C O R R E C T E D V E R S I O N

PORT OF MELBOURNE SELECT COMMITTEE

Inquiry into the proposed lease of the port of Melbourne

Melbourne — 30 September 2015

Members

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

Staff

Secretary: Mr Keir Delaney

Research officer: Mr Anthony Walsh

Witnesses

Mr Rod Sims, Chair,

Mr Michael Cosgrave, Executive General Manager, Infrastructure Regulation Division, and

Ms Sarah Sheppard, General Manager, Infrastructure and Transport — Access and Pricing, Australian Competition and Consumer Commission.

The CHAIR — I welcome Mr Rod Sims, the chairman of the Australian Competition and Consumer Commission; Mr Michael Cosgrave, the executive general manager, infrastructure regulation division; and Sarah Sheppard, general manager, infrastructure and transport — access and pricing.

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

The committee has allocated 1 hour for this session. I invite you to make a brief opening statement, if you wish, and the committee will then proceed to questions. We also thank you very much for your earlier written submission.

Mr SIMS — Thank you very much. I will make a statement. I will try to keep it as brief as I can. I thought I would break this into two bits: firstly, providing context for the views of the ACCC on this topic; and secondly, just focusing more specifically on the port of Melbourne. We have often said that we are very comfortable with privatisation. We understand that the private sector will often operate assets more efficiently and if key assets are operated more efficiently, then that benefits the economy of Victoria — and of Australia, if I am speaking generally.

The concern that we have been stating over the last couple of years is that the desire for a good sale price can come at the cost of poor competitive structures or outcomes or poor regulatory outcomes. The concern we have is that to, dare I say it, artificially boost the price, people selling private assets — and I emphasise again that I am speaking generally here to provide the context for our concern over the last couple of years — could sell assets with non-compete clauses or bundle potentially competitive assets together or they could put in place price regulation that really had no effective price regulation. These days, I am afraid, that is termed light-handed regulation. Personally I think light-handed regulation of a monopoly is a contradiction in terms.

We have been advocating on this for some time. We do so because we believe that if there are artificial arrangements to boost a sale price, that can have the effect of imposing an effective tax on future users of whichever facility it is — whether it is an airport, a port, a railway or whatever — thereby damaging the competitiveness of the economy that the infrastructure facilities serve. So we have very real concerns. We have been expressing these concerns where there is a very clear monopoly — people have to use the asset — and I guess we simply would say to people who do not share our concerns, '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.

I will just give one example, if I could. The port of Newcastle was privatised in May 2014, with a 98-year lease. It is the world's largest coal port, which is why I mention that. Pre privatisation, it was making around $23 million to $25 million a year, both profit or cash flow, whichever way you want to look at it. It was sold for $1.75 billion. The financial press universally welcomed the high price. As I say, that was in May 2014. On 1 January 2015 they increased the navigation charges by 40 per cent, which increased their profit or cash flow by about 20 million — that is, more or less doubled it. Then in April this year the people who owned the asset revalued the asset to about from 1.7 billion to 2.4 billion. I think it is fair to say that the coal industry and the ACCC have concerns about many more very large price increases to come, because there just does not seem to be much in the regulatory regime that can prevent that happening.

That is the example — yes, a high one-off price, but we would argue an effective tax on the value chain thereafter. That is our general concern. There have of course been many assets privatised, including ports. We do not think the port of Brisbane, for example, has very effective price regulation either. I think it is fair to say that our concerns have grown over time. We have been following this debate over the last couple of years. We have therefore been advocating on this issue, and we have had some success. The port of Darwin, for example, originally really did not have much of a regulatory regime. We now understand they are going to have a negotiate-arbitrate regime, which we think is helpful, so that is a good step.

Those were my general context remarks. Turning to the port of Melbourne, which is why we are here, there was of course, if I go back in history, some talk of selling the port of Melbourne and a potential port of Hastings together. We had concerns that that would be a very anticompetitive thing to do, and we are very pleased that that is now not happening. There was then a proposal, as I think everybody now knows, of a 750 per cent increase in the rents that the stevedores would pay. Both DP World and the ACCC, and many others, voiced strong concerns, and I am pleased that this has now been resolved. That is very helpful. We do acknowledge that resolving it comes at some cost to the future sale price, but we add a gain to the future economy of Victoria.

We did have some early discussions with the government over the port of Melbourne, and we have acknowledged that the regime in place, as we understood it when we issued our submission, did have some good features and in many ways was better than many of the other ports I have just talked about. But we did in our submission list three concerns, which I do want to address. I have to point out that since we put the submission in the Victorian government did make contact with us and had further discussions around the regulatory arrangements, and I will touch on some of those now. As I understand it, the Victorian government has now made those new arrangements public, but I think that is very recent. Obviously those changes do improve the regime quite a bit from the one we commented on in our submission, so I will just briefly touch on the three issues we voiced concerns on, what our concerns were and the extent to which the recent changes affect those concerns.

The first concern we had — as I say, there were three of them — was we noted that there was a provision that provided for compensation if a second port was built, or facilitated by the government to be built, before the port of Melbourne reaches its capacity. I have to say governments — and I should say of all persuasions in all states — really want to plan these sorts of things. They feel it is much better to have a degree of control over when and how investment takes place. We have a different view. We believe that competition, or the credible threat of competition, will drive better investment outcomes, more market-driven investment outcomes, so we do have that philosophical difference with the government, and I daresay with other governments around the country as well. Our concern is that the compensation regime could deter actual or potential competition at some stage down the track.

That was our concern, as we voiced it in our submission. In the discussions we have had with the Victorian government they have talked about their willingness to disclose the capacity levels and also the trigger events that would sit behind any port growth regime — that is, the capacity that would trigger the removal of the compensation regime and the arrangements behind the compensation regime. They have talked about that, and we would say that 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. On the compensation issue, I think I summarise it by saying 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, so we welcome the change that has been made but there is a philosophical difference that sits there behind it.

On the second topic of the general regulatory regime, again the regime that was there had price caps on most major services capped at CPI for 15 years. There are various ways to prevent monopoly pricing, but we welcome the fact that you have got that regime. It is not something you see in other port privatisations. But 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.

The Victorian government, in the letter I have only very recently received but which is consistent with the discussions over the last day or so, notes the minister's ability to reregulate the port after the 15 years, with the Essential Services Commission determining the form of price regulation, so the minister now has that ability. With that threat of reregulating, the minister can, as we understand it, seek a clawback of any inappropriate pricing. I think that is a helpful threat.

Obviously this would be triggered by an adverse finding from the monitoring. The minister can then seek a clawback. The minister can direct that the port be reregulated. Those are significant consequences. To address our concern about this only ever occurring every five years, the letter says that the minister can direct the Essential Services Commission to monitor at any time if there are concerns about the port pricing. We think that does improve the regime considerably in relation to this regulatory aspect. We think if you are going to have price monitoring after year 15, you have to have a ready and easily implementable threat, if I could use the word, of consequences, and this seems to do that. I guess we hope that that would be done through some form of regulatory instrument rather than legislation, but the bigger issue is that you have got a consequence. The regime, as it looks to us, would be a monitoring one against principles, and if that monitoring raised concerns, there is a credible threat there.

On the third issue we raised, which is around land rents, this is what the 750 per cent applied to. This is the rents paid by the stevedores. Obviously that resolution with DP World has sorted that issue out, I think, until the late 20s or so, but we had concerns that the land rents were excluded from the price regulation regime I have just talked about. 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. I have probably gone on — —

Mr ONDARCHIE — Is that recent, is it?

Mr SIMS — We met with the Victorian government about a week or so ago, and these changes are very recent, yes. They were agreed over the last couple of days or talked about over the last couple of days, and the government said to me that they were going to be releasing the letter that contains all this late this morning, so it is extremely recent.

Members interjecting.

Mr SIMS — I will just conclude with these statements and say that this has really been a bit of advocacy on our part, which is what all competition regulators around the world do. We have thought this was a particularly important issue, given how many assets are being sold. We understand that there is a difference of views on these issues. As a competition regulator we want to make sure that there is as pro-competitive an outcome as can be and that there can be effective regulation. We acknowledge the changes that the government has made and that they certainly move the dial quite a lot from our point of view. I realise that is a confusing story, because you have got our submission and a bit of late-breaking news, but I felt I had to refer to that in what I said, otherwise I would be misleading on the state of play.

The CHAIR — Thank you, Mr Sims. The committee appreciates your opening statement, the way in which matters have shifted since the original submission was made and indeed the detailed submission you have provided to the committee. You referred to a letter from the Treasurer. The committee currently does not have the benefit of having seen that letter, but I have seen that the Treasurer issued a media statement early this morning.

Mr SIMS — That is the advantage of iPads, Chair.

The CHAIR — Have you seen the media statement that has been issued by the Treasurer?

Mr SIMS — Literally prior to walking here one was sent through to the office, and I had a quick glance at that. I assume it is the one that has been released. If it is not, it is very close to it.

The CHAIR — It states:

> The ACCC has acknowledged that these strengthened safeguards constitute significant progress …

and that:

> The ACCC acknowledges that the Labor government's proposed regulatory regime for the port, including the new additional safeguards, will provide for stronger oversight than applies to any other privately operated port in Australia.

Are you familiar with the comments that have been attributed to the ACCC, and are you comfortable with those attributions?

Mr SIMS — I had a very quick glance at the press release. I cannot claim to have read it as closely as that would require, but nothing jumped out at me as causing of any great angst. I read it very quickly, I have to say.

The CHAIR — Regarding the undertakings that have been given to you, if I can describe them as undertakings, is it your understanding that they will be enacted via amendments to the legislation? What is your understanding of how the government proposes to give effect to these changes?

Mr SIMS — I would guess — and my colleagues might want to add to this — that they would either be in the legislation or be in the contract of sale or the lease conditions. I must be honest and say that over the last couple of days I was just referring to the gist of the changes rather than the detail. I take your point that the detail and how they are done is extremely important — making sure that everything is in the wording and how it is done — but I did not focus too much on that. I think it is a combination of the legislation and the contract.

The CHAIR — Does the ACCC have a view on what is preferable in terms of giving teeth to those undertakings as to whether it is a civil, contractual matter or something that is actually enshrined in legislation with the oversight of the Parliament?

Mr SIMS — I think it is a bit of horses for courses. For example, where there is a provision that says, 'You must include in all your rent agreements with stevedores the right for third-party arbitration', that is probably sensibly something that is put in the contract, but generally there is benefit in making sure that where it is issues to do with regulation they are in legislation or some form of regulatory instrument. But it would depend on exactly which issue we are talking about.

The CHAIR — Can I take you to the first issue you raised, which was the compensation provisions, and the view the ACCC put with respect to the potential for those to deter competition? The undertakings you received from the government today relate to transparency?

Mr SIMS — Yes.

The CHAIR — But is it fair to say that they do not give effect to any change to the actual compensation regime and that the concerns you had around the potential for that compensation mechanism to deter competition remain?

Mr SIMS — That is right. Let me put it this way. If you are going to have a compensation regime, then that transparency is to be welcomed because everybody knows the rules of the game, and that is helpful. But clearly we would prefer to have no compensation regime; there is in 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 no-one 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 up-front with the government that we have an agreement to disagree on that topic. We would prefer no compensation; that is clear.

The CHAIR — In terms of the compensation mechanism, which deters competition, that would essentially be through creating a disincentive for government to facilitate a second port. The secretary of the Treasury gave evidence early on in the inquiry where he described the compensation basically as a refund of an element of the port sale price, so the disincentive is on the government. Does providing transparency, as the Treasurer has undertaken to do, actually advance the case in any way?

Mr SIMS — It does — —

The CHAIR — Sorry, the government is already going to be aware of the circumstances of the compensation.

Mr SIMS — Yes.

The CHAIR — This will provide information to a third party who may wish to develop a second port — —

Mr SIMS — Yes.

The CHAIR — But ultimately the disincentive for that to occur is still with the government, and that does not change.

Mr SIMS — I think what changes — —

Our concern would be with a compensation regime that everybody knows is there but without the detail becoming clear, it would not just be a disincentive to government. It would be a disincentive to private investors, because they would know that the compensation regime was there, and they would not know much about it. They would just know, 'Don't go here. Don't bother'. With the regime being transparent, we actually think if you are going to have a compensation regime — we would rather you did not, but if you are going to have one — that helps a lot, because it means that it is clear to everybody if you are progressing your tonnage up, as inevitably you will over time, you can project when you are going to hit that level. You can start preparing. Alternatively, you could even approach the government. I will take an extreme example that you might regard as silly, but you could sit there and say, 'I will buy the government out of the compensation regime'. If it is transparent, it just allows people to move in ways that a lack of transparency means they would not. As I say, we agree to disagree over compensation, but if you are going to have one, transparency does help.

The CHAIR — Can I also ask you about your second issue, which was the general regulatory regime? The bill provides for, as you indicated, certain prices to be regulated and capped at CPI for 15 years. Does the ACCC have a view on the appropriateness of CPI as the capping index? It was raised with the committee earlier that CPI bears no relationship to the costs associated with the port. Tying the prices to the retail price of bread and milk does not bear any relationship to the actual costs of the port and, indeed, with growing volumes you should expect some efficiency and a reduction in real costs over that period of time. Does the ACCC have a view on that?

Mr SIMS — Yes, we do, as follows. I think our general preference when you have an infrastructure asset with large users of that asset is to have a negotiate/arbitrate regime, where these things are negotiated but have binding arbitration. There is no point being able to negotiate with a monopoly if you do not have some recourse to arbitration. That is something we have always preferred, but I think having someone who has just bought the asset, giving them certainty but making sure that they cannot extract extravagant monopoly rents, is a good outcome. Everyone knows where they stand. 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.

A discount rate — of course you could. Again, I do not think it much matters. The ACCC is not about fine-tuning things. You may have a different view, but our view is we are not about fine-tuning. 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 job does that for 15 years. That is fine. We are not fussed about a discount rate.

The CHAIR — On the mechanism that has been agreed with the government for the minister to direct the ESC to undertake monitoring, if the minister forms the view that, if I understand it correctly, market power has been exercised by the operator with respect to rents and other matters — is that the appropriate mechanism that discretion sits with the minister rather than the ESC having as of right capacity?

Mr SIMS — There are two issues there. One is the general regulatory regime, which is where the ESC, as I understand it, monitors against agreed pricing principles, which would be some element of a standard regulatory framework. If the ESC finds that — this is separate from the rent; the rent has its own regime — they have not accorded with the pricing principles, then you are right: the minister has the ability to reregulate the port.

I guess we would like, if I can use the term, the 'threat' — that is, the threat that underpins their ability to stick to the pricing principles — to have as much automaticity as possible. We certainly would prefer something the minister can do rather than having it go back to Parliament. Obviously if the ECSC could do it — —

Mr COSGRAVE — ESC.

Mr SIMS — Sorry, I am getting confused with one of our own committees — I do that all the time. The trade-off is if you leave it to ministerial discretion, you can describe the circumstances in higher level terms than you can if you say the Essential Services Commission — I will stick to the name rather than the acronym — has the right of step-in, because if they have the right of step-in, it has to be much more prescribed. I think that is a legitimate trade-off. I think the only thing I would add is that we would like it to be as automatic as possible. We would like it not have to go back to Parliament. Whether it is by ministerial — —

As you can tell, I am a little bit thinking on my feet here, but I think it does not matter as much because provided the minister can just do it, the users of this port are going to be so large that they are going to be watching those pricing principles as well. If they think there is a monopoly rent extraction, I would think they would be putting a lot of pressure on the minister. So while I think there is a theoretical preference for the Essential Services Commission doing it, you have to add the caution that you would have to qualify the terms under which they do it a lot more, and I am not sure, at the end of the day, there is much in it given that you have large users who will also be policing this.

The CHAIR — I guess the counter to that is that you would need to look at what are the incentives for a minister to intervene and trigger that mechanism. The incentives for a minister may be different than the incentives that exist for the ESC if it had its own prescribed power to — —

Mr SIMS — Absolutely, but I think here where you have large users, first of all the Essential Services Commission has got to find that there has been some falling-out against the pricing principle, so they are the trigger in that sense. I think if they get up and say, 'This port owner is not playing by the rules', it is not clear to me why the minister would not then act on that. I think if you have a transparent trigger, then having the minister able to do it — I am pretty relaxed about that. I think the pressure will be there to get a good outcome. At the end of the day this is a big step. Politicians are elected to take big decisions. Personally I am not uncomfortable leaving that as a political decision, as long as they do not have to go back to Parliament — I think that just is too much of a hurdle.

The CHAIR — Mr Sims, I am conscious of the need to share with my colleagues, but I would like to ask you about one other matter. It goes to the legislation, clause 69. I do not know if you are familiar with clause 69 of the bill.

Mr SIMS — I think I am about to be.

The CHAIR — It is the clause titled 'Competition and Consumer Act and Competition Code', and to read you the operative clause:

> For the purposes of the Competition and Consumer Act 2010 of the Commonwealth and the Competition Code, the following things are authorised by this Act …

So it is a clause that authorises a number of things to happen under the scope of the commonwealth legislation. My understanding of it is that it effectively would be this legislation providing an exemption from a number of provisions of your legislation with respect to competition and monopoly power et cetera. Are you able to outline the significance of this clause to the transaction — what those exemptions from your act mean for the port operator?

Mr SIMS — I will have a start at that, and then my colleagues can jump in. A couple of high-level points: firstly, we obviously, as the ACCC — —

Sorry, first step, I have to point out that a lot of governments do this. I think when you are selling assets it is quite a common thing to do. Secondly, we at the ACCC would rather they not do that. We think the competition provisions of the act should have general application, particularly in matters relating to commerce. We understand that these provisions — —

I must say — I am embarrassed to say — I have not read the particular provision. I am fully aware of it but not across its detail, so I am going to pass to my colleagues to properly answer your question, but as I understand it, it would certainly seek to exempt the compensation provisions for examinations under our act. I am not honestly sure what else they do. Do you want to comment?

Ms SHEPPARD — As we understand it, this clause is directed at conduct which could be a breach of part IV of the act, although we do note that these types of clauses cannot exempt the act from consideration under section 50, which is the substantial lessening of competition provision.

Mr SIMS — Merger provision.

Mr COSGRAVE — Merger.

Mr SIMS — But I think — and I am thinking on my feet here — it really affects, mainly, the compensation, does it not? Everything else we have talked about today is a regulatory matter that would not be affected by part IV of the act anyway.

Mr MULINO — Everything else is the same.

The CHAIR — And it is the ACCC's view that the regime around the lease would be stronger if this provision was not in the legislation?

Mr SIMS — I think we would say that as a general principle in relation to all privatisations. So yes, 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.

The CHAIR — Final question. The government has indicated a willingness or a consideration to undertake this lease transaction not via this legislation but via bypassing this legislation and using the State Owned Enterprises Act, which would mean this provision would not be enacted. Does the ACCC have a view on what that would mean to the value of the leased asset if this provision was not available but exempted the operator from part IV of your act?

Mr SIMS — I have not turned my mind to that extensively. I think its main effect would be to affect the compensation. If the provision was not there, you would then have to assess at least two things. The main provision that would be brought into play would be section 45 agreements would have the purpose or effect of substantially lessening competition. Step one would be to assess whether the compensation regime does have the purpose or effect of substantially lessening competition, so we have to form that view. That is never a simple thing to do; it would take a bit of analysis. Then secondly, one has to have a look at the way the act now limits the government to — —

Governments are only caught by the act to the extent they are engaging in trade or commerce as distinct from undertaking a decision with commercial consequences, so how that played in you would have to look at. It would be something that would need a bit of assessment. Obviously with the provision in, that assessment just does not arise; with that provision, the assessment is there. If it was felt that there was a risk of it falling afoul of section 45, then it would be up to the port owner to seek authorisation of that provision, which would bring into play a cost-benefit test.

I accept that without the provision — without that section — that compensation regime would be under some scrutiny from the act. What exactly would be the outcome of that scrutiny is a bit hard to tell. I am sorry for being so uncertain, but I am surrounded by lawyers, and these things are complicated.

The CHAIR — You do have parliamentary privilege. Thank you, Mr Sims.

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.

Mr MULINO — What are some of the advantages of the building block evaluation of a monopoly business?

Mr SIMS — It is just really a fancy term for — —

Essentially infrastructure assets are large, big bulky things with quite small operating costs, and the building block says: take the asset value and multiply it by a very contentious rate of return and allow the owner that return plus depreciation' — that is usually the bulk of it — and then throw on top the operating costs. It is a pretty basic way of working out whether the owner is going to get a fair return on the assets. Because most of the return comes from the rate of return multiplied by the asset base, it is, at its highest, a pretty simple method to apply.

Mr MULINO — One of the elements of that approach is that you only allow for efficient costs?

Mr SIMS — Yes.

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.

Mr MULINO — So it is important that part of the regulatory regime is about only allowing reasonable costs to be passed on?

Mr SIMS — Yes.

Mr COSGRAVE — Assuming it was developed and applied properly by the regulator, who develops it and applies it under this regime.

Mr MULINO — Sure. There has also been some discussion around the appropriateness of CPI as a benchmark.

Mr SIMS — Yes.

Mr MULINO — From what I am hearing from your evidence, you think it can be appropriate. There are a number of possible benchmarks that you can use and it is really the way you apply these benchmarks that is more critical?

Mr SIMS — I think the way I would put this is: we are living in a world where ports are being privatised out there with no regulation at all. Now at least we have got some form of limitation on the excessive returns that the new owner can get, so I think we are comfortable that there is something there, rather than trying to pick at the detail of how it is done. I think if right across Australia every time a port was privatised you had some form of price-capping mechanism, then I would be much happier to engage in the debate about exactly what the form of price cap was. But when I am living in a world where there is not much capping of the ability to charge excessive monopoly prices, I am not going to worry too much about whether it is CPI or something else. That is a silly answer, I guess, but that is the way I am viewing it.

Mr MULINO — We do not want you to get into all the pros and cons of different benchmarks. CPI minus X is a pretty commonly applied benchmark in different industries where it is used as a price path to capture efficiency gains?

Mr SIMS — Yes it is; absolutely it is. There is no doubt that there is a sensible argument for a CPI minus X. As I think the Chair said in his remarks, there is the first question of whether CPI reflects the costs, and then the second question of whether you want to allow some efficiency dividend against that. All that is standard regulatory practice. I am happy to acknowledge that. All I am really saying is, compared to all the other ports I have looked at, at least having that is a big step forward.

Mr MULINO — Sure. So what we are seeing here is much stronger than elsewhere?

Mr SIMS — Yes.

Mr MULINO — On the non-prescribed services, as a general principle, taking a helicopter view, there are clearly a lot of organisations and businesses in our society which have market power — a lot of utilities. It is also true, is it not, in general terms, that even where a business has market power or monopoly in one aspect of its operations, that need not be the case in every single aspect of its operations?

Mr SIMS — Correct.

Mr MULINO — So even in some utilities, for example, we see strong regulation for some aspects, but not necessarily every single aspect. Does that mean that you would be comfortable with an approach where, where we have clear market power and broad agreement by regulatory experts that certain things should be prescribed services, they should be subject to a stronger form of regulation.

Mr SIMS — Yes.

Mr MULINO — But where there are other aspects of the operation which are a bit less clear. a periodic review might make sense with economic rigour to determine whether market power exists or not?

Mr SIMS — I may be misunderstanding the question, but where we think there needs to be regulation is where you have a monopoly — a significantly declining cost asset, no-one is going to duplicate it, you have got to use it. I am adding unnecessarily to your question, but for us this is not a pro or anti-regulation question. I would probably sit down and debate with you and want probably a lot less regulation than others would in a whole lot of areas, but we have a monopoly. I know exactly what they are going to do — I would do it the same way — so you have to regulate. Where there is part of the service that is contestable or competitive then the need for regulation can fall away. If they are doing things that are truly contestable, provided they cannot bundle the monopoly element with the non-monopoly element, then the need for regulation would fall away.

Mr MULINO — Exactly. I was just getting to the issue of rents, I suppose, and just thinking that even within rents there could be a range of degrees of market power, potentially, given the different nature of businesses operating. It is an area where it is worth having a rigorous examination to work out what you think might be the right regulatory approach.

Mr SIMS — If I could make two points. One is that, if the point you are making is that the rent you are setting for the stevedore is going to be benchmarked against the rent for somebody with a factory some kilometres away, so that you have — —

Mr MULINO — Just to clarify my question: it is worth clarifying the presence of market power before you put in place regulatory arrangements as a general principle. That is what I am getting at. You would not want to just do it without that kind of examination.

Mr SIMS — I completely agree with that. I completely agree with that philosophically, totally. But I guess I would make the point that with the rents, they are rents from the monopoly port owner, and as I understand it the port owner owns that land, so they have got monopoly control over that if they wish to exercise it. That is why I think there does need to be a proper regime over the land rental, because that is at the behest of the monopoly owner.

Mr MULINO — On the broader proposition around the certainty of the investment environment, you outlined that one of the rationales for the compensation regime is to provide sufficient certainty to the new lessee such that they would make efficient investment in the state's infrastructure. That would be something that would be beneficial for the state's investment. It is also true to say, is it not, that regulatory arrangements generally have investment certainty as one of the factors. You generally want to provide long-term certainty to investors in significant sum cost assets that they are going to be able to recover a long-term reasonable return on those assets. This kind of investment certainty, this goal of a regulatory arrangement, is a sensible one, to be traded off against others in some instances. But it is a sensible goal.

Mr SIMS — It is. You are right. We, all three of us, are in the regulating monopoly assets business and we do that with a view to provide certainty. The difference here, though, is that we would always prefer competition to regulation. Regulation is way better than just letting a monopolist do whatever they want — way better — but if you can introduce competition, that is better still. I guess our concern is, yes, we understand the

need for certainty, but where you can inject the potential for competition would have a better effect. Again, that is not a provable statement; it is very much a philosophical one. As I said earlier, there is a philosophical difference between ourselves and the government, but the threat of competition would be a better mechanism in this case.

Mr MULINO — I think we are in agreement, though, that embedded within the regulatory framework of monopolies this broader concept of investment certainty is a sensible goal subject to trade-offs.

Mr SIMS — People need to have some certainty over their investment. But if I could just say that people all around this building are investing in, needless to say, coffee shops and all sorts of other wonderful places that — —

Mr ONDARCHIE — Not on the public holiday, we are not. It is going to be closed.

Mr SIMS — But it is the cultural event of the year. You have to — —

Ms SHING — Yes, indeed.

Mr MULINO — So we have ACCC tick-off!

Mr SIMS — ACCC tick off-on anything to do with the AFL.

Ms SHING — Own goal, Mr Ondarchie.

Mr MULINO — You are dealing with a zealot there.

Mr SIMS — You are dealing with one right here, that is for sure, You have thrown me right off my track now. I have thrown myself off.

Mr MULINO — I think we have already agreed that in context — —

Mr SIMS — Investment certainty. I guess the point I was making is that people invest all the time in with things and they do not get much certainty. In a sense, when you are regulating assets, there is a trade-off. You are regulating to limit their monopoly rents, but you give them some degree of certainty as the trade-off. The stores around here — —

Mr MULINO — Because otherwise you could ignore some costs in a lot of contexts?

Mr SIMS — But the stores around here can earn whatever profits they want. No-one is going to regulate them, but they have got no certainty. The certainty is a trade-off for the regulation that is being done, but it needs to be seen in that light, I think. In a truly competitive economy in a truly competitive environment I am afraid no-one gets certainty. When you regulate it, you can get a bit of it.

Mr BARBER — The Treasurer has put out this press release saying where you agree with him. I want to clarify where he may not yet agree with you. Has he agreed with you on negotiate/arbitrate with what he has put forward?

Mr SIMS — I think it is probably fair to say the main answer has probably got to be no. But the regulatory regime has, as we have discussed, the 15-year capping. Thereafter if they do not adhere to the regulatory pricing principles, then it is up to the ESC to decide what that model would be. But I think that is a fair point to say we have not got agreement on that.

Mr BARBER — There is also the ability, is there not, to introduce other sorts of charges that are not covered by either what he was previously promising or what he is now promising. Is that a concern with something like a port?

Mr SIMS — My understanding — and I am subject to my learned colleagues on my left and right — is that the bulk of the assets are either caught by the regulatory regime or by what would essentially now be a negotiate/arbitrate on the rent regime. So I suppose I need to change my answer earlier. There is at least a negotiate/arbitrate regime on the land rent, and that is helpful, but my understanding is most of the key charges are caught.

Mr BARBER — You still do not agree on this compensation for competition clause, albeit that it is now no longer a state secret what the magic number was?

Mr SIMS — As I understand it the capacity number is going to be negotiated with the buyer and settled in that context, and then made public after that. That is my understanding.

Mr BARBER — So nobody knows what that number is until it has been negotiated between him and the government?

Mr SIMS — True. As I say, I have made my point that we would rather it was not there, but the point is that as long as it is known over time so that people know the circumstances in which a new port can be built — if the whole world knows that, the press knows that, the users of the port know that — then that will help.

Mr BARBER — We have been given a copy of the draft pricing order, but the figure for the regulatory asset base has been blacked out — not to be inserted later like some other numbers that are to go in this document, but actually blacked out. Is that regulated asset base number a fairly big and important number for someone like me to know?

Mr SIMS — I certainly would have no hesitation in saying that I think it should be a transparent number at some stage. I do not particularly have a view on when that needs to be known, but I think that when the transaction is done it would be helpful for everybody to know that.

Mr BARBER — Because in fact the whole discussion over here about the building-block method, as you said, depends entirely on what you are calling the regulated asset base.

Mr SIMS — Absolutely. That is the key number.

Mr BARBER — Yes, thank you. Are there any other strengths and weaknesses of the building-block method that you would like to talk to us about from your point of view as a regulator?

Mr SIMS — I think it is a bit like democracy; it has its faults but nobody has found a better way of doing it. We have been trying, and we come up with 'CPI minus Xs' and a whole range of nuances. VAR has recently been doing a bit of benchmarking, but they are all really still variations on the theme. I think building block is a bit maligned, but really at its base it is just multiplying a regulatory asset base by rate of return and allowing depreciation on the same regulatory asset base; it is not rocket science, so I think it is largely fine.

Mr COSGROVE — And it is certainly a way in which many of the utility assets in this country are valued — energy, telecommunications, et cetera.

Mr BARBER — It is not rocket science for them to work out how to game it, either, is it?

Mr SIMS — If it is applied by a regulator who knows what they are doing, I think it is fine. We regularly get beaten up by the entities being regulated and the entities using the regulatory assets, but I think we have a pretty good handle on it and know the ways to game it.

Mr BARBER — I am not talking about you, of course, but other regulators.

Mr SIMS — The main gaming is where they will put in very high capex or opex proposals and then know they are going to come in under and therefore benefit from the price path that they artificially inflated. A good regulator will see that, but I guess the more important point is they will only fall for it once. We had very good examples here in Victoria when the assets were privatised. You had a very good regime. The regulator was initially gamed and then the regulator worked that out and responded accordingly, so I think these things can be worked through.

Mr BARBER — This bloke has 15 years to think about it when he is under his CPI cap by which point we do not know; we might have already hit the capacity for the port or we might not have, so there are a few different things interacting there, are there not?

Mr SIMS — There are. As I said earlier, the price cap is an arbitrary way to do it, but from our point of view we are just pleased there are some limits on the monopoly power.

Mr BARBER — Mr Mulino asked you the same question four times, which was — —

Mr SIMS — That was probably my bad answer rather than his question — —

Mr MULINO — I am sure it was not.

Mr SIMS — but we were getting distracted over the AFL football.

Mr BARBER — He was trying to suggest that investment certainty could be a trade-off for monopoly. But in fact those are two different concepts, are they not? If you have monopoly, you have your certainty.

Mr SIMS — You do. I guess the point I was trying to make — rather badly — is that the only way a regulator — we regulate in ways that limit the upside, because we take away the chance to make monopoly profits. But the trade-off is you limit the downside, and that is what regulation does. We have not thought of a better way of doing it, but most businesses in Australia do not operate with any investment certainty and that keeps them on their toes, and that is probably a very good thing.

Mr PURCELL — Thank you for your submission — it is detailed — and particularly your comments today as well. They certainly help explain a lot of the issues. Probably one, though, that I would like to raise is that you come out strongly in favour of privatisation — privatisation in general and more specifically of the port. There are no reservations shown in the submission to that at all. So the ACCC does not have any general reservations in regard to the privatisation of the port?

Mr SIMS — I guess just experience and, speaking privately — and here I will separate out hospitals and prisons and things like that — where you have an infrastructure business, simple experience and observations suggest they are operated better by the private sector. That same experience says to me, 'Make sure you properly regulate them, otherwise you will get bad outcomes'. So if the question is: would I rather keep them in public ownership or have them badly regulated in private ownership, I may well prefer keeping them in public ownership. But if we can get decent regimes, I think the private sector will run them more efficiently. There are many examples of that. I accept that again some may see that as a philosophical issue as well; however, my observed experience has been that the private sector generally finds new ways to run things and run them better.

Mr PURCELL — Just to take that to the next step, do you think the public interest test probably stops around hospitals or schools?

Mr SIMS — I think the public interest test for me is where you can define a clear objective that you want the owner to pursue and then you can privatise. I am speaking very personally here. Where the objectives are complicated, they are very hard to measure, you want them to achieve a mix of things, then the arguments for privatisation are much more difficult.

Mr ONDARCHIE — This bit of legislation around this 70-year monopoly has gone through the Legislative Assembly. The Treasurer championed it as a great piece of legislation. It seems like he has changed his mind this morning, according to your testimony, on a few things. It looks like, as the government said, your overstepping role was not quite valuable, as it turns out to be. This legislative debacle has all the hallmarks of desalination mark II, but I want to talk to you about — —

Members interjecting.

Mr ONDARCHIE — I just want to talk to you about your concerns about the compensation regime associated with the second port that could deter competition. Having said that, give it 24 hours and the Treasurer might well change his mind, but we will see how that plays out. The ESC said they have a preference for competition for a second port. The problem is the Parliament will not know what the triggers are for a second port until the legislation passes the Parliament. Therefore it is possible that the government could put in place trigger points that effectively enshrine a monopoly for a long period of time. How can the ACCC be comfortable that those trigger points are reasonable?

Mr SIMS — I think again I have already mentioned the philosophical difference where we would rather there is no compensation clause, so that is our high-level point. In that sense we would rather the thing was not there. I agree with you; it depends very much what those trigger points are and how they are worded. Obviously

one wants to make sure that any limit on the TEUs is not excessive and that it is sufficiently clear that people know where they stand. I think those are important criteria. I think it is helpful to know those things.

Mr ONDARCHIE — Therein lies the problem, doesn't it, that the government are asking for this legislation to pass the Parliament without the Victorian taxpayer — and you — knowing all the details. It is possible that they could put a trigger point in that keeps this as a monopoly for ever and ever.

Mr SIMS — In concept I would have to agree with that, but the counterpoint I guess is that if once the legislation has passed those hurdles are such that they are very unattractive, then I guess there are political consequences. I am stepping into the area of politics here. It is obviously an issue for the Victorian Parliament to work out, but I just point out there are political consequences even after the event, which hopefully provides discipline on what you are suggesting.

Mr ONDARCHIE — This is a moving feast, Rod. As I said, go 24 hours and the Treasurer might come up with a different regime.

Ms SHING — Thank you very much for your submission and in particular for the statements that you have made in relation to recent developments on the three issues of concern that were set out in the submission, namely, compensation, the price caps and the land rents issue paid by stevedores. I have a relatively simple question to ask. At the outset you took us through the various transactions and developments as they related to Brisbane, where you referred I think to not very effective regulation that had declined, in your view, over time, and those concerns had risen; and Darwin, which was I think initially scant and has now incorporated a negotiate/arbitrate regime, which is an important step forward.

What I gathered from all of this, and also from your comments on the regulatory economic framework, is that sunlight is in fact the best disinfectant you can have for greater levels of transparency on the one hand and also discouraging the type of behaviour and conduct which you have a priority to deter. Is it therefore a fair comment that the framework which is now proposed, incorporating the undertakings which have been referred to this morning in your opening remarks and the more robust economic regulatory framework as it already stands, will provide a comparatively greater level of confidence and security as far as this particular transaction is concerned?

Mr SIMS — There is no doubt. Two things: firstly, the regulatory regime that we commented on in our submission already had some good features compared to other ports, and we were happy to acknowledge that. The improvements that have now, as we understand, been made public certainly do improve things quite a lot because you have got monitoring but with an effective step-in right for the regulation, and for land rents you have got permanent negotiate/arbitrate. On those two issues, which were two out of our three issues, it is a considerable improvement. There is no doubt about that.

Ms SHING — Putting to one side the philosophical position that you take and that you will invariably take in relation to the compensation issue, the compensation around the second container port that you have indicated was facilitated to be built before the port of Melbourne reached its capacity will in fact be tempered as a consequence of the incentives around privatisation for the port of Melbourne to reach capacity through innovative streamlining of efficiencies, freight and logistics, rail and other issues. What is your position in relation to that?

Mr SIMS — Again I think I would just say that I understand that the government is going to do what it can and the port owner will do what it can to make best use of the port and to maximise its capacity. I guess it just gets back to that philosophical issue that if they were looking over their shoulder, worried about the threat of new entry, that would also give them a bit of a spur to make the investments and do the right things as well. I think you can just never underestimate exactly what competition can do in terms of putting an extra spur to bring about outcomes that you just cannot get through regulation.

Ms SHING — Like the east–west link and the side deal letter that we got at the last minute. All right. Thank you very much.

Mr ONDARCHIE — Or myki or desal. You leave it to future generations. That is the problem.

The CHAIR — Are there any further questions for Mr Sims? If not, Mr Sims, thank you very much for your evidence this afternoon and indeed for your written submission. Obviously, as we have seen, it is a moving feast as to the regime, and the committee may have some follow-up — —

Mr MULINO — A bit of editorialising.

Ms SHING — Yes, that is right.

Mr ONDARCHIE — Give it 24 hours.

The CHAIR — I think we have seen this morning, Mr Mulino, from the Treasurer's announcement that it is a moving feast.

Ms SHING — You love progress, though, don't you, Chair?

The CHAIR — The committee may have some follow-up matters that we wish to pursue with the ACCC. But we appreciate your submission and your attendance here today and that of your colleagues.

Mr SIMS — We appreciate your time and the opportunity to be here.

Mr ONDARCHIE — On a point of order, Chair, given there have been some changes this morning, if there are some more changes, is it possible we can get the ACCC back to talk to us about them?

The CHAIR — It is something we can certainly consider — —

Ms Shing interjected.

Mr SIMS — Unfortunately it will not be in grand final week, but I do appreciate you inviting me down in grand final week. That is extremely kind of you.

Mr ONDARCHIE — Unfortunately Melbourne is shut on Friday.

Mr SIMS — That does not worry me a bit.

Witnesses withdrew.