



PUBLIC PRIVATE PARTNERSHIPS PUTTING GUIDANCE INTO ACTION



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FOREWORD

We need to continue to develop our infrastructure if we are to maintain economic growth and enhance services to our community. Governments accept that the private sector has a vital contribution to make, and view Public Private Partnerships (PPPs) as a policy and procurement tool to develop both social and economic infrastructure.

With increasing and competing calls on scarce Government revenue, the construction industry has a critical role to play in the finance, design, building, maintaining and operation of infrastructure. But if the industry is to continue to participate, it must do so efficiently and on terms that are reasonable and acceptable to all parties.

ACA members have welcomed the effort from Australian governments to establish a framework for a viable PPP market. The PPP guidelines published by the various jurisdictions are extensive and draw on international experience. The initiative to establish a National Ministerial Forum on PPPs is a welcome development.

The challenge is to translate the guidelines into practice, which to date has not eventuated. The cost of bidding and delivering PPPs is far too high and the allocation of risk is often inappropriate, unbalanced and unfair. The industry will not continue to participate unless these inequities are removed.

ACA members are economically dependent on the industry's major clients and work very hard to maintain harmonious working relationships. The current evolution of the PPP model in Australia will challenge those relationships unless serious structural weaknesses are addressed. Necessary progress will only be made to reform PPP procurement if it is managed in a co-ordinated and co-operative manner.

This document details the concerns of Australia's major contractors and provides a series of recommendations for future action. ACA members participate not just as constructors but as shareholders in PPP Special Purpose Companies and service providers. The implementation of the following recommendations is therefore fundamental to the successful development of PPPs.

Healthy competition has been a hallmark of the Australian construction industry. An equitable PPP marketplace will enhance competition in that arena by encouraging more companies to participate. This will only occur if existing flaws in the procurement process are eliminated.



W. M. King AO
President
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ACA TASK FORCE

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PRINCIPLES

The principles behind private sector involvement in social infrastructure are set out in several government guidelines¹. The aims are to:

- deliver better infrastructure and services and maximise value for money
- develop an integrated and whole of life approach to managing assets and services over a long period
- share risk by allocating it to the organisation best able to manage and mitigate that risk.

ACA members agree with these principles and endorse the work that has been undertaken by governments to develop them. However, the problem resides in the implementation of such principles.

The following areas must be better managed if PPPs are to play an integral role in improving the country's social infrastructure:

- **Risk allocation needs to be appropriate.**
Governments and contractors generally agree that risk should be allocated to the party best able to manage it and acknowledge that some risks should be shared. Some public agencies believe they should transfer as much risk as possible. Advisers take the same approach, sometimes without their client realising the fact. Investment Banks have often facilitated this risk transfer when, as project leaders, they have accepted risks in the belief that they can find other parties to carry them, and take a return for their role in the process. This needs to change.
- **Contracts must be managed in partnership.**
A long-term partnership between government and the owners and/or service providers requires interaction, co-operation and joint resolution of problems. There should be clear principles on who is responsible and how matters of contention should be resolved constructively.
- **Procurement processes need to become more efficient.** The very process chosen for tendering and negotiating sets the framework for the relationship that follows. In practice, too many PPPs are put to the market before the public sector has a firm basis for a project, and the management of the process can often hinder rather than help the development of competitive responses. A well-conceived, well-managed PPP process will attract quality, competitive responses. However the converse is also true.

The following pages consider each of these areas and suggest how the industry's public and private participants can introduce better contracts and processes in the future.



APPROPRIATE ALLOCATION OF RISK

PAYMENTS FOR PERFORMANCE

A fundamental feature of PPPs is that the Government pays the private partner for performance. In a school or a hospital the key measure of performance is the availability of facilities to appropriate standards and with appropriate support services, so that the classroom or ward can be used by the teachers or doctors. This is sensible. It gives the private sector responsibility for making things work.

Such measures are established by agreeing to an output specification, choosing Key Performance Indicators (KPIs) and setting payments according to the performance achieved. The rules that should be adopted are as follows:

- The contractor must not be able to make money by reducing what it spends and then suffering only a small deduction from its payments. Deductions should be higher than the avoidable costs, to make sure the specified/required service is provided.
- However, the size of adjustments must be reasonable. It is right for the contractor to forego some fixed costs if performance is poor, thereby receiving a reduced return on equity. But it is wrong for all the capital that has been invested in the facility to be at risk of large payment deductions for small variations of performance. If this is proposed, proponents will quote much higher prices, which will destroy value for money and reduce the likelihood of the project proceeding.
- Payment adjustments should be the key incentive for the contractor and “exclusive remedy” for the Government. There also has to be a reasonable limit placed on this liability. The Government can retain its rights under common law to take action in the unlikely

event that the contractor is negligent or causes physical damage. But it should not try to make the payment deductions equal to the full consequential loss that poor performance, in theory, causes for users. This is unrealistic.

- In the unlikely event the contractor does persistently miss its performance targets, the Government should insist upon remedial action. If this does not produce the desired results, the contractor should receive a warning, which in turn should lead to termination of part of the contract. This would involve significant loss of income for the contractor and protect the Government and the public.
- At the same time there should be the potential for the contractor to earn a bonus for delivering better than expected performance. Payment adjustments should not be asymmetrical.

These rules are consistent with the Government guidelines. Partnerships Victoria refers to “An incentive for the private party to perform in accordance with the Project requirements” and “Mitigating the consequences for Government if performance is substandard”². In practice, however, payment adjustments are often one-sided, irrationally high, and combined with liability for consequential loss. This creates an inefficient allocation of risk, deters ACA members from participating and drives up costs.

FITNESS FOR PURPOSE

It is important that facilities provided under PPPs remain up-to-date and appropriate for use by the public, and for the people that provide services in them. The contracting industry accepts this and fully understands that partnerships need to establish a methodology to review standards and update assets when regulations or customer expectations change.

The methodology needs to clearly outline how such changes are managed. Government should have the responsibility for the cost of changes to the design of facilities that have arisen from regulation changes. Service delivery contractors should agree to the potential responsibility for additional tasks that arise, within pre-defined parameters.





This project for the design, construction, operation and maintenance of a 300 bed Correctional Program Centre and a 600 bed Remand facility in the south and west of Melbourne offers examples of both a good procurement process and commercial regime.

Tenders for design, construction, financing and maintenance of the two correctional facilities were sought from a shortlist of bidders. A single preferred bidder was selected and after a period of negotiation the project reached financial close. There was no necessity for a BAFO. Financial close was in January 2004 and the facilities will be fully operational in 2006. This is a good model of procurement management.

The risk allocation and commercial arrangements under the Project Deed also offer an example of a sensible commercial regime:

- A monthly services charge is paid for the provision of accommodation services and security systems services. This can be abated where the contractor fails to provide all services in accordance with the performance standards at all times.
- The abatement is calculated on a daily basis. There are seven levels of performance failure event (PFE) and the abatement amounts range from 600% for the most serious security failures to 30% for the least serious failures. There is a Response Time and a Rectification Period for each performance failure and Abatement occurs when the PFE is

not rectified within the Rectification Period. The Periods are reasonable and achievable and the abatement amounts are in proportion to the seriousness of the events to which they apply.

- The maximum aggregate abatement amount in any month is not to exceed 100% of the monthly services charge. The contract permits relief from performance in certain circumstances.
- An event of default under the contract occurs where:
 - a failure is not rectified within a certain cure period;
 - the number of failures of a particular level which are not rectified within the relevant Rectification Period exceeds a certain limit and this situation is not rectified within a given cure period, or
 - The contractor wilfully or persistently fails to try to rectify a failure.
- The contractor has the right, before the expiry of a cure period, to request the State to extend it. The State cannot unreasonably refuse to grant an extension if the contractor demonstrates to the reasonable satisfaction of the State that:
 - an extension to the cure period is required
 - it has in place a plan to cure the event of default
 - temporary measures are being undertaken in the meantime, and
 - The contractor is diligently pursuing a cure of the default.



CS02

KPIs are usually worthy attempts to measure what matters to the public sector, but when combined with the times allowed for remedying problems and the resultant payment deductions, the results often do not make commercial sense. Here are some examples:

- A project where if a room is unavailable for more than one half hour period then payments for that part of the facility are not made for the whole day, removing a substantial proportion of the PPPs total revenue, not just the service element of the payments.
- A hospital where late delivery of meal service at one mealtime in one area leads to failure of the meal delivery KPI for the whole catering payment for the whole facility for that period.
- Educational facilities where the rectification time for deficient cleaning or problems such as broken windows is half an hour, requiring employment of an inefficient number of estate employees to avoid significant payment deductions.

KEY PERFORMANCE
INDICATORS

At present, some government contract proposals make the contractor responsible for an asset's "fitness for purpose" over a long-term. This is usually impossible to manage or price efficiently. For example, a contractor can undertake to design and build a road that will carry a certain amount of traffic for a certain period. However it would be extremely difficult for a contractor to give an undertaking that a classroom will be suitable for the unforeseeable needs of the education system in 20 years' time, as technology and teaching methods evolve. This risk is inappropriate for the proponent and cannot be priced. Such risk should be assigned to the Government.

At best, there might be scope to request the contractor to price options for specific changes that provide the Government with flexibility.

TERMINATION PROVISIONS

Sometimes projects go wrong. Governments have a responsibility to ensure their positions are protected in these circumstances so that alternative arrangements can be made for service provision if necessary.

The Guidance recognises that it is often appropriate for compensation to be paid to the private proponent if this occurs. There are arrangements to pay compensation if termination occurs during construction after the proponent has invested capital to develop an asset that has value to the State³, and there are separate provisions relating to the operations period.

The construction industry does not believe it is appropriate to negotiate different arrangements for every contract. Contractors need consistency and certainty regarding their position. ACA members endorse the concept of a "market value" termination during the operating phase, whereby the value of the private sector's interests are set by determining what the contract is worth to new owners. But there is often no objective basis for determining this if there are few potential purchasers of the asset, or if the Government has rights to control who can become involved and on what basis. In such circumstances an amount should be payable, based on the determination of an independent expert, to underpin the concept of market value. This is normal practice in Victoria and in the UK but has not always been followed in New South Wales.

The construction industry will:

- take responsibility for performance that is within its control
- provide facilities to meet an output specification over an accepted timescale
- accept an appropriate abatement regime in accordance with any shortcomings in the service it provides.

The public sector should:

- tender commercially realistic performance and payment regimes
- not transfer unmanageable risk
- provide for reasonable compensation on termination.

EFFICIENT PROCUREMENT

EFFICIENT PROCUREMENT

Government's guidance on how PPP processes should be managed reflects the fact that States and the Commonwealth are experienced procurers. Some of the most important principles in their documents can be summarised as follows⁴:

- projects should be properly defined and have business case assessments before procurement commences
- the position on planning and environmental approvals should be clear
- a shortlist of proponents should be drawn up based on submissions that show parties' experience and capacity in relevant areas
- the assessment criteria for shortlisting should be published
- requests for Detailed Proposals should be based on high quality documents including a draft Project Deed so that the risk allocation and other aspects of the relationship are clear
- the information submitted by proponents should be sufficient to ensure there is agreement on commercial and legal issues and appropriate evidence of commitment to the funding before a Preferred Bidder is selected, and
- the winning Proposal should offer Value for Money compared to a Public Sector Comparator.

All participants in the construction industry agree with these principles. However, few would agree they are being implemented appropriately. Below are key recommendations for improvement.

GATEWAY REVIEWS

Gateway Reviews are the checks undertaken by the Government to ensure projects have been properly considered prior to the release of tender documentation to the marketplace. For example, has it been established that there is a business case that the Government can afford to implement?

These checks are meant to safeguard both the Government and the private sector against money being spent on a procurement process prematurely.

Three issues often need more consideration in this process:

Is the project affordable? Sometimes the enthusiasm for new facilities can overshadow the importance of a fully-costed, thoroughly investigated business case. For example, do the projections take account of what it will cost to deliver any higher standards of service required by the specification — particularly in areas such as maintenance — which the Government may have managed in the past within available budgets rather than to specified standards? Has all the preliminary work on community consultation and project planning been properly costed?

Can the Government meet its own obligations in the procurement? Proponents put together large and experienced teams to participate in these processes and to address a range of technical, commercial and legal issues. Such teams require access to information, such as the interface between the PPP service provider and public sector employees. Sometimes the Government has an experienced and well-resourced team to respond to such information requests. Often it does not, and/or relies heavily on consultants and advisers who cannot communicate authoritatively about the objectives and constraints of the Project.

Are the tender documents ready? The timetable for transactions is always tight and often the subject of political commitments. The industry welcomes a determination to get things done but not if it results in documents being issued to meet announced deadlines before they are ready. Such instances make it difficult for contractors to respond efficiently. For example, how can they consider whole of life cost issues if they have a design brief but not the performance standards? Yet the bid team will have mobilised in anticipation of the documents, and that will be costing money. Tenders should only begin when all the documentation is ready and the Government knows what it wants. It is not appropriate to require pricing of a large number of variants to defer the need for the Government to make appropriately timed decisions. Exploring material variants within the bid should only be done with the Preferred Bidder.



This project for the construction of a new Women's Hospital and Neo-natal facility in Melbourne, plus provision of related services is currently in procurement:

- there has been constructive discussion with the proponents to ensure compliance with the tender requirements
- probity procedures have not been allowed to dictate the process
- the State has generally delivered according to its published timetable
- the process has allowed continued review of risk transfer and associated practices, and
- the documentation is clear and in most respects incorporated a reasonable and commercial position from the outset.





This project for the construction and refurbishment of various hospital facilities at the Newcastle Mater Misericordiae Hospital (Mater Hospital PPP) is currently in procurement. As far as the market can see the process has shown:

- an absence of a real 'partnership' approach to the administration of the process; indeed, a lack of willingness to engage in discussions with bidders during the site visit, and
- delayed release of the documentation, perhaps because issues were not fully resolved before beginning the procurement.

This approach in the early stages made it difficult for tenderers to obtain responses or even to ask questions, and therefore to understand the risks being transferred and the State's requirements.

PUBLIC SECTOR COMPARATORS

A Public Sector Comparator (PSC) is an estimate prepared for the Government on what it would cost to meet the performance specification for a PPP in the public sector, using traditional delivery methods and taking proper account of risk. ACA members recognise the role that a PSC can play in the procurement process. It helps to inform the public sector on issues raised by a project and provides a benchmark for assessing the value for money of PPP proposals.

PSCs are important for all stakeholders, given the PPPs lack of track record in Australia. Whilst the construction industry approves of the PSC in principle, it believes there are issues that need to be addressed in its application.

- **Risk.** Governments' own guidelines state that "The Value of Transferable Risk to Government needs to be included in a PSC to allow a like-for-like assessment with Private Sector bids". It sets out in detail how this should be undertaken⁵. Estimating the cost the Government would incur if risks crystallised is a crucial component of the PSC. Extensive research and an independent report in the UK by Mott MacDonald has shown how there is common 'optimism bias' in the way governments assess the likely cost of projects, as final costs often exceed the original estimates by up to 51% for non-standard buildings⁶. In Australia, governments typically underestimate this factor when preparing PSCs.
- **Role of PSC in Assessment.** The role of the PSC should be made clear. Some parties argue that the PSC should remain confidential to avoid proponents gearing proposals to the costs specified in the PSC. This misunderstands the strength of a competitive bidding process. Proponents are vying to outbid competitors rather than the PSC. As in any sector of business, if one side of a transaction has unrealistic expectations, then the other side may not want to waste time in participating. One approach is to use the PSC as a guide for the Government's purposes (that can be developed to reflect changing understanding of the project) rather than as a decision making tool. This is increasingly the approach taken in the UK⁷. In Australia, unfortunately, the PSC is more typically used as a Pass/Fail test. Some governments have aborted procurement on the grounds that bids fail to beat the Comparator even though the PSC is a theoretical set of numbers that may never be capable of delivery by the public sector.

If this is the approach then it is essential for the risk-weighted PSC to be published, illustrating the true hurdle that the proponents have to beat after adjustment for risk.

Contractors have a reasonable interest in whether the PSC is a realistic asking price, so the PSC should be developed and published at the time bids are invited.

STANDARDISED CONTRACT CLAUSES

One of the foundations of efficient procurement is standardised contract documentation. The work undertaken in the UK to develop standardised documents was very important in reducing bid costs, fast-tracking negotiation and completing more projects. There is some evidence that this works in Australia, for example New South Wales road projects. However, in the case of social infrastructure PPPs we are seeing a wide range of approaches to project delivery. Even when precedents from earlier contracts are available, government officials and their advisers often come to the table with the idea that they can improve on precedents by bringing their own wish lists and trying to get "best possible deal" for the State.

This is counterproductive. Everyone recognises that new contracts sometimes need new approaches, but there are several areas where standardisation should be possible. These include the areas of risk allocation discussed previously (payments for performance, fitness for purpose and termination provisions) and other areas such as force majeure, representations and warranties. Governments should work together to achieve standardisation in such areas, in consultation with the PPP industry. ACA members would be happy to work with other stakeholders and invest time in a standardisation process to ensure an optimum outcome.

BID BONDS

Even with standard documentation, the cost of bidding for a PPP will remain significant. At the Request for Detailed Proposal (RDP) stage a proponent can easily incur expenses of \$2m on design work and advisers. On a large scheme with extensive submission requirements the dollar figure could increase exponentially. Yet some governments still ask for tender bonds that are callable if a proponent withdraws from the process.

ACA members do not regard bid bonds as appropriate. In all cases proponents have clear financial and reputational incentives to complete tenders. In a partnership process this should be regarded as sufficient.

NUMBER OF BIDDERS

There appears to be an increased acceptance for three proponents only being short-listed for PPP projects. This is welcomed by the ACA. However, there is still a tendency to rely on a BAFO stage, sometimes not only to finalise terms and price but also to introduce variations or options into the tender. This increases costs, takes time, and should not be necessary if the original scheme is well-thought through. It should only be acceptable in circumstances where two bidders cannot be separated on the evaluation criteria.

FINANCIAL COMMITMENT

The ACA accepts there should be agreement on commercial and legal issues and reasonable evidence of commitment in principle to a funding package before a Preferred Bidder is selected. However, governments and proponents need to share the objective of minimising costs before the appointment of a Preferred Bidder.

Proponents accept the need to consider the Project Deed in detail at the first stage of a bid because everything else flows from it. The work is costly, but if it is managed sensibly it is an appropriate part of the decision-making process, the cost of which will reduce as contracts become more standardised. The same arguments do not apply to the financing documents such as loan agreements, bond circulars and inter-creditor agreements. Drafting these can easily cost more than comments on a Project Deed and it is inefficient and unnecessary for several

parties to do such work before a Preferred Bidder is identified. For the purposes of choosing a Preferred Bidder a detailed termsheet from the proponent describing its funding package, supported by letters from funders and cross referenced to the financial model, should suffice.

PROBITY PROCESSES

All market participants agree that the highest standards of Probity must be maintained to ensure confidence in public tender processes. Rules on contact with bidders and access to information must be fair, even-handed and transparent. This principle, however, need not — and should not — prevent governments from engaging with bidders constructively during the tender process.

On some projects this is understood and well-managed. Workshops are held to discuss issues and there is constructive and well disciplined interaction between the procurement team and proponents. On other projects, the probity rules are allowed to dominate, resulting in the project team being denied contact with the prospective client. This rules out forums for further clarification or discussion of ideas, which may be critical in delivering value for money, and which can still be discussed with a proponent without being unfair to other bidders. This approach in fact can discourage innovation and result in proponents producing similar, conservative or “off the mark” proposals.

The ACA strongly encourages governments to follow probity plans that allow sensible interaction with proponents in confidence, and that are proportionate to the potential issues they are designed to address, not over-engineered to cope with potentially disgruntled, failed bidders.

The construction industry will:

- invest resources in developing PPP solutions
- aim for competition and wide participation in the process
- invest time and money in negotiating Project Deeds.

The Government should:

- be more rigorous in testing and preparing schemes before procurement
- allow a competition to determine the best price but at minimum publish full PSC figures if they are to play any role in bid assessment
- invite a maximum of three bidders, minimise reliance on BAFO processes and select Preferred Bidders sooner
- rely on term sheets rather than full drafting for financing documents and Design and Construct (D&C) and O&M contracts until a Preferred Bidder is selected
- remove the requirement for bid bonds
- avoid unduly restrictive probity procedures.

PROCUREMENT SUMMARY

The Southbank Education and Training Precinct Development Project in Brisbane is Queensland's first PPP under its Value for Money Framework. It involves the redevelopment of Southbank TaFE and part of Brisbane State High School. It is an ambitious project with several stakeholders and is one of the first PPPs in Queensland. Perhaps partly for these reasons there have been issues in two important areas:

- **Adherence to timetables.** Expressions of Interest were requested in February 2003. It took six months for the State to announce the shortlist of bidders and a further four months from that date before the release of the project brief. The timetable has been continuously pushed out and consequently it has been difficult for bidders to manage resources. A stop-start procurement process of this sort no doubt indicates a genuine attempt by the State to get things right but reduces the confidence of the bidders in the commitment to the project and the Government's ability to deliver it.
- **Interaction with bidders.** Attempts to have an interactive procurement process have not gone far enough. There appears to have been a lack of willingness to communicate with bidders, apparently due to a fear of leading the private sector to a particular solution. Free flowing discussions about the brief have not been permitted. More interaction and joint working would have resulted in better structured bids and helped the State achieve its timetables.

CS06

This project offers an example of a good partnership approach, which may be applicable to PPP style transactions. It was a \$220m project to design, construct and maintain a 4.5km bypass north east of Brisbane, connecting the South-East Freeway to Kingsford Smith Drive. Construction occurred adjacent to some of Brisbane's busiest roads and intersections.

The contract was originally let as a firm lump sum contract, but the 'Phase Two Relationship', as it was called, involved:

- gain-share provisions which saw cost savings shared
- shared risk provisions which promoted joint ownership of problems and solutions, and
- a collaborative approach to managing third parties.

In early 2000, the joint project team began working from a common office. This brought people from different cultural organisations together to work collaboratively. A relationship management process was adopted whereby senior management met monthly to review common objectives. These forums often led to fast-tracked solutions, ensuring that issues or concerns were dealt with quickly and effectively.

CHANGES UNDER A CONTRACT

All long-term contracts need to provide for change, particularly where they govern the interface between support services and public operations that can be affected by new customer requirements or technology change. Under some PPP contracts the Government can therefore make changes in specification and cover the cost.

The Guidance⁸ suggests that a contractor can be compensated by increasing the payments made over time. This puts the obligation on the private party to raise new money to fund any investment required to implement the change, and then spread the cost to the Government over a period. This is not appropriate. Governments should recognise that PPPs are usually managed by special purpose companies that have borrowed under strict conditions, and are not able to raise new money efficiently in such circumstances. The Government should pay for the cost of changes in the year that they arise and not rely on the PPP company raising debt and equity.

EMPLOYEE ISSUES

Project company employees and their contractors make PPPs work. They have the day-to-day contact with the public. Contracts need to give proper consideration to the matters that impact on them. The private sector is ready to play its full part in creating the appropriate environment for this to happen. The private sector recruits and trains new employees and accepts responsibility for public sector employees who transfer to the private sector in cases where that is appropriate.

The framework for this delivery method needs to be appropriate and ACA members are happy to take responsibility for managing employee relations effectively, to avoid disruption to the service. Government needs to have similar obligations to facilitate interface between the private sector PPP team and the public sector. For example, where public and private employees work alongside each other, the Government should make sure employees make information available and take responsibility for meeting their obligations where there is an interface. This is not a risk the private sector can manage or accept.

REFINANCING

It is normal practice for PPPs to be refinanced, for example, once construction has been completed and the lower risk profile of the project allows debt to be obtained on more attractive terms. The Guidance⁹ recognises this. It says that requiring a share in the benefits of refinancing would amount to “double dipping” by Government if such changes had been reflected in the price already offered through a competitive bidding process.

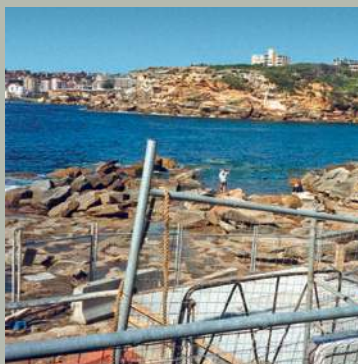
The prospect of refinancing is important to project investors. ACA members (who hold equity in such projects) view it as one source of return and take it into account when setting a return hurdle rate. The target return before refinancing will be lower if there is a reasonable prospect of an additional refinancing benefit. If governments have the right to prevent refinancing or take the major part of the benefit from it then target Base Case returns will be higher.

It is therefore important that governments acknowledge the legitimacy of returns from this source. The industry believes it would be better if governments did not ask for a share of refinancing gains, recognising that they will then be factored into the base case. One could argue that if governments want to take a share of such potential financing upsides, they should also be willing to share in potential financing downsides. As a minimum, if governments want to share refinancing gains then the draft Project Deed should clearly set out such terms.

BID COSTS

ACA members accept they need to invest time and money in bidding processes, including those of PPPs. Contractors have done so for a long time in D&C tenders and the principles should be no different for PPPs. In practice the costs of preparing fully detailed designs at an earlier stage and meeting the legal and financial requirements of PPPs are substantial. There is no case for the construction industry to bear such costs. The industry can play its part in a PPP without doing so. Requiring proponents to bear these costs in full will discourage companies from participating and leave the responsibility for bidding with a small number of financial institutions that do not have the full range of skills to lead the process.

CS07



SewerFix is an alliance between Sydney Water Corporation and five private sector alliance partners Bovis Lend Lease, Sinclair Knight Merz, Tenix, CH2MHill and the Phillips Group. It was formed in 2001 to upgrade 230 pump stations over three years, and has been an example of an effective partnership.

The selection process was effective and comparatively inexpensive. It included a submission, interviews and an intensive two-day live in workshop where the major issues facing the alliance and its delivery of the upgraded pump stations were analysed.

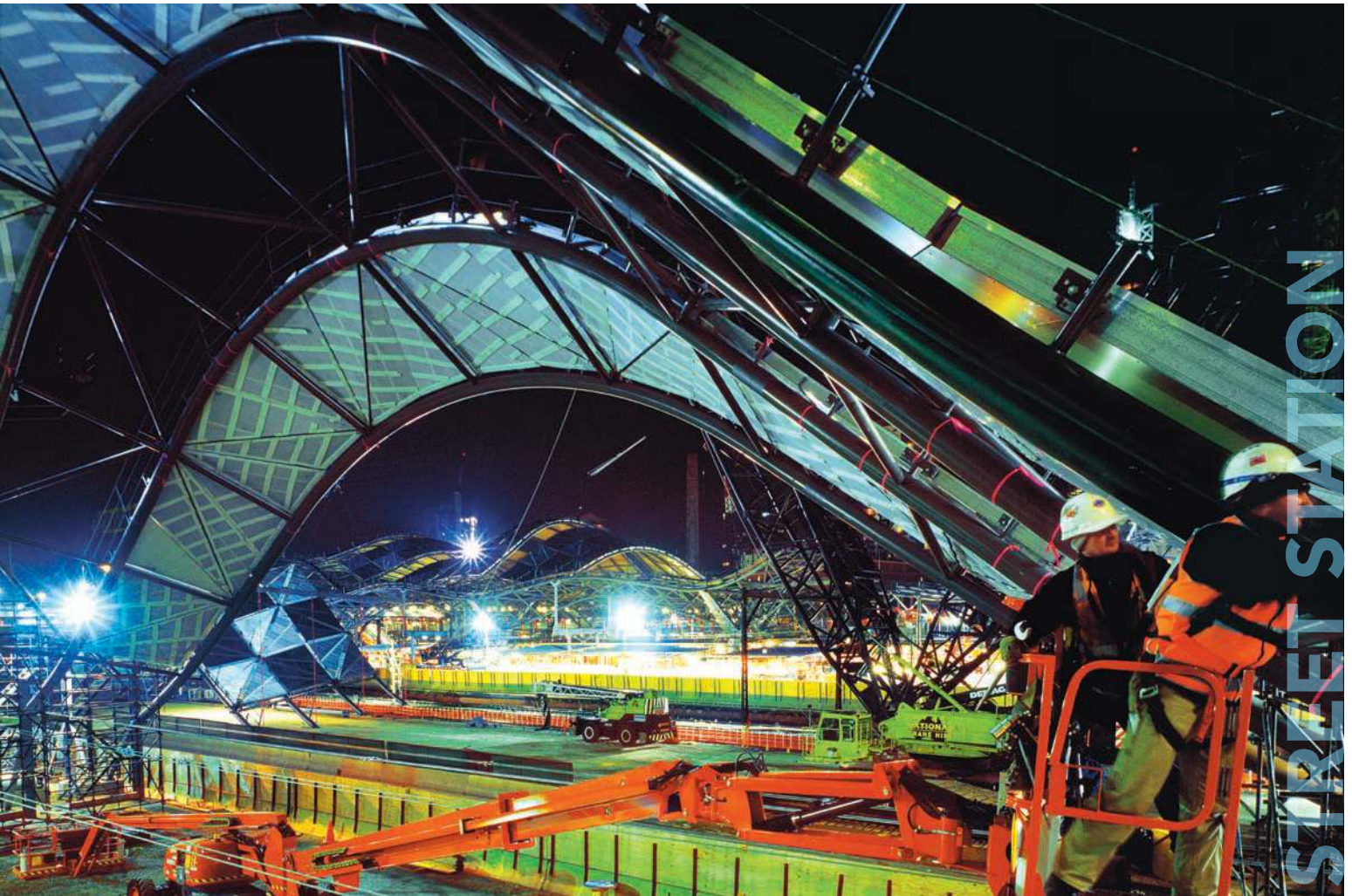
This workshop was the genesis of the alliance. The vision, principle and objectives were set, the major issues agreed and commitments made that were then set as KPIs covering cost, time safety, environment, community, quality and legacy.

This collaborative and inclusive approach ensured team ownership of all the KPIs, based on agreement that a high performance team should achieve better than "Business As Usual" and that there should be stretch targets. Achievement of this would lead to improved returns for the alliance but substandard performance would have the opposite effect.

Detailed start up plans were developed, presented, analysed and agreed. This set the scene for a fast and efficient start to the program which enabled Sydney Water to meet its Licence and EPA commitments. Over the three years SewerFix delivered on time, 15% under the target cost estimate, whilst achieving outstanding results in safety performance.



SYDNEY WATER



CS08

SPENCER STREET STATION

The project involves the redevelopment of Spencer Street Station in Melbourne and was one of the first PPPs under the Partnerships Victoria Policy. It involves complete refurbishment of the station while it continues to operate as a busy metropolitan and regional/interstate terminus.

The project has been hampered by transferring to the private sector the whole responsibility for gaining access to a difficult site, including dealing with the demands of train operators, drivers and a range of government and semi-government authorities. The contractor has no direct relationship with any entity that governs access to the platforms above which it must work. The result has been significant delay and cost escalation, with well publicised dissatisfaction about the expense the private proponent has had to bear.

This is an example of where the State, the shareholders in the SPV and the contractor should between them have seen that such a key risk would best be shared in partnership between the State and the private sector.



The Guidance¹⁰ acknowledges that consideration may be given to reimbursing bidders' costs where a project is aborted for reasons other than value for money, commercial or technical considerations; and that in limited and clearly defined circumstances there may be a contribution towards the bid costs of a losing component. This approach should be the rule rather than the exception. The cost to Government of mitigating contractors' investment in expensive bids will be more than outweighed by benefits gained in terms of wider competition, greater innovation and improved value for money.

If Government is requiring work on project deed terms that do not follow a standardised form, or asking for extensive financing documentation before preferred bidder, then unsuccessful proponents who have submitted bona fide bids should receive around 1% of the value of the PSC in cost reimbursement (perhaps 0.5% for larger projects). If a project is aborted after a Preferred Bidder is selected and the process has advanced then that bidder should be paid a higher percentage or auditable expenses.

PERFORMANCE BONDS

It is normal under large contracts for a contractor to offer a bank bond as part of the security for its performance. This is callable in the event of works not being completed or the contractor creating costs for the client. ACA members endorse this and see it as an appropriate commitment to their responsibilities.

The level of bonding should reflect a sensible analysis of the risks in the contract if and when they materialise. In normal circumstances a bond should be no more than 5% of the D&C contract value at the outset and may reduce as risk reduces. Combined with normal monitoring to ensure progress is being made against a contract timetable, this is perfectly sufficient to provide discipline on the contractor and security for the client under a partnership arrangement.

In a PPP, the bond is normally lodged with the project company that enters into the agreement with the Government to ensure its contractor performs the necessary works. However, in some cases governments are also seeking a direct bond from the contractor for performance under the construction contract. This is not appropriate. It doubles the bonding costs of the contractor and is inefficient. There should be one bond only in the construction phase and it should normally be 5%.

A similar approach should be taken to bonds for Operating and Maintenance Performance, which should not exceed 10% of the annual contract value.

The construction industry will:

- price options for the Government to make changes, if possible
- manage employees for which it is responsible
- offer appropriate security for its performance.

The Government should:

- offer compensation at the time for any changes it requires
- manage interface with its own employees
- help the competitive process by giving appropriate support for bid costs
- avoid requirements for inefficient levels of bonding.

PARTNERSHIP SUMMARY



This project was procured by the NT and SA Governments as a BOOT scheme awarding a 50-year concession over the new 1,420km railway, built between Alice Springs and Darwin, and the existing track from Tarcoola to Alice Springs. The Governments provided a grant to assist with the viability of the project. Debt and equity were covered by prospective freight revenues and the grant financed the Nation Building aspects of the new transport link.

This project was delivered as a partnership between the Governments and the successful Consortium. It was well conceived from initial tender inquiry and led to a successful project where the Government promoter and the winning Consortium all benefited.

Some positive aspects of the procurement philosophy, which could be incorporated into PPP concepts, are:

- Government retained the land risk by providing the railway alignment, commitment to land sub-leases (including the risk of Aboriginal heritage issues) and granting leases over existing infrastructure as an additional financial incentive.
- Government committed to pay unsuccessful tenderers \$3m each. A single preferred proponent was selected. Selection criteria did not require tenderers to fully complete the concession deed or finance documentation before preferred bidder.
- Partnership continued throughout the period leading to financial close with amendments to the concession deed granted to accommodate the complexity of the deal. The Government financial grant was managed flexibly to facilitate financial close.
- Close communication at all times between the Government and the Consortium meant probity issues were no barrier. Partnership continued throughout the construction with a great deal of support in community relations from the NT and SA Governments.



ALICE SPRINGS TO
DARWIN RAILWAY

RECOMMENDATIONS

Given the issues considered in this document the ACA makes the following practical recommendations to the National Council about how the Government should work with the construction industry to improve PPPs:

1. It should consult industry on standard documentation for common issues, so that these are not re-examined on each project. The priority issues include:
 - linking payments to performance
 - fitness for purpose obligations
 - termination, including compensation based on determination of an independent expert.Boilerplate drafting can also be agreed on standard matters such as representations and warranties.
2. The work on standard documentation should create a more equal partnership between governments and contractors by addressing practical areas such as how change is managed under the contract, employee issues and appropriate levels for performance bonds.
3. Tenders should only begin when a project has been properly examined and the documentation is ready.
4. Public Sector Comparators should have the right level of allowance for risk and should be published.
5. Governments should not require bid bonds.
6. Full financial, and D&C and O&M contract documentation should only be required from preferred bidders.
7. There should be recognition that some probity procedures are currently too restrictive, counterproductive, and should be simplified.
8. Governments should support the cost of unsuccessful tenderers where, before preferred bidder stage, significant costs are needed. For example, the project deed does not follow a largely standard form, or work on financial documentation is required.

These recommendations will reduce the cost of procuring PPPs, strengthen competition and deliver better outcomes for everyone.

FOOTNOTES

1. In referring to guidance we draw principally on: **Victoria:** *Practitioners' Guide, Partnerships Victoria Guidance Material*, Department of Treasury and Finance, June 2001; *Risk Allocation and Contractual Issues, Partnerships Victoria Guidance Material*, Department of Treasury and Finance, June 2000; *Public Sector Comparator Technical Note, Partnerships Victoria Guidance Material*, Department of Treasury and Finance, June 2000; and **NSW:** *Working With Government Guidelines for Privately Financed Projects*, November 2001. **Queensland:** *Value for Money Framework*, Queensland Government, August 2002 and *Risk Management*, Queensland Government, August 2002. **WA:** *Partnerships for Growth Policies and Guidelines for PPPs in Western Australia*, Department of Treasury and Finance, December 2002.
2. PV, *Risk Allocation and Contractual Issues*, s5.3.
3. PV, *Risk Allocation and Contractual Issues*, s26.3.
4. PV, *Practitioners' Guide*, s10.1. and WWG ch2.
5. PV, *Public Sector Comparator Technical Note*, s2.4.3 and s5.
6. *Review of Large Public Procurement in the UK*, Mott Macdonald, July 2002, Table 2 page 2.
7. Refer to: *PFI: Meeting the Investment Challenge*, HM Treasury (UK), July 2003, s7.8 to s7.12 and Annex A: Public Sector Comparator Reform.
8. PV, *Risk Allocation and Contractual Issues*, s29.2.
9. PV, *Risk Allocation and Contractual Issues*, s10.9
10. WWG 3.6.3 and PV, *Practitioners' Guide*, s16.4

The Australian Constructors Association (ACA) was formed by a group of major construction companies in 1994. The ACA's Mission is to make *"the construction industry safer, more efficient, more competitive and better able to contribute to the development of Australia"*.

The Association has 14 member companies. A company must operate nationally and have a minimum \$A200m annual turnover to be eligible for membership. A pre-condition of membership is that the Chief Executive must represent the member on the Association's Board of Directors.

ACA member companies have combined annual revenue in excess of \$A15b and collectively employ over 40,000 people in their Australian and international operations. They operate in a range of markets including residential and non-residential building, civil construction, process engineering, contract mining, infrastructure maintenance, oil & gas, telecommunications and environmental services.

The Association has four key objectives:

- (i) To require the highest standards of skill, integrity and responsibility of member companies.
- (ii) To represent the interests of major contractors to Government and other decision makers.
- (iii) To enhance and promote the status of construction contractors and the industry which they serve.

- (iv) To facilitate the exchange of information and encourage further research on technical and economic matters of interest to construction contractors.

The Association has been active for many years in promoting improvements in the commercial life of the industry – and has used its energies to inform, to identify issues and to propose strategies to improve performance.

The Association's first booklet *Relationship Contracting, Optimising Project Outcomes*, was published in 1999. It was the product of an Association project to improve the delivery of major projects following an ACA survey of its major clients. In 2001 ACA published *D&C Projects, A Model Procurement Process* and in June 2001 published *Guidelines for Tendering*. More recently the ACA, in partnership with the Minerals Council of Australia, published *Relationship Contracting in the Australian Minerals Industry*.

The Association has also been instrumental in promoting the use of Dispute Resolution Boards in Australia through the Dispute Resolution Board Foundation.

These initiatives have demonstrated the Association's credentials and commitment to contribute to the development of the contracting industry by confronting problems in a positive way.

ABOUT THE AUSTRALIAN CONSTRUCTORS ASSOCIATION

ACA MEMBERS

Abigroup Contractors Pty Limited
Barclay Mowlem Construction Limited
Baulderstone Hornibrook Group
Bovis Lend Lease Pty Limited
Clough Limited
Henry Walker Eltin Group Limited
John Holland Group Pty Limited

Leighton Holdings Limited
Leighton Contractors Pty Limited
Macmahon Holdings Limited
McConnell Dowell Corporation Limited
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