

Delivery of the Moorebank Intermodal Terminal

Moorebank Intermodal Company

Department of Infrastructure and Regional Development

Department of Finance

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Canberra ACT
19 December 2017

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken an independent performance audit in the Moorebank Intermodal Company, the Department of Infrastructure and Regional Development and the Department of Finance titled *Delivery of the Moorebank Intermodal Terminal*. The audit was conducted in accordance with the authority contained in the *Auditor-General Act 1997*. Pursuant to Senate Standing Order 166 relating to the presentation of documents when the Senate is not sitting, I present the report of this audit to the Parliament.

Following its presentation and receipt, the report will be placed on the Australian National Audit Office's website—<http://www.anao.gov.au>.

Yours sincerely



Grant Hehir
Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra ACT

AUDITING FOR AUSTRALIA

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Contents

Summary	7
Background	7
Audit objective and criteria	8
Conclusion	8
Supporting findings	9
Summary of entity responses	11
Key learnings for all Australian Government entities	13
Audit findings	15
1. Background	16
Introduction	16
Project history	16
Audit approach	21
2. Value for money	22
What was the policy rationale for the Australian Government's development of the Moorebank Intermodal Terminal?	22
Was a competitive procurement process adopted?	23
Were risks from adopting a direct negotiation process identified?	28
Were negotiation timeframe risks well managed?	30
Did negotiations secure the expected contractual commitments?	32
Was probity in the procurement process well managed?	34
What advice on the value for money of the project was provided to Shareholder Ministers?	37
3. Access arrangements	42
Why is open access provided through contractual arrangements?	42
Are the key elements of the open access regime now in place?	44
Is the open access regime comprehensive in its coverage?	47
Is an effective compliance regime in place?	49
How is oversight of open access and other oversight responsibilities to be resourced?	55
4. Supporting the achievement of policy objectives	56
Were the Australian Government's policy objectives clearly identified?	56
Do the contractual arrangements facilitate the development of an intermodal freight precinct at Moorebank?	57
Will the contractual arrangements facilitate operation and use of the terminals?	62
Are arrangements in place to enable a future privatisation?	63
Appendices	65
Appendix 1 Entity responses	66
Appendix 2 Use of non-government email services for official Australian Government business	87
Appendix 3 ANAO analysis of direct negotiations	90

Summary

Background

1. The Moorebank Intermodal Terminal (MIT) is a 241 hectare intermodal freight precinct in the south-western Sydney suburb of Moorebank consisting of an import-export (IMEX) rail terminal, interstate terminal and up to 190 hectares¹ of onsite warehousing. The Australian Government first announced its plan to relocate the School of Military Engineering (SME) to enable the construction of the MIT on its freehold land in September 2004. Following the Government's consideration of various studies it had commissioned, the project's implementation commenced in April 2012.

2. Within that timeframe, a private sector joint venture—the Sydney Intermodal Terminal Alliance (SIMTA)—was formed in 2007 to develop an IMEX-only terminal and onsite warehousing at Moorebank. SIMTA had planned to build this on its freehold land that was purchased from the Australian Government in 2003 (the original purchaser was Westpac). The original sale was on a leaseback arrangement, where Defence immediately signed a 10-year lease (with two five-year extensions at Defence's sole discretion) for the Defence National Storage and Distribution Centre's (DNSDC) operations to remain on the site.² The SIMTA site is situated directly across Moorebank Avenue from the SME land.

3. The Moorebank Intermodal Company (MIC) is a Government Business Enterprise (GBE). It was established in December 2012 and assumed full responsibility from the Department of Finance for the delivery of the project. This governance framework was selected to enable the MIT to be delivered by an entity with 'an appropriate commercial focus while maintaining effective Government oversight'. A large component of MIC's first year was comprised of setting up its operations. This included establishing its Board; appointing a permanent Chief Executive Officer (CEO); engaging a range of key advisory firms to support a competitive procurement process to find a private sector delivery partner; and undertaking market interactions.

4. Following an expression of interest (EoI) process in early 2014, SIMTA was selected by MIC as the preferred private sector partner (from a total of five respondents) to be responsible for the delivery of the precinct. The parcels of developable land that make up the precinct are owned by the Australian Government (158 hectares) and SIMTA (83 hectares). The two entities entered into a formal direct negotiation process in May 2014 with contractual close occurring on 3 June 2015. Financial close was achieved on 24 January 2017, and the project is now in its delivery phase.

1 This was the amount of Gross Developable Area allocated for warehousing in the precinct's financial model as at contractual close.

2 Defence records for the sale and leaseback of the DNSDC site indicated that the users of that property required guaranteed use of the site for at least 20 years. See: ANAO Audit Report No.44 2004–05, *Defence's Management of Long-term Property Leases*, p. 49.

Audit objective and criteria

5. The objective of the audit was to assess whether the contractual arrangements that have been put in place for the delivery of the MIT will provide value for money and achieve the Australian Government's policy objectives for the project.

6. To form a conclusion against this objective, the following high-level criteria were adopted:

- Do the terms of the transaction represent value for money, including appropriate management of demand risk?
- Is non-discriminatory open access available within all aspects of the intermodal precinct?
- Does the project's governance framework support achievement of the Australian Government's policy objectives, including the planned future privatisation process?

Conclusion

7. Value for money progressively eroded during the negotiation of the contractual arrangements. The contractual arrangements support the achievement of all or part of each of the policy objectives for the project.

8. The procurement process has resulted in contractual arrangements being negotiated for the private sector to develop and operate an IMEX terminal, interstate terminal, and associated warehousing. Negotiating directly with one respondent, rather than the original plan of maintaining competition during the second stage of the procurement process, gave rise to a number of risks. Those risks were recognised and mitigation strategies identified but those strategies were not implemented. This situation makes it difficult to conclude that value for money has been achieved.

9. It is not possible to provide assurance that non-discriminatory open access is likely to be available within all aspects of the intermodal precinct given:

- the contractual framework does not apply to all elements of terminal operations, partially applies to the rail shuttle service between Port Botany and the MIT and internal transfers within the terminal precinct, and does not apply to warehouse operations;
- most of the key detailed documents that are required for implementation of effective open access arrangements have yet to be developed; and
- significant non-compliance is permitted before enforcement action can be taken.

10. Clear policy objectives were established for the project. The contractual arrangements support the achievement of all or part of each of those objectives. This includes providing a level of assurance that a commercially viable intermodal precinct will be constructed and operated, and future privatisation will be able to occur.

Supporting findings

Value for money

11. The key policy rationale underpinning the development of the MIT was the significant national productivity improvements anticipated by a road to rail modal shift. Of particular importance was the placement of the terminals along the Southern Sydney Freight Line, which was considered to support existing strategies to substantially increase rail utilisation in the region.
12. The procurement process was not sufficiently competitive. MIC suspended its planned procurement process at the end of the EoI stage to enter into direct negotiations with one respondent. This was on the basis that this respondent's proposal was significantly stronger than those lodged by the other four respondents. The planned approach had been to select two or three EoI respondents from which to obtain detailed and committed proposals before proceeding to direct negotiations. Competitive pressure was also hindered by MIC not informing EoI participants of the eight criteria that it would apply in scoring responses, or that the criteria were weighted.
13. Risks to removing competition from the second stage of the procurement process were identified. Risk mitigations were also identified.
14. Negotiations took twice as long as had been planned. There was no evidence that MIC contemplated implementing the planned risk management strategy of terminating negotiations and re-engaging with other parties on 'stand-by' when it became evident that the negotiations were not proceeding in accordance with the planned timetable.
15. Negotiations were expected to commence after MIC had obtained a binding commitment to the key elements of the successful respondent's EoI. No such commitment was obtained. There is no evidence that going to direct negotiations at an early stage produced a better outcome than was achievable under the original planned procurement approach of getting firm and binding offers from two or three competing parties to select from.
16. The direct negotiations secured contractual commitments to the development and operation of intermodal freight terminals and warehousing, as well as to an open access regime for the terminals. Between the commencement of direct negotiations and the final contracted outcome, MIC agreed to arrangements that have increased the Australian Government's financial contributions and contingent liabilities (as compared with those proposed within the successful proponent's EoI); mitigated private sector exposure to demand risk; reduced the coverage and effectiveness of the access regime; and reduced the revenue streams to the Australian Government.
17. There were shortcomings in the management of probity. For example, the probity plan did not apply to all stages of the procurement process. In addition, a probity adviser and a separate probity auditor were appointed later in the procurement process than is desirable through processes that did not involve open and effective competition for the roles. Further, MIC's response to the probity audit of the EoI process did not adequately address each of the findings that underpinned the auditor's recommendations.

18. Advice on the project's progress and whether value for money was expected to be obtained was provided to Ministers at key milestones. At the conclusion of the negotiation process, MIC advised the Shareholder Ministers (the Minister for Infrastructure and Regional Development and the Minister for Finance) that the outcome represented 'excellent value for money'. Ministers were separately advised by their departments that the negotiated outcome represented value for money.

Access arrangements

19. Notwithstanding that the preferred tenderer would gain exclusive access to a significant tract of Commonwealth land, MIC's view was that an open access regime administered through contractual arrangements was the only mechanism that would attract private sector interest in the development of the project. The alternative approach preferred by the Shareholder Ministers' departments was an access undertaking under the *Competition and Consumer Act 2010* which would then be administered by the Australian Competition & Consumer Commission. The 2013 approach to the market did not seek to test whether an access undertaking would deter private sector interest in the project.

20. The open access arrangements have been agreed at a framework level. Most of the key detailed documents that are required to complete and operationalise the regime have yet to be developed.

21. The open access arrangements apply to the IMEX and interstate terminals, but not the warehousing component of the Moorebank precinct. MIC's approach to the market did not seek to include warehousing in the coverage of the open access arrangements. Only some parts of the open access regime apply to the port shuttle service between Port Botany and the terminal precinct, and internal transfers within the terminal precinct. These two partial exclusions are inconsistent with the coverage envisaged in the approach to the market, but reflect the result of the direct negotiations process.

22. A compliance regime is in place. There are shortcomings in its design that can be expected to limit its effectiveness. For example, it does not include a graduated regime of financial penalties in response to non-compliance, as was the stated preference in the request for expressions of interest. In addition, a significant number of non-compliance events can occur before there are any consequences.

23. MIC is contractually responsible for monitoring and enforcing adherence to the open access arrangements over the 99-year term of the leases. There are also other ongoing oversight responsibilities, including in relation to the capacity expansion arrangements. The resources required to undertake ongoing oversight have not yet been quantified.

Supporting the achievement of policy objectives

24. The Australian Government's policy objectives for the MIT were clearly identified, including by MIC in its approach to the market.

25. The contractual arrangements provide for the private sector to construct and operate the intermodal freight terminals and associated warehousing at Moorebank. Specifically, SIMTA has a contractual obligation to build both an IMEX terminal and an interstate terminal, each with an initial capacity of up to 250 000 Twenty-foot Equivalent Units (TEU) per annum. The

contracts define the ultimate capacities for the IMEX and interstate terminals as 1.1 million and 500 000 TEU per annum, respectively. Expansion of the terminals to meet the ultimate capacities is set out within a heavily conditioned contractual regime, involving expansion following certain market demand signals. There is less certainty over the development timeframe for warehousing. This uncertainty is partially mitigated by warehouse ground rental payments being linked to the passage of time and MIC's expectation that warehousing will be highly profitable for Precinct Developer Co (warehousing is not subject to the Open Access Regime).

26. The contractual arrangements enable the operation of flexible and commercially viable intermodal terminals. Until the open access arrangements are completed and shown to be operating effectively, it is not possible to provide assurance that the MIT is available on reasonably comparable terms to all rail operators and other terminal users and, as a consequence, that the desired national productivity benefits of the project will be realised.

27. The transaction was structured in a way that will enable a privatisation process through the creation of predictable income streams. Such a process is not expected to take place for some years as advice to the Department of Finance (Finance) is that sustainable positive cashflows are not expected for 15 years. There are also contractual restrictions on the entities to which the Australian Government can divest its interests.

Summary of entity responses

28. The proposed audit report was provided to MIC, the Department of Infrastructure and Regional Development (DIRD) and Finance. Extracts from the proposed report were also provided to SIMTA, Macquarie Capital, Herbert Smith Freehills, Walter Partners and Risk Reward.

29. Formal responses to the proposed audit report were received from MIC, DIRD, Finance, SIMTA, Macquarie Capital and Herbert Smith Freehills. If entities provided a summary response, these are below, with the full responses provided at Appendix 1.

Moorebank Intermodal Company

The commercial and contractual arrangements agreed with SIMTA are complex and unique. MIC absolutely disagrees with the ANAO's analysis that the direct negotiations did not secure a contractual commitment aligned to the Australian Government's preferred approach. MIC has met the objectives that the Australian Government determined for MIC and has demonstrated how these objectives have been satisfied in the procurement of the intermodal facility.

Moorebank Intermodal Company's response letter considers the government's objectives, then comments on the audit's high-level criteria. We have taken this approach because the ANAO appears to have not adequately understood this complex and unusual transaction and as a result has drawn several incorrect and misleading conclusions.

MIC is satisfied the arrangements represent very good value for money for the Commonwealth, provide a robust and commercially sensible open access regime, and leave the Commonwealth with a structure purpose built for divestment while maintaining full flexibility on what is sold and when.

ANAO comments on MIC's summary response

30. The conclusion against the audit objective is outlined between paragraphs 7 and 10. In reaching a conclusion that value for money progressively eroded during the negotiation of the contractual arrangements, the ANAO analysed the outcome of the negotiations against **both**:

- the Australian Government's preferred approach, as articulated in the Request for EoIs issued by MIC (noting that MIC suspended its planned procurement process at the end of the EoI stage to enter into direct negotiations with SIMTA on the basis that SIMTA's proposal was significantly stronger than those lodged by the other four respondents); and
- key elements of SIMTA's EoI response (given MIC's analysis had been that the 'commitments' given by SIMTA justified not continuing with the planned competitive approach, and that a key risk management strategy for negotiations was to have been to bind SIMTA to those commitments prior to commencing negotiations).

Department of Finance

Finance notes the findings and key learnings of this audit report regarding the *Delivery of the Moorebank Intermodal Terminal*.

Key learnings for all Australian Government entities

31. Below is a summary of key learnings identified in this audit report that may be considered by other Commonwealth entities when engaging with the private sector to deliver major infrastructure projects.

Governance and risk management

- Accountable Authorities should ensure that the coverage and scope of the probity management framework is commensurate with the nature and level of the risks involved. This framework should be established before market engagement commences, and should apply to all phases of the market engagement process.
- Selection processes for probity advisers and probity auditors should be transparent.
- Concerns, findings and recommendations of probity advisers and probity auditors should be effectively addressed in a timely manner.
- The risks of contracted advisers having a conflict of interest with potential/actual market respondents should be fully considered and addressed.

Procurement

- Market engagement processes should objectively test potential partners' preparedness to accept preferred Australian Government positions.
- Competition throughout the process of selecting a private sector project delivery partner plays an important role in obtaining, and being seen to obtain, value for money.
- An evaluation plan should be established before market responses are sought.
- Informing potential respondents of the evaluation criteria, and any weighting of those criteria, helps to promote competition as well as provide transparency.
- Significantly increased risks exist when negotiations commence with a single respondent in advance of a binding offer having been received. Experience has shown that Australian Government entities find it difficult to implement planned risk mitigation strategies, and this should be carefully considered before deciding that the risks of entering into negotiations are acceptable.
- Negotiations should retain a strong connection with the key elements of the successful proposal that supported the decision to proceed to direct negotiations.
- Where a future privatisation process is envisaged, this can be assisted by structuring the transaction in a way that enables an efficient sale process.
- Compliance regimes should be designed to be effective, and resourced appropriately.

Records management

- Good records should be created of the negotiations process including documentation that clearly identifies each meeting, the participants, agenda and outcomes.
- Information assets should be effectively managed, including by ensuring that entities not party to the transaction do not hold confidential project-related information.

Audit findings

1. Background

Introduction

1.1 The Moorebank Intermodal Terminal (MIT) is currently under construction in the south-western Sydney suburb of Moorebank. The intermodal freight precinct includes an import-export (IMEX) rail terminal, interstate terminal and a significant warehousing footprint.

1.2 The Moorebank site is in close proximity to major road and rail infrastructure (the Southern Sydney Freight Line and the M5 and M7 Motorways). The MIT will manage freight containers carried by rail to and from Port Botany as well as freight containers carried on the interstate rail network. It is intended to increase the proportion of containerised freight carried by rail, in comparison to containers carried by truck.

1.3 The parcels of land that make up the precinct are owned by the Australian Government and the Sydney Intermodal Terminal Alliance (SIMTA). Of the 383 hectares allocated to the precinct, 241 hectares is developable land. The parties own 65.63 (158 hectares) and 34.37 (83 hectares) per cent of the precinct's developable land, respectively. The remaining land is associated with the biodiversity offsets required to meet the New South Wales and Australian Governments' environmental requirements, and was also contributed by the Australian Government.³ The land ownership is reflected in the map at Figure 1.1.

Project history

1.4 The project and its location were first announced in 2004 by the Australian Government. In 2010, a detailed business case was commissioned to examine the project's economic merits.⁴ The results and recommendations from this business case were presented to the Australian Government in April 2012. This formed the basis of a decision to provide \$887 million⁵ for the delivery of the project via a new Government Business Enterprise (GBE)—the Moorebank Intermodal Company Limited (MIC).

1.5 The land on which the MIT was proposed to be built is owned by the Australian Government, but was occupied by a number of the Department of Defence (Defence) units, including the School of Military Engineering (SME). In order to develop the MIT, these Defence units were required to relocate. The activities undertaken on the land by Defence for in excess of 40 years meant that substantial remediation work was required to be undertaken before the land could be developed.

3 These parcels will remain quarantined from development, but their contribution has meant that a larger percentage of the main Australian Government site has been approved for clearing and industrial development.

4 A Final Scoping Study was also produced in February 2011.

5 This allocation was for the construction of the first phase of the project, which consisted of the IMEX terminal and associated infrastructure.

Figure 1.1: Moorebank Intermodal Precinct land parcels

Source: MIC records.

Moorebank Intermodal Company

1.6 MIC was established in December 2012 to 'optimise private sector development of an open-access terminal'. A large component of MIC's first year was comprised of setting up its operations and considering the means of procuring, delivering and operating the terminal. This included establishing its Board; appointing a permanent Chief Executive Officer (CEO); and engaging a range of key advisory firms to support and commence the procurement process to find a private sector delivery partner.

1.7 MIC's sole shareholder is the Australian Government, which is represented by two Shareholder Ministers: the Minister for Infrastructure and Transport⁶ and the Minister for Finance. The Shareholder Ministers' departments⁷ are responsible for supporting their Ministers in this role.

1.8 To facilitate the delivery of the MIT, the Australian Government provided a 99-year lease over the parcels of ex-Defence land to the Moorebank Intermodal Development Investment Trust (MIDIT), a subsidiary of MIC.

1.9 The Commonwealth Procurement Rules (CPRs), which are issued by the Finance Minister, apply to all non-corporate Commonwealth entities. The CPRs can be applied to corporate Commonwealth entities but have not been applied to MIC.⁸ Rather, as is the case with most corporate Commonwealth entities, MIC develops and implements its own procurement policies and procedures. These policies and procedures are required to meet general obligations on the organisation that it promote proper use of resources and employ effective internal controls. The Joint Committee of Public Accounts and Audit has recently commented that 'corporate Commonwealth entities not subject to the CPRs should more closely model their procurement arrangements on the CPRs as a matter of best practice'.⁹

Sydney Intermodal Terminal Alliance

1.10 SIMTA was formed in 2007 to develop an IMEX-only terminal and onsite warehousing at Moorebank. SIMTA had planned to build this on its freehold land that was purchased from the Australian Government in 2003 (the original purchaser was Westpac). The original sale was on a leaseback arrangement, where Defence immediately signed a 10-year lease (with two five-year extensions at Defence's sole discretion) for the Defence National Storage and Distribution Centre's (DNSDC) operations to remain on the site. The SIMTA site is situated directly across Moorebank Avenue from MIC's land.

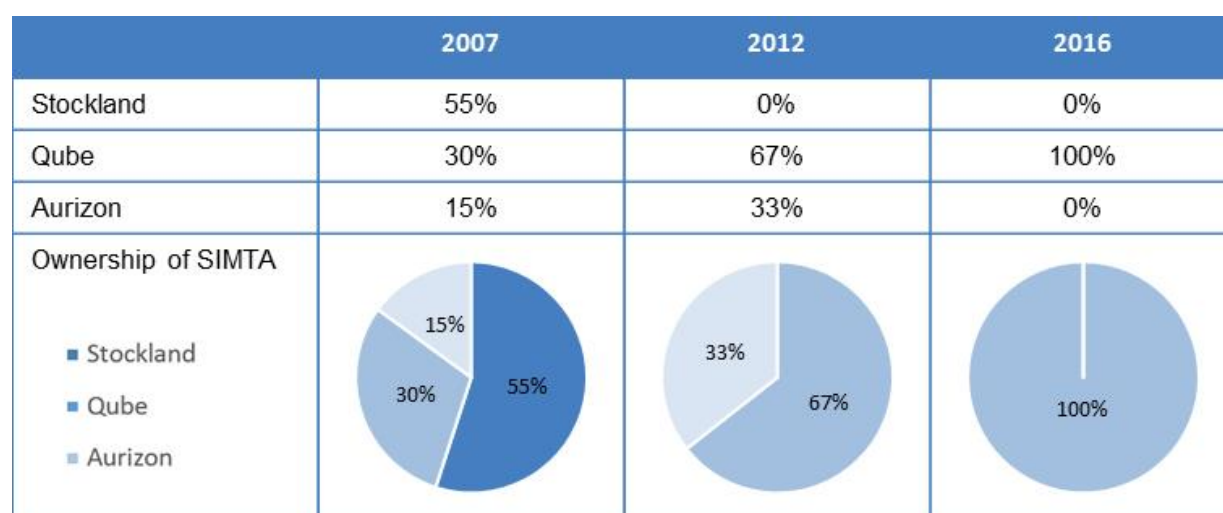
1.11 Initially formed as a joint venture, SIMTA's owners were publicly listed companies: Stockland, Qube and QR National (rebranded as Aurizon in 2012). Since then, the ownership of SIMTA has changed twice, as shown by Figure 1.2.

6 From February 2016. Between September 2013 and February 2016, this Shareholder Minister was the Minister for Infrastructure and Regional Development.

7 The Department of Infrastructure and Regional Development; and the Department of Finance.

8 *Public Governance, Performance and Accountability Act 2013* (PGPA Act) Rule 105B enables the Finance Minister to require adherence to the CPRs by wholly-owned Commonwealth companies or corporate Commonwealth entities. MIC has not been prescribed.

9 Joint Committee of Public Accounts and Audit Report 465, *Commonwealth Procurement*, September 2017, p. 10.

Figure 1.2: Changes in SIMTA ownership between 2007 and 2016

Source: ANAO analysis.

1.12 Between 2010 and 2012, SIMTA asserted on a number of occasions that the Australian Government was acting in direct competition with SIMTA. This was on the basis that SIMTA's request to build rail access to its site over adjacent Australian Government land (to the south of the SIMTA site) was denied. SIMTA claimed that its proposal was fully self-funded and would be in operation up to three years ahead of the project being developed by the Australian Government.

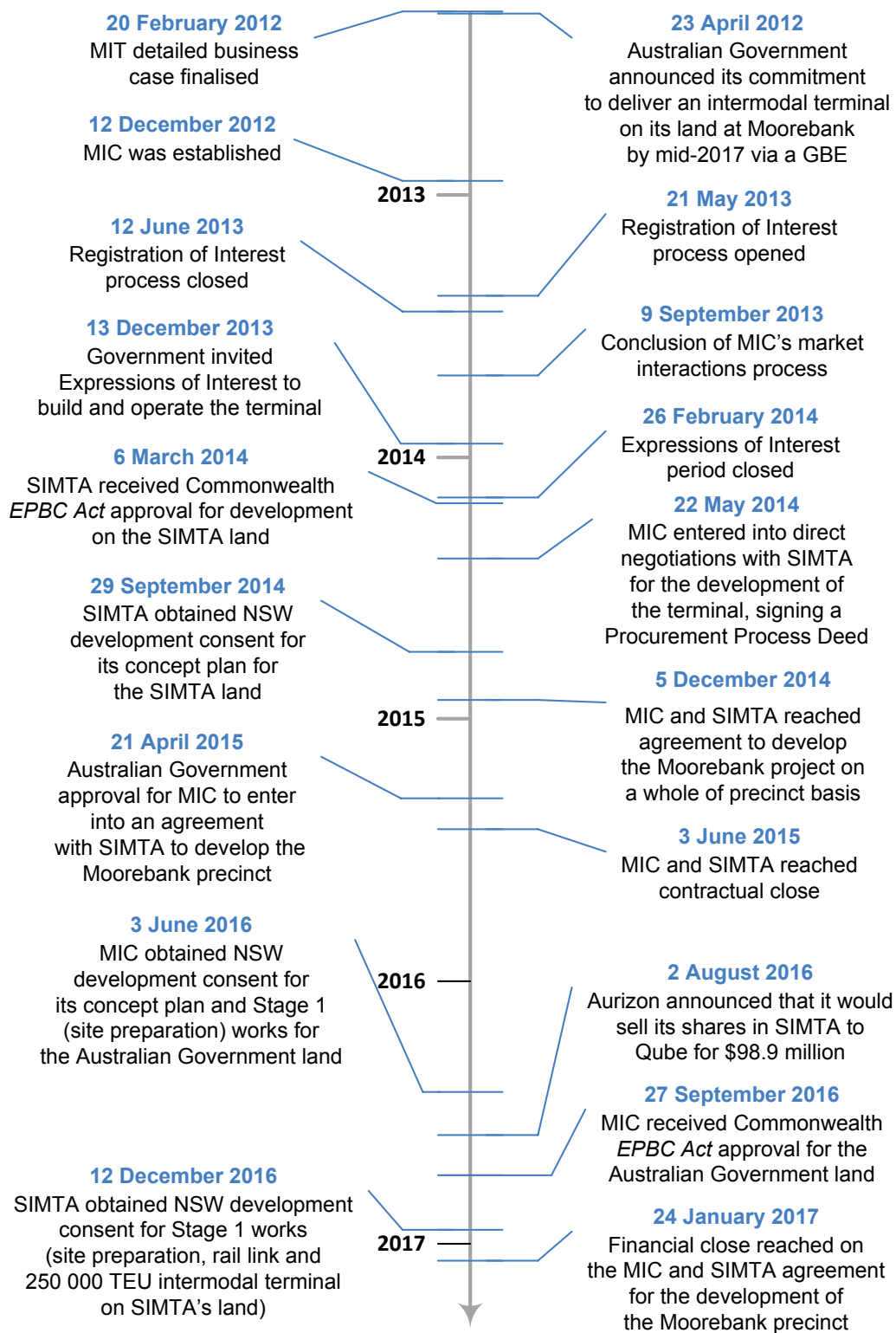
1.13 Following MIC's establishment and a change of Australian Government in September 2013, SIMTA commenced lobbying activities in order to achieve its desired outcome. It purported that a 'combined' whole of precinct approach would lead to a more efficient and valuable intermodal facility. This combined approach involved the use of both MIC and SIMTA's sites and was said to deliver substantial budget benefits to the Australian Government. SIMTA made direct contact between late September and early October 2013 with at least three new Ministers' offices to discuss the abandonment of MIC's upcoming tender process. In this respect, MIC advised the ANAO in September 2017 that it:

had discussions with SIMTA in September 2013 during the market soundings and subsequently. SIMTA indicated that it wanted to develop an IMEX terminal on the SIMTA land and MIC could develop an interstate terminal on the Commonwealth land.

MIC had made it clear to SIMTA that the only way SIMTA could proceed with any development would be to participate in MIC's procurement process, or wait until MIC's procurement process was completed.

1.14 MIC's tender process proceeded, with a request for expressions of interest (Eoi) issued in December 2013 to select a private sector partner to build and operate a terminal precinct that would deliver on the Australian Government's project objectives (see paragraph 4.1). SIMTA was the successful party, with contracts exchanged in June 2015. Financial close was reached in January 2017. Figure 1.3 provides an overview of key milestones to date for the project.

Figure 1.3: Timeline of the Moorebank Intermodal Terminal milestones



Source: ANAO analysis.

Audit approach

1.15 The objective of the audit was to assess whether the contractual arrangements that have been put in place for the delivery of the MIT will provide value for money and achieve the Australian Government's policy objectives for the project.

1.16 To form a conclusion against this objective, the following high-level criteria were adopted:

- Do the terms of the transaction represent value for money, including appropriate management of demand risk?
- Is non-discriminatory open access available within all aspects of the intermodal precinct?
- Does the project's governance framework support achievement of the Australian Government's policy objectives, including the planned future privatisation process?

1.17 The audit focussed on the arrangements that were negotiated between MIC and SIMTA.

1.18 To inform the examination of the arrangements, the audit scope also included the Shareholder Minister's departments (DIRD and Finance).

1.19 The audit was conducted in accordance with the ANAO Auditing Standards at a cost to the ANAO of approximately \$471,589.

1.20 The team members for this audit were Amy Willmott, Cherie Simpson, Joe Keshina Danielle Page, Emily Drown and Brian Boyd.

MIC use of non-government email services for official Australian Government business

1.21 Email communications are a widely used and accepted form of communication by and within the Australian Government. As such, they provide evidence of the conduct of government business and are important information assets. Guidance from the Australian Signals Directorate is that using non-agency-sanctioned webmail to conduct government business heightens the risk of the unauthorised disclosure of government information.¹⁰

1.22 In the course of this audit, the ANAO identified various instances of non-MIC corporate email services being used (including free web-based personal email accounts) for work purposes. This included instances where confidential documentation relating to the project was being transmitted (such as evaluation results, contracts, project valuation information, negotiation records including notes of meetings with SIMTA marked 'confidential' and a Shareholder Ministers' letter). The security risks that come with using web-based email services are well known and have been publicised. These practices also represent a limitation on the scope of this ANAO performance audit as the ANAO is unable to be satisfied that all relevant email communications are captured in MIC records.¹¹

1.23 Further detail on this matter can be found in Appendix 2.

10 See further at: <https://www.asd.gov.au/publications/protect/webmail-government-business.htm>

11 While it is considered good practice for wholly owned Commonwealth companies under the PGPA Act (such as MIC) to apply the Australian Government Protective Security Policy Framework (PSPF) and Information Security Manual (ISM), it is not mandatory.

2. Value for money

Areas examined

The ANAO examined whether the transaction represents value for money, including appropriate management of demand risk.

Conclusion

The procurement process has resulted in contractual arrangements being negotiated for the private sector to develop and operate an IMEX terminal, interstate terminal, and associated warehousing. Negotiating directly with one respondent, rather than the original plan of maintaining competition during the second stage of the procurement process, gave rise to a number of risks. Those risks were recognised and mitigation strategies identified but those strategies were not implemented. This situation makes it difficult to conclude that value for money has been achieved.

What was the policy rationale for the Australian Government's development of the Moorebank Intermodal Terminal?

The key policy rationale underpinning the development of the Moorebank Intermodal Terminal (MIT) was the significant national productivity improvements anticipated by a road to rail modal shift. Of particular importance was the placement of the terminals along the Southern Sydney Freight Line, which was considered to support existing strategies to substantially increase rail utilisation in the region.

2.1 In 2012, the MIT was identified by Infrastructure Australia as one of the most important infrastructure projects in the country. This was primarily because the MIT was seen as the best way to substantially increase the proportion of Sydney's container freight moved by rail—an important part of both Infrastructure Australia's National Land Freight Strategy and the Australian Rail Track Corporation's (ARTC) North-South strategy.

2.2 Supported by a detailed business case, an approach that involved a co-located import-export (IMEX) terminal, interstate terminal and onsite warehousing was considered the most efficient and commercially viable option for the delivery of the project.¹² Specifically, the business case indicated that the:

- MIT was expected to generate approximately \$10 billion in economic benefits through improved productivity, reduced business costs, reduced road congestion (by reducing the number of truck trips in Sydney by 3 300 per day) and provide positive environmental outcomes;
- Australian Government's involvement in the project was considered necessary to ensure the delivery of additional interstate freight capacity that will enable efficient freight

12 The detailed business case revealed that the future viability of the interstate terminal (in around 2028) was dependant on the more immediate delivery of the commercially viable IMEX terminal, requiring the delivery of the terminals to be linked in a precinct approach.

movement between port, rail and road—and in the future—across a network of intermodal terminals; and

- School of Military Engineering (SME) site was considered optimal for the development of an intermodal terminal with an interstate freight component, due to its unique proximity to key rail infrastructure and its capacity to accommodate interstate trains of 1 800 metres.

2.3 Due to the significant national productivity benefits expected to be realised, as well as the strategic size and the location of the MIT, a consistent (and current) Australian Government objective for the project has been to ensure that the terminal will be operated on an open access and non-discriminatory basis (that is, available for use by other operators on a reasonably equal basis).

Was a competitive procurement process adopted?

The procurement process was not sufficiently competitive. MIC suspended its planned procurement process at the end of the expression of interest (Eoi) stage to enter into direct negotiations with one respondent. This was on the basis that this respondent's proposal was significantly stronger than those lodged by the other four respondents. The planned approach had been to select two or three Eoi respondents from which to obtain detailed and committed proposals before proceeding to direct negotiations. Competitive pressure was also hindered by MIC not informing Eoi participants of the eight criteria that it would apply in scoring responses, or that the criteria were weighted.

2.4 Some 40 companies were consulted during the preparation of the detailed business case. It was concluded that their interest in participation in the project was 'very strong'. The project's business case considered that, to deliver value for money, it would be important to attract market interest through a competitive procurement process.

2.5 Consistent with the project's business case, a competitive procurement process was designed by MIC.

Registration of interest

2.6 An open registration of interest (Rol) process was conducted between May 2013 and June 2013 to:

- encourage the development of a competitive field of tenderers with the required experience, capability and capacity; and
- establish a process for further interaction with select respondents, including market testing key commercial and design principles, processes and timing regarding project development and operations.

2.7 The Rol documentation noted that parties choosing not to participate in the Rol process (which included SIMTA) could participate in MIC's later formal procurement processes commencing with expressions of interest.

2.8 In responding to the Rol process, parties were asked to provide information on their interest in and expectations of the project, comment on the concept design and identify factors

likely to affect the successful delivery of the project. Nineteen parties responded, of which 16 were from the targeted group (of domestic and international organisations that operate within the freight and logistics industry; are involved in the development/management of warehousing and distribution centres; or own similar or related infrastructure).

2.9 MIC concluded from the RoI process that the number of serious bidders was likely to be limited to between two and four parties, and that the procurement process needed to recognise this and be effective at maintaining competitive tension.

Market sounding

2.10 Following the RoI process, in September 2013 MIC undertook some more targeted market sounding activities with selected parties. MIC's Board was advised that this was to 'seek input from selected market participants to inform the selection of a commercial structure and procurement process to meet the project objectives and maximise the commercial success of the project.' The RoI documentation noted that MIC could, at its sole discretion, hold direct discussions with any party regardless of whether they had responded to the RoI.

2.11 MIC prepared a 'Market Interaction Brief' to provide to the selected parties. The brief outlined, amongst other things, a project description; proposed commercial principles; short listed IMEX terminal procurement models; and warehouse development options.

2.12 MIC wrote to three potential developers on 26 August 2013, inviting them to: review the brief after signing a confidentiality agreement; provide written responses to a set of 12 questions; and participate in a formal market sounding discussion with MIC and its commercial adviser. The brief was provided to each of the three developers (which included SIMTA). MIC and its commercial adviser also held an informal discussion with a container logistics company operating out of Port Botany on 2 September 2013.

2.13 In September 2017, MIC advised the ANAO that there were a further three parties that participated in market interactions with MIC regarding the project in August and September 2013. MIC further advised the ANAO that it provided the Market Interaction Brief 'to all parties on 26 August 2013 with the same content'. The evidence did not support that all parties MIC engaged with as part of the market sounding received the same information. In particular:

- MIC's records do not include any evidence of the brief being provided;
- there were no confidentiality agreements signed by four of the parties (the brief is identified as 'MIC Confidential Information' in the three agreements that were signed); and
- papers for one MIC Board meeting state that the container logistics company had not received the brief.

2.14 MIC's approach in inviting a subset of potential developers to participate in the market sounding process gave rise to a risk of providing an unfair advantage to those parties that were invited to participate. This issue was raised with MIC by its probity adviser (Walter Partners) before it invited participants. MIC records did not include a response to the probity adviser or otherwise indicate that any action was taken by MIC in response to the concern that had been raised.

Expression of interest

2.15 MIC designed a competitive two-stage expression of interest (Eoi) process. Responses to the first stage were to be used to shortlist at least two (but no more than three) respondents to proceed to the second ('Project Development Request' or PDR) stage. The second stage was to involve MIC working with shortlisted respondents to develop detailed and committed proposals from which a successful partner would be selected.

2.16 A public call for expressions of interest was made on 13 December 2013. The Eoi document sought operators to lead the MIT development by establishing consortia with builders and financiers and submitting proposals to build and operate the terminal. The closing date for Eois was 26 February 2014.

2.17 The first Eoi stage was in two parts. The first part involved the public release of Part 1 of the Request for Eoi document. The second part involved MIC admitting parties it assessed as qualified¹³ to a confidential data room with the information in the data room then to be used by admitted parties to develop their Eois.

2.18 Admitted parties were also provided with the second part of the Eoi document. This provided potential respondents with confidential information on various technical and business related aspects of the MIT including the:

- proposed allocation of risks;
- proposed approach to open access; and
- financial and other support MIC envisaged providing to the project.

2.19 A healthy level of market interest was generated by the Eoi process. MIC admitted eleven parties to the data room. Five parties proceeded to submit Eois.

Evaluation approach

2.20 The Request for Eoi documentation outlined that MIC's assessment process would involve:

- considering proposals as a group to first determine the optimal commercial structure for the project; followed by
- assessment of individual Eoi responses and shortlisting of respondents based on MIC's view of each respondent's ability to satisfy the published project objectives, in the context of the selected commercial structure.

2.21 MIC's approach allowed for it to select the best elements of the proposals put forward by Eoi respondents for a commercial structure. But the approach also meant that MIC's shortlisting of respondents would occur in the context of respondents not having had the opportunity to submit proposals directly responding to the commercial structure adopted by MIC. In this respect, a further stage of submissions addressing the optimal commercial structure was integral to maintaining competitive tension and achieving value for money. This was to occur as part of the planned second (Project Development Request) stage of the Eoi process.

13 Defined as 'competent operator-led consortia' that 'have suitable experience in operating intermodal terminals, either within Australia or offshore'.

2.22 Consistent with good procurement practice, MIC prepared an EoI evaluation plan. Among other matters, the plan identified the assessment criteria that would be applied, the criteria weightings and the assessment scoring system to be employed. This plan was focused on the EoI process, with an additional evaluation plan to be prepared for the PDR phase prior to commencement of that phase of the procurement process.

2.23 The EoI Evaluation Panel was chaired by MIC's Procurement Director with three other members (the MIC CEO, the MIC General Counsel/Company Secretary and MIC's contracted Commercial Adviser from Macquarie Capital). The Panel was to assess EoI responses against each of the evaluation steps and report to an Implementation Committee (which was a committee of the MIC Board). The Implementation Committee's recommendations would be considered by the full MIC Board.

Evaluation criteria and weightings

2.24 Part 1 of the EoI document outlined that MIC expected that the development of the MIT would be phased. It also set out five objectives for procuring the initial phase of the MIT. Those objectives were drawn from the Australian Government's policy objectives for the project (outlined at paragraph 4.1).

2.25 Part 2 of the EoI document (provided to the parties admitted to the data room) included a section titled 'Your response—what you need to tell us'. This identified 21 types of information that needed to be provided.

2.26 There were eight criteria used to evaluate the EoIs that were received. One of the criteria was described in MIC's evaluation plan as being a 'gateway objective' and had a weighting of 25 per cent. To proceed to be evaluated against the other seven criteria a proposal was required to achieve a score of at least four out of ten against that criterion. The criterion was expressed as follows:

Provide certainty that those allocated with responsibility for development and operation of the IMEX Terminal and Interstate Terminal have the appropriate capacity, skills and industry knowledge to do so.

2.27 The other seven criteria were weighted at 7.5 per cent (one criterion), 10 per cent (four criteria), 12.5 per cent (one criterion) or 15 per cent (one criterion).

2.28 A shortcoming in MIC's procurement process¹⁴ was that the EoI documentation provided to potential respondents did not identify the assessment criteria that MIC would apply in scoring the responses.¹⁵ The EoI documentation also did not identify that the criteria were weighted, or otherwise inform potential respondents as to those considerations that were of greatest importance to MIC.

14 By way of comparison, the Commonwealth Procurement Rules require that evaluation criteria be included in request documentation to enable the proper identification, assessment and comparison of submissions on a fair, common and appropriately transparent basis.

15 April 2014 commercial advice to Finance had questioned whether the EoI evaluation criteria had been provided to potential respondents (in the context of noting that, the assessed gap could potentially narrow 'with appropriate time, information and further dialogue').

Engagement with respondents and selecting the optimal commercial structure

2.29 As part of its assessment process, MIC engaged with each of the Eol respondents in respect to their proposals (see Table 2.1).

2.30 As noted at paragraph 2.20, the first assessment stage was to involve MIC considering proposals as a group to first determine the optimal commercial structure for the project. The optimal commercial structure for the project was identified by MIC taking into account a range of considerations. These included responses to the Eol and guidance from the Shareholder Ministers' departments.

Table 2.1: Expressions of interest engagement with respondents and scoring of responses

	SIMTA	Respondent B	Respondent C	Respondent D	Respondent E
Total weighted score ^a out of 10	7.7	4.9	4.5	3.9	N/A
Number of tailored written questions asked by MIC	25	23	14	16	8
Number of one-on-one interactions with MIC ^b	5	4	4	4	2

Note a: Scores of four or higher were considered to have satisfactorily met the criteria. As Respondent E scored less than four on the 'gateway' criterion, it was not assessed against the remaining criteria and, as a result, there was no overall weighted score.

Note b: These interactions involved one interview for each respondent, with the remaining interactions via email.

Source: ANAO analysis of MIC records.

2.31 The commercial structure selected by MIC as optimal most closely resembled the Eol submitted by SIMTA. Therefore the SIMTA proposal scored significantly higher than the other proposals (see Table 2.1 above).

Assessment outcome

2.32 By April 2014, MIC had completed its assessment of the five Eols received. After the results were presented to the MIC Board, MIC wrote to its Shareholder Ministers (the Minister for Infrastructure and Regional Development and the Minister for Finance) advising that it planned to change its approach to the next phase of its procurement process. In this latter respect, MIC's advice to Ministers was that it:

[...] received five responses from potential operators. This was a strong response though the quality of responses varied substantially. One respondent's submission was significantly stronger than the others, being willing to provide substantial capital and accept more risk.

Following lengthy and detailed deliberation (including taking the advice of our probity auditor), the board agreed to proceed to direct negotiations with one respondent.

2.33 The ANAO's analysis is that MIC had not fully tested the extent to which respondents were 'willing to provide substantial capital and accept more risk', as the Eol process had only sought responses at a 'conceptual level'. The Eol documentation had indicated that shortlisted respondents would be afforded a further opportunity through a subsequent Proposal Development Request (PDR) stage involving the development of fully detailed and committed

proposals. The PDR process was to have outlined and sought direct responses to the key elements of the optimal commercial structure identified by MIC through the EOI process. In this respect, abandoning the PDR stage was inconsistent with maintaining competitive tension.

2.34 In late April 2014, the MIC Chair and CEO met with the Finance Minister and senior Finance officials to discuss MIC's proposed approach. In May 2014, following receipt of additional details from MIC substantiating the proposed direct negotiations approach¹⁶, DIRD and Finance recommended that their Ministers provide MIC with the requested consent. This was based on advice from MIC that:

- the parties would enter into a Procurement Process Deed, which would set out:
 - a negotiation timetable, including 'approval hurdles' that needed to be met at each stage;
 - MIC's plans to cease negotiations with SIMTA should it not be able to come to agreement on the commercial arrangements by 20 November 2014 (the deed's termination date); and
 - the 'clear commitments'¹⁷ proposed by SIMTA in its EOI submission;
- it could sustain competitive tension by SIMTA knowing that MIC could terminate the negotiations if hurdles were not met;
- it was open to MIC to re-engage with two other qualified respondents, who would be kept on stand-by during the exclusive negotiation period; and
- based on probity advice, there was no legal or probity impediment to proceeding to direct negotiations.

2.35 MIC and SIMTA signed the Procurement Process Deed on 22 May 2014, entering them into a six month period of direct negotiations. During the direct negotiation period, the parties were to have progressed through five 'stages' of negotiations, with the final stage being contractual close.

Were risks from adopting a direct negotiation process identified?

Risks to removing competition from the second stage of the procurement process were identified. Risk mitigations were also identified.

2.36 MIC's decision to proceed straight to direct negotiations at the conclusion of the EOI stage effectively afforded SIMTA the opportunity it had unsuccessfully sought in late 2013 (see paragraph 1.13).

2.37 In the context of achieving value for money, entering into direct negotiations with one proponent can significantly impact the level and balance of competitive tension between the parties to the transaction. MIC's Negotiation Strategy identified various risks relating to moving

16 Including advice that SIMTA's offer reflected a substantial shift in its position from 'wanting to develop only an IMEX terminal on its site, independently of any Australian Government initiative, to a position where it has offered to build and operate both an IMEX and an interstate terminal in an integrated whole-of-precinct comprising both its land and the Commonwealth's land'.

17 Specifically, MIC advised Ministers: 'We also have the clear commitments and position put to us by the preferred respondent in its EOI response, which will form the basis of the negotiation.'

away from a competitive procurement process, as well as a number of mitigation strategies for each of these risks.

2.38 The risks from adopting a direct negotiation process were also raised in advice to the Shareholder Ministers by their respective departments in mid-April 2014. The departmental advice was informed by commercial and legal advice, which was provided to Ministers in full, and outlined that:

- given the proposal [is] for 6 months of negotiations, this assumes that there are a significant number of matters of substance to be agreed;
- whilst granting “Preferred Proponent” status is not unusual in commercial negotiations per se, it usually occurs after intense competition and the lodging of final and binding bids—namely bids capable of acceptance and the timeframe for discussion is usually days, not months. This process design ensures that other Respondents do not disengage during the period of negotiation;
- there is no certainty that the period of exclusivity will not be extended once MIC has spent 6 months negotiating with [SIMTA] (which may further diminish competitive tension). Such extensions are common in commercial negotiations once exclusivity is granted; and
- there would be real merit in issuing a Proposal Development Request (PDR) document (in the form contemplated by the Request for EoI)¹⁸ and seeking a formal response from [SIMTA] before progressing to negotiations. This is because:
 - a PDR document would establish a clear baseline of the Commonwealth's objectives and preferences against which any final negotiated outcome with [SIMTA] could be objectively assessed (both by MICL and external stakeholders); and
 - a formal response provided by [SIMTA] should represent a substantially developed offer capable of acceptance by MICL and, provided the PDR document is appropriately framed, should also reduce the risk of [SIMTA] resiling from its formal offer on key issues during the course of negotiations.

2.39 MIC advised the Shareholder Ministers that ‘some competitive tension’ could be maintained through: the clear commitments given by the preferred respondent in its proposal; and the ability to fall back to a competitive process by keeping two other respondents on ‘stand-by’. The two respondents placed on stand-by were those that scored second and fourth highest. This reflected a request from the third ranked respondent that it not be shortlisted if there were other respondents that were willing and able to develop the MIT.

18 The PDR document contemplated by MIC’s Request for EoI was the detailed project proposal to be developed by the two to three shortlisted bidders following the conclusion of the EoI process (discussed at paragraph 2.15).

Were negotiation timeframe risks well managed?

Negotiations took twice as long as had been planned. There was no evidence that MIC contemplated implementing the planned risk management strategy of terminating negotiations and re-engaging with other parties on 'stand-by' when it became evident that the negotiations were not proceeding in accordance with the planned timetable.

2.40 On 16 May 2014, MIC informed SIMTA that it intended to continue the procurement process by undertaking direct negotiations with SIMTA 'for a period of time', subject to MIC and SIMTA agreeing on the terms of this negotiation. MIC's Negotiation Plan envisaged that contractual close would occur 24 weeks after a Procurement Process Deed was signed with SIMTA. As noted at paragraph 2.34, MIC's advice to decision-makers had been that risks associated with direct negotiations could be managed, in part, by MIC terminating the negotiations if timeframes were not being met and re-engaging with two other EoI respondents that would be on stand-by.

2.41 The Procurement Process Deed was signed on 22 May 2014, to govern the conduct of the negotiations. Also on 22 May 2014, MIC informed the two EoI respondents that were being placed on stand-by that:

- it was 'deferring the commencement' of a multi-proponent PDR phase 'for a limited time' while direct negotiations occurred with SIMTA;
- direct negotiations with SIMTA would be for a period of 'up to six months'; and
- it 'may' seek to re-engage with those respondents 'in due course'.

2.42 The Procurement Process Deed outlined that the successful completion of Stage 5 was to result in the production of a 'Final Binding Offer' (FBO)—synonymous with contractual close. The FBO was also to signify the determination of SIMTA as the 'preferred proponent' and the release of the remaining qualifying EoI respondents from stand-by. Consistent with advice to the Shareholder Ministers, a key condition of the deed was that if the parties failed to complete Stage 5 by the 20 November 2014 termination date, MIC would cease direct negotiations with SIMTA.

2.43 The effectiveness of this approach as a control in maintaining competitive tension during direct negotiations was reliant on timely achievement of the approval hurdle milestones; and ensuring that documentation forming the basis of the FBO was sufficiently detailed. Table 2.2 highlights that considerable delays occurred throughout the negotiations.

Table 2.2: Stages for direct negotiations between MIC and SIMTA

	Approval hurdle to be achieved	Forecast date	Completion date
Stage 1	MoU Agreement on Fundamental Matters	Mid-July 2014	12 September 2014
Stage 2	Term Sheet and largely complete precinct master plan prepared by SIMTA	31 July 2014	20 November 2014
Stage 3	Detailed negotiation of all transaction documents	25 September 2014	2 April 2015
Stage 4	MIC Board and Australian Government approvals	23 October 2014	21 April 2015
Stage 5	Contractual close	20 November 2014	3 June 2015

Source: ANAO analysis of MIC records.

2.44 In September 2014, MIC advised its Board that the MoU Agreement on Fundamental Matters discussions were far more detailed and lengthy than either MIC or SIMTA first contemplated, and due to this, the parties brought discussions for that stage to a conclusion by documenting the position on each fundamental matter whether agreed or otherwise. For matters yet to be agreed, the position of each party was recorded with a commitment to resolve the matter in Stage 2 (proposal negotiations). The MIC advice did not contemplate terminating negotiations and re-engaging with the two parties it had placed on stand-by.

2.45 The parties agreed an aggressive program to finalise the remaining transaction documentation, but were unable to make up for the time lost. This resulted in eight amendments to the Procurement Process Deed, each with the effect of extending the deed's termination date. There was no evidence of MIC, prior to any of these amendments, contemplating the merits of implementing the planned risk management strategy of terminating negotiations and re-engaging with the two parties on stand-by.

2.46 Six months after entering into direct negotiations and shortly after finalising the detailed Term Sheet on 20 November 2014, media releases¹⁹ were published announcing that MIC and SIMTA had reached an agreement to develop the Moorebank project. As reflected in commercial and legal advice commissioned by DIRD and Finance, by this point in time and based on the process that had eventuated, MIC's capacity to pursue an alternate process or new proposals had become limited and likely to carry substantial risk. On 11 December 2014, MIC wrote to the two other EoI respondents it had placed on stand-by thanking them for their time and effort in participating in the procurement process.

2.47 Contractual close was reached six months after the announcement was made, and more than six months later than had been intended when the decision had been taken to enter into direct negotiations.²⁰

19 The media releases also indicated that the agreement was subject to formal approvals by the Australian Government and the Qube and Aurizon Boards.

20 The ANAO has recently examined two other procurement processes where direct negotiations were undertaken instead of maintaining competitive pressure. Similar to the MIT, there were significant delays in finalising the procurement along with challenges in demonstrably obtaining value for money. See: ANAO Audit Report No. 41 2016–17 *Conduct of the OneSKY Tender* and ANAO Audit Report No. 45 2016–17 *Replacement Antarctic Vessel*.

Did negotiations secure the expected contractual commitments?

Negotiations were expected to commence after MIC had obtained a binding commitment to the key elements of the successful respondent's expression of interest. No such commitment was obtained. There is no evidence that going to direct negotiations at an early stage produced a better outcome than was achievable under the original planned procurement approach of getting firm and binding offers from two or three competing parties to select from.

The direct negotiations secured contractual commitments to the development and operation of intermodal freight terminals and warehousing, as well as to an open access regime for the terminals. Between the commencement of direct negotiations and the final contracted outcome, MIC agreed to arrangements that have increased the Australian Government's financial contributions and contingent liabilities (as compared with those proposed within the successful proponent's Eol); mitigated private sector exposure to demand risk; reduced the coverage and effectiveness of the access regime; and reduced the revenue streams to the Australian Government.

2.48 According to May 2014 departmental advice, and consistent with the approach suggested to the departments by their advisers (outlined at paragraph 2.38), the May 2014 Procurement Process Deed was to bind SIMTA to the 'commitments' expressed in its Eol submission. Similarly, in September 2017, MIC advised the ANAO that:

The first step in the direct negotiation was to secure SIMTA's commitment to the key elements of its Eol response. This is recorded in Schedule 1 to the Procurement Process Deed executed by MIC and SIMTA on 22 May 2014.

2.49 The ANAO's analysis is that the terms of the Procurement Process Deed did not involve MIC obtaining a commitment from SIMTA to key elements of its Eol response. Rather, the Deed set out the parties' rights and obligations in relation to the conduct of the direct negotiations process. Further, the express purpose of Schedule 1 to the Deed was to 'summarise the Eol response, including the respondent's response to MIC's written evaluation questions and the evaluation interview'. There was no commitment expressed in the Schedule, or elsewhere in the Deed, to the Eol response. The lack of any such commitment was consistent with:

- the Eol request having been issued by MIC on the basis that no legal or other relationship or obligations would arise between any Respondent and MIC unless and until binding legal documentation was signed, and that acceptance of any EOI response would not create a binding contract between MIC and the respondent; and
- responses to the Eol request not being in the form of binding bids (including clear commitments) that were capable of acceptance.

2.50 Key elements of the transaction changed significantly during the course of negotiations compared to the commercial arrangements envisaged by the Eol request and in SIMTA's Eol response. The ANAO's analysis is that the direct negotiations did not secure a contractual commitment to important elements of the Australian Government's preferred approach to some matters (as articulated in the Request for Eols); or to all key elements of SIMTA's Eol response. This was the case in relation to:

- the Australian Government's financial contributions and contingent liabilities increasing over the course of negotiations. For example, the successful Eol had indicated that no government subsidies would be sought to fund connecting rail infrastructure, or for the relocation of Moorebank Avenue.²¹ The Fundamental Matters MoU agreed in September 2014 stated that the Australian Government would fund a portion of the Southern Sydney Freight Line rail access and that SIMTA's contribution towards relocating Moorebank Avenue would be capped at \$20 million. The final contracted outcome reflected the same cap in relation to Moorebank avenue, but involved the Australian Government funding the entirety of the Southern Sydney Freight Line rail access²²;
- the Australian Government being prohibited from divesting its interests to rivals of the successful respondent,²³ as opposed to its original preference for an unfettered privatisation process;
- the mitigation of private sector exposure to demand risk. The successful Eol response had stated that the Australian Government (through MIC) would not be required to assume any demand risk for the project. The negotiated outcome maintained a position that demand risk is predominantly with the terminal operators but private sector exposure to demand risk is mitigated by the contractual arrangements:
 - providing a number of grounds on which terminal capacity is not required to be expanded even in circumstances where there is unmet demand; and
 - allowing the operator to set the prices it charges for terminal services and warehousing at market rates, without any reference to its costs with the contractual arrangements involving concessions from the Australian Government that reduce those costs;
- the value of land rent revenue streams from SIMTA diminishing progressively throughout negotiations from a starting position of 'market value' set out in the Eol response to a contracted position well below market rates;
- concerns raised by the Shareholder Ministers' departments that the contractual arrangements should guard against the risk of the IMEX terminal being delivered, but not the interstate terminal. The contractual arrangements seek to address this issue, but there remain some circumstances under which the obligations to develop the interstate terminal to its ultimate capacity may be terminated, with SIMTA retaining its rights and obligations in relation to the IMEX terminal and rail access;

21 The Eol outlined that SIMTA, would 'not seek any subsidies from the Government to fund the development of the project. Specifically, it is envisaged that connecting rail infrastructure, IMEX and Inter/Intrastate Terminals and warehousing developments will be funded through various (and predominantly private) sources'.

22 The costs relating to the realignment of Moorebank Avenue were not linked to MIC's future revenues streams. The recovery of MIC's rail access contribution and future earnings are discussed at paragraph 15 of Appendix 3.

23 MIC advised the ANAO in November 2017 that: 'This is, in MIC's opinion, of little or no consequence on the sales value of the businesses for the Australian Government and maintains a sufficiently broad market for the investment to be attractive to local and overseas investors.' This was because 'MIC's subsidiary trusts and their annuity style revenue streams were deliberately set up to facilitate the Commonwealth's objective of divesting its commercial interest in MIC by being attractive to superannuation funds and infrastructure investors.' See further at paragraph 4.25.

- MIC making a number of significant concessions in regard to warehousing development, most notably the granting of 99-year warehousing ground leases that will survive contract termination; and
- the contractual arrangements excluding certain aspects of terminal services that the Eol had identified would be captured as part of the Open Access Regime. In addition, the compliance arrangements for the Regime are not as strong as was envisaged in the Eol.

2.51 Details of the ANAO's analysis are provided in Appendix 3.

Was probity in the procurement process well managed?

There were shortcomings in the management of probity. For example, the probity plan did not apply to all stages of the procurement process. In addition, a probity adviser and a separate probity auditor were appointed later in the procurement process than is desirable through processes that did not involve open and effective competition for the roles. Further, MIC's response to the probity audit of the Eol process did not adequately address each of the findings that underpinned the auditor's recommendations.

Probity framework

2.52 In May 2013, MIC appointed a probity adviser for the approach to the market. MIC did not conduct an open tender process for this role. Rather, it obtained and evaluated three quotes from firms recommended by its legal adviser (Herbert Smith Freehills). The contract specified a capped monthly fee of no more than \$30 000 over a thirteen and a half month period representing a total potential fee value of \$405 000. An engagement of this value should have been subject to an open tender under MIC's procurement policy.

2.53 The statement of works for the probity adviser developed by MIC emphasised that its status as a GBE meant that it was not required to comply with Australian Government probity requirements. Rather, MIC was seeking to 'work with the adviser to apply commercially appropriate and pragmatic probity practices for competitive procurement processes with a total project value of approximately \$1 billion, and to implement good probity practices within its day-to-day business'. The adviser was paid a total of \$54 130 for work undertaken between November 2013 and April 2015. Although the adviser was appointed in May 2013, no work was invoiced as having been undertaken prior to November 2013.

2.54 MIC also engaged a probity auditor (Risk Reward Pty Ltd)²⁴ for the Eol and the direct negotiations processes. The July 2014 engagement was through a non-competitive process of MIC's legal adviser seeking a quote from a provider that had previously (in December 2013) been identified by MIC. In September 2017, MIC advised the ANAO that the firm had been

24 There is a distinct difference between the role performed by a probity adviser and that of a probity auditor. A probity adviser works closely with the client from the beginning of the procurement process, providing advice on probity/process issues which may arise and strategies to overcome potential problems. Consequently, a probity adviser cannot be regarded as an 'independent' party. In contrast, a probity auditor's role is more generally an 'after the fact' role, auditing the process and associated documentation after it has been completed, or at key stages during the process. See further in ANAO Audit Report No. 1 2016–17 *Procurement of the International Centre for Complex Project Management to Assist on the OneSKY Australia Program*.

‘recommended by MIC’s former General Counsel’ and that ‘given the relatively small size of the consultancy (approximately \$25 000), an open tender was not adopted’.²⁵

2.55 A probity plan was produced, although advice from MIC’s probity adviser had been that probity protocols would have been a better approach. The probity plan did not apply to the Registration of Interest process or the September 2013 market sounding exercise. The ANAO sought advice from MIC as to why a probity plan was not in place for the full extent of the engagement with the market. MIC’s advice to the ANAO in September 2017 was that:

The market sounding process was market research / information gathering for MIC. It was not proponent procurement or selection. The probity adviser reviewed and commented on the RoI documents and market sounding process, and his feedback was taken into account.²⁶

2.56 The appointment of a probity adviser and probity auditor, and the establishment of a probity plan also occurred after MIC had made its major adviser appointments.

EoI process

2.57 A draft report from the probity adviser on the EoI process was provided to MIC on 1 May 2014. MIC amended the draft report, prior to the probity adviser’s final sign-off, to state that the adviser had attended ‘key meetings’ and that he endorsed the proposed approach of entering into direct negotiations. Accordingly, the adviser’s report signed on 1 May 2014 stated that:

- the EoI processes had been conducted fairly and properly and in a manner consistent with all probity requirements and those of procedural fairness; and
- it supported the entering into of exclusive negotiations with the first-ranking respondent ‘given the clear gap between this respondent and the other respondents’.

2.58 The probity auditor’s September 2014 report on the EoI process concluded that, apart from three areas, it believed the probity requirements were met during the EoI phase, including in relation to evaluation of the bids and the decision to proceed with direct negotiations with SIMTA. The three areas of findings and related recommendations addressed: management of conflicts of interest; transparency and accountability matters; and access security over confidential data and documentation.

2.59 MIC’s response adequately addressed the findings and recommendation relating to access security. But its response did not adequately address each of the findings that underpinned the probity auditor’s recommendations in the other two areas (see Table 2.3).

25 The probity auditor’s fee was not to exceed the equivalent of 10 days’ work for the EoI process and a further 10 days for the direct negotiation process (MIC informed the engaged firm that its expectation was that the examination of the direct negotiation process would involve less than five days’ work). The total amount paid to the probity auditor was \$26 390 for 11.4 days’ work.

26 Records examined by the ANAO did not support MIC’s advice. For example, although engaged in May 2013 the probity adviser did not invoice MIC for any work undertaken prior to November 2013, which was after the RoI process had been conducted.

Table 2.3: Management response to probity auditor findings and recommendations

Finding	Recommendation	ANAO analysis of MIC's response
Conflict of interest declarations by consultants addressed personal conflicts but not those on behalf of their employer organisations.	Undertakings be obtained from consultant organisations that they are not assisting any EoI respondents. If they are, they should be asked to provide details of how the organisation is managing the conflict.	The recommended undertakings were not sought. Instead, MIC's response was that it was in the process of obtaining confirmation from each key adviser or consultant organisation that it has appropriate internal processes in place to check for conflicts of interest. Confirmations were to be sought on or before the 30 September 2014. The ANAO sought from MIC all confirmations obtained (as the ANAO had been unable to locate this information in MIC records). This revealed that MIC had not implemented the action it had committed to in its response to the probity audit. MIC advised the ANAO in October 2017, that it 'has no record of conflict of interest declarations from consultant organisations, only employees within the consultant companies'.
Minutes of the meetings of the Evaluation Panel and the Implementation Committee were not compiled and reports were unsigned and undated meaning the Panel and Committee had not formally reported in a transparent and accountable manner in accordance with the probity plan.	Noting that the Negotiation Plan for the direct negotiations stage did not require minutes/notes to be compiled of each meeting, to satisfy the probity principles of transparency/ accountability and fairness/impartiality described in the Probity Plan, it was recommended that formal minutes/notes be compiled.	<p>MIC considered it was 'impractical' to keep meeting minutes/notes. Instead, its response to the recommendation:</p> <ul style="list-style-type: none"> advised that it maintains registers of 'Q&A during Direct Negotiations' and 'Actions' and 'Decisions' arising out of the direct negotiations with SIMTA, which are shared with SIMTA; and stated that it would create a record of agenda items, attendees and dates for all direct negotiation meetings held with SIMTA. <p>In this latter respect, evidence provided by MIC to the ANAO in September 2017 indicated that 46 direct negotiation meetings had taken place and formal minutes recorded. The ANAO's analysis of these records indicated that the probity adviser was present at 35 of these. Additional records examined by the ANAO suggest that at least a further 85 negotiation meetings^a—for which there were no minutes or formal documentation—may have taken place between MIC and SIMTA.</p>

Note a: These further negotiation meetings predominantly involved discussions between senior MIC and SIMTA employees (including MIC's Chair and CEO) without the presence of their respective advisers. The occurrence of these meetings was identified by the ANAO from examination of MIC calendar entries and email correspondence.

Source: ANAO analysis of MIC records.

Direct negotiation process

2.60 On 2 April 2015, MIC sought a sign-off from the probity adviser on the direct negotiations process. MIC informed the probity adviser that a final binding offer had been received that day from SIMTA, provided the adviser with the covering letters and outlined that the final binding offer would be available to view in MIC's offices from 7 April 2015. On Saturday 4 April 2015, the probity adviser provided a sign-off that the probity adviser had:

- reviewed the final binding SIMTA offer²⁷;
- monitored the entire negotiation process and attended all²⁸ high level negotiation meetings to ensure that all probity requirements were met; and
- concluded that: 'the process was conducted in a manner consistent with the Procurement Process Deed, principles of procedural fairness and all probity requirements and that, in view of the meeting of Commonwealth objectives with relatively low Commonwealth capital investment and SIMTA adopting the majority risk, value for money for the Commonwealth is able to be obtained'.

2.61 The probity auditor's August 2015 report on the direct negotiation process stated that it was satisfied that the key controls put in place to mitigate the major probity risks to MIC were appropriate and operated effectively during the direct negotiation process.

What advice on the value for money of the project was provided to Shareholder Ministers?

Advice on the project's progress and whether value for money was expected to be obtained was provided to Ministers at key milestones. At the conclusion of the negotiation process, MIC advised the Shareholder Ministers that the outcome represented 'excellent value for money'. Ministers were separately advised by their departments that the negotiated outcome represented value for money.

2.62 Advice in respect to the project's optimal delivery mechanism and its value for money has been provided to Ministers over a substantial period of time. Key advice was typically provided leading up to important project milestones, such as when the project's detailed business case was finalised in February 2012; the selection of a preferred respondent in April 2014; and prior to the execution of the project contracts in June 2015.

Initial Australian Government approval

2.63 Initial Australian Government approval for the MIT was given in April 2012 and included \$887 million²⁹ for the implementation of the project via a dedicated Government Business Enterprise.³⁰ The Government's decision was on the basis of comprehensive departmental advice, which was underpinned by the project's detailed business case.

27 ANAO sought advice from MIC as to when the adviser viewed the final binding offer given MIC's 2 April 2015 request for a sign-off said the final binding offer was not available to be viewed by the probity adviser until 7 April 2015, 3 days after the probity adviser provided his sign-off. MIC's September 2017 advice to the ANAO was that it 'is not able to advise when the probity adviser reviewed the final and binding offer in April 2015'.

28 The ANAO's analysis of MIC records was that the probity adviser was present at 36 of 131 (27 per cent) identified direct negotiations meetings (see Table 2.3). The probity adviser was not present at some high level negotiation meetings. In most instances, there is no evidence the probity adviser was aware of those high level negotiation meetings he did not attend.

29 This allocation was for the construction of the first phase of the project, which consisted of the IMEX terminal and associated infrastructure.

30 The GBE model was recommended on the basis that it is a typical model used in the operation of major infrastructure projects. For example, it is common for a public body to own the strategic assets at ports and for stevedores to lease these assets and operate the terminals using their own equipment.

2.64 A benefit cost ratio (BCR) was calculated for the MIT as part of its business case, in order to ensure the economic benefits outweighed the economic costs. This analysis indicated that the project showed a BCR of 1.72 and a positive net present value of \$1 billion.³¹ This is the BCR referred to by Infrastructure Australia in its evaluation of the business case.³²

2.65 The BCR of 1.72 did not take into account the cost to the Australian Government for the relocation of the School of Military Engineering (SME) from the Moorebank site—which was explicitly linked to the project—as these costs were considered as part of a separate Moorebank Units Relocation (MUR) business case compiled by the Department of Defence. In considering the Defence-specific costs and benefits, the MUR business case:

- identified that 78 per cent of the total cost of the Moorebank Units Relocation project were directly attributable to the MIT—as at September 2013, these costs were in the vicinity of \$517 million;
- noted that the MUR project was ‘driven by the Government’s need to develop an Intermodal Terminal on the Defence land at Moorebank that lies between Moorebank Avenue and the Georges River’; and
- did not calculate a BCR for the MUR project.

2.66 Department of Finance advice was that the BCR for the project was 1.27 taking into account the Defence relocation costs.³³

Advice provided throughout contractual negotiations

2.67 Following the September 2013 Federal Election, the new Shareholder Ministers approved the continuing operations and activities of the MIC in line with advice received from their respective departments.

2.68 This approval saw MIC continuing to be responsible for the procurement and, later, the contractual negotiations for the development of the MIT. The formal and informal governance arrangements between MIC and the Shareholder Ministers’ departments involved regular liaison between officials, and the seeking of approvals from the Ministers at key milestones. These milestones have included Shareholder Ministerial agreement that MIC:

- release its Request for EoI documentation in December 2013;
- depart from its published procurement process by entering into direct (one-to-one) negotiations with SIMTA;
- formalise high-level commercial arrangements via a ‘Fundamental Matters’ Memorandum of Understanding (MoU) with SIMTA in September 2014;
- accept a detailed Term Sheet via an offer made by SIMTA in November 2014³⁴; and

31 Based on a seven per cent discount rate over a 30-year operational period.

32 See: <http://infrastructureaustralia.gov.au/projects/files/NSW-moorebank-Intermodal-Terminal.pdf> accessed 21 August 2017.

33 In September 2017, MIC advised the ANAO that a BCR of 1.93 for the project was also calculated in 2017 after agreement had been reached with SIMTA. This BCR did not take into account the Defence relocation costs.

- execute the finalised Development and Operations Deed on 3 June 2015 to achieve contractual close.

2.69 These approvals were sought and received by way of letters between the MIC Chair and the Shareholder Ministers. Advice and recommendations from the two Shareholder Ministers' departments were often accompanied by copies of advice from the departments' legal and commercial advisers.

Advice on the negotiated outcome

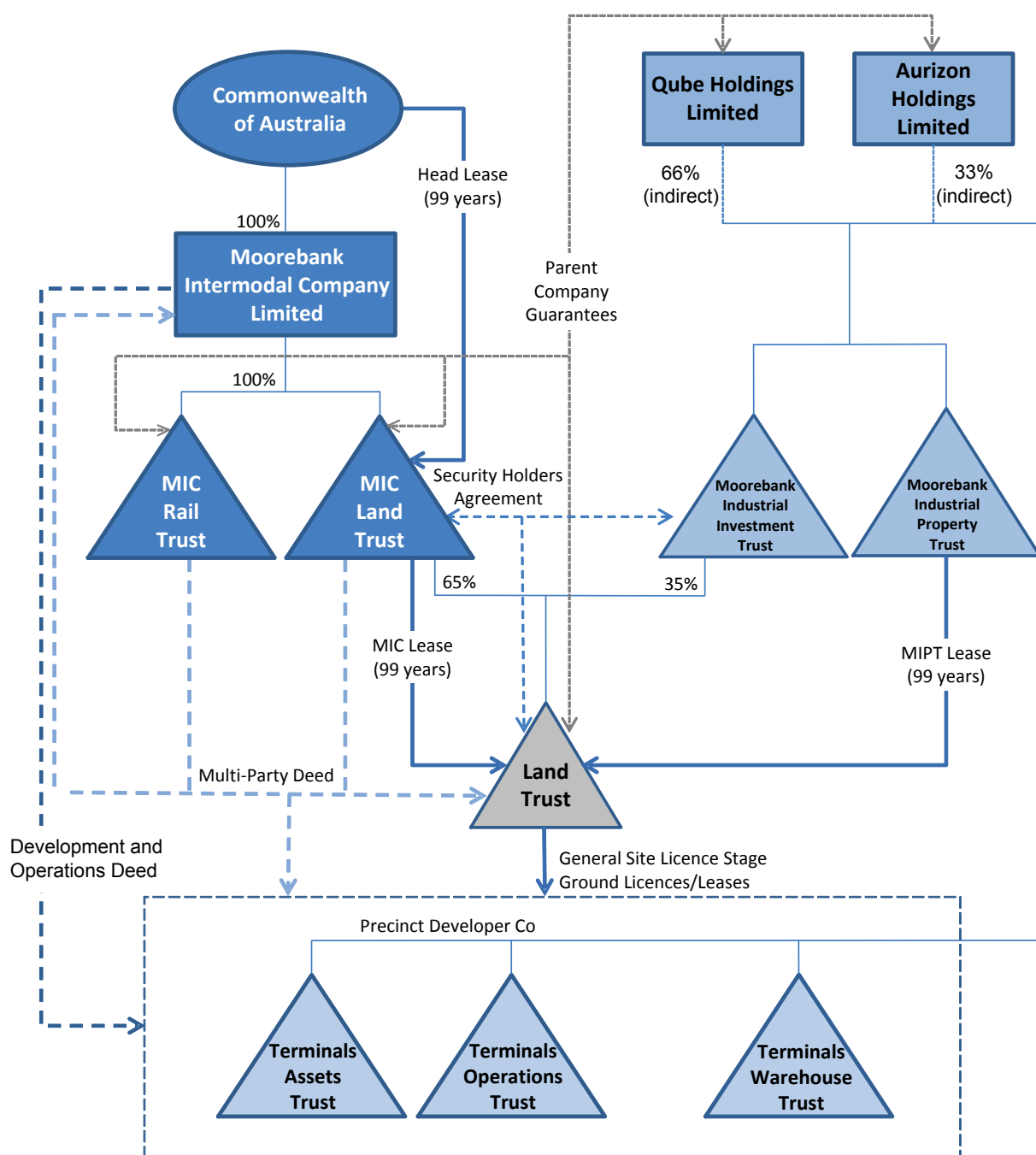
2.70 In April 2015 MIC wrote to Shareholder Ministers on the outcome of the negotiations. The settled commercial and contractual arrangements for the delivery of the project included:

- MIC assuming a landlord role, with no investment in the development of the terminal, warehousing or precinct infrastructure;
- all land required for development of the intermodal terminal would be leased to a land holding entity (Land Trust), jointly owned by MIC and SIMTA in proportion to the areas of developable land contributed (with this proportion being 65.63 per cent from MIC and 34.37 per cent from SIMTA);
- Land Trust leasing its land to Precinct Developer Co (PDC, a wholly owned SIMTA/Qube subsidiary), which will:
 - develop and operate the interstate terminal, IMEX terminal, associated precinct infrastructure and warehousing for 99 years, subject to certain conditions; and
 - assume the demand risk for the project;
- MIC funding the provision of the rail connection between the Southern Sydney Freight Line (SSFL) and the terminal; and
- MIC entering into a monitoring and enforcement role in respect to PDC adhering to the contractual open access regime.

2.71 Figure 2.1 provides a simplified illustration of the contractual relationship between the parties to the transaction.

34 The date for cessation of the Process and Procurement Deed was extended from 20 November 2014 to 10 December 2014 in order to allow enough time for the parties' Boards and, in MIC's case, the Shareholder Ministers, to consider the terms of the proposal. The cessation date in the deed was further amended on 25 November 2014 to '10 December 2014 (or such other date as is agreed by the parties in writing)'.

Source: MIC records.



2.72 The Shareholder Ministers were advised by MIC that the following attributes of the commercial agreement that had been reached meant that the project represented ‘excellent’ value for money:

- SIMTA's willingness to take the demand risk and to fund the majority of the investment required to develop the terminal. MIC suggested that the Australian Government's contribution was limited to the land and up to \$370 million in funds, which 'was about

- \$1 billion³⁵ less than foreshadowed in the 2012 business case'.³⁶ Further, the Australian Government would earn a real equity return on its contribution over the longer term;
- the size of SIMTA's contribution—being its land, valued at \$105 million, and \$693 million of capital expenditure on terminals and precinct infrastructure, consisting of \$448 million over the period 2016 to 2020 (primarily on initial terminal development and associated infrastructure) and \$244 million over the period 2021 to 2027 (primarily on terminal expansion and associated infrastructure)³⁷; and
 - SIMTA is obliged to develop and operate the intermodal terminal in accordance with contractual requirements that include development to an agreed master plan, and operation on principles of non-discrimination.

2.73 Separate but largely similar advice was provided to the Shareholder Ministers by their departments. Finance's advice to its Minister was that 'while there are trade-offs in the final negotiated outcome, MIC and SIMTA's proposal represents a value for money proposition'. DIRD's advice to its Minister was that 'while there are trade-offs in the final negotiated outcome, we conclude that on balance, the MIC-SIMTA proposal represents a value for money proposition'.

35 In respect to how it calculated these savings, MIC advised the ANAO in October 2017 that: 'The 2012 detailed business case notes Stage 1A IMEX nominal capital costs of \$804.3 million and Stage 2 Interstate nominal capital costs of \$534.7 million, totalling \$1,339 million. (Stage 1B Warehousing costs were not included as it was not intended that the Commonwealth would construct the warehousing). Under the MIC/SIMTA deal (which includes the IMEX, interstate and warehousing), the Commonwealth has committed to a \$370 million contribution, that is, \$969 million less'.

36 In September 2017, DIRD commented to the ANAO that it 'had previously utilised the Budget 2012 figure of \$887 million provided in the Contingency Reserve fund for the project to determine the magnitude of the size of the potential saving to the Government by proceeding with the SIMTA proposal.' On this basis, the savings to the Australian Government were in the order of \$517 million, around half the amount claimed by MIC.

37 Additionally, a further \$786 million was forecast for warehousing development over the period 2018 to 2027 and is expected to be provided by SIMTA or third parties acquiring warehousing opportunities.

3. Access arrangements

Areas examined

The ANAO examined whether non-discriminatory open access is likely to be available within all aspects of the intermodal precinct.

Conclusion

It is not possible to provide assurance that non-discriminatory open access is likely to be available within all aspects of the intermodal precinct given:

- the contractual framework does not apply to all elements of terminal operations, partially applies to the rail shuttle service between Port Botany and the MIT and internal transfers within the terminal precinct, and does not apply to warehouse operations;
- most of the key detailed documents that are required for implementation of effective open access arrangements have yet to be developed; and
- significant non-compliance is permitted before enforcement action can be taken.

Why is open access provided through contractual arrangements?

Notwithstanding that the preferred tenderer would gain exclusive access to a significant tract of Commonwealth land, MIC's view was that an open access regime administered through contractual arrangements was the only mechanism that would attract private sector interest in the development of the project. The alternative approach preferred by the Shareholder Ministers' departments was an access undertaking under the *Competition and Consumer Act 2010* which would then be administered by the Australian Competition & Consumer Commission. The 2013 approach to the market did not seek to test whether an access undertaking would deter private sector interest in the project.

3.1 An Australian Government policy objective for the Moorebank Intermodal Terminal (MIT) is that it be a flexible and commercially viable common user facility that is available on reasonably comparable terms to all rail operators and other terminal users.

3.2 Part IIIA of the *Competition and Consumer Act 2010* establishes a regime to facilitate third party access to certain services provided by means of significant infrastructure facilities. The Australian Competition & Consumer Commission (ACCC) is responsible for assessing Part IIIA access undertakings³⁸ put forward by owners/operators of infrastructure facilities, and also arbitrates access disputes. There are no intermodal facilities that have an access undertaking in place. The ACCC has accepted an access undertaking from ARTC for the Interstate Rail Network as well as another undertaking from the ARTC in relation to the Hunter Valley Rail Network.

3.3 The mechanism by which the open access principles would be administered was a point of difference between MIC and the Shareholder Ministers' departments. The departments preferred an access undertaking approach with independent approval and oversight by the ACCC. MIC

³⁸ An access undertaking is a document that sets out matters relevant to obtaining access to a particular service. These matters may include the terms and conditions on which the service provider will offer access, the price for the service, and dispute resolution processes in the event the parties cannot agree.

considered that an access undertaking, which is designed to prevent abuses of market power for services provided through facilities with natural monopoly characteristics, would undermine the ability of the MIT to compete with road transport and other intermodal terminals.

3.4 MIC's view was that all concerns related to open access should be addressed through a contractually enforced regime. Notwithstanding that the preferred tenderer would gain exclusive access to a significant tract of Commonwealth land, MIC believed that an open access regime administered through contractual arrangements was the only mechanism that would attract private sector interest in the development of the MIT.

3.5 The approach to the market did not seek to test whether an access undertaking would deter private sector interest in the project. Rather, the EoI documentation outlined that MIC was seeking a contractual rather than a regulatory solution. The documentation also sought respondent feedback on the MIC's preferred contractual Access Regime principles.

3.6 The approach to open access was re-visited during the direct negotiations with SIMTA. In particular, in September 2014, the Shareholder Ministers were advised that DIRD's strong preference was for the MIT operator to develop an ACCC approved access undertaking given that:

- the Australian Government was making a significant monetary contribution to the project and therefore needed to ensure that all terminal users had access to the benefits of this public funding;
- there are currently no intermodal terminals in NSW that are regarded as truly open access; and
- there was a need to adequately regulate and ensure that terminal users are provided non-discriminatory access to onsite warehousing. Ministers were advised that warehousing is the most commercial aspect of the project and the merged precinct design proposed by SIMTA provided for a significantly greater warehousing capacity than was originally envisaged.

3.7 During the MIC and SIMTA negotiations period, DIRD noted that there was a risk that SIMTA's negotiating capital may increase to the extent that it threatens to 'walk away' if the Commonwealth does not agree that a negotiated outcome would meet policy objectives. In September 2014, MIC conveyed to DIRD that this risk was likely to occur if the departments continued to advise against a contractual regime. Then, in early October 2014, Aurizon confirmed that SIMTA would 'walk away' from the project if an ACCC approved access undertaking was imposed.

3.8 Also in early October 2014, the Shareholder Ministers wrote to MIC to reiterate the importance of the Government objectives and to outline the features the Ministers considered were 'non-negotiable'. Included in these features was the open and non-discriminatory access outcome that was intended to apply to all aspects of the development. The correspondence also drew MIC's attention to a 'light-handed' access undertaking that would allay MIC's concern regarding the imposition of monopoly price regulation while also providing assurance to terminal users in regards to SIMTA's market power arising from the joint venture with MIC. This approach would have included independent monitoring by the ACCC, which had recommended the arrangement to the Shareholder Ministers' departments as an alternative to the Part IIIA approach.

3.9 On 14 October 2014, senior SIMTA staff made direct contact with each of the Shareholder Ministers' offices to arrange meetings to discuss 'issues raised by the ACCC concerning the Moorebank Intermodal Facility'. These meetings took place in late October (separately, but on the same day) and did not include DIRD, Finance or MIC representation. SIMTA's planned 'primary messaging' (as it advised MIC)³⁹ for the meetings were as follows:

- SIMTA, being Qube and Aurizon, consider any ACCC intervention or oversight completely unnecessary.
- The Moorebank terminals, both IMEX and Interstate, will be adding very significant competition and capacity to the market and themselves will face extensive competition from road freight, and the terminals at Enfield and Chullora.
- This is a clear case of regulatory overreach which should not be entertained by the shareholder departments.

3.10 MIC provided SIMTA with the consent required under the Procurement Process Deed for these meetings on 15 October 2014 and the meetings between SIMTA and the Shareholder Ministers' offices took place on 28 October 2014.

Are the key elements of the open access regime now in place?

The open access arrangements have been agreed at a framework level. Most of the key detailed documents that are required to complete and operationalise the regime have yet to be developed.

3.11 Negotiations resulted in an 'Open Access Regime' (OAR) being set out within a schedule to the Development and Operations Deed (DOD) signed by MIC and SIMTA. There are separate but similar OARs for the IMEX and interstate terminals. A separate schedule, the 'Open Access Reporting and Compliance Regime' (Compliance Regime), also forms part of the DOD.

3.12 The stated purpose of the OAR is to provide a framework that facilitates the following policy objectives:

- i. providing Third Party Operators open and non-discriminatory access to the terminal[s] in accordance with the open and non-discriminatory access obligations; and
- ii. allowing Precinct Developer Co, to operate, through the appointment of an Approved Operator[s], the terminal[s] in accordance with its commercial and operational judgment so as to promote efficiency, productivity and volume through the terminal[s].

3.13 Some of the terminology used within the OAR is subjective and open for interpretation. Specifically, no additional advice or guidance has been included to assist with determining whether discrimination is 'unreasonable', 'materially detrimental to competition' or to the 'competitive detriment' of third party operators (or who is responsible for determining that). In addition to being difficult to interpret and apply in practice, the onus is on MIC, or a complainant, to prove that the discrimination is unreasonable and materially detrimental to competition.

39 SIMTA emailed this advice to MIC on 14 October 2014.

Documentation not yet developed

3.14 The OAR framework documentation is to guide the later drafting of more detailed and specific documentation. The responsibility for developing these documents rests with SIMTA. Specifically, there are 10 detailed documents that are not expected to be developed until around June 2018. Table 3.1 identifies which of these documents are to be subject to MIC approval (and the approval timeframes) as well as which are to be made publicly available.

3.15 MIC will have up to six months prior to the commencement of terminal operations to conclude consultation with potential access seekers (where required; Table 3.1 refers) and successfully negotiate the documents' contents with SIMTA. If an extension to that timeframe is required due a dispute resolution process, this could result in documents not being finalised in time for the commencement of operations. In these circumstances, PDC will either:

- implement the documentation as originally submitted by SIMTA, pending the outcome of the dispute resolution process; or
- where consultation with potential access seekers has taken place, and MIC and SIMTA cannot agree the changes that have been made as a result of that consultation, PDC will implement the documentation that was initially approved prior to the commencement of the consultation process, pending the outcome of the dispute resolution process.

Access protocol

3.16 The Access Protocol will be a particularly important document in ensuring that access seekers are treated fairly.⁴⁰ For that reason, in November 2014, MIC sought an oversight role so that it could ensure that the protocol remained consistent with the project's open access and non-discrimination objective.

3.17 In practice, the oversight role that MIC secured through the June 2015 OAR provides MIC with a limited role in the development of the protocol. Its role is to involve:

- reviewing the initial protocol developed by SIMTA within the six week review period, requesting amendments where relevant;
- granting final approval where agreement can be reached (otherwise, matters of disagreement can be referred for dispute resolution);
- consulting with 'access seekers' and 'potential access seekers'⁴¹ after the final protocol has been approved (with the result that this feedback may be incorporated into the protocol). Other stakeholders with an interest in the protocol (such as the Shareholder Ministers' departments) are not identified as being parties that can be consulted; and
- negotiating in good faith with SIMTA anything arising from consultation submissions (noting that where agreement to changes cannot be agreed, the matter can be referred to dispute resolution).

40 The Access Protocol will set out the: reference services available at the terminal; procedures for submitting, assessing, negotiating and finalising access applications; capacity allocation process; confidentiality obligations; matters that can be raised with or investigated by MIC regarding compliance; public reporting requirements; and process for resolving disputes.

41 Access Seekers are third party operators or associated operators seeking to access reference services. An Associated Operator is defined as an entity related to PDC which provides rail or truck transport services.

Table 3.1: Open Access Regime documentation that has not yet been developed

Name of document	Consultation with access seekers and potential access seekers?	Number of months submission is due before operations commence	Time allowed for MIC review	Leeway to finalise document ^a	MIC approval rights?	Publicly available
Access Protocol (AP)	Yes	6 months	6 weeks	4.5 weeks	Yes	Yes
Capacity Allocation Protocol	Yes	6 months	6 weeks	4.5 weeks	Yes	Yes
Confidentiality Mechanism	Yes	6 months	6 weeks	4.5 weeks	Yes	Yes
MIC – Dispute Resolution Mechanism	Yes	6 months	6 weeks	4.5 weeks	Yes	Yes
Reference Pricing Protocol	No	N/A – not required to be submitted	N/A – not required to be submitted	N/A – not required to be submitted	No	Yes
Non-standard Reference Pricing Protocol	No	3 months	8 weeks	1 month	Yes	No
Terminal Operating Protocol	Yes	6 months	6 weeks	6 weeks	Yes ^b	Yes
Cost Allocation Methodology	N/A	6 months	8 weeks	4 months	Yes	No
Precinct Developer Co – Complaints and Dispute Resolution	Yes	6 months	6 weeks	4.5 weeks	Yes	No
Standard Customer Contract	No	N/A – not required to be submitted	N/A – not required to be submitted	N/A – not required to be submitted	N/A – not required to be submitted	Yes

Note a: This is provided that no matters of disagreement are referred for dispute resolution.

Note b: MIC does not have approval rights over subsequent amendments made to Terminal Operating Protocol, but PDC cannot make changes that are ‘inconsistent’ with the open and non-discriminatory access obligations. MIC can refer amendments for dispute resolution if the changes are considered not to be consistent with the obligations.

Source: ANAO analysis of the OAR and Compliance Regime.

Is the open access regime comprehensive in its coverage?

The open access arrangements apply to the IMEX and interstate terminals, but not the warehousing component of the Moorebank precinct. MIC's approach to the market did not seek to include warehousing in the coverage of the open access arrangements. Only some parts of the open access regime apply to the port shuttle service between Port Botany and the terminal precinct, and internal transfers within the terminal precinct. These two partial exclusions are inconsistent with the coverage envisaged in the approach to the market, but reflect the result of the direct negotiations process.

Terminal services

3.18 The EoI outlined that the OAR was to apply to all of the terminal services provided by the successful proponent. The EoI defined terminal services to be covered by the OAR as including the following (either individually or in combination):

- a) rail transportation of containers between the Moorebank Intermodal Terminal, Port Botany and other locations (i.e. haulage services to the extent to which access can be obtained to the below rail service);
- b) provision of rail access to the Moorebank Intermodal Terminal for train services provided by others;
- c) management of trains on railway lines and sidings within the Moorebank Intermodal Terminal (including the movement of trains, shunting and attaching or detaching rolling stock);
- d) train loading and unloading (including access to specialised equipment, as required);
- e) transfer of containers between loading/unloading facilities and storage areas;
- f) container storage;
- g) truck management (including turnaround times); and
- h) ancillary administrative and customer interface services.

3.19 The OAR implemented through the contractual arrangements applies to reference and ancillary services at the IMEX and Interstate terminals. Reference services include: rail terminal access service; rail terminal loading and unloading service; and truck terminal access service. An ancillary service is a non-reference terminal service that is to be provided at commercially determined prices subject to available capacity.

3.20 The open and non-discriminatory access obligations of the OAR regime mean that (subject to the terms, access and operating arrangements of the OAR and having regard to capacity constraints) the approved operator must:

- permit access at the terminal for third party operators;
- not unreasonably discriminate against third party operators to their competitive detriment in favour of an operator associated with PDC in providing reference or ancillary services; and
- offer to provide access in relation to reference services on transparent and published terms and conditions and in accordance with published reference prices.

3.21 Services that are not considered reference or ancillary services include the: port shuttle service, transport of containers to or from the terminal (including by internal transfer vehicle), and refuelling services. The regime requires that, where refueling services are made available to Associated Operators, that refueling is also made available to Third Party Operators at the same published price.

3.22 The non-discrimination principle of the OAR does not apply to the port shuttle or internal transfer vehicle (ITV) services.⁴² This is at odds with the EoI which identified that the access regime would apply to the rail transportation of containers between the terminal and Port Botany⁴³ as well as the transfer of containers between loading/unloading facilities and storage areas. Instead, the OAR requires:

- spare capacity on the port shuttle⁴⁴ to be made available to potential users at a price which either recovers 'efficient costs'⁴⁵ and includes a commercial return, or is competitive with a road transport alternative. These pricing conditions apply until a competitor third-party port shuttle service alternative is operational; and
- in circumstances where PDC chooses to make an ITV service available to a Precinct Customer who is deciding between the services of a Third Party Operator or an Associated Operator, PDC must offer the same standalone price for the ITV service to the Precinct Customer regardless of which operator they choose to transport containers to or from the precinct.⁴⁶ Even if there is available capacity, there is no requirement that PDC must offer these services to the Precinct Customer.

Warehousing

3.23 The availability of onsite warehousing at the MIT is expected to improve logistics efficiency by eliminating additional road/truck movements from the terminal. Under the contractual arrangements, an additional warehousing footprint of approximately 580 000m² has been made available to SIMTA (as compared with the footprint anticipated by SIMTA in its original IMEX-only project on its own freehold land).

3.24 The EoI did not propose that the OAR apply to warehousing. SIMTA's EOI response from February 2014 outlined that:

42 The terminal design includes internal transfer roads throughout the precinct to facilitate the transport of containers by ITV between terminals or to onsite warehousing.

43 MIC records outline that the reason it had proposed that the port shuttle be a reference service reflected its assessment that 'It is likely that Qube will be the only port shuttle operator for some time and, in these circumstances, if prospective terminal users cannot get access to the port shuttle they will not be able to get access to the terminal'. This advice was provided to the MIC Board.

44 In this respect, MIC advised the ANAO in September 2017, that 'the planning approval conditions imposed by NSW Department of Planning and Environment in respect of rolling stock servicing the Moorebank terminals will, at least in the short term, limit the port shuttle to those operators that can comply [with the conditions of the approval]'.

45 The OAR does not define this term.

46 The OAR defines a Precinct Customer as a user of warehouse facilities in the precinct. An Associated Operator is a related entity of PDC which provides rail or truck transport services, and a Third Party Operator is a truck and rail operator that is not an Associated Operator.

- sufficient warehousing and cross docking facilities will be essential to support and enhance the terminal's rail based transportation service for both the IMEX and Inter/Intrastate Terminals;
- SIMTA's modelling shows that warehousing services for forwarding and distributing products are very important to the success of the project;
- effective linkages between the intermodal terminals and warehousing within the precinct will be the key to offering a highly efficient, integrated warehousing solution for freight customers to drive modal shift for their logistics operations more effectively than competing road based freight solutions; and
- the appetite in the market well exceeds the supply currently available for premium warehousing product. The amount of warehouse stock unlocked through the integrated precinct approach will only partly satisfy the extent of demand currently in the market.

3.25 During the course of negotiations, the Shareholder Ministers' departments raised concerns about warehousing not being included in the OAR. The contracted outcome was that there are no open access obligations in relation to warehousing. MIC advised the ANAO in August 2017 that:

[t]he regime was designed as a traditional access regime, with a focus on access to the terminal. Throughout the negotiations, it was very clear that SIMTA is very focussed on developing the warehousing. The companies that will be interested in using the warehousing will be sophisticated entities who will be able to negotiate effectively with SIMTA, including in relation to ongoing arrangements following making the initial investment. MIC was more concerned to ensure that access to the terminal was provided fairly to all parties seeking access regardless of whether or not they were using warehousing provided by SIMTA.

Is an effective compliance regime in place?

A compliance regime is in place. There are shortcomings in its design that can be expected to limit its effectiveness. For example, it does not include a graduated regime of financial penalties in response to non-compliance, as was the stated preference in the request for expressions of interest. In addition, a significant number of non-compliance events can occur before there are any consequences.

3.26 The request for expressions of interest issued by MIC informed potential respondents that:

The Successful Proponent will be required to make agreed payments to compensate for breaches of the Access Regime by the Successful Proponent. The amount of the payment required will vary depending on the nature and scale of the breach as well as the Successful Proponent's prior history of compliance under a performance regime (i.e. a minor initial infringement will attract a lesser payment than a more serious infringement which is part of a history of non-compliance).

3.27 Under the contractual arrangements that have been finalised, SIMTA is responsible for ensuring that the approved terminal operator complies with all aspects of the IMEX and Interstate Terminal OARs. The Open Access Reporting and Compliance Regime (Compliance Regime) outlines the consequences for failing to comply with the obligations of the OAR. MIC is responsible for monitoring and enforcing the Compliance Regime. The Compliance Regime adopts terminology that has not been defined, similar to that within the OAR (see paragraph 3.13).

3.28 There are two types of non-compliance; 'minor' and 'major'. Minor non-compliance relates to a breach of the obligations set out in the OAR. A major non-compliance relates to

systematic and repeated material non-compliances which can ultimately lead to a PDC Operational Event of Default.

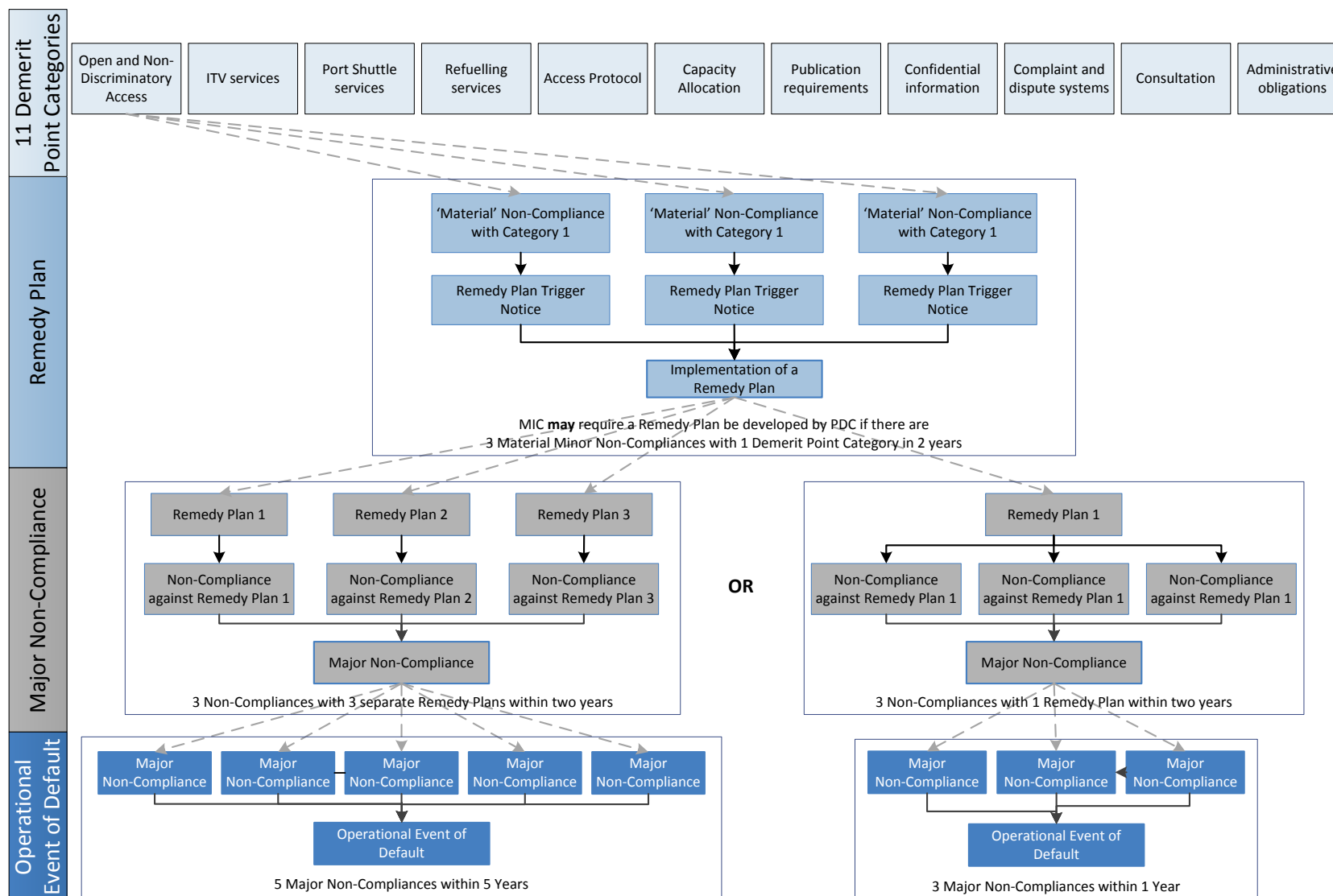
Minor non-compliance

3.29 Minor breaches of the OAR incur demerit points, which are accounted for under 11 categories of minor non-compliance (or 'demerit point categories', listed in Figure 3.1). There are three demerit point thresholds which impose increasing reporting and external audit requirements as each threshold is reached. The heaviest consequences involve the submission of monthly compliance and performance reports and quarterly external audits of compliance.

3.30 There are no financial penalties to be applied. This approach is inconsistent with the EoI documentation. Specifically, the Request for EoI outlined MIC's intention that financial penalties would be imposed for all non-compliance, with the amount to vary.

3.31 The quantum of demerit points accrued depends on which of the 11 categories of minor non-compliance is breached. Breaches and respective demerit points are set out in a 'Table of Demerit Points' in the Compliance Regime.

Figure 3.1: Major non-compliance scenarios



Source: ANAO analysis of the OARCR.

3.32 In January 2015, MIC calculated the number of breaches required to reach the first demerit point threshold (up to 11 in five years). This analysis was in respect to a draft of the regime. The scenario calculated by MIC involved breaches of a category for which the most demerit points would be incurred (that is, a category of higher importance). MIC noted:

The examples ... look at how hard it is to get to the first reporting threshold of 60 points. Based on these examples, I don't think we should agree to any change to the demerit point levels or the thresholds for extra reporting.

3.33 Subsequent amendments to the Compliance Regime were agreed.

3.34 The ANAO replicated MIC's analysis against the amended June 2015 Compliance Regime. This analysis identified that up to 15 breaches can occur before reaching the first threshold, and up to 49 breaches can occur before reaching the third and final threshold (over five years). This range demonstrates the number of breaches that can occur when PDC 'self-identifies' instances of non-compliance. To qualify as a self-identified non-compliance, the breach must be reported before MIC issues a notice of suspected non-compliance. Table 3.2 sets out how many of these breaches are required to meet each threshold over five years.

Table 3.2: The number of 'self-identified' minor non-compliances against the open and non-discriminatory access obligation required to reach each threshold

Threshold	Number of 'Self-reported' non-compliances required to reach threshold				
	Year 1	Year 2	Year 3	Year 4	Year 5
1	6	8	10	13	16
2	12	16	21	28	33
3	18	24	32	42	50

Source: ANAO analysis.

Major non-compliance

3.35 There are two ways in which a finding of major non-compliance can be made against the approved terminal operator under the Compliance Regime, being:

- systematic repeated non-compliance within a single demerit point category; or
- non-compliance with the open and non-discriminatory access obligations of the OAR.

3.36 There are no penalties or consequences related to individual findings of major non-compliance, but if there are enough major non-compliances within a certain timeframe, a PDC Operational Event of Default can be triggered.

3.37 MIC may choose to issue a major non-compliance notice if:

- there is repeated (at least three within two years) 'material'⁴⁷ minor non-compliances against a single demerit point category;
- a Remedy Plan is implemented (Remedy Plans are only required if MIC chooses to request that one be developed by way of a Remedy Plan Trigger Notice); and

⁴⁷ The term 'material' is not defined in the Compliance Regime.

- the Approved Operator of the terminal repeatedly fails to comply with that Remedy Plan (this process is illustrated in Figure 3.1). In this regard there are only two scenarios for declaring major non-compliances:
 - three non-compliances against three separate Remedy Plans within two years; or
 - three non-compliances against the same Remedy Plan within two years.

3.38 This restrictive design excludes other non-compliance scenarios, such as three non-compliances against two separate Remedy Plans. It also requires the non-compliances to be considered ‘materially’ detrimental to competition. The number of material minor non-compliances that can occur before a PDC Operational Event of Default is triggered ranges between 18 and 60.

3.39 Alternatively, a major non-compliance notice can be issued for non-compliance with the open and non-discriminatory access obligations of the OAR provided that such non-compliance:

- is ‘material’ having regard to the policy objectives in the OAR and that the non-compliance is ‘unreasonable’ and ‘materially detrimental’ to competition for the transport of containerized freight;
- was not caused by or materially contributed to by the customer; and
- was not outside of the Approved Operator’s control, providing all reasonable steps to minimize the occurrence of the non-compliance have been taken.

3.40 MIC must first issue a draft Major Non-Compliance Notice to PDC and the Approved Operator and provide reasonable opportunity for responses to be submitted to MIC outlining why the notice should not be issued. MIC may then issue a Major Non-Compliance Notice or may exercise discretion to not issue the notice if the non-compliance is resolved in a timely manner. If a notice is not issued the non-compliance is considered to be a minor non-compliance for which demerit points will be accrued and a Remedy Plan Trigger Notice may be issued. In the event that a notice is issued, a PDC Operational Event of Default is triggered where:

- three Major Non-Compliance Notices are issued with a period of one year; or
- five Major Non-Compliance Notices are issued with a period of five years.

Pricing and Revenues

3.41 During negotiations SIMTA expressed a strong opposition to the publication of prices, other than reference services, on the grounds that it would place them at a competitive disadvantage. The only prices required to be published under the OAR are reference and refueling prices. This means that non-standard reference pricing principles, and prices for ancillary, port shuttle, and ITV services are not made publicly available. This differs to the more comprehensive approach anticipated by MIC for pricing matters. Specifically, Request for EoI documents stated that:

- prices for Terminal Services⁴⁸ must be published on the Successful Proponent’s website; and

48 Terminal Services included the port shuttle and ITV.

- the complaints mechanism for Third Party Operators and Access Seekers was to encompass the port shuttle and ITV services.

3.42 In this latter respect, the final OAR does not provide customers with the right to dispute pricing. Complaints may be referred to MIC regarding the pricing of reference and ancillary services in relation to compliance with the non-discrimination principle. But, there is no avenue to dispute or raise a complaint regarding the pricing of the shuttle service or internal transfer vehicle services as the non-discrimination principle does not apply to these services. Similarly, there is no avenue to address warehouse pricing as this service is not captured by the OAR. MIC advised the ANAO in September 2017 that:

It was not considered appropriate nor desirable to include warehousing in the OAR, noting that the warehousing will be developed by private sector tenants under commercial agreements for lease, with SIMTA paying ground rent for 99 years to Precinct Land Trust. To extend the OAR to the warehouse space is not appropriate and would be near impossible to monitor and enforce.

3.43 The contractual arrangements also allow SIMTA to use multi-part pricing and price discrimination to encourage volume and efficient utilization of the terminal. The inclusion of this clause provides the opportunity for the Terminal Operator to enter long term contracts for reference services in favour of associated customers, thereby reducing or eliminating the opportunity for third party customers to access the terminal. In response to ANAO's September 2017 request to advise how this risk is managed, MIC advised that:

Both Qube and any competitors will be constrained by the road price of moving a container from the port to Moorebank. Noting the underlying economics of road and rail over short distances, MIC considers it very unlikely that rail will earn significant margins given it must match road prices (after taking into account any quality differences in the services). While we note that the OAR is not intended to set prices and there is no right to dispute prices for terminal services in the dispute resolution process, clause 2.2 of the OAR prohibits hindering access. A breach of the OAR has consequences for SIMTA under the transaction documents, with termination being the ultimate sanction.

3.44 The OAR includes a clause for the recovery of accrued early losses. This is on the basis that at the commencement of operations, there will not be sufficient demand or volume to recover costs or to achieve a commercial return.⁴⁹ In order to encourage demand and volume, the regime is designed to allow PDC to set reference prices at a level below that required to fully recover costs, or to achieve a commercial return.

49 The term 'commercial return' is not defined under the OAR.

How is oversight of open access and other oversight responsibilities to be resourced?

MIC is contractually responsible for monitoring and enforcing adherence to the open access arrangements over the 99-year term of the leases. There are also other ongoing oversight responsibilities, including in relation to the capacity expansion arrangements. The resources required to undertake ongoing oversight have not yet been quantified.

3.45 MIC's responsibilities to date have focused on managing the procurement and negotiations to contract for the delivery of the MIT.

3.46 The contractual arrangements mean there will be a longer term oversight and enforcement role (the lease arrangement is for 99 years) in relation to the OAR as well as, for example, the capacity expansion provisions. The ANAO queried whether MIC has quantified and costed the resources that are expected to be required to discharge the Australian Government's ongoing oversight role under the contractual arrangements. MIC advised that this:

has not been costed in any detail. However, MIC envisaged and discussed with its shareholder departments that long term oversight could be transferred to another government entity following the divestment of MIC's subsidiaries. No decision needs to be made at this stage.

4. Supporting the achievement of policy objectives

Areas examined

The ANAO examined whether the project's governance framework supports achievement of the Australian Government's policy objectives, including the planned future privatisation process.

Conclusion

Clear policy objectives were established for the project. The contractual arrangements support the achievement of all or part of each of those objectives. This includes providing a level of assurance that a commercially viable intermodal precinct will be constructed and operated, and future privatisation will be able to occur.

Were the Australian Government's policy objectives clearly identified?

The Australian Government's policy objectives for the Moorebank Intermodal Terminal were clearly identified, including by MIC in its approach to the market.

4.1 MIC's constitution sets out the objectives for the company which incorporate the broad objectives for the project, as follows:

- To facilitate the development of an intermodal freight terminal at Moorebank including an import/export facility, interstate freight terminal capable of catering for 1,800 metre trains and ancillary facilities by optimising private sector investment and innovation in the development, construction and operation of the intermodal terminal.
- To facilitate the operation of a flexible and commercially viable common user facility which shall be available on reasonably comparable terms to all rail operators and other terminal users.
- To ensure the intermodal terminal operates with the aim of improving national productivity through an efficient supply chain, increased freight capacity and better rail utilisation.
- To operate on commercially sound principles having regard to the Commonwealth's long-term intention to sell its interest in MIC.
- Upon notification by the Commonwealth Shareholder, provide assistance as required to facilitate a sale of the Commonwealth's interest in MIC.

4.2 Similar project objectives were articulated by MIC when it approached the market in 2013 for registrations of interest for a private sector party to work with it to develop and operate the intermodal terminal.⁵⁰ The contractual framework also recognised these objectives.

50 The last corporate objective was not included in the EoI documentation.

Do the contractual arrangements facilitate the development of an intermodal freight precinct at Moorebank?

The contractual arrangements provide for the private sector to construct and operate the intermodal freight terminals and associated warehousing at Moorebank. Specifically, SIMTA has a contractual obligation to build both an import-export terminal and an interstate terminal, each with an initial capacity of up to 250 000 Twenty-foot Equivalent Units (TEU) per annum. The contracts define the ultimate capacities for the IMEX and interstate terminals as 1.1 million and 500 000 TEU per annum respectively. Expansion of the terminals to meet the ultimate capacities is set out within a heavily conditioned contractual regime, involving expansion following certain market demand signals. There is less certainty over the development timeframe for warehousing. This uncertainty is partially mitigated by warehouse ground rental payments being linked to the passage of time and MIC's expectation that warehousing will be highly profitable for PDC (warehousing is not subject to the Open Access Regime).

4.3 The contractual arrangements entered into by MIC and SIMTA provide reasonable assurance for the delivery of the initial stages of each terminal; and options for increasing the capacity of the terminals to their ultimate capacities. The project's stages are defined within the 'Expansion Master Plan' (Exhibit 6 to the Development and Operations Deed, or DOD). This plan contains a conceptual level of detail and was initially agreed at contractual close in June 2015. SIMTA may revise this plan from time to time with MIC's approval.⁵¹ The deliverables of each stage are outlined by Table 4.1.

Table 4.1: Expansion Master Plan terminal delivery stages

Stage	IMEX terminal	Interstate terminal
1 ^a	Stage 1 of the IMEX Terminal Expansion Master Plan includes the part construction of the IMEX terminal and Rail Access.	Stage 1 of the Interstate Terminal Expansion Master Plan includes the construction of: <ul style="list-style-type: none"> the interstate terminal, accommodated within approximately 17 hectares; and rail storage and marshalling tracks to accommodate 1 800 metre total train length.
2 ^a	Stage 2 includes the operation of Stage 1. It is anticipated that Stage 2 would have a throughput ultimate capacity of 250 000 TEU per annum and would be accommodated within the ultimate IMEX terminal area of approximately 18 hectares.	Stage 2 includes the operation of the interstate terminal with an expected ultimate capacity of 250 000 TEU throughput per annum.
3	Stage 3 includes the extension of the IMEX terminal accommodated within approximately 18 hectares.	Stage 3 includes the refurbishment of the interstate terminal, accommodated within approximately 17 hectares. The operations of the interstate terminal will progressively expand with an expected ultimate capacity of 500 000 TEU throughput per annum.

⁵¹ Such approval is 'not to be unreasonably withheld' by MIC.

Stage	IMEX terminal	Interstate terminal
4	Stage 4 includes the operation of the IMEX terminal extension with an expected ultimate capacity of 500 000 TEU throughput per annum. It is envisaged that Stage 2 would maintain operations until such time as Stage 2 requires refurbishment.	N/A
5	Stage 5 includes the refurbishment of Stage 1 of the IMEX terminal accommodated within approximately 18 hectares.	N/A
6	Stage 6 includes the operation of the ultimate IMEX terminal to its ultimate capacity of 1.1 million TEU throughput per annum.	N/A

Note a: The delivery of these stages is a contractual requirement under the DOD entered into by MIC and SIMTA. The remaining stages are to be delivered if and when certain capacity expansion triggers have been met.

Source: ANAO representation of MIC records.

4.4 SIMTA is to 'use its best endeavours' to deliver Stages 1 (for the IMEX terminal) and 2 (for the interstate terminal) by the target dates for completion defined by the DOD. These dates represent the anticipated time required to complete detailed design, construction and commissioning of the respective terminals. Specifically, these dates are:

- two years from when financial close was achieved for completion of the first stage of the IMEX terminal; and
- four years from when financial close was achieved for the completion of the second stage of the interstate terminal.

4.5 Each of these target completion dates also represent the dates on which the payments for ground rent must commence for the respective terminal land. Failure to develop the terminals by the relevant completion dates is an event of default by Precinct Developer Co (PDC, a wholly owned SIMTA/Qube subsidiary), which triggers a cure plan. The completion dates are immediately followed by a further two-year 'sunset' period. If the breach remains uncured and PDC fails to complete the development of a terminal by the relevant sunset date, this may lead to a termination event. Figure 4.1 illustrates the sequencing of these dates.

4.6 In addition to these obligations, under the DOD, PDC provided a warranty that Qube, Aurizon or their related parties will transfer a specified amount of their current intrastate freight volumes to the Moorebank interstate terminal.

4.7 MIC's financial model forecasts (finalised in March 2015) anticipate the interstate terminal volume will reach 120 000 TEU in its first year of operation. MIC advised the ANAO in October 2017 that, of the 120 000 TEU:

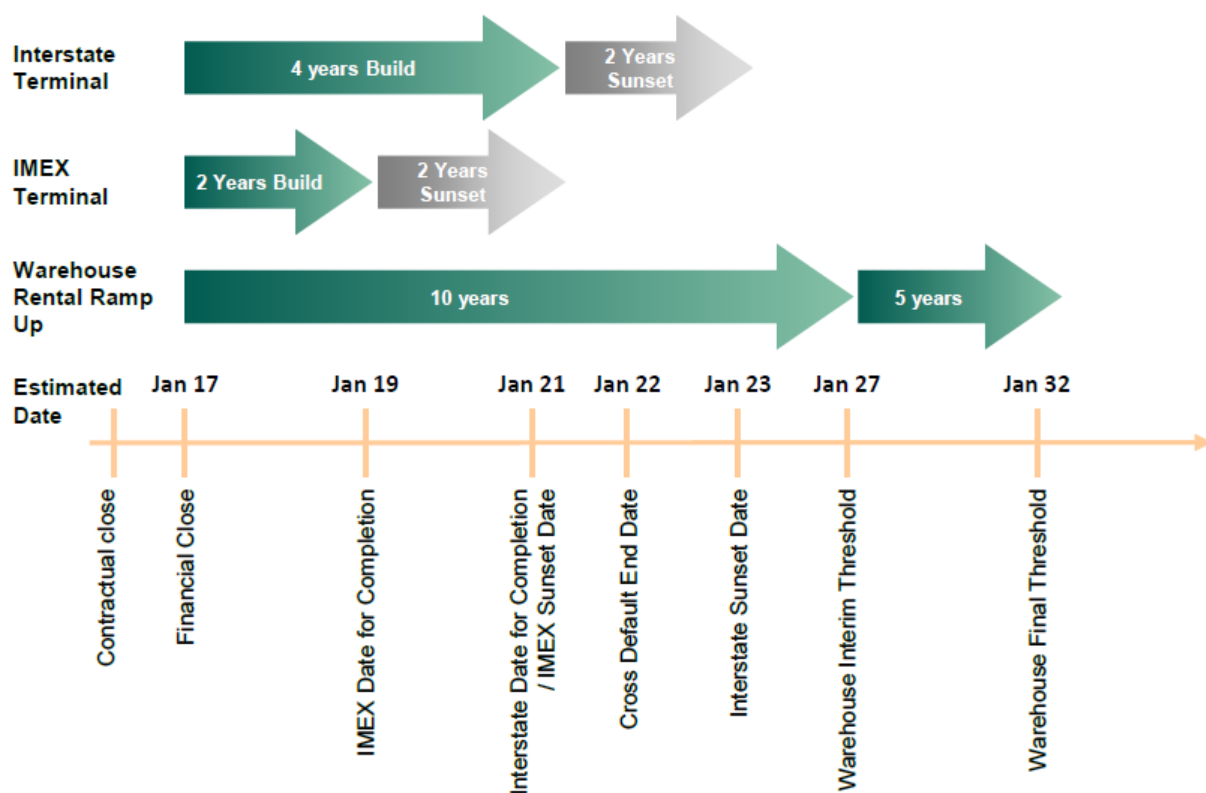
80,000 is likely to be source [sic] from transfer of Qube's "Regional Volume", and 40,000 TEU was transfer [sic] of "Aurizon Existing Volume".

4.8 In July 2016, MIC was advised of Aurizon’s intention to sell its shares in SIMTA to Qube.⁵² Given Aurizon’s proposed exit from the arrangements, MIC held concerns about the surety of the interstate container throughput volumes it had secured via the PDC warranty. It therefore sought a direct warranty from Qube for the transfer of this freight. This is because there was no specific remedy available to MIC if PDC did not meet its warranty. MIC was unable to secure the commitment it sought. In this context, the ANAO sought advice from MIC as to whether it plans to enforce the warranty provided within the DOD. MIC confirmed in October 2017 that it ‘intends to enforce the contractual provision in respect of Qube in clause 20.5(b)(2)(B) upon completion of the Interstate Terminal.’

4.9 The completion and sunset dates can be extended in specified circumstances. Where termination occurs, a termination payment would need to be made by the Australian Government. In terms of how it monitors completion of project milestones such as planning approvals and construction activities relating to the project, in August 2017 MIC advised the ANAO that:

MIC undertakes only limited tracking of progress as time is PDC’s risk under the terms of the DOD, subject to any limited ‘Relief Events’ entitling an extension to the ‘Sunset Dates’.

Figure 4.1: Project timeline and sunset dates



Source: DIRD records.

⁵² This exit took effect in January 2017 with Aurizon selling its shares in SIMTA to Qube.

Terminal capacity expansion

4.10 The contracted ultimate capacity of the IMEX terminal is 1.1 million TEU per annum⁵³, and the interstate terminal 500 000 TEU per annum with a capability of accommodating 1 800 metre long trains.

4.11 Development of the terminals from their initial contracted capacities to their potential ultimate capacities (see Table 4.1) is governed by a heavily conditioned Capacity Expansion Regime. This regime:

- is based on the agreed expansion master plan and demand-driven capacity expansion triggers (rather than fixed dates). Capacity expansion is only triggered where:
 - there has been a bona fide request for access which has been refused on the basis of insufficient available capacity; or
 - utilisation exceeds 90 per cent of capacity on an annualised basis; and
- provides that capacity is not required to be expanded in a number of circumstances, including when:
 - the anticipated incremental revenue from expansion is insufficient to cover the incremental cost of expansion plus a ‘reasonable commercial return’;
 - insufficient rail and port interface capacity is available; or
 - the costs of expansion are unable to be financed at a ‘commercially acceptable rate’.

4.12 The Capacity Expansion Regime was agreed by MIC and SIMTA in all material aspects at the Term Sheet stage in November 2014. The design of the regime has resulted in the ultimate decision to expand the terminals’ capacities resting with SIMTA (through PDC). Advice provided to the Shareholder Minister’s departments indicated that a number of the conditions⁵⁴ required to trigger future expansions of the terminals’ capacities are designed such that if PDC prefers not to pursue expansion, that it would likely be able to manufacture a reason not to do so.

4.13 Nevertheless, the departments’ advisers subsequently concluded that SIMTA is likely to be economically incentivised to expand the terminals, provided there is sufficient available demand. This is because SIMTA is entitled to all of the related profits, with the exception of a small increase in the revenue paid to MIC via its interest in the Land Trust. This increase is linked to the annualised throughput at each terminal.

Southern Sydney Freight Line capacity constraints

4.14 Included among the factors that could impact the future expansion of the MIT is the capacity of the Southern Sydney Freight Line (SSFL). MIC’s direct negotiations with SIMTA were informed by the results from an assessment of the SSFL capacity in July 2014. With specific regard to the capacity sought for the MIT, the report advised that the:

53 According to the NSW Planning Assessment Commission concept approvals for the project (granted between September 2014 and June 2016), the ultimate capacity of the IMEX terminal is less, at 1.05 million TEU.

54 For example, conditions related to the availability of competitive financing or there being an appropriate economic return.

- SSFL, at that time, had the capacity to accommodate an additional 493 000 TEU up to about 2021;
- addition of a passing loop at Warwick Farm and the extension of an existing loop at Leightonfield would increase the capacity to 1.046 million TEU up to about 2024⁵⁵; and
- Inland Rail line between Melbourne and Brisbane has the potential to release capacity of up to eight train paths per day in each direction. If the MIT was able to utilise this capacity it would provide an additional 400 000 TEU (approximately) beyond 2024.

4.15 This assessment was undertaken prior to Pacific National's announcement (in 2015) that it would double its Chullora terminal capacity from 300 000 to 600 000 TEU. This is significant because the Chullora terminal is also situated along the SSFL and will compete for train paths with the MIT.

4.16 Subsequent to contractual close, in October 2015 the ARTC produced its *2015–2024 Sydney Metropolitan Freight Strategy*. The ARTC strategy was based on MIT throughputs of 1.05 million TEU of IMEX freight and 500 000 TEU of interstate freight per annum, and the expansion of Chullora from 300 000 to 600 000 TEU per annum. The ARTC's strategy concluded that a number of projects would be required to be undertaken to increase the capacity of the rail network to accommodate this and other expected increases to rail traffic. This means that additional Australian Government expenditure will be required (specifically, for the passing loop at Warwick Farm) for the MIT to achieve the full extent of the outcomes envisaged by the 2012 MIT business case.

Warehousing

4.17 The contractual framework does not prescribe any target dates for the development of warehousing. Rather, the development of warehousing is at the discretion of PDC, with an expectation that this will be principally driven by demand for warehousing facilities. MIC's financial modelling for the precinct indicates that it expects warehousing operations to be highly profitable (warehousing is not subject to the Open Access Regime).

4.18 The land identified within the Precinct Master Plan for warehousing has been divided into 10 lots.⁵⁶ Under the contractual arrangements, PDC can access these lots under a licencing arrangement with the Land Trust. Upon completion of construction of the warehousing, a rent holiday period commences for that particular lot. PDC is to commence paying ground rent at the end of that holiday period.

4.19 While there are strong commercial incentives to the contrary (that is, the potential profitability of the warehousing development), there is a risk that PDC could choose not to access any of the lots allocated for warehousing. This would result in no ground rent being earned for some 150 hectares of the warehouse land within the precinct. To mitigate this risk to some extent, the contractual arrangements require that PDC commences paying ground rent as follows:

55 This represents the maximum capacity of the SSFL without further considerable cost and significant land resumption.

56 The DOD allows for subdivision of the original 10 lots, with a maximum of another four lots able to be created.

- ten years from the date of financial close, PDC must commence paying ground rent on 50 per cent of the warehousing land (unless it has developed more than 50 per cent, in which case it must pay ground rent on that actual amount); and
- fifteen years from the date of financial close, PDC must commence paying ground rent on 100 per cent of the warehousing land.

4.20 MIC advised the ANAO in September 2017 that '[t]hese provisions were intended to cap MIC's exposure to demand risk, which is reflected in the pace of warehouse development'. The ANAO notes that the provisions, once enacted, may also incentivise SIMTA to develop the land on which it is already paying rent.

4.21 Until the threshold 15 years from financial close, PDC's warehousing development rights are 'at risk', and unexercised warehousing development rights are forfeited upon a termination.⁵⁷ After year 15, the warehousing development rights do not terminate, provided that PDC continues to pay the ground rent.

Will the contractual arrangements facilitate operation and use of the terminals?

The contractual arrangements enable the operation of flexible and commercially viable intermodal terminals. Until the open access arrangements are completed and shown to be operating effectively, it is not possible to provide assurance that the MIT is available on reasonably comparable terms to all rail operators and other terminal users and, as a consequence, that the desired national productivity benefits of the project will be realised.

4.22 The contractual arrangements, and the ANAO's analysis of financial modelling for the MIT, support a conclusion that the project is commercially viable. The contractual arrangements also provided flexibility in terms of the pace with which the intermodal precinct is developed having regard to demand and other factors.

4.23 Figure 4.2⁵⁸ illustrates the revenues (and anticipated costs for PDC) predicted by MIC's financial model (as at contractual close).

⁵⁷ SIMTA's pre-existing warehousing on its site is not forfeited upon a termination.

⁵⁸ In November 2017 SIMTA advised the ANAO that in respect to Figure 4.2, 'the projections do not reflect any model developed by SIMTA and do not reflect the forecast revenue of SIMTA in respect of the MIT'.

Figure 4.2: Forecast project revenue and net profit for MIC and PDC as at contractual close

Source: ANAO analysis of MIC records.

4.24 Whether the MIT is made available to all rail operators and other terminal users on reasonably comparable terms will depend to a significant extent on the implementation of the open access regime discussed in Chapter 3, and whether that regime is effective (both in its design and its administration). This will also impact significantly on the extent to which the MIT improves national productivity through an efficient supply chain, increased freight capacity and better rail utilisation.

Are arrangements in place to enable a future privatisation?

The transaction was structured in a way that will enable a privatisation process through the creation of predictable income streams. Such a process is not expected to take place for some years as advice to Finance is that sustainable positive cashflows are not expected for 15 years. There are contractual restrictions on the entities to which the Australian Government can divest its interests.

4.25 The contractual documentation separated MIC's oversight role from its commercial role. This was achieved by creating two trust vehicles owned by MIC. One trust (MIC's land trust) holds MIC's units in the (jointly-held) Land Trust and the other (MIC's rail trust) funds the rail spur construction, and is entitled to receive the Rail Access Charges through the Rail Access Deed. It was envisaged that a future privatisation could occur by:

- selling the units in the land trust and/or the rail trust;
- transferring MIC's ongoing oversight functions to another public sector entity; and
- abolishing MIC.

4.26 In June 2017, Finance and DIRD obtained advice on the likely optimal timing for a privatisation (15 years after financial close as a sustainable positive cash flow would not be visible earlier) as well as potential impacts on demand for a privatisation:

The Land Trust rental stream and Rail [Access] Charge should be reasonably predictable cashflows, particularly 15 years after Financial Close. Assuming that the market for real estate and infrastructure assets which exists today exists at the time of sale, then there should be a reasonable number of potential investors that could compete for the assets. However:

- The transaction structure creates a passive investment privatisation opportunity given the returns which are constrained, but reasonably predictable as outlined above. Accordingly, what can be privatised is a stable cash flow and not a business which could be subjected to value creative innovation by a purchaser. Accordingly, the potential purchasers will be passive real estate and infrastructure investors and not operators of businesses.⁵⁹
- The Land Trust units are held in a joint venture with SIMTA and this may limit the number of prospective purchasers, and hence constrain the sales price, if investors did not wish to be a passive investor alongside the operator. However, the asset is more likely to appeal to passive investors by its nature. The cashflows should be transparent and reasonably predictable allowing appropriate due diligence and assurance as to reliability. Accordingly if there is no capacity to “game” the returns, then potential purchasers should not be concerned about the co-investment with the operator. Finally, SIMTA might dispose of its interests in either the Land Trust or PDC, which would alter this balance.

4.27 There are also contingent liabilities embedded in the Rail Trust that may be unattractive to future buyers (these liabilities are outlined in Appendix 3).



Grant Hehir
Auditor-General

Canberra ACT
19 December 2017

59 In addition, the contractual documentation prevents MIC from selling its Land Trust units to a direct rival to Qube or Aurizon's Australian intermodal freight logistics or container freight logistics business (discussed in Appendix 2).

Appendices

Appendix 1 Entity responses



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8 December 2017

Mr Grant Hehir
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Australian National Audit Office
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Canberra ACT 2601

Dear Mr Hehir

ANAO Audit Report on the Delivery of the Moorebank Intermodal Terminal

Thank you for the opportunity to comment on the Australian National Audit Office's proposed report of the performance audit of the procurement of the Moorebank Intermodal Terminal, provided under section 19 of the *Auditor-General Act 1997*.

The objective of the audit was to assess whether the contractual arrangements that have been put in place for the delivery of the Moorebank Intermodal Terminal will provide value for money and achieve the Australian Government's policy objectives for the project. The ANAO adopted the following high-level criteria:

1. Does the transaction represent value for money?
2. Is non-discriminatory open access available?
3. Does the project governance framework support the achievement of the Government's objectives, including the planned privatisation?

This response, prepared by Moorebank Intermodal Company Ltd (MIC), considers first the Government's objectives, then comments on the audit's high-level criteria, and provides some concluding remarks. The reason we have taken this approach is because the ANAO appears to have not adequately understood this complex and unusual transaction and as a result has drawn several incorrect and misleading conclusions.

Commonwealth objectives

The Australian Government determined clear objectives for MIC, as set out in the company's constitution. These objectives guided MIC's procurement of the intermodal facility, along with other guidance provided by the ministers and their departments during the course of the procurement.

The objectives are set out below, along with commentary on their achievement.

To facilitate the development of an intermodal freight terminal at Moorebank, New South Wales including an import/export facility, interstate freight terminal capable of catering for 1,800 metre trains and ancillary facilities by optimising private sector investment and innovation in the development, construction and operation of the intermodal terminal.

The intermodal terminal is to be developed on the Commonwealth-owned land, formerly the site of the School of Military Engineering, and neighbouring land owned by Sydney Intermodal Terminal Alliance (SIMTA), combined to form an intermodal freight precinct of some 240 ha of developable land.

The precinct development is subject to an agreed master plan, comprising:

- an import-export (IMEX) terminal with an ultimate capacity of 1,100,000 TEU p.a.;
- an interstate and regional terminal with an ultimate capacity of 500,000 TEU p.a., capable of handling 1,800 metre long trains;
- approximately 850,000 sqm of warehousing; and
- other associated facilities.

The development will be constructed and operated by SIMTA, now a wholly-owned subsidiary of one of Australia's leading private sector logistics-specialist companies, Qube Holdings.

The IMEX terminal is expected to be operational by 2019. The interstate terminal is expected to be operational by 2021, some 10 years earlier than the Government's expectations in its original (2012) business case.

Optimising private sector investment has been achieved through SIMTA assuming most of the funding burden, with MIC's investment being limited to land owner's responsibilities and those aspects where government control or ownership has merit for policy or other reasons.^a

MIC will contribute a long term leasehold interest in the Commonwealth land and capital funding of about \$315 million (including contingency)¹. MIC will pay for contamination remediation of and other preparation works for the Commonwealth land, and contribute to the upgrade of Moorebank Avenue and some local road works, in return for which it will earn land rental. MIC will also pay for the construction of the rail connection between the terminal and Southern Sydney Freight Line, giving it ownership of most of the important spur line that enables entry to the terminals². SIMTA will pay MIC a fixed rate of return for that investment.^b

SIMTA will contribute its land and fund all other aspects of the terminal development. SIMTA's funding requirements are in the order of \$1.5 billion, made up of \$490 million for precinct enabling infrastructure and the below rail infrastructure for the IMEX and interstate terminals, \$180 million for operating equipment for the interstate and IMEX terminals, and about \$800 million for new warehousing.³

¹ The figure of \$370 million referenced elsewhere includes MIC's past and forecast corporate overheads (which were not a subject of the negotiation).

² MIC holds a first-ranking registered security interest over the section of the rail spur not owned by MIC.

³ The new warehousing is expected to be built on demand and with pre-commitments from tenants. There is a range of funding options for future warehousing development including third party funding, tenant funding, or Qube

- a. As outlined in Chapter 2 of the audit report, between the commencement of direct negotiations and the final contracted outcome, MIC agreed to arrangements that have increased the Australian Government's financial contributions and contingent liabilities (as compared with those proposed within the successful proponent's EoI).
- b. While MIC is paying for construction of the rail connection, it will not have full ownership (it will not own the component of the spur line that traverses the Glenfield Waste Site). MIC paying for the rail spur is inconsistent with SIMTA's EoI response and follow-up responses by SIMTA to questions from MIC during the EoI process.

To facilitate the operation of a flexible and commercially viable common user facility which shall be available on reasonably comparable terms to all rail operators and other terminal users.

Central to the transaction is a comprehensive, contractually enforceable open access regime intended to ensure the intermodal terminals are common user facilities, operated on a non-discriminatory basis.

The open access regime sets out the rules for reference and ancillary services, application processes, capacity allocation, pricing, cost allocation, complaints, disputes, and monitoring and enforcement. The regime includes requirements to publish reference prices, a standard customer contract, an access protocol and a terminal operating procedure.

The open access regime and its supporting compliance and reporting regime measure the terminal operator's performance and impose consequences for non-compliance. Ultimately, failure to adhere to the open access regime can lead to termination of the terminal operator.

Through consultation with the ACCC and expected access seekers, MIC tested the adequacy of the access regime. The regime also requires consultation with industry as the details of the access protocol and the terminal operating procedure are developed by SIMTA and approved by MIC.

The regime recognises that, while SIMTA will be operating within a highly competitive industry, it is a vertically integrated entity. A contractually enforceable access regime is the only way to achieve the Government's open access objective while also attracting private sector investment in development of the terminal initially and, in future, in the Government's sale of its commercial interest in the terminal. The Government has the ability to ensure the regime is enforced while MIC remains Government-owned and, after divestment, the access regime should be administered by an appropriate Commonwealth or State government entity with the skills and incentives to continue to enforce it. This future arrangement would be put in place prior to or concurrently with any privatisation of MIC.

To ensure the intermodal terminal operates with the aim of improving national productivity through an efficient supply chain, increased freight capacity and better rail utilisation.

The proposal adopts a whole-of-precinct approach that combines the Commonwealth site with the neighbouring SIMTA site. This approach provides greater opportunity for complementary warehousing development and for the introduction of new technological innovation including robots now being used in the logistics industry. The warehousing will drive terminal use and significantly enhance the facility's cost effectiveness compared to road, thus supporting higher throughput and greater rail utilisation. The facility is expected to drive significant cost reductions in the freight supply chain.

Co-locating the IMEX and interstate terminals will facilitate more efficient rail connectivity between regional areas and Port Botany, reducing costs for exporters and this offering greater export opportunity.

funding. The funding of future warehousing will be driven by tenant partnering considerations. Nevertheless, sourcing the funding is SIMTA's responsibility under the contractual arrangements. (Source: Qube AXS announcement 31 May 2017.)

To operate on commercially sound principles having regard to the Commonwealth's long-term intention to sell its interest in MIC

The factors outlined above underpin the commercial business case for the terminal, which increases the attractiveness of the asset and supports the Government's intention to divest its commercial interests in the terminal.

The transaction generates a relatively predictable, annuity-like revenue stream from ground rents and a capital charge on the rail access, which has a size, risk profile and degree of certainty that will be sought after by superannuation funds and infrastructure and real estate investors. This interest is apparent already through several enquiries from investor funds.

In order to maximise proceeds, the timing of such a sale would be driven by when cash flows to MIC have become relatively certain. An earlier sale would be possible but likely to raise materially less proceeds. Current expectations are that a sale in the early to mid 2020s may be optimal but faster warehousing take-up would bring this date forward. The sale is expected to enable the Commonwealth investment to be at least recouped at that time, if not bettered. The developing business of MIC has been structured to be an attractive investment opportunity for superannuation and other funds interested in stable cash returns as noted below.

Upon notification by the Commonwealth Shareholder, provide assistance as required to facilitate a sale of the Commonwealth's interest in MIC

The commercial and contractual structure, including MIC's two subsidiary trusts that receive the revenue streams, has been established specifically to facilitate a future sale of the Commonwealth's interest.

There is a delineation between MIC's ongoing monitoring and enforcement role (which will not be the subject of any sale) and MIC's passive revenue streams (which would be attractive to investors).

This landlord model avoids placing MIC in an operating joint venture with the developer-operator, thereby increasing the attractiveness of MIC's interest to a range of potential investors, in particular superannuation funds seeking reliable cash flows.

Following the Commonwealth's sale of its commercial interest, the ongoing rights and obligations of MIC under the contractual agreements would remain with the Government through a department or agency as deemed appropriate by the Government at that time.

ANAO's high-level criteria

1. Value for money

Underpinning the contractual arrangements is SIMTA's willingness to take the demand risk (i.e. the risk of the number of containers passing through the terminal) and to fund the majority of the investment required to develop the terminal. The Government's contribution is thus limited in both quantum and in the risk it faces.^c

The amount the Government is contributing is limited to the value of the land and a cash equity investment of up to \$370 million. MIC was very mindful that this was about \$1 billion less than the public sector comparator in the Government's detailed business case prepared in 2012.

c. See paragraph 2.50 and Appendix 3, paragraphs 1 to 10.

The detailed business case estimated Stage 1A IMEX nominal capital costs of \$804.3 million and Stage 2 Interstate nominal capital costs of \$534.7 million, totalling \$1,339 million. Stage 1B Warehousing costs were not included as it was not intended that the Commonwealth would construct the warehousing. (Following the completion of the detailed business case, the then Government agreed to provide \$877 million for the delivery of the first phase of the project, i.e. the IMEX terminal and associated infrastructure, and not the interstate terminal.) Under the MIC-SIMTA agreements (which includes the IMEX terminal, interstate terminal and warehousing), the Government's contribution is \$370 million, i.e. \$969 million less than the 2012 business case estimate.

Importantly, the Commonwealth faces only limited exposure to the consequences of uncertainty in the volumes of container throughput. Furthermore, the Commonwealth will earn a real return on its contribution over the longer term.

The contractual agreements include safeguards and mitigation of risks to returns, including for instance:

- agreed dates for completion trigger the payment of ground rent, making the terminal ground rent streams immune to delays in construction;
- if the warehousing development is slower than expected, sunset dates trigger the payment of ground rent across initially half and eventually all of the land earmarked for warehousing;
- a guaranteed return on the actual costs of the rail access; and
- a ground rent largely independent of throughput volumes.

Even though SIMTA is taking the bulk of the investment risk, it is obliged to develop and operate the intermodal terminal in accordance with contractual requirements that include development to an agreed master plan and program, and operation on principles of non-discrimination.

Taken together, these attributes represent good value for money while achieving the Commonwealth's stated objectives for the Moorebank intermodal terminal. ^d

Procurement

Following a period of market soundings during 2013 to test the private sector's interest in investing in the development of the terminal, MIC concluded that there was sufficient interest to test this formally with a request for expressions of interest.

This request in late 2013 sought far more than a traditional capacity and capability statement from respondents. It also asked specific and detailed questions about respondents' willingness to take demand risk, invest their own funds, adopt MIC's open access framework, and accept preferred risk allocation (amongst other things). It asked for respondents' views on the level and form of Government contribution they sought, details of their proposed precinct masterplan, their views on the timing and nature of the development of the interstate terminal, and their views on the warehousing development. The request for expressions of interest did not seek binding offers from respondents that were capable of acceptance at that stage.

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- d. The MIC comments in this section addressed only positive aspects of the contractual outcome that it negotiated with SIMTA. The ANAO audit report outlines the key terms of the contractual arrangements, including analysing how value for money progressively eroded during the negotiation of the contractual arrangements (in comparison both to the terms of the request for expressions of interest issued by MIC, and statements made by SIMTA in its EoI response).

MIC received five responses. This was a strong response though the quality of responses varied substantially. SIMTA's submission was significantly stronger than the others. SIMTA demonstrated considerable freight and logistics expertise, and was willing to provide additional land to the development proposal and substantial capital, and offered to accept all the demand risk. No other respondent was prepared to contribute funding or take demand risk to the same extent. SIMTA also committed to developing a fully functional interstate terminal earlier than any other respondent, and some ten years earlier than the public sector comparator.^e

Faced with a situation where one submission was significantly stronger than others and was considerably more aligned to the relevant objectives, and following lengthy and detailed deliberation and examination of the potential options (including taking the advice of our probity adviser), MIC proceeded to direct negotiations with one respondent. Given the substantially lower value offered by the other respondents, the board was concerned at making an implied representation to the 'under bidders' that they had a commercially realistic possibility of succeeding at a bid cost anywhere near their expressions of interest, and the board did not wish to induce the 'under bidders' to expend further bid costs on the basis that it could be construed as being a materially misleading omission. This concern was also raised by the probity adviser.^f

This was a matter discussed at length also with the shareholder ministers and their departments and advisers.

Accordingly, MIC considered how best to maintain competitive tension in the context of an exclusive negotiation with one party. MIC entered into exclusive negotiations with the preferred party (SIMTA) for a period of six months. During that period, various approval 'gates' were set to allow (or not allow) the negotiations to continue. Further, the negotiations did not commence until a Procurement Process Deed was executed between the parties. This approach and the deed (modelled on recognised NSW and Victorian government guidelines for unsolicited proposals) covered such matters as confidentiality, requirements about approaches to other parties, and the steps by which the negotiation was to proceed. It made clear that if the negotiation was not successful from MIC's point of view, then MIC would move to negotiate with the next preferred proponents. In addition, the option of MIC developing the terminal alone had been explored previously, and all parties were aware of it as another fall-back position.^g

MIC asked two other proponents to suspend their interest, and to remain on standby, until such time as the negotiations ended (either successfully or otherwise). This course did not cause these respondents to expend funds on the basis of a misleading omission.

This process was entirely appropriate and fit for purpose given the initial feedback received from the market. It was not appropriate and practically commercially impossible for MIC to require respondents to a request for expressions of interest to provide a binding offer capable of acceptance in the circumstances.^h

MIC and SIMTA rigorously followed the steps set out in the Procurement Process Deed. The first step involved the recognition, negotiation and agreement of certain fundamental matters that were listed in the Procurement Process Deed. MIC adhered to the structure, order and format of the steps and their approval 'gates', requiring SIMTA to state its final position at each milestone. Although each step took longer than initially envisaged (in particular the early steps), at no time did MIC lose

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- e. The MIC comments do not address the shortcomings identified by the ANAO in the conduct of the EoI process. See, for example, paragraph 2.28.
 - f. See paragraphs 2.31 and 2.33.
 - g. See paragraphs 2.43 to 2.47 (including Table 2.2).
 - h. See paragraphs 2.39, and 2.48 to 2.50.

confidence in the process or in SIMTA, and so there was never any need to consider terminating the negotiation.

Only one respondent could deliver what was achieved. MIC is confident that better value for money has clearly been achieved from the arrangements with SIMTA than could have been achieved from any of the other parties – none of the others offered anything comparable to SIMTA's offer. The other parties expected MIC to take the bulk of the demand risk and to contribute significantly more capital to the development (and in some cases, all the demand risk and all the capital).ⁱ

The procurer or principal in any procurement is obliged not to mislead respondents. It would have been unethical and possibly illegal to mislead the other bidders by drawing them into a procurement process in which they could never have succeeded.

Negotiation outcomes

As explained above in the discussion of the Commonwealth's objectives, MIC believes the direct negotiation resulted in contractual arrangements for the delivery and operation of the Moorebank intermodal terminal that meet all the Commonwealth's objectives and achieve value for money.

ANAO's report is critical of a number of the negotiation outcomes. ANAO concludes that value was eroded over the course of the negotiation because the Commonwealth contributions increased, contingent liabilities were introduced and revenue streams were reduced. The report overstates these matters individually which creates misleading resulting conclusions. The report does not acknowledge that these elements and others, were negotiated as a package that took into account the transfer and acceptance of risks by the parties. Each element or risk in some way or another is interdependent with other elements or risks, requiring trade-offs and compromise. This is the nature of any negotiation, and is particularly the case of the complex and unique circumstances of this negotiation.^j

The ANAO's comments on contingent liabilities do not provide the full analysis provided to the shareholder ministers by MIC nor acknowledge why the liabilities are acceptable. In the case of unknown, pre-existing contamination, this is a liability that goes with ownership of the land and cannot be contracted out of at an acceptable cost. The Australian Government was well aware of this liability and in fact, the land was leased to MIC by the Government with a requirement to remediate contamination at the Government's cost.

In the case of potential termination payments, the likelihood of the Commonwealth needing to make any payment is remote, and only occurs if, in the unlikely event that a termination event is triggered, the Commonwealth and MIC chose to terminate in the further unlikely event that there is no external market for the terminated facility. MIC fully briefed the shareholder ministers and departments about the termination regime and how it was structured to mitigate the need for MIC or the Commonwealth to be exposed to making a termination payment. In particular, if MIC or Commonwealth does not want to terminate, it can continue with a cure period or elect not to issue a termination notice. However, if MIC or Commonwealth does elect to terminate, then from a balance sheet perspective, any outgoing payment would be offset by the acquisition of valuable terminal(s) and associated precinct infrastructure (i.e. no net impact).

i. See paragraphs 2.28, 2.33 and 2.49.

j. Transparency over when and why MIC agreed to key aspects of the negotiated outcome has been impeded by its approach to managing probity. See paragraphs 2.52 to 2.61.

The ANAO's report notes the shareholder departments were initially concerned about the risk of the interstate terminal not being built, especially given that the IMEX terminal was to be built on the SIMTA-owned parcel of land. The report does not acknowledge how this concern was mitigated. MIC also had this concern; however, after assessing several precinct layouts (including seeking advice from an external operational specialist), MIC concluded that the location recommended in SIMTA's precinct master plan was optimal. There are a number of ways in which the contractual arrangements mitigate the concern, including sunset dates for terminal stage completion, a breach of which would trigger the termination regime; mandated dates for completion that set the timing of charging ground rent (whether or not the works are completed); and the manner in which all land within the jointly-owned precinct land trust is treated equally to ensure 'best for precinct' planning and development.

On balance, the evidence supports MIC's view that the outcome is fair, reasonable and good value. The Commonwealth exposure to risk and capital outlay is vastly less than the base case comparator. The forecast real internal rates of return are satisfactory.

Probity

Throughout MIC's procurement process, Walter Partners provided probity advice to and oversight of MIC. A senior representative of Walter Partners attended the key negotiation sessions held between MIC and SIMTA.^k

With regard to the direct negotiations phase of the procurement process, Walter Partners provided a representation letter, which concluded that "the process was conducted in a manner consistent with the Procurement Process Deed, principles of procedural fairness and all probity requirements and that, in view of the meeting of Commonwealth objectives with relatively low Commonwealth capital investment and SIMTA adopting the majority risk, value for money for the Commonwealth is able to be obtained."

It is also worth noting that MIC is a government business enterprise set up specifically to take a commercial view of the development. It has a board (and management) comprising experienced and well regarded public and private sector practitioners in procurement and delivery of major projects with the private sector. MIC engaged highly experienced, industry-leading financial and legal advisers, who have advised on many and various successful procurements.

The shareholder departments scrutinised the transaction as it progressed (and asked many difficult but sensible questions). The departments were advised by their own industry-leading commercial and legal advisers, who also have a wealth of experience in complex procurements, and who were satisfied that the deal represented value for money and met the Commonwealth's objectives for MIC.

The ANAO report notes that the probity adviser may not have been present at all negotiation meetings, and that agendas and notes were not kept of some meetings. There were several informal discussions where MIC and SIMTA developed and compared options without agreeing final positions. These informal discussions informed subsequent formal negotiation meetings where positions were agreed and recorded, in the presence of the probity adviser.^l

k. See the last cell in the second row of Table 2.3.

l. See Note (a) to Table 2.3.

2. Open access

The contractual agreements facilitate the operation of a flexible and commercially viable common user facility by including a contractually enforceable open access regime that sets out the rules for open and non-discriminatory access to reference and ancillary services by third party and associated transport operators. The regime includes rules for applying for access, capacity allocation, pricing, cost allocation, complaints, disputes and compliance monitoring. The regime includes requirements for SIMTA to publish reference prices, a standard customer contract, an access protocol and a terminal operating procedure.^m

A balance was required between a tightly controlled access regime and the need for the private sector investor to be able to make a commercial return on its investment (bearing in mind it is making most of the investment and taking the bulk of the risk). The private sector has a strong commercial incentive to allow access to its terminal because that is where its revenue comes from. The regime recognises that, while SIMTA will be operating within a highly competitive industry, it is a vertically integrated entity.

The overarching objective of the open access regime is that the terminal operator must provide access to the terminals for rail and road operators on an open and non-discriminatory basis. This is consistent with the Government's objectives in establishing MIC.

This means that the terminal operator:

- must permit access at the terminal for third party operators (access seekers who are not associated with the terminal operator);
- must not unreasonably discriminate against third party operators in favour of an associated operator (access seekers who are associated with the terminal operator) in providing reference or ancillary services;
- must offer to provide access to reference services on transparent and published terms and conditions and in accordance with published reference prices; and
- must not hinder or prevent access at the terminal by a third party operator.

If the terminal operator provides an ancillary service to an associated operator, that service will also be available for access seekers on commercially negotiated, non-discriminatory price and non-price terms. Ancillary services might include services like access administration, use of a vehicle booking system or container washing.ⁿ

Access seekers will also be able to apply to obtain 'other services', which are not reference or ancillary services, but are intended to complement the open access regime. These include refuelling, port shuttle services (to the IMEX terminal) and internal transfer vehicle services to onsite warehousing. If the terminal operator provides refuelling services to associated operators for instance, it will provide the service to third party operators at the same published price.^o

The regime does not extend to cover the warehousing of the precinct, noting that warehousing will be developed by private sector clients under commercial agreements for lease. To regulate warehousing is not appropriate nor was it a requirement prescribed by the Australian Government in setting up MIC. Hence, it was not part of the procurement or negotiated deal.

m. See paragraphs 3.14 to 3.17, including Table 3.1.

n. See paragraphs 3.43 and 3.44.

o. See paragraph 3.22.

Neither the precinct, the terminals nor the warehousing component can be viewed as a monopoly asset, given the many other commercial/industrial developments in the Liverpool area with access to transport links. The regime or any form of regulation is not appropriate for warehousing, with privately developed warehouses being occupied by tenants with sufficient power to negotiate commercial terms or seek alternative warehousing and/or freight transfer options.

The open access regime is supported by a reporting and compliance regime that articulates the various ways that non-compliances can be identified and the consequences for non-compliance, which range from additional audits and reporting to termination of the terminal operator. The ANAO is critical of the regime's absence of financial penalties. It is worth noting that the escalating degrees of additional reporting and auditing as a result of breaches of the regime imposes an extra and considerable operating burden and additional costs on the operator. Further, ACCC regulated regimes or undertakings typically do not include financial penalties but rather impose requirements for regular auditing.^p

Ultimately, if access is unsatisfactory, there is nothing to stop the ACCC reviewing the application and effectiveness of the contractual regime at any time, and stepping in if necessary.

MIC consulted with potential access seekers and industry in December 2014. MIC is confident the open access regime will meet, and in some cases exceed, the expectations of industry participants. There will be further opportunities to consult with industry when the access protocol and terminal operating procedure are prepared by SIMTA prior to the commencement of the initial terminal operations.

The ACCC considered the competition issues associated with leasing of the Commonwealth land to Qube (under section 50 of the *Competition and Consumer Act 2010*), and concluded that there was no issue to warrant a review of whether there would be a substantial lessening of competition.^q

3. Governance framework

Contractual structure

The contractual structure provides a robust and enforceable governance framework to protect the investment, deliver the policy outcomes and safeguard the Commonwealth from unintended consequences.

All the Commonwealth land and the SIMTA land that form the precinct, including land required for biodiversity offsets, has been contributed into a jointly owned unit trust, via 99-year leases.

Based on the relative proportions of developable land contributed, MIC owns (by way of units) 66% of the land trust and SIMTA 34%. This, importantly, provides MIC (and therefore the Commonwealth) with the controlling interest in the land.

The precinct land trust's role is, by design, limited primarily to granting leases and collecting rent. The land trust has no operational oversight of terminal development (which is the responsibility of MIC). The obligations to develop and operate the terminals are governed by a suit of carefully negotiated and drafted contractual documents between MIC and SIMTA that embed the Commonwealth's objectives, set out SIMTA's development and operations obligations, and set out MIC's obligations and rights, including monitoring SIMTA's performance.

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- p. See paragraph 3.26. The request for EoI issued by MIC proposed a graduated regime of financial penalties in response to non-compliance.
 - q. Section 50 prohibits acquisitions that would have the effect, or likely effect, of substantially lessening competition in a market. For the Moorebank project, the ACCC review of the likely effect on competition was conducted prior to Term Sheet stage. The ACCC subsequently wrote to MIC and informed MIC that the Commission remained of the view that a purely contractual access regime may not be adequate to address potential competition issues that could arise over the term of the lease.

Commonwealth divestment

MIC has specifically structured the transaction to facilitate the Commonwealth's divestment of its financial interests in the precinct and rail access. MIC also carefully considered the timing of divestment.

Two trusts, each subsidiary to MIC, were established:

- an interposed land trust vehicle that entered into the Commonwealth Head Lease and in turn sub-leased the Commonwealth land into the precinct land trust vehicle, and will receive the distributions from that trust (i.e. MIC's share of ground rent); and
- a rail trust vehicle that will fund and own the rail infrastructure connecting the Moorebank terminal to the Southern Sydney Freight Line, and collect the rail access charge. (MIC has no role in operating or maintaining the rail access, and the rail access charge is not exposed to demand for freight services using the rail access.)

These subsidiary trusts can be sold by the Commonwealth either together or separately. The relatively predictable cash flows from the land trust's distributions and the capital charge on the rail access will be highly attractive to superannuation funds, infrastructure funds and similar investors.

It is important to note that the Commonwealth's land itself would not be sold (as the 99-year lease remains with the land trust); only the rights to the cash flows would be sold.

The structure and approach meets the Commonwealth's long term intention to sell its interest. The sale of the MIC trusts should enable the Commonwealth investment to be recouped without any residual financial obligations.

Following the Commonwealth's sale of either or both of the MIC trusts, the ongoing rights and obligations of MIC under the contractual arrangements would remain with Government, through a government department or agency as deemed appropriate by the Commonwealth at that time.

Based on the cash flows projections in the transaction's financial model, the most appropriate time for divestment is when clear and positive cash flows have been established. Earlier divestment, before MIC's cash flows are positive, could result in a heavily discounted value.

While 100% of the sustainable positive cash flows are not expected to be certain until 15 years after financial close, significant proportions will be sustainable well beforehand. Sustainable positive cash flows, without residual construction funding risk for MIC, are expected from year 7 after financial close, from terminal ground rent and the rail access fee. By year 7, a minimum of 40% of the total revenue streams are established and certain. From 7 years, 55% of the full revenue stream is expected to be established, including forecast warehousing ground rent. From 10 years, 77% of the full revenue stream is established and certain. From 15 years, 100% of the revenue stream is established and certain. The point at which a sale is optimal can be determined once development and construction risk has passed. A reasonably certain cash flow is the trigger requirement.

MIC's subsidiary trusts and their annuity style revenue streams were deliberately set up to facilitate the Commonwealth's objective of divesting its commercial interest in MIC by being attractive to superannuation funds and infrastructure investors (several of whom have confirmed their interest to MIC). Because the functions of the MIC subsidiary trusts are deliberately non-operational (thus not exposing MIC or the Government to operational risks), and because their revenue streams are

effectively fixed and cannot be influenced by operational input, operators would have little or no interest in acquiring the trusts. SIMTA sought pre-emptive rights in the divestment and stated this in its expression of interest. MIC would not agree with this; however agreed instead to prohibiting divestment to SIMTA's rivals is. This was, in MIC's view, of little or no consequence on the sales value of the businesses for the Government, and maintains a sufficiently broad market for the investment to be attractive to local and overseas investors. This requirement was accepted as one of many trade-offs in the negotiation.

MIC does not agree with the ANAO's analysis that the revenue streams are constrained or that the investment would not be attractive when the Government seeks to privatise. To the contrary, investors have confirmed their interest in a future privatisation and desire to invest in steady annuity style revenue streams, and this fact is behind the way MIC's subsidiaries have been set up. ^r

Concluding remarks

The commercial and contractual arrangements agreed with SIMTA are complex and unique. MIC absolutely disagrees with the ANAO's analysis that the direct negotiations did not secure a contractual commitment aligned to the Australian Government's preferred approach. MIC has met the objectives that the Australian Government determined for MIC and, as set out above, has demonstrated how these objectives have been satisfied in the procurement of the intermodal facility. ^s

MIC is satisfied the arrangements represent good value for money for the Commonwealth, provide a robust and commercially sensible access regime, and leave the Commonwealth with a structure build for divestment while maintaining full flexibility on what is sold and when.

We note that the ANAO has made no recommendations to which MIC is required to respond.

We also note that the proposed report prepared by ANAO includes commercially sensitive information, which, if included in the final report, could unfairly prejudice the commercial interests of the parties, creating an unknown and unquantifiable impact on the commercial viability and success of the precinct as a whole and limiting optionality to achieve value for money outcomes – all of which are contrary to the public interest. The disclosure of this information will unfairly prejudice not only SIMTA but also MIC and the Commonwealth's overarching objective to operate the precinct, particularly the terminals, on commercially sound principles having regard to the Commonwealth's long-term intention to sell its interest in MIC. ^t

Yours sincerely



Kerry Schott AO
Chair

r. See paragraph 4.26.

s. The conclusion against the audit objective is outlined at paragraphs 7 to 10.

t. The matters raised by MIC were considered in accordance with Section 37 of the *Auditor-General Act 1997*.



Australian Government

Department of Infrastructure and Regional Development

**Secretary
Dr Steven Kennedy PSM**

*File Reference: F17/2527
PDR ID: EC17-001757
Contact: Andrew Hyles*

Ms Lisa Rauter
Group Executive Director
Performance Audit Services Group
Australian National Audit Office
GPO Box 707
CANBERRA ACT 2601

Dear Ms Rauter

Australian National Audit Office (ANAO) - Proposed Audit Report: Delivery of the Moorebank Intermodal Terminal

Thank you for your email of 24 October 2017 providing the ANAO's Proposed Audit Report under Section 19 of the *Auditor-General Act 1997* on the Delivery of the Moorebank Intermodal Terminal.

I note that the audit report sought to assess whether the contractual arrangements that have been put in place for the delivery of the terminal will provide value for money and achieve the Australian Government's policy objectives for the project. While no specific recommendations have been made, the Department has considered the ANAO's observations and key learnings, and acknowledges the generally positive tone of the report.

I note the ANAO's findings in relation to the Moorebank Intermodal Company's procurement processes and establishment of non-discriminatory open access arrangements for the various aspects of the intermodal terminal. These will provide key learnings for the Department in its oversight of the delivery of other major infrastructure investment projects being delivered in partnership with private sector entities.

Thank you for the opportunity to comment on this report.

Yours sincerely

Steven Kennedy

21 November 2017

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Australian Government
Department of Finance



Rosemary Huxtable PSM
Secretary

Our Ref: SEC0015008

Mr Grant Hehir
Auditor-General
Australian National Audit Office
GPO Box 707
ACT 2601

Dear Mr Hehir *Grant*

I refer to the Australian National Audit Office's (ANAO's) correspondence dated 24 October 2017 providing the proposed section 19 Audit Report, *Delivery of the Moorebank Intermodal Terminal* and seeking the Department of Finance's (Finance's) response.

Thank you for the opportunity to respond to the matters raised in the proposed audit report.

Finance's response to the audit report is:

Finance notes the findings and key learnings of this audit report regarding the *Delivery of the Moorebank Intermodal Terminal*.

Finance will continue to examine opportunities to support the adoption and implementation of best practice monitoring and governance arrangements for Commonwealth entities, including Government Business Enterprises. The findings of this audit will be an important input to support this process.

Yours sincerely

Rosemary Huxtable
Secretary

16 November 2017

21 November 2017

*Proposed Report under s.19 of the Auditor-General Act 1997
Delivery of the Moorebank Intermodal Terminal
Extract for the Sydney Intermodal Terminal Alliance "the Report"*

Submission under section 19 of the Auditor-General Act 1997.

We refer to the draft Report.

SIMTA welcomes the invitation of the Auditor-General to comment on the Report under section 19 of the Auditor-General Act 1997 (the Act).

SIMTA also refers to its submission under section 37(1) of the Act in relation to parts of the Report that it considers the Auditor-General must not include in the public report of the Report.¹

Whilst SIMTA agrees with many of the comments contained in the Report, many of the statements made by the Auditor-General in the Report are incorrect. In addition, SIMTA has some observations that may assist the Auditor General in understanding the project and finalising the Report.²

SIMTA is happy to meet with the Auditor-General to discuss these errors in the Report and to discuss its observations in respect of the Report.

Regards,



William Hara

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- 1** The matters raised by SIMTA were considered in accordance with Section 37 of the *Auditor-General Act 1997*.
 - 2** In accordance with Section 19 of the *Auditor-General Act 1997*, SIMTA was afforded 28 days to provide the ANAO with comments on the proposed report. The ANAO had three telephone discussions with SIMTA during this 28 day period. SIMTA was asked to provide the ANAO with details as to those parts of the report SIMTA considered incorrect or to contain errors, as well as those parts of the report where SIMTA considered the ANAO's understanding would benefit from SIMTA's observations. SIMTA did not provide any details to the ANAO in respect to those matters.

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6 December 2017

STRICTLY CONFIDENTIAL

Lisa Rauter
 Group Executive Director
 Performance Audit Services Group
 Australian National Audit Office



Dear Ms Rauter

Extract from the ANAO's proposed Audit Report on the Delivery of the Moorebank Intermodal Terminal

Thank you for your email of 24 October 2017 and the opportunity of reviewing and providing comments on the extracted paragraphs of the ANAO's proposed Audit Report on the Delivery of the Moorebank Intermodal Terminal (**Transaction**) that includes a reference to Macquarie Capital (Australia) Limited (**Extract**).

This letter seeks to clarify aspects of the Extract where we consider additional context may provide further insight into, or avoid any potential misunderstanding of, certain elements of the Transaction. We understand the ANAO may make amendments to the Extract following consideration of our comments. If the ANAO considers it appropriate, we would be pleased to update our comments to reflect any subsequent amendments.

The Transaction was a complex and important project for Moorebank Intermodal Company (**MIC**) and its shareholders. We were pleased to have assisted in the outcome achieved by MIC under its agreement with SIMTA, which included:

- delivering a valuable precinct solution for a new intermodal terminal that caters for both IMEX and interstate freight and facilitates the modal shift from road to rail and a more efficient freight logistics system;
- the development of up to 850,000 sqm of warehousing in the precinct;
- a significantly lower required capital contribution from MIC than the amount anticipated by the Australian Government when MIC was established in 2012; and
- demand risk remaining predominantly with SIMTA, as the terminal operator, without the Australian Government needing to underwrite either throughput or related project revenues.

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We offer the following observations on the Extract.

Was a competitive procurement process adopted and were risks from adopting a direct negotiation process identified?

As noted in Chapter 2 of the Extract, the risks associated with suspending the planned procurement process and proceeding to direct negotiation with the leading bidder were identified and considered at length. Many of the relevant considerations are outlined in the Extract. To provide additional context, we note the following:

- Given the strength of SIMTA's EoI response, MIC was faced with balancing two alternatives, being:
 - Enter into direct negotiations with SIMTA as the preferred bidder, and accept the risk that a completed transaction may not eventuate from those negotiations or on terms initially proposed or agreed. In these circumstances MIC could seek to commence negotiations with other bidders who were put on hold; or
 - Shortlist and negotiate with multiple bidders, and accept the risk of a failed procurement process if those other bidders withdrew because they were not prepared to pursue the preferred terms and structure proposed by SIMTA (including in relation to demand risk). The key risk in this case being that MIC would find itself negotiating directly with SIMTA, with both parties aware that there were no viable alternative bidders.
- The second alternative (shortlisting multiple bidders) posed a material risk to the procurement process and the Transaction, and MIC determined it would pursue direct negotiations with SIMTA and seek to maintain competitive tension by leaving open the possibility of re-engaging with other bidders.

Did negotiations secure the expected contractual commitments?

Funding of the Southern Sydney Freight Line rail access (Paragraph 2.50)

Paragraph 2.50 of the Extract states that the Australian Government's financial contributions and contingent liabilities increased over the course of negotiations. As an example, the Extract cites SIMTA's EoI which indicated that no government subsidies would be sought to fund connecting rail infrastructure.

We note that:

- SIMTA's starting position in respect of its EOI assumed that MIC may have the opportunity to contribute capital for rail spur, but that a decision by MIC not to contribute capital would result in its interest in the terminal being diluted.
- The Term Sheet agreed in November 2014 between MIC and SIMTA provided that MIC would fund and own all of the Rail Access Works, being all scope required to link the IMEX terminal and interstate terminal lot boundaries to the SSFL.

Demand risk (Paragraph 2.50)

We agree with the ANAO's conclusion in paragraph 2.50 that the negotiated outcome resulted in demand risk remaining predominantly with SIMTA as the terminal operator, and the Australian Government not being contracted to underwrite either throughput or related project revenues.

The final contractual arrangements reflected the commercial agreement reached in exchange for SIMTA taking throughput risk. That is, in exchange for assuming that risk, SIMTA was also entitled to benefit from any upside in demand. Further, SIMTA is expected to expand terminal capacity as throughput grows, but is not required to expand under certain circumstances.

Ground rent negotiation (Paragraph 2.50 and Appendix 2)

Paragraph 2.50 provides that the value of land rent revenue streams from SIMTA diminished progressively throughout negotiations, from a starting position of 'market value' set out in the Eol response to a contracted position well below market rates. It also cites, as an example, the rate for warehousing falling to a final value per square metre (**Ground Rental Rate**) from an amount discussed in early negotiations which was significantly higher and many times the value of the Ground Rental Rate (**Warehousing Rental Rate**). ¹

We note that the Warehousing Rental Rate used in that example is not directly comparable to the Ground Rental Rate in respect of the land area used for warehousing development for the following reasons:

- The Warehouse Rental Rate was to have been levied on the significantly smaller net lettable area component of the land, whereas the Ground Rental Rate is levied on the whole of the land area made available for warehousing development.
- The Warehousing Rental Rate was premised on MIC contributing significant at-risk capital to fund the development of the warehouse, including the risk that tenants could be found for the warehouse development at this rate. Please refer to the final section of this letter below in relation to MIC's determination not to participate in funding the development of the warehouse.

Further, MIC concurrently negotiated improved commercial terms on other elements of the Transaction, including:

- additional variable rent payable to MIC if throughput exceeded certain thresholds, compared with that originally proposed by SIMTA; and
- additional rental indexation compared with that originally proposed by SIMTA. ²

These improved commercial terms provided MIC with additional value on top of the final agreed rental rate for warehousing.

Development of Interstate Terminal (Paragraph 2.50 and Appendix 2)

Paragraph 2.50 and Appendix 2 note the concern regarding the need to mitigate the risk of the interstate terminal not being built.

We note the final agreement with SIMTA in relation to this matter included a number of contractual protections designed to:

- ensure that the interstate terminal would be built within a certain timeframe; and
- avoid a situation whereby SIMTA would still have the ability to operate the IMEX terminal in circumstances where it failed to deliver the interstate terminal. ³

MIC's role in warehousing development (Appendix 2)

We note that items 28 and 29 of Appendix 2 could be misinterpreted as suggesting that the determination for MIC not to participate in the warehousing development was a concession made by MIC during negotiations with SIMTA.

- 1 The final report no longer makes the comparison referred to by Macquarie Capital in these comments. Rather, the final report outlines that the negotiated amounts for ground rent (including warehousing) were significantly below market rates. In particular, the final rate agreed for warehousing ground rent was half MIC's original expectation (based on advice to MIC from its commercial adviser).
- 2 Paragraph 4.13 recognises that there is a small increase in the revenue paid to MIC via its interest in the Land Trust that is linked to the annualised throughput at each terminal. Forecast project revenue and net profit for MIC, including the effect of rental indexation, is reflected in Figure 4.2.
- 3 See paragraphs 2.50; 4.3 to 4.9; and Appendix 3 paragraphs 23 to 24.

In early August 2014, a number of alternate Transaction structures were presented to MIC's shareholders, including structures whereby MIC would contribute capital for warehousing development as a co-developer. The expected capital contribution requirements and expected returns under the base set of assumptions were presented for all potential structures, which led to the selection of the landlord model prior to the signing of the MoU Agreement.

We thank you once again for the opportunity to comment on the Extract, and would be pleased to answer any questions arising from this letter.

Yours sincerely

Macquarie Capital (Australia) Limited



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22 November 2017

Dear Ms Rauter

Extract from the ANAO Proposed Audit Report on the Delivery of the Moorebank Intermodal Terminal (Proposed Report)

Thank you for the opportunity to comment on the extract of the Proposed Report which you provided to us pursuant to section 19 of the *Auditor-General Act 1997* (Cth) (the Act).

As the Australian National Audit Office (ANAO) is aware, Moorebank Intermodal Terminal (the Terminal) is a nationally significant infrastructure development that will transform the way containerised freight moves through Port Botany and will deliver a faster, simpler and more cost-effective service for business and consumers. The Terminal will be the largest intermodal freight precinct in Australia, and in our experience is one of the most complex and forward thinking infrastructure projects in the country – which involved many first of its kind elements including innovative methods of procurement.

We thought it may be useful if we provide some background to our engagement and the procurement process generally. Herbert Smith Freehills was engaged in May 2013 by Moorebank Intermodal Company (MIC) as its legal adviser. Our firm worked closely with the relevant parties, including MIC, the probity advisers, the Commonwealth and the respective parties' legal and financial advisers to run a procurement targeted at achieving the objectives for the Terminal. This included ensuring that the Terminal has the capacity to satisfy interstate and regional freight needs, will be an open access facility that optimises competition among users of the Terminal and achieves value for money for the Commonwealth.

In addition to these objectives, all stages of the procurement process were also driven by MIC's objectives for the Terminal. These were enshrined in the project documents as follows:

- facilitate the development of an intermodal freight terminal at Moorebank, including an IMEX facility, an interstate freight terminal capable of catering for 1,800 metre trains and ancillary facilities, by optimising private sector investment and innovation in the development, construction and operation of the intermodal terminal;
- facilitate the operation of a flexible and commercially viable common user facility that shall be available on reasonably comparable terms to all rail operators and other terminal users;
- ensure the intermodal terminal operates with the aim of improving national productivity through an efficient supply chain, increased freight capacity and better rail utilisation;
- operate on commercially sound principles, having regard to the Australian Government's long-term intention to sell its interest in MIC;

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- operate and maintain the terminal facilities in order to provide an intermodal terminal that abides by the principles of open-access; and
- expand efficiently and prudently the capacity of the IMEX terminal and interstate terminal in anticipation of sustainable increases in demand, so far as practicable, to avoid capacity constraints.

In this market, there are only a limited number of operators potentially capable of delivering the Terminal and the relevant objectives. After the detailed expressions of interest process was conducted, we agreed with the conclusions of the other project team members that there was only one operator who could deliver the Terminal at an acceptable level of risk and value for money. Consequently, the procurement process was complex and bespoke for the particular circumstances, taking into account fair probity and process, including not to cause to waste or misdirect the resources of respondents whose responses did not meet MIC's or the Commonwealth's objectives.

In addition, once the procurement progressed to negotiations with the one respondent, the project parties worked to ensure that competitive tension was maintained. This was achieved through various mechanisms, including through the execution of and compliance with a process/governance agreement and the structuring of the procurement similar to an unsolicited proposal, so that key points in the negotiations corresponded with key approval stages of the procurement, with no surety that the negotiations would continue.

Please do not hesitate to contact Peter Paradise on (02) 9225 5366 if you have any queries.

Yours sincerely

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Herbert Smith Freehills LLP and its subsidiaries and Herbert Smith Freehills, an Australian Partnership ABN 98 773 862 646, are separate member firms of the international legal practice known as Herbert Smith Freehills.

Appendix 2 Use of non-government email services for official Australian Government business

1. Email communications are a widely used and accepted form of communication by and within the Australian Government. As such, they provide evidence of the conduct of government business and are important information assets.
2. The Australian Government Protective Security Policy Framework (PSPF) states that agencies must implement policies and procedures for the security classification and protective control of information assets (in electronic and paper-based formats) which match their value, importance and sensitivity. In addition, the Australian Government Information Security Manual (ISM) is to be used for the risk-based application of information security controls. It draws attention to the security risks that come with using web-based email services. These risks are well known and publicised, for example, a 2012 speech by the then Defence Signals Directorate (DSD) to the Parliamentary Library notes that:

We hear reports of hacking in the media every day. Almost all government and large private sector organisations have been affected by cyber security incidents ...

DSD strongly advises against using webmail, such as Hotmail or Gmail, for work. The use of such services may bypass some of the security measures that have been put in place to detect, and respond to malicious activity.⁶⁰
3. Similarly, current guidance from the Australian Signals Directorate is that using non-agency-sanctioned webmail to conduct government business heightens the risk of the unauthorised disclosure of government information.⁶¹
4. While it is considered good practice for wholly-owned Commonwealth companies under the *Public Governance, Performance and Accountability (PGPA) Act 2013* (such as MIC) to apply the PSPF and ISM, it is not mandatory. In this respect, MIC advised the ANAO in September 2017 that ‘MIC does not hold ‘classified’ information but applies an ICT Security Policy that has been developed and made fit for purpose for an organisation of MIC’s size and risk profile.’
5. In March 2013, the MIC board resolved that an interim solution to password protect future electronic Board communications until a longer term solution was identified and implemented. The ANAO’s analysis identified that while MIC implemented password protection of its Board papers, it also has a practice of sending the respective passwords to the same email address that the password protected papers were sent to. MIC advised the ANAO in September 2017 (more than four years after the interim solution had been adopted) that a longer term solution has not yet been identified.

60 First Assistant Secretary Cyber and Information Security (FASCIS) Speech for Parliamentary Library Guest Lecture Series, 15 August 2012, “Cyber Security” available from: https://www.asd.gov.au/speeches/20120815_DDCIS_Parliamentary_Library.pdf.

61 See further at: <https://www.asd.gov.au/publications/protect/webmail-government-business.htm>.

6. In the course of this audit, the ANAO also identified various instances of non-MIC corporate email services being used (including free web-based personal email accounts) as shown in Table A.1.

Table A.1: Examples of private email accounts used

Officer	Examples
Chair of the MIC Board	From 25 January 2013, all Chair correspondence was sent and received via a web-based email account. Examples include board papers; commercial contracts; and notes from negotiation meetings with SIMTA marked 'confidential'.
Board Members	Eight of 10 directors received almost all board papers via free web-based email accounts and/or email accounts administered by private organisations they work for. ^a Examples of information sent through these channels include: papers relating to the direct negotiations process (e.g. the negotiations plan, probity plan and evaluation results); legal due diligence information; and letters titled 'Confidential—Phase 1 negotiations with SIMTA'.
Chief Executive Officer	Used a web-based email account and an account administered by another private organisation to send/receive MIC documents. Examples include a communications and government relations strategy; project valuation information; and a leasing structure proposal.
Chief Operating Officer	Used a private account to receive draft communications material and from which information was sent about the costing of contractual services.
Project Procurement Director	Sent the project's transaction summary document (detailing the legal and financial structure of the project) to his private email address and used the address when consulting with the probity adviser.
General Counsel/ Company Secretary	Sent documents to her private email address. Examples include: board minutes (such as those relating to financial close and easement negotiations); legal advice and management representation letters; and draft commercial contracts.
Corporate Affairs Manager	Sent documents to her private account including a Shareholder Ministers' letter (covering a range of issues such as future privatisation and open access); various documents on the open access regime; and SIMTA's comments on a draft ACCC open access presentation.

Note a: Of the other two, one requested for all MIC correspondence to be sent to their MIC email address, and the other has received emails at both their MIC and private email addresses. The ANAO has identified that all directors have been issued with MIC email addresses, with the exception of the most recent appointee who used a personal email address initially, then shortly after his appointment changed to a private organisation email address. MIC advised the ANAO in September 2017 that 'directors prefer to use personal email addresses to avoid management of multiple email addresses'.

Source: ANAO analysis of MIC email records collected for the audit. Due to the above practices, this analysis is limited to the extent that not all emails associated with the delivery of the project may have been captured into MIC's corporate records.

7. The Information and Communications Technology (ICT) Security Policy was first approved by the MIC Board in September 2015 and was updated in February 2017. The purpose of the policy is 'to ensure that appropriate measures are in place to protect corporate information and the ICT systems, services and equipment of MIC and associated infrastructure.' These policies were informed by specific testing of MIC's ICT

security vulnerabilities and reflect the importance of securing the corporate information MIC holds in its systems.⁶²

8. The 2015 and 2017 ICT Security Policies include provisions for the creation, modification and disabling of email accounts on MIC's system but does not address the desirability of, or potential need to recover, information/documents sent to external web-based email services outside of MIC's control.
9. In early 2017, MIC sought to procure broader insurance cover for cyber enterprise risks. In response to an ANAO query in September 2017, MIC advised that its insurance broker was not informed that non-MIC email addresses are used by directors (and occasionally by staff). The board resolved not to take up additional cyber security insurance.

62 These policies apply to all staff members and provide measures regarding: password configuration; user access management; change management; and problem and incident management.

Appendix 3 ANAO analysis of direct negotiations

Australian Government financial contributions and contingent liabilities

1. Originally, \$887 million had been identified as the expected cost of the Australian Government delivering the first phase⁶³ of an intermodal terminal at Moorebank. At the conclusion of negotiations, the Australian Government expected to contribute land valued at \$95.4 million with equity contributions totalling \$370 million expected to be required.
2. The number of items for which a financial contribution would be required from MIC increased progressively throughout negotiations. The EoI from SIMTA had stated that MIC would not be required to contribute any capital nor provide any financial support other than with respect to the remediation of the MIC site. Further, no government subsidies would be sought to fund development of the project and it was 'envisaged' that connecting rail infrastructure, the terminals and warehousing developments would be funded through various (and predominantly private) sources.
3. The Term Sheet was agreed in November 2014 and included some significant additional financial contributions from MIC. Namely, a portion of the costs of the Moorebank Avenue works and the entirety of the costs of the Southern Sydney Freight Line rail access.⁶⁴
4. A significant termination payment to SIMTA was also factored into the contractual arrangements at this stage. Under the arrangements, an obligation to make a termination payment will arise in the event that SIMTA's development rights for the MIT are terminated. The payment would compensate SIMTA for this loss and, while currently unquantifiable, would be material in size.⁶⁵
5. MIC's advice to the Shareholder Ministers between November 2014⁶⁶ and April 2015 was that the termination payment should not be disclosed within the annual financial statements as a contingent liability⁶⁷. This advice was incorrect, and the Shareholder Ministers were advised by their departments in April 2015 that the termination payment would need to be disclosed as a contingent liability. Accordingly, the termination payment was included in

63 The first phase of the project consisted of delivering the IMEX terminal and associated infrastructure.

64 The costs relating to the realignment of Moorebank Avenue were not linked to MIC's future revenues streams. The rail access earnings are discussed at paragraph 15 of Appendix 3.

65 In respect to the termination payment, advice provided to Ministers in relation to the termination event, should it be triggered, was that the Australian Government would seek to offset this cost by running a competitive tender process which, if successful, would be used to fund the termination payment. The advice also noted that the Government would only fund the payment if a new developer could not be sourced through the tender process.

66 For example, in an attachment to a letter from MIC's Chair to the Shareholder Ministers in November 2014, MIC advised that: 'It is MIC's view that the termination payment should not be considered a contingent liability because it is always in MIC or Commonwealth's control whether to exercise its termination right. If MIC or Commonwealth does not want to terminate, it can continue the cure period or elect not to issue a termination notice. If MIC or Commonwealth does elect to terminate, then from a balance sheet perspective, any outgoing payment is offset by the acquisition of valuable terminal(s) and associated precinct infrastructure (i.e. no net impact).'

67 A contingent liability is a liability that may occur, depending on the outcome of an uncertain future event that is not wholly within the control of the entity. Unless the possibility of any outflow in settlement is remote, entities must disclose the contingent liability in the notes to their annual financial statement.

DIRD's 2016–17 Financial Statements and in the Statement of Risks in the Australian Government's 2017–18 Budget Papers.

6. Ministers were also advised in April 2015 that the Australian Government's ongoing responsibility for removal of latent contamination, via MIC, constituted a contingent liability. This was in respect of the land it was contributing to the Precinct Land Trust.

7. Advice to Ministers was that the risks presented by the contingent liabilities would be 'appropriately mitigated by various obligations within the contractual documents and due to SIMTA's commercial incentives to develop the [MIT]'.

8. MIC had included \$119.6 million in its June 2015 budget for the land preparation activities required to remediate the land to the condition agreed with SIMTA. Following contractual close, MIC's planning activities revealed the existence of perfluorinated alkyl substances (PFAS) contamination on the MIC site.⁶⁸ MIC advised the ANAO in September 2017 that the budgeted land preparation costs will be exceeded as a result of the contamination. Remediation of the contamination may also require an ongoing and annual monitoring and maintenance cost. MIC advised the ANAO in September 2017, that it was not yet in a position to reliably estimate the likely cost overruns resulting from the discovery of contamination on the site. A detailed risk assessment and a biota study in the Georges River must first be undertaken (in the 2017–18 summer) before MIC can determine how to manage the associated risks.

9. Two days prior to contractual close in June 2015, Ministers were advised by their departments of 'new material risks' that had been introduced within the final contracts. Specifically:

- MIC (through the Rail Trust) will be liable to fund the reconstruction of the rail spur if it is damaged as a result of an uninsurable risk. It is not entitled to recover those costs by increasing the rail access charges;
- MIC (through the Rail Trust) will be required to fund contract price variations under the rail spur construction contracts in limited instances;
- the Australian Government will be required to indemnify the Glenfield Waste Site (GWS) for any losses caused by the Australian Government or its agents, throughout the term of the project (arising out of the grant or breach of the contractual arrangements for the rail access easement over its land); and
- the Rail Access Deed—governing funding to construct the rail spur and collection of the Rail Investment Access Charges—contains no right of recourse for non-payment of those charges except through the courts.⁶⁹

68 NSW Government Planning and Environment, *Moorebank Precinct West (MPW) – Stage 2 Proposal—Site Contamination Summary Report*, October 2016. See: <https://majorprojects.accelo.com/public/e755762e6006de52a3b1dd6972752ea9/2016-10-25%20Appendix%20S%20Contamination%20Summary%20Report%20October%202016.pdf> (accessed 10 October 2017).

69 In September 2017, Finance advised the ANAO that its briefing included 'advice from the advisers that these risks can be mitigated and are not expected to prevent future divestment of MIC's income streams. Further, the brief notes the advisers did not consider that the changes to the terms and conditions should alter the Commonwealth's decision on whether to proceed with the transaction'.

10. In the context of a future sale, potential future liabilities may negatively impact the amount potential buyers are willing to pay. This was a particularly late stage at which to raise such risks, and in particular, ones that have potential adverse effects on the future privatisation value of the Rail Trust revenue stream.

Restrictions on future privatisation

11. The SIMTA EoI response had stated that the proposed joint venture would provide MIC with liquidity should it wish to divest or downsize its stake in the joint venture at any time in the future. To further enhance the attractiveness of this proposal, SIMTA stated that it would underwrite the value of MIC's equity stake should MIC seek to divest its interests in the joint venture entity in the short term.

12. The November 2014 Term Sheet, as well as the contractual documentation signed in June 2015, introduced restrictions on the privatisation process. Specifically, MIC is prevented from selling its subsidiary units to a direct rival to Qube or Aurizon's Australian intermodal freight logistics or container freight logistics business.

Allocation of demand risk

13. Demand forecasts underpinned the business case for the MIT. In terms of those forecasts, MIC advised the ANAO in August 2017 that:

MIC had expected the forecasts in the Demand Refresh Study to be part of the tender process with short-listed operators. SIMTA's proposal included SIMTA taking most of the demand risk, so in the end the Demand Refresh Study was used to check SIMTA's demand assumptions, which were more conservative (i.e. slower ramp-up) than MIC's.

14. As part of the EoI data room, MIC provided potential respondents with preliminary information on demand estimates. Part 2 of the EoI document had outlined that a major consideration in the planned PDR phase was to be the degree to which each shortlisted proponent would reduce potential Australian Government exposure to demand risk and funding.

15. The negotiated outcome maintained a position that demand risk is predominantly with the terminal operator. As a result, in the event actual usage of the MIT is less than forecast, the Australian Government is not contracted to underwrite either throughput or related project revenues. But private sector exposure to demand risk is mitigated by the contractual arrangements:

- providing a number of grounds on which terminal capacity is not required to be expanded even in circumstances where there is unmet demand (see paragraph 4.11); and
- allowing the operator to set the prices it charges for terminal services and warehousing, without any reference to its costs. In terms of the cost base:
 - the amount that is paid for the use of land for terminals and warehousing has been set through the contractual arrangements at a low fixed rate;

- the ‘Rail Access Charge’ is contractually fixed on the basis of CPI plus a fixed percentage per annum of the actual capital cost for the development of the necessary rail access spur;
- rent holidays were agreed that had not been foreshadowed in the Eol response; and
- no rent is payable in the first 10 years on undeveloped⁷⁰ land that has been allotted for warehousing. On the tenth anniversary of financial close (24 January 2027)—regardless of actual development—ground rent must be paid for 50 per cent of the land allocated for warehousing.⁷¹ On the fifteenth anniversary, 100 per cent of warehouse ground rent must be paid.

16. In August 2017, in response to questions from the ANAO about how the ground rent price and the rail access charge was negotiated, MIC advised that in both cases, they were solved to target internal rates of return.

Pricing of ground rent

17. The likely value of land rent revenue streams from SIMTA diminished progressively throughout negotiations.

18. Between February and May 2014 the project documentation indicated that both parties anticipated that the pricing for the Land Trust rent revenue would be set at market rates as a minimum. This was subsequent to SIMTA formally stating in its Eol submission that it did not require the Australian Government (through MIC) to assume any demand risk for the project. Specifically, MIC’s evaluation of the SIMTA Eol response stated that the:

- land lease payment would be at ‘market’ (undefined) and incorporate a return to JV Co that also covers the cost of providing other enabling infrastructure (although note that this does not include rail connection to the SSFL, which is covered separately); and
- [proposal was for a] joint venture for a ‘whole of precinct’ development which would not require MIC to assume any demand risk and, *prima facie*, would limit MIC’s contribution to the joint venture to the MIC site (remediated to a condition suitable for industrial development).

19. To support the negotiation of rent prices at market rates, MIC sought advice from its commercial advisers. ANAO’s analysis of MIC’s records indicates that:

- SIMTA provided MIC with a copy of its financial model for the project in July 2014, which envisaged ground rental rates being provided at substantially higher rates than those agreed in November 2014;
- between August and November 2014, the parties continued to discuss ground rent rates, variable components of rent (as a means for MIC to share in upside revenues) and periodic rental increases;

⁷⁰ Rent becomes payable for warehouse lots after they have been drawn down and developed. Warehouse lots are each subject to rent holiday periods. This holiday period commences after the completion of construction.

⁷¹ Unless more than 50 per cent of warehousing land has been developed. In which case, warehouse ground rent must be paid according to the actual percentage of land developed.

- in October 2014, MIC's commercial adviser provided a 'for discussion' rent summary for MIC's proposal to SIMTA. It was designed to include a 'base rental'; and
- in November 2014, MIC received independent land valuation advice.

20. The final negotiated outcome was significantly lower than market rates. The amounts payable for the IMEX terminal, interstate terminal and warehousing were set at the same fixed per square metre rate. For example:

- the rate for the IMEX terminal was less than half the rate included by SIMTA in the financial model it provided to MIC in July 2014 (this was the first time a rate was quantified); and
- the final rate agreed for warehousing was half MIC's original expectation (based on advice to MIC from its commercial adviser).

Location of the terminals

21. SIMTA had originally suggested there were two options for the positioning of the terminals:

- Option 1 involved the IMEX terminal on the SIMTA site and interstate terminal on the MIC site; and
- Option 2 involved both terminals on the MIC site, with the SIMTA site to be used for warehousing.

22. Both options were included in the Procurement Process Deed. In finalising the September 2014 MoU, MIC agreed to adopt the scenario under Option 1 for the Initial Precinct Master Plan. The EoI submission, while suggesting Option 2 was viable, clearly identified that Option 1 was strongly preferred by SIMTA. The submission stated that:

- Option 2 abandons the considerable benefits of utilising current (and ongoing) work undertaken by SIMTA in obtaining planning consent to develop and operate an IMEX facility on the SIMTA site. As a result Option 2 does not facilitate the expedient delivery and speed to market operations for Phase 1⁷² that are available with Option 1;
- Option 2 does not permit the most efficient use of developable land for warehousing and reduces the material efficiencies that are available in Option 1; and
- Locating the Phase 1 works on the MIC site exposes the project's delivery to risks which include remediation, rezoning, planning approvals, and other environmental impacts. These risks have already been addressed in the SIMTA planning approvals process (nearing completion), utilised within Option 1. Our assessment demonstrates that by deploying Option 2 the Terminal Operations cannot be delivered by the MIC target date of 2017.

23. A concern expressed by the Shareholder Ministers' departments throughout negotiations has been that the contractual arrangements entered into by MIC and SIMTA needed to be able to sufficiently mitigate the risk of the interstate terminal not being built. That is, the contractual arrangements need to prevent SIMTA from walking away from its obligations

72 Phase 1 work referred to the works required to progress the development of the IMEX terminal.

under the DOD following the successful delivery of the IMEX terminal. This is a particularly important concern when considered in the historical context of SIMTA's original plans for its site. These plans were reflected in the planning approvals referred to in SIMTA's EoI and involved the development of an IMEX terminal alone—being the significantly more profitable terminal. In November 2017, MIC commented to the ANAO that these concerns were dealt with through a combination of:

- the sunset dates and the termination regime;
- the dates for completion and the timing of charging ground rent; and
- the holding of all land in Precinct Land Trust.

24. If there is a Termination Event solely related to the interstate terminal after the Cross-Default End Date⁷³, then PDC's rights to develop and operate the IMEX terminal and the rail access under the DOD do not terminate. Nor does PDC's obligation for the operation and maintenance of the rail access.

25. The extent of MIC's recorded rationale for agreeing to the IMEX terminal being built on the SIMTA site was recorded in its July 2014 Board papers:

SIMTA has shown MIC the various layout options it considered and the pros and cons of each option. The assessment has concluded:

- The interstate terminal needs to be on the [MIC] site to accommodate the 1800 m rail sidings.
- The location of the IMEX terminal on the SIMTA site appears to maximise the development area for warehousing⁷⁴

26. In regards to the delivery timing benefits outlined by SIMTA's EoI through adoption of Option 1, the planning approvals referred to related to concept approval, which was granted in September 2014. This planning approval did not allow for the IMEX construction activities to commence. The approval for Stage 1 construction activities (for the SIMTA site) required a more detailed submission and was granted by the NSW Planning and Assessment Commission (PAC) in December 2016. By that time, both the concept and Stage 1 approvals for the MIC site had been submitted and obtained.⁷⁵ These approvals for each respective parcel of developable land to the Land Trust were identified as 'conditions precedent' to financial close between MIC and SIMTA, which occurred on 24 January 2017.

27. There has already been a request from SIMTA to the Australian Government to amend the terms of a 99-year rail access easement granted by the Australian Government (also identified as a condition precedent). The Australian Government was one of three parties from which SIMTA obtained landowners consent for the construction of the rail link from the terminals to the Southern Sydney Freight Line. Without rail access, the ANAO's analysis is that

73 This date is defined within the Development and Operations Deed, and is the point at which a Termination Event in respect of one terminal no longer results in the automatic termination of PDC's rights in respect to the other terminal.

74 The ANAO notes that the respective Board Minutes recorded that '[t]he Board noted the importance of ensuring MIC maintains control over the land on which the terminals are built.'

75 Previous concept and Stage 1 approvals were granted by the PAC by July 2016.

SIMTA's site would remain landlocked without rail access, a situation to the Australian Government's advantage in both negotiations as well as in ongoing management of the fulfilment of the contracted development and operation obligations.

28. In March 2017, SIMTA requested that this easement be granted in perpetuity, rather than for 99 years. This request was made just two months after the achievement of financial close. If granted by the Australian Government, MIC's ability to enforce the arrangements in the DOD would be significantly impaired. With ongoing rail easement rights not attached to the success of the MIT as a precinct there would be an increased risk of the interstate terminal not being developed, or not being fully developed.

Warehousing development

29. The warehousing component of the MIT precinct is expected to be highly profitable. MIC's understanding of this was reflected in July 2014 correspondence with SIMTA. Specifically, MIC stated that it:

recognises that the returns on the land held in the land [trust] may be low over the longer-term, so is seeking to participate in the warehousing development to ensure a commercially defensible return.

30. The results of subsequent negotiations did not result in MIC participating in the warehousing development. MIC records outline that:

During negotiations MIC made a number of significant concessions in regard to the warehouse development concept in order to support private sector development of the precinct warehousing, most notably the granting of 99-year warehousing ground leases which would survive a terminal termination event.

Open access arrangements

31. The EoI had outlined that the Open Access Regime was to apply to all of the terminal services provided by the successful proponent. The contractual arrangements exclude certain aspects of terminal services that the EoI had identified would be captured as part of the Open Access Regime. The regime does not apply to warehouse operations and partially applies to the:

- rail transportation of containers between the terminal and Port Botany (called the port shuttle service); and
- internal transfer vehicle services within the intermodal precinct.

32. In addition, the compliance arrangements for the Open Access Regime are more lenient than was envisaged in the EoI (see Chapter 3).