PARLIAMENT OF VICTORIA

Legislative Council
Port of Melbourne Select Committee

Inquiry into the proposed lease of the Port of Melbourne

Parliament of Victoria
Port of Melbourne Select Committee

Ordered to be published

VICTORIAN GOVERNMENT PRINTER
December 2015

PP No 119, **Session** 2014-15
ISBN 978 1 925458 08 4 (print version)
978 1 925458 09 1 (PDF version)

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Chairman's foreword

Seventy years ago, the Second World War had just ended, and Australia was a nation of only seven million people. What could the Victorian Government of 1945 have anticipated for the future? Could it have foreseen the enormous changes in Australia over the subsequent seventy years; in our economy; in society; in the region; and across the world?

The Andrews Government, through the Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015 (the Bill) proposes to lease the Port of Melbourne to a private operator for a term of 50 to 70 years. The Legislative Council needs to consider whether that lease is in the interests of Victorians over that period. It needs to be confident that the lease will allow a future Victorian Government the capacity and flexibility to respond to circumstances that may be as inconceivable today, as modern Victoria would have been to the government of 1945.

The Committee has considered a number of key elements of the proposed lease, looking at the long term interests of Victoria, and the need to maximise flexibility and certainty for Victorians.

In this regard aspects of the transaction that may be considered common in the commercial world can have long term negative public policy implications.

While the Bill facilitates some elements of the lease, many key provisions will be reflected in contract rather than legislation. The Committee's request to government for details of those contractual aspects revealed that many key parameters such as compensation triggers and the upfront payment of the Port Licence Fee have not yet been determined, or are subject to contestability in the lease bidding process.

The inability of government to provide certainty as to how key provisions of the transaction will work, and the resulting exposure for the State in the longer term is of concern.

Leasing an asset like the Port of Melbourne to a third party operator should, if properly structured, drive efficiencies in the operation, while releasing capital for reinvestment in new infrastructure. The Committee has, on balance, recommended that the Council support the Bill subject to the Government agreeing to a range of amendments.

The Committee's recommendations are designed to reduce the uncertainty around the transaction; preserve flexibility for future governments; protect port users by reducing the scope for monopoly behaviour by the new operator; and, improve environmental monitoring as the volume of shipping activity in Port Philip Bay increases.

The Committee heard evidence that the Andrews Government's decision to cancel the East-West Link had created concerns among capital markets about sovereign risk in Victoria.

Recognising those concerns, the Government has proposed the Port Growth Regime (PGR) to compensate the port operator in the event that a new state sponsored port commences operation. The PGR however does not reflect the range of circumstances in which a future government may need to bring forward a new port, and under the PGR the level of compensation is uncapped.

The Committee recommended the exclusion from the transaction of the PGR and an amendment to the Bill that would prevent it being applied by contract. It remains open to the Government in addressing the Committee's recommendation to propose alternatives to the PGR that better protect Victoria's interests over the long term.

The Committee's Report was adopted unanimously with the majority of recommendations supported by all members.

With the Bill scheduled to return to the Council for debate, the onus is now on the Government to consider the Committee's recommendations and bring forward amendments, or suitable alternatives, to give them effect.

The Committee received 87 written submissions and took evidence from 58 witnesses at hearings in Melbourne, Geelong, Shepparton, Horsham and Hastings. On behalf of the Committee I would like to thank those individuals and organisations for their input to the Committee's work.

The Committee Secretariat led by Keir Delaney, and our specialist advisors Dr Bill Russell, Natalia Southern, and Will Georgiou provided outstanding support to the Committee and I thank them for their contribution.

Finally, I would like to thank my fellow Committee members for their commitment, co-operation and goodwill which allowed the Committee to undertake a complex investigation in a compressed timeframe and report to Parliament as scheduled.

Hon Gordon Rich-Phillips MLC
Chairman

Terms of reference

On 5 August 2015, the Legislative Council agreed to the following resolution:

A Select Committee of eight members be appointed to inquire into and report on the proposed lease of the Port of Melbourne as contemplated by the Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015 and, in particular —

(a) the structure and duration of the proposed lease

(b) the potential impacts of the proposed lease on the development of a second container port in Victoria

(c) the potential impacts on the environment of the further expansion of the Port of Melbourne

(d) the potential impacts of the proposed arrangements on the competitiveness of the Port of Melbourne, the supply chains that depend on it and cost effects on goods passing through the Port of Melbourne

(e) the effectiveness of the proposed regulatory framework in dealing with the transfer of a monopoly asset from the public sector to the private sector

(f) how the proposed lease balances the short-term objective of maximising the proceeds of the lease with the longer-term objective of maximising the economic benefits to Victoria of container trade

(g) any other relevant matters.

The reporting date for this Inquiry was 30 November 2015.

Executive summary

Introduction

The Port of Melbourne is Australia's oldest and largest container port and is a key economic asset supporting the international trade and movement of freight for the Victorian economy.

On 26 May 2015, the Government introduced the Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015 (the Bill) into the Victorian Parliament. The Bill authorises and facilitates leasing the Port of Melbourne's existing land and assets for a period of 50 years, with an option for the Government to extend the lease for a further 20 years.

While the Government advised that the Port lease transaction could be completed without specific legislation, the Committee believes that it is appropriate that the privatisation of such a significant asset is underpinned by legislation rather than commercial in confidence agreements.

The proposed transaction comes at an important time for Victoria. It follows a series of recent port privatisations around the country. The anticipated proceeds together with the Commonwealth Government's 15 per cent Asset Recycling Initiative will provide substantial capital to meet Victoria's significant need for new infrastructure investment.

It is important that the proposed transaction is not structured in such a way as to compromise the long term interests of the State. To this end, the Committee has made 15 recommendations which are discussed further below.

The appropriateness of the 50 year lease term

The Bill authorises a 50 year lease and provides scope for the Government under regulations to grant an additional term of up to 20 years to the leaseholder.

The Committee accepts that a 50 year term is appropriate given evidence around what might constitute the maximum achievable capacity of the Port in its current location and forecast trade growth. A 50 year term is likely to provide sufficient time for the new Port operator to invest in further development of capacity, and to provide port services at lower overall supply chain cost.

However, the Committee is not convinced about the reasons for allowing Government to extend the lease for a further 20 years – particularly given the consensus that a second container port will be needed well before the end of the proposed 50 year lease.

The Committee recommends that the Bill be amended to provide that a lease or licence may be issued for no more than 50 years, and may not be extended. The effect of such an amendment is to require Parliamentary approval via amending legislation if a future government considers that an extension is in the interests of the State.

A further issue is that the Bill enables regulations to be made but these are not subject to disallowance by either House of Parliament, pursuant to the *Subordinate Legislation Act 1994*. The Committee believes the Bill should be amended to allow either House of Parliament to disallow any such statutory instruments particularly given the range of matters that are yet to be determined in relation to the transaction, and the broad power under the Bill to make statutory and administrative instruments.

Enhancing the Port's competitiveness and efficiency

Maintaining and enhancing the Port of Melbourne's competitiveness and efficiency is a high priority particularly given the critical role that the Port plays in Victorian import and export markets.

However, the Port of Melbourne's competitive position and standing as Australia's largest container port is under challenge. Recent port privatisations in New South Wales and Queensland and improvements in interstate road and rail links are improving the competitiveness of other ports. There is already evidence that some of Port Botany's growth may be occurring at the expense of the Port of Melbourne.

Achieving enhanced competitiveness of the Port of Melbourne requires two critical actions – immediate commitment to completing the Port Rail Shuttle project and the development of a comprehensive transport plan for the State.

The Port Rail Shuttle project

The Port Rail Shuttle is a project that has been contemplated for nearly two decades. It involves moving containers from the Port by rail (rather than road) to a series of metropolitan intermodal terminals. This project would significantly reduce truck traffic around the port precincts and adjustment residential areas.

The Committee notes that the 2014-15 State Budget included $58 million of funding for the project. In light of the urgent need for the project and likely significant benefits, the Government should immediately commit to completing the Port Rail Shuttle project and re-activate the Expressions of Interest process to select a party to deliver it.

Development of a transport plan

The second urgent priority is to improve transport and logistics planning to manage the projected growth in Port capacity. The Committee considers that there has been inadequate planning in relation to the road and rail upgrades

required to accommodate the Port expanding to the 8 million twenty-foot equivalent unit (TEU) capacity envisaged by the Government. The Committee notes as an example that the $1.68 million Port Capacity Project presumes that the additional 1 million TEU capacity will be dealt with by road given that there are no plans for a rail connection to the new Webb Dock container terminal.

The Committee recommends that the Government develop a comprehensive plan setting out the transport and logistics required to support further Port expansion, including a rail link to Webb Dock. The planning process must include consultation with local councils and communities.

Planning for a second container port

The timing and location of a second container port for the Melbourne region was a key issue for many of those who provided evidence to the Committee.

The Port of Melbourne currently has a throughput of 2.5 million TEU per year. Its overall capacity is expected to increase to around 5.5 million TEU once the Port Capacity Project is completed in 2016-17. Estimates of the Port's ultimate capacity range from 5 million TEU to 8 million TEU. This uncertainty reinforces the need to maintain maximum flexibility for planning and providing future Port capacity after the proposed lease.

While there is some disagreement as to the pace of capacity growth, there is no dispute that existing capacity will be fully utilised at some point after 2025 as Melbourne and Victoria's population moves to an expected 7.7 million and 10 million respectively by 2051. The likely 10 years or more required to plan and develop a second container port to handle any further capacity suggests that the decision making and planning process needs to commence sooner rather than later.

The Committee heard a range of views about the locational, logistics and environmental consequences of a second container port – particularly focusing on previously canvassed locations at Hastings or Bay West. These issues will need to be carefully assessed as part of any advice that is provided to Government on the ideal port location and timing of a second container port.

Compensation under the Port Growth Regime

The Government has proposed a compensation regime known as the Port Growth Regime (PGR) that involves making payments to the new Port operator in the event that the State develops or sponsors a second port that handles international containers that could otherwise have been handled at the Port of Melbourne.

The Bill does not set out any details of the PGR, although clause 69 of the Bill exempts the PGR arrangements from the Australian Competition and Consumer Commission's (ACCC) scrutiny under Part IV of the *Competition and Consumer Act 2010* (Cth).

DTF was not able to provide the Committee with clear and definitive information about how the PGR will apply, and the State's potential financial exposure. DTF and its advisors told the Committee that a number of key aspects of the PGR were either yet to be decided, were to be decided through the competitive bid process or could not be released on the basis of commercial sensitivity. This includes the proposed formula and key trigger points.

The Committee is concerned that the PGR may create a risk that Government could delay developing a second port in order to avoid compensation payable, leading to a shortfall in container port capacity in Melbourne. If this were to occur, the State risks significantly higher costs associated with port services by virtue of capacity constraints and the entrenched monopoly position of the Port of Melbourne.

The Committee also notes that stakeholders expressed significant concerns – particularly around the impact that the PGR might have on investment and competition. This included concerns from the ACCC that 'the compensation regime would likely hinder the prospects of future competition, entrenching substantial market power at the Port of Melbourne'. These impacts are difficult to assess without full details about how the regime will apply in practice.

The lack of detail and heavy reliance on the competitive bid process to determine key aspects of PGR means that the Parliament is being asked to endorse a compensation structure that creates an unquantifiable financial exposure. As a result, the Committee recommends that the Bill be amended to prohibit a compensation or refund mechanism being included in any agreements related to the transaction, however so defined.

The Committee also considers that the clause 69 exemption of the PGR from ACCC scrutiny is inappropriate. It notes the ACCC's preference for the competition provisions of the Act to apply to the transaction and is not persuaded by the need for an exemption to be granted.

An appropriate economic regulatory framework

The privatisation of such a strategic and essential natural monopoly asset as the Port of Melbourne warrants an appropriate economic regulatory regime that recognises and balances the interests of port operators and port users as well as the long term interests of the community.

The proposed economic regulatory regime is both broader in its coverage of services and applies a building block approach to price setting, which allows the port operator to recover its operating costs and cost of capital and depreciation on the asset base. The Committee supports this more detailed approach compared to what is currently adopted in Victoria and other jurisdictions, particularly in light of the experience with other ports that have experienced significantly increased prices prior to and after privatisation. Adopting this approach will provide greater transparency to Port users as to the drivers and basis of the new operator's port prices.

However, stakeholders were concerned to ensure that the economic regulatory framework did not provide scope for the Port operator to exercise its market power by increasing prices. In response, the Committee has noted that:

- the proposed changes to the objectives under section 48 of the *Port Management Act 1995* reduce the focus on protecting the interests of users of prescribed services by ensuring that prescribed prices are fair and reasonable. The Committee does not support this change in the objectives of the regime. It recommends that the Bill be amended to restore the existing focus on protecting the interests of Port users by ensuring that prescribed prices are fair and reasonable.
- a price cap of CPI over the initial 15 year period does not recognise the opportunities available to the Port operator to achieve efficiency improvements, and the prospect of achieving the greatest improvement in efficiency in the initial decade of the lease. The opportunity for efficiency improvements should be recognised in improved pricing for Port users.
- the role of the Essential Services Commission (as regulator) will largely be limited to assessing the Port operator's compliance with the Pricing Order as part of the proposed five yearly reviews. The Committee believes that this is not sufficient to enable any issues to be addressed outside of the five yearly reviews. It recommends that the Bill be amended to include a complaints mechanism that will progressively inform the five yearly compliance reviews and also allow any issues to be brought to the Minister's attention where they may warrant further inquiry or investigation.

Regulation of land rents

A major area of concern to Port users was the prospect of a new Port operator significantly increasing stevedore and land rents given that it is not covered by the regulatory regime. These concerns have been exacerbated by the Port of Melbourne Corporation's recent but now resolved proposal to increase DP World's rent by 767 per cent.

The Committee notes that while services prescribed under the Bill and subject to oversight extend to approximately 86 per cent of current Port revenues, that oversight does not extend to the remaining 14 per cent associated with land rents.

In the course of this Inquiry, the Treasurer announced a strengthening of arrangements related to market rents including:

- a requirement for the Port operator to offer a market standard rent review mechanism with dispute resolution by an independent property market expert to any new tenants or renewing tenants that wish to apply this mechanism
- a periodic review by the Essential Services Commission of whether the Port leaseholder has misused its market power in the setting of rents at the Port.

The Committee welcomes the Government's acknowledgement of the need to extend the oversight regime, and endorses its proposed changes. However, it remains concerned that the Government's proposals do not provide the same degree of oversight or rigour in price setting as required for prescribed services and may result in the Port operator imposing large increases in port rents to offset the relative constraint on the pricing of prescribed services.

As a result, the Committee believes that the granting of a lease or sub-lease should be defined as a prescribed service and brought within the regulatory oversight and price setting mechanisms. The Pricing Order should include a rent capping mechanism that prevents the exercise of monopoly power in relation to leases or sub-leases.

Controls on vertical integration

The ACCC is able to examine whether any cases of horizontal integration will substantially lessen competition under section 50 of the *Competition and Consumer Act 2010* (Cth), and that this should be sufficient to address any concerns about cross ownership.

The Committee believes that it is appropriate for restrictions on vertical integration to be included in the Bill, rather than simply in the lease. This will provide Port operators and other potential investors with clear and transparent rules in relation to ownership. The Bill should be amended to include explicit prohibitions on both an entity engaged directly or indirectly in stevedoring or terminal operations becoming a Port operator; and on a Port operator engaging directly or indirectly in stevedoring or terminal operations, other than in exceptional circumstances that require a temporary 'step in'.

Environmental protections and monitoring

The proposed allocation of marine, environmental and safety functions to the State represents an appropriate division between the State's role in protecting the public interest and the role of the lessee in managing Port operations.

Some stakeholders were concerned that increased traffic movements and further expansion of the Port of Melbourne would create adverse environmental and community impacts. Consultation with councils and communities should allow concerns related to traffic congestion and health impact to be debated and addressed. More broadly, the Committee believes that it is appropriate to provide ongoing monitoring of the condition and major impacts on the Bay. It recommends that the Bill re-establish the Office of the Environmental Monitor, and regularly publish a report on the 'State of the Bay'.

The Port Licence Fee and Cost Contribution Amount

The Bill requires the Port operator to pay a Port Licence Fee (PLF) each financial year (currently valued at $80 million) and also enables the Treasurer to require the PLF to be paid as a lump sum upfront. DTF advised that it is not clear whether the Treasurer will exercise this option.

The Committee considers that the Government has not established a sound policy basis for including the option to bring forward 50 years of PLF revenue. Doing so enables the current government to benefit from the recurrent revenue that would otherwise be available to fund future government activity over several generations. On this basis, the Committee considers that the mechanism to levy an upfront lump sum PLF should be omitted from the Bill.

In addition to the PLF, the leaseholder is required to recover from Port users a CCA. This represents the operating and capital costs associated with StateCo, the legacy Port of Melbourne Corporation entity, to provide government-retained port services such as the Harbour Master and the Vessel Traffic Service. DTF advised that the CCA is yet to be finalised.

There is the potential for the CCA to be set at a level that does not match the costs associated with current Port of Melbourne Corporation's functions that will be delivered in future by StateCo. In the interests of transparency, the Government should publish prior to the release of the Expression of Interest the CCA amount to be passed on to Port users through prescribed prices, the basis on which it has been determined and how it compares to the actual amounts incurred currently for those functions.

Ensuring Victorians benefit from proposed lease proceeds

The Government has indicated that it will use the transaction proceeds to remove 50 metropolitan level crossings in Victoria. It has also announced that it will establish a $200 million Agriculture Infrastructure and Jobs Funds.

The Committee accepts that the Government has made a clear commitment to fund its level crossing program. However, it considers that a share of the transaction proceeds should be spent on alternative infrastructure, transport and logistics projects particularly in rural and regional Victoria.

Regional and rural participants noted that only 2 per cent of the proceeds were planned to be directed to regional communities, and called for a higher proportion of Port lease proceeds to be reinvested back into improving logistics infrastructure in rural and regional Victoria. The Committee recommends that ahead of the lease transaction, the Government should commit to allocating a minimum percentage of net lease proceeds to rural and regional logistics infrastructure.

Recommendations

1 Introduction

RECOMMENDATION 1: Subject to the Government proposing amendments to the Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015 (the Bill) and adopting the policy changes outlined in this Report, the Committee recommends that the Council support the Bill. 4

2 Structure and duration of the proposed lease

RECOMMENDATION 2: Clause 11 be amended to provide that a lease or licence may be issued for no more than 50 years, and may not be extended. The effect of such an amendment is to require Parliamentary approval via amended legislation if such extension is desired by a future government. 14

RECOMMENDATION 3: The Bill be amended to allow for the 'as-of-right' disallowance of statutory instruments by either House of Parliament pursuant to section 23(1)(a) and section 25C(1)(a) of the *Subordinate Legislation Act 1994* (Vic). 14

4 Competitiveness of the Port of Melbourne, supply chains and cost effects

RECOMMENDATION 4: The Government:

(a) immediately commit to completing the Port Rail Shuttle project for which funding of $58 million was provided in the 2014-15 Budget

(b) immediately re-activate the Expressions of Interest process to select a party to deliver the Port Rail Shuttle project

(c) ensure that the short term delivery of the Port Rail Shuttle project is fully reflected in the transaction documents. 37

RECOMMENDATION 5: The Government:

(a) develop a comprehensive transport plan of the additional links that Port expansion will require

(b) include provision for a rail link to Webb Dock by the most cost-effective means

(c) ensure that local councils and communities are consulted in the planning process. 38

5 Environmental impacts of further expansion of the Port of Melbourne

RECOMMENDATION 6: The Government provide ongoing monitoring of the condition and major impacts on the Bay by:

(a) amending the Bill to re-establish the Office of the Environmental Monitor

(b) preparing and releasing publicly a 'State of the Bay' report on a regular basis. **45**

6 Economic regulatory framework

RECOMMENDATION 7: Clause 90 of the Bill be amended to ensure that the objectives under section 48 of the *Port Management Act 1995* (Vic.) include an objective: to protect the interests of users of prescribed services by ensuring that prescribed prices are fair and reasonable. **53**

RECOMMENDATION 8: The Bill be amended to provide a mechanism for complaints regarding pricing to be directed to the Essential Services Commission. **56**

RECOMMENDATION 9: The Government:

(a) amend clause 90 of the Bill to extend prescribed services to include the granting of a lease or sub-lease by the Port of Melbourne for the purposes of terminals or stevedoring operations

(b) provide within the Pricing Order a rent capping mechanism that prevents the exercise of monopoly power in relation to leases or sub-leases. **66**

RECOMMENDATION 10: The Bill be amended to explicitly prohibit:

(a) an entity engaged directly or indirectly in stevedoring or terminal operations becoming a Port operator

(b) a Port operator engaging directly or indirectly in stevedoring or terminal operations, other than in exceptional circumstances that require a temporary 'step in'. **69**

7 Balancing short and long term objectives

RECOMMENDATION 11: The Bill be amended to:

(a) exclude the enabling provision for the Port Growth Regime (see subsequent recommendation in relation to clause 69)

(b) prohibit the inclusion in contract of a compensation or refund mechanism however so defined. **81**

RECOMMENDATION 12: The Bill be amended to omit clause 69 thereby preserving the full application of the *Competition and Consumer Act 2010* (Cth) and the Competition Code. **84**

1 Introduction

1.1 Background

The Port of Melbourne is Australia's oldest and largest container port. It is visited by over 3,000 cargo ships annually and accounts for 35 per cent of Australia's container trade.[1]

The Port of Melbourne occupies 510 hectares of land to the west and south west of the Melbourne CBD, spanning both banks of the Yarra River from Bolte Bridge to the river mouth. The Port of Melbourne Corporation (PoMC) is also responsible for the Station Pier cruise ship facility.

In 2014-15, the Port of Melbourne handled 87 million revenue tonnes of two-way trade, including 2.58 million twenty-foot equivalent unit (TEU) containers and a further 350,000 new motor vehicles.[2] PoMC generated revenue of $382 million and profit after tax of $46 million.[3] It paid the Victorian Government a Port Licence Fee of $78 million and a dividend of $33 million.[4] PoMC employed 221 people as at 30 June 2015.[5]

1.2 The proposed lease of the Port of Melbourne

On 26 May 2015, the Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015 (the Bill) was introduced into the Legislative Assembly. The Bill authorises and facilitates the leasing of the Port of Melbourne to a private operator for an initial period of 50 years.[6]

The proposed lease of the Port of Melbourne comes at an important time given the current need in Victoria for significant investment in State infrastructure. The potential lease proceeds together with the Commonwealth Government's 15 per cent Asset Recycling Initiative are likely to provide substantial capital for new infrastructure investment.

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1 Bureau of Infrastructure, Transport and Regional Economics, Department of Infrastructure and Regional Development, *Containerised and non-containerised trade through Australian ports to 2032-33*, Research Report No 138 (2014), p.5.

2 Port of Melbourne Corporation, *Annual Report 2014-15* (2015), p.16.

3 Ibid., p.19.

4 Ibid., p.44.

5 Ibid., p.15.

6 Hon T. Pallas MP, Treasurer, Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015, *Second Reading Speech*, 27 May 2015.

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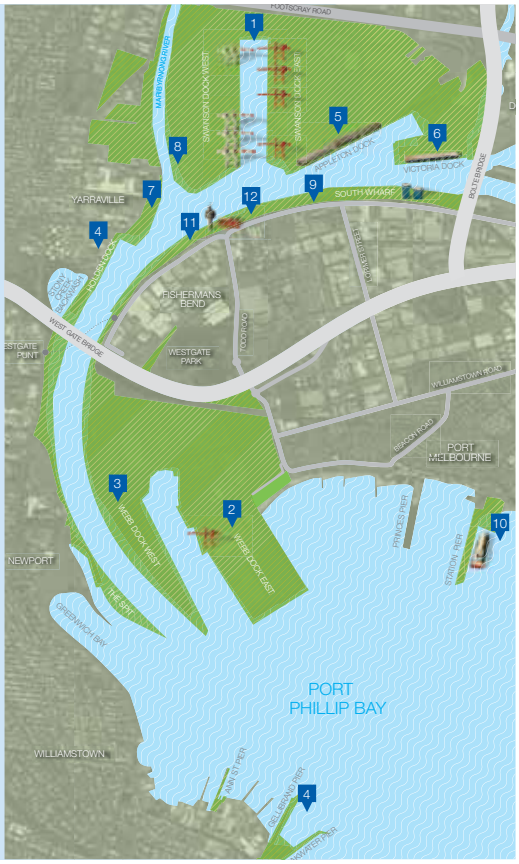
Figure 1.1 Port of Melbourne berths and facilities

Port of Melbourne berths and facilities

1. Swanson Dock – main container hub with two international terminals
2. Webb Dock East – Tasmanian freight facilities and international container terminal (currently under development)
3. Webb Dock West – purpose built automotive facility (under further development)
4. Holden Dock and Gellibrand Pier – handles bulk fuel, petroleum and oil
5. Appleton Dock – dry and breakbulk, roll-on / roll-off vessels, including the automotive trade
6. Victoria Dock – general cargo, warehousing facilities
7. Yarraville berths – bulk cargo berths for sugar, gypsum and fertiliser
8. Maribyrnong No. 1 – non-hazardous, hazardous and liquid bulk berth, servicing Coode Island facilities
9. South Wharves – multi-purpose berths for steel, gypsum, paper products and cement
10. Station Pier – Victoria's premier cruise shipping and Tasmanian ferry hub
11. Port Operations Control Centre – shipping navigation services and emergency response management
12. Port Education Centre – community education facility



Source: Port of Melbourne Corporation, *Annual Report 2014-15* (2015), p.25.

The proposed lease follows a series of port privatisations across other Australian states, including the privatisation of the Port of Brisbane in November 2010, Port Botany and Port Kembla in April 2014 and the Port of Darwin in October 2015. The Western Australian Government has also recently announced its intention to sell Fremantle Port and Kwinana Bulk Terminal.

The Government has opted for transaction-specific legislation to provide an overarching framework for the lease, with many of the key transaction features to be determined by negotiation and reflected in contract.

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

- regulating the Port of Melbourne to ensure it continues to operate competitively and efficiently to support Victoria's freight and logistics network
- requiring that the transaction delivers the optimal overall long term economic benefit to Victorians and Victorian businesses
- treating employees fairly and equitably
- maximising the financial return to the State from the transaction within overall policy settings, while minimising the ongoing financial risks and liabilities to the State

- ensuring that appropriate activities, including marine, environmental and safety functions, remain with the State and are managed in an efficient manner
- completing the transaction efficiently with appropriate probity, transparency and accountability standards
- securing Victoria's role as the freight and logistics capital of Australia.

The Bill requires the proceeds from the proposed lease to be applied to the Victorian Transport Fund (VTF) for use on the Level Crossing Removal Program and/or other transport infrastructure.

The Bill will create a new stand-alone Act holding the transaction provisions for the proposed lease, and make consequential amendments to the *Port Management Act 1995* and the *Essential Services Commission Act 2001* to create a framework for the ongoing operation of the privatised port.

Key provisions of the Bill include:

- allowing the Port to be leased for 50 years, with an additional renewal period of up to 20 years to be provided for through regulations
- creating the VTF to which the proceeds from the lease are to be directed and giving wide powers as to how such proceeds from the VTF may be applied
- providing that the Port Licence Fee may be payable upfront
- establishing transaction entities to facilitate structuring the lease transaction
- allowing for the transfer of the Port's assets by way of transfer order
- setting up transfer arrangements in respect of current Port of Melbourne Corporation staff
- authorising certain agreements that may otherwise be precluding by operation of the *Competition and Consumer Act 2010* (Cth) and the Competition Code[7]
- amending the objects of the *Port Management Act 1995* to remove references to protecting the interests of users of prescribed services through ensuring fair and reasonable pricing
- widening the scope of 'prescribed services' that will be under the control of the future lessee and making provision for state retention of certain functions such as environmental monitoring and safety
- allowing for some regulatory oversight in respect of prescribed services in the form of a Pricing Order and compliance monitoring by the Essential Services Commission.

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7 See *Competition Policy Reform (Victoria) Act 1995* (Vic) section 4.

1.3 The Inquiry process

The Committee met for the first time on 12 August 2015 to elect a Chair and Deputy Chair and to establish a work program.

Following that inaugural meeting, the Committee undertook informal briefings with the Department of Treasury and Finance (DTF) and PoMC, including a site visit and waterside tour of the Port facilities.

The Committee resolved to seek written submissions and received a total of 87 submissions from organisations and individuals including the Victorian and Tasmanian Governments, local government, shipping, stevedore, and logistics operators, academics, industry peak bodies and community groups.

Formal hearings commenced on 8 September 2015 in Melbourne with public evidence from DTF and PoMC. Hearings were subsequently held in Geelong, Shepparton, Horsham, Hastings and Melbourne with evidence taken from 58 witnesses.

On 4 November 2015, hearings concluded with DTF, PoMC and the Victorian Government's legal and financial advisors on the transaction.

In providing this Report to the Parliament, the Committee has considered all evidence, both oral and written, provided to it. The Committee would like to thank all individuals, witnesses and organisations who participated in the inquiry and raised issues. The issues raised included, among other things, the compensation mechanism, regulatory framework, environmental protection, Port rail access and the option to extend the lease.

The Committee has commented on these issues in more depth in the report. The Committee considers that many of these concerns can be addressed by appropriate amendments to the Bill and policy changes.

RECOMMENDATION 1: Subject to the Government proposing amendments to the Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015 (the Bill) and adopting the policy changes outlined in this Report, the Committee recommends that the Council support the Bill.

2 Structure and duration of the proposed lease

2.1 Introduction

The authorising framework for the proposed lease is set out in the Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015 (the Bill). It is supported by a series of transaction documents that the Department of Treasury and Finance (DTF) has advised are yet to be finalised.

This chapter addresses a number of key aspects of the overarching framework – in particular, the approach of adopting transaction specific legislation, the proposed scope of the lease and division of responsibilities between the Port operator and government, and the appropriateness of the 50 year lease term (and 20 year option).

2.2 Transaction enabling legislation

The Bill establishes the authorising framework for the Port of Melbourne lease transaction. Specifically, the Bill:

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

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

DTF advised the Committee that the transaction could be completed without transaction specific legislation.[8] It advised that the most likely form of alternative transaction would be to use contracts and existing legislation such as the *State Owned Enterprises Act 1992*. However, it described such an approach as 'sub-optimal'[9] and noted that:

> This approach substitutes contractual for legislative certainty and compromises timeliness, value and overall economic outcomes. By contrast, transaction specific legislation delivers a timely and more comprehensive, certain and transparent authorisation for the Transaction as well as a range of statutory safeguards and benefits such as a strengthened economic regulatory regime.[10]

Infrastructure Partnerships Australia also emphasised the importance of the legislation providing an accepted bipartisan position that provides some comfort for investors:

> These transactions are very complex, and there are a lot of risks that ideally you are wanting to retire through the use of legislation. There is a lot of additional aspects of the transaction and the structure of the freight market that are being considered by the committee and Parliament. The other thing I would say is that if it is done under regulation, if it is done under the State Owned Enterprises Act, then that would suggest that the Parliament was not able to reach a bipartisan position around the transaction. I think that that probably would raise questions in the minds of some potential investors. This is a very longlived asset — a 50 year payback for debt and equity. People are going to want some degree of certainty that people accept the outcome, that the Parliament supports the outcome, that it remains a bipartisan issue.[11]

Overall, the Committee agrees that it is appropriate for the transaction to be established in specific legislation. This is consistent with previous privatisation transactions both in Victoria and other jurisdictions, and provides certainty for the potential Port operator and Port users about how the State's largest port will continue to be managed over the next 50 years.

Some stakeholders questioned whether the legislation was prescriptive enough, and noted the heavy reliance on the commercial in confidence transaction documents.

2.3 Appropriateness of what is to be leased

The key structural features of the transaction are as follows:

- the leaseholder is responsible for the Port of Melbourne's commercial operations, except for Station Pier and West Finger Pier, and use of channels for commercial shipping

8 Victorian Government, Department of Treasury and Finance, Submission 8, pp.2-3.

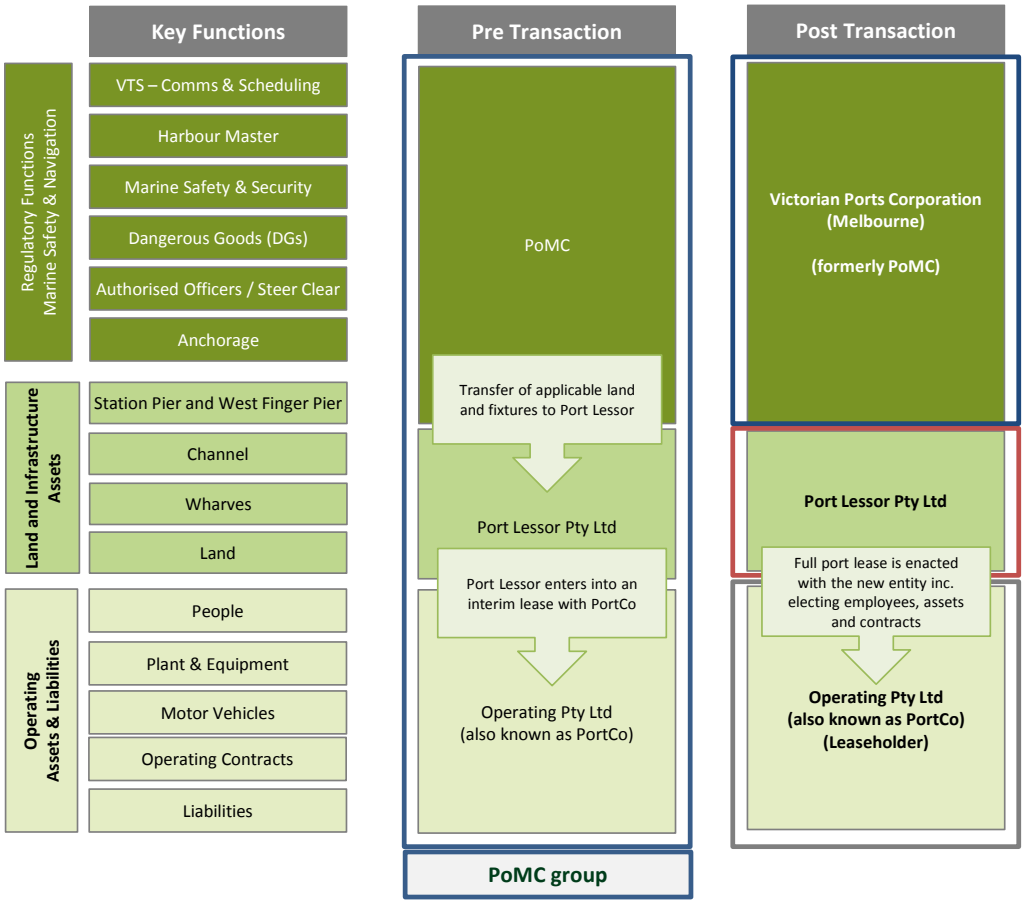
9 Ibid., pp.13-14.

10 Ibid., p.3.

11 Mr B. Lyon, Infrastructure Partnerships Australia, *Transcript of Evidence*, 14 October 2015, p.536.

- the State retains marine and regulatory functions including the Harbour Master, the Vessel Traffic Service (navigation in Port of Melbourne waters), dangerous goods oversight, waterside emergency management, marine pollution response, management of Port of Melbourne anchorage and towage regulation.
- there is no automatic right for the leaseholder to develop a second container port.

Figure 2.1 PoMC assets and functions allocation and transition over time



Source: Victorian Government, Department of Treasury and Finance, Submission 8, p.17.

While most stakeholders did not comment explicitly on the division of responsibilities between the State and the new Port operator, there did appear to be general support for the separation of commercial operations from regulatory functions as part of the transaction. The focus of most stakeholders who commented was on the importance of the State retaining responsibility for environmental regulation.

The Association of Bayside Municipalities supported the State Government retaining responsibility for maintaining the health of the Bay, indicating that this 'is a responsibility that cannot be transferred'.[12]

12 Cr F. Frederico, Association of Bayside Municipalities, *Transcript of Evidence*, 8 September 2015, p.58.

The Victorian National Parks Association supported the State retaining responsibility for environmental regulation. However, it also commented that there 'needs to be some significant strengthening of the various environmental planning and management regimes in terms of Port Phillip Bay and Western Port and the marine and coastal environment in general along Victoria'.[13] The Maribyrnong Truck Action Group also supported the Government retaining responsibility for environmental regulation, albeit on a strengthened basis.[14]

Issues related to environmental regulation and monitoring are further discussed in Chapter 5.

Overall, the Committee considers that the allocation of responsibilities between the Port operator and the Government appear appropriate.

2.4 The lease term

2.4.1 Appropriateness of the 50 year lease term

The Bill authorises a 50 year lease and provides scope for the Government under regulations to grant an additional term of up to 20 years to the leaseholder.[15] Specifically, clause 11 authorises the transfer to a private sector entity or public sector entity of Port assets subject to limitations that—

- the land comprising Port assets may be leased or licensed to a private sector entity, however the ownership of the freehold title to that land must remain with a public sector entity
- the maximum term of a lease or licence of land comprising Port assets to be granted to a private sector entity, including any period of a further lease or licence of those Port assets, is 50 years or, if the Premier makes an order under subclause (3), for a period not exceeding 50 years and 30 days or, if the regulations prescribe an additional period, for an aggregate period not exceeding 70 years or, if the Premier makes an order under subclause (3), for an aggregate period not exceeding 70 years and 30 days.[16]

Most other Australian jurisdictions have sought to privatise their port assets for longer terms. Lease terms of 99 years were set for South Australian ports (sold in 2001), Port of Brisbane (2010), Port Botany/Kembla (2013) and the Port of Darwin (2015) while the Port of Newcastle was leased in 2014 for 98 years.[17]

Despite recent Australian port privatisations being around 99 years, the KPMG scoping study supported the view that:

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13 Mr C. Smyth, Victorian National Parks Association, *Transcript of Evidence*, 9 September 2015, p.157.

14 Mr M. Wurt, Maribyrnong Truck Action Group, *Transcript of Evidence*, 30 September 2015, p.6.

15 See Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015 clauses 11(2) – (3).

16 Explanatory Memorandum, Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015, p.6.

17 Victorian Government, Department of Treasury and Finance, Submission 8, p.20.

> ...it does not seem appropriate to contemplate a lease term for anything like 99 years. On balance the negative impacts on flexibility around the opportunity to redevelop the port precinct in a manner which supports the growth of Melbourne, impacts on achieving smooth transition to Port of Hastings and uncertainty around achieving value for money suggest that this option does not merit too much detailed consideration.[18]

The KPMG scoping study also advised that:

> ... a minimum term of 25 to 30 years will be required to attract reasonable market interest and deliver value – with the general principle the longer the lease (with appropriate confidence around the timing and nature of competitive port capacity) the greater the value which would be achieved in terms of sale proceeds.[19]

KPMG's own market soundings at the time also supported a minimum lease term of around 30 years, and a preference for a longer lease term.[20]

DTF advised that the Government considered a number of possible options for the lease term ranging from 40 years to 99 years, including scenarios where the lease term varied for different port precincts. It noted a number of critical policy and commercial decisions including the expected operating life of the Port, possible alternative land use, capital expenditure incentives and market bidding considerations.[21] Table 2.1 below summarises DTF's key reasons supporting a 50 year lease term.

Table 2.1 **DTF assessment of key policy and commercial considerations underpinning the 50 year lease term**

Policy/commercial consideration	DTF assessment
Expected operating port life	Significant remaining capacity based on expected natural capacity within its existing footprint in the range of 7.0 to 8.0 million TEU. Not allowing the Port of Melbourne to grow to its natural capacity will impose unnecessary and avoidable higher costs to industry, Victorians and government earlier than necessary.
Possible alternative land use	Option of using port land in future possible higher and better use, such as urban development. However, predicting future use is difficult and depends on factors such as population growth and availability of land outside the port. Initial analysis shows no demand driven requirement for urban development of port land for perhaps another 60 years due to significant land available in inner Melbourne (Docklands, E-Gate, Fishermen's Bend and North Dynon).
Capital expenditure incentives	50 year lease term should incentivise leaseholder to facilitate additional container or other trade capacity growth and ensure port assets are maintained appropriately. Shorter lease term would diminish time for leaseholder to recoup investment (given the long-life nature of the port's assets) and incentives to spend optimal capital expenditure as it approaches the end of lease or alternatively effectively recover the expenditure through the regulatory regime over a short period to end of lease.
Market bidding considerations	Most infrastructure asset bidders prefer a longer investment period to receive cash flows and provide more flexibility in operations and opportunities to optimise financing.

Source: Victorian Government, Department of Treasury and Finance, Submission 8, pp.19-20.

18 KPMG, *Project Blue Scoping Study, Scoping Study Draft BERC 281* (2014), p.157.

19 Ibid., p.156.

20 Ibid., p.166.

21 Victorian Government, Department of Treasury and Finance, Submission 8, p.19.

DTF concluded that:

> The option of 50 years plus the capacity for up to an additional 20 years provides the best blend of preserving State strategic flexibility and policy needs, and provides sufficient time to promote efficient capital investment by the leaseholder and tenants.[22]

A number of submissions supported the proposed 50 year lease term. The Victorian Employers Chamber of Commerce and Industry (VECCI) said:

> In our view, the proposed 50 year lease term is appropriate. It provides the purchaser with a clear timeframe to maintain and improve the port's operations, raise efficiency and boost competitiveness. It also ensures that the government of the day can maintain control over the long-term ownership of the Port [of Melbourne] and future alternative uses of the land.[23]

Emerald Grain also supported a 50 year term on the basis that it would provide certainty for industry investment:

> The length of lease term is crucial to future investment by Emerald Grain in further facility improvements, berth refurbishment, and potential deepening to panamax capability (currently berth depth doesn't permit full loading of panamax vessels).[24]

Other submissions suggested a lesser term – reflecting either their view of when the Port of Melbourne would reach full capacity or the current issues with traffic congestion and logistics around the Port. For example, Frankston City Council favoured a 30-40 year lease term:

> ... due to the likelihood of its capacity being reached and the need for a second container port in Victoria.[25]

Avalon 2020 proposed a 25 year lease term based on current locational issues:

> ... we believe this period is far too long as it fails to recognise the port is causing a significant problem in its current location for Melbourne. We believe the maximum period of the lease should be 25 years.[26]

Overall, the Committee considers that 50 years is appropriate. It provides a sufficient term to enable the Port operator to invest in further capacity development, and to provide port services at lower overall supply chain cost. However, the debate about what might constitute maximum achievable capacity at the Port is a very relevant consideration in the context of deciding whether to extend the lease term by a further 20 years, as discussed in the following section.

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22 Ibid., p.22.

23 Mr H Horsfall, Victorian Employers Chamber of Commerce and Industry, *Transcript of Evidence*, 30 September 2015, p.2.

24 Emerald Grain, Submission 24, p.1.

25 Frankston City Council, Submission 51, p.1.

26 Avalon 2020, Submission 75, p.1.

The Government will need to remain focused on planning for the development of a second container port and closely monitor and address transport and logistics issues associated with increasing capacity to minimise the risk that the Port of Melbourne will be unable to meet capacity growth without imposing significant transport, logistics, congestion and environmental costs on the community. This is further discussed in chapter 3.

2.4.2 Exercise of the 20 year lease extension option

Clause 11 of the Bill allows the Government of the day to decide whether to exercise the option of allowing an additional 20 year lease term. DTF explained that this:

> ... provides the State with flexibility to exercise policy levers and manage timing of second container port development and future Port of Melbourne land use. A capacity to grant an additional term of up to 20 years to the private sector future proofs the arrangements and allows the government of the day flexibility.[27]

DTF further explained that the option to extend the lease is to be exercised via a regulation making power:

> The legislation limits the maximum term of any lease or licence of port land to the private sector to 50 years. The legislation also includes a regulation making power to authorise an additional term for all or part of the port lands by up to 20 years beyond the initial 50 year lease.
>
> This regulation making power does not provide for an automatic extension of the lease term, it merely authorises the government of the day to agree a further lease. The commercial terms of any such additional lease term, including any consideration, would need to be negotiated between the government of the day and a leaseholder at the time.[28]

Submissions and hearings focused on two key issues:

- whether the 20 year option was justified
- whether the Parliament rather than the Government of the day should be required to exercise the option to extend the lease.

Appropriateness of the 20 year extension

The Australian Logistics Council sought to clarify the reasons for the 20 year extension:

> Given the nature of the asset, it is appropriate for the lease to be granted for a 50 year period fixed by the legislation, although it is incumbent on the Government to set out the reasons why regulations can be made to extend the life of the lease by an additional 20 years.[29]

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27 Victorian Government, Department of Treasury and Finance, Submission 8, p.21.

28 Ibid., p.12.

29 Australian Logistics Council, Submission 47, p.4.

In its submission, DTF outlined a number of situations which could justify an additional 20 year option namely to allow:

- an orderly and progressive transition of part or all of the port operations to a new second container port location, which is better served through a short extension of all or part of the Port of Melbourne lease, and for which there is little value in competing a short lease extension at the time
- additional time in the event of a force majeure event (eg. catastrophic damage to the asset) to enable the leaseholder and tenants sufficient time to recover and allow a reset of the investment cycle
- strategic flexibility for the State to determine when the second port will be built, particularly in situations where, for example, container growth is slower than expected and a short extension better aligns with physical built capacity being optimised at Port of Melbourne or
- strategic flexibility for the State to determine at the appropriate time in the future what the land use for some or all of the port land will be; if the decision for best use is development of commercial and residential buildings, then the State will not have locked in a longer term arrangement that prevents the option of urban development.[30]

Some submissions supported the lease extension option. For example, VECCI supported the 20 year option on the basis that:

> ... it is made explicit (either through the legislation or lease agreement) that any extension is entirely at the discretion of the State; delivers a clear financial benefit to the State and is linked to port infrastructure investment.[31]

However, a number of other stakeholders questioned the basis for the 20 year option. Infrastructure Partnerships Australia argued that:

> ... the lease option should be removed. Our analysis suggests little taxpayer value in offering a contingent extension. Rather, the lease should be set at circa 50 years reflecting government and opposition support for a medium term (which we understand to be circa 40-50 year) lease.[32]

ANL Container Line questioned the justification for both the decision to offer a 50 year lease and the 20 year extension:

> The decision to offer a 50 year lease has no logical basis other than to maximise revenue as this is well past all forecasts of when the current port will reach capacity. There is also the ability for the Government of the day to extend this by a further 20 years. How can this be justified given all the forecasts are talking full capacity of the Port of Melbourne being reached late 2020's?[33]

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30 Victorian Government, Department of Treasury and Finance, Submission 8, p.21.

31 Victorian Employers Chamber of Commerce and Industry, Submission 78, p.1.

32 Infrastructure Partnerships Australia, Submission 33, p.6.

33 ANL Container Line, Submission 63, p.3.

Parliamentary approval of the 20 year lease option

Both the Australian Peak Shippers Association and Shipping Australia called for there to be parliamentary agreement to extend the lease term beyond 50 years.[34] In particular, Shipping Australia argued that such a possible extension exacerbates its concerns and leaves it open to being used for political advantage.[35]

Bega Cheese also called for '... stipulations to be included in the legislation to ensure that parliamentary approval is required to exercise the proposed twenty year extension'.[36]

In relation to exercising the decision to extend the lease term by 20 years, the Australian Industry Group queried:

> Would the decision be one that is made by Parliament? That is who we would prefer a further decision being made by and not necessarily just by the executive. Any extension, again, must be transparent and in the interests of the State. The very important factor here is that the longer the agreement, the more factors that need to be taken into account in binding a government. There will be many factors arising over the next half a century that we cannot contemplate now, so any extensions of the lease should therefore be something for the Parliament to consider, not just the executive.[37]

While DTF advised that the option to extend the lease term is not expected to be exercised until later in the lease term or in response to the type of situations described earlier, it is possible that the decision to extend could be taken by the Government at any time:

> The regulation to allow for an additional 20 year term can be made by government at any time. However, this is designed to future proof for State needs towards the end of the lease term. This ability to grant an additional term is not expected to be used in the near future for a range of reasons, including it being inconsistent with preserving strategic flexibility.[38]

There appears to be nothing in the legislation that prescribes the timing of this decision or restricts a Government from deciding to extend the term of the lease once the legislation is enacted.

The Committee considers that there is insufficient reason for the Bill to provide for a 20 year extension to the lease by statutory instrument, and considers that any future extension of the lease beyond the proposed 50 year term should be subject to Parliamentary approval.

Accordingly, clause 11 of the Bill should be amended to provide that the lease is for a term of 50 years only.

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34 Australian Peak Shippers Association Inc., Submission 11, p.3; Shipping Australia, Submission 22, p.6.

35 Shipping Australia, Submission 22, p.5.

36 Bega Cheese, Submission 70, p.1.

37 Mr T. Piper, Australian Industry Group, *Transcript of Evidence*, 30 September 2015, p.318.

38 Victorian Government, Department of Treasury and Finance, Submission 8, p.6.

RECOMMENDATION 2: Clause 11 be amended to provide that a lease or licence may be issued for no more than 50 years, and may not be extended. The effect of such an amendment is to require Parliamentary approval via amended legislation if such extension is desired by a future government.

2.5 Regulation making power

In addition to the capacity under clause 11 to grant a 20 year extension to the lease under regulations, the Bill provides for the creation and execution of a range of statutory and administrative instruments.

Clause 72 of the Bill provides that the Governor in Council may make regulations for or with respect to any matter required or permitted in the Act to be prescribed.

As noted in section 2.4.2, a number of stakeholders queried whether the regulations required to give effect to the 20 year extension would in any way be subject to parliamentary scrutiny.

There is scope for statutory rules including regulations to be subject to disallowance by either House of Parliament, pursuant to the *Subordinate Legislation Act 1994*, however those provisions are not contained within the Bill.

It is the Committee's view that, given the range of matters that are yet to be determined in relation to the transaction, along with the broad power under the Bill to make statutory and administrative instruments, it is appropriate that the Bill be amended to provide that either House of Parliament, as-of-right, may disallow any such statutory instruments.

RECOMMENDATION 3: The Bill be amended to allow for the 'as-of-right' disallowance of statutory instruments by either House of Parliament pursuant to section 23(1)(a) and section 25C(1)(a) of the *Subordinate Legislation Act 1994* (Vic).

3 Development of a second container port

3.1 Introduction

The timing and location of a second container port for the Melbourne region was a key issue for many of those who provided evidence to the Committee. The existing Port has a current throughput [2014] of 2.5 million twenty-foot equivalent units (TEU) per annum, based on current operating practices. Under the Port Capacity Project already underway, the Webb Dock redevelopment is expected to add a further 1 million TEU of capacity by 2016-17. The Port of Melbourne Corporation (PoMC) advised the Committee that reports provided to the Corporation estimated the capacity of the Port at 7 to 8 million TEU. PoMC also said that:

> the work around the port capacity project...will drive capacity to around the 5 to 5.5 million, we think that will reach that capacity in the 2035–2045 time frame.[39]

There is some contention as to the ultimate capacity of this infrastructure, with capacity estimates ranging from 5 million TEU to 8 million TEU per year. As discussed in the next section, this capacity is determined by a range of issues including berth sizes and quay line, portside land area, the efficiency of stevedoring practices, the degree of automation and the ability to clear container stacks quickly.

There is no dispute that existing capacity will be fully utilised at some point after 2025. While there is some disagreement as to the pace of growth, there is general agreement that maximum capacity will be reached at some point in the next 50 years as Victoria's population moves towards an expected 10 million people in 2051 and Melbourne's population to an expected 7.7 million.[40]

The two interconnected issues of trade growth and Port capacity were the subject of substantial discussion and evidence before the Committee and are examined in more detail in the next sections.

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39 Mr N. Easy, Port of Melbourne Corporation, Transcript of Evidence, 8 September, p.19.

40 Department of Environment, Land, Water and Planning, State Government of Victoria, *Plan Melbourne Metropolitan Planning Strategy* (2014), p.6.

3.2 Capacity of the existing port

There have been several major studies focusing on the capacity, development and management of the Port of Melbourne over the past decade. The Victorian Government's submission stated that:

> ... the natural container capacity of the port within the existing footprint is consistently estimated to be from 7.0 to 8.0 million TEU per annum, subject to the relevant approvals.[41]

The submission goes on to state that 'the Port of Melbourne's natural container capacity is likely to be exhausted before the end of the 50 year lease term'.[42]

The Victorian Government identified four factors that it considered were relevant to the optimal operating life of the Port, namely:

- expected capacity
- timing, staging, transition to and operation of a second container port
- whether or when possible alternative uses of the Port of Melbourne represent the highest and best use of the land
- whether the Port of Melbourne is required to operate in parallel with a second container port due to capacity constraints at the second port and/or size of the trade demand.[43]

At hearings, the Department of Treasury and Finance (DTF) cited two PoMC reports as further support for its 7 to 8 million TEU capacity estimate – namely the 2006 *Port Development Plan 2006-2035* and the 2009 *Port Development Strategy 2035 Vision*. DTF also referred to 'work performed in the confidential setting of the data room that provides us with sufficient confidence that that is achievable'.[44]

PoMC itself referred to the 2006 and 2009 reports in its evidence to the Committee as plans prepared for the Corporation that 'have a look at the expectations and the assumptions around the growth of trade in the port'.[45]

PoMC's CEO advised the Committee that the current $1.68 billion Port Capacity Project would increase the capacity of the Port to 5.5 million TEU per year. He said that he expected the 5.5 million TEU capacity would be reached in the period 2035 to 2045.[46] He also added that 'work done by the Corporation under previous plans' supported a capacity of 7 to 8 million TEUs however:

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41 Victorian Government, Department of Treasury and Finance, Submission 8, p.6.

42 Ibid.

43 Victorian Government, Department of Treasury and Finance, Submission 8, p.19.

44 Mr N. Rizos, Department of Treasury and Finance, Transcript of Evidence, 8 September 2015, p.10.

45 Mr N. Easy, Port of Melbourne Corporation, Transcript of Evidence, 8 September 2015, p.17.

46 Ibid., p.19.

to support that growth it is not only about investment in the terminal facilities, it is not only about investment on internal roads and infrastructure within the port, but it assumes that the operator, and like the port does today, will work with the State and the agencies to ensure the access is appropriate into the port.[47]

A number of submitters questioned this level of capacity. Table 3.1 sets out the views of several submitters who told the Committee that the capacity of the existing port (including the new Webb Dock terminal) is closer to 5 million TEU.

Table 3.1 Submitter views on ultimate Port of Melbourne capacity

Submitter	Estimate of capacity (TEU)	Limiting factors
Institute for Supply Chain and Logistics[(a)]	5.0 to 5.5 million	Length of quay line Area of landside
DP World[(b)]	5.0 to 5.5 million	Technology Available land area for container storage
Captain Richard Cox, former Harbour Master of Western Port[(c)]	'just over 4 million TEU'	Dock access Ship size Quay line productivity Available land
Mr Sandy Galbraith, international maritime consultant[(d)]	4.5 to 5.5 million	Landside reinforcement needed Higher container stacks needed Bass Strait trade would need to be relocated

(a) Mr P. van Duyn, Institute for Supply Chain and Logistics, Victoria University, Transcript of Evidence, 8 September 2015, p.32.

(b) Mr P. Scurrah, DP World, Transcript of Evidence, 14 October 2015, p.46.

(c) Capt. R. Cox, Transcript of Evidence, 28 October 2015, pp.17-18.

(d) Mr S. Galbraith, Maritime Trade Intelligence, Transcript of Evidence, 28 October 2015, p.32.

These issues are discussed in more detail in section 3.4 below.

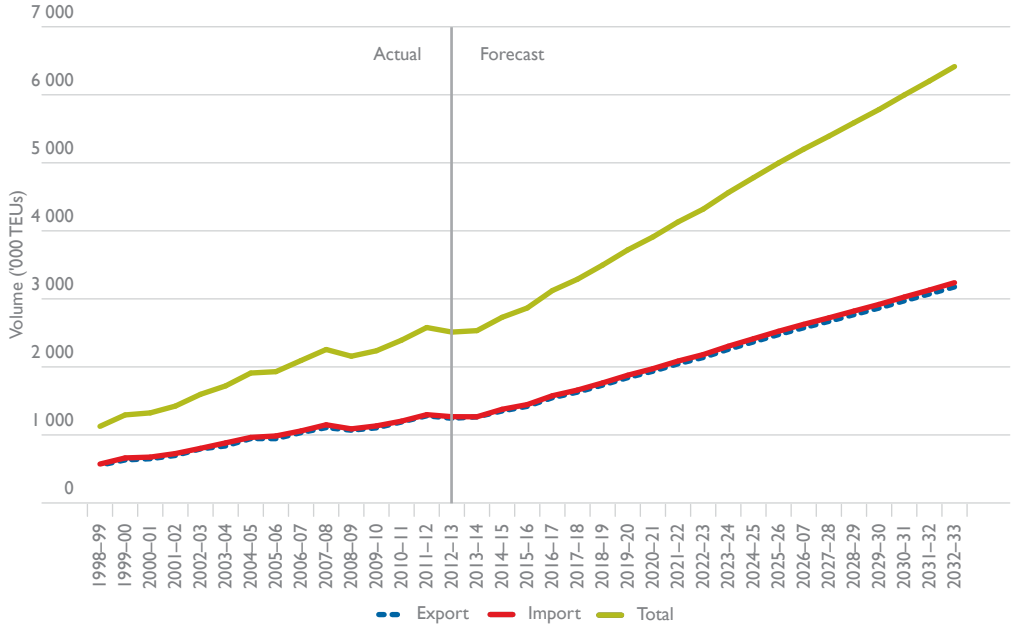
3.3 Trade growth

Expected trade growth is a key factor in the projected need for a second container port in Victoria. There is no dispute that Melbourne and its hinterland are growing rapidly, and that population growth is driving increasing import container trade, dominated by imports from China. The Commonwealth Bureau of Infrastructure, Transport and Regional Economics (BITRE) forecasts that container trade through the Port of Melbourne will grow each year by 4.8 per cent to 2032.[48]

47 Ibid., p.19.

48 Bureau of Infrastructure, Transport and Regional Economics, Department of Infrastructure and Regional Development, *Containerised and non-containerised trade through Australian ports to 2032-33*, Research Report No 138 (2014), p.45.

Figure 3.1 Port of Melbourne container trade



Source: Bureau of Infrastructure, Transport and Regional Economics, Department of Infrastructure and Regional Development, *Containerised and non-containerised trade through Australian ports to 2032-33*, Research Report No 138 (2014).

The Victorian Government submission refers to growth of Victoria's population from 5.5 million in 2011 to an expected 10 million in 2051 as promoting 'a commensurate increase in the demand for goods'.[49] However, it also notes the 'inherent uncertainty as to how trade growth might manifest'.

PoMC's 2006 *Port Development Plan 2006-2035* states that the most likely growth figures are as follows:

Table 3.2 2006 Port development plan forecast trade growth

Year	Compound annual growth rate (%)	Million TEU
2015	5.6	2,062
2025	5.1	4,466
2035	4.7	7,057

Source: Port of Melbourne Corporation, *Port Development Plan 2006-2035* (2006), section 5.2, p 28.

PoMC maintained these forecasts in the 2009 *Port Development Strategy 2035 Vision*.[50] PoMC provided little further explanation of its expectations around forecast growth except to say that the Global Financial Crisis had affected short term revenue, however this was not expected to affect its long term ability to meet its objectives.[51] The Committee is surprised that the Government would rely on 10 year old forecasts to support its decision around the future of the Port.

49 Victorian Government, Department of Treasury and Finance, Submission 8, p.23.

50 Port of Melbourne Corporation, *Port Development Plan 2006 - 2035: Consultation Draft* (2009), p.11.

51 Ibid.

Despite the importance of this issue, very little information was put to the Committee on expected trade growth. The Institute for Supply Chain and Logistics submitted that its discussions with industry suggest that a growth rate closer to 3-4 per cent is more realistic for the Port, compared to 6 per cent.[52] The Institute's view is that a second container port would be needed between 2026 and 2034 if the 6 per cent growth rate was realised, or between 2038 and 2050 if the growth rate was 3 per cent.[53]

More recent authoritative forecasts on the likely growth of international container trade at the Port of Melbourne are contained in the December 2014 BITRE Report, which covers a broadly similar period to PoMC's Port Development Plans.[54] The following table compares the Port of Melbourne 2006-2009 figures with those in the December 2014 BITRE Report:

Table 3.3 **Comparison of PoMC and BITRE forecast international container trade**

	Port of Melbourne/DTF (million TEU)	BITRE (million TEU)
2015	2,062	2,729
2025	4,466	4,562
2033	n/a	6,415
2035	7,057	n/a

Source: Port of Melbourne Corporation, *Port Development Plan 2006-2035* (2006), section 5.2, p 28; Bureau of Infrastructure, Transport and Regional Economics, Department of Infrastructure and Regional Development, *Containerised and non-containerised trade through Australian ports to 2032-33*, Research Report No 138 (2014).

BITRE expects the compound annual growth rate for international containers over the period to be 4.8 per cent,[55] compared to PoMC's figures of 5.1 per cent for 2015-25 and 4.7 per cent for 2025-35.

3.4 Other factors affecting port capacity

The Committee received evidence of other factors that would be likely to affect the capacity and useful life of the Port. These factors included:

- landside space and available quay line
- landside logistics
- automation, technology and work practices and
- the ability to handle larger vessels.

52 Dr H. Parsons, Institute for Supply Chain and Logistics, Victoria University, Transcript of Evidence, 8 September 2015, p.31.

53 Ibid.

54 Bureau of Infrastructure, Transport and Regional Economics, Department of Infrastructure and Regional Development, *Containerised and non-containerised trade through Australian ports to 2032-33*, Research Report No 138 (2014).

55 Ibid., p.28.

3.4.1 Landside space and available quay line

The Institute for Supply Chain and Logistics submitted that international benchmarking of the available landside space and quay line suggested that the capacity of the Port could be around 5.5 million TEU per year. The Institute for Supply Chain and Logistics told the Committee that:

> quay line... is where the ships berth and it is internationally accepted that you can do about 2,200 TEU per metre of quay line per annum. Currently, including the new Webb Dock, we will have 2,500 metres of quay line. Multiply that by 2 200, it is about 5.5 million. That we think is roughly about the capacity. Yard space is a little bit different. That is the area behind the berth — 40,000 TEU throughput per hectare per annum. We have about 120 hectares, again including Webb Dock. Multiply that, and you get to again 5 million.[56]

3.4.2 Landside logistics

While the number, size, depth and length of berths are critical factors in determining port capacity, they must be complemented by the efficient handling of containers on the wharf and their prompt handling and transport to or from trucks or trains. Poor landside logistics can reduce the effective capacity of a port significantly. Logistic deficiencies often reflect ageing technology and/or inadequate investment in loading facilities, straddles, or road or rail transhipment capacity.

A number of submitters referred to Port Botany's improved efficiency in recent years arising from the large intermodal facility at Moorebank that has allowed more rapid movement of containers from the portside area.

The Victorian Government recognised the importance of landside logistics:

> Efficiently moving traffic and freight is [an] important factor in the Victorian economy, industry and supply chain...the State retains the ability and responsibility to manage landside issues as and when they arise.[57]

While its submission provides few details on this matter, it does state some basic principles:

- the State is considering a range of projects for road network enhancements
- the State will be preserving rail modal outcomes through maintaining planning controls over existing rail corridors
- bidders will be required to maintain PoMC currently owned rail assets
- bidders will be required to pursue a rail modal outcome.[58]

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56 Mr P. van Duyn, Institute for Supply Chain and Logistics, Victoria University, Transcript of Evidence, 8 September 2015, p.32.

57 Victorian Government, Department of Treasury and Finance, Submission 8, p.31.

58 Ibid.

The Secretary of the Department of Economic Development, Jobs, Transport and Resources also emphasised the importance of landside links:

> Much of the port's success is built on the quality of the road and rail links that connect the port to the city and beyond the city. In that respect, as you have been previously apprised, Melbourne enjoys a very strong competitive advantage over other Australian ports. We have a relatively congestion-free network and direct road links, which contrasts strongly with, for example and in particular, the Port of Botany. Road links such as the M80, M1 and City Link do connect the port effectively to our key freight-generating areas, and the port also has multiple points of connection to the standard and broad gauge rail networks. In addition to our role in overseeing the leaseholder, assuming the transaction proceeds, our focus is going to be on the landside links.[59]

However, a number of logistics industry submitters were critical of the adequacy of landside logistics. For example, Qube Holdings submitted that:

> We have been a big advocate for years of rail in and out of the port. We are doing a lot of intermodal rail work in Sydney. We are handling 300,000 TEUs on metro intermodal in Sydney, and quite frankly we have given up in Victoria. We have exited the Somerton intermodal terminal on 30 June 2015 essentially because no-one in the Port of Melbourne Corporation is really focused on metropolitan intermodal rail. There has been no government drive for that.[60]

Similarly, Salta Properties submitted that poor landside logistics and in particular poor rail access would limit the Port's capacity:

> The existing road-based system limits the capacity of Swanson Dock to 2.9 million TEU. That is not to be confused with berth capacity, but if you have a higher berth capacity, you need the landside capacity to match the berth capacity. At the moment ... the landside capacity lags the berth capacity of the port.[61]

3.4.3 Automation, technology and work practices

Port capacity is also significantly influenced by the degree of automation and the efficiency of work practices and container handling on the dock.

Mr Maurice James of Qube Holdings, who for over 12 years managed the Patrick Stevedores container handling operation, provided examples of how a move from medium density container stacking to high density container stacking could improve efficiency at Swanson Dock:

> ... I have a very good understanding of capacity of container terminals and no-one can really give you a specific figure around container terminal capacity. As technology is advancing, that number is constantly changing, so you can look around the world and look at international benchmarks that will tell you it is so much per metre of quay line, or you can look at it and say that it is based on area constraints

59 Mr R. Bolt, Department of Economic Development, Jobs, Transport and Resources, Transcript of Evidence, 30 September 2015, p.517

60 Mr M. James, Qube Holdings, Transcript of Evidence, 30 September 2015, p.468

61 Mr S. Tarascio, Salta Properties, Transcript of Evidence, 9 September 2015, p.141.

> so it is so much per hectare, but I certainly know that our container terminals here in Melbourne are what I would call medium density type stacking terminals; they are not high density stacking terminals. There is certainly scope at Swanson Dock to introduce high density stacking, which is what is proposed to go into Webb Dock, and increase the capacity of the port significantly.[62]

3.4.4 Ability to handle larger vessels

The increasing size of container ships is, in the opinion of many shipping experts, a key driver for the planning of a second container port. Container ships have continued to increase in size worldwide over the past years, and there has been a trend to 'cascade'[63] vessels to the Australian trade as they are replaced on the world's busiest container routes that operate east-west from China to North America and Europe.

Swanson Dock is a river terminal on a relatively narrow waterway. It is constrained by the depth of the river, the size of the turning basin at the mouth of Swanson Dock, and the clearance or air draught of vessels under the West Gate Bridge. Both Swanson Dock and the new Webb Dock development at the river mouth are in turn constrained by the depth of the entrance to Port Phillip Bay and the depth and breadth of Port Phillip shipping channels. Currently, the largest vessels that can enter the heads are around 8,500 TEU capacity. However, the Committee was advised that such vessels cannot be fully laden and can only do so under certain tides.

Although some submitters questioned whether vessels beyond the present maximum of 8,500 TEU or more would ever come to Victoria, others thought that such vessels would come. For example, ANL Container Line told the Committee that:

> The Port of Melbourne needs to be prepared for the big ships coming in, because they will be coming in. It is either that or they will potentially lose volume to other ports.[64]

This is a significant issue for the future, since Melbourne needs to be able to cater for the largest vessels servicing the Australian run. Otherwise, in future some vessels may bypass Melbourne and visit other Australian ports instead. Sydney can cater already at selected berths in Port Botany for vessels of 10,000 TEU capacity. Further, the new port to be opened for London at Tilbury is designed for vessels of 18,500 TEU.

Figure 3.2 was tendered in evidence to the Committee from the Institute for Supply Chain and Logistics. The circle represents typical ship size today, while the star indicates the largest vessel size that can currently use the Port of Melbourne – with 14.5 metre draught. All the ships in the top row can be

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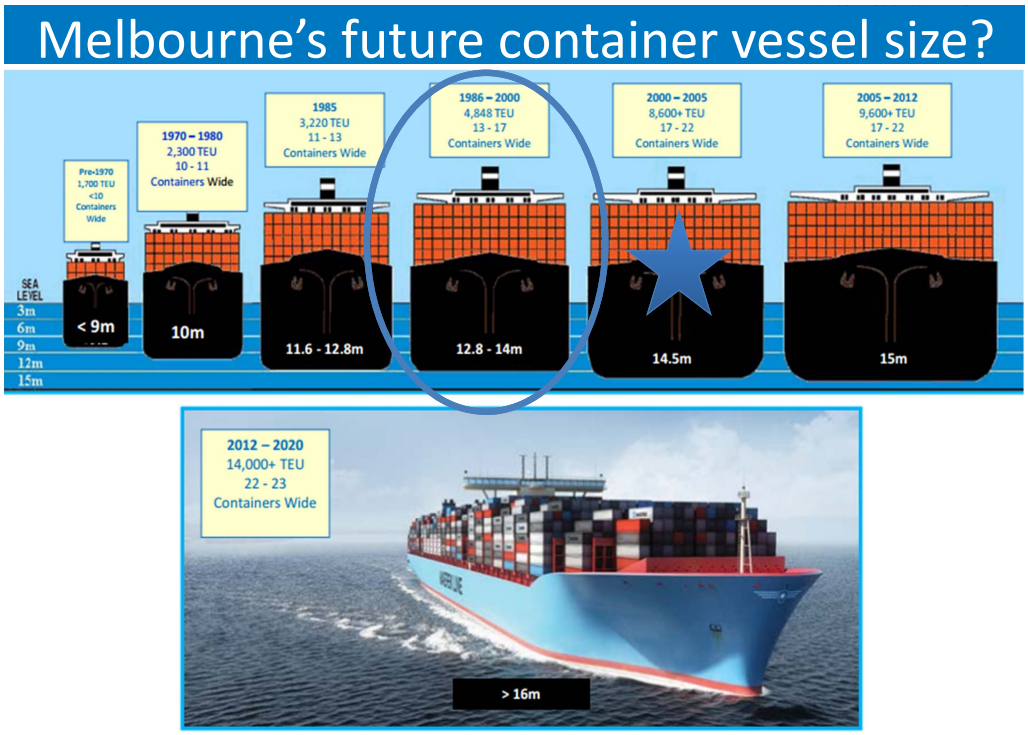
62 Mr M. James, Qube Holdings, Transcript of Evidence, 30 September 2015, p.466.

63 The term 'cascade' is used to describe the practice whereby older and smaller vessels are relegated to lesser roles as larger and more modern vessels are introduced on the massive east west trade routes from China.

64 Mr N. Dent, ANL Container Line, Transcript of Evidence, 14 October 2015, p.478.

accommodated in Port Botany. However, the 15 metre and 16 metre draught vessels are too large for Melbourne's existing port.[65] The majority of the ships currently using the Port are 4,000 to 5,000 TEU.[66]

Figure 3.2 **Current and future shipping dimensions and capacity**



Source: Institute for Supply Chain and Logistics, Victoria University, Submission 66, Attachment 1.

The impact of larger vessels is an independent factor driving the future need for a second container port in Melbourne that is outside the control of the current lease negotiations. Regardless of the terms of the lease, Victoria may find itself having to build a second container port to meet the requirements of larger ships, irrespective of whether the Port of Melbourne continues to operate at the present site for a further 50 to 70 years.

In its submission, the Victorian Government referred to risk allocation issues associated with the Port Growth Regime (PGR), and asserted that 'the State has full control over [the decision to build the second port]' and 'the State is better able to manage the uncertainty of a second port impacting the leaseholder'.[67] However, the State does not control the future decisions of shipping lines to use larger ships, nor does it control the decisions of competing ports to provide larger berths. These factors may drive the need to provide a second container port well before the Port of Melbourne reaches capacity.

65 Institute for Supply Chain and Logistics, Victoria University, Submission 66, Presentation.

66 Mr N. Easy, Port of Melbourne Corporation, Transcript of Evidence, 8 September 2015, p.17

67 Victorian Government, Department of Treasury and Finance, Submission 8, p.26.

The Victorian Government describes its proposed PGR as a mechanism that will allow this to be managed since 'PGR payments will be made where a State sponsored second port derives revenues from international container throughput which is otherwise capable of being handled at the Port of Melbourne'.[68] This issue is discussed in more detail in Chapter 7.

Submitters suggested that if the State does need to build a second port to cater to increased vessel size, it is likely that the second port will attract the remaining available international container trade from the Port of Melbourne.

The Committee heard evidence that shipping lines prefer to service a single container port in a region, and that container ships would not call at more than one port in Victoria.[69]

It is also likely that the development of a second port to handle bigger ships would come with state of the art planning, transport connections, buffering, and logistics parks. This may prompt some users to transfer their trade to the new facility.

The Victorian Government submission did not further assess this issue. PoMC expressed the view that while vessels of 5,000 to 8,000 TEU would service Melbourne, 18,000-20,000 TEU vessels would not come to Melbourne because of the size of Australia's population and the limits of infrastructure around Australia, not just Melbourne.[70]

The Institute for Supply Chain and Logistics noted that the largest ships currently visiting Swanson Dock can only use the turning basin during daylight hours, and that berth length prevents two of the largest ships currently visiting from being simultaneously unloaded. It also submitted that it is reasonable to expect that post-Panamax ships of 10,000 TEU will come to Australia.[71]

The Committee is disappointed by the Victorian Government's cursory treatment of this issue, and the relatively limited information supplied.

Evidence received by the Committee varied widely as to the potential capacity of the Port of Melbourne over the life of the lease. Estimates ranging from 5 million TEU to 8 million TEU, highlight the uncertainty of this key metric. This level of uncertainty reinforces the need to maintain maximum flexibility in planning and providing future Port capacity after the proposed lease.

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68 Ibid.

69 See for example, Mr M. Dowling, Riordan Grains Group, Transcript of Evidence, 24 September 2015, p.178.

70 Mr N. Easy, Port of Melbourne Corporation, Transcript of Evidence, 8 September 2015, p.19.

71 Mr P. van Duyn, Institute for Supply Chain and Logistics, Victoria University, Transcript of Evidence, 8 September 2015, p.32.

3.5 Options for providing extra container capacity

The Committee heard that there are several ways to provide the new container capacity that will be needed to serve Melbourne. Examples include:

- **enhance existing Port capacity through new technology or work practices** – for example, advocates of the Port Rail Shuttle told the Committee that the more efficient removal of containers by rail to distributed intermodal terminals could extend the life of the Port by up to eight years. This would delay rather than displace the need for a second container port.
- **develop a second container port to accommodate incremental growth in container trade while leaving the existing port in operation** – such a development might be needed if shipping lines introduced ships larger than 8,500 TEU as these would be too large to enter Swanson Dock. A variation on this approach was suggested by Captain Richard Cox, who argued that there could be a case for the co-existence of three ports: one around Geelong, for bulk trade; Hastings for container trade, and the Port of Melbourne.[72]
- **develop a second replacement container port on a 'greenfield' site away from the existing port to take all container traffic in and out of Melbourne** – a greenfield port development could be designed with modern landside road and rail connections, automated technology, wide buffer zones against urban encroachment, connections to air freight and an associated logistics park. If it replaced much of the present Port of Melbourne, the Port land could be recycled to new uses such as housing and open space, and allow for negative aspects of port use, such as traffic congestion and air pollution in central Melbourne, to be reduced.[73]
- **port expansion in Melbourne could be restrained by diverting imports and exports to other ports** – this could occur either by interstate container ports coming on stream or back on stream, or via land-bridging (transferring containers by road or rail to or from other ports). There is already a degree of contestability with regard to exported primary produce from the Riverina and southern New South Wales, where some trade has been diverted from Melbourne to Port Botany. Other land bridging could occur via the proposed Melbourne to Brisbane inland railway or even via rail land-bridging to Darwin. Melbourne has already lost some traffic to Adelaide, while Tasmania has several small container ports that could be re-energised.[74] The extent to which port traffic is diverted will depend to some extent on the Port operator's commercial success, its investments in productive capacity, and the State's investments in productive transport infrastructure. Contestability is more likely with respect to container exports than imports, given that 80 per cent of import containers that arrive at the Port are destined for Greater Melbourne.

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72 Capt R. Cox, Transcript of Evidence, 28 October 2015, p.16.

73 Mr M. Dowling, Riordan Grains Group, Transcript of Evidence, 24 September 2015, pp.177-178.

74 Mr A. Garcia, Infrastructure Tasmania, Transcript of Evidence, 13 October 2015, p.8 referred to some container capacity at Burnie, Devonport, Bell Bay and Hobart.

3.6 Timing of a second container port

There is considerable uncertainty as to the urgency and timing of a second container port. Shipping line representatives and the Institute for Supply Chain and Logistics expect a second port will be required in about 10 to 15 years, while the Victorian Government expects it to be required 'before the end of the 50-year lease term'.[75]

Table 3.4 summarises the differences in expectations as to when a second container port will be needed, as well as differences as to the key drivers. The most common expectation is around 2035.

Table 3.4 Timing expectations for a second container port

Submitter	Expected need for second port	Drivers for second port
Victorian Government, Department of Treasury and Finance	'before the end of the 50 year lease term'	Lowest cost incremental port capacity development[(a)] Advice that 'there is greater value to the State to incentivise ongoing investment in brownfield capacity at the Port of Melbourne'[(b)]
Port of Melbourne Corporation[(c)]	2035-2045	Population and trade growth, climatic conditions, and level of investment by stevedores
Institute for Supply Chain and Logistics[(d)]	15-20 or 20-25 years 2026-2034 at 6% 2038-2050 at 3%	Trade growth
ANL Container Line[(e)]	10-15 years 2025-2030	Vessel size compared to physical limitations of the Port
Customs Brokers and Forwarders Council of Australia[(f)]	2035	Trade growth

(a) Victorian Government, Department of Treasury and Finance, Submission 8, p.24.

(b) Ibid., p.25.

(c) Mr N. Easy, Port of Melbourne Corporation, Transcript of Evidence, 8 September 2015, p.19.

(d) Dr H. Parsons, Institute for Supply Chain and Logistics, Victoria University, Transcript of Evidence, 8 September 2015, p.31.

(e) Mr D. Munro, ANL Container Line, Transcript of Evidence, 14 October 2015, p.477.

(f) Customs Brokers and Forwarders Council of Australia, Submission 13, p.12.

There is scope for investment in improved technology and work practices to extend the capacity of the present port, and for there to be some loss of trade to interstate container ports as they become more competitive and efficient. However, none of these developments will remove the need for a second container port in Victoria at some point, driven by increased population and trade, and the need to accommodate vessels too large for the present port.

Most submitters agree that a second container port of some kind will be needed before the end of the lease term. There is disagreement as to how soon, with the earliest suggestion being 2025 and the most common around 2035.

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75 Victorian Government, Department of Treasury and Finance, Submission 8, p.24.

3.7 Implications for the Port of Melbourne lease

This section examines the implications for the Port of Melbourne lease of a second container port.

3.7.1 Port capacity

The capacity of the existing port may be somewhat less than the 'natural capacity' of 7 to 8 million TEU referenced by the Government. If it is substantially less, the second port will need to come on stream well within the life of the lease. The implications are that:

- the compensation scheme, if retained, should not be onerous or constrain government's strategic flexibility
- the compensation scheme, if retained, should be designed to avoid a stream of payments for the life of the lease
- the expected capacity requires the lessee and the stevedores to work efficiently and invest in port technology. The five-yearly Port Development Plans required in the lease are important and must be studied by future governments. The incentives to invest in the lease package are important if potential capacity of the existing port is to be realised
- the capacity of the Port will be enhanced by more use of rail. The current requirements in the transaction for a rail modal share to be bid are weak, and the delay in implementing the Port Rail Shuttle exacerbates this weakness. Stronger incentive to commit to rail is essential
- planning for the new port may need to begin soon; if it is the case, as submitters have suggested, that a ten year lead time is needed, planning and the reservation of land will need to commence in the next 5 to 10 years.

3.7.2 Trade growth

The figures for container trade growth advanced by the Government appear reasonable. It should not be necessary to adjust the lease for a higher or lower than expected trade growth.

3.7.3 The impact of larger vessels

The advent of larger vessels that cannot access the existing port easily or at all has been forecast by several shipping experts appearing before the Committee. This is a matter outside the control of the Government or the lessee. It may require the Government to bring forward the provision of a second container port. A mechanism that exempts the Government in whole or in part from the compensation scheme in this event should be incorporated in the transaction.

4 Competitiveness of the Port of Melbourne, supply chains and cost effects

4.1 Introduction

The Port of Melbourne has long been and remains a critical state asset for Victoria, and a driver of the State's economic success. For many years, it has been Australia's largest and most successful container port. Extensive logistics, warehousing and transport industries and supply chains have developed around the Port. These supply and distribution chains extend into the neighbouring states of New South Wales, South Australia and Tasmania.

This economic powerhouse has thrived because of its competitiveness and efficiency. In considering the proposed lease transaction, it is vital to consider the Port's current competitiveness, supply chain and cost issues. The transaction should not weaken the Port's competitive position, impose undue costs on the Victorian economy and community, nor lead to the progressive loss of trade to competing ports.

The Committee heard evidence as to the current strength of the Port, the importance of Port capacity improvements currently in progress, and of related road and rail transport chains that support or could support port efficiency. However, some stakeholders told the Committee that Melbourne was losing some contestable trade, partly due to aggressive competition from recently privatised ports elsewhere, especially Port Botany. There was also evidence that Victoria is lagging in the development of needed transport infrastructure, such as a metropolitan intermodal system supported by a port rail shuttle.

The Committee believes that in this economic climate, the transaction must promote the efficiency of the Port. It is not sufficient for Government to leave necessary improvements to transport infrastructure to be resolved down the track. Once the Port is privatised, the Government's scope to act will be constrained. The economic importance of the Port is such that these issues cannot be dismissed or left to chance.

4.2 The Port of Melbourne's competitive advantages

The Port of Melbourne's current competitive advantage derives from history, geography, the distribution of primary exporting industries, as well as effective management and cost containment over many years.

The historical advantages of the Port arise from Victoria's past economic strengths, which allowed the Port to be developed as an effective port through extensive engineering projects. These projects included the redirecting of the Yarra River through Coode Canal (and the creation of Coode Island), as well as the creation of Victoria and Appleton Docks as wholly engineered and man-made harbours close to the city, industry, and the transport network. The footprint then obtained by the Port provided for the adjacent development of Swanson Dock as Australia's first modern container port in 1969, still close to the city; warehousing and logistics industries; road and rail networks; and vibrant exporting industries, importers and consumers.

Victoria also developed a superior transport network. Victorian highways were sealed and developed from the 1920s before those of adjoining states. Additionally, the Victorian broad gauge rail network extended into the flat Riverina lands at several points, including Deniliquin, Balranald and Oaklands, bringing New South Wales export products through the Port of Melbourne instead of through Sydney. Two of these rail routes continue today, with rice from Deniliquin still delivered by rail to the Port as well as grain from Oaklands.

Standardisation of the north eastern rail network and the introduction of competitive private rail operators has strengthened the flow of products such as wine and grain to Melbourne from new and important catchments, such as the Griffith region. However, these are now contested markets, from which goods can equally flow to Sydney.

Until recently, geographical constraints helped this trade flow to Melbourne, as road and rail routes into the Sydney basin involved many steep curves and hills, and the congested road and rail networks there slowed journeys.

4.3 Threats to the Port of Melbourne's competitiveness

Today, the Port of Melbourne faces potential competition from New South Wales and South Australia.

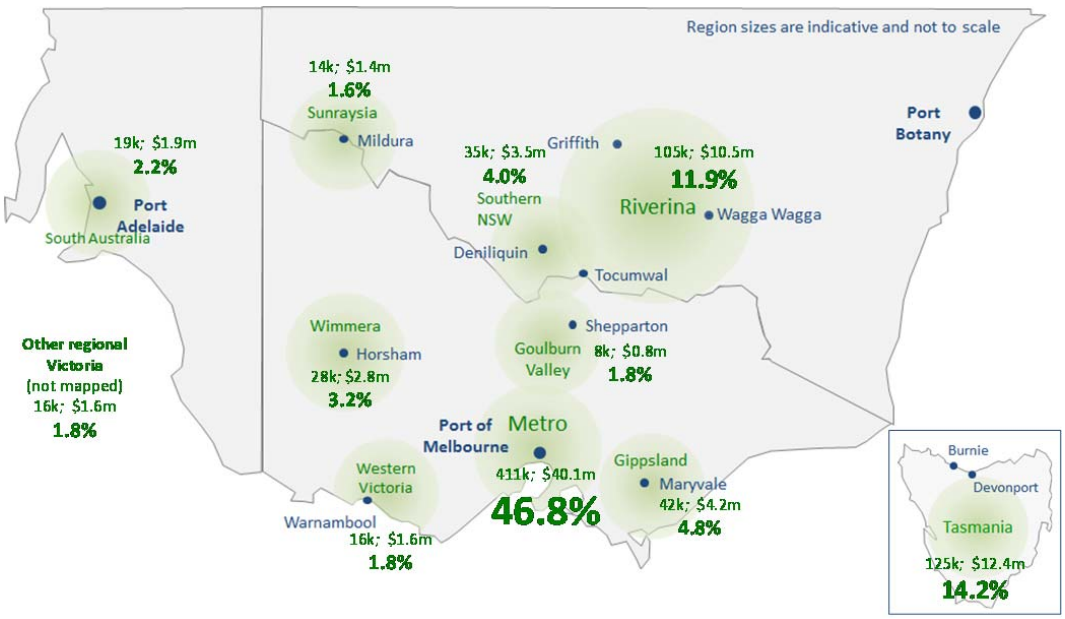
The prospect of increased competition from New South Wales is most significant, driven by four key developments:

- the duplication of the Hume Highway and freeway network from the Riverina into Port Botany – which was completed in 2013, after 30 years of projects
- the upgraded New South Wales rail link from the Riverina to Port Botany. In 2004 the Australian Rail Track Corporation commenced a 60 year lease of the line from the New South Wales Government and it has since invested $186 million in the line. A further $1 billion has been invested in the 36km South Sydney Freight line from Macarthur to Sefton, which also opened in 2013, allowing freight trains to and from the Riverina to bypass passenger trains to reach the Port and to avoid consequent delays

- a major new intermodal terminal with a capacity of 1.05 million twenty-foot equivalent units (TEU) is being created on a 220 hectare site at Moorebank, near Liverpool, served by a port rail shuttle that enables containers to move quickly by rail into and out of congested areas around the Port. The site is adjacent to the South Sydney Freight Line, the interstate rail line to the south, and the M5 and M7 freeways. The company created by the Government to manage the project describes Sydney as 'Australia's most important port'; and the New South Wales Government has set a target to double the 14 per cent of containers now moved from the Port by rail
- in 2013, the New South Wales Government sold both Port Botany and Port Kembla to NSW Ports. Since then, NSW Ports has sought to modernise its ports and has become a strong competitor for contestable trade.

Figure 4.1 shows the percentage of the Port of Melbourne Corporation (PoMC)'s export revenue received from various catchment areas. In particular, it highlights that around 16 per cent of PoMC's export trade originates in New South Wales.[76] This trade can now reach Sydney by duplicated highways and a direct rail link. Similarly, import containers destined for this catchment will clear Port Botany via its intermodal hub for prompt delivery.

Figure 4.1 **The Port of Melbourne's trade catchment areas[77] – export volumes (TEU), revenue for 2013-14 and relative proportion of total export volume**



Source: Port of Melbourne Corporation 2015 (as provided by the Victorian Government, Department of Treasury and Finance, Submission 8, p.34).

The figure also notes that a further 14.2 per cent of the Port's export trade originates from Tasmania. Tasmania has some container handling capacity at Burnie, Devonport, Bell Bay and Hobart, but currently, the Port of Melbourne

76 Victorian Government, Department of Treasury and Finance, Submission 8, p.34.

77 Ibid.

dominates its export container trade.[78] South Australia also contributes 2.2 per cent of export containers. All of these revenue streams are now contestable to some extent.

Contestability is not restricted to neighbouring states or to exports. In the case of imports, many retailers and distributors operate on a nationwide basis, and make commercial choices about where to locate their distribution centres. These are often connected by long haul trucks to distant markets. The Port's competitiveness will continue to be an important factor when firms make location decisions for these centres and related supply chains. This is an issue of importance to the whole Victorian economy, not just to the future lessee.

4.4 Transport links and supply chains

The efficiency of road and rail transport links is a vital factor in the value of the Port to any future bidder. Likewise, it is a key issue when considering the future relationship of the Port to its surrounding economy and community. In this regard, it is notable that the New South Wales Government has been investing heavily in road and rail infrastructure to support Port Botany, whereas in Victoria, a number of significant challenges remain in transport infrastructure surrounding the Port. These challenges include:

- unresolved issues in relation to the proposed Transurban Western Distributor and/or the Government's proposed West Gate Distributor (WGD)
- continued heavy levels of port related truck traffic through suburban streets in Maribyrnong
- uncertainty regarding the Metropolitan Intermodal System and the Port Rail Shuttle
- very limited use of on-dock rail
- the lack of a rail connection or plan for a rail connection to Webb Dock.

Many submitters were concerned that failing to address these issues in a timely way would compromise the new Port operator's ability to cater to the projected doubling or tripling of the Port's throughput.

4.4.1 Road transport links to the Port

The Victorian Government's submission to the Committee states that:

- the State retains the ability and responsibility to manage landside issues as and when they arise...
- ...[the State] is currently considering a range of projects for road network enhancements to address traffic movements on city roads

78 Mr A. Garcia, Infrastructure Tasmania, *Transcript of Evidence*, 13 October 2015, p.8.

- Although port-related traffic on the broader transport network is a very small proportion of overall traffic, it is recognised there may be localised near-port impacts around the Port of Melbourne.[79]

The Committee is concerned that these general statements suggest that the Government does not have a clear port related transport strategy. The Committee would be more willing to accept the proposition that the State can manage transport issues as and when they arise, if it had been provided with a comprehensive plan for handling port related traffic. However, it has not been provided with such a plan despite explicitly asking for this.

If the Government intends to 'warrant' the Port expanding to up to triple its present capacity, it should be able to indicate, in general terms, how that amount of traffic will be handled. Stating that there are freeways nearby is not an adequate response since several of those freeways are already at or near capacity, particularly during peak times.

Further, the Committee regards as misleading the argument that port related traffic is a small proportion of the whole State's traffic and hence, is unlikely to have a significant impact. Evidence received from a number of witnesses highlighted that port related truck traffic in the immediate vicinity of the Port was of considerable concern to local communities from a congestion, environmental, and health perspective. Noting the Government's view that the Port has the capacity to handle approximately three times its current throughput of containers, reducing the local impact of truck movements will be critical.

4.4.2 Rail links to the Port

The Victorian Government's submission concerning rail links to the Port states that:

- ...the State will be preserving rail modal outcomes through maintaining planning controls over existing rail corridors for any future needs (eg. Webb Dock Rail)...
- ...[the State will be] requiring the leaseholder to maintain PoMC currently owned rail assets
- Bidders will... be required to pursue a rail modal outcome as agreed with the State.[80]

As with road transport issues, these propositions are not specific. The Committee considers it will be important to plan for the transport (and especially rail transport) requirements of the Port in a pro-active manner, as has been the case in New South Wales.

The first issue above concerns the maintenance of planning controls over rail corridors such as the former Webb Dock rail corridor. This is an important issue. The present Webb Dock rail corridor opened in 1986 and is not connected nor readily able to be connected to the rail network.

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79 Victorian Government, Department of Treasury and Finance, Submission 8, p.31.

80 Ibid.

The second issue above concerns a requirement for the leaseholder to maintain PoMC currently owned rail assets. This proposition suggests that such assets should be kept on a care and maintenance basis. There is no suggestion that they should be used for the purpose of transporting freight or reducing the road freight task.

The third issue concerns a requirement that the leaseholder should 'agree a rail modal outcome with government'. This requirement, which the Government proposes to require through contract rather than legislation, is vague and provides no assurance that improved rail connections to the Port will be achieved.

4.4.3 The Port Rail Shuttle

Several witnesses told the Committee that a significant strength of the Port of Melbourne is its central location. It is close to the CBD, relatively close to the bases of many freight forwarders, logistics companies and importers, and at the centre of radial freeway and rail networks.

However, there are corresponding weaknesses. The Port is close to the centre of the city and is surrounded by residential real estate that limits the land available for off-dock port related uses like warehousing, distribution and container parks. Its proximity to residential neighbourhoods means there is strong resistance to heavy port-related truck traffic on residential streets both east and west of the Port. Further, the Port's central position relative to the road network means port related freight must compete for road space on a freeway network approaching capacity in several directions.

A system of shuttle trains to ferry containers to three inland ports on the edges of Melbourne at Altona, Somerton and Lyndhurst has been proposed for nearly two decades as a means of overcoming these problems. This approach was formerly known as the Metropolitan Intermodal System and is often referred to as the Port Rail Shuttle project. This solution has received support from all political parties, and both public and private investment has brought the project close to completion. As part of the project, the Government constructed the Footscray Road grade separation at a cost of $350 million.

The Port Rail Shuttle concept involves moving containers from the Port by rail to terminals at Altona, Somerton and Lyndhurst. This would greatly reduce truck traffic around the port precincts and adjacent residential areas, an important goal if the Port is to grow to twice or three times its present size. The Metropolitan Intermodal Rail Terminal (MIRT) is the principal infrastructure required to complete the Port Rail Shuttle system.

The three inland terminals have been created through private investment. Completion requires construction of a terminal at Swanson Dock at an existing but disused rail siding, as well as the construction of rail spurs into the terminals from existing lines at Somerton and Lyndhurst. Altona is already connected.

Figure 4.2 The Port Rail Shuttle proposal and related terminals

Source: Department of Transport, Planning and Local Infrastructure, *Port Rail Shuttle Project Outline* (2014), p.5. See Mr S. Tarascio, *Transcript of Evidence*, 9 September 2015, p.150

The State Budget currently sets aside $58 million funding to complete the project – comprising $38 million from the Commonwealth and $20 million of State funds. However, the Department of Treasury and Finance (DTF) advised the Committee that the funds for this project have been frozen.

Salta Properties advised the Committee that advice from GHD consultants suggested that Stage 1 of this project would remove nearly 3,500 truck trips per day from the Port, reduce CO_2 emissions by 23,000 tonnes per annum and expand the capacity of the Swanson Dock by an additional 1.4 million TEU per year.[81] GHD also estimated that completing the Port Rail Shuttle would increase the likely proceeds from the Port lease by $545 million.[82]

Many witnesses appearing before the Committee supported the proposal, including stevedores, rail and operators, Port tenants, the trucking industry, the owners of the inland ports and local government.

For example, the Rail Freight Alliance called for the rail shuttle terminal 'to be constructed now'.[83]

81 Mr S. Tarascio, Salta Properties, *Transcript of Evidence*, 9 September 2015, p.141.

82 Ibid.

83 Rail Freight Alliance, Submission 81, p.3.

The Victorian Transport Association also emphasised how important the project was in order for the Port and the State to remain competitive:

> ...if we are to stay competitive, we need to adopt a similar notion [to Moorebank] here in Melbourne, and that is: we get the containers or whatever the freight may be into the port — to the wharf ...in the most efficient and effective way possible; get the containers back out to a large intermodal terminal that allows then for distribution to take place, be that north, south, east or west, wherever these intermodal terminals fall. If we connect those properly with the port, then the trucks can do the job of making the final last-mile deliveries, rather than carting them all the way out and having all these double-handling movements in it as well. We cannot just expect to put twice as many trucks on the road to do the job, because it simply cannot happen. We cannot do it from a social conscience perspective. We cannot do it from a skills base at the moment as well.[84]

Austrak also noted the urgency and cautioned against leaving it to the whim of the bidders:

> If the government is serious, and I hope they are, about getting some trucks out of the metro area of Melbourne — and giving us all a bad name while we do it, because we have not got any other options — they need to get on with it. Do not miss the opportunity to do it now and leave it to the whim of one of the bidders and all their commercial drivers, which may be not quite what you think.[85]

While Salta Properties and Austrak have commercial interests that would benefit from the completion of the Port Rail Shuttle project, their interests in the process do not preclude a transparent and competitive approach to tendering the development of the project.

The Committee did not receive any evidence from participants opposing the project.

One major rail and logistics operator, Qube Holdings, told the Committee that it had abandoned its involvement in two Melbourne intermodal terminals, focussing instead on the $1.5 billion Moorebank intermodal terminal development in Sydney:

> Melbourne has stagnated. We have not seen a serious government push for modal shift to rail. We are not wasting any more time on that in Melbourne.[86]

Salta Properties did not understand why the project had stalled:

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84 Mr B. Close, Victorian Transport Association, *Transcript of Evidence*, 8 September 2015, p.47.

85 Mr K. Baxter, Austrak, *Transcript of Evidence*, 14 October 2015, p.497.

86 Salta Properties, Presentation, 9 September 2015, p.4, citing Mr M. James, Qube Holdings in Philip Hopkins, 'Lack of rail driving Melbourne to lose 'number one' container port status', *The Sydney Morning Herald* (online), 19 August 2015 <www.smh.com.au/business/lack-of-rail-driving-melbourne-to-lose-number-one-container-port-status-20150818-gj1lxd.html>.

> Quite frankly, we do not understand what the barrier to this project is. Even the $58 million, in context with the various things that are going on in the freight and logistics industry, and relative to the other spending that is going on, is very small. We do not understand why this money cannot be spent to make the network active as soon as possible.[87]

The Committee sought to understand why plans to develop and implement the Port Rail Shuttle had been put on hold. In response, the Secretary of the Department of Economic Development, Jobs, Transport and Resources advised:

> As best I know, [funding] remains available for the possible application to that project should the other parties that would need it commit to it if it wants to do so...[88]

The Committee then put the issue to DTF, which advised that the matter should be postponed for discussion in due course with the successful bidder.

The decision to freeze development of the Port Rail Shuttle is in contrast with the very broad consensus that exists in industry and the community to support its urgent development.

This project is already funded, cost-effective, supported by the rail, trucking, and logistics industries, and environmentally and socially beneficial. The Committee considers the project should proceed and that bidders should be required to demonstrate how they will utilise the system during the lease.

RECOMMENDATION 4: The Government:

(a) immediately commit to completing the Port Rail Shuttle project for which funding of $58 million was provided in the 2014-15 Budget

(b) immediately re-activate the Expressions of Interest process to select a party to deliver the Port Rail Shuttle project

(c) ensure that the short term delivery of the Port Rail Shuttle project is fully reflected in the transaction documents.

4.4.4 Webb Dock Rail

A further logistical issue is that the $1.68 billion Port Capacity Project does not include any plans for a rail connection to the new Webb Dock container terminal. This terminal is expected to add 1 million TEU to the Port's capacity, all of which is proposed to be handled by road.

The Victorian Government's submission stated that:

> Consistent with maintaining strategic flexibility, the State will be preserving rail modal outcomes through maintaining planning controls over existing rail corridors for any future needs (eg. Webb Dock Rail)...[89]

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87 Mr S. Tarascio, Salta Properties, *Transcript of Evidence*, 9 September 2015, p.145.

88 Mr R. Bolt, Department of Economic Development, Jobs, Transport and Resources, *Transcript of Evidence*, 14 October 2015, p.524.

89 Victorian Government, Department of Treasury and Finance, Submission 8, p.31.

However, this statement is misleading for a number of reasons:

- rail modal outcomes (that is, the share of containers moved from the Port by rail) are declining, and some industry participants such as Qube Holdings, attribute this to a lack of government support for rail
- preserving the rail corridor to Webb Dock does nothing to preserve rail modal outcomes. The existing rail corridor to Webb Dock was cut off in the mid-1990s and the rail bridge over the Yarra was re-assigned to other roles. Preserving the remainder of this corridor does not replace the need for a feasible plan to provide rail access to the Webb Dock terminal
- if the successful bidder is to develop the existing port to its capacity, Webb Dock will need to be fully utilised. This may involve relocating the current motor vehicle and Tasmanian terminals to other locations. Such developments would magnify the traffic impact of a terminal constructed without feasible rail access.

The Victorian Government's submission does not provide any analysis of these issues. However, participants such as the Rail Freight Alliance insisted that 'planning should be undertaken now for the Webb Dock rail connection'.[90]

The Committee asked DTF to provide any comprehensive study of the transport implications of the expansion of the Port, and expected that this would include details of such planning. However, it did not provide any such study.

On the basis of the evidence presented, the Committee is of the view that there has been inadequate planning in relation to the road and rail upgrades that would be necessary if the Port expands to the capacity envisaged in the lease documents.

RECOMMENDATION 5: The Government:

(a) develop a comprehensive transport plan of the additional links that Port expansion will require

(b) include provision for a rail link to Webb Dock by the most cost-effective means

(c) ensure that local councils and communities are consulted in the planning process.

90 Rail Freight Alliance, Submission 81, p.3.

5 Environmental impacts of further expansion of the Port of Melbourne

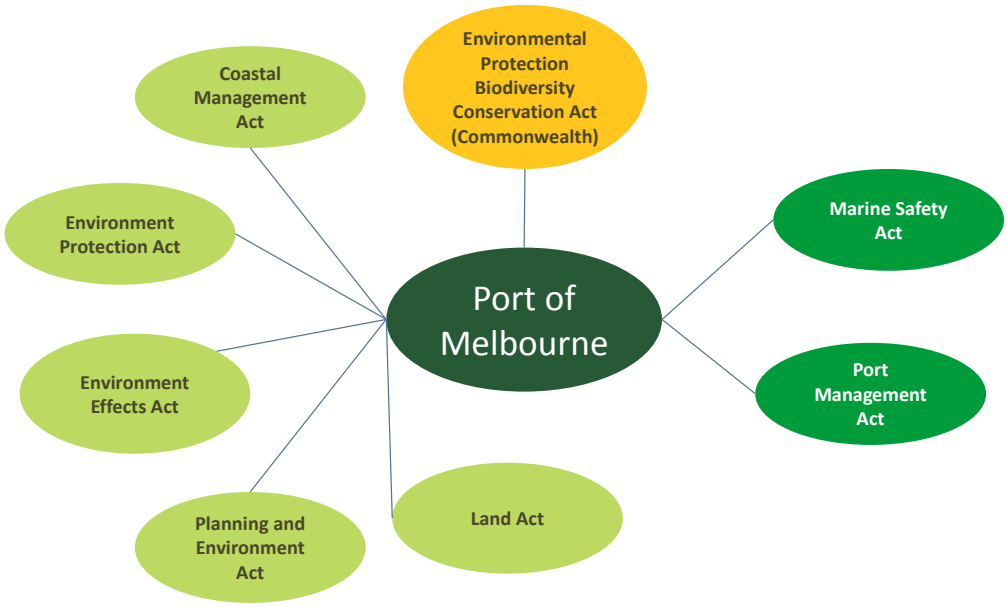
5.1 Introduction

The Port of Melbourne is currently subject to general environment and planning controls that apply across the State. The Victorian Government's submission indicated that it intends to leave this framework for planning and environmental regulation relatively unchanged:

> The Transaction will not change any existing environmental or planning statutory approval requirements. The Port of Melbourne today, in public hands, operates within an existing statutory framework at both a Commonwealth and State level for environmental and planning matters. This will remain unchanged for the Port of Melbourne whether in the hands of the State or a leaseholder.[91]

Figure 5.1 provided by the Department of Treasury and Finance (DTF) below illustrates the various environmental and planning Acts that apply to the Port of Melbourne.

Figure 5.1 Environmental and planning frameworks that apply to the Port of Melbourne



Source: Victorian Government, Department of Treasury and Finance, Submission 8, Figure 5.1, p.30.

91 Victorian Government, Department of Treasury and Finance, Submission 8, p.7.

In its submission, the Victorian Government emphasised that:

- the transaction does not change any of the environmental or statutory controls over the condition and performance of Port Phillip Bay, including the Heads
- the new Port operator will need to seek necessary approvals to undertake any significant works, including dredging.[92]

Stakeholders raised issues about the impact that increased trade growth and traffic around the Port of Melbourne would have on the environment and local communities. Concerns were also raised about the impacts of any further dredging of the Bay and ongoing arrangements for monitoring the health of the Bay.

5.2 The impact of further dredging of the Bay

Submissions were divided on the topic of further dredging of Port Phillip Bay. While some submissions voiced their strong concerns about the environmental impacts of dredging, others considered that further dredging was unlikely or that the impacts were able to be managed effectively.

5.2.1 Concerns about impacts of future dredging

The Port Phillip Conservation Council was particularly concerned about the impact of future dredging and provided evidence of a report that found high levels of toxins in the dredge disposal grounds used by the Port of Melbourne Corporation (PoMC) in its dredging operations.[93] The Council argued that future dredging and thus dumping of dredge spoil at this location would further exacerbate the issue.[94]

The City of Kingston submitted that any future expansion of the Port of Melbourne that involved dredging or widening of Port Phillip Heads would cause 'irreparable environmental damage'.[95]

Similarly, the Victorian National Parks Association (VNPA) expressed its concern that dredging of the Bay impacted tidal flows leading to a loss of sand on Portsea beach.[96] The Mornington Peninsula Shire Council was also strongly opposed to future dredging of the Bay and widening of the Heads, drawing a link between dredging and beach and coastline erosion, changing storm surge profiles and marine environment damage.[97] Frankston City Council added its concern over

92 Ibid., p.31.

93 Port Phillip Conservation Council, Submission 10, p.5 – referring to *Baseline Benthic Fauna Surveys for Port of Melbourne DMG*, SE DMG and Yarra River Estuary, Sinclair Knight Merz (2006).

94 Ibid., p.5.

95 City of Kingston, Submission 15, p.4.

96 Victorian National Parks Association, Submission 21, p.6.

97 Mornington Peninsula Shire Council, Submission 35, p.3.

further deepening to allow larger vessels into the Port of Melbourne, focusing on the negative impacts beach erosion would have on the liveability and commercial prosperity of bayside locations.[98]

As discussed in Chapter 3, the Committee heard a range of views about whether further dredging would be required in future to accommodate the draught and height of larger vessels entering the Bay. Captain Richard Cox told the Committee that larger 10,000 twenty-foot equivalent unit (TEU) vessels were a possibility.[99] Similarly, the Institute for Supply Chain and Logistics indicated that it was likely that ships carrying 10,000 TEUs (requiring a draught of 14 to 15 metres) would be likely in around 15 to 20 years - but that this would be the maximum foreseeable size given shipping trade flows.[100]

In contrast, PoMC advised:

> We think the system and the configuration of the channels is sufficient to accommodate growth in vessels, and the growth in vessels that will service this port in the time frame of the lease.[101]

Some stakeholders thought that further dredging would not be required given that large ships would be unlikely to visit Australia. For example, the Customs Brokers and Forwarders Council of Australia (CBFCA) submitted that:

> Further dredging of the bay or port channels may have an impact on the environment but CBFCA believes dredging may not be required as shipping lines will not deploy the large 8,600+ TEU vessels into Australian trade lane as we are not a big trade lane.[102]

CBFCA further explained at hearings:

> Talking to Shipping Australia and the experts, they say that there is no chance that ships above 8,000 TEU will be coming to Australia. We seem to traditionally get the recycled ships, and they keep the massive mega ships for the USA and Europe trade. A lot of them so far have said they would like to get as much as possible, but you would not see more than 8,000 TEU. When you talk about height and draught, I cannot see ships bigger than that coming in.[103]

98 Frankston City Council, Submission 51, p.4.

99 Capt R. Cox, *Transcript of Evidence*, 28 October 2015, p.17; see also Mr S. Galbraith, *Transcript of Evidence*, 28 October 2015, p.28.

100 Dr H. Parsons, Institute for Supply Chain and Logistics, Victoria University, *Transcript of Evidence*, 8 September 2015, pp.33-34; see also Mr P. van Duyn, Institute for Supply Chain and Logistics, Victoria University, *Transcript of Evidence*, 8 September 2015, p.32.

101 Mr M. Dowling, Riordan Grain Services, *Transcript of Evidence*, 24 September 2015, p.182.

102 Customs Brokers and Forwarders Council of Australia, Submission 13, p.2.

103 Mr Z. Kostadinoski, Customs Brokers and Forwarders Council of Australia, *Transcript of Evidence*, 13 October 2015, p.59.

Mr Michael Dowling, representing Riordan Grain Services and former chairman of the Victorian Regional Channels Authority, told the Committee:

> My view is that some of the ships — and I have read the Victoria University [Institute for Supply Chain and Logistics] submission and I have spoken to them on a number of occasions — might become wider, and there might be some need for changing the channels, but not necessarily deepening them.[104]

Overall, the Committee believes that there remains a possibility over the next 50 years that there will be a need for some sort of dredging of Port Phillip Bay to accommodate larger ships if they come to Melbourne – particularly if it is in advance of an alternative container port that is capable of servicing these ships. It is also possible that the advent of larger ships to Australia could hasten the need to bring forward a second container port capable of servicing the increased size requirements. This underscores the importance of ensuring that the existing systems for approving capital projects such as these are effective in identifying and protecting the environment from the impacts of such projects.

5.2.2 Channel Deepening Project

Between 2008 and 2009, PoMC undertook an almost $1 billion infrastructure project to deepen channels in Port Phillip Bay to allow access for larger container ships with draughts from 11.6 metres to 14 metres. In addition to deepening the channels, the project involved transporting and disposing of dredged material to underwater storage sites, upgrading shipping berths to accommodate larger vessels in deeper water, upgrading, replacing and installing new navigational aids and protecting utility tunnels, pipelines and cables affected by the dredging activity and the movement of larger cargo ships. It also involved environmental monitoring and management.

PoMC explained the key aspects of the channel deepening project:

> That was a project that involved the removal of over 20 million cubic metres of material from both the northern and the southern sections of Port Phillip Bay, the first time that the heads had been dredged using a methodology that was developed and undertaken by an alliance between the Port of Melbourne Corporation and Royal Boskalis Westminster. That dredging technology was low-impact technology that was able to manage what was identified as the risks and to ensure that there were no long-term consequences to the environment.[105]

The project involved significant environmental risks and required:

- an assessment under the *Environment Effects Act 1978* to provide confidence that PoMC could effectively manage any environmental impact on Port Phillip Bay
- a requirement for PoMC to prepare an environmental management plan

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104 Mr M. Dowling, Riordan Grain Services, *Transcript of Evidence*, 24 September 2015, p.182.

105 Mr N. Easy, Port of Melbourne Corporation, *Transcript of Evidence*, 8 September 2015, p.18.

- baywide monitoring programs which operated during the project and continued until June 2012.

In addition, the Office of the Environmental Monitor (OEM) was established as an independent body to monitor the project's compliance with environmental approval conditions and evaluate its impact on the health of Port Phillip Bay.

Some stakeholders questioned the effectiveness of the arrangements put in place for the channel deepening project. For example, VNPA said:

> The channel deepening project was very controversial. Unfortunately the environmental management plan which was established around it failed to have a comprehensive and robust monitoring program, and so a lot of the impacts which it may have had we do not really know much about.[106]

However, PoMC said that it was a robust process:

> A stringent Environmental Management Plan was put in place and it was able to be delivered successfully with no longterm environmental impacts and in a sustainable way. That framework has set the scene in terms of any dredging undertaken in the port in terms of the controls, the approval requirements and the oversight that is in place for dredging within the Port of Melbourne.[107]

The Victorian Auditor-General's Office 2012 audit of the Port of Melbourne channel deepening project found that:

> OEM's independent scrutiny of the project's environmental compliance was active, comprehensive, and reliable, and that its conclusions were evidence based and could be relied on.
>
> The corporation has delivered the project in compliance with the applicable environmental approval conditions with three minor exceptions relating to the clean-up, disposal and location of dredging works.
>
> The corporation closely monitored its environmental performance during the course of the project. It also actively engaged with the public through media releases and press conferences about the project's activities and its environmental incidents. The corporation appropriately managed all minor non-conformances and environmental incidents which occurred. Importantly, the environmental effects of these incidents were inconsequential.
>
> The project has not adversely impacted on the Bay and the Bay remains in good health.[108]

The Committee notes the arrangements put in place for the Channel Deepening Project to manage environmental impacts and the view expressed by the Victorian Auditor-General's Office that the arrangements put in place were

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106 Mr C. Smyth, Victorian National Parks Association, *Transcript of Evidence*, 9 September 2015, p.155.

107 Mr N. Easy, Port of Melbourne Corporation, *Transcript of Evidence*, 8 September 2015, p.18.

108 Victorian Auditor-General's Office, *Port of Melbourne Channel Deepening Project: Achievement of Objectives*, VAGO Report 2012-13:13 (2012), p.xi.

robust and effective in managing environmental impacts. However, there is a need to consider longer term monitoring of the Bay and environmental impacts associated with future shipping and capital works.

5.2.3 Ongoing monitoring of the Bay

While a number of stakeholders acknowledged the monitoring arrangements that were put in place for the channel deepening project, they also noted that some of those arrangements no longer applied.

VNPA said that it was the role of Government to ensure that there was a comprehensive ongoing monitoring program in place:

> If someone said, 'What effect did the channel deepening project have on the marine environment in Port Phillip Bay?', there are a lot of anecdotal comments that people have. But if you were to say, 'What data do you have to show whether seagrass meadows have declined in that area or if water quality has changed and so on?', that monitoring process has not been put in place. .... So if there was going to be another channel deepening project, there are a lot more things that need to be put in place before that should actually happen.[109]

The Association of Bayside Municipalities noted the abolition of the OEM – which ceased operations on 1 July 2014:

> The Office of the Environmental Monitor was set up to look at the monitoring of the dredge activities, and there were regular reports from that about the health of the Bay. I am not sure on how many parameters, because it was before my time, but I think they closed the monitoring office and said that their job was done.[110]

VNPA also expressed the view that 'there had been no significant monitoring in place since then'.[111]

As part of its election policy commitments, the Government foreshadowed its commitment to undertake a five yearly 'State of the Bay' report to monitor the health of coasts, bays and waterways.[112]

Both VNPA and the Association of Bayside Municipalities noted the Government's commitment to periodic reporting through the 'State of the Bay' report, although the Association of Bayside Municipalities preferred that it be undertaken annually:

> We would like to see periodic reporting, and we would like that periodic reporting to be at an absolute minimum, at least — and this is the worst case scenario — once every four years, the reason being the political cycle for local government and for State government is four years, and we would like to see the reporting at an absolute minimum to be once every political cycle, just so that corporate memory is retained

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109 Mr C. Smyth, Victorian National Parks Association, *Transcript of Evidence*, 9 September 2015, pp.158-159.

110 Mr B. Cotter, Association of Bayside Municipalities, *Transcript of Evidence*, 8 September 2015, p.59; see also Ms J. Warfe, Port Phillip Conservation Council, *Transcript of Evidence*, 8 September 2015, p.80.

111 Mr C. Smyth, Victorian National Parks Association, *Transcript of Evidence*, 9 September 2015, p.155.

112 Premier D. Andrews, Victorian Labor, *Our Environment, Our Future* (2014), p.4.

> in a political cycle. But that is the absolute minimum. The Treasurer has come back and suggested once every five years, and we are still yet to go back and say that we will not accept five years. It was our preference to have annual reporting, but, as I said, at an absolute minimum once every political cycle.[113]

The Committee notes the Government's view that the Port of Melbourne can accommodate a threefold increase in container throughput from 2.5 million TEU to approximately 8 million TEU before it reaches its expected capacity. Given evidence that substantial growth in ship size is unlikely, the growth in container volumes will require a significant increase, potentially more than doubling, in ship movements accessing the Port.

For this reason the Committee believes it is appropriate to formalise ongoing monitoring of environmental impacts of shipping in the Bay over the life of the lease. It welcomes the commitment by the Government to release a State of the Bay report as a means of providing ongoing reporting on the condition of marine and coastal environments.

The Committee considers that the Government should re-establish the Office of the Environmental Monitor to ensure that there is an appropriate focus on ongoing monitoring of the Bay. The responsibilities of the Office could include the ongoing collection and reporting of necessary information to compile the 'State of the Bay' report.

RECOMMENDATION 6: The Government provide ongoing monitoring of the condition and major impacts on the Bay by:

(a) amending the Bill to re-establish the Office of the Environmental Monitor

(b) preparing and releasing publicly a 'State of the Bay' report on a regular basis.

5.3 The impact of traffic around the Port of Melbourne

It is estimated that Victoria's population will reach 10 million by 2051.[114] The Government has stated that it is confident that the Port of Melbourne will be able to support up to 8 million TEU of container throughput in order to service the needs of this growing population.[115]

A number of stakeholders noted the likely impact that this level of increased population and throughput would have on the movement of freight by road and the consequential traffic and congestion impacts.[116]

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113 Cr F. Frederico, Association of Bayside Municipalities, *Transcript of Evidence*, 8 September 2015, p.57.

114 Department of Environment, Land, Water and Planning, *Victoria in Future 2015: Population and Household Projections to 2051* (2015), p.1.

115 Mr N. Rizos, Department of Treasury and Finance, *Transcript of Evidence*, 8 September 2015, pp.9-10.

116 Mr B. Close, Victorian Transport Association, *Transcript of Evidence*, 8 September 2015, p.52; Mr M. Kilgariff, Australian Logistics Council, *Transcript of Evidence*, 9 September 2015, p.122; Mr S. Tarascio, Salta Properties, *Transcript of Evidence*, 9 September 2015, pp.140-141; Mr P. Tuohey, Victorian Farmers Federation, *Transcript of Evidence*, 30 September 2015, p.8.

Congestion around the Port of Melbourne is exacerbated by the fact that Victoria's trade is handled almost exclusively by trucks. At hearings, Salta Properties advised the Committee of the potential implications of increased road based freight on congestion, safety and the environment:

> ... everything in Melbourne is handled by truck and road. Eighty-seven per cent of imports and 52 per cent of exports have a metropolitan destination or origin respectively. Because there is no adequate rail connectivity to the port, all of these volumes are handled by truck. That means currently there are 5,500 trucks that visit the port each day, and if unabated, and with the projected growth, this could rise to over 30,000 trucks per day within the initial term of the proposed lease.[117]

The Maribyrnong City Council also referred to results from its truck survey conducted in conjunction with VicRoads and GHD,[118] which indicated that currently 22,000 trucks move daily through the streets of the Maribyrnong City Council municipal boundary.[119] Both the Council and other groups such as the Maribyrnong Truck Action Group (MTAG) were very concerned by the implication of these figures now and in the future, especially for local residents.[120] Ms Narelle Wilson of MTAG noted that:

> Every day 22,000 trucks use our narrow residential streets, and up to 72 per cent of them are container trucks. They go through countless school and pedestrian crossings; they go metres past our childcare centres, kinders and schools; they drive past our houses as we are trying to sleep at night, metres from cyclists; and they get stuck in endless traffic congestion.[121]

Stakeholders also pointed out the significant health and safety impacts that come from increased truck traffic. The effects of diesel emissions were an area of particular concern.[122] They referred to a recent 2012 report from the World Health Organisation which listed diesel exhaust as carcinogenic[123] and further studies that pointed to the adverse health impacts of diesel exhaust exposure including respiratory problems (such as asthma), heart disease, neurotoxicity and adverse birth outcomes.[124]

The Maribyrnong City Council was especially outspoken on the matter, with Mr Stephen Wall, Chief Executive Officer stating that:

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117 Mr S. Tarascio, Salta Properties, *Transcript of Evidence*, 9 September 2015, p.140.

118 GHD, Vic Roads and Maribyrnong City Council, *Inner West Truck Surveys: Final Report*, April 2015.

119 Maribyrnong City Council, Submission 62, p.1.

120 GHD, Vic Roads and Maribyrnong City Council, *Inner West Truck Surveys: Draft Report*, June 2014.

121 Ms N. Wilson, Maribyrnong Truck Action Group, *Transcript of Evidence*, 30 September 2015, p.2.

122 Salta Properties, Submission 55, p.2; Customs Brokers and Forwarders Council of Australia, Submission 13, p.2; Maribyrnong Truck Action Group, Submission 32, p.5; Infrastructure Partnerships Australia, Submission 33, Attachment, p.vi; Public Transport Users Association and Public Transport Not Traffic, Submission 41, p.2; Maribyrnong City Council, Submission 62; Municipal Association of Victoria, Submission 76.

123 International Agency for Research on Cancer – World Health Organisation, *IARC: Diesel Engine Exhaust Carcinogenic* (Media Release, 12 June 2012).

124 See NEPM, *National Environment Protection, Ambient Air Quality, Measure Review*, review report prepared for the National Environment Protection Council (2011).

> There is overwhelming medical evidence on the serious adverse health effects of exposure to diesel exhaust. These include asthma attacks, strokes, heart attacks, adverse birth outcomes, effects on the immune system and multiple respiratory effects. According to a federal government paper there is no safe threshold for diesel exhaust.[125]

The Maribyrnong City Council noted that the Environment Protection Authority (EPA) has undertaken noise and air quality monitoring that revealed concerning results for the residents in the freight path:

> The EPA air quality monitoring on Francis Street, Yarraville, noted eight days that exceeded the daily objective over 16 months. Further, the small particles measured on Francis Street, it noted, exceed that of the cities of Seattle, Stockholm and Toronto. The EPA also conducted noise monitoring over 12 months in Francis Street. Based on the World Health Organisation guidelines for community noise, it was high enough to cause annoyance and disturbed sleep and speech. Similarly the average noise levels in all monitored sites along Moore and Francis streets at all times exceeded the VicRoads noise limit applied to new arterial roads and freeways. Further, eight out of nine locations exceeded the VicRoads criterion for considering noise mitigation. [126]

A final issue brought to the attention of the Committee was that of the safety of residents in light of increasing truck presence on local roads.[127] The safety of pedestrians and road users (including cyclists) was also mentioned as freight shares the infrastructure of congested urban and residential areas.[128]

125 Mr S. Wall, Maribyrnong City Council, *Transcript of Evidence*, 13 October 2015, p.62.

126 Ibid., p.63.

127 Maribyrnong Truck Action Group, Submission 32.

128 Infrastructure Partnerships Australia, Submission 33, Attachment, p.6; Mr S. Hill, Submission 37; Maribyrnong City Council, Submission 62; Mr F. de Meneval, Submission 72; Mr N. Roth, Submission 73; Rail Freight Alliance, Submission 81, p.5; Ms N. Wilson, Maribyrnong Truck Action Group, *Transcript of Evidence*, 30 September 2015, p.2; Mr S. Wall, Maribyrnong City Council, *Transcript of Evidence*, 13 October 2015, pp.62 and 66.

6 Economic regulatory framework

6.1 Introduction

The main concern when a monopoly infrastructure asset passes from the public sector to the private sector is what impact that this will have on access to services, including in relation to the prices levied for those services.

The Victorian port sector is currently subject to an economic regulatory framework established under Part 3 of the *Port Management Act 1995* (the PMA). The Essential Services Commission (ESC) is the relevant independent regulator responsible for administering the framework. Currently the framework is a light-handed price monitoring framework and applies to limited services provided by the Port of Melbourne only.

The Government has proposed an economic regulatory framework that comprises:

- an overarching legislative framework established by proposed amendments to the *PMA* and supported by relevant provisions of the *Essential Services Commission Act 2001*
- an Order in Council known as the Pricing Order that will set out more specific details about the approach to pricing.

6.2 The need for price regulation

Where a firm (either private or government) provides natural monopoly infrastructure services, economic regulation may be justified in order to address the potential for the firm to exercise market power either by restricting access or setting prices above cost.

The ESC's own assessments of the Port of Melbourne Corporation's (PoMC) market power have concluded that it has substantial market power in each of the three distinct service market segments that the ESC assesses, namely channel services, container trade services and motor vehicle trade services.

The ESC has continued to recommend ongoing regulation of these key services. However, it has progressively adopted a more light-handed price monitoring approach in light of evidence that PoMC has not sought to exercise its market power.[129]

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129 Essential Services Commission, *Review of Victorian Ports Regulation: Final Report 2014* (2014), p.73.

A privatised operator, having paid a full market price for the asset, will have a strong incentive to maximise its return by maximising its revenue. Where the opportunity exists to exercise market power, it is likely that the leaseholder will seek to derive further value from the business either through new charges and/or higher prices.

The prospect of this behaviour was highlighted by the Australian Competition and Consumer Commission (ACCC):

> ...'How do you think you would behave if you owned this asset, if you had paid a very high price for it and if you had shareholders who had very high expectations of a return?'. I think you would naturally be pricing as high as you could within the limits of any regime. That is why we think regulatory regimes need to be effective.[130]

The overwhelming concern expressed by both supporters and opponents of the proposed Port privatisation was the need to ensure that there will be an appropriate economic regulatory (and pricing) regime in place.

DP World also noted the risks to the State of not having an appropriate framework in place:

> ... it is critical to the economy of Victoria – and Australia – that we get the privatisation and associated regulatory framework right. A failure to do so would mean the benefits of privatisation risk being more than offset by potential damage to the State and national economies resulting from the new incentives of a private operator, which will quite understandably be focused on maximising shareholder returns rather than promoting the national interest in maximising throughput and minimising supply chain costs at the Port.[131]

A number of stakeholders, including Shipping Australia, were wary because other recent port privatisations have driven significant price increases:

> At the port of Newcastle, navigation charges for coal ships were increased by more than 60 per cent within a few months of privatisation and there was no price control mechanism preventing it.[132]

The Committee considers that the privatisation of such a strategic and essential natural monopoly asset as the Port of Melbourne warrants an appropriate economic regulatory regime that will balance both the interests of the new Port operator, Port users and the long term interests of all Victorians. It should provide sufficient transparency and certainty to the Port operator and Port users about the basis on which prices will be determined and set.

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130 Mr R. Sims, Australian Competition and Consumer Commission, *Transcript of Evidence*, 30 September 2015, p.2.

131 DP World, Submission 49, p.1.

132 Shipping Australia Limited, Submission 22, p.3.

6.3 Overview of the proposed regulatory framework

The Bill proposes to amend the PMA to provide the overarching framework for the regulation of prices to be applied by the Port operator. However, the detail of the regulatory regime is to be set out in a Pricing Order to be issued by the Governor in Council. The Department of Treasury and Finance (DTF) provided the Committee with a copy of the draft Pricing Order as at 4 September 2015, albeit with some critical details such as initial asset values redacted. DTF advised the Committee that it intends to finalise the Pricing Order prior to the transaction being complete.

Table 6.1 summarises the key features of the economic regulatory regime.

Table 6.1 Overview of the proposed Port of Melbourne pricing regime

Approach to pricing	Role of the regulator	Ministerial role
Leaseholder must set prices having regard to: • Initial prescribed tariffs set for first year • Detailed building block • Prescribed initial asset base, rules around depreciation methodology • Pricing principles requiring efficient cost • 15 year consumer price index (CPI) price cap, rebalancing constraints and export pricing decision • Cost allocation principles • Financial information requirements. Leaseholder must annually: • Publish Reference Tariff Schedule • Publish Tariff Order Compliance Statement • Follow consultation requirements for the Reference Tariff Schedule.	Annual processes: • receive annual copy of Reference Tariff Schedule and Tariff Compliance Statement • assess and accept rebalancing applications for first 15 years. Periodic reviews: • undertake 5 yearly reviews of leaseholder's Pricing Order compliance • undertake 5 yearly reviews into whether port operator has misused market power in setting and reviewing rents • review any matter that may be referred by ESC Minister under ESC Act section 41. Other: • determine nature of supporting information required to support regulatory applications and Tariff Compliance Statement • approve application to cease price capping and applications for rebalancing • determine alternative indices or alternative revenue estimates where required • determine service standards and conditions of service and supply if requested by ESC Minister.	Refer an ESC Act section 41 inquiry on a regulated matter, including matters related to ports Direct ESC to exercise powers related to service standards and conditions of service and supply Issue a show cause notice to the leaseholder, having regard to an ESC report on significant and sustained non-compliance Recommend to the Governor in Council that a Pricing Order be made Decide whether to make a re-regulation recommendation that amends the Pricing Order Decide whether to accept a written undertaking in relation to a show cause notice Apply to the Supreme Court for an order enforcing compliance with enforceable provisions Issue licences to port operators including determining terms and conditions, and enforcing provisions.

Currently, the ESC adopts a light-handed regime that:

- focuses solely on three services, namely: provision of channels; provision of berths, buoys and dolphins; and provision of short term storage or cargo marshalling facilities
- applies only to containerised trade and motor vehicles cargoes
- monitors prices having regard to certain pricing principles.

The Bill extends the coverage of prescribed services to all cargo types (including dry bulk, liquid bulk and break bulk cargoes, rather than just containers and motor vehicles) for both wharfage and short term storage, and cargo marshalling facilities. It also expands the regime to a number of services that are currently not covered, such as: slipways; licence and right of access to third parties; and other port services such as wharf inspections, tanker inspections and gangway hire.[133]

DTF emphasised that the Bill's expanded prescribed services covering all ports meant that approximately 86 per cent of PoMC's current revenue would now be regulated.[134]

The regime proposed embodies a more prescriptive approach than applies currently in Victoria and in most Australian ports, including those that have been privatised. The Committee supports a more stringent regime being applied, particularly given that some other jurisdictions that have privatised their ports have experienced significant price increases.

However, there are opportunities to strengthen the regime further to protect the long term interests of Port users, as discussed in the following sections.

6.4 Assessment of the proposed economic framework

6.4.1 Objectives of the regime

Clause 89 of the Bill proposes to amend section 48 of the PMA which relates to the objectives that the ESC must have regard to in performing its regulatory functions (see Table 6.2).

Table 6.2 Comparison of the *Port Management Act 1995* objectives guiding price regulation

Existing section 48 of the *Port Management Act 1995*	**Proposed clause 89 amendment to section 48 of the *Port Management Act 1995***
The objectives of the Commission in relation to the regulated industry are, in addition to the objectives under section 8 of the *Essential Services Commission Act 2001* (but subject to section 5(2) of that Act)— (a) to promote competition in the regulated industry; (b) to protect the interests of users of prescribed services by ensuring that prescribed prices are fair and reasonable whilst having regard to the level of competition in, and efficiency of, the regulated industry; (c) for the purposes of Division 4, to ensure users have fair and reasonable access to prescribed channels whilst having regard to the level of competition in, and efficiency of, the regulated industry.	The objectives of this Part are— (a) to promote efficient use of, and investment in, the provision of prescribed services for the long-term interests of users and Victorian consumers; and (b) to allow a provider of prescribed services a reasonable opportunity to recover the efficient costs of providing prescribed services, including a return commensurate with the risks involved; and (c) to facilitate and promote competition— (i) between ports; and (ii) between shippers; and (iii) between other persons conducting other commercial activities in ports.

133 Victorian Government, Department of Treasury and Finance, Submission 8, p.41.

134 Ibid., p.8.

DTF advised the Committee that there were three main reasons why it has amended the PMA objectives:

- to apply the overall objectives of the new regulatory regime more broadly than just the ESC
- section 8 of the *Essential Services Commission Act 2001* already provides that 'in performing its functions and exercising its powers, the objective of the Commission is to promote the long term interests of Victorian consumers', including by having regard to 'the price, quality and reliability of essential services
- to reflect updated thinking as to what is regulatory best practice, such as the objectives related to the national electricity and gas sectors.[135]

DP World noted that the statutory objectives governing regulation of services under the PMA had been changed to remove reference to the need for prescribed prices to be 'fair and reasonable'.[136]

The proposed amendments appear to shift the objectives away from protecting the interests of users and ensuring users have fair and reasonable access, to focusing more so on the interests of the provider of prescribed services and competition.

The Committee considers it is important for the economic regulatory regime to appropriately recognise and balance the interests of Port operators and Port users as well as the long term interests to the community of maximising investment and competition. As such, the Committee recommends that the Bill be amended to restore the ESC's objective under the *Port Management Act 1995* of ensuring that prescribed prices are fair and reasonable.

RECOMMENDATION 7: Clause 90 of the Bill be amended to ensure that the objectives under section 48 of the *Port Management Act 1995* (Vic.) include an objective: to protect the interests of users of prescribed services by ensuring that prescribed prices are fair and reasonable.

6.4.2 The building block approach

The draft Pricing Order requires the Port operator to apply a 'building block' approach to set prices for prescribed services. This involves setting prices based on the revenue required by a business to deliver prescribed services, having regard to forecasts of demand. The revenue includes three key components: the level of operating expenditure; a return on the asset base – comprising the initial asset base and any adjustments to reflect additional capital expenditure incurred less depreciation; and an allowance for depreciation of the asset base.

135 Department of Treasury and Finance, Response to Questions on Notice, 30 October 2015, pp.19-20.

136 DP World, Submission 49, p.5.

DTF, the ACCC and the ESC all confirmed that the building block approach is a well-established and well understood methodology often used to determine utility prices.[137]

One of the advantages of applying the building block approach is that it provides detail about the key cost components, to enable customers to engage with the regulated entity on the key drivers of prices. Port users generally welcomed the transparency associated with this approach. For example, the Greater Shepparton City Council commented:

> ... I think the more transparency there is in terms of the costing, the better it would be. I think some of the issues, as I said in my opening statement, have been the concern around increasing costs. Now if this proposal will assist in demonstrating either (a) why that cost is required or, (b) what makes up the cost that would certainly be helpful to the growers.[138]

The building block approach is a more heavy-handed approach than the price monitoring approach that is currently applied by the ESC, and applied by most other jurisdictions – including in the context of the privatised New South Wales and South Australian ports. Having said that, some jurisdictions with price monitoring have experienced significant price increases.

The Committee considers that the use of the building block approach will provide reasonable transparency to Port users as to the drivers and basis of port prices set using this methodology.

6.4.3 The role of the regulator in assessing compliance

Most regulatory regimes that adopt a building block approach, typically over a five year period, involve the regulator assessing, in advance, the appropriateness of forecasts used to set prices. This provides confidence that the prices set are reasonable and incentives to the firm to operate more efficiently.

However, the draft Pricing Order does not require the ESC to review proposed prices or the building block components underpinning those prices before they take effect. DTF's legal advisors confirmed that ultimately the setting of the prices under the schedule is a matter for the Port operator. It is not approved by the ESC.[139]

Instead, the ESC's role is essentially limited to reviewing at five yearly intervals whether there has been significant and sustained non-compliance with the Pricing Order. As DTF explained:

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137 Mr N. Rizos, Department of Treasury and Finance, *Transcript of Evidence*, 4 November 2015, p.9; Mr R. Sims, Australian Competition and Consumer Commission, *Transcript of Evidence*, 30 September 2015, p.364; Dr R. Ben-David, Essential Services Commission, *Transcript of Evidence*, 9 September 2015, p.131.

138 Mr J. Rajaratnam, Greater Shepparton City Council, *Transcript of Evidence*, 29 September 2015, p.237.

139 Mr G. Carter, Minter Ellison, representing the Department of Treasury and Finance, *Transcript of Evidence*, 4 November 2015, p.14.

> ... 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.[140]

However, it is unclear how any issues or complaints about the Port operator's compliance with the Pricing Order are to be dealt with between five yearly reviews.

In its *2014 Review of Victorian Ports Regulation*, the ESC recommended that:

> ... some form of complaints notification requirement should be developed with the objectives of building the Commission's understanding of the nature of complaints and associated commercial behaviour of PoMC. While such a requirement would not give the Commission any role in complaints investigation or dispute resolution, it would ultimately assist the Commission to form a view about the appropriate nature of economic regulation, if any, that is required in future.
>
> The purpose of a notification requirement would be to enable the Commission to stay informed about emerging issues of concern at the port. It would provide an opportunity for port customers/users to raise general, or systemic issues, about port performance including concerns about the nature of quality of consultation undertaken in setting reference tariffs. This may extend to matters beyond the provision of prescribed services because it would be difficult in practice to effectively ring fence complaints solely to prescribed services.[141]

The ESC has previously set out the elements that it considers should be included in a complaints notification mechanism including:

- either PoMC or a Port user or customer to notify the ESC when a Port user or customer (or potential user or customer), or industry association makes a complaint in writing
- PoMC to advise the ESC of its response to the complaint and any steps taken to address the issue raised
- the ESC to keep a record of and provide any relevant commentary in its Annual Report on the number and nature of complaints received and addressed by PoMC.[142]

The Government has not responded formally to the recommendations made by the ESC in June 2014. However, the ESC's recommendation to establish a port complaints mechanism would appear to have equal relevance in the context of the proposed privatisation of the Port of Melbourne and Port users concerns about the need for effective oversight.

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140 Mr N. Rizos, Department of Treasury and Finance, *Transcript of Evidence*, 4 November 2015, p.10.

141 Essential Services Commission, *Review of Victorian Ports Regulation: Final Report 2014* (2014), pp.97-98.

142 Ibid., p.98.

Given that the ESC's role will largely be limited to assessing the Port operator's compliance with the Pricing Order as part of the five yearly review, it is important that any significant issues or complaints are notified to the ESC to be able to progressively inform the review.

RECOMMENDATION 8: The Bill be amended to provide a mechanism for complaints regarding pricing to be directed to the Essential Services Commission.

6.4.4 The Consumer Price Index (CPI) price cap and export price discount

Under the proposed regime, the Government has proposed that a CPI price cap will apply for 15 years and that PoMC's recently announced export price discount of 2.5 per cent will continue to apply for the next four years.

In relation to the CPI price cap, DTF advised the Committee that:

> The legislation protects port users by imposing a CPI price cap on port charges for at least 15 years. No other port has this level of price regulation.[143]

DTF also noted the requirement to progressively reduce loaded international container export charges by 2.5 per cent annually for the next four years:

> This means that by the year 2020 we expect that loaded international container export charges will be 22 per cent lower than equivalent import charges.[144]

Most stakeholders welcomed the proposed CPI price cap proposed. The Tasmanian Government, for example, said that the 15 year price cap would 'provide a significant degree of medium-term price certainty for port users'.[145]

Bega Cheese also said:

> ... anything that we can actually budget for, we can actually put that into our forecasts as well. That gives us the opportunity to forward plan.[146]

The ESC agreed that the CPI price cap, together with the ability for the Port operator to rebalance prices, would provide greater certainty and predictability for Port users:

> One of the sometimes written, sometimes unwritten principles of economic regulation is price stability and price certainty for users, so certainly a CPI cap as envisaged will provide that. The regime does provide for some rebalancing between prices, and our role will be to monitor that that rebalancing overall does not mean that prices do not increase by more than CPI, and even the rebalancing will be constrained within certain boundaries. I think overall the net effect of the regime is to provide quite a degree of certainty and transparency where prices do change.[147]

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143 Mr D. Martine, Department of Treasury and Finance, *Transcript of Evidence*, 8 September 2015, p.3

144 Ibid.

145 Tasmanian Government, Submission 58, p.2.

146 Mr M. Lamperd, Bega Cheese, *Transcript of Evidence*, 29 September 2015, p.61.

147 Dr R. Ben-David, Essential Services Commission, *Transcript of Evidence*, 9 September 2015, p.132.

However, the Victorian Farmers Federation (VFF) queried whether CPI was an appropriate index for transport/export services, and Shipping Australia asked why the CPI price cap (and export container wharfage discount) was not reflected in legislation. The ACCC advised the Committee that CPI provided an acceptable approach:

> I accept that it does not reflect the costs, but regulation is always a bit of a second best. It is never going to be perfect. I think having a CPI link is fine. You can be picky and find some other index, but I honestly do not think it matters over a period of time.[148]

Overall the Committee believes that the use of CPI as the basis for indexing prices is reasonable. CPI is a common measure used by many industry regulators to index prices, including the ESC and ACCC. While it may not mirror exactly the extent to which the costs of the relevant business are likely to increase, it provides a reasonable benchmark.

Scope for efficiency gains

While most welcomed the certainty of a maximum CPI escalation, some stakeholders questioned whether allowing prices to escalate by CPI each year was in fact too generous, and whether prices to Port users would be likely to reduce in line with efficiency improvements.

VFF emphasised the importance of providing clear signals to the Port operator about the need for efficiency:

> We want someone who comes in and wants to run a port and wants to run the most efficient port. That is the environment we want to create, so we have to make sure that the pricing framework is such that they know that is what they are stepping into.[149]

VFF went on to argue that it should be possible to cap price at much less than CPI given not only efficiency improvements but also expected increases in volumes:

> Mr HOSKING — … There is even an argument, given that we know container volumes through the port are going to increase in coming years, CPI is pretty generous to a new operator. Possibly we should be looking at a CPI minus 20 per cent or something like that to account for the natural increase in volumes that is going to come along. The CPI is where it is at the moment and I think that should be treated as a cap, not as a set amount that it should be increased.
>
> The CHAIR — With the CPI minus 20 you would like to see something that reflects a real reduction in real prices because of efficiencies through volume.
>
> Mr HOSKING — Yes, and it creates an incentive for an operator to not be lazy, to come in there and actually invest in the port and build capacity and increase throughput, improve those truck turnaround times, get rail access into the port — automation and mechanisation, all those things that make for a competitive and efficient port. Those incentives, if they are there, then I believe a new investor will jump at the opportunity

148 Mr R. Sims, Australian Competition and Consumer Commission, *Transcript of Evidence*, 30 September 2015, p 6.

149 Mr B. Hosking, Victorian Farmers Federation, *Transcript of Evidence*, 30 September 2015, p.5.

> of growing that port. There is some money in it for them, there are some efficiencies there for the growers, for the people of Victoria, and it is a win-win, and it is how these public-private partnerships really should be working.[150]

Australian Paper also told the Committee that he would prefer to see a 'CPI minus X' price cap rather than simply CPI for the first 15 years:

> Definitely CPI minus — definitely. A capping indicates that an operator can spend up to about that amount of money. As I mentioned, in the port of Botany fee structure you can see that the export boxes actually cost less than import boxes, so they have priced it differentially. That is a mechanism that could be built into the regulatory framework — that the actual heavy lifting, if you like, is being borne by the very necessity of the inputs.[151]

The City of Kingston supported efficiency gains being passed onto Port users rather than being internalised by the Port operator:

> In the monopoly situation whilst they may not exercise necessarily total monopoly power, the imperatives for efficiency gains and for those efficiency gains to be passed through is also not there. So the efficiency gains themselves can then be just internalised to the lease operator so that the users of the port may not get increases in costs, but they also will not get the efficiencies that should be passed through in a competitive situation.[152]

In contrast, the ACCC did not consider it necessary to adopt an X factor:

> ... I do not think it much matters. The ACCC is not about fine-tuning things. ... We are about just making sure that there is not considerable monopoly rent extraction that damages the economy, particularly of Victoria, and I think a CPI cap does that for 15 years. That is fine. We are not fussed about a discount rate.[153]

DTF advised that:

> To be clear, the 15 year CPI price cap is a maximum price implemented so as to strike an appropriate balance between providing pricing certainty to users, while ensuring there is sufficient flexibility to the leaseholder to respond to any new investment needs that might arise due to changing circumstances. Should the Aggregate Revenue Requirement (ARR) be below the price cap (clause 3.1.1) then that will apply earlier in accordance with clause 2.1.1(a) of the Pricing Order.[154]

The Committee does not believe that a price cap of CPI over the initial 15 year period recognises the opportunities available to the Port operator to achieve efficiency improvements, and notes that the greatest improvement in efficiency would reasonably be expected in the initial decade of the lease. Consistent with achieving a public benefit from the lease of the Port, efficiency improvements should be recognised in improved pricing for Port users.

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150 Ibid., p.4.

151 Mr B. McLean, Australian Paper, *Transcript of Evidence*, 13 October 2015, p.434.

152 Ms S. Ferguson, City of Kingston – South East Melbourne Group of Councils, *Transcript of Evidence*, 30 September 2015, p.4.

153 Mr R. Sims, Australian Competition and Consumer Commission, *Transcript of Evidence*, 30 September 2015, p.6.

154 Department of Treasury and Finance, Response to Questions on Notice, 30 October 2015, p.17.

6.4.5 Approach after 15 years

Under the draft Pricing Order, it is proposed that the Port operator will continue to apply a building block approach in the setting of its prices after the first 15 years. However, prices would no longer be capped at CPI and instead would reflect the Aggregate Revenue Requirement. As with the first 15 years, the Port operator would continue to set prices itself and the ESC would be required only to report, every five years, on whether there was evidence of significant and sustained non-compliance with the remaining provisions of the Pricing Order.

While many welcomed the certainty provided to users by a CPI price cap for 15 years, a number of stakeholders were concerned about what might happen to prices after 15 years once the CPI price cap was lifted. For example, ANL Container Line said:

> The issue is what happens in the remaining 35 years of the lease and the potential 20 year extension. This poses a significant risk to port users and the broader Victorian economy as cost increases are passed through the whole supply chain.[155]

The Australian Industry Group also expressed concerns:

> Beyond that time, there will be an opportunity to increase prices beyond the CPI. What are the safeguards to ensure increases will not get out of hand? If those safeguards are the Essential Services Commission's powers, what factors will be taken into account to ensure increases are appropriate?[156]

These concerns were echoed by Shipping Australia, Frankston City Council, Latrobe City Council and the Rail Freight Alliance. Wine Victoria called for further assurances beyond the proposed capping of service prices at CPI for 15 years.

DTF noted that, depending on the profile of the Port's trade volumes and charges, the CPI price cap may be in place up to 20 years, but will cease at that time. Beyond the 15 to 20 year price cap period, DTF advised that prices were in fact expected to fall:

> The expected price impact following the end of the CPI price cap period is that per unit trade charges will progressively fall in nominal and real terms as they will be capped by the growth in [Maximum Allowable Revenue] (which are expected to be less than CPI) and with increasing volumes, it is anticipated that per unit prices will decline.[157]

155 ANL Container Line, Submission 63, p.3.

156 Australian Industry Group, Submission 36, p.5.

157 Department of Treasury and Finance, Response to Questions on Notice, 30 October 2015, p.12.

The ACCC suggested that 'an effective publish-negotiate arbitrate model should apply after the first 15 years so as to provide a greater incentive for the Port of Melbourne lessee to offer reasonable access terms and conditions'.[158] The ACCC Chair, Mr Rod Sims, explained:

> ... the concern we put in our submission was that post year 15 there would only really be what looked like price monitoring, and it is all very well to monitor things but not much use if you cannot do anything about it. To be fair, the monitoring was against predetermined pricing principles, and that was helpful because it gave you a framework for the monitoring. Our concerns were the monitoring would occur every five years, and we had some concerns about what the consequence of that monitoring would be. That is to say, if you monitored pricing and found that they were not in accordance with the pricing principles, what then followed? That is the concern we voiced in the submission.[159]

However, the Victorian Employers Chamber of Commerce and Industry (VECCI) expected competitive pressures to influence prices beyond the 15 years:

> We believe that a longer than 15-year price cap — and it is a cap only — given the nature of the environment in which the port operates, which also would affect the port leaseholder, is not warranted, because of competitive pressures. Again I make an earlier point that the port will need to have regard for international prices and international pressures. Capital and trade is footloose. This means that the port owner-operator would not want to, one would think, price themselves out of the market. To do so would be very uneconomic.[160]

The Committee considers that Port users have legitimate concerns about what may occur to the level of prices once the CPI price cap ceases to apply. While recognising that this may not occur for at least 15 years, there is the potential for the Port operator to increase prices significantly to cover its Aggregate Revenue Requirement if trade growth does not increase sufficiently to cover any increases in expenditure and investment required at that time. Further the nature and extent of any competitive pressures is unclear at this stage and would need to be monitored closely.

6.5 The monitoring of land rents

The Port of Melbourne is a 'landlord port' which owns basic port infrastructure, and as one of its core activities leases it, often on a long basis, to third party operators such as the stevedoring companies. PoMC currently has around 65 leases in place with terms averaging 25 years, though up to 50 years, across its 510 hectare site.

158 Australian Competition and Consumer Commission, Submission 27, p.2.

159 Mr R. Sims, Australian Competition and Consumer Commission, *Transcript of Evidence*, 30 September 2015, p.3.

160 Mr S. Wojtkiw, Victorian Employers Chamber of Commerce and Industry, *Transcript of Evidence*, 30 September 2015, p.6.

It is common in Australia for rents charged by port operators to be set by contractual provisions, which often include some form of market rent review mechanism.

Many stakeholders expressed serious reservations about land rents being left unregulated. In particular, these concerns had been heightened by two recent factors:

- PoMC's recent stevedoring lease negotiations with DP World and
- the experience in other jurisdictions pre and post privatisation whereby port operators had significantly increased rental charges.

In December 2014, PoMC proposed a rent increase to DP World of 767 per cent to around $120 per square metre. In its own evidence to the Committee, DP World advised that the 767 per cent increase at the time 'was not palatable'.[161] DP World's Chief Financial Officer explained:

> The basis of that increase, to our knowledge, was a market-determined rent in the opinion of the port based on one observable transaction, and in our opinion — and I am not an economist and nor am I a land valuer, so I cannot opine on whether that is appropriate just to use one data point — but to me it does not seem appropriate just to reference what rent should be paid by all parties based on what someone was prepared to pay in a competitive bid process.[162]

PoMC explained the basis for the proposed rental price increase as follows:

> ... the corporation went through a process for procurement of a third operator within the Port of Melbourne, which is around investment, provision of new facilities and competition within the Port of Melbourne and introducing a third operator. That procurement process had not occurred before; it had not occurred for decades; and there is no market information to inform any market rent review in the Port of Melbourne, so that became a new market input. Based on valuation advice, and based on the provisions under the lease, that is the basis for the commencement of discussions on rent with DP World.[163]

DTF considered that PoMC's approach to proposing an initial rent of $120 per square metre was appropriate:

> The view of the board and the Port of Melbourne was that the appropriate place, in terms of what was market rent, was the most recent rental outcome, which was at Victorian International Container Terminal, which was the $120 a square metre. We would expect Port of Melbourne to seek the best outcome for the State and for its shareholder. Based on the evidence which was in front of it, which was a recently completed transaction, I think it was entirely appropriate to go out there with an initial rent indication of $120 a square metre. The lease provisions have in there effectively an independent determination if they are in dispute, and that played out.[164]

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161 Mr P. Scrurrah, DP World, *Transcript of Evidence*, 14 October 2015, p.41.

162 Mr J. Varsamidis, DP World, *Transcript of Evidence*, 14 October 2015, p.42.

163 Mr N. Easy, Port of Melbourne Corporation, *Transcript of Evidence*, 8 September 2015, pp.21-22.

164 Mr D. Webster, Department of Treasury and Finance, *Transcript of Evidence*, 8 September 2015, p.4.

However, the ACCC said that the approach that had been adopted by PoMC in basing rents on the lease price paid by the new terminal operator was inappropriate as it would 'lead to a continuing upward spiral in prices'.[165]

Ultimately, DP World agreed to a $20 per square metre charge for the first few years, increasing to $45 per square metre for the remainder of the 50 year lease. However, as the Committee heard, this outcome followed DTF involvement, extensive lobbying by a number of industry groups as well as a public campaign by DP World itself.

Some stakeholders welcomed the resolution of the dispute with DP World. The Tasmanian Logistics Committee said that the announced outcome provided 'some commercial precedent to favourable, privately negotiated, long term lease structures for the port'.[166] However, it also recognised that 'there remains some uncertainty for smaller operators who do not have the leverage of an organisation as large as DP World'.[167]

Nevertheless, there was genuine concern about the precedent that it set for future negotiations, including from Asciano:

> Whilst it appears this issue may have been resolved between DP World and the PoMC, it remains an issue for Patrick [Asciano]. It also demonstrates what can happen in future if the market power of the PoMC is not constrained in any way with regard to rents...[168]

The Victorian Transport Association also spoke of the disruption to industry by virtue of the significant proposed rent hike:

> There is nothing to say that further down the track we do not see more increases, but the concern for us as a whole was to take it from the $19 or $20 that it was to $120 overnight with practically no warning. It would mean that for a lot of the transport companies — they are costs that they just could not absorb or transfer really quickly, you know. Some of the businesses that do wharf cartage now have got contracts with their customers, and for them to take that, it changes the platform. It changes the game completely, and there are people who would not be able to absorb it and would not be able to function the next day.
>
> What it did for us as an industry is it stalled us. It stopped the orders for new trailers, new prime movers et cetera because people did not know what was going to happen next. The downstream effect of that is that we saw the orders stop at the truck manufacturers. We saw businesses that were looking to maybe upgrade their fleet and get away from the older trucks and older trailers sort of going, 'No, hang on. We'll hold back for a moment. Let's just see where this is going to land, because if that comes into play, am I going to be able to afford to take the payments across the new fleet?'.[169]

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165 Australian Competition and Consumer Commission, Submission 27, p.9.

166 Tasmanian Logistics Committee, Submission 40, p.1.

167 Ibid.

168 Asciano, Submission 61, p.5.

169 Mr B. Close, Victorian Transport Association, *Transcript of Evidence*, 8 September 2015, p.50.

Concerns about the impact of such significant price increases were raised not just by stevedores but also others down the supply chain who would ultimately need to absorb the costs passed down to them. For example, the Australian Industry Group noted estimates from one major exporter that the proposal would have increased their transport costs by $3 million per annum. DP World had estimated that the rental increase would add $80 per container passing through the Port of Melbourne.[170]

Rail Freight Alliance also noted the potential impact on farmers and their limited capacity to absorb the charges:

> I think we have got some real challenges going forward with the capacity of producers to continue to absorb costs. Without overcomplicating it, the simple fact of the matter is — and we often hear the term 'farm gate price' — that really is what it costs the producer to get it to what his or her return is after it leaves his farm or her farm. So any cost along that supply chain is passed directly back. We are competing on a world market, and there is nowhere else to go. There are no subsidies for farmers; there are no subsidies for any producers of product that goes out of Australia. Exactly what the quantum is, that is a very vexed question, because it really depends on the point of origin for which it takes place.[171]

Bega Cheese said that passing on significant price increases to customers would be difficult in the current economic climate.[172]

Others expressed concerns that such as significant price hike would drive at least some Port users to seek out alternative ports, with consequential impacts on the Victorian economy:

> I think what you will find is the port of Sydney will get very busy. ... At the expense of Melbourne. That will be the breaker, because what else can people do? You are not going to sit there and just cop it. What you are going to do is you are going to go out in the market. You are going to see where you can put your freight in another direction. There is a company in the Riverina, they would love to have options. At the moment they come down through Melbourne, but all their freight is shelf life. The ship goes Melbourne, Sydney, Brisbane. As I have said, if you are going to Sydney, we would think you are wonderful. If you went out to Brisbane, obviously it saves them four days in shelf life. Sometimes you have got to get above the politics, above everything else and think about your customer. What is best for your customer? This customer is employing 450 people in the Leeton area currently today — what does that mean for regional Australia? — with the opportunity to a third grow the business again. For a country town, that is huge.[173]

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170 Ibid., p.6.

171 Mr R. Mather, Rail Freight Alliance, *Transcript of Evidence*, 30 September 2015, p.246.

172 Mr M. Lamperd, Bega Cheese, *Transcript of Evidence*, 29 September 2015, p.64.

173 Mr C. Rees, Colin Rees Group, *Transcript of Evidence*, 29 September 2015, p.285.

Other jurisdictions have also experienced significant increases in rental charges to stevedores both in the period immediately before and following privatisation. Shipping Australia noted:

> ... in Brisbane there were substantial land revaluations leading to privatisation, which increased port rents and has subsequently increased costs of services through the port of Brisbane since privatisation, but it was due to the government's action prior to privatisation.[174]

Asciano raised concerns about increases in rents pre and post privatisation in the context of its submission to the Harper Competition Policy Review:

> ... in the three years prior to privatisation rents increased at the Brisbane container terminal by 128 per cent. Further charging increases post port privatisation have occurred. More charging increases are likely given the high prices paid for the ports and the return on investment requirements of the port operators. ... profitability will need to increase and one of the key levers to influence profitability for a monopolist is to raise existing prices or commence charging of new prices.[175]

The Customs Brokers and Forwarders Council of Australia noted:

> Based on the experience that we have seen with DP World and what we have seen in Brisbane and Sydney since the privatisations of ports, I believe there is not that much confidence in industry that without any regulation it can be controlled and managed.[176]

It is evident to the Committee that there is broad concern among Port users at the possibility of substantial rental increases once the Port is leased to a private operator. The increase proposed by PoMC in relation to the DP World site earlier in 2015 has exacerbated those concerns. Consequently, many witnesses and submissions have called for stronger controls on the ability of the privatised Port operator to increase rents significantly.

On 30 September 2015, the Treasurer announced a strengthening of the regulatory framework from that contained in the Bill. This included among other things:

- requiring the Port leaseholder to offer a market standard rent review mechanism with dispute resolution by an independent property market expert to any new tenants or renewing tenants that wish to apply this mechanism
- a periodic review by the ESC on whether the Port leaseholder has misused its market power in the setting of rents at the Port.[177]

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174 Mr R. Nairn, Shipping Australia, *Transcript of Evidence*, 8 September 2015, p.67.

175 Asciano, *Competition Policy Review Response to the Draft Report* (2014), pp.16-17.

176 Mr Z. Kostadinoski, Customs Brokers and Forwarders Council of Australia, *Transcript of Evidence*, 13 October 2015, p.53.

177 Mr T. Pallas MP, *Government Strengthens Port Regulatory Regime With Additional Safeguards* (Media Release, 30 September 2015).

At subsequent Committee hearings, DTF advised that the Government proposed to amend the Bill to implement the ESC's new role relating to the review of the land rent setting process (as announced and detailed in the letter to the ACCC). It also advised that no changes are required to the Pricing Order to implement the new role for the ESC.

The Treasurer's announcement followed criticism from submissions and witnesses appearing before this Committee, as well as concerns expressed by the ACCC to DTF about the proposed pricing arrangements for the Port of Melbourne lease. The ACCC indicated to the Committee that in its view the announced changes represented 'significant improvements'.[178]

Other stakeholders appearing after the Treasurer's announcement supported the proposed changes, such as the Victorian Farmers Federation:

> Putting a bit of regulation, a bit of certainty around it, would relieve some of the angst from some of the port operators so they know where they are into the future and they know that they are not going to have this huge rental increase, which is going to impact upon their businesses. They have little ability to recoup huge rental increases. It needs to be balanced out. ... Those sureties should help to build the regulation around trying to make sure there is a framework there to make sure rental increases are under review but not allowed to be pushed up through huge spikes where it is going to impact upon their businesses.[179]

Infrastructure Tasmania also supported the announced changes:

> From the contractual aspect, requiring a market standard rent review with independent dispute resolution, we see as being a very positive step forward, and from the legislative aspect, extending the essential services commissioner's power to conduct periodic reviews on misuse of market power is also welcome. While it probably does not go to the full price regulation that we were looking at in our submission, it provides a level of comfort and is in line with our suggestion for an oversight mechanism for rents.[180]

Some parties, such as Asciano, were sceptical of how well the market rent review provisions would protect against excessively high rents, and considered that they were much less rigorous than a regulatory process. It also noted that there would be no protection whatsoever outside of a lease.[181]

Qube Holdings questioned whether the proposed market rent review mechanism was sufficient to address any disputes about rents:

> We end up in a process that on the surface sounds very nice — if you cannot agree on the rent, you go to an independent assessor and the independent assessor evaluates the rent. The problem is no-one really can define what market rent is in a port. No-one knows really what market rent is in a port. I have been through processes where valuers say, 'No, it is the South Melbourne industrial rents that

178 Mr R. Sims, Australian Competition and Consumer Commission, *Transcript of Evidence*, 30 September 2015, p.4.

179 Mr P. Tuohey, Victorian Farmers Federation, *Transcript of Evidence*, 30 September 2015, p.6.

180 Mr A. Garcia, Infrastructure Tasmania, *Transcript of Evidence*, 30 September 2015, p.2.

181 Dr T. Kuypers, Asciano, *Transcript of Evidence*, 9 September 2015, p.107.

> should be applied to the port'. The reality is a port tenant has a lease with a specific purpose — if you take it to the extreme of a stevedore, which we are not, they cannot operate anywhere else but beside the water. So what is that market valuation here in Melbourne? You end up with valuers making judgements. As a tenant, we are the entity that ends up copping what an individual valuer determines. I can assure you, over the times that I have been through this, valuers all have different views. It is a lottery as to what you might end up out of a dispute mechanism on rent. For that reason, we feel fairly strongly about having a mechanism in there that assures that rents do not go out of kilter. That is the driver for the view around some form of regulation.[182]

DP World also emphasised that the market rent review mechanism needed to be sufficiently broad:

> ...the market rent reviews need to be true market rent reviews where they take into account an open market, not what is considered to be a closed market. Where the asset owner was using precedents of stuff that was inside their asset base, we felt that that lent us to a fair bit of risk.[183]

The Committee notes that while services prescribed under the Bill and subject to oversight extend to approximately 86 per cent of current Port revenues, oversight does not extend to Port rents.

The Committee welcomes the Government's acknowledgement of the need to extend the oversight regime with new provisions relating to the setting of Port rents, and endorses its proposed changes.

However, the Committee is concerned that the Government's proposals do not provide the same degree of oversight or rigour in price setting as required for prescribed services and may result in the Port operator imposing large increases in Port rents to offset the relative constraint on the pricing of prescribed services.

For this reason the Committee believes that Port rents should also be defined as prescribed services and brought within the oversight and price setting mechanisms.

RECOMMENDATION 9: The Government:

(a) amend clause 90 of the Bill to extend prescribed services to include the granting of a lease or sub-lease by the Port of Melbourne for the purposes of terminals or stevedoring operations

(b) provide within the Pricing Order a rent capping mechanism that prevents the exercise of monopoly power in relation to leases or sub-leases.

182 Mr P. Digney, Qube Logistics, *Transcript of Evidence*, 14 October 2015, p.466.

183 Mr P. Scurrah, DP World, *Transcript of Evidence*, 14 October 2015, p.41.

6.6 Vertical and horizontal integration

The Committee notes that the ACCC will be able to examine whether any cases of horizontal integration will substantially lessen competition under section 50 of the Competition and Consumer Act, and that this should be sufficient to address any concerns about cross ownership.

Vertical integration of a port operator into upstream or downstream markets can pose a significant risk to effective competition. There are a number of scenarios whereby a port operator may seek to vertically integrate including:

- one of the stevedores operating at the Port of Melbourne could purchase the lease
- after purchasing the lease, the Port operator could merge with or acquire a Port of Melbourne stevedore or terminal operation
- after purchasing the lease, the Port operator could expand its services into stevedoring or terminal operation.

The Victorian Government's submission advised that the lease would be likely to include a prohibition on a leaseholder or its controlling entities or its associates being (or becoming) a 'Prohibited Port Operator', ie. a stevedore or motor vehicle terminal operator. It also advised that a Port operator would not be able to become a prohibited port operator during the term of the lease without prior written consent of the Government. Further, DTF advised that the Government had already announced that stevedores will not be permitted to bid in the transaction.

However, submissions including from DP World, Shipping Australia, the Rail Freight Alliance and the Australian Peak Shippers Association noted that the Government's submission did not deal with the situation where a Port lessee may later become a stevedore.

The Australian Peak Shippers Association highlighted the dangers of not sufficiently addressing any vertical integration concerns:

> Vertical integration could do a lot of damage to the integrity of the operation of the port. The intended incumbent certainly would have the opportunity to vertically integrate and get involved in the business of the port users. They would have a distinct advantage over the port users themselves and put them in a situation possibly of being uncompetitive. That then leads further down the track to possibly a monopoly, and that is the last thing, as shippers, that we want. ...We would like to see something in the legislation that takes the opportunity of vertical integration out of the system.[184]

184 Mr R. Coode, Australian Peak Shippers Association, *Transcript of Evidence*, 9 September 2015, p.87.

DP World noted that an example of the impact of vertical integration is Flinders Ports[185] which operates seven ports at Port Adelaide, Port Lincoln, Port Pirie, Thevenard, Port Giles, Wallaroo and Klein Port. Asciano also referred to the South Australian example:

> They are not only the port operator but also an active stevedore through the wholly owned Flinders Logistics which offers a full range of stevedoring service across bulk export and import, container services and general cargo. ... This type of unconstrained vertical integration undermines the competitive process and, ultimately, the efficiency of the supply chains.[186]

DP World provided a number of specific examples of how a vertically integrated Port operator may be able to limit competition, for example, by:

- denying potential competitors access to port (or other essential) facilities or discriminating in the quality or price of services provided to competitors
- providing access on less favourable/discriminatory terms and conditions (ie. by restricting the quay length/yard space allocated to third party users)
- refusing to grant long-term leases of terminals to unaffiliated stevedores, which will have the effect of stevedores becoming unwilling to invest sufficiently in capital to provide a more efficient service for its customers as they cannot secure long-term leases
- making port planning decisions such as relocating existing lessees who have made significant investments in their leased terminals to less favourable locations within the port in order to benefit its own downstream business
- using commercially sensitive information gained in its role as port operator to unfairly advantage its own stevedoring activities
- shifting costs from its competitive business to its regulated business to enable it to recover those costs through users/competitors and
- investing in the port in a way that favours its own operations.[187]

DP World called for assurances in the Bill around restrictions on vertical integration on the basis that future legislative instruments (such as Orders in Council) or contractual restrictions (in the Port lease) are not sufficiently certain, transparent or able to be directly enforced by third party users.[188]

The Committee notes that there is scope for the ACCC to examine acquisitions that may result in a substantial lessening of competition under section 50 of the Competition and Consumer Act. However, Asciano questioned whether the ACCC would likely intervene in all types of vertical integration:

> It is important to recognise that vertical integration can occur via both organic and inorganic (ie through acquisition) means. While the ACCC would have the ability to intervene in future on non-organic vertical integration it would not be able to address organic vertical integration such as the Flinders Ports example discussed below.[189]

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185 DP World, Submission 49, p.3.
186 Asciano, Submission 61, p.7.
187 DP World, Submission 49, p.3.
188 Ibid., pp.4, 6.
189 Asciano, Submission 61, p.7.

The ACCC advised that:

> Even if a purchaser of a privatised asset has no upstream or downstream interests at the time of sale, the ACCC's merger assessment would take into account whether the acquisition of the lease would provide them with the incentive to vertically integrate into related markets at a later time
>
> Section 46 of the [Competition and Consumer Act] prohibits a business with a substantial degree of power in a market from using this power for the purpose of eliminating or substantially damaging a competitor or to prevent a business from entering into a market.[190]

The Australian Industry Group supported explicit provisions in the legislation for the ACCC to step in to deal with cases of vertical integration:

> ... it seems reasonable for the ACCC to be dealing with [vertical integration]. It is what it does on a day-to-day basis in ensuring that there are the competitive neutralities and competitive values that are maintained, yes. But I think it would need to be specifically mentioned that the ACCC would be able to step in under these circumstances irrespective of what legislation the ACCC had itself.[191]

The Committee believes that it would be appropriate for restrictions on vertical integration to be included in the Bill, rather than simply in the lease. This would provide Port operators and other potential investors with clear and transparent rules.

RECOMMENDATION 10: The Bill be amended to explicitly prohibit:

(a) an entity engaged directly or indirectly in stevedoring or terminal operations becoming a Port operator

(b) a Port operator engaging directly or indirectly in stevedoring or terminal operations, other than in exceptional circumstances that require a temporary 'step in'.

190 Letter from Australian Competition and Consumer Commission to Port of Melbourne Secretariat, 12 November 2015, p.3.

191 Mr T. Piper, Australian Industry Group, *Transcript of Evidence*, 30 September 2015, p.320.

7 Balancing short and long term objectives

7.1 Introduction

There are a number of other critical aspects of the proposed lease arrangements that have short term and long term implications for the Port and the State of Victoria. Key issues include:

- the proposed Port Growth Regime (PGR)
- the proposal to require the Port operator to pay the existing Port Licence Fee upfront
- proposals around how the proposed lease proceeds will be used.

These features attracted significant stakeholder comment throughout the Inquiry and are discussed further in this chapter.

7.2 The Port Growth Regime

7.2.1 Purpose

The Government has proposed a compensation regime known as the Port Growth Regime that involves making payments to the new Port operator in the event that the State develops or sponsors a second port that handles international containers that could otherwise have been handled at the Port of Melbourne.

As noted in Chapter 3, at this stage it is unclear when and where the second container port will be built. However, DTF and most other stakeholders agree that it is likely that the natural capacity of the Port of Melbourne will be exhausted well before the end of the 50 year lease term – with some estimates as early as 2025.

DTF advised the Committee that the PGR was important to:

- ensure that the new Port operator did not face a disincentive to develop the Port of Melbourne to its natural capacity given that this is accepted as being the lowest cost outcome for the State
- reduce the risk of the commercial transaction for bidders. Without the PGR, DTF argued that bidders will likely price conservatively to reflect the risk that the State will develop a second container port.

DTF emphasised that the PGR was not there to 'pump up the price'. Instead it was 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'.[192]

7.2.2 How the Port Growth Regime is proposed to work

The proposed PGR compensates the Port of Melbourne leaseholder for international container trade that goes through a Statesponsored second port where it could have been accommodated by the Port of Melbourne.

There are a number of pre-conditions or thresholds that need to be met for compensation to be paid which are summarised in Figure 7.1.

DTF argued that it is not unusual in the context of major private sector transactions for there to be some form of penalty or compensation clause:

> 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.[193]

Apart from the New South Wales (NSW) cap and compensation scheme, the Committee was not provided with evidence of any other similar schemes proposed in the context of other recent port privatisations. In the context of the NSW scheme, most of the details were contained in commercial in confidence transaction documents and have not been made publicly available.

In relation to other recent privatisations, DTF's transaction advisors advised the Committee that:

> 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.[194]

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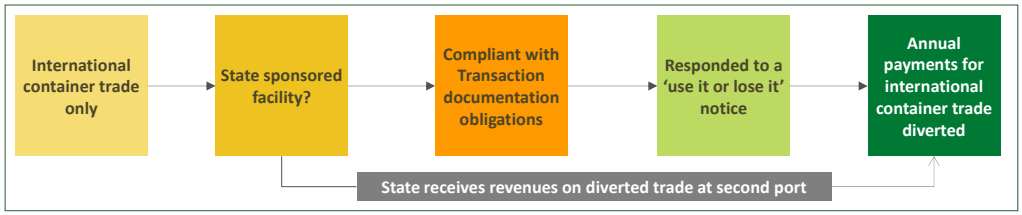
192 Mr D. Webster, Department of Treasury and Finance, *Transcript of Evidence*, 4 November 2015, p.42.

193 Mr T. Burgess, Flagstaff Partners, representing Department of Treasury and Finance, *Transcript of Evidence*, 4 November 2015, p.46.

194 Mr J. Peck, Morgan Stanley, representing the Department of Treasury and Finance, *Transcript of Evidence*, 4 November 2015, p.45.

Figure 7.1 The Port Growth Regime threshold requirements



Threshold	Comments
International container trade	• The PGR only applies to the diversion of international container trade • Does not apply to other trades – e.g. bulk liquid, break bulk, automotive, Bass Strait trade
State sponsored facility	• A State sponsored facility is a container facility where the State provides specific support in competition to PoM, whether in capital contribution or through specific benefits (e.g. subsidies) • Excludes port facilities sponsored by private operators
Compliant with Transaction documentation obligations	• Leaseholder must be in compliance with transaction documentation • To be eligible for payments, the leaseholder needs to be meeting its obligations and not frustrating the PoM's operations
Responded to a 'use it or lose it' notice	• To incentivise the leaseholder to meet demand when commercially feasible, the State will have the ability to serve a notice on the leaseholder to build capacity • Where the State has served such a notice, then if the leaseholder has not responded then the State can build capacity that will not be captured by PGR
Payments	• Payments are annual and are calibrated to meet some, but not 100 per cent of trade revenue lost • These payment features are designed to incentivise the leaseholder to mitigate losses and to prevent claims for small losses • The State will be receiving offsetting revenues at a State sponsored second container port for the diverted international trade

Source: Victorian Government, Department of Treasury and Finance, Submission 8, p.28.

DTF's transaction advisors went on to explain the special circumstances in the context of this Victorian privatisation:

> I think Melbourne is a bit unique in that you had a preelection 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.[195]

195 Ibid.

DTF's submission provided examples of the alternative compensation type arrangements that it had considered:

- calculating a net present value payment from lost new cash flows compared to a base case financial model
- including Material Adverse Event (MAE) type clauses with the compensation to be determined
- providing the State with the ability to mandate growth capital expenditure at its discretion – eg. where the State can 'call' for investment
- providing State guarantees of the leaseholder's equity return on new capacity developed under a 'take-or-pay' style regime (ie. the State effectively purchases new international container capacity)
- including the second port development in the transaction.

However, it expressed the view that the PGR had a number of advantages including:

- providing the bidder with a more conventional revenue model that represents overall revenues as close to 'actual' as possible
- providing more transparency upfront about the circumstances when compensation will be payable and avoiding protracted and expensive disputes about compensation clauses (such as under an MAE approach)
- avoiding the need to record payments as an ongoing financial liability for the State's balance sheet
- ensuring that the Port operator retains responsibility for market/ demand risk.

7.2.3 Stakeholders' concerns

Stakeholders raised a number of concerns about the PGR that can be broadly categorised as follows:

- a lack of transparency around the details of the PGR, including how it would apply and the extent of any compensation payments that the State would be exposed to
- how it might impact on decisions by the Port of Melbourne to invest to maximise capacity
- how it might impact on competition for port services
- how it might affect the Government's decision to invest in a second container port.

Each of these is briefly discussed below.

Transparency

DTF was unable to provide definitive propositions to the Committee about how the PGR was expected to operate in practice, and detailed analysis of the impacts associated with the regime.

A number of submissions echoed concerns about the lack of transparency and detail about how the PGR would work and its likely impact. These included the Australian Industry Group, DP World, Asciano, ANL Container Line, Shipping Australia, the Victorian Farmers Federation (VFF) and the Victorian Employers Chamber of Commerce and Industry (VECCI).

Shipping Australia argued that the PGR lacks transparency:

> ... the Bill simply enables the Government to pay compensation, it does not provide the details of the amount, and there is no statement of the port capacity at which this will commence – presumably such detail will be included in a commercial-in-confidence lease agreement and the people of Victoria will never know.[196]

VFF also called for the details not to be hidden behind 'commercial in confidence claims':

> Full transparency around such agreements, prior to privatisation, will ensure port users and the wider public have a clear understanding of any impacts that the Port of Melbourne lease agreement may have on the development of a second port, any applicable caps on throughput and leaseholder compensation provisions.[197]

The lack of detail presented about the regime meant that many stakeholders were ill-equipped to comment on the potential impacts, and to ultimately assess whether the PGR was a good proposition for the State. For example, VECCI stated that 'it is difficult to comment more specifically on the implications of including a compensation regime without knowing the amount of compensation proposed and the Port of Melbourne container capacity that would be used to determine whether the compensation provision is triggered'.[198]

On 30 September 2015, the Treasurer committed to the public release of the capacity levels and trigger points in relation to the PGR after the lease transaction is completed.[199]

In response, some stakeholders welcomed the additional transparency from releasing capacity levels and trigger points associated with the regime. However the ACCC maintained its preference for there to be no compensation:

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196 Shipping Australia, Submission 22, p.4.

197 Victorian Farmers Federation, Submission 29, pp.12-13.

198 Victorian Employers Chamber of Commerce and Industry, Submission 78, p.2.

199 Mr T. Pallas MP, *Government Strengthens Port Regulatory Regime with Additional Safeguards* (Media Release, 30 September 2015).

> ... that does bring a degree of sensible transparency to the situation; that is to say, people who might want to build an alternative port, rather than it being a black box, would have that information and that would allow them to plan at an early stage to bring on another port. ... we welcome the further changes to bring transparency, but of course we still do have this philosophical difference where we think it would be better without any compensation regime...[200]

At hearings, DTF often referred to the 'intent' of the regime and provided a number of examples where at this stage the detail of the PGR was still to be finalised:

- 'Government has not considered that definition [of State sponsored]'[201]
- 'we are *contemplating* allowing bidders to actually bid [the maximum capacity] figure'[202]
- [How significant is the buffer?] 'Again nothing has been decided'[203]

The lack of transparency and precision around critical details associated with such a fundamental aspect of this transaction significantly hampers the Committee's ability to consider the value and impacts of the regime – which are further discussed below.

7

Incentives to invest

DTF emphasised the important incentives that the new Port operator would have through the PGR to invest in maximising capacity:

> The PGR is designed to incent the leaseholder to invest in efficient international container capacity at the Port of Melbourne (PoM). The uncertainty that the State might build a second container port during the lease term before it is required, and uncertainty over what capacity might be built as well as the extent that State support endows a competitive advantage on a new second port, are challenging for infrastructure investors to price. Without mitigation of this uncertainty, the Port of Melbourne lease transaction (Transaction) proceeds will be materially adversely impacted.[204]

The incentives to invest in capacity naturally exist under the economic regulatory regime proposed by the Government, because additional capital expenditure will earn a rate of return based on the application of a building block approach. However, where trade volumes are diverted to the new container port, this will likely reduce at least some of the return available to the Port operator.

The use it or lose it provision would also likely provide an incentive for investment, since if the Port operator failed to invest, the State would likely develop and commence the handling of container trade at a second point.

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200 Mr R. Sims, Australian Competition and Consumer Commission, *Transcript of Evidence*, 30 September 2015, p.3.

201 Mr D. Webster, Department of Treasury and Finance, *Transcript of Evidence*, 4 November 2015, p.35.

202 Ibid., p.36.

203 Mr J. Peck, Morgan Stanley, representing the Department of Treasury and Finance, *Transcript of Evidence*, 4 November 2015, p.39.

204 Department of Treasury and Finance, Response to Questions on Notice, 30 October 2015, p.1.

However, a number of stakeholders were concerned about whether the PGR would dampen incentives for the new Port operator to invest in capacity.

VECCI, for example, stated:

> We are also keen to avoid a situation where the new Port of Melbourne leaseholder, anticipating completion of a second container port, modifies operation investment or productivity in order to limit the growth of port throughout.[205]

The VFF was also very strongly opposed to the payment of compensation and questioned whether businesses operating in a competitive environment would be able to benefit in the same way:

> That port now should be fully utilised between 2025 and 2040. The port operators there should be able to lock in their customers in that time frame. If they are not doing that, as a commercial business that is operating, they are doing something seriously wrong. We do not see the need to compensate the port leaseholder in any way or means to benefit them. I mean, that is just like giving them a free handout. They are not doing their job. They have got plenty of opportunity to make sure they manage the business, as we all do when we operate commercial businesses, and we do not get any compensation if somebody else opens up a business up the road.
>
> … you have got a 10 to 15-year time frame before a port will be built — certainly time for the current operators of the port to lock in their customers and look after themselves. We totally oppose that compensation.[206]

Competition

Many stakeholders were concerned about the impact that the PGR would have on competition, and the longer term effects on prices for Port users, including the Australian Peak Shippers Association:

> Offering compensation severely restricts competition between the ports by giving the incumbent an unfair advantage not to mentioned the use of public monies that could be directed to more urgent needs.[207]

The impacts of the PGR on competition are difficult to unpack. To date there has been relatively little active competition between Australian ports albeit, as discussed in Chapter 4, there is some contestability of container trade across ports and recent growth in market shares of other ports. Evidence presented to the Committee suggests that the origin-destination of most containerised trade is within 50 km of the Port of Melbourne.[208] High land based transportation costs, and other warehouse and logistics considerations, are likely to make switching to another port an unlikely proposition.

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205 Victorian Employers Chamber of Commerce and Industry, Submission 78, pp.2-3.

206 Mr P. Tuohey, Victorian Farmers Federation, *Transcript of Evidence*, 30 September 2015, pp.4-5.

207 Australian Peak Shippers Association, Submission 11, p.2.

208 Essential Services Commission, *Review of Victorian Ports Regulation: Final Report 2014* (2014), pp.32-33.

More broadly, as Qube Holdings noted, 'the competition argument in the industry has traditionally been around competition between stevedores, not necessarily competition between ports'.[209] This was confirmed also by the 2014 KPMG advice to the then Government which advised that stevedore costs are a more important driver than port costs in influencing choices about which port to use – assuming that those ports are not constrained in terms of vessel size.

However, the privatisation of eastern seaboard ports over the last few years has meant that there is a prospect of increasing competition, even if only at the margin. The Committee heard from a number of stakeholders who confirmed that they and others would actively consider shifting their cargo to another port (such as South Australia or Port Botany) if prices at the Port of Melbourne were to increase significantly.[210]

In evidence to the Committee, Shipping Australia noted that the costs associated with Australian ports were around double those of New Zealand ports. Shipping Australia put this down to the effect of open competition between geographically close ports in New Zealand:

> Australian ports are quite expensive, and if you look at the difference between Australia and New Zealand, the one striking difference is that there is proper, open competition between ports that are relatively closely spaced; for example, Auckland and Tauranga, and Lyttelton and Timaru on the South Island. I think this is the key to ensuring efficiency in port operations. We do not have that in Australia.[211]

Qube Logistics confirmed that competition was among one of the key drivers for the significantly lower port charges in New Zealand:

> Mr PURCELL — It is interesting, though, in some of your comments in regard to costs and New Zealand being 50 per cent of the cost of the Port of Melbourne, I think you said. Why and how can they do that? Is it subsidised or what is the reason or how do they do that?
>
> Mr DIGNEY — It is competition.[212]

Some stakeholders questioned whether the PGR would be likely to have a significant impact on competition, given in particular the lower costs associated with developing capacity at the Port of Melbourne compared to a greenfield site.

However, the ACCC said that 'such a compensation regime would be likely to hinder the prospects of future competition, entrenching substantial market power at the Port of Melbourne'.[213] At hearings, the ACCC further elaborated:

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209 Mr M. James, Qube Holdings, *Transcript of Evidence*, 14 October 2015, p.467.

210 Mr G. Allen, Australian Grain Link, *Transcript of Evidence*, 29 September 2015, pp.268-269; Ms L. Stoyles, Asciano, *Transcript of Evidence*, 9 September 2015, p.106; Mr M. Rocke, Rocke Brothers, *Transcript of Evidence*, 24 September 2015, p.189.

211 Mr R. Nairn, Shipping Australia Ltd, *Transcript of Evidence*, 8 September 2015, p.66.

212 Mr P. Digney, Qube Logistics, *Transcript of Evidence*, 14 October 2015, p.469.

213 Australian Competition and Consumer Commission, Submission 27, p.2.

> ... we would prefer to have no compensation regime; there is [no] doubt about that. The logic for compensation, as we understand it, is that the new owner can invest knowing that they will be able to reap the benefits of their investment because noone can invest until capacity gets to a certain level. I am sure there are other arguments, but that, as I understand it, is the gist of it. There are many governments that have held that view; it is not an isolated view. But our view would be that not having a compensation regime would be better; that the port owner, to protect its investment without a compensation regime, would then need to make sure that they invest to make sure that they do not leave a gap for someone else to fill, and if someone else saw a gap that the owner of the Port of Melbourne did not, then they would fill that gap. We think competition is a better way around it. We are being quite upfront with the government that we have an agreement to disagree on that topic. We would prefer no compensation; that is clear.[214]

Government decision making

Stakeholders were concerned that the PGR would be likely to weigh heavily on the Government's decision to develop a second container port, as a means of avoiding or minimising the extent of compensation payable.

VECCI indicated that it was:

> ... keen to avoid a situation where a future government, in order to avoid triggering a large compensation liability, postpones the development of a second port resulting in businesses being disadvantaged by capacity constraints at the Port of Melbourne.[215]

These concerns were heightened by the wide-ranging views about the maximum possible capacity of the Port of Melbourne and uncertainty about future growth forecasts. The Institute for Supply Chain and Logistics considered that the different views about growth and capacity meant that it was likely 'significant compensation will need to be paid to the new port manager sooner than the government forecasts'.[216]

Shipping Australia expressed concerns that the PGR could create an incentive for the Government to delay the development and commencement of a competing container port:

> ... such a compensation regime will be a disincentive for any Government to invest, in a timely manner in the necessary infrastructure to support a future deep-water port (be it Hastings, Bay West or another option).[217]

Similarly, Infrastructure Partnerships Australia highlighted the potentially significant costs associated with delaying the development of additional capacity:

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214 Mr R. Sims, Australian Competition and Consumer Commission, *Transcript of Evidence*, 30 September 2015, p.5.

215 Mr H. Horsfall, Victorian Employers Chamber of Commerce and Industry, *Transcript of Evidence*, 30 September 2015, p.3.

216 Institute for Supply Chain and Logistics, Victoria University, Submission 66, p.2.

217 Shipping Australia, Submission 22, p.4.

> Obviously a lack of capacity would damage Victoria through higher than necessary costs as scarce capacity becomes more expensive, and potentially through a loss of trade to other jurisdictions or countries. ...The principal losers from overly late or overly early delivery of a new port can only be the consumers, workers and businesses which together comprise the State's economy.[218]

DTF has stated clearly that 'the State retains full strategic flexibility to build and start operating a second container port at any time'.[219] It has further stated that:

> Where the Government acts commercially, ie., builds a second container port in response to demand and once the lower cost port of Melbourne natural capacity is reached, then the State will not be out of pocket.[220]

However, there is a risk that the Government, in seeking to avoid liability under the PGR, may excessively delay the development of a second port, leading to a shortfall in container port capacity in Melbourne. If this were to occur, the State could potentially risk significantly higher costs associated with port services by virtue of capacity constraints and the entrenched monopoly position of the Port of Melbourne.

Overall assessment

DTF has not been able to provide the Committee with clear and definitive information about how the PGR will apply, and the extent of the State's potential exposure. There have been a number of areas where DTF and its advisors have told the Committee that key aspects of the PGR have either yet to be decided, are to be decided through the competitive bid process or cannot be released on the basis of commercial sensitivity. This includes the proposed formula and key trigger points.

The Committee notes the significant concerns expressed by stakeholders – particularly around the impact that the PGR might have on investment and competition. These impacts are difficult to assess without full details about how the regime will apply in practice. This includes concerns from the ACCC that the '... compensation regime would be likely to hinder the prospects of future competition, entrenching substantial market power at the Port of Melbourne'.[221]

The lack of detail and heavy reliance on the competitive bid process to determine key aspects of PGR means that the Parliament is being asked to endorse a compensation structure that creates an unquantifiable financial exposure and inherent disincentive for the State to provide for a second port. In light of this, and the strong reservations expressed about the PGR by key stakeholders, including the ACCC, the Committee believes that it is in the longer term interests of Victoria that the PGR be removed from the lease transaction.

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218 Mr B. Lyon, Infrastructure Partnerships Australia, *Transcript of Evidence*, 14 October 2015, p.530.

219 Victorian Government, Department of Treasury and Finance, Submission 8, p.3.

220 Department of Treasury and Finance, Response to Questions on Notice, 30 October 2015, p.6.

221 Australian Competition and Consumer Commission, Submission 27, p.2.

RECOMMENDATION 11: The Bill be amended to:

(a) exclude the enabling provision for the Port Growth Regime (see subsequent recommendation in relation to clause 69)

(b) prohibit the inclusion in contract of a compensation or refund mechanism however so defined.

7.2.4 Exemption from ACCC scrutiny

Section 51 of the *Competition and Consumer Act 2010* (Cth) (Competition and Consumer Act) allows for an Act of a State Parliament to authorise Part IV conduct under the Competition and Consumer Act, which prohibits certain restrictive trade practices. These practices include cartel conduct; exclusive dealing; prohibition of acquisitions that would result in a substantial lessening of competition; contracts, arrangements or understandings that restrict dealings or affect competition; prohibition of contracts, arrangements or understandings affecting the supply or acquisition of goods or services.

As noted by the ACCC at hearings, these types of clauses cannot exempt conduct under other relevant provisions of the Competition and Consumer Act – including section 46 related to the misuse of market power and section 50 relating to mergers and acquisitions that may have the effect of substantial lessening of competition.

Clause 69 of the Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015 (the Bill) authorises:

> an agreement connected with 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 one or more of the following occurs—
>
> (a) the loading, unloading, handling, transport or transhipment of cargo containers serving international trade;
>
> (b) the storage of cargo containers serving international trade.

The effect of clause 69 is to authorise provisions related to the PGR. This was confirmed by DTF's legal advisors who informed the Committee thus:

> 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 Statesponsored ports or Statesponsored 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 that 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.[222]

A number of submissions and witnesses at hearings were concerned that clause 69 of the Bill would prevent the ACCC from scrutinising any potentially anti-competitive aspects of the lease agreements. In particular, the ACCC considered that the PGR could potentially have anti-competitive effects,[223] and further advised the Committee that:

> Any restrictions imposed by governments which have the purpose of effect of substantially lessening competition are likely to be of concern to the ACCC. This would include any sale conditions designed to boost asset sale prices by reducing potential competitive pressures on the asset operator.[224]

However, DTF asserted that the State was not of the view that any of the documents comprising the PGR would have the effect of substantially lessening competition – 'in fact, quite the contrary'.[225]

A number of stakeholders were concerned about the application of this clause. For example, the VFF said that:

> If the lease agreement is exempt from Part IV of the Trade Practices Act, the question which arises for the VFF in consider: what will prevent a misuse of market power by a private entity that is seeking to maximise return on its investment?[226]

Both the VFF and the Australian Logistics Council expressed the view that some provisions of the Bill had been 'designed to increase the value of the lease rather than the efficient operation of the port'[227] and recommended that clause 69 of the Bill be deleted. Asciano also called for clause 69 to be removed:

> ... we cannot quite understand the purpose or the regulatory or policy justification for a clause like that. Our position would be to go back to the fundamental position that any operator in Australia should be treated in the same way as any private operator. Even if there had been a prior government-owned monopolist, we think once they are privatised, they should be treated in the same way as any private operator.
>
> ... From our perspective, provided there was the appropriate ACCC scrutiny and the ACCC had clear powers to scrutinise any transaction like that, that would probably give us the comfort that we need. I think the airlines have been subjected to more intrusive regulation. In addition to those particular provisions, there is also a provision in the Brisbane legislation which precludes vertical integration beyond

222 Mr G. Carter, Minter Ellison, representing the Department of Treasury and Finance, *Transcript of Evidence*, 4 November 2015, p.68.

223 Mr R. Sims, Australian Competition and Consumer Commission, *Transcript of Evidence*, 30 September 2015, p.3.

224 Letter from Australian Competition and Consumer Commission to Port of Melbourne Secretariat, 12 November 2015, p.2.

225 Mr G. Carter, Minter Ellison, representing the Department of Treasury and Finance, *Transcript of Evidence*, 4 November 2015, p.69.

226 Victorian Farmers Federation, Submission 29, p.11.

227 Australian Logistics Council, Submission 47, p.7.

> 5 per cent. That has been a more intensive type of regulation, which I think can work. But, generally speaking, we would not argue for really intrusive regulation, as long as there was the appropriate ACCC scrutiny.[228]

Asciano further commented:

> ...The other thing just about the ACCC scrutiny would be the ACCC would be looking at everything, including the ESC regime. They would say, 'What's the impact of this transaction, given that you've got this regulatory regime?'. ... we are not quite sure what benefit it delivers for Victorians to exclude that.[229]

The Australian Peak Shippers Association said:

> We want the ACCC to be able to oversee the whole box and dice to make sure that (a) there is no vertical integration, which will cause anti competitiveness, and that (b) they are able to look at any anticompetitive activities that are occurring.[230]

The ACCC noted that many governments have previously chosen to include such provisions in their agreements when selling assets. However, the ACCC Chair, Mr Rod Sims, also expressed the view that the lease would be stronger if the provision was not in the legislation:

> ... we at the ACCC would rather they not do that. ... we would have a view that all commercial transactions of government should be subject to part IV. Professor Harper in his review has tried to strengthen that as well so that when governments take commercial decisions they are subject to the competition parts of our act — part IV is the competition part. So we would have that as a general view, and it would not change with this transaction.[231]

Asciano suggested that expediency may be a reason why clause 69 is considered necessary:

> We know that some members of the committee are concerned around the timing and delay that might be caused as a result of ACCC involvement, but our experience has been that the ACCC can work to extremely tight time frames and is able to turn these sorts of reviews around. It would not be a particularly new issue for the ACCC, given that they have been involved in these other privatisations elsewhere.[232]

The Committee notes the ACCC's preference for the competition provisions of the Competition and Consumer Act to apply to the transaction and is not persuaded by the need for an exemption to be granted. The Committee also notes DTF's view that while the proposed exemption from ACCC jurisdiction provides certainty, nothing contemplated in the transaction necessitates the exemption.

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228 Ms L. Stoyles, Asciano, *Transcript of Evidence*, 9 September 2015, p.102.

229 Dr T. Kuypers, Asciano, *Transcript of Evidence*, 9 September 2015, p.102.

230 Mr R. Coode, Australian Peak Shippers Association, *Transcript of Evidence*, 9 September 2015, p.96.

231 Mr R. Sims, Australian Competition and Consumer Commission, *Transcript of Evidence*, 30 September 2015, pp.7-8.

232 Dr T. Kuypers, Asciano, *Transcript of Evidence*, 9 September 2015, p.101.

Given those factors, along with the strong concerns expressed by witnesses about the proposed exemption, the Committee believes that the transaction can be enhanced by the retention of ACCC oversight under the Competition and Consumer Act and the Competition Code.

RECOMMENDATION 12: The Bill be amended to omit clause 69 thereby preserving the full application of the *Competition and Consumer Act 2010* (Cth) and the Competition Code.

7.3 The Port Licence Fee and Cost Contribution Amount

7.3.1 The Port Licence Fee

In 2012-13, the Victorian Government introduced a Port Licence Fee (PLF) that the Port of Melbourne Corporation (PoMC) is liable to pay each financial year.[233] The PLF was initially set at $75 million and is escalated by a Consumer Price Index (CPI) adjustment factor each year. DTF advised that the current value of the PLF is approximately $80 million.[234]

A number of submitters noted the significant impact that the introduction of the PLF had on their prices. For example, Shipping Australia noted that the introduction of the PLF has contributed to the Port of Melbourne charges rising by approximately 54 per cent since 2009, the highest rises of east Australian ports.[235] The Tasmanian Government also advised:

> In 2012, Tasmanian shippers endured significant tariff increases at the Port, following the introduction of the Victorian Government's PLF. The PLF increased port tariffs, on average, by around 50 per cent. The PLF is unrelated to the cost of providing port services and is utilised by the Victorian Government as a general revenue raising measure; it is effectively a 'port tax' levied on all users.
>
> Notwithstanding the PoMC's efforts to spread the legislated PLF cost impost broadly and on an equitable basis, it is worth noting that current port tariffs – which will be used as the baseline for annual increases following privatisation – still incorporate an $80 million per annum cost pass-through to users that is unrelated to actual port services or costs.[236]

Clause 83 of the Bill retains the requirement for a Port licence holder to pay a PLF. It also enables the Treasurer to require the Port licence holder to pre-pay the annual PLF for the duration of the lease, as an upfront lump-sum. DTF advised the Committee that a decision was yet to be made as to whether the PLF will need to be paid upfront, and that this decision would likely be made prior to the transaction Expression of Interest being released. [237]

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233 *Port Management Act 1995* part 2B.

234 Mr N. Rizos, Department of Treasury and Finance, *Transcript of Evidence*, 4 November 2015, p.3.

235 Shipping Australia Ltd, Submission 22, p.2.

236 Tasmanian Government, Submission 58, pp.4-5.

237 Mr N. Rizos, Department of Treasury and Finance, *Transcript of Evidence*, 4 November 2015, p.3.

Under clause 86 of the Bill the proceeds from the PLF are to be paid into the Consolidated Fund, or in the case of an upfront PLF, are to be paid into the Victorian Transport Fund, or the Consolidated Fund if the Treasurer decides. This point was recognised by Shipping Australia:

> It is clearly attractive to provide a massive cash injection (in the order of $3.5bn) to the Victorian Government, but as the PLF is not hypothecated to port or freight development it can be used for any purpose.[238]

Requiring an upfront payment of the PLF means that the Government is able to effectively capitalise this future income stream at the time of privatisation, and thereby increase the current receipts from the transaction. However, a number of submissions were concerned that the Port operator would need to borrow funds in order to effect the prepayment, and this would need to be financed either through higher port charges or lower transaction proceeds.

DP World stated that:

> ... it is a Government loan that will ultimately be paid for by Victorian exporters and consumers.
>
> If the Port purchaser is allowed to recover interest on this amount and a return on investment for the premium that they pay for the future potential earning power of the asset this could impose an immediate and very substantial up front cost on Port users.[239]

The Australian Peak Shippers Association commented that the estimated upfront payment of $3.5 billion would:

> ... [generate] an interest bill that the purchaser will have to pass on to his tenants, and in turn the tenants will pass it through the chain, again on a costplus basis, until it reaches the shippers. We say: why place this unnecessary burden on the port users? If the government needs to borrow to cover a shortfall, then it should be upfront about it. It is bad enough that the port users currently get slugged with this form of a tax without having to endure an interest bill on top of that.[240]

Evidence from ANL Container Line supported the view that the upfront payment of the PLF would result in higher capital servicing costs for the Port operator, flowing through to port charges:

> The up-front payment of the port licence fee means that the ports' charges will include an interest component going forward, and the income from property leases needs to be included in the review of port pricing as these charges to tenants will flow onto importers and exporters.[241]

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238 Shipping Australia, Submission 22, p.4.

239 DP World, Submission 49, p.5.

240 Mr R. Coode, Australian Peak Shippers Association, *Transcript of Evidence*, 9 September 2015, p.87.

241 Mr. D. Munro, ANL Container Line, *Transcript of Evidence*, 14 October 2015, p.476.

However, DTF advised the Committee that the PLF would have no impact on the prices ultimately paid by Port users. The PLF would continue to be treated as a pass through cost for the Port and that the question of:

> whether or not the leaseholder funds its acquisition with debt or equity is a matter for them and makes no difference to the CPI price cap period or the allowable costs under the economic regulatory regime... In other words, a prepayment of the PLF makes no difference to the allowable efficient costs of the port.[242]

The Committee notes that the CPI cap and pricing model are not ubiquitous and that there are other opportunities for the new Port operator to pass through the financing costs associated with the PLF.

The Committee considers that the Government has not established a sound policy basis for including under clause 83 of the Bill, the option to bring forward 50 years of PLF revenue. Such a bring forward has the characteristic of diverting recurrent revenue from future governments over several generations to the current government.

Clause 83 of the Bill provides very broad power for the Treasurer to determine an upfront PLF on whatever basis at whatever level the Treasurer sees fit.

The Government has been unable to advise the Committee as to whether it intends to use this bring forward mechanism.

Given the uncertainty around the Government's intentions with respect to an upfront PLF and the lack of a clear policy rationale for such a mechanism, the Committee considers that the mechanism to levy an upfront lump sum PLF should be omitted from the Bill.

RECOMMENDATION 13: Clause 83 of the Bill be amended to omit section 44HA allowing the Treasurer to require payment of an upfront lump-sum Port Licence Fee rather than annual Port Licence Fees.

7.3.2 The Cost Contribution Amount

In addition to the Port Licence Fee, clause 4.1.2 of the Pricing Order allows the leaseholder to receive an amount equal to any Cost Contribution Amount (CCA) under the Port Concession Deed.

DTF advised that the CCA reflects amounts to be paid to StateCo, the legacy PoMC entity, for the operating and capital costs incurred in providing Government-retained port services such as the Harbour Master and the Vessel Traffic Service. It further advised that the amount per annum is still being finalised as operational and organisational matters are being settled as part of the separation activities.[243]

242 Department of Treasury and Finance, Response to Questions on Notice, 30 October 2015, p.19.

243 Department of Treasury and Finance, Response to Questions on Notice, 30 October 2015, p.18.

The Committee notes that there is the potential for the CCA to be set at such a level that does not match the costs associated with those PoMC functions that will be delivered in future by StateCo.

In the interests of transparency, the Government should publish details of the CCA to be passed on to Port users through prescribed prices prior to the Expression of Interest. These details should include the amount, the basis on which it has been determined and its relativity to the actual cost incurred currently for those functions. Making this information publicly available will provide transparency and confidence that Port users will not pay significantly higher amounts to cover the cost of these functions in the transition to the new regime.

RECOMMENDATION 14: The Government should publish, prior to the release of the Expressions of Interest, the amount of the Cost Contribution Amount to be passed on to the Port operator and the basis of its calculation.

7.4 Application of lease proceeds

7.4.1 Government policies and commitments

The Port of Melbourne lease proposal was presented to the community as a pre-election commitment by the Government, coupled with a promise to remove 50 metropolitan level crossings. This was reiterated in the Victorian Government's submission to the Committee:

> The Transaction facilitates a broad range of transport infrastructure including the Level Crossing Removal Program and infrastructure projects for public transport, roads, rail, and the movement of freight, ports or other infrastructure.[244]

The Bill requires the proceeds from the proposed lease to be applied to the Victorian Transport Fund (VTF) for use on the Level Crossing Removal Program and/or other transport infrastructure.

7.4.2 The Victorian Transport Fund

The Bill proposes that the VTF be established as an account in the Trust Fund. Section 14 of the Bill covers payments into the Fund and provides that it would receive the proceeds of the Port lease transaction, as well as Funds appropriated by Parliament, interest on the investment of money in the fund, and money directed to the Fund by legislation.

Payments out of the Fund are covered by section 15, and are to include the cost of all or any part of the development of the Level Crossing Removal Program; infrastructure projects for or in relation to public transport, roads,

244 Victorian Government, Department of Treasury and Finance, Submission 8, p.9.

rail, the movement of freight, ports or other infrastructure, as well as the cost of administration and monitoring and reporting on the financial position and operations of the Fund.

7.4.3 Agriculture Infrastructure and Jobs Fund

Following the Government's announcement of the proposed Port lease, and the introduction of the Bill into Parliament, the Government advised that it would create a $200 million Agriculture Infrastructure and Jobs Fund, to 'support investment in agricultural infrastructure and supply chains to boost productivity, increase exports and reduce costs so our farmers, businesses and industries can stay competitive'.[245]

The Bill does not provide for the Agriculture Infrastructure and Jobs Fund, many elements of which are out of scope of the VTF. However, the Committee has found that there was a perception among submitters (especially in rural areas) that this Fund represented the distribution of part of the proceeds of the Port lease transaction to rural projects.

DTF explained that although payments for this Fund would not directly come from the Port lease proceeds in the VTF, the lease proceeds would provide 'budgetary room' to fund the Agriculture Infrastructure and Jobs Fund.[246]

7.4.4 Submitters' views

The views from submitters in relation to the proposed application of the lease proceeds can be categorised as follows:

- substantial support for the Level Crossing Removal Program, with some marginal disagreement as to the process for assigning priority as to which level crossings should be removed
- a call, particularly from rural and regional councils and representatives, for a greater share of the proceeds to be applied to rural and regional transport infrastructure
- a view that some of the proceeds should be allocated to manage and protect Port Phillip Bay
- a view that Infrastructure Victoria should be involved in setting priorities for spending from the Fund.

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245 Premier of Victoria, *$200M Fund To Support Farmers From Paddock To Port* (Media Release, 2 August 2015).

246 Mr N. Rizos, Department of Treasury and Finance, *Transcript of Evidence*, 4 November 2015, p.74.

7.4.5 The Level Crossing Removal Program

The Victorian Government's plan to remove 50 level crossings was generally supported by those submitters that referred to it. The Committee for Melbourne supported the Level Crossing Removal Program and claimed some credit for raising level crossing removal as a public priority:

> The Committee [for Melbourne] actually was probably the entity that really raised the awareness of the need to remove level crossings or undertake grade separations because of the impact that they have on our capacity to add more into our train system. ... to run more trains down any train line if we have got more capacity, we cannot have boom gates down for longer periods of time. We have to remove them, and I think still with about 168 or so left in the metropolitan area to remove, it is a big piece of work.[247]

The Municipal Association of Victoria supported the Level Crossing Removal Program as well as other infrastructure projects that might receive funding from the Victorian Transport Fund:

> The level crossing removal project will increase the capacity of the road and rail network, decreasing travel times for businesses and the community with estimates that this project will create 4,500 jobs during the project. By uncoupling the rail and road network, both systems will be able to work more efficiently.[248]

The Committee also took evidence from the Department of Economic Development, Jobs, Transport and Resources as to the work done to assess the business case for the Level Crossing Removals.

7.4.6 Investing in rural and regional transport infrastructure

The VFF as well as a number of rural and regional Councils, Regional Councils Victoria, the Wimmera Development Association and the Rail Freight Alliance identified rural and regional transport infrastructure needs that could be addressed with some of the Port lease proceeds. For example, the Wimmera Development Association told the Committee that:

> The major infrastructure projects are road and rail because of the freight tasks. We are strongly supporting the Murray Basin rail investment, duplication of the Western Highway, investment into the Henty Highway north and south and, through the councils, concerns about funding for C-class roads.[249]

Regional Councils Victoria (RCV) stated that a 'greater portion of funding is required to support the development of assets that will facilitate and grow the movement of freight' in addition to funds already allocated to regional Victoria under the Agriculture Infrastructure and Jobs Fund. It also expressed a preference for freight routes, logistics and warehousing hubs to be identified

247 Ms K. Roffey, Committee for Melbourne, *Transcript of Evidence*, 13 October 2015, p.23.

248 Municipal Association of Victoria, Submission 76, p.2.

249 Ms J. Bourke, Wimmera Development Association, *Transcript of Evidence*, 27 October 2015, p.30.

early, and new freight activities to be located in regional cities. RCV also supported an ongoing allocation of funds for upgrading logistics and road and rail freight routes to the Port.[250]

Several councils in the north-east of the State, such as the Shires of Indigo and Towong, argued that they should receive a share of the lease proceeds because trucks carrying primary production to the Port were significant in their areas. For example, the Shire of Towong submitted that:

> The majority of the sale proceeds should not be directed to metropolitan projects. It is the regional areas that bear an unequal cost burden for roads and bridges maintenance related to Port usage and this should be addressed more equitably with proceeds from the sale...the allocation of funds to rural regional areas should be based on the proportion of produce that is exported and imported through the Port from rural and regional Victoria.[251]

7.4.7 Management and protection of Port Phillip Bay

Several councils, the Association of Bayside Councils as well as environmental groups argued that a proportion of the proposed lease proceeds should be applied to the protection of Port Phillip Bay. Such groups typically argued that shipping activity could threaten aspects of the Bay environment through channel works, fouling, or the importation of foreign marine organisms.

For example, the City of Frankston argued that the Government should:

> Establish a 'Fund' from the lease of the Port of Melbourne with proceeds to improve the amenity of Port Phillip Bay
>
> Ensure that the health, amenities, economic benefits and environment of the bay are protected for now and future generations...[252]

The Association of Bayside Councils provided a detailed submission on these issues and reported that it was involved in discussions with the Treasurer on these issues. These discussions could give rise to a further call on lease proceeds, which would be appropriate if the link between port activity and the need for bay management and monitoring can be shown.

7.4.8 Overview of allocation

The Government had decided the proposed allocation of Port lease proceeds to level crossing removals, and priorities within the Level Crossing Removal Program, in advance of the creation of Infrastructure Victoria. Similarly, the allocation to the Agriculture Infrastructure and Jobs Fund was also a prior government decision.

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250 Regional Cities Victoria, Submission 77, p.2.

251 Cr D. Wortmann, Towong Shire Council, *Transcript of Evidence*, 29 September 2015, p.233.

252 Frankston City Council, Submission 51, p.4.

The Committee was also advised that a comprehensive business case for the Level Crossing Removal Program is being prepared but is not yet complete. It may be that when this process has been completed that there is some scope for alteration of priorities within the list of 50 level crossings.

Evidence provided to the Committee by witnesses, including those from DTF, confirmed an understanding that receipt of the lease proceeds will free up room in the Budget for other regional projects and priorities.

The Committee's inquiry has shown that there are potentially a number of productivity enhancing uses for the proposed lease proceeds, including many projects and proposals related to regional and supply chain infrastructure as well as additional funds for the management and/or protection of the Bay.

Ranking of projects in terms of their social and economic priority is a complex task, and many submitters advised the Committee that they supported the future role of Infrastructure Victoria in providing advice to government on such matters.

The Committee has received a range of proposals and commends them for Government consideration. A recurring theme to the evidence it received was strong support for a dedicated proportion of Port lease proceeds to be reinvested back into improving logistics infrastructure in rural and regional Victoria.

RECOMMENDATION 15: The Government, ahead of the lease transaction, commit to allocating a minimum percentage of net lease proceeds to rural and regional logistics infrastructure.

Committee Room, 30 November 2015.

Appendix 1
List of submitters

1. Mr David Linaker-Liberal
2. Sturrock Grindrod Maritime (Australia)
3. Mr Clem Newton-Brown
4. Corangamite Shire Council
5. Riordan
6. Mr Kevin Chambers
7. Mr Walter Grahame
8. Victorian Government
9. Mr Robert McLean
10. Port Phillip Conservation Council Inc. (PPCC)
11. Australian Peak Shippers Association Inc. (APSA)
12. G21 (Geelong Region Alliance)
13. Customs Brokers and Forwarders Council of Australia Inc.
14. Bass Coast Shire Council
15. Kingston City Council
16. Great South Coast Group
17. Australian Maritime College, University of Tasmania
18. Mordialloc Beaumaris Conservation League Inc.
19. Mr Tom Whitfield
20. City of Greater Dandenong
21. Victorian National Parks Association (VNPA)
22. Shipping Australia Limited (SAL)
23. Habitat Melbourne Trust
24. Emerald Grain
25. Colac Otway Shire
26. City of Greater Geelong
27. Australian Competition and Consumer Commission (ACCC)
28. Southern Melbourne Regional Development Australia Committee (RDA)
29. Victorian Farmers Federation (VFF)
30. Tasmanian Farmers and Graziers Association (TFGA)
31. Greater Shepparton City Council
32. Maribyrnong Truck Action Group (MTAG)
33. Infrastructure Partnerships Australia
34. Victorian Transport Association (VTA)
35. Mornington Peninsula Shire
36. Australian Industry Group (Ai Group)
37. Mr Stephen Hill
38. Australian Dairy Industry Council (ADIC)
39. Committee for Geelong (CfG)
40. Tasmanian Logistics Committee (TLC)
41. Public Transport Users Association (PTUA) and Public Transport Not Traffic (PTNT)
42. Committee for Dandenong (C4D)
43. City of Casey
44. Preserve Western Port Action Group
45. Victorian Auditor-General's Office (VAGO)
46. Latrobe City Council
47. Australian Logistics Council (ALC)
48. Association of Bayside Municipalities (ABM)
49. DP World Australia (DPWA)
50. Committee for Melbourne
51. Frankston City Council
52. Maritime Union of Australia
53. Ms Maris Leger
54. South East Melbourne Manufacturers Alliance (SEMMA)
55. Salta
56. Colin Rees Group
57. City of Ballarat
58. Tasmanian Government
59. Austrak
60. Federal Chamber of Automotive Industries (FCAI)
61. Asciano
62. Maribyrnong City Council

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63. ANL Container Line Pty Ltd
64. Towong Shire Council
65. TransVolution
66. Institute for Supply Chain and Logistics, Victoria University
67. South Gippsland Shire
68. Indigo Shire Council
69. Mr Clement Elliot
70. Bega Cheese
71. Mr Craig Deegan
72. Mr Francois de Meneval
73. Mr Norman Roth
74. Urban Development Institute of Australia (Victoria)
75. Avalon 2020
76. Municipal Association of Victoria (MAV)
77. Regional Cities Victoria (RCV)
78. Victorian Employers Chamber of Commerce and Industry (VECCI)
79. Wine Victoria (WV)
80. The Committee for Gippsland Inc
81. Rail Freight Alliance
82. Freight & Trade Alliance (FTA)
83. Murray Goulburn Co-operative Co. Limited
84. Horsham Rural City Council
85. Johnson Asahi
86. Moyne Shire Council
87. Property Council of Australia

Appendix 2
Public hearings

Tuesday 8 September 2015, Melbourne

Department of Treasury and Finance
Mr David Martine, Secretary,
Mr David Webster, Deputy Secretary
Mr Nick Rizos, Director, Port Transaction Unit

Flagstaff Partners
Mr Anthony Burgess, Chief Executive Officer

Morgan Stanley
Mr Julian Peck, Managing Director

Port of Melbourne Corporation
Mr Nick Easy, Chief Executive Officer

Institute for Supply Chain and Logistics, Victoria University
Dr Hermione Parsons, Director
Mr Peter van Duyn, Maritime Logistics Expert

Victorian Transport Association
Mr Brad Close, Industry Services Manager

Association of Bayside Municipalities
Cr Felicity Frederico, President
Cr Bev Colomb, Vice President
Mr Bernie Cotter, Executive Officer
Cr Jane Touzeau
Cr Rosemary West
Cr James Dooley

Shipping Australia Limited
Mr Rod Nairn, Chief Executive Officer
Mr Phil Kelly, Victorian State Secretary

Port Phillip Conservation Council
Mr Len Warfe, President
Ms Jenny Warfe, Secretary
Mr Walter Grahame, Vice President

Wednesday 9 September 2015, Melbourne

Australian Peak Shippers Association
Mr Robert Coode, Executive President

Patrick Asciano
Dr Tim Kuypers, General Manager, Regulation
Ms Lyndall Stoyles, Group General Counsel and Company Secretary

A2

Australian Logistics Council
Mr Kerry Corke, Policy Adviser
Mr Michael Kilgariff, Managing Director

Essential Services Commission
Dr Ron Ben-David, Chairperson
Mr Dominic L'Huillier, Acting Director, Transport and Research and Reviews Division

Salta Properties
Mr Sam Tarascio, Managing Director
Mr Tristan Anderson, Business Development Manager

Victorian National Parks Association
Mr Chris Smyth, Acting Executive Director

Thursday 24 September 2015, Geelong

City of Greater Geelong
Mr Peter Bettess, General Manager, Planning and Tourism

Riordan Grains Services
Mr Michael Dowling

Rocke Brothers
Mr Michael Rocke, Operations Director

G21 - Geelong Region Alliance
Ms Elaine Carbines, Chief Executive Officer
Cr Helene Cameron

Geelong Chamber of Commerce
Ms Bernadette Uzelac, Chief Executive Officer

Committee for Geelong
Ms Rebecca Casson, Chief Executive Officer
Mr Justin Giddings, Board Member

Tuesday 29 September 2015, Shepparton

Greater Shepparton Council
Mr Johann Rajaratnam, Acting Chief Executive Officer

Indigo Shire Council
Cr Bernard Gaffney, Mayor

Towong Shire Council
Cr David Wortmann, Mayor

Rail Freight Alliance
Mr Reid Mather, Executive Officer

Committee for Greater Shepparton
Mr Matt Nelson, Chief Executive Officer

Kreskas Bros Transport
Mr Peter Hill, General Manager

Australian Grain Link
Mr Graham Allen, General Manager, Trading

Colin Rees Group
Mr Colin Rees, Owner
Mr Cameron Jackson, Chief Operating Officer

Bega Cheese
Mr Michael Lamperd, Group Transport Manager

Wednesday 30 September 2015, Melbourne

Victorian Farmers Federation
Mr Peter Tuohey, President,
Mr Brett Hosking, Grains Group President
Ms Melanie Brown, Policy Manager, Victorian Farmers Federation

United Dairy Farmers
Mr Vin Delahunty, Manager

Maribyrnong Truck Action Group
Mr Martin Wurt, Secretary
Ms Narelle Wilson, Vice-President, Maribyrnong Truck Action Group

Freight and Trade Alliance
Mr Paul Zalai, Director
Mr Peter Hodder, Victorian Representative, Freight & Trade Alliance

City of Kingston
Cr Geoff Gledhill, Mayor

City of Kingston
Ms Suzanne Ferguson, Manager, Economic Development

City of Greater Dandenong
Mr Paul Kearsley, Group Manager, Greater Dandenong Business

Australian Competition and Consumer Commission
Mr Rod Sims, Chair
Mr Michael Cosgrave, Executive General Manager, Infrastructure Regulation Division
Ms Sarah Sheppard, General Manager, Infrastructure and Transport, Access and Pricing, Australian Competition and Consumer Commission

Victorian Employers Chamber of Commerce and Industry
Mr Steven Wojtkiw, Chief Economist
Mr Hugh Horsfall, Manager, Economics and Industry Policy, Victorian Employers Chamber of Commerce and Industry

Australian Industry Group
Mr Tim Piper, Victorian Director

A2

Tuesday 13 October 2015, Melbourne

Wine Victoria
Mr Damien Sheehan, Chair, Wine Victoria Board
Ms Rachael Sweeney, Executive Officer

Committee For Melbourne
Ms Kate Roffey, Chief Executive Officer

Australian Paper
Mr Ben McLean, Development Manager, Supply Chain
Ms Kelly Drew, Development Analyst, Supply Chain

Customs Brokers and Forwarders Council of Australia Inc
Mr Zoran Kostadinoski, Regional Manager, Victoria, Tasmania and South Australia

Maribyrnong City Council
Mr Stephen Wall, Chief Executive Officer
Cr Nam Quach, Mayor

Tuesday 13 October 2015, Melbourne (via teleconference)

Infrastructure Tasmania, Tasmanian Government
Mr Allan Garcia, Chief Executive Officer
Mr Luke Murphy-Gregory, Senior Policy Analyst, Infrastructure Strategy Branch, Department of State Growth

Wednesday 14 October 2015, Melbourne

Qube Holdings
Mr Maurice James, Managing Director
Mr Paul Digney, Managing Director, Qube Logistics

ANL Shipping
Mr Noel Dent, General Manager, Operations and Logistics
Mr David Munro, Manager, Business Development, ANL Container Line

Regional Cities Victoria
Mr Bill Forwood, Secretariat
Ms Chanmali Tregambe, Senior Adviser

AusTrak
Mr Mark Assetta, Chief Executive Officer
Mr Tony Assetta, Director

Farmer Packing Group
Mr Kel Baxter, Chairman, Farmer Packing Group and Owner, Baxter Transport

RM Consulting Group
Mr George Warne, Senior Consultant

DP World Australia
Mr Paul Scurrah, Managing Director and Chief Executive Officer
Mr Jason Varsamidis, Chief Financial Officer
Mr Ian Ross, General Manager, Projects and Risk

Department of Economic Development, Jobs, Transport and Resources
Mr Richard Bolt, Secretary

Level Crossing Removal Authority
Mr Kevin Devlin, Chief Executive Officer

Infrastructure Partnerships Australia
Mr Brendan Lyon, Chief Executive Officer
Mr Jonathan Kennedy, Executive Director, Policy and Strategy
Mr David Jiang, Policy Officer

Tuesday 27 October 2015, Horsham

Great South Coast Group
Cr Colin Ryan, Chair

West Wimmera Council
Cr Annette Jones, Mayor

Horsham City Rural Council
Mr Tony Bawden, Director of Planning and Economic

Northern Grampians Shire Council
Cr Kevin Erwin

Johnson Asahi
Mr Mark Johnson, Managing Director
Mr Gary Pilgrim, Horsham Operations Manager

Wimmera Development Association
Ms Jo Bourke, Executive Director
Ms Tammy McDonald, Project Officer

Wakefield Transport
Mr Ken Wakefield, Managing Director

Wimpak
Ms Jo Cameron, General Manager

Wednesday 28 October 2015, Hastings

Frankston City Council
Cr Sandra Mayer, Mayor
Mr Jonathan Reichwald, Co-ordinator Economic Development

City of Casey
Mr David Wilkinson, Manager Economic Development

City of Greater Dandenong
Mr John Bennie, Chief Executive Officer

Bass Coast Shire
Cr Neil Rankine
Cr Clare Le Serve

A2

Mornington Peninsula Shire
Cr Bev Colomb, Mayor
Mr Carl Cowie, Chief Executive Officer
Cr David Garnock

Cpt Richard Cox

Mr Sandy Galbraith

South East Melbourne Manufacturers Alliance
Mr Simon Whiteley, President
Mr Markus Spindler, Board Member

Preserve Western Port Action Group
Mr Jeff Nottle, Chairman
Ms Kate Whittaker, Secretary
Mr Graeme Hanigan, Committee Member
Mr Kevin Chambers, Committee Member

South East Australian Transport Strategy Inc.
Mr John Duscher, Executive Officer

Wednesday 4 November 2015, Melbourne

Port of Melbourne Corporation
Mr Nick Easy, Chief Executive Officer

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

Appendix 3
Site visit

Thursday 27 August 2015, Port of Melbourne

Port of Melbourne boat tour aboard the vessel, *MV Melburnian*, hosted by:
Mr Keith Gordon, Executive General Manager, Port Operations
Ms Caryn Anderson, Executive General Manager, Business and Planning
Mr Peter Harry, Head of Corporate Affairs

Extracts of proceedings

Legislative Council Standing Order 23.27(5) requires the Committee to include in its report all divisions on a question relating to the adoption of the draft report. All Members have a deliberative vote. In the event of an equality of votes, the Chair also has a casting vote.

The Committee divided on the following questions during consideration of this report. Questions agreed to without division are not recorded in these extracts.

30 November 2015

Recommendation 4

The Government:

(a) immediately commit to completing the Port Rail Shuttle project for which funding of $58 million was provided in the 2014-15 Budget

(b) immediately re-activate the Expressions of Interest process to select a party to deliver the Port Rail Shuttle project

(c) ensure that the short term delivery of the Port Rail Shuttle project is fully reflected in the transaction documents.

Mr Drum moved, That Recommendation 4 stand part of the Report.

The Committee divided.

Ayes 5	Noes 3
Mr Barber	Mr Mulino
Mr Drum	Ms Shing
Mr Ondarchie	Ms Tierney
Mr Purcell	
Mr Rich-Phillips	

Question agreed to.

Recommendation 5

The Government:

(a) develop a comprehensive transport plan of the additional links that Port expansion will require

(b) include provision for a rail link to Webb Dock by the most cost-effective means

(c) ensure that local councils and communities are consulted in the planning process.

Mr Ondarchie moved, That Recommendation 5 stand part of the Report.

The Committee divided.

Ayes 5	Noes 3
Mr Barber	Mr Mulino
Mr Drum	Ms Shing
Mr Ondarchie	Ms Tierney
Mr Purcell	
Mr Rich-Phillips	

Question agreed to.

Recommendation 9

The Government:

(a) amend clause 90 of the Bill to extend prescribed services to include the granting of a lease or sub-lease by the Port of Melbourne for the purposes of terminals or stevedoring operations

(b) provide within the Pricing Order a rent capping mechanism that prevents the exercise of monopoly power in relation to leases or sub-leases.

Mr Drum moved, That Recommendation 9 stand part of the Report.

The Committee divided.

Ayes 5	Noes 3
Mr Barber	Mr Mulino
Mr Drum	Ms Shing
Mr Ondarchie	Ms Tierney
Mr Purcell	
Mr Rich-Phillips	

Question agreed to.

Recommendation 11

The Bill be amended to:

(a) exclude the enabling provision for the Port Growth Regime (see subsequent recommendation in relation to clause 69)

(b) prohibit the inclusion in contract of a compensation or refund mechanism however so defined.

Mr Mulino moved an alternative Recommendation, That 'The Bill be amended to:

(a) provide greater transparency in relation to the operation of the compensation clause in the legislation

(b) contain a cap specifying the maximum total compensation payable that is determined having regard to the regulatory asset base, expected earnings, the need to provide the lessee with certainty and any other relevant matters.'

Question — That the motion be agreed to — put.

The Committee divided.

Ayes 4	Noes 4
Mr Mulino	Mr Barber
Mr Purcell	Mr Drum
Ms Shing	Mr Ondarchie
Ms Tierney	Mr Rich-Phillips

There being an equality of votes, the Chair gave his casting vote for the Noes.

Question negatived.

The Chair moved, That Recommendation 11 stand part of the Report.

The Committee divided.

Ayes 4	Noes 4
Mr Barber	Mr Mulino
Mr Drum	Mr Purcell
Mr Ondarchie	Ms Shing
Mr Rich-Phillips	Ms Tierney

There being an equality of votes, the Chair gave his casting vote for the Ayes.

Question agreed to.

Recommendation 12

The Bill be amended to omit clause 69 thereby preserving the full application of the *Competition and Consumer Act 2010* (Cth) and the Competition Code.

Mr Drum moved, That Recommendation 12 stand part of the Report.

The Committee divided.

Ayes 5	Noes 3
Mr Barber	Mr Mulino
Mr Drum	Ms Shing
Mr Ondarchie	Ms Tierney
Mr Purcell	
Mr Rich-Phillips	

Question agreed to.

Recommendation 13

Clause 83 of the Bill be amended to omit section 44HA allowing the Treasurer to require payment of an upfront lump-sum licence fee rather than annual licence fees.

Mr Drum moved, That Recommendation 13 stand part of the Report.

The Committee divided.

Ayes 5	Noes 3
Mr Barber	Mr Mulino
Mr Drum	Ms Shing
Mr Ondarchie	Ms Tierney
Mr Purcell	
Mr Rich-Phillips	

Question agreed to.

Recommendation 1

Subject to the Government proposing amendments to the Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015 (the Bill) and adopting the policy changes outlined in this Report, the Committee recommends that the Council support the Bill.

Mr Drum moved, That Recommendation 1 stand part of the Report.

The Committee divided.

Ayes 4	Noes 4
Mr Drum	Mr Barber
Mr Ondarchie	Mr Mulino
Mr Purcell	Ms Shing
Mr Rich-Phillips	Ms Tierney

There being an equality of votes, the Chair gave his casting vote for the Ayes.

Question agreed to.

Minority reports

Index of minority reports

Minority Report

The proposed privatisation of the Port of Melbourne was never about the economically efficient operation of the Port, or about delivering the best possible freight system for Victoria. As an export oriented economy, the operation of our ports is a critically important issue.

The rationale for the port sale always was to release funds for other projects the government wants to deliver. In this instance, that is unlikely to include a major investment in our degraded freight system. In fact some important projects, such as the Port Rail Shuttle have actually been delayed because of the proposed sale, and we have no guarantee they will proceed under a private operator.

In addition, future options for port capacity expansion have been made more difficult and uncertain by the proposed capacity cap/compensation arrangement.

It has been made very clear that private investors are only interested in buying the port as a monopoly. The idea that port might have to face future competition, we are told, would likely scuttle the sale.

The bill, the regulations, and the new regulatory measures the government has proposed during the process of the inquiry itself, are there simply to limit the monopolistic power of a privatised port. The inquiry processed focussed on these issues. The evidence collected gives the opinions of a sub group of submitters on how these arrangements might work, or not.

However the most compelling testimony is from those export oriented businesses who are the ultimate customers, and through port fees, funders of the Port. These are often agricultural products, but also paper and other manufactured goods. They face continuous downward competitive pressure, and rapid loss of markets when their prices don't meet those required in overseas markets. Their voices largely doesn't feature in this report. They are generally opposed to, or at best agnostic about the port privatisation. They do have a great insight into the failures of our existing freight system. It's a pity the government isn't bringing forward a plan to meet their needs.

As the inquiry has proceeded, I have uncovered even more compelling reasons to be concerned about this privatisation and remain opposed to the Bill, even with the suggested changes in the majority report.

Greg Barber, Greens MLC, Northern Metropolitan.

MINORITY REPORT

EXECUTIVE SUMMARY

Both major parties went to the 2014 election with a policy of leasing the Port of Melbourne and investing the proceeds in infrastructure. The 2014 election gave a clear mandate for that policy. The Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015 gives effect to the policy in a manner that is consistent with the government's election commitments and that is based on the advice of commercial experts engaged by the previous government and retained by the current government.

While the Majority report of the Select Committee Inquiry into the Lease of the Port of Melbourne ("majority report") contains some sound analysis in relation to regulatory and logistical issues, the recommendations relating to commercial matters are deeply flawed and would not constitute sound transaction practice. If implemented, these recommendations would necessarily increase risks associated with the transaction, thereby materially reducing transaction proceeds and weakening the incentives for appropriate investment over the medium term.

Government members believe that the transaction should proceed, but on the basis of a Bill and transaction documents that are informed by sound commercial advice.

Compensation clause

If reflected in the Bill, Recommendations 11 and 12 would represent an unprecedented restriction on the State's capacity to negotiate a lease that is commercially beneficial for the State. To provide bidders with absolutely no clarity or certainty in relation to key aspects of sovereign risk could result in multiple bidders dropping out of the tendering process and remaining bidders heavily discounting their bids.

Further, it would not be in the state's long-term interests as it would remove a powerful incentive for appropriate investment in additional capacity. This investment will be critical both in terms of ensuring that the state has sufficient international container trade capacity and also in terms of reducing the state's overall supply chain costs.

Up-front payment of the PLF

The report recommends a reversal of policy in relation to the Port Licence Fee (PLF) established by the previous government and continued by the current government following the 2014 election. This is inconsistent with expert commercial advice accepted by both the previous government and the current government.

It is important to note that the recommendation in the majority report is not based on commercial analysis but, rather, excerpts from witnesses who were called based on their expertise in relation to other matters.

Lack of commercial advice

The key deficiency of the majority report is the lack of commercial and financial underpinnings behind the recommendations relating to commercial matters. Recommendations relating to material issues such as the compensation clause and the PLF are based on observations that are, on occasion, speculative or not based on detailed analysis. At the same time, key quantitative analysis from experts is treated in a cursory manner.

The importance of obtaining independent commercial advice was reflected in evidence received by the Committee. Unfortunately, the Committee did not obtain such advice. This is reflected in the sections dealing with commercial and financial matters.

Policy and regulatory issues

The majority report contains solid analysis in relation to a number of regulatory and logistics related issues. This reflects the breadth and high quality of evidence received in relation to these matters.

As such, we have supported many of the recommendations contained in the majority report, some with caveats. An outline of our response to each recommendation is contained on the following page.

Overall conclusion

Notwithstanding agreement on some issues, we do not support the amendment of the Bill to reflect Recommendations 11, 12 and 13. To do so would materially adversely affect the interests of Victoria's taxpayers and the community more broadly.

Response to Recommendations

Recommendation 1:	**Reject. If Recommendations 11-13 are reflected in the Bill, the transaction will not be commercially sound and will not reflect value for money for the Victorian taxpayer or the community more broadly.**
Recommendation 2:	Accept in principle. Government should clarify on what basis the 20 year extension might be exercised and put in place an obligation to explain its reasons if that is to occur.
Recommendation 3:	Accept
Recommendation 4:	Accept in principle. Government members support the strengthening of the transaction requirements in relation to rail investment. However, we do not accept that specifying a particular project is suitable at this stage. Instead, a competitive process should be undertaken that elicits the best ideas from the private sector and allows for the most innovative, low cost solution.
Recommendation 5:	Accept in principle. As with the response to Recommendation 3, Government members support a timely and competitive process for selecting, procuring and delivering future rail options.
Recommendation 6:	Accept
Recommendation 7:	Accept
Recommendation 8:	Accept
Recommendation 9:	Accept in principle. Rather than immediately proceeding to heavy-handed regulation of rents, Government members suggest that the initial step should be a rigorous evaluation of market power by the ESC, as occurs with other industries before regulation is applied. Should a misuse of market power be identified, Government members believe that the Government should ask the ESC to devise and implement an appropriate form of price regulation.
Recommendation 10:	Accept. A provision giving effect to this recommendation would require drafting that allows for step-in during extraordinary circumstances.
Recommendation 11:	**Reject. This recommendation is inconsistent with expert commercial advice and would not be in the interests of Victorian taxpayers or the longer term productivity of the economy.**
Recommendation 12:	**Reject. Inconsistent with expert commercial advice.**
Recommendation 13:	**Reject. This recommendation is based on flawed financial reasoning and factual errors. It erroneously conflates price pressures with the financing structure of the lessee.**
Recommendation 14:	Accept
Recommendation 15:	Accept in principle. Government members support additional regional projects being considered by Government where there is a sufficiently strong business case.

Policy Context

In Victoria, there is a broad bipartisan commitment across both major parties to the concept of "asset recycling". Asset recycling occurs where brownfield infrastructure assets that generate a relatively low risk income stream are leased or sold with the proceeds being used to fund higher risk greenfield infrastructure that the private sector may be less willing to finance.

Asset recycling can be particularly attractive where:

- the income stream from the brownfield asset is well understood and the private sector will not heavily discount the right to future earnings;
- the risk profile of the income stream is well suited to the investment portfolio of large, long-term investors. In particular, where returns are low-risk over the longer term and inflation hedged, many large pension funds and infrastructure funds will pay a premium to lease and operate assets;
- the asset could require significant future capital expenditure that it may be difficult for the state to fund; and/or
- there is scope for improved operational efficiency by a private sector operator.

An additional benefit to the State in relation to asset recycling arose from the Australian Governments' 2013/14 Budget which provided a fund for payments to State governments to supplement and proceeds from brownfield asset privatisations where it could be demonstrated that the proceeds were to be dedicated to greenfield investments. This initiative provided for the Australian Government to pay State governments a 15% "bonus" where asset recycling initiatives met certain criteria.

In addition to the benefits associated with asset recycling, the lease of the Port of Melbourne was supported by government on the basis that, with the right regulatory settings, a private sector lessee could improve the productivity of the port. A number of witnesses gave evidence in support of this proposition including the Victorian Employers Chamber of Commerce and Industry (VECCI):

> **Mr MULINO** — Just to drill down on one of the points you made, subject to there being the right regulatory environment, there should be the capacity for the private sector to bring in know-how, expertise and innovation and potentially increase the efficiency of the port's operations.
>
> **Mr WOJTKIW** — Absolutely. Ports operate in a very competitive marketplace, and the nature of trade is such these days that for a state like Victoria to remain competitive it needs to operate a port that really is operating at world's best practice and that deploys the best of technologies that are efficient in terms of productivity levels in terms of keeping costs down to port users — yes.[1]

[1] Mr Steven Wojtkiw, Chief Economist, VECCI, Transcript of Evidence, 30 September 2015, p4.

QUBE also gave evidence in support of the potential benefits of a private sector operator:

> **Mr BARBER** — Just in terms of these extra operating efficiencies, do you think it makes any difference whether the port is owned by the state of Victoria or a bunch of superannuation funds in terms of driving those
> efficiencies?
>
> **Mr JAMES** — With respect, it is quite clear. If I took a personal view, when privatisation started I had a view that ports are essentially monopoly assets in this country and they should stay with government. Having seen what has happened elsewhere, I no longer have that view. I think the biggest advantage of the ports being in private hands, with respect, is that it takes a lot of it out of the political processes that we are in and the political influences that happen through ports.
>
> We have experienced a high degree of frustration around the port here. I am not taking sides, because there has been different governments over the last few years, so I am not taking a political position here at all. But the frustration at the bureaucracy around wanting to improve this port and deliver efficiencies is quite a contrast to what is actually happening in New South Wales now, where a private owner is really focused on improving the efficiency of their port — in cooperation with the government — improving the efficiency of the port and looking at how to attract trade. Melbourne is losing trade to Sydney. Melbourne is going to lose trade to Tasmania; there is international shipping going back into Tasmania. The private ports are far more responsive, proactive than they are in government ownership. That is the experience we have had.[2]

The 2014 Election Mandate

Both the ALP and the Liberal-National coalition went to the November 2014 election with a policy of leasing the Port of Melbourne.

The ALP committed to dedicating the proceeds of the lease to infrastructure projects including upgrading 50 of the state's most dangerous and congested level crossings.

By late 2014, the previous government had already commenced the process of leasing the port. This work included engaging a number of consultants including:

- Commercial advisers Morgan Stanley and Flagstaff
- Economic regulation consultants
- Environmental consultants
- Engineering consultants

The result of the 2014 election provided the incoming Andrews government with a mandate to continue the process already commenced by the earlier Napthine government. The incoming

[2] Mr Maurice James, Managing Director, QUBE Holdings, Transcript of Evidence, 14 October 2015, pp 467-468.

government decided to retain the existing consultants given their strong experience and reputation in relation to transactions of this type.

Delivering Victorian Infrastructure (Port of Melbourne Lease) Bill 2015

Following the 2014 election, the incoming Andrews Government worked towards a bill that would provide a regulatory framework for completing the lease of the Port. The bill was designed such that the transaction would achieve the best possible outcomes in terms of:

- the long-term operation of the port and the State's logistics industry more generally;
- broader policy objectives including the integrity and effectiveness of the regulatory environment and the capacity of the State to develop an additional international container port where and when appropriate; and
- transaction outcomes including proceeds and risk allocation.

Infrastructure Victoria

An issues that has been discussed in some detail in the public hearings of the inquiry is the appropriate location for a second international container port and when such a facility will be needed.

The ALP made it clear in the lead-up to the 2014 election that it considered this to be an issue of such complexity that is warranted detailed analysis by experts across a range of disciplines.

An additional commitment was to establish Infrastructure Victoria – an independent, expert body to advise government on complex infrastructure issues of this nature. The Government has now established Infrastructure Victoria and has made it clear that examining the issue of the location and timing of a second international container port will be one of Infrastructure Victoria's first tasks.

This report notes that the government is expected to outline the details of such an inquiry shortly. As such, we do not believe that it is appropriate to conflate the issue of where a second container port should be located with the appropriate regulatory and commercial content of the Bill and transaction documentation.

Recommendation 1 – Subject to the Government proposing amendments to the Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015 (the Bill) and adopting the policy changes outlined in this Report, the Committee recommends that the Council support the Bill.

OPPOSE

Government members support the passage of the Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015 with some of the changes recommended in the majority report.

However, some of the changes recommended – particularly those related to allocating commercial risks and to financing arrangements – would mean that the transaction would not represent value for money for Victoria and that it would not deliver good policy outcomes over the short and longer term.

In particular, we have concerns in relation to:

- Recommendation 9 in relation to imposing a cap on rents;
- Recommendation 11 in relation to banning the inclusion of any compensation clause;
- Recommendation 12 in relation to section 69 of the Bill; and
- Recommendation 13 in relation to the upfront payment of the Port Licence Fee.

As such, Government members would not support passage of the Bill if all of the recommendations in the majority report are reflected in the Bill.

Recommendation 2 – Clause 11 be amended to provide that a lease or licence may be issued for no more than 50 years, and may not be extended. The effect of such an amendment is to require Parliamentary approval via amended legislation if such extension is desired by a future government.

ACCEPT IN PRINCIPLE

The key reason for the proposed option to extend the lease by up to 20 years at the mutual agreement of the lessee and the government of the day is to allow flexibility in the case a short extension is necessary. This might arise where, close to the end of the 50 year term, a second container port is operational and it would be useful for the lessee to continue for a period to manage transitional arrangements – but not necessarily for a period long enough to warrant a full legislation-based renegotiation of the lease.

It is important to stress that the option would only be exercise at the mutual agreement of both the lessee and a future government.

Some stakeholders expressed concerns that the option might be exercised early in the term of the lease. This is unlikely as:

- The Government would not find such an extension attractive as the net present value (NPV) of future cash flows would be very small early in the lease. It will only be in the interests of the government to exercise the option closer to the end of the lease when it will receive value for money from the lessee for future cash flows.
- The lessee would probably find an extension at an early stage problematic in that it would extend the horizon for which the lessee will have paid for the right to income but it would not increase the horizon over which the assets are considered for regulatory purposes (ie incurring a cost for little gain).

Other witnesses expressed concerns about the Executive rather than the Parliament granting the extension (should the lessee wish to take it up). This was, in part, due to the greater transparency and accountability associated with parliament passing new legislation.

Given that the purpose of the 20 year option is to provide greater flexibility, it would defeat the purposes of the section for it to be triggered by legislation. Parliament would retain that right with or without Clause 11.

If the principle concerns relate to transparency, it would be possible to amend Clause 11 such that the option could only be exercised if the Government publishes reasons for exercising the option, including:

- Transitional benefits for the state.
- Commercial considerations, including value for money.

Recommendation 3 – The Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015 be amended to allow for the "as-of-right" disallowance of statutory instruments by either House of Parliament pursuant to section 23(1)(a) of the *Subordinate Legislation Act 1994* (Vic).

ACCEPT

CHAPTER 3 – DEVELOPMENT OF A SECOND CONTAINER PORT

Government members believe that the majority report contains a misleading impression of the evidence that was received in relation to port capacity and the likely time at which a second international contain port will be needed. The majority report:

- conveys a greater sense of disagreement than existed in the evidence;
- did not undertake sufficient analysis to determine how much weight to give to competing claims.

Skewed presentation of evidence in relation to port capacity

The report does not accurately convey the balance of evidence and, in particular, indicates a greater level of uncertainty than would a more balanced presentation of the evidence.

For example, the Majority report draws out the minority of submissions that differ from the PoMC in a table in order to give the impression that many experts differ from the PoMC's estimate of capacity. It does not include a table of the many witnesses supporting PoMC's analysis.

Moreover, and even more misleadingly, DP World is included in that table as being a submitter that "questions" the Port of Melbourne analysis in relation to capacity. It is cited as having estimated capacity at 5.0 – 5.5 million TEU. Yet the evidence was as follows:

> **Mr PURCELL** – … I think your answer to Mr Barber's query about capacity said that your capacity with your quay line would be about 2 million overall capacity. If you had the whole of the port of Melbourne for containers, where does that put the capacity of the port of Melbourne?
>
> **Mr SCURRAH** – Somewhere around five to five and a half with the current equipment profile and [inaudible areas]. However, we do strongly believe that that can be increased if you maximise the use of adjacent land that is not currently used for container usage. We think quite comfortably you could get more than five.[3]

After confirming that the initial estimate included Webb Dock East, Mr Scurrah continued:

> **Mr SCURRAH** – I have seen commentary of the [inaudible] high rate. If you take into account the use of land that is not currently dedicated to container stevedoring and you add that to some of the technology that is emerging in the industry, then that is possible.[4]

The cited figure is clearly taken out of context. The 5.0-5.5 figure is based on "the current equipment profile" and also current technology. DP World submits that comfortably more than five is possible. This evidence is entirely in accord with the PoM whose estimates of 7-8 million TEU are

[3] Mr Paul Scurrah, Managing Director and CEO, DP World Australia, Transcript of Evidence, 14 October 2015, p46.
[4] Mr Paul Scurrah, Managing Director and CEO, DP World Australia, Transcript of Evidence, 14 October 2015, p46.

based upon a changed equipment profile and more land being devoted to container traffic. To suggest that DP World was querying the PoM analysis is incorrect.

Lack of analytical rigour in balancing competing claims

The earlier issue reflects a broader problem with the approach to quantitative analysis in the majority report. On issues such as capacity and likely trade growth, the report frequently cites evidence with little effort to undertake analysis in order to give appropriate weight to different sources of evidence.

For example, there is cursory reference to the PoMC estimate in section 3.2. Yet this evidence was based on PoMC's experience as port operator and also extensive stakeholder consultation undertaken in the production of the port development plans. The majority report does not explore this authoritative study in detail. As noted earlier, neither does the majority report cite evidence in support of the PoMC analysis (which is extensive). Rather, the report simple cites sources that it claims query the port's analysis (misleadingly in Table 3.1 as noted above) with little or no analysis as to the weight that should be given to various claims.

All claims appear to be treated as of equal value no matter the source or the basis on which a claim is made.

The 2009 Port Development Strategy states that:

> For infrastructure planning purposes PoMC has prepared detailed trade forecasts for all major trade segments …
>
> These trade forecasts are used to estimate the port's future land and berth requirements.[5]

Over the medium term, total container capacity at PoM is estimated at between 7-8 million TEU.[6]

It is also worth noting an extract from the CEO of the PoMC's evidence:

> There has been some discussion on capacity. The corporation as part of its charter produces port development plans that have a look at the expectations and the assumptions around the growth in trade through the port of Melbourne. Again there are a number of elements that determine growth and capacity. There are two plans that are published and available on the corporation's website. One is the Port Development Plan 2006–2035 that was put together in 2006, and a further plan in 2009, the Port Development Strategy 2035 Vision, which also articulated conceptually a framework for capacity for the types of cargoes that will be serviced through the port of Melbourne. They clearly had a look at trade forecasts. Trade forecasts do vary and they are influenced by a range of considerations. Clearly population and population growth is important. That influences consumption and the level of imports that come into the port of Melbourne.

[5] Port Development Strategy 2035 Vision, Port of Melbourne Corporation, August 2009, p11.
[6] Port Development Strategy 2035 Vision, Port of Melbourne Corporation, August 2009, p11 and section 7.

> Climate conditions such as rainfall are very important in terms of the level of exports through the port of Melbourne, because clearly they drive agricultural production and therefore the volume of goods that can be exported through the port of Melbourne. The third key area that influences capacity is the investment in the facilities by the stevedores in the terminals themselves and the level of productivity that occurs within those terminals. Each of those are quite important in terms of what will ultimately drive capacity through the port of Melbourne. Those plans indicate a conceptual framework that would deliver between 7 and 8 million containers, 7 million international containers and 1 million Bass Strait containers, over a period of time in response to trade growth and trade demand.[7]

The Majority report does not cite the extensive support for the PoMC analysis, including QUBE logistics:

> Mr MULINO — I just wanted to go back to one of your earlier comments around port capacity and whether you think there is significant additional capacity. Is that view based in part upon the work that led to the 2006 and 2009 reports by the port?
>
> Mr JAMES — I cannot recall those specific reports but I managed the Patrick container terminal business for 12 years nationally, including the port of Melbourne, and managed the investment into Patrick's terminal in particular to a straddle operation from 1994 through till 1996 so I have a very good understanding of capacity of container terminals and no-one can really give you a specific figure around container terminal capacity.
>
> As technology is advancing, that number is constantly changing, so you can look around the world and look at international benchmarks that will tell you it is so much per metre of quay line, or you can look at it and say that it is based on area constraints so it is so much per hectare, but I certainly know that our container terminals here in Melbourne are what I would call medium density-type stacking terminals; they are not high-density stacking terminals. There is certainly scope at Swanson Dock to introduce high-density stacking, which is what is proposed to go into Webb Dock, and increase the capacity of the port significantly.
>
> Whether it is 7 million or 8 million TEUs, people will give you different views. In my history, no-one has ever been right in hindsight when you look back and it is the same issue with trade forecasts. Lots of people around the country and economists have spent a lot of time on trade forecasts but never ever got it right. The two factors in that are really: what is the capacity and what is the time frame over which trade will grow and Melbourne will reach potential capacity?
>
> Mr MULINO — But you are broadly comfortable with the kinds of numbers, the band that the port suggests, which is about 7 million to 8 million?
>
> Mr JAMES — Yes.[8]

[7] Mr Nick Easy, CEO Port of Melbourne, Transcript of Evidence, 8 September 2015, p17.
[8] Mr Maurice James, Managing Director, Qube Holdings, Transcript Evidence 14 October, p466.

Other examples of major organisations operating at the Port that supported the PoMC analysis include:

- DP World, another major operator, at the port also supported the PoMC analysis as noted above.
- Patrick Asciano, whose General Manager of Regulation, Dr Tim Kuypers estimated a potential capacity of 6.5 million TEU[9]
- Wakefield Transport whose Managing Director estimated port capacity at least 7 million TEU.[10]

Therefore, the PoMC's analysis is supported by both of the stevedores who gave evidence along with major transport and logistics firms.

Those disagreeing with the PoMC analysis were a single university research centre and two individual people. It was not clear if these individuals were familiar with the details of the PoMC analysis undertaken in 2006 and 2009.

Timing of a second international container port

The majority report's analysis in relation to the timing of a second container port is similarly skewed.

In Table 3.4 and the following commentary, a misleading impressive is given of expectations as to timing of a second container port. Little analysis is undertaken as to the weight that should be given to different claims. Given that many large organisations support the PoMC analysis of port capacity, as noted earlier, the degree of disagreement is significantly less than is portrayed.

Moreover, the analysis of the future rate of growth does not reflect changing forecasts over time given evolving economic conditions and other factors. As is reflected in the graph below (Figure 1) provided by DEDJTR, estimates of the cumulative annual growth rate (CAGR) in international container traffic have fallen since the KPMG scoping study. This is, in part, due to changed global macroeconomic conditions following the GFC.

For example, in his evidence, the CEO of PoMC observed that:

> **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.[11]

The majority report observes that there is disagreement as to how soon a second port will be required with "the earliest suggestion being 2025 and the most common around 2035."

[9] Dr Tim Kuypers, General Manager Regulation, Patrick Asciano, Transcript of Evidence, 9 September 2015, p110.
[10] Mr Ken Wakefield, Managing Director, Wakefield Transport, Transcript of Evidence, 27 October 2015, pp36-37.
[11] Mr Nick Easy, CEO of Port of Melbourne, Transcript of Evidence, 4 November 2015, p48.

This is misleading. First, to quote the "earliest" and "most common" but not the full range of estimates skews the dates rather than giving a balanced perspective of the full range of opinion.

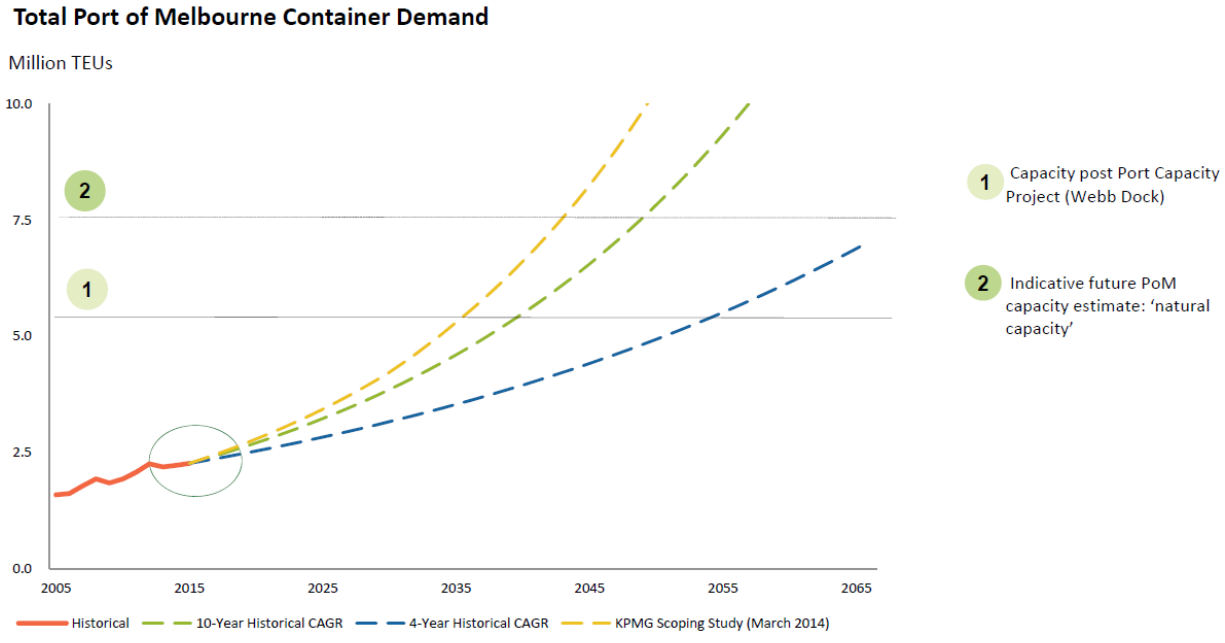
Second, as with PoM capacity, all estimates are given equal weighting in the majority report regardless of when they are made (ie regardless of the currency of assumptions) and what analysis underpins the estimates. PoMC analysis is treated as being of equal value to claims that are not based on detailed, thorough analysis and consultation (as were the 2006 and 2009 reports) and that are not based on direct operational experience.

Using a "natural capacity" of 7.5 million TEU (which is broadly accepted by most expert witnesses as the 'natural capacity' as noted above), the PoM capacity will be reached in approximately:

- 2040 based on the CAGR at the time of the KPMG Scoping Study (which is commonly accepted to be higher than is likely given subsequent events).
- 2045 based on growth rates observed over the past decade.
- Beyond 2050 based on recent growth rates (the most recent four years).[12]

The range of estimated dates at which capacity will be reached is wider than reflected in table 3.4 and is later than represented in that table based on the most rigorous and most current estimates.

Figure 1: Port of Melbourne Container Demand Projections[13]



[12] See DEDJTR submission extract in Figure 1: http://www.parliament.vic.gov.au/images/stories/committees/pomsc/Transcripts/DTF_Presentation.pdf

[13] DEDJTR submission, http://www.parliament.vic.gov.au/images/stories/committees/pomsc/Transcripts/DTF_Presentation.pdf

Recommendation 4 – The Government:

- **immediately commit to completing the Port Rail Shuttle project for which funding of $58 million was provided in the 2014-15 Budget**
- **immediately re-activate the Expression of Interest process to select a party to deliver the Port Rail Shuttle Project**
- **ensure that the short term delivery of the Port Rail Shuttle project is fully reflected in the transaction documents.**

ACCEPT IN PRINCIPLE

Government members support measures that will encourage additional investment in rail capacity at the port. However, any process should:

- be based on a competitive tendering process
- elicit innovative solutions from the private sector rather than being based on a particular project or approach
- be timed in such a manner that the new lessee has time to ensure that any new project fits within its short term and medium term priorities.

The majority report failed to provide context for the Port Rail Shuttle proposal. It wrongly asserts:

> The decision to freeze development of the Port Rail Shuttle is in contrast with the very broad consensus that exists in industry and the community to support its urgent development.[14]

Firstly, there is a range of opinions on exactly how rail capacity could be increased. Patrick Asciano gave evidence stressing that it has the capacity to deliver rail options:

> **Ms STOYLES** – I am not completely across the whole Salta proposal. I know that there is something that they are putting place. But we are certainly an alternative provider of railroad and any of that container management in and around port.[15]

Similarly, DP World indicated that they are strong proponents of rail investment but that "I do not yet think anyone has got it right in driving true modal change, and it almost becomes a backstop when road congestion gets too much."[16] DP World also stated that, as a strong supporter of rail, they believe governments need to "… actually think about the level of investment that is required to have rail take a step change in terms of ports."[17]

[14] Majority Report, Select Committee Inquiry Into the Lease of the Port of Melbourne, Section 4.4.3.
[15] Ms Lyndall Stoyles, Group General Counsel and Company Secretary, Patrick Asciano, Transcript of Evidence, 9 September 2015, p106.
[16] Mr Paul Surrah, Managing Director and CEO, DP World Australia, Transcript of Evidence, 14 October 2015, p49.
[17] Mr Paul Surrah, Managing Director and CEO, DP World Australia, Transcript of Evidence, 14 October 2015, p49.

In other words, while many stakeholders support more rail and inland rail terminals in principle, there is no clear consensus on the particular project that would be suitable for Port of Melbourne.

Secondly, the majority report does not accurately convey what has transpired to date. In particular, it is important to note that it was the previous government which decided not to proceed with the Port Rail Shuttle Project on the basis that a more competitive process was appropriate.

In its answer to questions on notice, DEDJTR indicated that:

> In October 2014, the **previous government** [emphasis added] decided not to progress with Salta's Melbourne Metropolitan Intermodal System proposal on the basis that it was considering a competitive market approach for delivering a Port Rail Shuttle (PRS).
>
> The PRS concept may not be the only way of achieving improved rail modal outcomes at the Port of Melbourne.[18]

It is also important to note that, under the **previous government**, a decision was made not to progress the Salta proposal to Stage Three of the Unsolicited Proposal Guideline. (David Webster letter to Salta dated 27 October 2014)[19]

[18] http://www.parliament.vic.gov.au/images/stories/committees/pomsc/Other_Docs/Port_of_Melbourne_QoN_Letter_.pdf

[19] http://www.parliament.vic.gov.au/images/stories/committees/pomsc/Other_Docs/Ref_1_-_Letter_from_DTF_David_Webster_Oct_2014.pdf

Recommendation 5 – The Government:

- **develop a comprehensive transport plan of the additional links that Port expansion will require**
- **include provision for a rail link to Webb Dock by the most cost-effective means**
- **ensure that local councils and communities are consulted in the planning process.**

ACCEPT IN-PRINCIPLE

As noted it he previous section, Government members support additional investment in rail capacity, but believe that there should be rigorous, competitive processes for selecting and delivering projects..

Recommendation 6 – The Government provide ongoing monitoring of the condition and major impacts on the Bay by:

- **amending the Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015 to re-establish the Office of the Environmental Monitor**
- **preparing and releasing publicly a 'State of the Bay' report on a regular basis.**

ACCEPT

Recommendation 7 – Clause 90 of the Bill be amended to ensure that the objectives under section 48 of the Port Management Act 1995 include an objective: to protect the interests of users of prescribed services by ensuring that prescribed prices are fair and reasonable.

ACCEPT

Recommendation 8 – The Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015 be amended to provide a mechanism for complaints regarding pricing to be directed to the Essential Services Commission.

ACCEPT

Recommendation 9 – The Government:

- **amend Clause 90 of the Delivering Victoria Infrastructure (Port of Melbourne Lease Transaction) Bill 2015 to extend prescribed services to include the granting of a lease or sublease by the Port of Melbourne for the purposes of terminals or stevedoring operations.**
- **provide within the Pricing Order a rent capping mechanism that prevents the exercise of monopoly power in relation to leases or sub leases.**

ACCEPT IN PRINCIPLE

Broad policy context

The pricing regulation regime proposed by the government is significantly broader in scope and more rigorous than arrangements currently in place at PoMC or that are in place at other major ports around Australia. The scope of economic regulation will broaden so as to cover 86 per cent of the PoMC's current revenue base.

Extensive evidence was received that this will benefit consumers and put downward pressure on supply chain costs.

The proposed regime will bring economic regulation of the Port of Melbourne into line with approach currently used both in Australia and many other countries in relation to long-lived monopoly infrastructure such as utilities. Under these arrangements, there will be a CPI price cap for at least 15 years (and possibly as long as 20) followed by building block price regulation by the Essential Services Commission (ESC).

The fact that the proposed regime is broader and more rigorous than arrangements at other Australian ports was acknowledged by the ACCC:

> **Mr MULINO**—Thank you very much for your evidence, both your written submission and your further evidence today. I want to ask a couple of questions around the pricing regime and your views of it. You have noted that light-handed regulation, in inverted commas, is somewhat oxymoronic and in fact often not regulation at all. My understanding is that your view of what is being proposed, which is the benchmark post year 15 against a building block method analysis, would be a material improvement?
>
> **Mr SIMS** – Yes.[20]

[20] Mr Rod Sim, Chair ACCC, Transcript of Evidence, 30 September 2015, pp8-9.

Mr MULINO — So implicit in that regulatory framework is that there would be a downward pressure on the costs that can be passed on to industry. That has obviously been a concerned raised from a number of witnesses.

Mr SIMS — Yes.[21]

Mr MULINO —… So what we are seeing here is much stronger than elsewhere?

Mr SIMS – Yes.[22]

Rents

The proposed regulatory regime would not include rents paid by sub-lessees (for example, as paid by stevedores) within "prescribed services". This is principally because:

- it has not yet been clearly established that misuse of market power exists in relation to rents;
- there are well established processes for resolving disputes over rent escalation, including arbitration by independent third party experts;
- current arrangements have been effective to date, notwithstanding that some disputes have become high profile at certain points during negotiations; and
- imposing on rents a regulatory regime such as a cap based on the building block method (which is more commonly used to regulate prices for capital-intensive, long-lived assets) may have unintended consequences and impose significant costs on industry. For example, it may involve the application of extensive information gathering powers on sub-lessees (such as stevedores) that may be inappropriate given that less onerous yet effective approaches such as independent arbitration are available and have proved to be effective.

Government's response to concerns

A number of witnesses gave evidence that rent should be included within prescribed services. This is reflected in the recommendation in the majority report. In response to concerns raised by the ACCC and also by stakeholders, the government moved to strengthen the proposed pricing regulation regime in relation to a number of matters, including the regulation of rents. In particular, it committed to:

- a periodical review by the ESC on whether there has been misuse of any market power by the Port Leaseholder in the setting of rents at the Port; and
- requiring the Port Leaseholder to offer a market standard rent review mechanism with dispute resolution by an independent property market expert to any new tenants or renewing tenants that wish to apply this mechanism.[23]

[21] Mr Rod Sim, Chair ACCC, Transcript of Evidence, 30 September 2015, p9.
[22] Mr Rod Sim, Chair ACCC, Transcript of Evidence, 30 September 2015, pp9-10.

The ACCC stated that these changes were a significant improvement in the regulatory arrangements:

> **Mr SIMS** - … On the third issue we raised, which is around land rents … In this letter that the government as I understand it has released, but certainly in the discussions we have had over the last couple of days, they are doing two things. One is giving the essential services commissioner a role of assessing whether the market power of the port owner has been misused in setting those rents, and if it has, then there is the ability to step in. Also they are putting into the contract that in any subsequent rent agreement that the port owner enters into, that rent agreement must have the ability for third-party arbitration. Again that, we find, is helpful. Those are again significant improvements.[24]

Conclusion

In conclusion, we agree that a sound regulatory regime is appropriate for the Port's overall operations, including rents. We note that it was generally agreed that the proposed regulatory arrangements will be far stronger than those currently in place at the Port of Melbourne and stronger and broader than at any other major port in Australia.

With respect to rents in particular, we believe that what has been proposed by the Government is appropriate – namely a rigorous review of market power by the ESC and mandating market standard rent review mechanisms in all agreements with tenants.

We believe that imposing a more heavy-handed regime should only occur on the advice of the ESC following its review of market power.

[23] Media Release, Minister for Ports and the Treasurer, September 30 2015, https://www.premier.vic.gov.au/government-strengthens-port-regulatory-regime-with-additional-safeguards/
[24] Mr Rod Sim, Chair ACCC, Transcript of Evidence, 30 September 2015, p4.

Recommendation 10 – The Delivering Victoria Infrastructure (Port of Melbourne Lease Transaction) Bill 2015 be amended to explicitly prohibit:

- **an entity engaged directly or indirectly in stevedoring or terminal operations becoming a Port operator.**
- **A Port operator engaging directly or indirectly in stevedoring or terminal operations, unless extraordinary circumstances justify step-in by the Port operator on a temporary basis.**

ACCEPT

Government members support regulation of vertical integration. While government members are not opposed to legislative clarification of vertical integration limitations, we also note expert evidence given by legal advisers to the transaction that best practice in relation to vertical integration issues is generally to allow the ACCC to regulate such matters under its legislation and to deal with exceptional circumstances (such as step in) through contract:

> **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.[25]

> **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.[26]

[25] Mr Peter Block, Minter Ellison, Transcript of Evidence, 4 November 2015, p59.
[26] Mr Geoff Carter, Minter Ellison, Transcript of Evidence, 4 November 2015, p59.

Recommendation 11 – The Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015 be amended to:

- **exclude the enabling provision for the Port Growth Regime (see Recommendation 12)**
- **prohibit the inclusion in contract of a compensation or refund mechanism however so defined.**

Recommendation 12 - The Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015 be amended to omit clause 69 thereby preserving the full application of the *Competition and Consumer Act 2010* (Cth) and the Competition Code.

REJECT BOTH RECOMMENDATIONS

Proposed alternative to Recommendation 11

Proposed Recommendation 11 – The Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015 be amended to:

- **provide greater certainty in relation to the operation of the compensation clause in the legislation; and**
- **contain a cap specifying the maximum total compensation payable.**

Compensation Clauses

Clauses providing a measure of protection against certain aspects of sovereign risk are standard in medium and long term commercial arrangements between the public and private sector.

Such clauses are usually included in contracts and leases which provide for a private sector entity to operate, maintain and/or invest in a long-lived infrastructure asset. This is particularly suitable where some or all of the private sector's compensation for undertaking such obligations is derived from payments for usage or availability of the asset over a long period of time.

Assets for which such clauses are used include toll roads, rail networks, ports and airports. Such clauses are common across all Australian jurisdictions and intenationally.

The key rationales for a compensation clause are:

- to provide suitable incentives for investments in and maintenance of the infrastructure assets. A clause that provides certainty against unhedgeable sovereign risk is particularly important for long-lived assets.
- to ensure that proceeds received by the state reflect "fair value" for the asset. In particular, a certainty clause aims to avoid private sector investors discounting what they are willing to

pay for an asset because they are worried about risks that are within the control of the state.

The risk being contemplated in the current situation is that the state government (or a future state government) will invest in a second port before it is justified by logistical and economic considerations. While the likelihood of this happening might be small given the many competing demands on the government's already tight budget, it is a risk that many international investors have signalled they will consider material if there is no certainty clause.

It is important to note that the types of investors likely to be interested in the PoM will be very familiar with certainty clauses both in the Australian and international context. They will see the total absence of a clause as an unusual aspect of the transaction that will raise a red flag.

Scope of Risks Covered

The types of sovereign risks covered by compensation clauses generally relate to activities that the state may undertake that have a negative impact on the operation of the assets. These activities could include:

- The government building infrastructure that has a negative impact on the infrastructure being operated by the private sector entity. An example of this would be building a second international container port in a city with an existing international container port before the second container port is justified on the basis of demand.
- The government making an unforeseen decision that hampers the operation of the infrastructure that is very specific to the infrastructure. An example of this would be a change to the regulatory environment that is very specific to a particular industry or piece of infrastructure – eg an industry specific taxation or regulatory measure.

Generally, compensation clauses deal with "unhedgeable" risks relating to the state that are wholly within the control of the state. Where a risk can be hedged and/or mitigated it is appropriate that private sector operators bear that risk.

Compensation clauses do not generally cover commercial risks that private sector entities face, such as:

- The potential negative impact of private sector competition as it is generally in the interests of the economy that infrastructure assets operate in competitive environments.
- The potential negative impact of unforeseen innovation or disruption to an industry as it is in the interests of the economy that innovation and disruption increase productivity and create new goods and services.
- Changes to the general regulatory environment (eg taxation or OHS). This is generally seen to be a risk that all businesses face.

The proposed compensation clause

The compensation clause being proposed by the government is very narrowly defined so as to only cover a narrow set of risks that are clearly unhedgeable. Moreover, in being tightly defined, it allows future governments maximum flexibility.

Specifically, the proposed clause requires a number of thresholds to be met in order for compensation to be payable:

- **That the second port is state sponsored.** This is critical in that the compensation clause in no way restricts a private entity from developing and operating a competing second port.
- **The clause only relates to international container trade.** The proposed clause will not apply to competition from any other port in relation to bulk or other non-container trade – eg bulk liquid, break bulk, automotive and Bass Strait trade.
- **The operator of PoM must be in compliance with Transaction documents.**
- **The PoM operator has responded to any 'use it or lose it' notices.** A second international container port will not trigger the certainty clause if the PoM operator has not invested sufficiently in the capacity of the PoM.

In summary, the proposed compensation clause will only be triggered if a second international container port is built and brought into operation by the State government before it is required in terms of logistical and commercial considerations.

According to the clause, the State can accelerate a second international container port if it considers that such an action is justified on the basis of non-commercial and non-logistical considerations, but it must compensate the operator of PoM where it does so.

Importantly, payments are calibrated to meet some, but not all of the trade lost by PoM lessee. This proposed calibration is intended to incentivise the lessee to mitigate losses and also compete for market share.

Nothing in the proposed approach precludes the state planning for and establishing the infrastructure associated with a second container port. It is important to note that payments under the proposed compensation clause will only be made when international container trade that could have gone to the Port of Melbourne is directed across the dock at the second "state sponsored" container port.

The state will actively engage with the lessee by way of the five yearly PDS and PDP to ensure that it has an awareness of projected demand and capacity initiatives at PoM. This will ensure that the state is best placed to form a view as to the appropriate planning decisions in relation to a second international container port.

Ubiquity of Compensation Clauses

Compensation clauses are standard practice when leasing or selling long-lived infrastructure. They feature in transactions relating to:

- Toll roads
- Casinos
- Ports
- Airports

It is worth noting that the previous government included a compensation clause in relation to the extension of Crown Casino's gambling licence to 2050. Mr O'Brien, then the Treasurer, claimed that the arrangement would provide "regulatory certainty".[27]

The Victorian government has also included such clauses in previous infrastructure transactions such as CityLink.

The total absence of a compensation clause would signal a significant red flag in relation to the transaction, particularly for international investors. Indeed, a legislative ban against even negotiating such a clause would be unprecedented.

Support for a certainty clause in the current transaction

The appropriateness of a compensation clause was supported by the KPMG scoping study commissioned by the previous government.

> While bidders will take some comfort that the State is unlikely to invest before it needs to given the significant cost of the development (and competing priorities for Government funding), it is likely that bidders will require, and the State will achieve greater value from, guarantees around the development of material additional port capacity (whether at PoH or elsewhere). This would provide for compensation in the case the development is brought on earlier than forecast and this has a material detrimental impact on PoM.
>
> Market feedback generally supported the need to provide bidders with appropriate certainty around cash flows to both maximise interest in the opportunity and extract the highest value.[28]

Support in principle for a compensation clause (subject to appropriate settings) was also provided to the Select Committee by witnesses with expertise in commercial transactions including Infrastructure Partnerships Australia (IPA), VECCI and the government's joint financial advisers.

[27] http://www.abc.net.au/worldtoday/content/2014/s4083874.htm
[28] Project Blue Scoping Study, Draft, 31 March 2014, www.portofmelbournelease.vic.gov.au, p158.

VECCI expressed support for the concept of putting in place appropriate incentives for growing the capacity of the Port of Melbourne:

> **Mr MULINO** — Just a couple of quick questions on the compensation clause. One of the rationales for the compensation clause is that there is a widely held belief that the lowest incremental cost for growing capacity to handle containers is going to be to increase capacity at the port of Melbourne over the next decade or two or three and that we want the right incentives in place for the port of Melbourne to undertake that investment and have the confidence it will get a return on that. From what I understand you are comfortable in principle with the clause that tries to provide that incentive such that it does not produce disincentives for an appropriate investment in a second port down the track?
>
> **Mr WOJTKIW** — That is correct. It is vitally important that the port of Melbourne continues to operate efficiently, that there is the capacity to continue to grow it and grow its container capacity and container handling efficiencies. That should not be at the exclusion of a second port. We believe that they very much, over time, will complement each other and that certainly for the medium to longer term there is very much a future for the port of Melbourne, and one to which both the port manager or owner needs to be active in facilitating. And so too government, in terms of providing adjunct infrastructure — whether that be road and rail facilities in and around the port — must continue to be supportive of the overarching connectivity to the port, as has been the case with governments to date.

IPA recommended consideration of a range of different compensation mechanisms and that, in deciding on which type of mechanism is appropriate, the Government should "seek to balance investors' need for certainty, against the public policy requirement for flexibility in meeting the economy's requirements."[29]

The government's joint financial advisers (appointed by the previous government) also explained the rationale for a compensation clause:

> **Mr PECK** - We have looked at different models for this, but we think this is the best model, where all of the risks of developing and managing a port are with the private sector, with the one exception that we are looking at here, which is a state-driven change in market share that the private sector would just find it very difficult to price.
>
> So there is confidence around the cash-flow forecast, there is confidence around discount rate, and you can look at those things in different ways, and investors will run different scenarios here, but I would stress, and I think Tony would echo this, that upfront proceeds are only part of the rationale here. The bigger saving, frankly, if you run a valuation model is if the state gets the benefit of ongoing investment in low-cost brownfield capacity of port of Melbourne and the state defers a greenfield port that might cost 12 billion according to KPMG by 10 years. That value to the state far outweighs the upfront proceeds.[30]

[29] Infrastructure Partnerships Australia submission, p5.
[30] Mr Julian Peck, Managing Director, Morgan Stanley, Transcript of Evidence, 8 September 2015, p11.

Committee not take up opportunity for expert advice

The commercial implications of including a compensation clause and the details of structuring such a clause are very complicated matters requiring expert advice. In its submission, Infrastructure Partnerships Australia indicated that:

> There are various ways in which the structure of the planned lease could deal with the requirement for future development of additional and potentially, competing port capacity.
>
> …
>
> We submit that resolving the best option for this transaction is beyond the expertise of this submission – and likely beyond the individual expertise of the Committee's members.
>
> For this reason we respectfully submit that the Committee agree an independent advisor to review the options and provide the Committee with clear advice on the best approach.

IPA went on to recommend:

> Noting both the complexity and importance of this aspect of the transaction, we recommend that the Committee engage an agreed, appropriately qualified transaction consultant to advise on the best approach.
>
> This would allow the Committee to recommend the best value solution for taxpayers and for consumers, and recognises that this transactional issue is beyond the direct expertise of this submission and the Committee.

Government members supported this suggestion from IPA.

Unfortunately, for reasons not made clear, the Committee did not take up this opportunity and decided to proceed in making recommendations on this complex issue without the benefit of independent expert opinion.

The majority report correctly notes that a number of witnesses expressed concern in relation to a compensation clause. However, the reasoning in the majority report treats all witnesses as equal on this highly technical commercial issue. It does not give extra weight to witnesses with relevant expertise but rather relies upon a string of disconnected quotes without any supporting analysis.

It is quite telling that the majority report makes a very strong recommendation – to include in legislation an outright ban on any certainty clause that would be unprecedented – without having any independent expert advice on which to make this recommendation.

The only expert commercial advisers who gave evidence to the Committee, the Joint Financial Advisers to the transaction, made it clear that such a clause would be untenable.

The need for expert advice on complex commercial matters is echoed in comments made by the Treasurer of the previous government, Mr Michael O'Brien in relation to the Casino and Gambling Legislation Amendment Bill 2014:

> … but as in many business agreements where there are opportunities – particularly in dealing with technical business concepts in relation to the gaming industry – **to bring in experts to seek to assist the parties to have resolution on triggers and on compensation levels, that is the preferable option.** [emphasis added][31]

Conclusion

Taking the unprecedented step of a legislative ban on negotiating any kind of compensation clause with a bidder would run counter to all expert commercial advice. The Select Committee has not given any clear commercial evidence for this strident recommendation.

Such an outcome would add considerable risk to the transaction, reducing expected proceeds materially below what would be considered "fair value" – in effect destroying value in a key State asset. In addition, it would remove appropriate incentives for long-term investments in port capacity.

As such, implementing the recommendation would significantly reduce the benefits for the Victorian community from a transaction that the electorate provided a clear mandate for at the last election.

[31] Mr Michael O'Brien, speaking on the Casino and Gambling Amendment Bill 2014, 18 September 2014, Victorian Legislative Assembly, Hansard, p3460.

Recommendation 13 – Clause 83 of the Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015 be amended to omit 44HA allowing the Treasurer to require payment of an upfront lump-sum licence fee rather than annual licence fees.

REJECT

Proposed alternative recommendation

Proposed Recommendation 13 – That the Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015 be amended to provide that the Treasurer may only require a payment of an upfront lump-sum licence fee rather than annual licence fees if:

- **The Treasurer has obtained independent commercial advice that the nominated sum will not put upward pressure on port prices**

The section of the majority report dealing with this issue fails to present a complete picture of this issue and is based in part upon erroneous reasoning.

No change in policy

It is critical to note from the outset that the proposed Bill reflects a policy that has not changed from the previous government.

This is reflected in the KPMG Scoping Study, which makes the following assumption underpinning indicative valuations:

- The Port Licence Fee currently paid to the State by the PoM can be monetised and form part of the value.[32]

The majority report states that no case has been made for this policy (incorrectly). Yet it makes no clear case for why there should be a complete reversal of a previously bipartisan policy on this matter, particularly given that:

- both the previous government and the current government based this policy on sound, expert commercial advice.
- there was a strong mandate at the 2014 election to continue the policy of leasing the port and the then Government (now Opposition) at no stage indicated that it would reverse such a key element of the transaction.
- the Committee did not seek out expert advice on this matter but rather relied upon evidence from witnesses primarily called to give evidence on other matters.

[32] Project Blue Scoping Study, Draft, 31 March 2014, www.portofmelbournelease.vic.gov.au, p146.

The impact of an up-front payment

It was made clear by DTF during evidence that there has been no change in policy and that an up-front payment would have no impact on prices:

> **The CHAIR** — … Can you outline the government's intentions with respect to the port licence fee and this transaction?
>
> **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.[33]

The majority report cites evidence claiming upward pressure on prices without any analytical exploration as to whether these claims are warranted.

Failure to engage commercial advice

As with the compensation clause issue, the Committee has done itself a disservice by not engaging suitable expert advice before making a very strident, yet unsupported, recommendation.

The majority report's analysis does not reflect the fact that:

- an up-front payment for the PLF, should the Treasurer require this, will be a **biddable amount**;
- each consortia's bid will include an up-front component that reflects **its own financing structure and costs**;
- the up-front component will **not put upward pressure on prices** (see evidence from Mr Rizos above and the Government submission); and
- the Treasurer need only accept the amount if he considers it to be **in the state's interests.**

[33] Mr Nick Rizos, Director DTF, Transcript of Evidence, 4 November 2015, p3.

This was confirmed in evidence to the Select Committee from the joint financial advisers, but not reflected at all in the majority report:

> **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.[34]

To legislate a blanket prohibition on an up-front payment regardless as to whether it is in the State's financial interests is inconsistent with expert commercial advice and transaction best practice. As such, Government members reject this recommendation.

[34] Mr Julian Peck, Managing Director, Morgan Stanley, Transcript of Evidence, 4 November 2015, p33.

Recommendation 14 – The Government should publish, prior to the release of the Expression of Interest, the amount of the Cost Contribution Amount to be passed on to the Port operator and the basis of its calculation.

ACCEPT

Recommendation 15 – The Government, ahead of the lease transaction, commit to allocating a minimum percentage of net lease proceeds to rural and regional logistics infrastructure.

ACCEPT IN PRINCIPLE

Government members note that the overall capacity of the Budget to fund regional projects will be significantly enhanced as a result of the State receiving fair value proceeds from the transaction. This enhanced budget capacity will indirectly benefit regional projects not directly receiving funding from the VTF. This is noted in the majority report.

Government members support a fair share of proceeds being allocated to rural and regional projects. Rather than a fixed percentage, government members prefer the allocation to be decided by the merit of projects. Only projects with a business case or other supporting documentation that represent value for money for taxpayers should proceed.

Instead of setting a fixed percentage, we call on the Government to clarify which rural projects that are ready to commence over the medium term can be funded from the lease proceeds.

DANIEL MULINO MLC (DEPUTY CHAIR)

Harriet Shing MLC

GAYLE TIERNEY MLC