

The Department of Treasury of the government of Western Australia has released its third asset sales update, relating specifically to the sale of Utah Point Bulk Handling Facility (Utah Point), Fremantle Port, Western Power Network and the Horizon Power Network.

In this briefing note we have set out the current state of play for each of those assets as well as some key issues which prospective purchasers of privatised assets should consider.

Utah Point

The Utah Point was constructed in 2010 and is one of four berths located in Port Hedland and owned by the Pilbara Ports Authority (PPA).

Utah Point is located in the world's largest iron ore export port. The Utah Point asset comprises of:

- A 272 metre berth with a harbour depth of 14.5 metres
- A shiploader with a peak load rate of 7,500 tonnes per hour
- Two stockyard product storage facilities
- Reclaiming and conveying equipment
- Supporting infrastructure

The PPA currently owns and operates the berth and facilitates. The export of bulk products (currently iron ore and manganese) generates revenue of AU\$132 million per year. Market soundings carried out during February and March 2016 indicated there may be prospective bidders from within Australia, as well as internationally.

The Pilbara Port Assets (Disposal) Bill 2015 was introduced to the Western Australian Parliament in November 2015, to transition Utah Point to the private sector through a long term lease arrangement, which has a maximum term of 99 years. Parliamentary debate on the bill is scheduled to resume in August 2016. Once the bill is passed, an invitation for expressions of interest will be released to commence the transaction process. The government of Western Australia has indicated it is ready to move once the bill has passed, and that it wishes to conclude the transaction before the scheduled state election in March 2017.

Fremantle Port

The government of Western Australia has undertaken extensive due diligence on the proposed long term lease of Fremantle Port for a maximum term of 99 years, with a particular focus on ensuring there are appropriate regulatory structures in place to maintain service levels, allow access, provide price protection to customers and preserve environmental standards.

Fremantle Port is Western Australia's largest container and general cargo port and operates from two locations. The operation and management of the Fremantle Port is currently under taken by the Fremantle Ports Authority. The Fremantle Port asset comprises of:

- The inner harbour at Fremantle including:
 - Seven container berths
 - Seven common user berths for general shipping and cargo handling
 - Two berths for cruise shipping
 - Two berths for smaller ships and layup
- The outer harbour at Fremantle (approx. 25kms from in the inner harbour) including:
 - Kwinana Bulk terminal
 - Kwinana Bulk jetty
 - Three privately owned jetties

The Fremantle Port Assets (Disposal) Bill 2016 and associated regulations were introduced into Parliament in May 2016 and include many provisions dealing with access rights to the Fremantle Port and details around a pricing regime for access and services. The Western Australian Economic Regulation Authority will be the regulator of the access and pricing regime and the government will retain oversight of the new port lease through a restructured Fremantle Ports Authority.

However, the passage of this legislation through parliament is not certain given that the National Party has refused to support the proposed legislation and sale on the basis that the Fremantle Port is an important strategic and commercial asset to Western Australia.

Western Power's and Horizon Power's Transmission and Distribution Networks

In the 2016–17 budget speech the government of Western Australia announced a proposal to sell and lease back the Western Power transmission and distribution assets and the Horizon Power transmission and distribution assets. Currently there are few details available in relation to the form of the proposed divestment including the term or duration of the lease although we assume it will also be divested by way of long term lease with a maximum duration of 99 years.

The Western Power asset comprises the South West Interconnected System (or SWIS), which is the primary electricity grid in Western Australia, supplying the bulk of the south west region. It extends from Albany in the south, to Kalgoorlie in the east and up to Kalbarri in the north. The Horizon Power asset comprises the North West

Interconnected System (or NWIS), which supplies electricity to sparsely distributed towns and resource industry in the north west of WA.

The current plan to lease the transmission and distribution network, rather than sell it together with the business will likely reduce any purchase price. The government of Western Australia has stated it will use the proceeds of the sale to reduce government debt and fund future infrastructure.

Any decision to sell or lease the NWIS and/or SWIS will be made after the next state election in March 2017 and upon confirmation that divestment is in the best interests of taxpayers and electricity consumers. It is anticipated that this will include the introduction of a regulatory regime to protect the interests of electricity consumers.

Key Issues for Purchasing Privatised Assets

There are a number of preliminary issues that any potential purchaser should consider when carrying out its investigations and diligence on privatised assets.

1. Regulatory Clearances

The two most likely regulatory clearances that will be required to purchase privatised assets in Western Australia are competition clearance and foreign investment approval. We have briefly outlined these below:

Competition Clearance / ACCC Clearance

Competition clearance may be required for the purchase of the privatised assets. This process is regulated by the Australian Competition and Consumer Commission (ACCC) and the ACCC is likely to be concerned if the acquisition of shares in a business or an asset could result in a substantial lessening of competition in any market in Australia. This is most likely to be relevant if:

- A party has existing industry-relevant operations in Australia
- Is a potential or active user of the enterprise, or
- Has a relevant ownership association with any such person

If competition issues are identified then an application would need to be made to the ACCC. The ACCC does not provide clearance without undertaking public market inquiries and as a result any bid would have to be made conditional upon ACCC clearance.

Foreign Investment Review Board Approval

Foreign investment in Australia is regulated by the Foreign Acquisitions and Takeovers Act (FATA) 1975 (Cth) and the federal government's foreign investment policy. The Foreign Investment Review Board (FIRB) is the regulatory body which administers the FATA and policy. Whether or not FIRB approval will be required will depend upon the circumstances of the proposed acquisition including:

- The type of investor
- The type of investment
- The value of the proposed investment
- The industry sector of the proposed investment

Australia has broadened its free trade agreement ties with many countries, and in certain circumstances under these free trade agreements Australia has increased its notification thresholds for FIRB approval to upwards of AU\$1 billion dollars of the purchase price. If FIRB approval is required and the bidder cannot take advantage of the higher notification thresholds, then a threshold of AU\$252 million purchase price applies.

In addition Australia has recently broadened its foreign investment policy to include a "national interest test". This is a relatively new addition to the policy and allows the federal government to raise national interest concerns where the asset is of significant public importance. It is likely that some infrastructure assets will fall within this new test and as such some additional regulations maybe imposed on a potential purchaser to allow the sale to progress.

2. Regulatory Oversight and Impact on Business

The potential purchaser should thoroughly investigate and understand the nature and extent of regulatory oversight of the business being purchased including:

- Developing an understanding of which regulatory bodies have oversight of the business and operations.
- The role and extent of that regulatory oversight, including how it will impact on business operations going forward – for example setting service standards, third party access rights, imposing restrictions on increasing costs and charges that can be levied from users

The starting point to develop this knowledge is understanding the privatisation bills, particularly in relation to the Fremantle Port Assets (Disposal) Bill 2016 which delves into this issue in quite some detail.

This investigation should include an assessment of the risk associated with any government "step in right" which might be applicable in circumstances where the government considers there has been a breach of the regulations.

The regulatory burden will be of interest to prospective purchasers because it will have an impact on the profitability of the business and the freedom with which the potential purchaser can operate the business going forward.

3. Future Obligations Including Expansions, Extensions and Capital Upgrade Obligations

The potential purchaser should investigate and understand if there are any future capital expenditure obligations incorporated in the privatisation process, or, if future development is contemplated, then how it is to be funded and developed and whether the purchaser may participate in that process, for example through a right of first refusal.

4. Other Due Diligence

The potential purchaser should undertake due diligence investigations in a number of different areas including:

- Existing contractual arrangements – a number of contractual arrangements will be transferred across with the new business. It will be important to understand how these operate, the length and term of the contracts and whether there is any competition for the provision of these services in the Western Australian market as well as assessing if the contracts are market standard.

- The impact of new technology on the business – particularly in relation to the NWIS and SWIS given that Australia has one of the fastest uptakes of rooftop solar in the world, meaning that fewer residential and commercial customers have total reliance on the distribution network provided by Western Power and Horizon Power – the impact of this on the business model will need to be assessed, including whether there are any means by which the potential purchaser can obtain value from those customers who are connected to the network (such as through a connection fee) but do not draw on the system or alternatively sell electricity back to the system for purchase by other customers (such as taking a “clip” on this transaction for facilitating it).
- Age of existing infrastructure by contrast to any capital upgrade obligation and service levels – some of the infrastructure for sale will require ongoing maintenance and future capital upgrades which, particularly where the infrastructure is located in remote regions of Western Australia, could prove expensive and the potential purchaser should ensure this is included in the business model which it develops.
- Property ownership issues including native title, licences and easements – including whether all such arrangements are in place and are adequately transferred across to the new business such that from day one the new business can operate on a standalone basis.
- Occupational health and safety – some of the businesses being privatised are inherently dangerous, the potential purchaser should develop an understanding of historical events and how the business has dealt with those, as well as understanding how Australia’s occupational health and safety laws and regulations impact on how business is conducted.
- Employee issues – including developing an understanding of the key employee issues such as the awards and enterprise agreements in place and whether there is any union presence within the business and how this has historically impacted on operations.
- Legacy issues – particularly in relation to the SWIS and NWIS there may be some legacy litigation issues arising out of bushfires which have had a sometimes deadly impact on areas in Western Australia.

5. Political and Sovereign Risk Issues

Australia is one of the most stable Western democracies in the world. It has low sovereign investment risk, as a consequence of many decades of conservative fiscal policies and a profitable highly regulated banking and securities framework. The ownership and divestment of state-owned infrastructure is often a partisan issue in state and federal politics. The Liberal Conservative government in Western Australia is keen to use the funds raised in assets sales (such as described above) to set off State debt and improve the State’s credit rating. The opposition Labor party position is, at present, that it opposes the sale of state-owned assets in order to

protect domestic jobs and maintain nationalistic principles supported by trade unions, a traditional supporter of the party.

There is a state election scheduled to be held in March 2017 and it is possible that there will be a change of government as a result of that election. It is also possible, that, following the election, a Labor government may also want to pursue an aggressive asset sale strategy to support declining State revenue. We are well placed to inform and guide you during this period, with our significant government and public policy connections.

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In Western Australia we advise our clients on a daily basis about the regulatory system in Australia and we are intimately familiar with how it will impact on these privatised assets.

For more information or to receive a copy of our Doing Business in Australia guide, please contact a member of our team.

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