues, again with respect to pricing. The committee has heard evidence raising the issue of anchorage services and their exclusion from the pricing order on the basis that, as I understand it, they will remain with the Victorian Ports Corporation. Can you just explain why that has been excluded? There has been concern expressed that because they are not covered by the oversight regime, there is scope for unreasonable price increases. Can you explain why they have been excluded?

Mr RIZOS — Chair, the regulatory framework obviously applies to the port operator — with the privatised entity, not StateCo. As a consequence of the separation exercise that was undertaken in relation to the transaction where certain functions went to PortCo and certain to the private entity and certain functions have been allocated to StateCo, it was deemed that anchorage would stay with StateCo. Anchorage services — I do not have the figures in front of me at the moment — are relatively small in the context of services that are provided. It was considered that, given the complexity that may come from having that captured by the

regulatory framework, which would apply to the private operator while the services were actually being provided by the state entity, it was not appropriate to roll those services into the pricing order and the regulatory framework.

The CHAIR — So there will be no ongoing oversight for PortCo, given that it is no longer the operator. It will not be the operator?

Mr RIZOS — Its terminology we might be careful with here.

The CHAIR — The Victorian Ports Corporation.

Mr RIZOS — The Victorian Ports Corporation (Melbourne) will be charging anchorage; StateCo, the state entity — the remnant entity that will stay with the state —

The CHAIR — The remnant entity.

Mr RIZOS — has the ability to charge anchorage services fees. Those fees were considered relatively minor in the scheme of things, and it was considered that the regulatory burden would outweigh the benefit of trying to incorporate those into the pricing order and into the regulatory framework that applies to the private operator.

The CHAIR — With respect to the department's response to the committee last Friday in reference to the 15-year capping period and how 15 years was determined, the department has indicated that in determining the price cap period, consideration was given to forecast trade growth and therefore the time period in which expanded capacity might be needed. Can you outline what forecasts were considered in reaching that decision on 15 years? What exactly was considered in terms of trade growth? What forecasts do you refer to?

Mr RIZOS — Chair, consistent with statements made earlier in relation to various parameters that have been used, it may be sensitive. We have not disclosed publicly any trade forecasts that we have made. I think our original submission uses a number of trade forecasts that are in the public domain, and we would point you in that direction to provide you with a general sense of trade forecasts, but we are not in a position to disclose internal modelling of trade forecasts.

The CHAIR — One of the other issues Mr Rizos touched upon before in respect of the CPI cap and the 15-year period was expected capital investment or required capital investment by the operator. Can you outline to the committee what Treasury's view of that investment profile is for future investment required?

Mr RIZOS — To be clear, we have looked at a number of scenarios that are potential scenarios. We have obviously considered those internally. They are sensitive but they are one view or a view, if you like, of what may play out. They are not necessarily a definitive view of what will play out. As we have indicated earlier, the operator of the port going forward will form their own view about what investment will be required. We are comfortable that, based on our analysis, there will not be a need for significant capital investment within that first 15-year window. You would appreciate that the new Webb Dock operations are coming online in the next couple of years. They will provide additional capacity at the port. We are confident that, within the port footprint and the port operating more efficiently, there is scope for that capacity to increase to somewhere in the order of 7 million to 8 million TEU, which we have said previously and provided for in our submission. The time frame over which those investments occur to facilitate the 7 million to 8 million TEU will be a function of a number of drivers. I probably cannot elaborate too much on the internal machinations to the transaction on what those capital investment profiles may look like. Suffice to say that we are confident that there are a number of options that allow the operator to get to 7 million to 8 million TEU over the 50-year lease.

The CHAIR — Okay. We will come back to that in closed session later. I will also take you to the answer provided in relation to question 14 on page 18 in relation to pricing, where the department has indicated that post the CPI cap period the expectation is that unit prices will decline. Although not in this sense, I think it might be in your submission, it is indicated that you expect them to decline both in real and nominal terms. What is the basis for that expectation?

Mr WEBSTER — It is effectively the same amount of fixed costs, so as volumes go up you are spreading those fixed costs over a larger number of units. We expect that volume impact to have an impact in terms of reducing both nominal and real prices per unit.

The CHAIR — Has that been the case with port charges to date, as volumes have increased from 1 million TEU a decade ago to 2.5 million TEU today, that nominal and real prices have declined?

Mr WEBSTER — Over to Nick Easy for that one.

Mr EASY — I think if we look at the history of the prices in the last three years, in the last price setting we saw an increase of CPI on our charges, with the exception of international export containers, which were reduced by 2.5 per cent. Prior to that the prices increased by 1 per cent, and in the year prior to that it was around 5 per cent. We have seen differences in the tariff setting across each year, taking into account a whole range of business inputs and clearly taking into account volumes and expenses and revenue over the course of that year.

The CHAIR — But we have not seen certainly nominal but even real reduction, given the volume growth and the amortisation of fixed costs, as Mr Webster referred to.

Mr EASY — I think the history would show modest increases each year.

Mr DRUM — On a per container basis?

Mr EASY — Yes. I am just talking about percentage increases on revenue, but we have seen an increase in unit costs again taking into account the circumstances in any financial year.

Mr BURGESS — Just for clarity, I think you have had some structural changes over the last 10 years. You had an infrastructure levy put in place for the dredging program and you also had the port licence fee introduced.

The CHAIR — One of the references in the government submission — several references in the government submission — refer to enhancing ESC oversight. Can we just clarify: when the government refers to enhancing ESC oversight, is the reference only to the scope of what will be prescribed services or is there a material difference in the oversight mechanism that is proposed under the legislation, as opposed to the oversight mechanism that applies currently?

Mr RIZOS — Our original submission provides an outline of the current framework and the proposed framework going forward. On page 39 of our original submission you will see a comparison of the Victorian framework to those applying in other jurisdictions. Then we go on to discuss subsequent to that the additional safeguards that are being applied by the adoption of the new framework that we are proposing through this transaction.

At a high level, I think it is safe to say both the breadth and depth of the ESC's role is being enhanced — breadth in terms of capturing services that are provided by the port under the regulatory net. So you will see that that is now broader than it has been previously. In addition to that, the recent announcement in relation to the periodic oversight of any misuse of market power through the inquiry function, which is not reflected in our original submission. That reinforces the breadth of the ESC's role.

The depth is that with the pricing order itself, there is no pricing order equivalent in place at the moment that provides the level of specificity that our pricing order provides going forward in relation to how costs are to be assessed. The order itself provides the ESC with the ability to point to a framework that the operator needs to adhere to that very explicitly calls out efficient and prudent expenditure and the appropriate tests that will be applied and makes very clear under that pricing order framework that the ESC has information-gathering powers that it can call on under that framework. Hence my suggestion that this can be characterised as both broader and deeper.

The CHAIR — That framework, though, is broadly similar to that which the Port of Melbourne already uses in terms of the building block methodology for its current pricing regime?

Mr RIZOS — I will let Nick talk to that, but my understanding is at the moment it is pretty clear that that methodology, or rather the oversight of the ESC, is not as thorough as what we are proposing under the pricing order.

The CHAIR — Mr Easy, do you want to add to that?

Mr EASY — We do have an asset base which informs the pricing in any financial year, and we have recently, as part of a five-yearly scheduled review, completed a further review of the asset base. That informs our pricing and the setting of pricing in any financial year.

The CHAIR — What drives that methodology — to use that methodology to set your prices?

Mr EASY — It is largely based on replacement value.

The CHAIR — What I am getting at is: what instrument dictates that you use that building block methodology currently to set your pricing structure?

Mr EASY — I think if you are interested in the instrument, I might need to take that on notice and I am happy to give you some further advice on that.

The CHAIR — As Mr Rizos said, there is not currently a pricing order per se of the nature of this proposed pricing order, but you are broadly following the same methodology currently.

Mr EASY — I think that is correct. We have a pricing policy which sets out the principles by which we look at and determine prices in any financial year. That is currently approved by the ESC, so that forms the basis for the setting of our prices in any financial year, which is considered by ESC and audited on an annual basis to confirm that what we are doing is consistent with the pricing policy.

Mr RIZOS — Chair, Mr Easy is absolutely correct. There are a set of principles that have been adhered to by the port to the satisfaction of the ESC under the current framework. The other remit the ESC has of course is to periodically look at the level of regulation, with a view to reducing regulation. If you look back over the history of the port of Melbourne, the ESC at five-yearly intervals has progressively reduced the application of economic regulation on the port of Melbourne. What we are in effect doing is saying we think one of the critical safeguards as part of putting this transaction to market and allowing a private operator to run the port is to ensure that the economic regulatory framework is more robust and more transparent and frankly does not provide the sort of flexibility that may have been there under the previous framework, if that was to continue under private operators' hands. Hence we have erred on the side of providing more rather than less guidance to the ESC but, as I said earlier, striking the appropriate balance in terms of information-gathering powers, which were requested by the ESC explicitly as part of our process.

The CHAIR — What drives that current framework? There are provisions within the ESC act around price monitoring for ports. Is that the basis on which ESC have set down principles and the basis against which Mr Easy now submits — —

Mr RIZOS — Correct. Sorry, Chair. On page 37 of our submission there is reference to the price monitoring determination, which happens over given periods of five-yearly intervals, and that allows the ESC to effectively set parameters that the port needs to adhere to. I have to say, though, that those parameters are not anywhere near as detailed as what we are proposing here.

Mr MULINO — Very quickly, just a couple of clarifications. On rents, there will be under the proposed legislation a periodic review. Is it plausible that the ESC in undertaking that review might find varying degrees of market power across different rental agreements and that in view of that possibility it is suitable to give them flexibility in what they might recommend?

Mr RIZOS — I might take this first and then pass on to Geoff Carter. Indeed as a matter of principle that is correct. We are in a position where we are advocating for the ESC to have a significant role in undertaking a review into the process for periodic market rent reviews and determining whether there is market power and then whether it is being misused. As this plays out — and I am conscious we referred earlier to drafting instructions that obviously have not been provided to the committee, and the secretary agreed to take that on notice — we would not want to be so prescriptive as to tell the ESC how to do its job in effect in this space, because the circumstances will vary. As we alluded to earlier, and as Mr Easy referred to, there are in the order of 50-plus leases that we are talking about here, so there are a number of leases with varying term and varying terms within those leases, so we need to be mindful of that. Geoff, do you want to add anything?

Mr CARTER — No, I do not have anything to add.

Mr MULINO — Then depending upon the degree of market power and what it finds in relation to different leases, it may be that a building block approach might be appropriate or there are other options that it might consider — for example, enhanced arbitration clauses or arrangements. Again you would not want to be overly prescriptive before the ESC has actually undertaken its review of market power.

Mr RIZOS — I think that is correct. I think what we said earlier still applies clearly, and that is that we are not talking about a generic homogenous service that is provided to a number of users, which is what the regulatory framework is designed to deal with. We are talking about individual leases on individual sites which are unique by definition, given the services that are being provided by those users. They will want to enter into discussions and negotiations with the port operator. We have referred to — I think it is in the correspondence to the ACCC — the requirement for there to be effectively an negotiate-arbitrate framework, a commercial framework, built into leases going forward and that that should provide for an independent arbiter to deal with those disputes if and when they arise. I would point to the fact that recently DP World has entered into an extended lease following negotiations with the port, so the framework clearly does work, and I think DP are on the record as saying they were happy with that outcome.

Mr WEBSTER — Just to point out that it is an enhanced framework in advance of anything north of the border as well.

Mr MULINO — Just on forecasts, is it fair to say that the challenge of forecasting is something that is present in a number of regulated industries and that it is a challenge that the ESC and other regulators have to deal with on an ongoing basis?

Mr WEBSTER — The ESC obviously plays a role in regulating the water sector. It is very difficult to forecast rainfall. Same in electricity generation, it is a function of most regulated businesses.

Mr MULINO — Part of the interaction between the ESC and the regulated entity will be a combination of backward looking at how effective their forecasts were but also forward looking, trying to drill down into the assumptions of forecasts. In a sense it is a bit of an iterative process, and in a sense legislation can never be too prescriptive in how they best undertake that.

Mr WEBSTER — Correct. I think the other important thing to note is we are only talking about a 5-year period, so in terms of forecasts over the next 5 years, obviously there is less scope for error than forecasts looking out over 20, 25 years.

Mr MULINO — The last question I had was just to clarify on the PLF and the potential for an up-front payment: if there was a decision to go down the path of entertaining offers for an up-front payment, any bidder would make a judgement in deciding how they discount future flows, based upon their reading of market conditions. Is it fair to say that in fielding any offer based upon each bidder's assessment of what it could justify as a discount rate based upon financing costs the state would then make a decision as to whether that reflected value for money, and that would ultimately be the determining factor as to whether that made sense to accept or not?

Mr PECK — Yes.

Mr MULINO — So that is the trade-off ultimately.

Mr PECK — And that is the reason we run a competition sort of state effectively — if the business case is identical, you get the lowest cost of capital, because we run a process and we — —

Mr MULINO — Obviously the more competition the more one is likely to get a value-for-money discount rate offering.

Mr PECK — Yes.

The CHAIR — I now move on to the port growth regime, which I understand Mr Barber has some questions on as well. Can you firstly explain the proposed formula for the port growth regime and its key components? The committee has obviously received the submission, which talks about it in terms of principles. What I would now like to do is fill in the detail around how it is actually proposed to work and indeed how the key metrics will be determined.

Mr MARTINE — I might just pass across to Mr Webster. Chair, we have tried to provide as much information as we can on the questions — I think it is one to four — in the response on Friday. We might just get Mr Webster to run through in a little bit more detail.

Mr WEBSTER — Sure. I think it is important to remember that there are a number of hurdles to go through before the port growth regime is triggered. Firstly, the state has to sponsor a competing second port. Secondly, there has effectively been a competition which has taken away international container trade from the port of Melbourne. The operator of the port of Melbourne has a number of protections around a use-it-or-lose-it notice if he has not developed capacity up to its natural limits within the existing footprint. There are protections there against force majeure. Effectively the port growth regime triggers an annual payment whereby containers in excess of a first-loss position have been diverted to a second port, and effectively there is a calculation which gives a refund of the original purchase price calculated against effectively a lost contribution margin for those containers.

Mr MARTINE — Chair, there is an important point — and I think we talked about this at our last appearance — which is on our response to question 4, paragraph 11. Effectively in that scenario the state is then receiving revenues which provide effectively the cash flow for that payment. In a sense that is why we tend to find the term 'refund' a more useful descriptor of what we are talking about here, but effectively the state is receiving then that revenue that the new owner of the port of Melbourne is no longer receiving, and effectively we are using that to, in a sense, refund the owner something that they originally purchased which the state made a decision along the way to effectively take away a portion of the trade. That is effectively what we are talking about here.

The CHAIR — Okay. To run through the elements of the PGR, firstly, the reference to sponsor — state sponsors a port.

Mr WEBSTER — Yes.

The CHAIR — Can you for the record, Mr Webster, elaborate on what exactly it means for the state to sponsor a port?

Mr WEBSTER — Obviously if any of the existing ports which are operated by the private sector developed additional capacity, additional capability of handling the national containers, that would not trigger the compensation clause. Effectively the state sponsoring a second port is there are lots of different ways of skinning a particular cat — for example, a second port could be delivered by a PPP-style design-build-finance-operate. That would be of concern to private sector bidders for the port of Melbourne, so the definition of a state-sponsored port would pick up that type of arrangement whereby the state is effectively financing and promoting the second port. It is drawing a distinction between where the state is financially advantaging a second port. The exact definition of what state-sponsored is will be ultimately in the transaction documents and will be probably heavily negotiated with the private sector bidders.

Mr RIZOS — Chair, I draw your attention to page 28 of our original submission, which does provide a description of a state-sponsored facility.

The CHAIR — Mr Rizos, I am just trying to find it.

Mr MARTINE — The second element of the table.

The CHAIR — Thank you. So 'specific support' is the term used there. Would that include the provision of planning approvals, environmental approvals, the fast-tracking of those approvals under the Transport Integration Act?

Mr MARTINE — I would envision that it would include those. As Mr Webster indicated, obviously the definition would need to be negotiated with bidders, but as we outlined on page 28, it is beyond what a government would normally be doing for private sector construction of a facility. Planning and approval is a normal course of business, so it is really where the state is stepping in to provide, as indicated on page 28, specific support to a potential competitor, whether that is through the state building the facility itself or having the facility constructed through a PPP or whether, as mentioned on page 28, the state is providing other support through subsidies. Once again, that is an area that no doubt bidders would want to have carefully articulated.

The normal course of business would not envisage that this would trigger the port growth regime. So it is the normal course of business for government to provide planning and approval. For a port, then, that would be outside the scope.

The CHAIR — So why is that definition subject to negotiation with bidders? Why has that not been determined as a hardwired precondition?

Mr WEBSTER — In terms of any condition that is in the transaction documents, ultimately it needs to be acceptable to both sides. Yes, government can start with an opening position, and if the market comes back with something that is materially different to that or different to that, then there needs to be a view in terms of whether it is acceptable or not, whether it is further negotiated or whether indeed it is a point of principle which at that point you would walk away from. Yes, we will obviously articulate in the transaction documents what our definition of state-sponsored port will look like. Given the sensitivity on the private sector side, you would expect some commentary around that and some element of negotiation around that.

The CHAIR — Do you have transaction documents that reflect a current government-preferred definition of 'state sponsored'?

Mr WEBSTER — Government has not considered that definition.

The CHAIR — Okay. It is a fairly fundamental question for what the port growth regime is going to mean.

Mr MARTINE — I think, Chair, the intent is that, yes, there will be discussions, as Mr Webster indicated, with bidders around some of the wording, which I would describe more as wording at the margin. The intent is very clear, and that is: if the private sector wants to come along and build a second port — that is separate to the state government taking action — the port growth regime would not be triggered. That is quite different to the state stepping in and facilitating through support the construction of a second container port. The whole intent from the government's point of view is very clear, and that is: this is around the state intervening and providing direct support to a second container port.

The CHAIR — Where would you envisage room to move in negotiations on that definition?

Mr MARTINE — Coming back to the point on page 28, the reference to subsidies, obviously the transaction documents would need to provide some clarity around what that actually means — you know, what is a subsidy? In regard to your question, Chair, about planning approval, you would expect that a bidder may ask the very same question, so it would be important that the documentation makes it very clear what, actually, the trigger is. So presumably we will need some discussion around the normal role of the state in providing a planning approval and there would be some discussion around subsidies.

Mr WEBSTER — In particular the landside infrastructure, I think, will require a fulsome definition, because obviously upgrading rail and road connections to existing private sector-operated ports would not come into the definition of a state-sponsored second port. But substantial new investment in a way that makes an unlevel playing field for a second port probably would. So that is the type of language which we can start with an initial position on, but we would need to test that with the market.

The CHAIR — Okay. The second element you referred to, Mr Webster, was the 'use it or lose it' notice. Can you expand on how that will work?

Mr WEBSTER — Yes, in the set of circumstances where the port of Melbourne has further development options to increase capacity there and, given that expanding capacity at the port of Melbourne is expected to be the lowest cost incremental capacity for the state, in the set of circumstances where the port of Melbourne for whatever reason has chosen not to expand capacity, the state has the ability to say, 'You have not expanded capacity at the port of Melbourne as we expected, so we reserve the right to build a second port, and we are giving you a "use it or lose it" notice that if you do not expand capacity at the point of Melbourne, then, to the extent that we put in capacity elsewhere — which is needed to accommodate trade growth — compensation will not be payable in respect of that capacity'. So effectively it is saying, 'We can provide the capacity, which the port of Melbourne has not done for whatever reason'.

The CHAIR — So with the conclusion of the port capacity project, the estimate is that the port will have capacity of around 5.3 million TEU?

Mr EASY — That is correct, yes.

The CHAIR — The term 'natural capacity' has crept into these discussions. I know it is not used in any of the port's planning documents, but a figure of 7 to 8 million — 7.5 million — TEU has been thrown about. So the 'use it or lose it' notice would refer to the obligation on the port operator to expand from 5.3 up to 7.5 million.

Mr WEBSTER — Sure. In the event that the operator did not expand it beyond 5.3 and the state built a second port to effectively cater for those volumes between 5.3 and 7 to 8, the state would give the port of Melbourne operator a 'use it or lose it' notice, which sort of says, 'If you do not expand beyond 5.3 and we develop a second port to take those volumes, then you do not get compensated for that notional lost trade that you would have had had you expanded'.

The CHAIR — And where will that upper figure sit?

Mr WEBSTER — That upper figure will be articulated in the transaction documents, and by upper figure I mean the trigger. We are building a first-loss position in there, so it is not an estimate of the future maximum capacity; it is a future maximum capacity less a first-loss position, because we think that is an appropriate incentive.

The CHAIR — But where will that maximum capacity figure sit? You have said it will be in the transaction documents. Treasury has previously advised it will be —

Mr WEBSTER — The trigger will be in the transaction documents

The CHAIR — subject to negotiation. Why is that subject to negotiation? Why is it not a hardwired figure common to all bidders?

Mr WEBSTER — In terms of the mechanism, we are contemplating allowing the bidders to actually bid that amount. In terms of the compensation trigger, we believe that gives us a competitive tension in terms of the amount of value that will be ascribed to that. I might just hand over to Julian in terms of that biddable amount.

Mr PECK — Sure. Just picking that up, the reality is we will start with a leading position on the amounts as well as the transaction documents and the preferred risk allocation to the state. Generally that is what we do in these things. And then invariably bidders will look at the full set of documents, and there were comments before around a state-sponsored port et cetera. They will look at all those and they will give us a range of comments. In terms of capacity, they will do their due diligence, and we will give them ours. We will say, 'Here is where we have set this number'. We will see if it balances with the position of the state. We are not trying set the number to the full capacity; we are setting it lower, because we do not want to start with this envelope and then set it to full capacity. Bidders may come back in their due diligence and say, 'Actually we think there is more capacity'. They all may have that view and think that the number should be X and that is in the best interest of the state. Conversely they may come back and say, 'Well, actually we think there's less capacity there, so we think the appropriate number is some other number'. That is the benefit of going through that process. We have done our due diligence. The port has already got its own plans for the port. Then we get three, four or five bidding groups through, they will do three, four or five lots of due diligence, and so this aspect of the port will be thoroughly worked over.

The benefit of getting that feedback from the bidders through that process is that we then get more confidence on that number and the appropriate risk allocations for the state, so we could lock in some number now never to be discussed, but I would query the benefits of that because you will not get the benefit of the diligence process and the Q and A and the interaction with the people who are potentially going to lease this port for 50 years.

The CHAIR — Is there any prospect of that number exceeding the 7 to 8 million TEU that is regarded as the natural capacity of the port?

Mr PECK — For my part that is, I guess, a government decision as to where they ultimately set it, but the whole discussion around this issue up until this date is to set it within the parameters of the port and not without it.

The CHAIR — Mr Martine or Mr Webster, do you have a comment on that?

Mr WEBSTER — That would not be the intention, no.

Mr PECK — I would add just within the 50-year lease life of the port obviously there comes a point in time — and hence the plus 20-year provision — where you would not continue to expand the port if you had a very short lease life left, and so there is a natural ceiling, if you will, within any duration asset as to when you can keep expanding capacity. You would not do it on the last day, for example, because you would never get a payback. Those things all come into play as well.

The CHAIR — What incentive does that create for government? If you have two like-for-like bids, the difference is where the two bidders regard the capacity and therefore the trigger point. One has a high trigger point; one has a low trigger point. Which bid is more attractive to government?

Mr WEBSTER — All other things being equal, the lower trigger point.

The CHAIR — Why?

Mr WEBSTER — Because they are taking a greater risk on the capacity which they could lose if the government develops a second port ahead of need.

Mr PECK — I would just add a comment to that. I think that is a great place for the state to be in because it gets to choose.

The CHAIR — All other things in the bid being equal, would different trigger points likely trigger different bid values?

Mr WEBSTER — Potentially. It is very difficult for the private sector to take a view on how a future government will behave. In terms of a discounted cash flow model I would not expect bidders to put in any value against specific payments under the port growth regime. It is effectively a risk type of item and they will, in terms of setting their return expectations, take a view as to what level the growth regime is set at and what impact that has on what returns they require, so it goes to return rather than cash flows.

Mr BURGESS — If I could add something to that, Mr Chairman, I think it would go to how much risk they think there is on the expected cash flow, because the lower the trigger point potentially the greater risk that volumes will be diverted to a state-sponsored second port and they would factor that in to how they look at the expected cash flow. I do not think it would alter the expected cash flow per se, because that would be a function of the trade forecasts and how long it would take to get to the so-called natural capacity of the port of Melbourne.

Mr BLOCK — Can I just interrupt too for a moment just as part of this context in respect of how the bid is run. When the bid is sent out there will be a series of evaluation criteria against which the bids received will be evaluated. Some of those are fairly self-evident, including value for money for the state. When you ask questions like 'All things being equal, what would you do?', those questions are very difficult to answer in that context because there are a whole series of evaluation criteria that need to be looked at.

Again when you come back and look at what the evaluation criteria will be for the bid, they will be determined closer to when the bid goes out as we interact with the state on the whole framework. As I said, the transaction documents at the moment are essentially vetted and signed off by the state, but as we go through them we will set those criteria. But the criteria, if you actually look at the answer that David Webster has given, essentially if you are asking a broadly commercial question, yes, the answer is as he gave it.

But in terms of when we develop the evaluation criteria, you might come back and say that the purchase price bid by the particular bidder is so unrealistic as to not be sustainable and that creates a tension that you think may not be achievable, and it creates a tension in the documents that the documents might fail. Again, there is always a balance in this, so again you need to just flavour the answers in relation to the way we will run the bid in terms of the procurement and the evaluation criteria.

Mr MARTINE — Chair, can I just add to our answers to your previous question around the definition of state sponsorship. In our submission to the committee on 1 October — this was the confidential submission to the committee — we attached the draft term sheets. They are effectively what is drawn upon in preparing the transaction documentation. On page 49 of 53 of that document there is some text that talks about the definition

of a state-sponsored port. I just want to point that out to the committee. As we indicate in the letter, these are the draft term sheets. The transaction documents will draw on this material as they are getting finalised. That is on page 49 of 53.

The CHAIR — Thank you, Mr Martine. Can I go to the next step of the regime, and I will use a hypothetical example: the government has agreed to a bid where the trigger point is 7 million TEU; the port currently has capacity for 5.5; a proposal for a state-sponsored port comes along at the time when the port of Melbourne has reached, say, 6 million TEU, so it is a million short of the trigger point; the new state-sponsored port commences operating. What happens under the port growth regime in terms of the refund to the port of Melbourne operator?

Mr WEBSTER — In that situation, has the port of Melbourne only got 6 million but can expand to 7 plus, or has it actually got latent capacity up to 7 built and in place at that point?

The CHAIR — We will assume it has undertaken expansion, and it has got 7 million capacity, which is what it bid for, but its current throughput is 6.

Mr WEBSTER — Its current throughput is 6. If the state-sponsored second port is operating and, let us say, 200 000 TEU physically move from the port of Melbourne to the second port, then there is a formula-based approach whereby the 200 000 effectively comes up to an annual compensation amount which is payable under the port growth regime.

The CHAIR — Okay, how would that formula work? What is it based on?

Mr WEBSTER — The formula would be based on, effectively, a marginal cost basis, and effectively we will seek to compensate them for the lost revenue net of avoidable costs.

Mr PECK — There is a concept in there as well of having a first-loss buffer. These numbers have not been set, and obviously they have not been disclosed, and therefore we will qualify our remarks somewhat, but if the first-loss buffer was set at X million containers and some number less than X was going through a state-sponsored port, then there is no consequence because you have not gone through that first-loss buffer. The reason for that, obviously, is we want the port of Melbourne to compete for every last unit of trade, and therefore they are always going to be better off attracting that trade back through the port of Melbourne rather than relying on any compensation that comes through.

The CHAIR — How will that first-loss buffer be set?

Mr PECK — It will be set in the contract, and there is an ongoing discussion around how that is quantified and whether that should grow over time in parallel with the growing capacity. There are different ways to do that, but that concept, I think, is attractive from a competition perspective. Also, obviously, often with these things you do not want a de minimis claim anyway, and so it will serve a couple of different purposes of ensuring that the port of Melbourne is competing and not relying on compensation payments, because they will always be better off. It also means that there are not de minimis payments out, because by definition anything that the state may pay out has some consequence because it has gone above a first-loss buffer amount that has been provided for.

I would note on top of that the state has collected revenues on every container going through the state-sponsored port, not just those over the first-loss buffer, so if the state had 200 000 containers going through, then it has collected 200 000 containers worth of revenue. If after the first-loss buffer the compensation payment was based on 10 000 TEUs and the state has obviously already collected 200 000 and is paying out on 10 000, it is actually in the money, so again there is no net compensation. We made the comment before that it is hard to see how the state could be out of pocket with this arrangement. That is one illustration of where the state has actually intervened in the container market. It has diverted 200 000 TEUs in that example, hypothetically paying out on 10 000. The state has obviously built a second port and has actually collected more revenue that is paid out.

The other comment I would make on your hypothetical example is that you assume that the port has obviously expanded to 7 million at Melbourne, but obviously from time to time if the port of Melbourne was not expanding, as David has said, and the state wanted to come in, it would automatically use the ‘use it or lose it’

notice to protect itself. So you are always going to have that incentive on the port of Melbourne to either expand efficiently, or otherwise they are exposed.

The CHAIR — The first-loss buffer will be seen as a proportion of the total capacity for the port of Melbourne?

Mr PECK — Yes, capacity or throughput. Again these documents have not been signed off by government, so there are different models and we will consider those.

The CHAIR — And roughly what proportion will we be looking at for that buffer? How significant is the buffer?

Mr PECK — Again nothing has been decided.

The CHAIR — What is the expectation? Would Mr Martine or Treasury like to comment?

Mr WEBSTER — We have not had those discussions with government.

Mr MARTINE — It is still under consideration.

The CHAIR — Just to clarify: Mr Webster, in the case of the 250 000 containers, you referred to 'diverted', or words to that effect. Does that suggest the regime only applies if an existing level of throughput for the port of Melbourne falls?

Mr WEBSTER — Or if the growth that could have been handled at the port of Melbourne is effectively handled by the second port. So it is lost current opportunity and lost future opportunity.

The CHAIR — Right. When the second port commences operation all further growth in international containers goes to the second port and the port of Melbourne remains static at 6 or whatever it had reached, then other than the first-loss buffer, compensation will be payable on all the containers through the second port?

Mr WEBSTER — Until the port of Melbourne reaches the upper limit of where it could not physically take those volumes. If you are talking about 10 million TEUs, clearly the port of Melbourne cannot process that volume, so there is an upper limit as well as a first-loss buffer.

The CHAIR — And the upper limit will be that trigger point negotiated?

Mr RIZOS — Yes, and that will be south of — —

Mr WEBSTER — South of the expected natural capacity, yes.

The CHAIR — South of the 7.5 million or 8 million or whatever it is.

Mr WEBSTER — Correct.

The CHAIR — Okay. The considerable evidence the committee has received suggests that the notion of two international container ports for Melbourne is a nonsense, in the sense of two operating ports, but if a second greenfield port is established and is more efficient et cetera, then what we will see is a diversion of trade from the first port to the second port and the closure of the first port. So rather than the port of Melbourne sitting at the 6 million it reached and the future growth at the second port, you in fact to see trade through the port of Melbourne diminish ultimately to zero in terms of international containers. Would that therefore mean that compensation would be payable on that loss of container traffic to the point where throughput theoretically diminished to zero?

Mr WEBSTER — I think in terms of the transaction design, obviously 50 years has one eye to how the second port is likely to be staged. Whilst it is impossible to know how the future may play out, I think it is a reasonable assumption that the capacity of the second port will be built in large-capacity chunks, but effectively staged. That staging allows the government to build a second port in a very complementary manner to the existing port. But yes, there is a risk that should the state wish to build a second port which can take all the capacity from the port of Melbourne, then potentially that has an impact on what is payable under the port

growth regime. That does not strike me as an investment proposition which would be compelling to a government. The staged approach to new capacity would seem a more reasonable assumption to make.

Mr PECK — If I can just add to that, I think ultimately the way this has been designed the government controls that risk. So if the government decided that was the best thing to do, that would be its conscious decision, not an accident. If there was such an economic case for a second container port — obviously the KPMG report makes some comments about that — then the state again can control that risk by letting the private sector develop it, and all bets are off and there is no state-sponsored port. So that is a pretty easy way for the state to deal itself out of that issue.

I go back to your premise. There are examples of other ports offshore being developed, new ports. You might look at the port of Hamburg and JadeWeserPort in Germany. That is a new deep-sea port more remotely located from the centre of trade. It has been very unsuccessful in attracting new trade and taking anything away from Hamburg, which is upriver. The benefit of an old city port, if I can call it that, is that it is obviously very close to the trade centre and has lower supply chain costs.

You may have had people come and say, 'A new port will mean all the traffic goes there'. I think the evidence from offshore, if you study some cases like the one I have mentioned, is quite mixed, and in fact ports that have been maybe a little bit more constrained on the waterside but close to the trade centres and therefore have had lower supply chain costs, because the road side supply chain cost is relatively expensive per kilometre, have actually done quite well and maintained market share. So I would challenge that premise somewhat, because I think the evidence from offshore is certainly mixed and in fact recent evidence of those ports is that the inland port, if I can put it that way, has actually maintained more market share and the new deep-sea port has actually struggled.

Mr BURGESS — I might also, Chair, just add that one of the key reasons why we are proposing a 50-year lease in this case rather than the more standard 99-year lease is the recognition that at some point with growth — whatever growth rates you have assumed — the port of Melbourne capacity, which is the lowest cost capacity, will be exceeded and there will be a need for a second facility. We do not have a crystal ball as to exactly when; we expect that to be not for some decades. Going forward with a 50-year lease actually gives the state the flexibility that you would want to have; should circumstances be such in 50 years time that it would be better to shift all the volume to a second state-sponsored port and redevelop the port of Melbourne land for residential or commercial it has actually got that flexibility. We think the risk that you are talking about is more apparent in the second 50 years rather than in the first 50 years.

Mr PECK — I think Tony makes a good point — that some of that risk allocation and design has been factored into that alternative lease.

The CHAIR — Can I ask with respect to the time frame for the port growth regime, is there any constraint on how long compensation or a refund can be payable under that regime — after it is triggered?

Mr WEBSTER — As there is no constraint on when the government can build a second port, there is no constraint on the timing for when payments on the port growth regime would start.

The CHAIR — And end?

Mr WEBSTER — And end — 50 years.

The CHAIR — So if it was triggered by a second port in the 10th year of the 50-year lease, there would then be 40 years of — —

Mr WEBSTER — Correct, but equally as you get to 40, 45 years et cetera you have only got a short period over which container trade might be lost to the second port.

Mr MARTINE — Chair, there is also, as we discussed earlier, an additional 40 years of revenue to the state, because we are now running a port.

Mr PECK — In light of that, can I just add to those comments. Obviously the regulatory regime mandates a return of capital over a period of time and a certain way in which that depreciates and is recovered. We have tried to design these things in concert. So forcing the leaseholder to return capital over a defined period of time

but then having a shorter period of time when you might compensate them for that loss would be an interesting transaction to design that way, because you are doing one thing on one aspect of it — in the regulatory model — and then are you taking away with the other. So you might need to think about other changes if you were to do what you are saying.

The CHAIR — Just on that — that raises a very good point — the basis of the refund, Mr Webster referred to a 'marginal cost basis'. Will that be determined on what the port has set down as its prescribed charges?

Mr WEBSTER — Yes, that would be my expectation.

Mr PECK — That would be the expectation.

Mr RIZOS — Chair, the other point, if I can, on this goes to our response to question 2, I think it was, where there is an outline of the advantages of the port growth regime as opposed to some alternatives. The fact that we provide for a quantification of the state's exposure up-front under the port growth regime can be seen as a more sustainable framework for future policymakers to be able to be fully informed in making their decision vis-a-vis the second port. So the state will have the ability to determine its own destiny vis-a-vis the second port. It will have complete visibility of the need to do that through the five-year port development plans. It will have the ability to issue the use-it-or-lose-it notice that David Webster referred to earlier. So the state will be in complete control of its own destiny.

If you put yourselves in the shoes of those decision-makers many years from now, the ability to have a business case in front of them that outlines the benefits of the second port versus PGR payment versus trade will be there and laid out for them and quantified to the best extent of the framework rather than having an MAE-type provision or other provisions that are qualitative and likely to be drawn out. So in effect the framework itself is designed in a way that the state is able at the right time to assess the costs and benefits of any decision it makes and understand the quantification of those implications.

The CHAIR — Just one final question before we break for lunch, and then I will give the call to Mr Barber when we resume. In your written response last week and I think also in the submission to the committee, you indicated that the value of having the PGR as part of the transaction in terms of proceeds up-front exceeds the cost of exercising the PGR later in the term, if it is indeed triggered. On what basis has Treasury reached that conclusion — that the risk avoidance or the risk quantification of providing a PGR will produce revenue up-front exceeding the downstream cost?

Mr WEBSTER — We believe that because of the significant costs of a second port it is not likely that any future government is going to be heavily incentivised to deliver a second port substantially ahead of need, and so we believe the most likely future behaviour of a government is to build a port at the right time, of the right capacity. That is going to have no or a minimal impact on what is payable under the port growth regime. However, the private sector, in terms of looking at that particular risk and given all of the public statements over the last few years around need for second port et cetera, will be conscious that the state can and does have complete flexibility as to what is built, where it is built and the timing of that. So the private sector will put in a risk premium for a competing port, and we believe that is potentially substantially in excess of the likely reality, which is minimal potential impact on the port of Melbourne.

Mr BLOCK — We need to look also at the protection. By putting protection in place or not putting in protection, one of the other factors you look at is what type of bidders you will attract. If you want to attract the bidders with the best sort of WACC, to get a better value, you have to match their investment profile. So it is just a matter of adding or subtracting from the protections you give, you attract a different pool of bidders and potentially have a different level of competition for the ultimate price they pay for the port.

Mr BURGESS — Chair, if I could just add, I think you could look at it like an insurance policy. For the bidder, it is a risk he or she cannot control, so the question is: what is the quantum of the risk? Given an expected set of cash flows if the port is allowed to develop to its natural capacity, that is what it might be worth, and then it could be worth less than that if the state did something unnecessary from a freight and logistics requirement point of view. Now the question is: who bears the risk? If you are asking the bidder to provide its own insurance policy against that, it is actually probably going to determine that it wants quite a large premium for that, whereas if you are asking the party that is actually controlling that risk by virtue of their own decisions, they are going to price that risk far more efficiently. That is actually how I would characterise it.

Mr WEBSTER — So the port growth regime is not there to pump up the price; it is effectively there to try and get as close to the full and fair price that somebody would pay for the port if they could be certain that the government would behave in a manner to deliver a second port when it is needed and not substantially ahead of need. So it is about getting a fair value for the asset rather than unnecessarily impairing the value with a risk premium for a risk that is not likely to arise.

Mr PECK — The answer on page 10 of those answers that we provided you breaks out, I think, all the comments that have been made. I would not underestimate the value of that future investment, deferring the need for a new port capital expenditure until it is actually required, given the multibillion-dollar nature of any new port. So I think it is a combination, in point 10 there, about bidder impacts on cash flows but also how they price their equity, the commonwealth payment the impact on the bidding field, which has been commented on, and then the value of deferral of capex that the state obviously does not need to spend or can be deferred if the new investor has that incentive to invest. So when you say value, I think there is a tendency to correlate headline sale proceeds with this regime, but it is not simply around what is the price of the insurance policy, as Tony puts it; it has all these multifaceted impacts. So the true value to the state is across all those things brought together.

The CHAIR — Thank you, Mr Peck. I propose that we now adjourn for lunch. It is 12.45, so we are a bit behind where we said, but we will adjourn until 1.45 and then resume with Mr Barber with his questions on the port growth regime.

We will resume with representatives of the Department of Treasury and Finance, its legal advisers and financial advisers, and the Port of Melbourne Corporation. Mr Barber has the call.

Mr BARBER — To understand where I think we have got to, the PGR is triggered if a state-sponsored port is developed before capacity is reached. The chair asked you for a definition of 'state-sponsored port'. You pointed us to various words in various documents, but then you kind of said that that definition and the aspects of it are pretty much something you will negotiate with the preferred bidder. Is that right?

Mr MARTINE — Perhaps a better terminology is, like any clause in transaction documents, as Mr Webster indicated earlier, that they require the agreement of both parties. The state will certainly articulate a view. Potential bidders may or may not accept those exact words, and obviously there will be a bit of discussion around the precise nature of the words.

Mr BARBER — I could ask you until the cows come home what the definition is, but in fact the answer to my question is that it will be negotiated. Is that right? Just to save us all a bit of time here.

Mr WEBSTER — The general principles articulated in terms of what the commercial intent is of the clause, which is the important thing, other than the exact wording — —

Mr MARTINE — If I could perhaps add to my earlier answer — and I think you just referred to this — pages 49 and 53 of the document that we provided, which are sort of the draft term sheets, are probably the start point on the definition of 'state sponsorship'.

Mr BARBER — Yes, I have had a read of that. A state-sponsored port is a port that is either funded by the state or has its costs subsidised by the state, located within Port Phillip Bay or Western Port Bay. At one end we have got something where the government invests in or subsidises it, and at the other end we have got something that is a commercial investment undertaken by the private sector, which is sort of how it is described across the two documents, but I do not know, Chair, that I am going to profitably get into all the things that might be included in or not included in 'invest in' or 'subsidise' — that is, a state-sponsored port.

It was stated earlier that if compensation payments are triggered under the PGR, the state would already be collecting revenues from this other second port. Why is it the case that we would be necessarily collecting revenue?

Mr WEBSTER — Container trade has to be diverted to the second port, so whoever is operating the second port will be receiving revenues for those containers going across the dock. Depending on the contractual relationships down there, that is either likely to be the state or, if the state has sold off the rights to a second port at some point, it could be whoever it has sold the rights off to, although the state would have effectively crystallised those revenue streams up-front as a payment from the new owner.

Mr BARBER — Who says they will do it that way? Maybe they will just give over a piece of land to this new developer at a nominal, peppercorn cost and say, 'There you go. Go and build and operate a second port'. There might be no revenue flowing to the state.

Mr PECK — Then there is no state-sponsored port, so you do not have an issue. You would not have a state-sponsored port, so there would be no throughput across a state-sponsored port in that case.

The CHAIR — Would it not be state sponsored if there was a contribution of land by the state?

Mr PECK — I assume that if the state was going to tender land to developers, it would run a tender, not just give it away, so I am assuming that in that case the market value of the piece of land — some blank piece of land somewhere on the coast — would be tendered out, and then if someone builds it and funds it themselves, that would not fall under the definition as we think about it.

Mr BURGESS — I think the proposition was that the land was granted, though, wasn't it, for free?

The CHAIR — Yes.

Mr BURGESS — But that would be a choice of the government of the day, wouldn't it, knowing what obligations have been entered into under the port growth regime?

Mr BARBER — Yes. We have been told that developing a second port would be really expensive, so I just wondered why it is we assume that there will be revenues flowing. Maybe we will just grant a piece of land to someone. Now, as I said, I am not going to get into whether that means 'invest in' or 'subsidise'; I am just sort of wondering and having difficulty imagining who would do a purely commercial investment by the private sector into container ports anywhere. It is difficult to envisage that circumstance rolling out — that someone does it without any reference to government.

Mr MARTINE — Clearly if there is demand for container throughput above the natural capacity of the port of Melbourne, then there are commercial opportunities for private providers to get involved in running a port.

Mr BARBER — Do you think they might start doing that down at Geelong, where there is sort of at least some infrastructure in place, or would they start from scratch and build a port somewhere on a piece of coast somewhere?

Mr MARTINE — That is one of the points we have been making as part of the port growth regime. It is better for the state overall for container throughput to feed through the port of Melbourne to its natural capacity. It is much cheaper to develop brownfield sites than greenfield sites.

Mr BARBER — Yes, it is interesting. You said that in your answer to one of our questions. You said:

> Consistent with the WoVG submission, the state's overall … interest is best served by allowing PoM brownfield capacity to expand for as long as possible.

Is there a piece of analysis somewhere that verifies that claim?

Mr PECK — I think the KPMG analysis, which has been public for some time, is the best analysis of that, and it is using information from the port of Hastings in that assessment. I think if you read through it, it makes it pretty clear that a new greenfield port will be more expensive, even if it was cheaper on the waterside.

Mr BARBER — What about the option, though, of just actually getting rid of the port of Melbourne and selling all the land for more yuppie apartments and taking that money and investing it in a greenfield port? Has anybody analysed whether that scenario might in fact be better for the state's overall economic interest?

Mr WEBSTER — In terms of the land demand, certainly the supply and demand projections for CBD or near-CBD central use would point to that land being far more valuable in a plus-40 or plus-50-year environment than it is today. So if we are looking at first and best use of the land, our view would be that the existing use is the best use currently for that land, although that will not always be the case.

Mr BARBER — No-one — not you or KPMG — analysed that particular option to see if there would be a better economic return?

Mr WEBSTER — No.

Mr BARBER — There is another statement here. It goes back to the PGR:

> In fact, because it is extremely difficult for bidders to price this risk, the key risk to the state is that without the PGR, there may be little interest at all from bidders and therefore the state is unable to meet its policy objective to lease PoM at a fair value.

Is that the reason for the PGR — in fact, that without the PGR no-one is really going to be interested in bidding for it?

Mr WEBSTER — I think it goes to the universe of bidders and prices rather than having no bidders. Effectively infrastructure investors are looking for, like any super fund, long-term, stable cash flows, and that is where you get the optimal pricing for infrastructure-type assets. If you are bidding for an asset which has substantial risk to the stability of those cash flows, that impacts on not only the types of bidders that are attracted to buying those assets, but also the prices they are willing to pay. So it goes into both of those limbs.

Mr BARBER — The statement says there may be little interest, and then your adviser, Mr Block, also said it would depend on the risk profile of the particular investor. Given this PGR thing is quite important, I suppose we might want to know as members whether the advice of the Treasury is that without the PGR there might not be anybody who wants to buy it, whereas the alternative view could be that maybe it will just be someone with a different appetite for risks.

Mr MARTINE — It is hard to test until you do go out to the market. But there is no question that a potential bidder without something like the port growth regime in place will discount the value because they are taking on significant risk that a future government may build a second port to divert throughput from the port of Melbourne.

Mr WEBSTER — And the Treasury advice says that the value decrement that you actually get from not having a port growth regime is not value for money to the taxpayer compared to actually having the regime in there. So it is a value-for-money play — having the port growth regime in there in terms of price certainty is far better off in terms of the overall likely economic impact to the state.

Mr BARBER — If you are going to flog off a public asset, you are better flogging it off as a monopoly or with compensation against competition. Is that the Treasury advice?

Mr MARTINE — What we are effectively saying is the state is better off building a second port which is complementary. Let us not divert resources in the state to build a second port that diverts container throughput away from an existing asset that can be worked.

Mr BARBER — Whether we sell the port or not, we would not want to build a wasteful, unnecessary second port.

Mr MARTINE — That is correct.

Mr BARBER — But my question is more about the statement that there is an economic benefit to the state of having the PGR as opposed to just not having it.

Mr BURGESS — Can I, Mr Chairman, through you, add another element to this, which is it is not only the upfront proceeds, but I think as we have indicated, and I think KPMG did do the analysis in their report, expanding the port of Melbourne to its natural capacity is the lowest cost supply chain solution for the state of Victoria, both in terms of capital cost per increment of capacity and supply chain operating costs. I think there are numbers in that report which indicate that the incremental expansion cost of taking the port of Melbourne from five to seven and a half, or whatever the number is, is much lower cost than a greenfield port. They did their numbers on Hastings, but I imagine the same would apply to wherever the greenfield port is. That has got two benefits because, A, you achieve lower costs for the ultimate consumers of goods imported through the port of Melbourne and the exporters and, B, it delays what, by KPMG estimates, would be a very, very expensive second port. They talk in numbers in excess of $10 billion for portside in terms of current dollars.

The other element of the PGR is not only do you give the investor certainty at the outset that he has got the opportunity to build the port of Melbourne to its natural capacity but along the way, when the next increment of

capacity is due in 15 or 20 years time, let us say it is Webb Dock North, that when they come to spend whatever dollars are involved at that point, they have got confidence that having spent that money the state is not going to pull the rug from under their feet by bringing a second port on sooner than required. That is actually in the interests of the state and all the stakeholders of the port of Melbourne in terms of the users of the freight and logistics network. I think there are two elements to the answer. It is basically a system that is designed to incent behaviour that is consistent with the state's best economic outcome.

Mr BARBER — Chair, no-one is arguing we should build an expensive port we do not need. What I am trying to understand is: why would a purchaser now be better placed to price all that than a government later that did not have to deal with the PGR but could simply observe things as they went along? Apart from the PGR being put in place to make sure there is a reasonable pool of bidders and to make sure the government gets the price it is seeking, I have not heard an argument why the PGR in and of itself creates economic value to the state.

Mr WEBSTER — The economic value in and of itself is, I think, as Tony alluded to, that without the PGR there is an effective disincentive for the port of Melbourne owner to invest in capacity if there is a threat of a competitive port coming in. You are sitting there about to put out big licks of capital. If there is a real threat that the state could build a second port in the time horizon you would expect to get a return on that capital, you have got a perverse incentive not to build capacity. Given the argument that port of Melbourne capacity up to its natural capacity is going to be the lowest cost, it is in the state's interest not to have that perverse disincentive in the structure. Conversely, given the state is likely to behave rationally and build a second port when it is needed, why embed a discount into the purchase price for effectively the state not behaving like that?

Mr BARBER — But if we do not sell the port, the same presumption applies that government will just invest rationally 10 years from now, 20 years from now, 5 years from now. My first question to Treasury right back at the other hearings was: what is the economic value of a private port versus a public port? The answer, more or less, was that there is not any inherent economic value; it is only if the money that we get from the sale is invested wisely. That is more or less what the answer was at the time, and now I am going to the second issue, which is PGR versus none.

Mr MARTINE — If I could just add, we did cover some of those issues off — I think it was a question from the Deputy Chair this morning — about some of the rationale, which did pick up on efficiency at the port, likewise future investment of a government-owned asset versus a private sector owned and run asset.

Mr BARBER — Apart from this recent privatisation in Sydney, which you say had a mechanism a bit like the PGR, what other ports have been sold with a PGR or like instrument associated with it?

Mr PECK — The port of Brisbane, for example, did not have one because the port of Brisbane is the only port within a good reach of that coastline that is actually suitable for a port; therefore the question does not really come up. You cannot put containers in at the port of Gladstone and ship them hundreds of kilometres down to Brisbane. That does not work, and so in that circumstance there was no like instrument. But in that circumstance that port lease has a change-of-law regime in it, which is a general provision which was negotiated in, so it is a different regime. I think Melbourne is a bit unique in that you had a pre-election debate around second ports and where they should be within a close proximity, much closer than the coastline of New South Wales. That is the context in which the state is thinking about transacting a port lease, and so our advice obviously is that this is the appropriate way forward.

Going back to your earlier question about value, I think if you were to pursue a transaction in the absence of this, our view would be that it would attract less interest and you would transact at a lower value because investors would price their risk aversely because they do not know what the state is going to do. If economic rationality takes its course and the state does not build a second port until one is actually required, then all you would have achieved, frankly, is to hand off the port at the start of the concession for less value than the state should have got. In terms of creating value, I think it is a clear case of creating value.

There are the other aspects that we have talked about, but I could not understand the logic of selling an asset for a lower price only to end up with the same result anyway. To me that is a clear case for doing this.

Mr WEBSTER — The other analogy is probably Sydney Airport, which was sold off with the first rights refusal on a second Sydney airport. We believe that that was probably a very poor outcome. It is very difficult

for the private sector to bid a value for a future first right of refusal on an asset they do not know when it will be built, they do not know where it will be built and they do not know what sort of government support will be there. Effectively there is the potential to give away a lot of upside without actually getting a lot of value for that, so there are different ways where that particular risk can be covered off.

Mr BURGESS — Through you, Chair, if you expand the analysis to other sorts of government concessions, Mr Webster has just mentioned Sydney Airport. We could look at toll roads. We could look at casino licences. I think you will find that there is a recent example of the casino licence here, I think, where there were some payments made for an extension of the term of the licence, and there is a penalty clause or compensation clause if the rules get changed such that what the incumbent there thought they were buying ends up being something different due to government action. It is the same with the CityLink concession in terms of what the state may do with competing roads and the like, so this is a pretty standard — that is, orthodox, I think I would use — approach in the sale or lease of government-related concessions. It is pretty standard across the world, and I think we have actually got some details in the materials we provided you in answer to the questions. I think we set out some considerable detail to that end.

Mr BARBER — Yes, Chair, I do not think there is any disagreement that if you want to maximise the price, you sell it as a monopoly. Can you really imagine any commercial investor who could come along and build any meaningful container capacity without a cent of public dollars going into it? Could anyone assemble the land to deal with the — —

Mr PECK — There are a few different points there. Monopoly pricing is dealt with by price regulation, so I think we are conflating two issues. In terms of other developments, as I said, there have been developments in Europe and other places where people have developed new terminals from time to time. A dollar of public money and how the state-sponsored port provisions are conceived are two different things. There are public roads and other assets that are developed by the public. The state is a provider of transport services, effectively, to all sorts of freight generators, whether it is the airport or ports or CBDs or whatever. The state is the major provider of road networks. If a new port was to be developed and the state was to build road links to a new port and price them or provide those services in the ordinary course, that would not be state sponsored. So a dollar of public money and what we conceive as a state-sponsored port where the state is participating in the capital structure or otherwise effectively going out of its way to subsidise those costs beyond what is generally available in general road pricing and general track pricing for rail would not fit into the sorts of things we are talking about. So, yes, there may be public money, but there is public money involved in an enormous number of assets throughout the community. A dollar of public money and what we would see commercially as fitting into that state-sponsored port bucket are two different things. I just draw that distinction.

Mr PURCELL — I have just got a couple of queries around the process, just to get into a bit of the detail. As I understand it, I think it has been stated that there will be negotiations with the preferred tenderer in regard to determining what actually is support and also in determining what actually is capacity. Is that correct?

Mr WEBSTER — Not in terms of what is the actual capacity. Capacity will effectively be what the natural capacity is. The capacity question goes to the trigger point of the port growth regime. That potentially is a big item. How these processes typically work is the state will go out with drafts of the transaction documents. There will be a number of commercial principles in there. The bidders can come back with mark-ups of those documents. Part of the evaluation criteria will be the extent of those mark-ups, and generally extensive mark-ups are heavily marked down. Potentially maybe some mark-ups are not acceptable at all regardless of price. Like any commercial negotiation, there are points of principle which you do not go beyond, but equally there can be some room in terms of exact drafting which can be contemplated as part of that negotiation process.

Mr PURCELL — Okay, so when the documents go out they will have a capacity figure in them?

Mr WEBSTER — They will have a trigger point for the port growth regime.

Mr PURCELL — Which in my terminology is a capacity figure, which would be 6, 7, 8 million.

Mr WEBSTER — To be clear, that will not be a cap on the physical capacity that the port of Melbourne can get to if the private sector wish to take it there. It will purely be a number for the purposes of the port growth regime.

Mr PURCELL — So that will be the figure that will trigger the payment if there is a new port built?

Mr WEBSTER — That will be included in the formula, yes.

Mr PURCELL — Okay; excellent. How does that actually get determined, then?

Mr WEBSTER — The starting position we would anticipate putting in front of government as part of our approvals. Then any divergence away from that, if bidders come back with an alternative process or number, we would need to actually put that up as part of the evaluation process with a recommendation whether to accept or not.

Mr PURCELL — So you have the figures there and then you actually probably do a little bit of tweaking with the preferred tenderer. Is it the preferred tenderer, or is it actually at an expression-of-interest stage or is it — —

Mr WEBSTER — No, it is further down the track in terms of the shortlisted process. In terms of getting to a preferred tenderer, one of the selection criteria for the preferred tenderer may well be if they come up with different trigger levels and what we think that value impact actually is.

Mr PECK — If I can just add, these processes go through a number of rounds, and so there will be an initial bid round which is indicative and non-binding. We will get some feedback no doubt through that, and there is a final binding stage where it is more invasive due diligence and people get access to site et cetera. Then, as I think was talked about before, you would have standard documents on the same commercial risk proposition. We will get comments from different bidders, but we will put back the formal documents that suits the state. We will get their input through that process, and then at the last what tends to happen is those documents in the final round, the final bid version, are mature — if I can call them that — documents. They have had considerable input and thought by that stage, and diligence. And we get bidders to give us their bids off those documents. To an extent they move risks or do other things through those documents back onto the state — that is taken into account in the evaluation processes Peter talked about earlier, and we will have our evaluation criteria. That is really at their own risk, because at that stage the state would have — hopefully — a number of bids in front of it with price and risk allocation, and obviously our job and the evaluation committee's job is then to select the tender that gives the state the best risk-adjusted price.

So, yes, we may have a preferred bidder at that point, but the gap in time of preferred bidder to actual execution and any negotiation in these things is generally relatively short and small, because that discussion process has happened through the bidding phase, so that at the last we are getting pretty refined mature documents, and substantial shifts in risk allocation at that point are generally pretty small. It is a more about who has got the best price.

Mr PURCELL — Would that be the same process for the compensation — the dollar amount — as well?

Mr PECK — The documents as a package. By the end of these transactions generally you have got thousands of pages of documents and they all have to fit together, so we would not agree to part of it and then have someone given the ability to come back on something else. So as a package, yes, and the idea there is that the state and the government can form the best fully informed view on price and risk at the same time with all the documents in front of them and having been through that contest, a competitive process, to get the best outcome.

Mr DRUM — I have just got some concerns about capacity. It has been a contentious issue that we have had to deal with for the whole range of evidence in relation to what capacity at the port of Melbourne is. Melbourne University presented and effectively put the capacity at the port of Melbourne at 5.4, 5.5 based on the quayside metreage that is available. If they were to calculate world's best practices on the docks with the total quayside metreage that is available, they come up with 5.5 million TEU maximum capacity at port of Melbourne. They are applying world's best practices about throughput per square metre, which is double the current rate that is being applied. What you are actually doing at the moment is their calculations are doubling the throughput on the total quayside metreage, and they are coming up with 5.5. How can we be so confident that we are going to get to 7 or 8 million TEU?

Mr EASY — Perhaps if I answer that question. Melbourne University did do an analysis on the potential capacity of the port of Melbourne. One of their key assumptions was that there would be no further change or increase in the footprint for container operations within the port of Melbourne. In my original presentation I think we indicated that there are 7 kilometres of quayline that currently services the port of Melbourne, and it is not just international containers but other cargo that comes through the port. One limitation of their analysis is that they assumed no further expansion or no increased berth area, so therefore naturally you would expect the 5.5 million, which equates to the port capacity project and Swanson Dock as it is today, will not change. One very simple example is the Swanson Dock quay could be extended closer towards Footscray Road, which would increase the length of the berth. In doing that you increase your capacity, so the Melbourne University analysis did not take into account that or any additional berth area at Webb Dock or elsewhere.

We have over a number of years produced port development plans. We have provided those to the committee. They are conceptual, they are at a point in time, but they do show that there are configurations in the port that can generate a capacity of 7 million international containers and 1 million Bass Strait. We are quite confident there are opportunities to increase the capacity beyond the 5.5 million at the port of Melbourne.

The CHAIR — Just for the purposes of the record, Mr Drum, I will just confirm that you were talking about the Victoria University, rather than Melbourne University, report?

Mr DRUM — Did I say Melbourne?

The CHAIR — You did. Mr Easy, I assume you were referring to the same VU work.

Mr EASY — **Yes.**

Mr DRUM — Sorry, Mr Easy. Yes, I meant Victoria University.

It is interesting, because we put that potential development for additional quayside metreage to them and they were adamant that that opportunity did not exist. We also had evidence from two gentlemen in separate sessions last week at Hastings. Again, both those gentlemen have a career in shipping and in ports, and again they said the capacity at port of Melbourne is in the range of 4.4 to 5 million TEU. So it is difficult for this committee to effectively hear people who have got a life or a career in shipping and in ports telling us one thing and then have the department and port, and it has been these two bodies, consistently saying that the capacity is much bigger.

The gentlemen last week when quizzed further on this potential increase of capacity were talking along the lines that — and I do not want to put it into exact words — you may be able to increase the quayside metreage, but what is in behind that is going to make it very, very difficult to have any substantial on-dock processing. You simply do not have the room in behind areas that may be increased for the quayside metreage. So that was the message last week — again, it was very clear, very succinct, very direct — that the capacity simply is not anywhere near. I think the gentlemen's language got very strong when we put it to them.

So the department is telling us or the port is telling us that there is a capacity of 7 to 8 million, and the language came back very strong and very clear that it cannot be done. As I said, I do not want to repeat what was said, but it was not nice — but it was direct, clear and succinct. It puts us in a difficult situation when we are hearing evidence totally contrary to that of other witnesses — independent evidence where there does not seem to be any reason as to why they would say it if they did not truly believe it.

Mr EASY — Perhaps in response, I think there are many views, and people are quite able to express their views regarding capacity, but I would hope the committee was also guided by some of the evidence presented by the stevedores, who I think confirmed the opportunity for further capacity and growth in the port of Melbourne. The corporation, as the manager of the port, and the stevedores who operate the terminals in the port, I think, gave a very clear message to the committee that there is an opportunity for additional capacity and further growth, and the opportunity to do that. Again, I respect the views of other parties, but I think there is enough information to suggest that there is further opportunity well beyond the 5.5 million.

Mr DRUM — Sure. Irrespective of whether the capacity is around 5.4 or 5.5, or whether it is 7.5, again another assumption that has been put in is in relation to what growth we are going to continue to see with throughput. For the moment it is just above 6 per cent year on year for container growth, no?

Mr EASY — No, that is a bit high.

Mr DRUM — Sorry?

Mr EASY — We are experiencing growth today closer to GDP. Last year growth was 1.8 per cent on containers through the port. I think there has been some information around 6 per cent numbers, but the indication is that is probably a bit optimistic, probably a bit high, in terms of trade forecasts moving forward.

Mr DRUM — There is a big difference between CPI and two and six — —

Mr EASY — Absolutely.

Mr DRUM — If you extrapolate 6 per cent, which is what we heard, again, as evidence — the port has experienced this type of growth — it does not take long before we reach 7 million TEU. It is only a matter of about 15 or 16 years. Again, we keep hearing about huge discrepancies in relation to when the port of Melbourne is going to max out. Again, it is very difficult. Are we supposed to pass legislation which is going to see this port sold and the government spend the money and not make any provision for a port we do not know when we are going to need? We have been told that we may have a 10-year lead time by the time we make all the necessary transport corridor overlays. All of these planning aspects have to be put into place, yet we are effectively saying no, it might be 30 or 40 years away.

Mr WEBSTER — If I can pick up two points on that, I think, firstly, as the chair pointed out, all we know about trade forecasts is that they will be wrong, so the transaction has been set up in a way which gives the state a complete, unfettered right to build a second port whenever they want to, whether it is ahead of need, whether it is on need et cetera. There is nothing that restricts the state from building a second port when it wants to. The transaction structure has been set up in a way which is effectively indifferent to when the port of Melbourne reaches their capacity and in terms of the impact on value that will be up to the bidders to take a view in terms of what throughput the port of Melbourne will do.

I think in terms of the second port the government has been very clear on the role of Infrastructure Victoria and how they expect that to report back initially on a second port as well as the ongoing role for Infrastructure Victoria in infrastructure planning for the state.

Mr DRUM — So Infrastructure Victoria may decide where the second port is going to be built; it may advise where it thinks the second port should be built. Again, the government will not be bound by that. What about the lead time? Can you talk me through the lead time? In the future the government can realise that the port is going to be maxed out in 10 years. So you are saying that in the lead-up, while there is still capacity at the existing port, any government can start investing in the development of a new port?

Mr WEBSTER — Absolutely. The port growth regime is only triggered when the second port is operating and when it is taking international container trade away from the port of Melbourne that might otherwise have gone across to it. That gives as long a runway as needed to make the necessary investments to have the port up and ready for operations.

Mr DRUM — Going back to Mr Barber's point, do you know anywhere around the world where the private sector has fully and totally moved into a port and simply built it from the ground up without government investment?

Mr WEBSTER — I would have to check on the Gateway port in London, which had substantial backing from DPW. I think Julian's point earlier around the landside infrastructure was that government always invests in terms of road and rail connections in the normal course of business. I think the London Gateway port was pretty well substantially privately funded.

Mr PECK — DPW? Yes, I think that was purely private. JadeWeserPort, I referred to, which Maersk has got an interest in, and that was, as I understand it, fully privately developed. So there are examples. I am sure we can take that question on notice if you like. Obviously the bigger the container market and therefore the smaller a new terminal is relative to that market, the easier it is for the private sector to incrementally bring in capacity as opposed to the small market we have here. I am sure we can find more examples if the committee would like us to do so.

Mr DRUM — We have been told a number of times that once any city's existing port is effectively past its use by date or reaches capacity, it is a very normal transition to move the port 10 or 15 kilometres further up the

river or up the bay or whatever. It seems to be what cities have done ever since they were built. Once the new ports are built, they tend to be built for the future, with greater capacity, greater everything, and then the ships will tell you that they will only stop once. Have you looked at this? We have 50 years, but probably if we are all being honest, it is going to be a 70-year lease — —

Mr WEBSTER — I would not say it is a 70 year lease. It is 50.

Mr DRUM — You do not think that some government will very quickly snaffle up the 20-year extension?

Mr MARTINE — As we were talking about earlier, you would not get the value of that extra 20 years if a future government in the short term tried to extend. So it would be a matter for the government of the day in 45 years time to make that judgement call about whether the best use of that land is to continue the port for 20 years or to use it for other purposes. It is hard to envisage a situation where a government in the short term would do a 20-year extension because you just would not get sufficient value from that extension. Fifty years is a long time, so the private operator would be discounting that value heavily, which is why, coming back to some of the earlier points from the JFAs, we are not going down the path of a 99-year lease.

Mr DRUM — Why would you bother putting a 20-year extension on a lease if you have no intention of using it for 40 years?

Mr MARTINE — It just gives the government of the day that flexibility.

Mr DRUM — The government has flexibility by simply passing an extension in the Parliament.

Mr MARTINE — The government of the day could pass different legislation in 45 years time.

Mr DRUM — Absolutely.

Mr MARTINE — We may be all here talking about it; I do not know.

Mr DRUM — Not likely!

Mr PECK — Can I just come back to your point about stopping twice. I think the practical reality is that you are right: the ships will not stop twice. Again there is ample evidence offshore of major ports being closer to each other in major population centres. In North America and Europe the ships do not stop twice. What they will do — in a future Melbourne example — some ships might call Melbourne, some ships might call at Hastings or at Bay West or whatever, and then they will turn and they will go up to Sydney or Brisbane or wherever. I clearly agree that they will not stop twice, but that does not mean you do not have both ports being utilised in that future scenario.

Mr DRUM — Yes, and that is the scenario that I have not been able to get my head around, Mr Peck — as to whether or not that does in fact happen around the world. Once you build a flash new one 20 or 30 kilometres away, because of the increased capacity it is able to handle bigger ships and operate in an area that has less houses all around it. All of a sudden it has the best in logistics, with its own indoor port and all these — —

Mr BARBER — Take Coode Island with you while you are it.

Mr WEBSTER — I think in the European context you have ports like Felixstowe and Southampton, which are not geographically that far apart, both operating completely independently. I think the other issue is in terms of the second port is likely to be staged, so if it is built in stages and a future government then has that flexibility, as the secretary said, at the end of 50 years to say, 'Okay, what happens next? Do I stage a withdrawal from the port of Melbourne and move to a second port, do I keep the two running in parallel or do I completely exit the port of Melbourne?'. So 50 years, in the context of a second port being staged, gives a lot of flexibility optionality and creates value to the state.

Mr DRUM — You probably cannot answer this, but has there been any nervousness at all from government to solidify the port of Melbourne in its current location for 50 and maybe 70 years? Has anybody picked up on what Mr Barber is talking about? There is a photo in today's paper with a cruise ship sneaking under the bridge by 4 metres. We hear stories of the draught as they come in through the Heads not clearing by all that much. We hear stories that if you have currently got 2.5 million TEU and you are going to have 7.5 million, you are going

to put three times as many containers through the Heads, three times as many ships in the bay, three times as many trucks dispersing the goods out through the City of Maribyrnong out to Altona to all those fantastic distribution centres that we have there. It is three times as many everything, and you just cannot help but shake your head and say, 'Well, are we really going to do this for 70 years?'.

Mr WEBSTER — Fifty years.

Mr DRUM — Fifty years plus 20.

Mr WEBSTER — Fifty years plus if a future government has the option to extend by 20.

Ms TIERNEY — Where is Harriet?

Mr DRUM — I was going to say there has been a bit of an in-joke about Mr Ondarchie and the Labor people.

Mr WEBSTER — A clear policy decision not to have a lease of 99 years was driven by concerns about the longevity of the port of Melbourne and whether the highest and best use of port of Melbourne land was as a continuing port. Fifty years is a good balance between certainty, which gives suitable time for the private sector to recoup investment and to invest in the short to medium term on incremental capacity, whilst giving the state sufficient flexibility and optionality as to what the future best use of that land may be and optionality in terms of how to stage the second port and bring on new port capacity, which at some point the state will need.

Mr PECK — Can I just pick up and add some comments there? I think on ripping out the port today and putting it somewhere else, you have got a supply chain that has built up around the port of Melbourne. It is easy in these discussions to forget there is a whole bunch of people outside of the port who rely on it —

Mr DRUM — Absolutely.

Mr PECK — and people who are leasing for 40 years in warehouses and investing, and I think if you were to hypothetically pull the port tomorrow, you would have other issues — not just the port but the whole supply chain would be dislocated.

Mr DRUM — You have gone to the exact opposite end of the argument. Whereas I am saying maybe at some stage in the next 10, 15 to 20 years there could be a transition. As it maxes out maybe we transition the thing out. You are saying, 'Do it tomorrow', and I am saying — —

Mr PECK — I was just picking up the question about whether anyone has done that analysis. I think the reality is the knock-on costs of doing that would be high and the land supply and demand for the port of Melbourne, given the slowness of the take-up with Docklands itself as evidence of how long it actually takes these lands to be redeveloped, is evidence that it is unlikely to be economic given the value of the port today and the use.

I think on your comments around intensity of use — absolutely, I think the infrastructure should be intensively utilised. I think as we have a discussion as cities grow — it is a common theme in Melbourne as well as Sydney — we are looking at infrastructure built 20 to 30 years ago and we are saying, 'Can we use it more efficiently or should we start building new stuff?'. What we are saying is use it as efficiently as you can because building very expensive new things will not be in the public interest until you have fully utilised what you have. On the comments around draught space and airspace et cetera, the port in Sydney is right next to the airport, there is an airspace limitation in Sydney because the ships can only get to a certain size given the radar at Sydney airport, so there are limitations in places like Sydney that cannot be ignored. Newcastle, the world's largest coal export port, has a tidal restriction, so we have the world's largest coal export fleet navigating through a river channel on a tidal basis; that is managed through. Port Hedland has tidal navigation. It is the world's largest iron ore export port.

Again managing around those constraints and doing it as efficiently as possible and getting the maximum value out of the installed infrastructure that is already there is a really important point, but I would say to you — and Nick might want to comment here — that is not an unusual dynamic and obviously there are a lot of operational things that sit behind that that we all see as laypersons, but I do not think Melbourne is unique in needing to

manage the flow of trade and shipping et cetera through these physical constraints, and that is the reality for any port. If you look overseas, you will see examples of that as well.

Mr EASY — I think there are constraints in Melbourne and in other ports on the south-eastern seaboard, and they will ultimately drive decisions on cargo and where they go. Just on your point on three times the volume, three times the vessels and three times the truck numbers, that is not quite right, because currently we are seeing less vessels call Melbourne, so while we have an increasing volume and an increasing trade, and we talked about moving from 1 million TEUs to 2.5 million TEUs over a decade, we are actually seeing a decrease in the number of vessels through the port of Melbourne. In the last financial year there were slightly less than 3000 vessels, and if you go back two or three years, it was 3500 vessels. You are seeing economies in scale and decisions on ships and what comes into Melbourne which improves the productivity and therefore the utilisation, and the usage reduces.

Mr DRUM — Can they get much bigger though, Nick?

Mr EASY — They can continue to get bigger, yes.

Mr DRUM — And still get in and still be fine without — —

Mr EASY — The average vessel today is around 4000 TEUs to 5000 TEUs. We think ultimately there is opportunity for vessels in the 5000 to 8000 TEU range to call Melbourne. Decisions will be made on the characteristics of Melbourne and the characteristics of other ports on the south-eastern seaboard, and the industry is accustomed to managing within those physical constraints. It is not unusual. I think ultimately volumes and economies of scale will determine some of those decisions and things that you are talking about as to what happens ultimately in the future, but 80 per cent of the cargo coming into the port today is distributed within a 50-kilometre radius of the port of Melbourne.

There are decisions, as Julian pointed out, around where people locate their industries and manufacturing and distribution hubs which clearly influence the way the port operates today and how they manage the total supply chain costs for the movement of those goods. They are all very important considerations. There are examples of hub ports elsewhere in the world where containers or cargo is taken to one spot and then moved by smaller vessel. Again, who knows? In time with volumes and ultimately demand by population growth — and we are talking a long way away — you will see different decisions made around how cargo is distributed.

Mr MULINO — Just a couple of questions on the port growth regime. I just wanted to start with points 3 and 4, in relation to question 2, on page 6. This is a point that has been raised, but just to reiterate, we are not talking here about inflating value. What we are really talking about is trying to avoid a situation where we are destroying value in a sense and we are not getting fair value for the taxpayer. We are trying to avoid value being unnecessarily taken away from the transaction.

Mr WEBSTER — Correct. So we are trying to achieve the fair value that somebody would pay if the government behaves as we would expect it to do and invests in capacity when it is needed and not ahead of need.

Mr MULINO — Just going back to that issue of risk allocation, it is a general proposition, isn't it, in many interactions between the public and the private sector — so PPPs are one example, but these kinds of transactions are another — that economic value will be maximised if risks are allocated to those —

Mr WEBSTER — Best able to control it.

Mr MULINO — best suited to understand them and to manage them and control them. In this instance the particular risk we are talking about, which unlike some other kinds of risk management regimes is quite a narrow one, is a risk that the state has entirely within its control, so it is quite an obvious risk for the state to take on board.

Mr WEBSTER — Correct, and the government's actions can ensure that it does not pay anything under the port growth regime if it so wishes to do so in terms of the timing and the manner in which it brings its second port. Whether it is triggered and how much compensation is paid is completely within the gift of a future government.

Mr MULINO — I just want to take this back to more general principles around risk allocation, because this affects more than just a lease transaction; it affects all sorts of relationships where there is procurement, whatever is the case. My understanding is — and I do not have references on me — that if we went to Infrastructure Australia or the World Bank or any body which puts out best practice in these kinds of procurement matters, they would say that getting the risk allocation right is critical.

Mr WEBSTER — Correct, and all of those organisations will somewhere have a quotation along the lines of, 'Risks should be allocated to the party best able to manage them', and then they will link that to optimal economic outcomes.

Mr MULINO — I do not have the page reference. I do remember, though, there was a list of risks somewhere in the DTF submission, but pretty much every other risk is with the lessee.

Mr WEBSTER — Correct — the majority of the risks. Equally the risk allocation is heavily influenced by precedent, so there is a pretty well trod path. Other governments are comfortable with the broad risk allocation, so we are highly confident that the risk allocation we go out with will be acceptable to the private sector.

Mr MULINO — We have talked about the fact that this is part of the rationale behind this being a very common clause in many long-term arrangements. Again, it is not limited to leases; it includes procurement fees and all sorts of things — we can look at CityLink. Is it fair to say that the vast majority of long-term arrangements of this sort include some kind of risk allocation clause?

Mr WEBSTER — Some form of protection against specifics of actions of government which discriminate or did discriminate against the owner of that particular asset, yes.

Mr BLOCK — Particularly where there is capital invested. Long-term arrangements which do not involve huge investments of capital generally do not have this type of protection because they reply on an operating service payment, where here somebody is investing a lot of money up-front — they want to get that money back over a period of time. The same applies to building a hospital on a PPP basis. What they are saying is, 'We invest on a set of criteria and assumptions, and we'd like to know that those assumptions will stay true for the life of the concession'.

Mr MULINO — Thanks. One of the issues that Infrastructure Partnerships Australia raised was that it would be sensible for the committee to consider different types of clause. One would be a clause as proposed, where there is a trigger threshold around volume; another possible form they suggested was a trigger around a date, which is another way of trying to conceptualise that kind of risk; another form was the first right of refusal; and I suppose another form, which they did not talk about, is a very broad material adverse effects clause, which we have seen with some toll roads. I think the committee will in due course consider the pros and cons of different approaches for this kind of risk allocation clause, but is it fair to say that what we are seeing here is a clause that is fairly narrow in scope and wide in the degree of flexibility the state retains relative to, for example, a first right of refusal clause?

Mr WEBSTER — Indeed, and I think one that gives both government and the private sector greater certainty. In terms of two of those alternative ways of going, with the first right of refusal it is very difficult to contemplate what value the state would get now from giving the owner of the port of Melbourne the first right of refusal over a second port to be built at some point in the future somewhere in the state of Victoria and of unknown size. In terms of these bidders, they do build detailed cash-flow models and they do it on a discounted cash-flow basis. They will not know, if they did have a first right of refusal, what assumptions to make in terms of timing, size, what they are actually being prepared to value. In my view the value that you would get from having a first right of refusal in terms of increment on the purchase price would be minimal and could even be a decrement.

These investors like certainty of cash flows. To the extent that you are putting any obligations on them in terms of developing a future second port, they will not know what those obligations entail and what impact that will have on the value. So it is more likely to be an optional upside for which we get very little price.

Mr MULINO — But they would use a very high discount rate given all that uncertainty?

Mr WEBSTER — A high discount rate and very minimal cash flows given they do not know when and they do not know what, if they put in any value at all, apart from a token option value.

The other regime is a material adverse effect-type regime. It is very difficult to take a view in terms of what the quantification of an MAE might look like. They are usually subject to intensive debate and potential litigation, because both sides have got completely different views in terms of whether there has been an MAE, and if there has been an MAE, what the value impact is. So MAEs are littered with expensive and long litigation over their use. Again, we think a formulaic best approach, which links back to demonstrable inputs, is both a suitable protection for the state and gives the private sector certainty which we will get the price benefit for or at least not a price detriment for.

Mr MULINO — The last question. There has been some discussion around some of the specific wording of some elements of this clause, and indeed this is an issue that has come up in relation to some other aspects of the transaction. Are there risks to the state achieving value for money if we, for example, fully drafted this clause right now and put it as a fait accompli, with no negotiation possible?

Mr WEBSTER — Absolutely.

Mr MULINO — What would that risk be?

Mr WEBSTER — At worst, the risk is the drafting is not acceptable to some of the likely bidders and they either do not bid or they withdraw from the consortia. Obviously the more competition that we have the greater the potential competitive pressure is in terms of downward pricing. In terms of being presented with a fait accompli, those bidders who are willing to bid on that basis will effectively factor it into their return requirements, so having flexibility around what the definition is and being able to negotiate — if somebody could come back and say, 'Well, if you tweak these three or four words here, then we are able to give you a better price', it is worth having that degree of flexibility.

Mr MULINO — Is that why it is standard practice to have a little bit of negotiating room at the margins with things like that?

Mr WEBSTER — Indeed.

Ms TIERNEY — Mine was very similar, in terms of the process and the content of what is being proposed. Is it very much within the realms of what generally is considered to be the norm in such transactions?

Mr WEBSTER — Risk allocation is completely within the norm of the transactions, and I would say it is pretty standard to have the risk allocation that we have got.

Ms TIERNEY — And from the joint financial advisers, is that the way the market is seeing it as well?

Mr BURGESS — Yes.

Mr PECK — The only thing I would add to that is that obviously we have designed a regime here that suits this particular circumstance, but absent that, change-of-law-type risks, if I could put it in this bucket, is something that bidders focus on.

The CHAIR — I will just go back to some of the issues around the port growth regime, with just a follow-up question from Mr Webster's evidence before lunch with respect to the operation of the port growth regime, where Mr Webster indicated that compensation under the PGR would be payable or could be payable when container throughput might otherwise have been processed at the port of Melbourne, so where containers have been diverted. Just to clarify that the assessment of a container being diverted or that could otherwise have been processed through the port of Melbourne will be demonstrated by the fact that there is an international container going through the second port, below the trigger threshold?

Mr WEBSTER — It is an actual volume, not a theoretical volume, so there has to be actual physical activity at the second port.

The CHAIR — Actual activity of international boxes at the second port?

Mr WEBSTER — Correct.

The CHAIR — With respect to the PGR, what is the state's maximum exposure under that proposed regime, or is it possible to assess the maximum exposure under that regime?

Mr WEBSTER — Maximum exposure would be if the state starts to build a second port a day after the transaction is closed and it opens within however many years and it takes every single container from the port of Melbourne. That is the maximum exposure.

The CHAIR — And how would you quantify that?

Mr WEBSTER — Approaching the purchase price.

The CHAIR — Is it conceivable that if the PGR is triggered over the term of the lease or halfway through the lease, the exposure under the PGR in nominal terms could exceed the proceeds of the lease?

Mr WEBSTER — With discounting, I think you would have to ask that in terms of real numbers rather than discounted numbers, say nominal numbers.

The CHAIR — In nominal terms.

Mr WEBSTER — Again, it depends on the timing of when it is built, what is built.

The CHAIR — But that cannot be ruled out?

Mr PECK — If I could just add on to David's comment there. I think you have to remember this is one trade, only international containers.

The CHAIR — Yes.

Mr PECK — The port is obviously the sum of its parts and you have a range of other trades — leasing income et cetera — so the total purchase value of the lease that someone will procure, the containers are part of it; there are obviously other trades as well.

Mr WEBSTER — You would be exactly right.

Mr PECK — If you are refunding something, you are refunding, in the worst case example, the effect of the contribution of marginal international container fees, because they would say they had sold it and then — to use David's example — taken it away again.

The CHAIR — But in nominal dollars that could exceed the proceeds of the lease?

Mr PECK — Nominal dollars — the revenues of port grow over time, obviously, so it is a question of how much in present value. But you have a value for ports and you have nominal revenues, so you are trading one or the other.

Mr WEBSTER — Extremely, extremely unlikely.

Mr PECK — I think it would be very unlikely.

The CHAIR — Can I ask: was one of the rationales for the PGR concern about sovereign risk among the bidding pool?

Mr WEBSTER — I would not term it sovereign risk. I would term it as state actions which impact on an asset which has been sold.

The CHAIR — Is there a difference?

Mr WEBSTER — It is in that change-of-law bucket, discriminatory change in law; it is very analogous to that. Sovereign risk is more towards the expropriation end of the spectrum.

The CHAIR — Have any of the bidding pool or potential bidders expressed concerns about sovereign risk around this transaction or other transactions in Victoria?

Mr WEBSTER — Not as far as I am aware.

Mr BURGESS — If I might, Chair, answer, I think the bidders are very conscious of the debate that was held before the last election as to the whereabouts of a second port and different estimates as to when that second port might be required. So certainly this is something they will be looking for some greater clarity on, if not certainty on, in terms of them actually stepping up to bid for the lease of the port of Melbourne.

The CHAIR — Have the government's actions with respect to the east–west link project heightened those concerns?

Mr MARTINE — Not that I am aware of. No-one has come our way expressing specifically those concerns. I think, as was just outlined, clearly a potential bidder needs a better understanding around future governments' actions on a second port. That is really the key issue, and that is essentially what this is trying to address, as we have been discussing.

Mr RIZOS — Indeed, Chair, I draw your attention to the KPMG report, on page 8, which clearly predates any of those matters that you just referred to, and that also refers to the need for a compensation regime.

Mr BLOCK — It is fair to say that when you are structuring infrastructure deals, regardless of ports or PPPs, two of the key risks which bidders will look at are change-in-law risk, whether a general change in law applying to all people across society or a specific and discriminatory change in law in relation to the particular project itself, and the other thing they look at is expropriation risk. This applies across every jurisdiction; this is not an Australian-based or a Victorian-based issue. All bidders will look at those two risks, no matter what the transaction, and they will work through those issues.

If you take a standard PPP transaction, there is change-in-law protection and there is also a termination for convenience right for the government, and usually that is put in to give the government flexibility that at some stage in the future, because governments cannot be bound, they have to have the right to change their mind and walk away from a transaction. Essentially, as the KPMG report demonstrates, these are just risks considered in the ordinary course of putting a transaction to market. The east–west link and discussions as to the second port and the election are merely circumstantial to the way you would actually look at this from an objective point of view.

The CHAIR — To move on to a couple of other matters related to the PGR, you have indicated that the trigger threshold will be biddable as part of the negotiations. Are there any other elements that will be subject to negotiation within the PGR framework?

Mr WEBSTER — Obviously we would expect the transaction documents to have a formula in there and definitions around 'state-sponsored port' et cetera, so I think it is really outlined there quite well how the documents evolved through time. In terms of a biddable item, asking for bids coming back is different from negotiation on whether somebody likes your drafting of a particular clause or not. I am not aware of any other items which we are expecting to be biddable items.

Mr PECK — I think we will go out with a proposition that we think meets the state's objectives, and that is how we have designed it. Obviously — and I think this might have been in the submission — if we went out with nothing, we would get a whole bunch of licorice allsorts back from different people which would not be comparable, so there are obvious benefits to the state taking a position on this. But then, as we talked about, generally we will put out a lease document, we have got a concession deed and we have got a financier tripartite, so there is a big set of documentation. I would not want to suggest to you that in all of that big set of documentation people are not going to try and mark up clauses and want to discuss things. Likewise, if we change a definition in the port lease, we might have to change a definition in the PGR deed because all these things will link to each other, so I think it is appropriate to say that we think that one will get the most focus, but there may be other elements where there is discussion around it or there are refinements and tinkering with them, but we think the trigger threshold is the obvious area.

Mr BLOCK — Also, the way you design the transaction structure is that when the documents go out to market it is not just a free-for-all for the bidders to mark the document up as they feel. Obviously there is an evaluation set of criteria against which all the mark-ups are evaluated, and every time you mark up a document you get marked down, so the mark-ups to the document have one mark, the pricing has another mark and the technical solution has another mark. There is an in-built tension that prevents people from marking up the document to things that are actually of fundamental value to them.

The CHAIR — That was to take me to my next point, which was: how will you evaluate on a value-for-money basis the bidder trigger points?

Mr WEBSTER — We will work that out and put a recommendation to government as part of the bid evaluation criteria.

The CHAIR — What is Treasury's preliminary view on how you would evaluate that?

Mr WEBSTER — I would not like to speculate.

The CHAIR — Does Treasury have a view?

Mr WEBSTER — Not one that has been discussed with government.

The CHAIR — Does Treasury have a view that is settled within the department?

Mr MARTINE — We will certainly finalise our assessment criteria and advise government as a matter of course.

The CHAIR — In terms of modelling for the PGR, what modelling has the department undertaken as to potential trigger levels, when they conceivably could be triggered and what refund levels would subsequently be required? Has that been modelled by DTF or the advisers?

Mr WEBSTER — In terms of hypothetical scenarios, that involves a whole heap of assumptions around when a second port is built, what capacity is built and where the thresholds are at, so in terms of not being able to take a view in terms of when that is likely to occur, the most likely scenario is that payments on the PGR will be nil.

The CHAIR — What assumptions have underpinned that conclusion?

Mr WEBSTER — The assumptions that underpin that are that the likely state behaviour is that the state is not incentivised to deliver capacity ahead of need and that it is likely to stage a second port, so on the bringing of those stages it is likely to be in a way that is highly complementary to the port of Melbourne, so any impact is going to be either negligible or nil.

The CHAIR — In terms of the PGR, that will be provided for in the contract as part of the package of documentation for the 50-year lease. Will that carry over to any 20-year extension, or would that be subject to fresh negotiations around that 20-year extension?

Mr WEBSTER — I would expect that would be subject to negotiation at the time. There is a package of things that would need to be negotiated as far as a lease extension went.

Mr RIZOS — Chair, to be clear, the 20-year option is one that is provided for in the bill; it is not provided for in the bid documentation, so we are going out with a 50-year lease term.

The CHAIR — So it will not be contemplated in any of the negotiated outcomes?

Mr RIZOS — What we are putting to market is a 50-year lease and documentation that supports a 50-year lease.

The CHAIR — And it will not be reflected in any of the negotiated outcomes?

Mr WEBSTER — That is not the intention. There will be nothing in the lease documentation that says, 'If this is extended by 20 years, then X happens'.

Mr BURGESS — Just for clarity, I think it is up to 20 years.

The CHAIR — Up to 20 years.

Mr BURGESS — Yes, because we have talked about the scenarios when it might be brought into play in the decades to come.

The CHAIR — Now I can move onto vertical integration. Are there any other questions with respect to the port growth regime?

Mr MULINO — No.

The CHAIR — I would like to take you to page 52 of the government's submission, which has commentary with respect to the issue of vertical integration. It is on the bottom of page 52, 'No vertical integration':

> Prohibition on leaseholder or its controlling entities or its associates being a 'Prohibited Port Operator', i.e. a stevedore or motor vehicle terminal operator.

But then there is a footnote:

> (Note that while not contained in the transaction documents themselves, the government has already announced that stevedores will not be permitted to bid in the transaction.)

How will that be given effect?

Mr BLOCK — There would be a concept of something called a 'prohibited port operator', and essentially there will be a criterion in the EOI document that goes out to market which says the following types of entities will not be permitted to submit a bid or be part of a consortium. The definition of a 'prohibited port operator' is still under discussion with the government, but basically it focuses on stevedores as one of the features.

The CHAIR — Are there any other prohibited or proposed prohibited port operators?

Mr BLOCK — Yes. There is the operators of the motor vehicle entities as well.

Mr CARTER — Essentially terminal operators.

Mr BLOCK — Yes, essentially terminal operators that are at that port at the moment. They broadly fall into the motor vehicle and the containers.

Mr WEBSTER — That will continue on through the term of the lease, so they are not only prohibited from having an equity stake at the beginning but also buying in during the lease.

Mr CARTER — If I might add, Chair, the ACCC will also retain a role under section 50 of the Competition and Consumer Act to vet any residual vertical integration concerns, if there were any.

The CHAIR — To take your point, Mr Webster, the submission says that condition will not be in the transaction documents. You refer to it being contained within the lease. Is that a change of policy?

Mr BLOCK — What will be in the transaction documents will be the change of control restrictions. The threshold for a bidder is to bid and to be appointed as the successful bidder. That will not be in the documents, but there will be a provision, a change of control restriction provision, that will say to the extent there is a change of control, it will not be permitted in relation to the following provisos, and one of those would be a prohibited port operator concept.

Mr PECK — Maybe just to add in there, in the bid process itself people have to express interest. They have to lodge their interest, tell us who they are, what their consortium is if it is a consortium, sign a CA et cetera. So through the bidding process we are able to regulate who is allowed into the process. The government has already announced that it does not want stevedores bidding in the process. It is very easy; we just do not let them in. We are not obliged to let anybody and everybody into the process, only bona fide bidders that meet the government's criteria. In the case of Victoria — and there have been precedents elsewhere — if the Victorian government says, 'We don't want stevedores bidding for the port because that will be counterproductive', it is very easy. We just do not let them in as part of the bidding rules. That does not preclude the ACCC scrutinising

every consortium anyway, but we are under no obligation to let people in that the state, for policy reasons, has decided not to let in.

The CHAIR — Is there any, given the proposal is essentially that will not be reflected in contract?

Mr PECK — There are two elements in one in that clause.

The CHAIR — Yes, there is.

Mr PECK — The bidding process is something we just regulate through contract and how we run the process. In the lease, the duration of the lease is dated at a certain period and says that there is a prohibited port operator concept, which lives through the course of the lease. Obviously the ACCC merger rules apply at transaction. But if there was a subsequent change of ownership through the course of the lease, the ACCC also would get to look at any vertical integration or any competition law issues that it wants to.

The CHAIR — Is there any reason that, given at the EOI stage it is essentially policy to exclude — it will not be reflected, by definition, in the contract because no contract is being entered into — is there any reason a prohibition on a prohibited port operator should not be reflected in the legislation or is not currently reflected in the legislation?

Mr PECK — I would say commercially, and others may want to jump in, I think the reason that is best in the contract is that you need to have some exceptions. For example, if the tenant defaulted on their lease and did not pay the rents, then the port landlord needs to be able to step in and potentially operate the terminal for a period of time before stepping back out again if a new owner is found for that terminal. Whilst this is a position in the lease, and it is a policy position, obviously from time to time you need to be able to have some flexibility around these things for effectively what are short-term issues, such as the one I have just illustrated, such that you can have that due flexibility and continue to operate the port. If you, I think, had those provisions just sitting in legislation, you would then need to draft all those exceptions. It is difficult through legislation and have someone oversee that.

I think it is more normal for step-in rights and the like and operator provisions to be dealt with in contracts between the parties. That just allows for more flexibility and from time to time, if circumstances change at the port or you need to add a new step-in right or what have you over time, that can be then amended. Obviously it is more difficult to amend in legislation because you have to go back through Parliament. I do not know if David or Peter want to pick this up, but it is quite normal for those sort of step-in rights and the like for a leaseholder or a landlord in this case to be dealt with via contracts in a concession. It is the leaseholder's financiers which also will have an interest in that, because they want to know the port is going to operate if there is a problem.

Mr BLOCK — Typically these types of issues that are regulated through the ACCC, the statutory framework for dealing with vertical integration, and then outside of that framework for these transactions restrictions are contractually based.

Mr CARTER — I might add that the general proposition here is that dealing with it in legislation adds significant complexity and lack of flexibility to something that is much better regulated through the ACCC's expertise and also through contract, and indeed the previous experience of cross-ownership regimes with very complex drafting has largely given way to giving the ACCC primacy in its role. We have adopted that sort of best practice, if you like, here.

The CHAIR — Another related issue of vertical integration. You referred to change of control provisions in the lease: what would apply though where there is not a change of control but where the leaseholder subsequently acquired a stevedore or established a stevedore operation or terminal operation at the port?

Mr CARTER — Clearly the ACCC would have jurisdiction over that, so that would be a matter which would be assessed by it in the ordinary course; and I might just have a discussion with Peter about something before we revert on that.

Mr BLOCK — The change of control clause that we are talking about is still under development, but as I recall, and I have to take this on notice, it focuses on the entities in a bid vehicle — so the shareholder of, say, the port lessee or whatever we are calling the private leaseholder at the moment — purchasing a stevedore or

having any influence over a prohibited port operator. It is a broad concept, but again we are still developing these concepts into one. If you look at the fundamental principle, where essentially vertical integration is involved — no matter which permutation of it — the change of control provision will attempt to pick that up.

The CHAIR — Even where there is not by definition a change of control so far as the port is concerned?

Mr BLOCK — A change of control of the ultimate underlying bid vehicle, so the two private sector entities that will be involved in the transaction, yes. But again we are still developing that area.

Mr PECK — I would not conflate the two; so change of control of the leaseholder itself at the top of the lease is a different item from, I think, your scenario. If the leaseholder bought a stevedore, for example, a couple of things would apply. That would trip the prohibited port operator clause that you have pointed out at the bottom of page 52, because they would be then acquiring a controlling interest of the stevedore. That would be a problem, apart from the fact the ACCC might decide that is not a good idea.

The CHAIR — Why would that trigger that clause that is set out on page 52 if it is the port operator acquiring an interest in a stevedore?

Mr PECK — That is the scenario you are asking about, is it not?

The CHAIR — I understood that scenario to mean a stevedore could not bid for the port in simple terms.

Mr CARTER — I am happy to take that.

The CHAIR — This is during the life of the lease.

Mr CARTER — Chair, certainly any acquisition of any shares or assets is subject to the jurisdiction of the ACCC. The first circumstance you referred to was a stevedore as part of a consortia, but even — —

The CHAIR — Putting aside the ACCC jurisdiction, I was talking about the jurisdictions being established through this transaction.

Mr CARTER — Sure; okay.

Mr PECK — Your scenario is the leaseholder buys a stevedore?

The CHAIR — Yes.

Mr PECK — That would trip that provision.

The CHAIR — It would?

Mr PECK — According to the port operator provision, yes.

The CHAIR — How?

Mr PECK — There are two protections. There is what is in the lease.

The CHAIR — Yes.

Mr PECK — Then there is what is in the financier tripartite, which is a three-way contact between the state, the leaseholder and the banks, and that regulates the amount of debt against the transaction. That would effectively have the same outcome of preventing such a transaction, because the banks would never allow the leaseholder to go and buy a stevedore because the state is in a position under those agreements — and this is quite typical — that the leaseholder would not be able to go and increase the financial risk to the state by going and buying stevedores or Ferris wheel companies or anything else without the state's consent, because obviously that would then affect the amount of debt under the tripartite. So there is what is in the lease itself — —

The CHAIR — What about if the vehicle did it through equity?

Mr WEBSTER — They would still need to get the debt-holder's approval.

Mr PECK — Yes, I think you would still trip up under that agreement.

Mr WEBSTER — I think it is worthwhile remembering that typically the bidders for these assets are consortiums of super funds and pension funds, so it is likely there will be three or four institutional investors ganged together to effectively put in the equity between themselves. It is unlikely to be one shareholder in the entity which invests in the port of Melbourne operator.

The CHAIR — Can I ask you about a practical example, given what is on foot at the moment. You would be familiar with Brookfield's play for Asciano. How would that fit within the scope of the EOI process? If this transaction went to market tomorrow, could Brookfield bid for the port of Melbourne, given they are seeking ownership of a stevedore?

Mr WEBSTER — As it currently stands, they do not have ownership. I would imagine until they do have ownership they would not be prohibited. I am busily looking at my legal advisers for that.

Mr PECK — If they subsequently acquired ownership, they would be in breach of the lease. Putting aside the individual entities, because I do not want to comment on them, but they could be in breach of the lease. As I talked about before, the way these leases are designed is if the lease is terminated because you are in breach, you are putting your entire equity at risk, so it would be a fairly foolhardy thing to do.

The CHAIR — But currently as it stands today they could bid?

Mr WEBSTER — Without owning a stevedore, yes.

Mr BURGESS — You might be asking them though to clarify their intentions on Asciano, because it is a pointless exercise, isn't it, if they are not actually going to be eligible. I think there would be a great deal of scrutiny applied.

The CHAIR — Can I ask one other question with respect to what you might call horizontal integration — cross-ownership of ports. Does Treasury have a view on the appropriateness of any restrictions on cross-ownership between the port of Melbourne and other east coast ports — the need for appropriateness for such restrictions?

Mr WEBSTER — In terms of the consortium which form, I think the view is that maximising competition is likely to get the best particular outcome. We think the role that other shareholders in the consortium as well as the banks are likely to have means the risk that somehow you get perverse behaviour just because one shareholder happens to have equity in two different ports is exceptionally unlikely given the additional protections that are around it.

I might flick over to the JFAs at that point.

Mr BURGESS — It is something the ACCC will look at. Any bidding consortia here that have equity interests in the port of Botany will undoubtedly be subject to an ACCC review. The threshold issue is: do they actually control either investment, and if they do not, which is probably the case if you look at the spread of ownership — as mentioned by Mr Webster before, these consortia tend to be comprised of a syndicate of investors, none of whom has a controlling interest —there will not be a problem. Tthe short answer to your question is that the ACCC will look at the issue of horizontal integration and satisfy itself that to the extent there is contestable trade between two ports no single party is in a position to control outcomes.

Mr PECK — History would also show, I think — and you could ask the ACCC — that parties who were in the ownership group in the port of Brisbane at the time were able to participate in the port of Botany transaction, so it was not raised as an issue. That is the precedent. Given that there is precedent value on these things and it has been looked at before, which it has, then history would suggest that has not been an issue.

Mr BLOCK — Chair, just as a matter of clarification, I have just been looking at the master transaction outline we provided to you on 1 October.

The CHAIR — Yes.

Mr BLOCK — If you look at page 11, there is a bullet point which runs over from page 10, which says that:

Prohibition on port lessee or its controlling entities or its associates being a 'prohibited port operator' (i. e. a stevedore or motor vehicle terminal operator) without the consent of the port lessor.

That covers both the two private sector entities, being prohibited port operators, being controlled by a prohibited port operator or controlling a prohibited port operator, so both ways.

The CHAIR — Sorry, Mr Block, where are you referring to?

Mr BLOCK — I am looking at page 10, and it rolls over to page 11.

The CHAIR — Thank you. Are there any further questions from the committee on vertical integration? Can I move now to the issue of the port rail shuttle and the issue of port rail more generally. Can you outline the obligations on a bidder in respect of developing rail capacity or further rail capacity at the port post lease?

Mr WEBSTER — Sure. The transaction does not reduce the option for the state to pursue a rail solution. I think you have heard from DEDJTR. They have got a very strong interest in developing the landside infrastructure in sync with the development of the port. I think it is fair to say in terms of rail there are a number of different ways that rail modal share could be increased down the port. Private sector operators have views, the stevedores have their views and ultimately the new lessor will also have their views. So it is important to note that the existing rail reservations will be preserved and the private port operator will be required to maintain existing rail assets in the lease area. We are looking at incorporating a framework for the government to consider the optimal way to get rail modal outcomes at the port of Melbourne. That is likely to look at both rail modal outcomes which are proposed by the leaseholder or ones which are required by government. We are likely to put options in front of government around how that could potentially fit into any port development plan process. So we think the optimal way forward is to let the leaseholder understand the asset and then come back with some innovation around what is the best way of achieving rail modal outcomes within the port.

The CHAIR — Does that extend to an obligation on the leaseholder to implement a rail outcome?

Mr WEBSTER — We are likely to put options in front of government which could look very similar to a PPP-style modification regime, where the government can achieve a rail modal outcome which it specifies.

The CHAIR — That would be a variation to this transaction rather than a condition of this transaction?

Mr WEBSTER — We are looking to put options in front of government where as part of the port development plan, which is periodically agreed between the leaseholder and government, they have to explore increased rail modal outcomes and give other options in that space, and as a potential backup as part of that process, giving government the option to require a process where the government can explore and if necessary execute a rail outcome at the port.

Mr PECK — I think, just to elaborate, the current thinking around the port development plan is already that on a periodic basis they would need to look at a whole range of things inside the port and also look at the supply chain and look at road and rail, use of the port and particularly as regards rail the options to increase rail modal share, so that has all been thought about and considered as part of the design. What David is saying is that if they come into government and say, 'Here is some design, here are some constraints around rail and track' — and sharing track with Metro rail is obviously an issue, for example — 'then here are some options for government'. If the government wants to then say, 'Okay, we would like you to pursue one of those options', the further piece of thinking we are doing is saying, 'Under what sort of circumstances does the government then require the leaseholder to go to market?'.

I think the thinking is around running a process, testing it in the market to make sure that you get the best outcome for whatever the criteria are at the time in terms of modal share — is it rail modal share or is it something else — so then the government has confidence that whatever outcome is there is the best outcome for the given target of rail modal share, number of trains or whatever is decided at the time that the government wants to get to.

I would emphasise that within the port gate there is only a certain amount things that the port itself can do. A lot of the flow of rail and obviously the use of rail relates to access to track and signalling and a whole range of things outside the gate that the port has no influence over. So any further development of a port rail shuttle or other rail ideas — individual tenants have their own ideas, and obviously we are privy to some of those

discussions — any of those solutions will involve effectively a partnership between the leaseholder and its tenants and the government outside the gate. I think that is going to take time, and it is going to require the leaseholder to be in the saddle, having full access to the site and full access to the tenants to talk about what the potential rail opportunities are and go through the port planning process.

The nuance around that that we are thinking about is if the government says, 'Okay, we would like to get rail modal share to X target, can you go to market on that basis and run a process between the private sector and the government?', because I think it is highly likely that any of those scenarios, particularly if they are in the lease, may require government money, and the benefit of running a process like that is that we can collectively ensure that the government's got value for money and you are getting the best outcome.

There are various different ideas around rail and how it should best work, and I think having the benefit of that market testing process and having the benefit of a leaseholder that has been operating the port for a while, that is a bit more seasoned and that has the opportunity to talk to its tenants, you are likely to get the best outcome, the best value for money and actually achieve the objective at the end of the day that the state wants to get. The broad planning around that, the way the port development process should work and the role of the leaseholder in the port is already there; it is really the go-to-market piece that we are thinking further about.

The CHAIR — Is that not something that could be achieved now given the knowledge of Mr Easy and his colleagues at the port of Melbourne and the knowledge of the tenants of how the port operates and the opportunities that are there now? Some of the evidence the committee has received fairly consistently is that this is a matter that should be settled prior to going to market with the lease rather than downstream of that.

Mr WEBSTER — I think, with respect, as Julian said, we need to give the incoming leaseholder the ability to understand the asset in great detail, to have the dialogue with the stevedores in particular around what their aspirations are in the rail space — as Julian said, we have been privy to some of those ideas and concepts — and then let them test what they believe are the potential viable options for rail versus the current government thinking. That is likely to maximise the potential for some innovative and creative thinking that we may not have looked at, but ultimately with the potential protection of the government being able to require a particular solution if it so wishes at some point.

The CHAIR — What sort of time frame would be involved in that process to allow the port operator to gain sufficient understanding of the asset and to allow its tenants to be able to make informed decisions or have informed discussion with government around rail investment? Is that a five-year delay?

Mr WEBSTER — The leaseholder can have that discussion with government at any point. There is a requirement within the port development plan.

The CHAIR — They are not going to have it on 1 July next year, are they?

Mr WEBSTER — Incorrect. At any time they can have that discussion with government around rail options and what might increase rail modal share. The port development plan process is a five-year cycle. That is a natural time in which to force a particular conversation or at least have that formally considered as part of that process, but there is nothing to stop that dialogue and that process happening between those five-yearly intervals. I think, as we alluded to, giving the new leaseholder some time to understand the asset and what the potential is would probably be a good thing.

The CHAIR — So realistically we would see a delay of up to five years in implementing a rail outcome?

Mr WEBSTER — It is impossible to speculate.

The CHAIR — So it will not be next year, will it, when the leaseholder takes over?

Mr WEBSTER — It is impossible to speculate. People have been looking at the asset for quite a long time. What comes back in the bids and their plans for the port come day one, I would not like to speculate.

Mr PECK — If I could just add to that, I think the reality is bidders do not have any status until they are actually the leaseholder, so if they want to work with the tenants et cetera and talk to them for a period of time about various ideas, concepts and amendments to leases. If you are plonking a new terminal — for example, if that were the outcome — in the middle of the port, you are going to have to go through a process with the

affected parties and you are going to have to work through how that best works. There is obviously rail already within the port, so if you are moving that around or reconfiguring it, you have to work that through, you have to talk about the leases, you would have to do site engineering, you would have to do some environmental studies to know what it is you are digging up, and you would have to do the engineering and the procurement.

All those things take some time, but bidders do not have any status, so the idea that bidders can simultaneously do this with the transaction on the port, I think, overlooks the fact that they do not have status and standing and they cannot do the full due diligence and negotiation until they are actually in the chair and the tenants know that they are the party they need to talk to and then go forward.

The CHAIR — I think that is absolutely the point, Mr Peck — that bidders do not have standing and will not have standing until sometime next year, which is why this committee is consistently hearing that this project should be implemented by the Port of Melbourne Corporation and the state prior to the transaction proceeding.

Mr PECK — Which project, sorry?

The CHAIR — The port rail shuttle project.

Mr BARBER — That road tunnel was built before the rail line, Chair.

Mr PECK — Just to finish that, what we would say is that we are aware of that projects. As I alluded to before, there are also other parties at the port who have ideas around other projects which they might say would be better. I think the benefit of the idea that we have talked about is the state to get the benefit of a process where you can be assured that you have the best outcome because you have actually run a competitive process, you have had the diligence and different people have put forward their own ideas, as opposed to mandating a single project to that, for example.

The CHAIR — Can I ask: with respect to the status of that port rail shuttle project, the funding that has been allocated by the state and commonwealth, some $58 million, which I understand was in the forward estimates, is that still allocated to the project?

Mr MARTINE — That is correct. It is still in the forward estimates.

The CHAIR — And that was 20 million from the state and 38 million from the commonwealth?

Mr MARTINE — I cannot remember the figures off the top of my head, but people to my right are nodding. I assume that is correct, Nick?

Mr RIZOS — Yes.

The CHAIR — What is the state's obligation with respect to that 38 million from the commonwealth in completing or delivering this project?

Mr WEBSTER — We need to take that on notice.

Mr MARTINE — We can certainly come back to the committee. We would need to have a look at the arrangements with the commonwealth. I am just not quite sure. I will take that on notice.

The CHAIR — What is the reason that project has not proceeded in the last 12 months? Is it simply that, as Mr Peck and Mr Webster suggested, it has basically stopped because of this transaction — in shorthand?

Mr MARTINE — Yes. For the reasons that have been outlined in the earlier answers.

The CHAIR — Are there any other questions on the rail?

Mr MULINO — Just a couple of points: when the process stopped there was some thought, I understand, to sole source a particular project, which is that proposal which Salta put forward.

Mr WEBSTER — Sure. I think there are two processes that need to be talked about. One is that under the former government there was a market-led proposal received from the Salta group. I understand Salta has given evidence here and provided a letter of the outcome of that. To paraphrase, the outcome of that was that whilst

there were some unique aspects to that proposal, the policy benefits of running a competitive process were thought to outweigh the benefits of going down a sole-sourced negotiation. Subsequently DEDJTR, or its predecessor DTPLI, were thinking about how they took forward a competitive process for a port rail shuttle. I am unaware of the reasons why it did not progress.

Mr MULINO — But it had not progressed to any public offering — it had not progressed to the EOI stage or any formal process?

Mr WEBSTER — No, they were still thinking in terms of the structure of the competitive process that they would take forward.

Mr MULINO — Is it your understanding that there is a range of views when it comes to what is the best way forward when it comes to rail access?

Mr WEBSTER — Correct. I think stevedores have particular views in terms of what suits their circumstances as do other potential providers of rail solutions into the port.

Mr MULINO — And, as you say, there is limited land that would be potentially damaging to or detrimental in the long run to offer a particular option if it was not fully tested.

Mr WEBSTER — Correct. And locking in a solution ahead of exploring a range of potential solutions which may have better outcomes, I think, could be premature. I think, as Julian Peck also alluded to, not all the land that is required for rail solutions is necessarily within the control of the port of Melbourne at the moment, and so there is a range of stakeholder negotiations, including with tenants and outside the port gate, which would need to occur for a realistic outcome to be delivered.

Mr MULINO — Interestingly, Salta themselves said they were happy to submit themselves to a competitive process, and so did their business partner. The last question on this is: previously we have talked a bit in this committee in evidence about the fact that the bidding process, as we understood it from your initial proposal, would require a submission from bidders as to rail mode options and that that would be evaluated as part of the bid evaluation process. Are you suggesting that it might be that the bid process might elicit something more binding and that there might be, for example, some kind of KPI which could form part of the first five-year plan?

Mr WEBSTER — Obviously what bidders bid back is up to them in terms of over and above the strict requirements of the transaction documents. What we are contemplating is looking at the port development plan process and how that port development plan process can potentially support the leaseholder putting up rail options or options to increase rail modal share through the port development process and/or government exploring and/or requiring rail modal outcomes through that process as well through dialogue and a testing process.

Mr MULINO — One option might be that a five-year horizon would allow for a bidder to have time to get to know the asset, get management on board and undertake —

Mr WEBSTER — Talk to the other stakeholders — —

Mr MULINO — competitive processes and then potentially procure something.

Mr RIZOS — The port lease on page 10 of the transaction document outline refers to the port lessee being obliged to pursue a rail modal outcome as agreed with the state. That is the obligation as it stands at the moment. What we are referring to here is the mechanics of how that can be given effect under the framework and therefore how the port development plan can help to give effect to that.

In our view it is not about picking winners now and just suggesting because someone has put their hand up today that they are necessarily the best solution for the port. In our view it is better to get the new port operator on board, get some of their innovative thinking together with an engagement with them and the stevedores and other users of the port to come up with a solution that maybe different to what has been put up at this point. We do not know what we do not know, so the benefit is it allows sufficient time for the new operator to get their feet under the desk, engage with the right players and come back with various options that can be market tested, and that will provide for the better outcome longer term.

It dovetails into what we were saying earlier about capacity at the port of Melbourne and allowing the new operator to think about different ways of configuring the port footprint to achieve the outcome, so you want that done in a holistic and a strategic sense through the port development plan. That is exactly what we are talking about.

The CHAIR — Just to clarify on that final point that both Mr Webster and Mr Rizos raised, is it fair to say that when the lease is executed and the other transaction documents are in place that there will be at that point no obligation on the leaseholder to invest in rail?

Mr WEBSTER — We anticipate putting options in front of government where as part of the port development plan there is a requirement to give government options in terms of rail modal outcomes and also as part of that process the ability of government to pursue a particular rail modal outcome through a testing process in terms of running that tender process et cetera.

The CHAIR — But that does not oblige the port leaseholder to invest in rail themselves, does it?

Mr PECK — Can I just clarify that question? When you say invest in rail, do you mean — —

The CHAIR — To undertake subsequent investment into rail infrastructure on the site.

Mr PECK — In a particular rail?

The CHAIR — No, just rail.

Mr PECK — I think what we have been talking about is given effect then — yes, there would be an obligation, but it would be an obligation that would occur when a particular solution has been agreed with government.

The CHAIR — Is that an obligation on the leaseholder to invest or merely an obligation on the leaseholder to go through a planning process?

Mr PECK — It would be more than a planning process because what we are thinking about doing is an actual tender process, so beyond planning to actually tendering once you agree with government as to what that should look like.

The CHAIR — To run a tender process as distinct from to actually invest themselves? To run a tender process for a third party to invest?

Mr WEBSTER — No, to run a tender process where ultimately they have to execute and invest themselves if there is the return on investment criteria that is met. In terms of an analogy, what we are contemplating putting in front of government is similar to a PPP modification regime, in which effectively a modification is proposed. The private sector can tell government it thinks this modification is going to cost Y dollars and this will have an impact in terms of price et cetera. The subtleties in here are around the role of the ESC as well in terms of signing off what is prudent and efficient investment, so we sort of simplified this discussion to not include the ESC oversight of what the operators are investing in. But ultimately, under the PPP analogy, in those circumstances if the private sector does not invest in that particular modification, then the government can invest itself and cause that modification to happen. That is the type of option that we are talking about putting in front of government.

The CHAIR — It has been brought to my attention that through the course of the hearing today some witnesses have been quoting from the document that was provided to the committee on a confidential basis under cover from the secretary on 1 October. This creates a challenge for the committee insofar as that evidence is public evidence and to verify quotes that have been made we need to provide that document to Hansard. I am wondering, to assist in that process, would it be possible for DTF — perhaps your legal advisers — to reassess the document as to what elements of it can be published?

Mr MARTINE — We can certainly have a look at that. Certainly the answers that have been provided during the course of the day that have referenced the document are okay for public disclosure. I am comfortable in what we have said and where we have quoted the documents. We can either confirm that those particular answers that relate to certain pages can be publicly released and certainly given to Hansard — —

The CHAIR — That would assist. There will be a draft transcript in the next day or two, which will have the quotes, subject to them being confirmed. If you are able to come back with the documents, or with the sections of the documents, to confirm — —

Mr MARTINE — The sections of the documents to support the quotes?

The CHAIR — That support the quotes, so we can then provide that to Hansard, that is probably the easiest way forward on that matter.

Mr MARTINE — Okay.

The CHAIR — There are a couple of other matters that I would like to canvass before we go into closed session. Firstly, with respect to landside development around the port, we have heard today, confirmed today, a natural capacity of 7 to 8 million TEU, which is roughly a trebling of the current volumes through the port. If that development is to take place on the current site, over a period of time it is going to put pressure on local infrastructure. A lot of the submissions refer to port traffic being a relatively small component of total traffic, which obviously is true, but equally true is it is a very significant component of traffic in the vicinity of the port. What assessment has Treasury undertaken as to the likely state-funded landside investment that will be required to support an increase from 2.5 million throughput to 7.5 million throughput on that site?

Mr RIZOS — Chair, as we have, I think, stated previously, there is no commitment on the state to undertake any landside investment as a consequence of the transaction, nor is there a restriction on the state undertaking such investment. Suffice to say, as you have alluded to, port-generated traffic is a relatively small proportion of traffic in and around the port. Our view is there is sufficient advice that we have received internal to the transaction that suggests it can be accommodated over the journey. Indeed, though, that is exactly why we are providing for the protection of rail corridors and rail optionality going forward as well — so the state can have the benefit of both outcomes.

I also draw to your attention the state announcements vis-a-vis the West Gate distributor commitment — not the western distributor commitment, obviously, because that is still in train. The West Gate distributor commitment is one of the things that is being taken into account, and that clearly supports the traffic movement in and out of Swanson Dock. Our understanding is that that is quite positive as far as traffic flow is concerned, and it gives us a sufficient degree of confidence. A western distributor would add even more capacity and flexibility for movement in and out of Swanson Dock, so that is also a positive should it play out. The advice we have, though, is irrespective of those investments there is nothing to suggest that the port cannot operate efficiently over the foreseeable future. Investment will be required at a point in time, and that investment will be determined by future governments.

We have had these discussions and analysis within the team in relation to recent transactions north of the border that at least one of our advisers has been involved with, and consistent with that transaction, the government did not make any commitments in relation to roadside investment as part of the transaction, but it was clearly something that the government saw — as population grew, as the city developed, there would be a series of investments that would be required over the journey.

Mr WEBSTER — Chair, if I may just add one thing, those investments will have to be made irrespective of what ownership structure the port is in.

Mr RIZOS — Indeed.

The CHAIR — If the growth occurs on the current site?

Mr WEBSTER — If the growth occurs, correct.

Mr RIZOS — Indeed.

The CHAIR — The KPMG study refers to significant amenity issues with that growth — the trebling of volume. Has any assessment been undertaken as to the cost of infrastructure to ameliorate those amenity impacts?

Mr RIZOS — No.

The CHAIR — Mr Rizos, you said it is Treasury's view, or government's view, that the existing infrastructure is adequate through the term. Adequate from what perspective?

Mr RIZOS — The ability to manage throughput in and out of the port based on the projections we have seen internal to the transaction. There is sufficient capacity on the road network in and around the port to manage that growth. Our understanding, or a statement of fact, would be that as population grows, demand for roadside infrastructure is likely to grow as well, so it is not just a function of the port's growth but a function of growth more generally in the economy and in the city in particular. But we have a degree of comfort that there is no additional, immediate need for roadside infrastructure in relation to the port of Melbourne's growth in the immediate short term, but what we have done is ensure that the framework that is in place for the transaction through the port development plans will provide sufficient visibility to government early enough in relation to any landside implications.

Given the earlier comment in relation to what is in our transaction document outline, I probably need to be careful about what I am quoting, but there are amenity considerations that need to be taken into account by the port operator in developing future capacity. That sits comfortably with us, because that is something that the state will have visibility on through the port development plan.

The CHAIR — Thank you. I have a couple of specifics in respect of the bill. Sections 74 through 76 of the bill insert into, I think it is, the Port Management Act a number of provisions where the minister may authorise the corporation to perform certain interventions. Where does the government envisage those interventions will take place? Under what circumstances would interventions that are allowed for under those provisions be triggered — some with respect to the port capacity project, but others with respect to the stevedoring operations?

Mr RIZOS — Chair, can we take that on notice and come back to you with some details?

The CHAIR — Thank you. Can I now take you to clause 69, which is the clause with respect to the ACCC and the competition principles, the Competition and Consumer Act and the competition code? What is the purpose of clause 69?

Mr CARTER — Chair, you will have heard that one of the primary purposes of the port growth regime is to de-risk the transaction in relation to state-sponsored ports or state-sponsored actions. This clause simply ensures that no other documents that give effect to the port growth regime are subject to the operation of the Competition and Consumer Act.

The CHAIR — In what way would the port growth regime be inconsistent with the ACCC legislation?

Mr CARTER — Bidders may have a concern that a contract might be characterised — the state would not characterise it in this way — as having a potential to contravene section 45 of the Competition and Consumer Act, which deals with contracts, arrangements or understandings that may have the purpose or the effect of substantially lessening competition, are potentially unlawful. This simply removes any doubt in relation to that issue. So it should be very clear the state is not of the view that any of the documents comprising the port growth regime would have that effect — in fact, quite the contrary. I know you have heard a lot in relation to investment incentives today. However, clearly, given the amount of money at stake, the view was taken that, given that this mechanism is available to the state to de-risk the transaction further, it was appropriate to include it in the legislation.

Mr RIZOS — Chair, I should point out that our response to your question 3 provides an outline of where effectively similar provisions have been exercised at state and commonwealth level, so the proposition we are putting here is not a unique one; it has been utilised previously — I note in the energy reforms that were undertaken in the 1990s.

Mr CARTER — I should add in particular financiers have very conservative approaches to these things and these protect, among other things, the financiers' rights under their financing arrangements with bidder consortia.

The CHAIR — Are there any other provisions of the transaction which are enabled by virtue of this clause, besides the PGR?

Mr CARTER — No. I am sorry. I should say there are some ancillary documents that relate to the primary agreement. With that caveat, no. I think you mean are there any other substantive transaction documents, and the answer is no.

The CHAIR — I was going to say it is very unusual to get such an unequivocal answer from legal counsel. But it is the government's view that this provision is essentially redundant because it is the government's view that section 45 of the commonwealth legislation is not infringed by the port growth regime?

Mr CARTER — It is a question of bidder perception of risk. So I would not say that something that reduces the bidder's perception of risk and therefore, as it was put earlier, creates a regime that both reduces risk and decrement to value and creates the appropriate environment for investment is redundant. From a purely legal perspective, yes, it is absolutely the Treasury's position that the port growth regime is not unlawful under the Competition and Consumer Act, but this exemption is available to the state, and so that is why it has been included in the legislation.

The CHAIR — Why is this clause drafted in such a general way, rather than simply reflecting the port growth regime?

Mr CARTER — Ultimately that drafting reflects parliamentary counsel's preferred drafting, reflecting our drafting instructions. But it is simply to provide flexibility, because the legislation will be passed obviously — assuming it is passed by the Parliament — prior to the transaction documents being finalised. So that is the reason.

The CHAIR — Presumably under this drafting a primary agreement, which is the mechanism that the clause engages, could effectively be any agreement which is part of this transaction?

Mr CARTER — That is not correct, insofar as the transaction documents are drafted. If you look at the definition of primary agreement, that makes it clear that it is related to 'an authorised transaction containing provisions for or with respect to the making of any payment by the state relating to a port in Victoria specified in the agreement' at which certain things occur — namely, the loading and unloading of containers serving international trade and also the storage of cargo containers. So it is actually related clearly to those activities.

Mr BLOCK — Chair, would you like me to clarify the question you asked us prior to that one, on sections 74 and 75 of the bill?

The CHAIR — Yes, if you are able to. Thank you.

Mr BLOCK — The legislation provides in section 74 that the particular provision here is to be substituted for the provision in the transaction legislation. When you go through and compare what is being deleted and what is being inserted, the prior section, section 141D of the Transport Integration Act, set out the primary objects of the Port of Melbourne Corporation. Those objects related to management and development of the port of Melbourne 'consistent with the vision statement and the transport system objectives', so a very broad set of obligations.

What is happening here in this transaction is the objects of the port are being split, so it is only having a much more narrow role. So where it looks like it is actually adding in new interventionist actions, it is actually just reflecting the more restricted activities of the port of Melbourne. So that is what section 141D does. Section 141E is similar. It is again changing to reflect the way the objects and functions of the port of Melbourne are, restricting it down to their new role. We are not creating new functions or objectives; we are just saying that the old functions were very broad, and now they are being narrowed down to specific functions.

Mr PECK — Otherwise the legacy corporation would have objects that actually could not perform.

The CHAIR — Are there any other questions on clause 69? If not, I have got a general question on regulations which occur a few times through the bill, some in relation to the extension mechanism and also general regulation provisions. Those are not subject to parliamentary disallowance as drafted. Is there any particular reason for that?

Mr RIZOS — We will take that on notice.

The CHAIR — And likewise with respect to other legislative instruments that are created by the bill, if you could offer a view on why they are not subject to disallowance as well, that would be helpful.

Mr RIZOS — We will.

The CHAIR — Just back on the issue of port capacity, which has been the subject of discussion between Mr Easy and Mr Drum, has there been any updated work commissioned by the department with respect to forecast capacity? Obviously there is the 2006 study and the 2009 work. Given how central this question is to so many of the questions around this transaction, has there been updated work commissioned?

Mr WEBSTER — Chair, as we said earlier, we have designed the transaction with a view to making sure that the structure is robust for however trade volumes actually turn out. I think it is fair to say that there has been no specific additional piece of work which we have commissioned and received in respect of trade volumes.

Mr DRUM — Can I just jump in, Chair? Mr Webster, there is just this overarching element with this whole deal that we are not quite sure what we are selling. There are so many questions about this whole thing, and capacity sort of sits right at the very core of it. Are we going to get the rail system running? Are we going to have a port that has rail to the dock? Are we going to be able to take the trucks out of Maribyrnong? Are we going to be able to have the trains that leave Horsham go all the way into the dock? We do not know what capacity is going to be. When will the second port happen? All of these variables are just sort of sitting out there, and we are going to let the bidders tell us the future and how they see it all happening.

Mr WEBSTER — No, that is — —

Mr MARTINE — Sorry, if I can just make two comments before Mr Webster, that is essentially why having a competitive bidding process is absolutely critical. We go out to market and, like a lot of transactions, there are some uncertainties, so bidders will make an assessment around all of these matters and form a view, which is why having enough bidders competing against each other is absolutely critical. Secondly, a number of the issues we have been discussing, which are really important issues that the state needs to deal with, are going to be issues we have to deal with regardless of the ownership of the port of Melbourne — questions around the second port and questions around the capacity of the port of Melbourne.

Certainly, if the port was remaining in government hands, our advice to the government of the day would always be to maximise the use of that asset before you build a second asset, because a second asset will be more expensive for the state. A lot of these issues are matters that in a way have to be dealt with regardless of whether it is public or private, but certainly the benefit of having a competitive process is actually to get bidders to form views around a lot of these issues and express their views on the value, which we will then go through and assess.

Mr DRUM — I think we are all in agreeance with that, but it just seems incredibly back to front. We talk about a port development plan, so I imagine with something that is crucial to the city of Melbourne and crucial to the state of Victoria that we would have a port development plan, just like any business has a business plan for the next two, three or four years. Footy clubs have master plans. Every organisation has a master plan of where they see their organisation going. But this is sort of: maybe we are going to do rail, and maybe we are not; maybe we are going to do the western distributor or the West Gate, and maybe we are not; maybe we are going to do Bay West in 20 years or 30 years or Hastings in 50; maybe we are going to max out capacity at 5, 6, 7 or 8 million TEU. There are all these maybes. I just keep coming back to: why aren't we doing more of this stuff first and at least working out where the future of this port is, how it is going to operate at its maximum and how we are going to get the best operational port? Why aren't we doing that work first and then selling the same product to whoever wants to bid the most for it?

Mr MARTINE — I think that work has been done. Yes, there are some questions — —

Mr DRUM — I do not think it has been done in any way. You are sort of allowing the bidders to do the work. They will come to you with a whole range of fantastic options, and you are going to cherrypick which one you think is the best.

Mr WEBSTER — In terms of, say, capacity, there has been a lot of work historically done down at the port of Melbourne in terms of ways of increasing capacity down there, and I will hand to Nick Easy in a moment as to outline that.

Mr DRUM — You just answered Mr Rich-Phillips's question saying you have not done anything since 2006. In 2009 it was done again — —

Mr WEBSTER — That specific question was on landside capacity — that is my understanding — in terms of truck movements.

Mr DRUM — As opposed to TEUs.

Mr WEBSTER — As opposed to TEUs, correct.

Mr DRUM — Righto, sorry.

The CHAIR — The latter question was in relation to TEUs — my last question — if that is what you are referring to.

Mr WEBSTER — I think we might be at cross-purposes here.

Mr DRUM — It was done in 2006 and it was done in 2009 — I think KPMG had a go at it — and Mr Rich-Phillips wanted to know if there was anything more recent than that.

Mr WEBSTER — Any more recent work will have the same degree of accuracy as the previous bits of work, so in terms of trade volume forecasts, yes, there are expert views out there. Expert views will differ. Expert views will change through time. It is beholden upon us to make sure that the transaction is future proof if transaction volumes are more than expected or less than expected, and that is all we have been designing a robust structure to cater for all of that.

In terms of the work that has been done on the capacity point of view, there is a substantial amount of work that has been done within the port of Melbourne, which will be available in the data room at some future point. There is also a corporate planning process around the port of Melbourne looking forward. So to say it has been done in isolation I think just is not true.

Nick, do you want to maybe comment in terms of the development of the work that has been actually done and the forward planning?

Mr EASY — I think the most recent planning work to support the most recent investment in the port of Melbourne is to do with the port capacity project. Clearly that was a policy environment that is now different, where there is a policy regarding Hastings being the next container port. That work and the business case and the investment decisions supported the growth of the port to the 5.3 million to 5.5 million containers with an understanding of capacity, volumes, the road network, the connections to the freeway system, and investment in amenity works to ensure that work is sustainable and will support the growth of the port of Melbourne. The port has done considerable work to support investment decisions in the future capacity and the decisions that have been made. In this environment we have a different policy setting, a different design structure supporting the transaction, which is about taking the port to the next level.

I think it is only right that the manager of the port will obviously be responsible for that time, for the investment in the future and the capacity and the growth, to set those next set of development plans for the port of Melbourne.

Mr DRUM — So you do not see the risk of the manager or the lessee of the port seeking to hide capacity and struggling to meet it?

Mr WEBSTER — That is his risk.

Mr PECK — That is his risk. I think it is — —

Mr DRUM — What is the time frame? Say I buy it and I set a high capacity, 7.8 million capacity, and over the period of 20, 30 years I struggle to meet it. We are slow at the port. We are slow getting our goods through.

The government says it is not good enough; we need a more efficient and better operational port. You cannot go and build another one. You cannot operate another one, because we are still 800 000 short of the trigger. It is up to me to develop this port to its maximum, and I am making money every year on 7 million but I have got a trigger at 7.8. Is that a risk?

Mr PECK — Just to clarify that, the trigger and the cap effectively on any compensation the state would pay is going to be set prudently within the envelope of the port.

Mr DRUM — Sorry, I did not get that last bit.

Mr PECK — The triggers or the cap levels we have talked about are to be set, as we have talked about, within the capacity of the port, not without it. We are already taking a step down from what we think the physical capacity is of the port in any way, shape or form. I would hope that the investor in the port will try to maximise capacity. We expect them to try to do that. But in terms of the port growth regime, we are expecting that and the starting position from the state will be to set that well within the physical parameters of the port.

You talked about the uncertainties around that. I guess we are guided by the experts. The best experts are the people at the port, Nick and his team, and the work they have done before. Yes, there are different views around that, but they are largely from people who are not living and breathing the port every day. We would have regard to those. I think the history would show that the port over a long period of time has thought that that was about the right capacity of the port. Studies have been done by engineers with their PI insurance at risk et cetera if they get it wrong, as opposed to people providing numbers but without that same level of access and rigour. We think that is the best evidence, so we do not really see that as an uncertainty. The economy will grow. The port will keep developing.

It is a good discussion around road versus rail and how do we get more rail modal share and the amenity around that. We think there is an opportunity for that to grow over time, but you also need a certain scale on rail. You need a certain level of volume to run high utilisation of trains on rail that are going to be able to haul 80 boxes back and forth and get the economics of rail to work. At the moment, it is a challenge. That is no surprise. I think the rail comes more economically from the regions when there are a couple of hundred kilometres of distance involved, and they are heavy boxes. That makes good sense on rail. If you look at other ports on the eastern seaboard, Sydney has relatively low rail modal share but they have taken some initiatives recently. They include dedicated rail parcel freight. We do not have that for intrametropolitan area rail here in Melbourne. Brisbane has a rail terminal in the heart of the port, right next to the container terminals, but Brisbane has the lowest rail modal share on containers because there is a freeway at the front of the port. So rail is always going to struggle until you get to a certain density and level on that.

The economy will grow. The port will grow. That will naturally go on road, because that is the cheapest and best option until it gets to a certain scale and a certain density that makes rail more viable. Clearly we need to go to a market solution that works on that. But I would also highlight in that conversation that if you bring in a third stevedore at Webb Dock, they are going to take some market share away from Swanson. Building a rail terminal at Swanson is going to have to get through that period where there might be fewer volumes at Swanson. All those things come into play. But I think there are some very clear signposts, as the gents have said, around what the state should be doing and where it is going. I think there is a good debate about rail versus road. But I think all those other things that you have highlighted as uncertainties I think over a period of time they are quite certain. It is just the rate at which they develop over time is obviously subject to the broader economy and how quickly trade grows.

Mr MULINO — Just on that issue of capacity, I thought I would firstly just drill down into the seven to eight number and secondly just deal with the issue of uncertainty, which Mr Drum has raised. We have heard that there has been a degree of uncertainty around what the port's capacity might be. Mr Easy, I would just like to ask you: the studies the port did in 2006 and 2009 were studies that were not just undertaken by the port in isolation. You engaged in consultation with stakeholders, port users and experts in completing those studies, did you not?

Mr EASY — Yes, we did. Certainly we engaged with the stakeholders and the users of the port. One of the benefits of the port development plan process run in those times was there was clear engagement — there was input from the stakeholders in the port. We sought their clear information and also their understanding of what they thought the capacity of their particular terminals and their operations were. So it was not done in a vacuum,

it was done with the input of industry. We had people involved internally and we also utilised external expertise, so there was a lot of input from a wide range of players to make sure it was reasonable, it was practical and it was realistic in terms of what sort of projections and forecasts were put forward in terms of, conceptually, the environment of the port and what might happen around capacity moving forward.

Mr MULINO — During the course of these hearings that broad number was backed up by DP World, by Qube, by Wakefield — there have been a number of people who currently use the port who are intimately involved in the operations of the port, many of whom understand what best practice is around the world. Except for the VU study and one or two individual people, they have basically corroborated your findings.

Mr EASY — I think that is the case. That was my point earlier, that others in the industry who are also intimately involved — it is their business and they have strong expertise — have confirmed those types of numbers in terms of capacity through the port of Melbourne.

Mr MULINO — If there are risks, if anything there is possibly upside risk in that there are probably logistical productivity improvements that are in the pipeline that we do not even know about. There could well be greater capacity than current best practice numbers.

Mr EASY — Definitely. The use of technology and even potentially automation of our current stevedore operations at Swanson Dock will lead to further improvements. I have got no doubt about that — the potential is for actually greater capacity rather than less capacity. As an example, our two stevedores at Swanson Dock run a straddle carry operation. They can move to RMGs and then they can move to automation. Each of those gives them a quantum leap in productivity and through the use of technology in their terminals, so I think our numbers probably over time will be seen to be still conservative but are very practical and realistic at this point in time.

Mr MULINO — There is one other thing which Mr Drum touched on, which is that we cannot pin down precisely what port capacity is and we cannot pin down precisely when that will be reached based upon growth numbers, therefore we should do yet another study and hold the whole transaction up until we complete another study. But if we started another study tomorrow and took a whole year to look at projected port traffic and what we might get in terms of throughput, we would end up in another year's time with uncertainty. Because in a sense we cannot pin down that number for what capacity will be in 30, 40, 50 years time and we cannot pin down exactly what trade flows will look like over coming decades, so the better approach I would have thought is to have a regime for managing the port such that you have long-term aspirations but you can reset over periods of time, such as five years, to deal with unknowable changing circumstances.

Mr MARTINE — I would agree with that comment. At the end of the day it does not really matter what the state says to the market in terms of capacity. We cannot present it as a statement of fact that capacity will be X in year 2030. Whatever we do and regardless of how many studies we do, bidders will form, in a sense, their own view. They will look at all of the information that is available and they will make an assessment and a judgement, and they will price it accordingly, which is why I made that point earlier of ensuring that we have got a competitive process to maximise value, given — like any modelling — there is always a level of uncertainty with any modelling.

Mr WEBSTER — And the likely bidders include some very sophisticated players in this space who will have very detailed knowledge of the port and logistics chain, ports elsewhere et cetera, so they will have very informed views in terms of trade volumes in particular.

Mr MULINO — I just want to reiterate that point: if we argue that we should hold this transaction up until we get absolute certainty over when trade volumes might hit some line in 20, 30 or 40 years, you would never do it.

Mr WEBSTER — You asking the impossible.

Mr RIZOS — In fact it is incumbent on us to design a framework that provides for that uncertainty and allows the state to protect its interests in that uncertainty, which is exactly what we are trying to do with the framework we are developing.

The CHAIR — The final area I would like to touch on before the committee goes in camera is in relation to the Victorian Transport Fund, which is established under this legislation. Firstly, with respect to proceeds into that fund, are they only available for capital purposes, or recurrent funding?

Mr MARTINE — Capital.

The CHAIR — Capital. The package that was announced by government after the legislation was introduced a couple months ago of the $200 million regional package — Mr Mulino might know its correct name — is it funded out of the transport fund?

Mr MULINO — Jobs and infrastructure.

Mr WEBSTER — I think it is funded out of the capacity which is freed up.

Mr RIZOS — It is the capacity that is generated by the proceeds of the transaction.

The CHAIR — So will it be drawn from this fund?

Mr MARTINE — I do not think that is the case.

Mr RIZOS — No, the proceeds of the transaction will go to the transport fund. By going to the transport fund it actually creates budget capacity, and that budget capacity will be freed up for the fund you just referred to.

The CHAIR — With respect to the port licence fee — the bring-forward as authorised by this legislation — would it be paid into the transport fund or into consolidated revenue?

Mr MARTINE — Chair, perhaps if you do not mind, when we go to our in-camera session I have an answer for you on the port licence fee. We can have a discussion then, if that is okay.

The CHAIR — Right; thank you. Okay, that is fine, Mr Martine.

Proceedings in camera follow.

Open hearing resumed.

The CHAIR — I will briefly go back to an open transcript so that I can thank Mr Martine and his colleagues from Treasury, Mr Easy and his supporters from the Port of Melbourne Corporation and of course our representatives from Minters, Morgan Stanley and Flagstaff for their attendance today.

It has been a very useful session for the committee to go through these issues, which have been raised over the course of our inquiry over the last couple of months. Obviously there are a number of matters which we will follow up on from the hearing, and Mr Martine has given an undertaking to follow up as well. The committee very much appreciates all your attendance and efforts today and indeed with the earlier hearings. It has been a particularly useful session for the committee. Thank you very much for your time. No doubt we will have further correspondence, but thank you for your efforts today.

Committee adjourned.