

# New developments in PPP delivery: An Australian perspective

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The development of government public private partnership (PPP) policy across Australia, at a state and federal level, has led to a shift in the public sector approach to procurement. This article examines the Australian PPP delivery experience to date and demonstrates that the critical issue in determining the suitability of a project for PPP delivery is not the primary source of finance or the type of infrastructure, but rather which relationship between the public and the private sector will best achieve a value-for-money outcome, avoid issues of deal creep and speed up deal closure.

## An effective method of government delivery: Policy development

### Background

In Australia, the term PPP is used broadly, and the idea of a "partnership" between the private sector and government has been adopted in a variety of forms for some years. Only recently has the development of such strategies moved from *ad hoc* progression to a more directed approach under a growing culture of flexibility and innovation on the part of government. Recent years have seen the Australian PPP market mature, with state governments developing a uniform and consistent approach to procurement and delivery, commencing with Victoria's publication of its *Partnerships Victoria* policy in June 2000, and subsequent Guidance Materials.<sup>1</sup> All Australian governments have now released similar PPP policies, and the increasing "nationalisation" of the Australian PPP market has manifested in the National PPP Forum<sup>2</sup>, revealing a far more structured and co-ordinated policy focus, and a growing culture of flexibility and innovation by government.

The various policies aim to provide a framework for delivery of the best value-for-money outcome for government by fostering private sector confidence in government's ability to facilitate and assess PPP proposals, and focusing on selection of an appropriate project delivery model and risk allocation profile.

Specifically, these policies encourage:

- innovation;
- risk transfer to the party best able to manage the risk at lower cost;
- structuring the payment mechanism to reward delivery of services;
- strategies to use assets beyond their specific purpose to maximise effectiveness of government investment; and

- value-for-money testing of PPP proposals using benchmarks such as the Public Sector Comparator.

### Contract standardisation and standard commercial principles

The non-standard nature of most Australian PPP contractual documentation is one factor contributing to the high project bidding costs. Recent procurement experiences characterised by shorter tender processes and lower transaction establishment costs illustrate the benefits of increasingly standardised documentation. However, standardisation presents difficulties as each project is different and has its own unique issues, frequently resulting in the need to tailor documentation to address project-specific requirements. Furthermore, different projects will require different risk allocations, which continue to be negotiated considerably on each project. Despite these difficulties, there is scope for greater consistency in boilerplate and non project-specific clauses (e.g. force majeure) and ancillary documents (e.g. charges and novation deeds).

In June 2005, after consulting industry and other Australian governments, the Victorian Department of Treasury and Finance published the *Standard Commercial Principles* setting out government's preferred position on standardised risk allocation in PPP projects. The NSW government has since released its own draft of similar commercial principles for PPPs in December 2006 called *Working with Government: Risk Allocation and Commercial Principles*, and is seeking market comment prior to producing the final version.

While such initiatives are encouraging, it will take time to evaluate their effectiveness. In the meantime, increased transparency may assist in reducing problems of negotiating non-standard contracts. For example, the Victorian Government places all major

contracts on the internet and provides summaries that include information on value for money and public interest, meaning that unrealistic positions taken by parties become less sustainable.

Engagement of common advisers in successive projects in different jurisdictions contributes positively to standardisation. For example, key advisers on recent NSW toll roads projects have advised on similar projects in Melbourne and Brisbane, producing consistent approaches to risk allocation between various projects.

Through this developing contract standardisation, the following trends can be discerned:

- plain English drafting and clear risk allocation to minimise uncertainty and potential disputes;
- delivery supervised by an independent party;
- increased reporting obligations on the private partner;
- multi-tiered dispute resolution process; and
- "step in" rights for government to remedy breaches by the private partner.

The objective of standardised documentation must be balanced against the desirability of continuous improvement, in that newer documentation should capture the lessons learned from previous projects and take account of changed circumstances. Contractual documentation for the Brisbane North-South Bypass Tunnel (NSBT) exemplifies this balance by incorporating project-specific requirements and building on previous project experience, resulting in risk allocation to the party best equipped to manage the risk.

Despite its benefits, standardised documentation is not yet fait accompli. To gain widespread acceptance, "standard" PPP documentation needs to be developed with wide stakeholder involvement.

### Deal structure and engagement strategy in the Australian market

Experience gained over recent decades from successive PPP projects in the Australian market has informed the approach taken in subsequent projects and given rise to various innovative strategies surrounding complex procurement issues.

#### **Maintaining competitive tension, improving deal closure and avoiding deal creep**

Competitive tension amongst bidders is the key to a successful outcome that delivers value-for-money to government and needs to be maintained for as long as possible. Experience shows that once a preferred proponent has been publicly announced, they may attempt to introduce new issues late in the process when the government is in a weaker negotiating position and under pressure to conclude

the deal.

From recent Australian PPP projects, a number of methods have developed which allow government to maintain competitive tension, including:

- announcing a second preferred bidder as a "reserve proponent" and thereby reserving the right to negotiate up until contractual close (e.g. NSW Long Bay Prison and Forensic Hospital project); and
- requiring all bidders to provide fully documented proposals prior to making the final selection (e.g. Melbourne Eastlink and Brisbane NSBT).

In the NSBT project, three consortia were short-listed to participate in the RFP stage, two of which ultimately submitted proposals following discussions between Council and each bidder. As with the Eastlink project, both proponents were required to sign commitment deeds prior to announcement of the preferred proponent to ensure no movement by either bidder in the period between selection of the preferred proponent and contractual close.

Throughout the NSBT process, the Council held feedback workshops with each bidder to clarify requirements and promote full understanding of Council's objectives. This provided advantages to both bidders by keeping them on track throughout the development of full documentation. It also provided benefits to Council by helping to ensure that all commercial issues were settled prior to closure thereby avoiding deal creep after selecting the preferred proponent. Both the winning and losing bidders found the process useful. This full documentation strategy has also been successfully employed in the procurement of the replacement rolling stock for RailCorp in NSW, the largest PPP to date in Australia.

Another benefit of these innovative deal engagement methods is that they tend to achieve speedier deal closure. In contrast to some early PPP projects which experienced lengthy negotiation phases following the appointment of a single preferred bidder (in some cases, over 18 months), the recent toll roads experience in Australia demonstrates the increasing efficiency of the process.

The NSBT project was the first such PPP project undertaken by a local governmental authority, and presents the latest example of a streamlined Australian toll road procurement process. On 27 April 2006, Brisbane Council announced the appointment of a preferred proponent after finalising all commercial terms in a competitive evaluation process which concluded just 13.5 months after the

initial call for expressions of interest. Achieving contractual close on 24 May 2006, this represents the fastest deal closure of any toll road project in Australia to date.

### **Probity and effective market engagement**

The deal engagement strategies outlined may raise significant probity issues for the government sponsor, particularly where two or more bidders are taken to full documentation.

One challenge for Australian PPP projects is effective market engagement. It is in the interests of all parties, particularly government, for bidders to have a clear understanding of government's objectives, requirements and priorities.

Some practical steps which project sponsors have taken to promote effective market engagement include:

- market sounding to assess market interest and competition issues;
- clear articulation of requirements and disclosure of benchmarks; and
- communicating with bidders.

Bidder communication is an effective way for government to promote effective market engagement by ensuring, for example, that there are opportunities for bidders to receive feedback on technical aspects of their proposals prior to submitting final bids.

Whereas in the past there have been limited opportunities for such feedback, recently government has begun to explore opportunities of issuing feedback during the bidding process. For example, in the NSBT project, Council engaged in an interactive process with each proponent prior to submission of bids to ensure that its requirements were fully understood.

A complicating factor to effective market engagement is the risk that unsuccessful bidders will bring legal claims alleging unfairness or impropriety in the tender process on the basis of statements made during such discussions. To avoid such situations, it is critical to the interests of both government and bidders that appropriate levels of probity are maintained throughout the tender process.

The rigorous but practical strategies employed by the Council during the NSBT bidding process provide an excellent example of successful management of probity issues. These included:

- appointment of a probity manager;
- the probity manager attending all meetings between Council and a bidder;
- treating verbal statements by Council as non-binding until confirmed in writing; and
- clarifying with each bidder whether any questions

they asked should be treated as confidential.

Provided such steps are taken and their implementation is properly monitored, government can benefit from more informed bidders without sacrificing the integrity of the process. This strategy's success implies that it will be adapted to and utilised in future projects.

### **Recent PPP trends**

#### **Economic and social infrastructure: Achieving value-for-money**

Despite the higher cost of private sector financing, there are differences between privately financed and publicly financed projects which can enable a privately financed delivery model to provide a better value-for-money outcome than a publicly funded alternative. Typically, the value-for-money drivers for privately financed PPPs are identified as risk transfer, whole of life costing, innovation and asset utilisation.

Traditionally it was thought that PPPs were best suited to "economic infrastructure", by providing the private partner with an independent revenue stream. In recent years, Australian PPP development has seen a dramatic upsurge in the construction of economic infrastructure, namely toll roads in Sydney, Melbourne and Brisbane. Such projects allow the private partner to source revenue directly from motorists through tolling, proving in many cases to be profitable for the private sector and cost-effective for the public sector. From the government's point of view, private funding of the construction, operation and maintenance of a facility over an extended period of time (e.g. BOOT with a 30-year concession period) provides value-for-money by ensuring contractor accountability for the long-term maintainability of the structure.

The Eastlink project presents a recent example of the benefits which government can derive from privately financed delivery. The central focus of Eastlink was to achieve value for users by providing the lowest cost toll road in Australia. Eastlink drew on the recent experiences in the NSW toll road market, building on the successes and avoiding the pitfalls of those projects. Eastlink achieved innovation on a technical and commercial level, particularly in relation to the tolling regime, which will include discounts for cars from the neighbourhood and for weekend usage – an Australian first. The project's highly competitive bidding environment, resulting from taking multiple bidders to full documentation, enabled achievement of the objectives and prompt deal closure.

The perception that economic infrastructure was best suited to PPP delivery originally precluded

development of privately financed "social" infrastructure (e.g. hospitals and schools).

However, the current PPP approach in Australia now takes the view that governments should be open to private sector involvement in both social and economic infrastructure, subject to:

- the reservation to government of "core" services; and
- the recognition that social and economic infrastructure usually rely on different revenue bases.

In this way, PPP projects may be distinguished from privatisation.

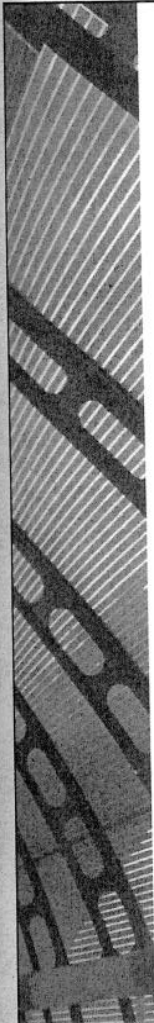
As the revenue sources ordinarily accessible in economic infrastructure projects are usually unavailable in social infrastructure projects, part of the challenge of the latter is the need to develop alternative remuneration structures.

This does not mean, however, that social infrastructure is beyond the scope of the PPP approach. One of the key reasons that social infrastructure projects are also considered suitable for a PPP delivery model is the concern of government that projects deliver value for money.

Thus, in these types of projects, where the main source of revenue comes from the government, the focus is on developing a payment mechanism which will motivate good performance outcomes by the private sector.

In addition, the project must be delivered in a manner that is consistent with the public interest. In considering whether the PPP approach is suitable for any particular infrastructure project, public interest criteria such as effectiveness, impact on key stakeholders, public access and equity and consumer rights need to be considered before the project is put to the market.

One recent example is the public tender for A\$700m Royal North Shore Hospital redevelopment, the biggest health PPP project ever carried out in NSW. This social infrastructure project involves the private sector providing design, construction, finance and maintenance of a new acute services facility, community health centre and refurbishment to some existing buildings, as well as provision of ancillary building and grounds maintenance and services post-construction by the private partner ("non-core services"), with the



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government remaining responsible for providing medical services ("core services") on the site. The delineation between providing core and non-core services in this project is illustrative of the desire of the public sector to retain control of critical services.

### **"Holistic" procurement and its alternatives**

It is only recently that PPPs have moved from *ad hoc* progression to a more directed approach under a growing culture of government flexibility and innovation. The present government preference for the PPP form can therefore be described as the result of state and federal government forays into more subtle alternatives for accessing private sector resources in the delivery and operation of public facilities.

The BOOT structure forms the backbone of the Australian PPP market, providing a "holistic" delivery model, in that a single tender process is undertaken to award the full concession to one PPP consortium comprising financier, equity provider, designer, builder, operator and maintenance.

Most recent Australian toll roads have been procured using the holistic model. An advantage of this model is that it provides government with a high level of certainty at the initial tender stage. Further, as it is a familiar model for the market, established documentation saves time and expense and helps to achieve prompt deal closure.

However, the holistic procurement model does have its disadvantages. For one thing, outside the process of forming the consortium, it provides very little opportunity for competitive tendering of the Design & Construction (D&C) cost or the debt financing package, and no opportunity for lower risk construction delivery. It is also difficult for new D&C contractors to become involved in the process.

Accordingly, it is useful to consider some possible alternative approaches to the procurement of PPPs where the traditional holistic approach is not the most efficient way to achieve market engagement.

One such alternative is the "developer" model, which has been aimed primarily at availability-based contracts where the developers are typically contractors and/or Operation & Maintenance (O&M) providers. Under this model, only debt financing is excluded from the initial procurement stage. While the developer model has seen some use in the UK, it has not been used to any great extent in Australia to date.

Another model which may be of greater relevance to the Australian market is appointment on commercial terms, which has several possible variations. The common factor is that it involves

government obtaining prices for certain components of the work by secondary tender, through a sponsor consortium appointed on the basis of a Project Deed and tendered financial model into which the additional costs can be slotted once they are known. Successful secondary tenderers and their terms of engagement are approved by government, which ultimately enters into a final concession with its sponsor on the basis of the tendered commercial terms, amended as necessary to reflect the outcome of the secondary tender process. For example, government might obtain prices for debt finance, D&C and O&M by secondary tender, or for construction delivery or debt finance only. As traffic projections, Equity IRR and the Project Deed are tendered upfront, this model has the advantage of certainty with respect to key commercial terms, while at the same time providing potential for stronger competition among players in relation to those components which are to be put to secondary tender. In contrast to the holistic model, this may provide government with certainty at the initial tender stage in relation to the terms and cost of the components to be put to secondary tender.

In considering whether these alternatives to traditional holistic procurement are viable, certain key issues should be kept in mind:

- Competition and market appetite: Will the alternative model provide for greater competition (particularly for D&C projects)?
- Government's risk profile: Does the alternative have the potential to result in greater risk exposure than the traditional concession model?
- Procurement process: What impact on bid costs will a "pathfinder process" have compared with a well understood and accepted model?
- Value drivers: While there may be greater risk exposure, the alternative model may represent greater value for money than the traditional model.
- Certainty of outcome: How certain is the outcome and at what stage would certainty be achieved?

Every alternative has its advantages and its disadvantages. Recent developments in undertaking Australian PPP projects show that the traditional approach is not the only available option for achieving market engagement. In some cases, an alternative approach may be more effective. To obtain value-for-money, it is important that all viable alternatives are considered and their suitability to the specific project is assessed before a project delivery model choice is made.

Notes:

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Partnerships Victoria and the Guidance Materials are available at <http://www.partnerships.vic.gov.au>

The National PPP Forum maintains a list of Australian PPP projects at

[http://www.pppforum.gov.au/national\\_pipeline](http://www.pppforum.gov.au/national_pipeline)

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