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Position of the Management and Supervisory Boards of Luka Koper d.d. as to the potential establishment of port authority and granting additional concessions within the port of Koper

At its session held on 30th August 2016, the company's Supervisory Board discussed and together with the Management Board adopted a position regarding the establishment of a port authority and granting additional concessions within the Port of Koper.

Port authority is a management model often employed in European ports, yet it is inappropriate in the case of the Port of Koper for historical reasons regarding its establishment and development as illustrated in more detail below. Moreover, the port authority as a management model has several faults, which the EU ports are trying to mend through the adoption of more market-oriented measures and operation. In this particular view, the Port of Koper has proven successful and efficient, as is corroborated by its business performance.

A port authority is a body usually formed by the government or local community. In most cases it is a public authority also engaged in funding and the construction of port infrastructure. Mostly in the past, port authorities funded infrastructure that the market actually didn't require, hence the investments couldn't pay off. In addition, they faced problems with regard to administrative procedures which were often an obstacle to the marketing activities within the port – i.e. marketing had to adapt to the administrative procedures and not vice-versa.

Back in the 1960's, the Port of Koper established a model of port management which prevented the funding of infrastructure not required by the market. This model allowed a rather easy management which did not impede the port's commercial activities. The port was managed by a subject that was simultaneously present on the market as well as financed the construction of port infrastructure with its own funds. For this reason, funds were only invested to meet market requirements, and the port management process, including administration, did not hinder the marketing activity. All these elements contributed to the development of the Port of Koper.

The efficient management was also facilitated by the fact that the port has always developed as a homogeneous system with the services required by the customers provided at a single site. Within the entire port zone, the customers dealt with only one subject that combined both the role of port authority as well as service provider, offering a wide range of services (many ports combine a lot of contractors that only provide partial port services, hence a customer interested in a comprehensive service needs to contact several providers). On one hand, this subject was obliged to comply with the legislation granting the authority over port management, while on the other it had to meet the needs and requirements of the customers. This was and still is a huge competitive advantage of the Port of Koper.

Through the Concession agreement for the provision of port services, as well as the management, development and maintenance of Infrastructure within the Port of Koper, No. 2411-08-800011 as of 8th August 2008 (hereinafter: Concession Agreement) granted by the Republic of Slovenia, Luka Koper d.d. as a port operator and service provider retained a certain autonomy which enables the successful development of the port.

The European Union was long aware of the port development issues (inefficiency of ports) but never took a decisive step in that direction. Some changes were anticipated as late as in the 1990s when the EU Commission released its Green Paper on Ports and Maritime Infrastructure (hereinafter: Green Paper). It addressed the problems of the European ports, in particular the fact that instead of depending on tax-payers money – which was facilitated through the established concepts of port authorities – they should operate as commercial, market-oriented entities. Moreover, the Green Paper lacks any explicit requirements or rules as to the port management model, such as port authority, but instead supports the variety of these models as being developed in the EU member states. This is also evident in the proposal for a regulation of the European Parliament and of the Council establishing a framework on market access to port services and financial transparency of ports.

Luka Koper d.d. is acknowledged for the efficiency of the port management model by its business partners and others beyond the Slovenian borders. In fact, some have analysed it. Italy, which consistently struggled with problems in port management, made the decision to reduce port authorities and superfluous administrative procedures within them (the latter being the largest problem of the Italian ports that is not argued only by economic operators and experts, but also finally came to the attention of the Italian government). In the process, they also analysed the management model of the Port of Koper and assessed it as extremely efficient.

The establishment of port authority not only poses a problem to the port management, but also in regard to the Concession Agreement. In fact, such a transformation would require a radical amendment of the agreement which involves a serious risk that EU authorities might consider the change illegal or a new concession agreement thus requiring a new procedure as to concession granting. Under no circumstances should the overhaul of the concession regulation be so radical as to be considered a new concession agreement. In addition, a concession agreement is not different from any other contract in that any amendments or changes must be agreed on by both parties. The Republic of Slovenia may also unilaterally change the current Concession Agreement in which case the concessionaire will be entitled to the reimbursement of any damage which would ultimately affect public finances.

According to the Ministry's letter, one of the principal reasons for the amendment of the Concession Agreement are the forthcoming investments of Luka Koper d.d. that will increase unamortised value which would cause serious problems for public finances and a new concessionaire. In terms of public finances, the solutions for this problem are defined in the provisions of Item 13.3. of the Concession Agreement (paragraph V) which explicitly determine

that should a new concession agreement for a new concession period be granted after the expiry of the current one, the funds in the amount of the unamortised value of investments will be considered part of the concession fee the new concessionaire will be liable to pay upon signing the agreement. In the event that Luka Koper d.d. is selected a new concessionaire, the company will be exempted from a portion of the concession fee payable at the conclusion of the concession agreement which will terminate Luka Koper's right for reimbursement of the unamortised part of investments. Neither will a new concessionaire be confronted with major problems; instead the problems are more likely to occur in the event of Luka Koper d.d.'s absence of investments in port infrastructure. Without investments, the port infrastructure will be out-dated and poorly maintained after the expiry of the Concession Agreement. Consequently, a new concessionaire will pay the Republic of Slovenia substantially lower unamortised value though this is not the principal problem; the port's infrastructure will require considerable investments, thereby giving a new concessionaire the possibility to negotiate the lowest possible concession fee with the Republic of Slovenia.

Last but not least, lack of investments in port infrastructure and its inadequate maintenance provides a problem for public finances also from another perspective. Without investments Luka Koper d.d. won't be able to keep abreast of the competition, the cargo throughput in the port won't increase and as a result the Republic of Slovenia will fall short of a portion of the concession fee. Not to mention that this will also affect dividends distributed to the Republic of Slovenia, a major shareholder.

From the market perspective, the establishment of a port authority in Koper doesn't add any competitive value. The Port of Koper's competition – i.e. the ports of the Northern Adriatic and beyond – require investing in constant efforts in development in order to keep up or win aspects of the competition. The current port management model enables the attainment of this goal, which is confirmed by the company's business results.

According to the Ministry's letter, the establishment of a port authority should also serve the purpose of bringing new concessionaires into the port that would build port infrastructure because the state is short of necessary funds. The issue here is the intertwinement of current port infrastructure. Ever since its foundation, the port developed as a homogeneous port constructed by a single operator which was also a service provider. This resulted in numerous terminals that mutually interlace and complement their operations. For this reason it is very difficult to bring into such a homogeneous space a new concessionaire that would operate on its own account while simultaneously being forced to use a part of Luka Koper d.d.'s infrastructure for its operation. Moreover, a new concessionaire would have to make new investments and the related costs might affect his ability to pay high concession fees.

Luka Koper d.d. has always provided the funds for investments in port development (either as a concessionaire or by its predecessors). It should be pointed out that the complete port infrastructure in the area of approximately 250 hectares was built exclusively with Luka Koper d.d. funds. In this respect, it never depended on tax payers, which has been the case (and problem) in many European ports. The company's strategic plans further anticipate autonomous investments in port infrastructure, including an additional extension of the port area compliant with the NSP - National Spatial Plan (the final solution based on NSP anticipates a total port area of 404 hectares), thereby pursuing a comprehensive and homogeneous port management in accordance with the current management model which has always excelled in responding and adapting to market requirements.

An increased number of concessionaires investing in the Port of Koper, regardless of their ROI, is not necessarily related to an increase in cargo throughput, which determines the amount of a

concession fee. Due to its spatial limitations, the port can only allow a certain volume of cargo, which is hardly dependent on the number of concessionaires. Moreover, Luka Koper d.d. is neutral to all its customers – meaning that it treats them equally without favouring certain shipping companies, logistics operators, forwarding agents, etc. In the event that shipping companies or individual logistics providers become concessionaires, it remains a question whether they would be interested in cargo increase or pursue their own interests which are not necessarily throughput growth. Other than spatial issues, the Port of Koper is also faced with inadequate hinterland connections, in particular railway links. Unless this problem is solved, any noticeable increase in cargo throughput is virtually impossible regardless of the number of concessionaires. On the other hand, Luka Koper d.d. sees large potentials in the growth of cargo throughput should the state enable a faster increase of the port's capacities, which is closely related to granting consents for the construction of port infrastructure and hinterland connections, particularly the second track of the Divača-Koper railway line. Not only would Luka Koper d.d. benefit from it, but also the Republic of Slovenia on account of a larger concession fee (due to increased cargo throughput), as well as dividends from distributable profit. In any case, should the Republic of Slovenia as a major shareholder of Luka Koper d.d. bring new concessionaires within the port zone, cargo throughput and consequently profit will most likely decrease and thereby also dividends of the Republic of Slovenia.

Based on the above, the Luka Koper d.d. Management and Supervisory Boards position is that the potential establishment of a port authority and the granting of additional concessions within the Port of Koper would invite considerably more problems than it would provide solutions.

Koper, 30th August 2016

LUKA KOPER, d.d.

Management Board

Supervisory Board