Victoria International Container Terminal
An ICTSI Group Company

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Essential Services Commission
Level 37, 2 Lonsdale Street
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Strictly Confidential

Dear Sir or Madam

VICT response to Port of Melbourne – Market Rent Inquiry

Thank you for the opportunity to respond to your enquiry into the possible misuse of market power in the way that Port of Melbourne sets and reviews land rents. We respond to each of your questions below.

By way of background, Victoria International Container Terminal Limited (VICT) is owned by International Container Terminal Services, Inc. and it is the owner and operator of the Webb Dock international container terminal.

Following an integrated development phase, Webb Dock became operational as an international container terminal in early 2017. Our terminal was designed, and is now equipped, to be fully automated, making it the most advanced container terminal in the world.

Since commencing operations in 2017, we have now secured a number of significant shipping line contracts and we are servicing in the order of 20% of Melbourne's international container market which equates to around 500,000 TEU annually. This is expected to grow to ~30% market share within the coming 6 months.

1. **Aside from the issues and questions raised in the scope and process paper, is there any other information relevant to the land rental market at the Port of Melbourne, which we should consider in our inquiry?**

   The Port of Melbourne encompasses land at two separate, unconnected sites: Swanson Dock and Webb Dock. The lack of connectivity between the two sites impacts efficiency, productivity and competition. As a starting point, the ESC should examine how the Port of Melbourne approaches its entire portfolio with a mind to mitigating these problems.

   VICT's view is that the Port of Melbourne remains unduly focused on the old port, Swanson Dock, and has little regard to how to integrate VICT's activities at Webb Dock. Swanson Dock is also favoured over Webb Dock when determining rents and infrastructure investment. For example, it recently announced rail upgrades as part of the wider Port Rail Shuttle (PRS) proposal, which is to be funded by a Port-wide increase in wharfage and which benefits only Swanson Dock terminals, placing Webb Dock at a significant competitive disadvantage in that its customers are paying the additional wharfage but seeing no benefit in rail access. This proposal will directly connect Swanson Dock by rail with regional exporters, meaning that the stevedore tenants at Swanson Dock will be able to operate at considerable cost advantage over the tenants at Webb Dock. The impact of this will make Webb Dock tenants uncompetitive, effectively ruling them out of the regional export market. This fact has been acknowledged by both the PoM and Freight Victoria; however no practical solution has yet been considered.

   PoM also acknowledges in its draft Port Development Strategy that bigger ships are coming and that VICT is the only terminal capable of taking the larger vessels and yet does nothing to support this strategy. Instead it continues to makes significant investments in the terminals inside the West Gate Bridge –

Swanson Dock – which by nature of the fact that they are only able to accept smaller vessels, will not be able to take advantage of this significant disruption to global shipping. In response to this global disruption, the market is increasingly moving towards utilising larger vessels and there have been no orders for vessels of between 5,000 to 10,000 TEUs since 2015. With no new orders of the maximum size vessel that can fit under the West Gate bridge, this surely limits the long-term viability of the Swanson Dock terminals.

Beyond this strategic problem, VICT is concerned about the PoM's proposal that is now before the Victorian State Government, to impose an additional $15 per container levy on import containers handled by VICT and the other stevedores to fund infrastructure improvements at Swanson Dock. This proposal is being presented as a funding option for the port side component of the Port Rail Shuttle (PRS) programme announced in 2018. Our concerns are twofold:

a. The process involves the purchase of existing Swanson Dock rail facilities from DP World and Patrick; the redevelopment of these facilities; and then providing both Patrick and DP World with indefinite free access to them. This will significantly reduce the cost per TEU for Patrick and DP World, at no additional relative cost, significantly enhancing their competitive position over VICT, and other Webb Dock tenants, which have no current rail access, nor any realistic future access, to the facilities.

b. These improvements will further enhance the competitive position of the tenant stevedores at Swanson Dock, as VICT will be equally saddled with the cost of purchasing and developing the dock side rail infrastructure. This will force VICT to pass on the cost of infrastructure to its customers, who have no ability to access the improved facilities. Whilst we support further investment in rail connectivity, particularly the creation of rail terminal facilities which are fully integrated with stevedoring operations, we believe that such a solution must enable all stevedores the ability to access them at a similar cost – regardless of whether they are at Swanson or Webb Dock. In the absence of fair and realistic access to rail connectivity for Webb Dock, we do not think it is fair to increase the wharfage charges for containers handled by VICT.

   Our main criticism of the PRS programme, as announced last year, is that it focuses all of its investment on the wrong side of the bridge. This goes directly to our wider view that the PoM is entirely focused on the needs of the old port. This ignores the fact that future port growth needs, especially in terms of increased demand for capacity, will be met by Webb Dock, not Swanson Dock. It ignores the fact that the VICT facility is the most technically advanced terminal, and the only fully automated terminal in Australia. In addition, the VICT facility is the only terminal which has the capacity to expand for future growth and the ability to accommodate the larger vessels which are the future of international shipping. In short, the only way to extend the life of the port is on our side of the bridge.

   We believe that the priority for infrastructure investment in the Port of Melbourne should be the overcoming of the physical separation of Webb Dock from port rail infrastructure. Whilst the proposal to create rail terminal facilities which are fully integrated with stevedoring operations has merit, and will improve access to regional exporters, it should consider ways to ensure that containers from Webb Dock can access these rail terminals without a significant cost impost. Until this issue is resolved we believe that a levy should not be imposed on containers handled by Webb Dock tenants, or any levy should also be used to fund a cost equalisation scheme for containers handled by VICT to address the cost differential. We have not had any meaningful engagement with PoM on these proposals as they have indicated that their sole focus is on getting the wharfage increase approved in order to commence the infrastructure works at Swanson Dock.

2. **What factors should / should not be included in our assessment of the Port of Melbourne's market power?**

The assessment should look beyond simply how rents are set and reviewed and include how the Port of Melbourne deals with its tenants and how it decides where to make its infrastructure investments. We are concerned that since privatisation, there is no legislative mechanism for the funding of the necessary maritime works to ensure the port increases efficiency and can meet the demands of the future. The PoM has shown a reluctance to fund any port infrastructure development within its own operations, preferring to directly levy port users. The increases in maritime related fees are prescribed under the terms of the sale for 10 years, and as such no investment of scale is occurring. By way of example, over the past 4 years, VICT has been lobbying the Port of Melbourne to demolish a small outcrop of land that represents a berthing hazard and is also an impediment to VICT operating as a two berth facility, as stated in the terms of lease.

The outcrop effectively restricts two larger vessels from coming alongside at Webb Dock because any vessel berthing on berth 4 needs 30m safe distance from the outcrop. This outcrop further protrudes some 35m into the natural alignment of VICT land, which de facto reduces our berth by 60m. This means that where VICT has two large vessels arriving at the same time, one will need to wait out at port until the first vessel is serviced, which could be up to 48 hours of delay, leading to significant impediments to getting goods to market. It is likely that the shipping lines will charge VICT for such delays, adding directly to the cost of imported and exported goods.

When ICTSI bid for the Webb Dock terminal, it was on the basis that it was a 2 berth facility and VICT is being prevented from fully utilising its land and superior access, for which it is paying a premium rent, because it is not able to properly develop and use the area behind the outcrop because this length of berth cannot be used safely. By refusing to undertake these simple and comparatively inexpensive works, the Port of Melbourne is effectively acting as a brake on the growth of VICT and its ability to compete with the incumbent terminals at Swanson Dock. At a basic level, it appears to the innocent bystander that the Port of Melbourne is unwilling to remove the knuckle as a crude means to ration market share in favour of the Swanson terminals but this decision comes at a high cost for consumers and the broader Victorian economy.

Now that the Port of Melbourne is a private entity and there is no direct financial return on these works, it is not willing to spend the money to optimise the VICT facility and to deliver the two berth facility that was envisaged as part of the tender for Webb Dock.

The ESC should examine not just how the Port of Melbourne determines rents but also how it determines which facilities and projects it decides to financially support.

3. **How is the Port of Melbourne's market power demonstrated, if at all, and in which type of leases is it most evident?**

The Port of Melbourne has absolute market power in leases across the entire port. There is no option for tenants, particularly stevedores, to go elsewhere to get a better deal. There is also no obligation on the PoM to invite market participation to all lease renewals, leading to bilateral negotiations between PoM and tenant. An example of this is the renegotiation of the lease for DP World in 2016, which was renewed at a level far below the price that the fully competitive process netted for the new lease at Webb Dock secured by VICT. This means that new entrants will always pay higher rents than incumbents, increasing barriers to entry, at the cost of efficiency.

When VICT was tendering for the right to develop and operate Webb Dock, the tender documents were offered on a "take it or leave it" basis, with minimal opportunity for discussion and negotiation. Indeed, VICT has a mandatory minimum annual increase in its rent of [redacted] which means that its rent is significantly above market rent and will continue to be so for duration of the lease. There was no real opportunity to negotiate on the increases without jeopardising the opportunity to lease Webb Dock.

4. **Are there any leases, for which the Port of Melbourne does not have market power (either none, or no more than to a minor or insignificant extent)?**

No. The Port of Melbourne is the sole landlord for all Port land and even sub-leases would require their approval and so they have clear market power across the entire Port.

5. **Are there are tenants who are able to match or respond to the Port of Melbourne's market power (for example, tenants might have some countervailing power).**

The only possible example of countervailing market power is the DP World lease renewal in 2016. We would argue that this was more an example of a poor use of market power by PoM, in that it failed to invite wider market participation into the lease renewal, thereby limiting its ability to set a realistic market price. We would also note that this negotiation happened prior to the privatisation of the port, when Government had a much greater ability to limit the excessive use of market power by the port.

6. **How should we assess parties' ability to bargain in the process for setting and reviewing rents?**

The ESC should examine whether the process for setting and reviewing rents is fair and uniform across the Port, by examining how rents for similar facilities are determined and reviewed. In addition, the ESC should determine whether the Port of Melbourne is uniform and consistent in how it determines rent. The disparity between the rents set for Patrick and DP World as against the rent that VICT is paying, as well as the level and frequency of rent increases is significant. VICT participated in an open tender to secure its Webb Dock terminal and legitimately expected that any lease renewals of the terminals at Swanson Dock would be on an open tender basis or would at least use the information received as part of the tender process from all tenderers to determine an appropriate market rent. This has not been the case. Port of Melbourne sought to renew both DP World and Patricks leases off market and at rents significantly below those submitted by all of the parties during the tender for Webb Dock.

The ESC should also consider how the Port of Melbourne approaches investment discussions with each tenant. VICT is seeking to hand back its Empty Container Park to the Port of Melbourne in order to maximise its terminal facility and so that the [redacted] area of land can be put to better use in Webb Dock. The Port of Melbourne are not willing to take back this land, despite having the contractual right to do so through the lease. This means that Webb Dock is losing out on having this area of land put to better use because the Port of Melbourne is taking a short term view on its approach to the area.

7. **What factors, if any, should be taken into consideration in assessing the process for setting and reviewing rents?**

It is a standard provision of market rent reviews that the assessor looks to the rent being paid by other similar properties in the vicinity. The Port of Melbourne, before privatisation, sought to increase DP World's rent in line with the market rent that had been demonstrated through the tender process for Webb Dock. DP World successfully lobbied the Port of Melbourne to set its rents at an amount significantly below the rents demonstrated through the open market tender and for a lease extension of 50 years, which is more than twice the length of the leases that were offered at Webb Dock through the open market tender. We understand that the Port of Melbourne is seeking to agree a similar deal with Patrick stevedores. There is no consistency in how the Port of Melbourne sets and reviews its rents across its portfolio.

8. **How has the Port of Melbourne complied / not-complied with the process of setting and reviewing rents? (i.e. what information is there to support the Port of Melbourne's compliance or non-compliance)?**

We have no evidence to support Port of Melbourne's compliance with an open and clear process for setting and reviewing rents.

9. **Should prices, access and efficiency be the Commission's primary focus in defining the material detriment caused by the misuse of market power?**

Looking at prices, access and efficiency should be the Commission's primary focus. It is VICT's submission that the Port of Melbourne focuses entirely on prices and not on access or efficiency. The impact this approach has on the port development has already been well documented in this submission. The Commission should also look at the impact of these prices on the Victorian consumer. VICT's rent bill adds more than [redacted] to the cost of importing and exporting through the Port of Melbourne and these costs will be ultimately borne by the consumer.

10. **What other factors, if any, should be taken into consideration in defining the material detriment caused by the misuse of market power?**

The Commission should also consider the impact the decisions of the PoM is having on competition within the port, and the significant changes they are having on individual terminal's ability to access markets. The prime example of this is the announced rail upgrades as part of the wider Port Rail Shuttle (PRS) proposal.

We also believe that there are other examples of the misuse of market power. As part of the tender for Webb Dock, the lease of an Empty Container Park adjacent to the terminal was included, because that is how the other stevedores operate their terminals. As a fully automated terminal, VICT operates with a different strategy to the traditional stevedores. Since 2015, VICT has indicated that the lease of the Empty Container Park is not required because we can accommodate empties directly into the terminal. The Port of Melbourne is not willing to entertain any discussions on the return of the Empty Container Park despite having the ability within the lease to take a surrender of the property so that it can be repurposed and used for an alternative port related purpose.

Instead, VICT is effectively paying the landholding cost for PoM until it decides to pursue an alternative use by paying a significant rent on a per square metre basis [redacted]

In its draft Development Strategy, PoM has indicated that it will relocate our neighbours Searoad and Toll, to an area further upstream and convert their leases and the Empty Container Park into an additional international container terminal. However, until it decides to pursue these plans and take back the land, VICT continues to pay the rent and effectively bank rolls the Port of Melbourne's landholding in Webb Dock until it decides to proceed with any future expansion.

Another consideration should be the lack of any 'public interest' criteria for the decisions of the privatised port. Without such criteria, the port is able to operate one of the State's key economic assets in a manner which could be to the detriment of the State's economic prosperity. We would argue that all major infrastructure decisions must be assessed on the basis of their benefit to the state of Victoria, rather than just the financial interests of private port owners.

11. **Are there any other ways of assessing the misuse of market power we should include / exclude in making our assessment?**
    Other than those points outlined above, e.g. how PoM makes its investment decisions in which decisions and projects to support, how it sets and reviews rents and a lack of a 'public interest' focus in PoM's decision making, we have nothing further to add on this point.

Yours faithfully

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