Governments and project financiers may achieve better value for money in adopting alliancing as a form of delivery structure in delivering PPP projects in Australia (rather than the traditional risk transfer methods).

Andrew Gout-Boon Chew
BEng (Civil) (UNSW), M Eng Sc (Const Mgt) (UNSW), Dip Law (SAB), LLM (UNSW)

Master of Public Infrastructure (Research)
University of Melbourne
September 2007

Submitted in full fulfilment of the requirements of the degree of Master of Public Infrastructure (Research)

Produced on archival quality paper
Abstract

The objective of the paper is to test whether governments in Australia and project financiers can achieve better value for money in adopting alliancing as a form of delivery structure in delivering complex PPP infrastructure projects in Australia (rather than the traditional risk transfer methods).

The paper looks at the development of PPPs in Australia (including current approaches by the Commonwealth, State and Territory governments in delivering major social and economic infrastructure projects), and the use of private sector capital and risk allocation patterns in PPP projects. It goes on to analyse the value for money framework used in Australia, which primary focus on the use of the Public Sector Comparator (PSC) model and government’s approach on risk transfer (and not necessary optimal risk allocation).

The paper also looks at areas of future research where project sponsors (including governments) and project financiers of major complex projects should be reconsidering their risk management approach towards alliancing projects.

The paper then provides an overview of PPP policies and experiences in Australia and internationally (in particular, the United Kingdom). It discusses the on-going reforms undertaken (which includes reforms to the value for money appraisal process and more direct government participation in the risk management and control of PPP projects) in the United Kingdom and Australia.

The paper provides an overview of relationship contracting (in particular, alliancing) including the legal conceptual basis, use of price competition and discusses the future way in using alliancing in privately financed projects or PFI PPPs.

The paper then discusses how government can achieve better value for money in adopting relationship contracting or having greater risk sharing in delivering complex PPP projects, recent trends in financing PPPs and greater focus on partnership in delivering projects.

The paper concludes by discussing the survey results from an interview of relevant “players” in government and industry bodies and their advisers to identify the “drivers” and “impediments” using alliancing and other forms of relationship contracting in the delivery of economic and social infrastructure and services.

This is to certify that the thesis comprises only my original work; due acknowledgement has been made in the text to all other material used.

Andrew Chew
Table of Contents

Executive summary 1

Part A: Public Private Partnerships 6
1 Development of PPPs in Australia 6
2 Background to development of PPPs 9
3 Private sector capital in PPP projects 11
4 Risk allocation patterns used in PFI PPPs 13

Part B: Value for money framework 19
5 VfM - general principles 19
6 Value for money and risk transfer in a PFI PPP framework 21
7 Optimal risk allocation 26
8 Risks management for PPPs 31
9 Evaluating risk in the PPP framework 32
10 Move away from a PFI PPP approach and why risk transfer may not be optimal value for money for governments 34
11 Risk sharing in PPP projects 35

Part C: Overview of Australian and international PPP policies and experiences 37
12 Australian PPP policies 37
13 Recent Australian PPP experiences 39
14 UK PPP policies and experiences 42
15 Other international PPP policies and experiences 45

Part D: An overview of relationship contracting 48
16 Relationship contracting 48
17 Use of alliancing in privately financed projects or PFI PPPs 56
18 Price competition in the selection process for an alliance project 58
19 Comparison of risk allocation under a PPP delivery structure and an alliance contract 61
20 VfM in non-PFI PPP projects 63

Part E: Can governments obtain better value for money in adopting principles from relationship contracting or greater risk sharing in delivering complex PPP projects. 65
21 Risk sharing

22 Trends in financing PPPs

Part F: Survey findings

Part G: References

Annexure 1 Brief comparison of the value for money policies set out by some of the State and territory governments and in some overseas countries.

Annexure B: Survey Questionnaire
Executive summary

Objective of research

The objective of this paper is to test whether governments in Australia and project financiers can achieve better value for money in adopting alliancing as a form of delivery structure in delivering complex PPP infrastructure projects in Australia (rather than the traditional risk transfer methods).

Methodology

The research methodology for this paper is based on the following:

- interviewing relevant "players" in government and industry bodies and their advisers to identify the "drivers" and "impediments" using alliancing and other forms of relationship contracting in the delivery of economic and social infrastructure and services\(^1\). This may include cultural and political bias, perceptions of risk sharing and transfer, probity concerns, financing imperatives and the like. This process is taken by a mixture of informal interviews, an analysis of conference papers presented by "players" and news paper interviews;

- identifying areas of research as to whether the current PPP approaches and alliancing are mutually exclusive due to different risk allocations and treatment of risk;

- a critique of existing PPP policies in Australia to identify whether those policies assist or hinder the use of the relationship contracting form of delivery structure in the delivery of PPP projects;

- analysing the data received from the survey of key players in the PPP market; and

- identifying any potential issues to be addressed in those PPP policies (including any policy changes) to enable or facilitate the use of relationship contracting in the delivery of PPP projects.

Findings

- Current approaches by government

The Commonwealth, State and Territory governments are delivering major social and economic infrastructure projects on a Public-Private Partnership (PPP) framework. The approach taken to date is that a PPP project will require the private sector to finance and build the project, to optimise risk transfer and maximise value for money based on a Public Sector Comparator (PSC) model.

\(^1\) Economic infrastructure generally covers those infrastructure facilities where users are charged directly for use of the asset such as tollroads, railways, power stations, etc. Social infrastructure generally covers those infrastructure facilities where the use of the facilities is funded through payments from the government to the private sector.
In addition, the significant growth in infrastructure development over the last decade and the planned requirements for substantial infrastructure improvement in the future have created a shortage of skilled resources and capacity in delivering projects in Australia.

Governments are increasingly looking at innovative contractual delivery approaches such as alliancing to deliver high-value complex projects. There is a slow paradigm shift in principals' approach in delivering projects using fixed price-fixed time contracts towards alliancing delivery structures. There are also hurdles to overcome in making such a shift, in particular the traditional conservative approach adopted by project financiers in ensuring that risks assumed by the project sponsors are transferred to the contractors and operators delivering the design, construction, operation and maintenance of the project.

- Current market views

In a survey conducted by the author of major players involved in delivering PPP projects, the government respondents indicated that the PPP framework should not include alliancing as part of the framework.\(^2\) They considered that PPP projects require some form of private sector financing for those projects. Financiers are also still not comfortable with providing project finance for projects delivered on an alliancing basis (due to concerns over the certainty of the final project costs). On the other hand, private sector proponents were of the view that alliancing should form part of the PPP framework.

A survey conducted by the Institution of Engineers Australia and the Chamber of Commerce and Industry, WA also showed that principals (in both public and private sectors) have a bias towards risk transfer and some 67% of the respondents indicated that risks that have been allocated to them were "impossible to manage". This raises the question as to whether principals are achieving value for money in delivering major projects as inevitably, the contractors will be putting a price premiums in the contract prices for assuming that category of risk.

The Victorian Treasury has issued guidelines for delivering projects on a project alliancing basis. Whilst the Commonwealth and various State governments have used alliancing to deliver major complex projects, there is no formal PPP policy framework dealing specifically with delivery of projects on non-conventional delivery structures such as alliancing. For example, the Victorian alliancing guidelines will be outside the Partnerships Victoria PPP framework.

- Risk transfer and value for money

\(^2\) The treatment of the survey data is discussed further in Part F.
The various State and Territory governments have adopted the PSC as the benchmarking tool in carrying out the cost-benefit analysis of risk transfer and value for money test. The analysis takes into account a series of different options and considers the alternative PPP delivery options.

In the United Kingdom, the National Audit Office has expressed the views that too much emphasis was given to the results of PSCs, especially in the late stages of the procurement process, and it was not rational to base a decision solely on costs (which the PSC is based on).

Criticisms have also been made that PSC evaluations were made based on costs but did not give adequate consideration to “optimum combination of whole-life costs and quality to meet user requirement”. In another recent report on the London Underground PPP\(^3\), the National Audit Office stated that the “Public Sector Comparators were subject...to considerable inherent uncertainty and therefore gave only limited assurance about the reasonableness of the prices quoted by the bidders”.

This statement would also apply in Australia. Government agencies should give greater consideration to the best way to deliver a project based on the specific nature and risk profile of that project (rather than rely on a structure that has been designed more specifically for PFI PPPs).

This view is also supported by criticisms by a number of leading PPP experts in the United Kingdom (including from within national audit offices) regarding the use of the PSC and suggestions that the PSC framework is not necessarily the best framework for decision making when looking for the best procurement method.\(^4\) The National Audit Office in the UK in a recent report on the construction performance of PFI projects also suggested that there are other different procurement routes (other than PFI) which can also deliver value for money in construction.\(^5\)\(^6\)

The UK government has highlighted the need to reform the PSC to ensure an economically rigorous appraisal of a project’s outline business case prior to its procurement, and to allow an alternative route to be chosen at that stage if it offers better value for money. Similar criticisms have come out of the Fitzgerald inquiry into Partnerships Victoria.\(^7\)

---

\(^3\) National Audit Office, “London Underground PPP: Were they good deals”, June 2004
\(^4\) PFI Intelligence Bulletin 2002, “Private sector backs PSC attack”
\(^5\) National Audit Office 2003, “PFI: Construction Performance”
\(^6\) Mott MacDonald 2002, “Review of Large Public Procurement in the UK”
\(^7\) Fitzgerald, P 2004, “Review of Partnerships Victoria Provided Infrastructure”
Areas of future research

It may be time that project sponsors (including governments) and project financiers of major complex projects reconsider their risk management approach towards alliancing projects. It may be that in complex projects with substantial “unknown” risks, the more appropriate form of project delivery structure (such as alliancing) is one that can manage those risks so as to achieve timely and cost-effective delivery targets (rather than transferring risks which will involve paying a risk premium to the contractor for taking those risks, and hence increase project costs) and where a “deep pocket” sponsor or government gives financial guarantees to support that delivery strategy.

Areas of future research include gauging the views and preparedness of various stakeholders to tackle the various issues identified below and to adopt alliancing as a form of PPP:

- The current policy frameworks established by the various State and territory governments are structured towards a project financed PPP delivery structure. Consideration should be given by the relevant government agencies to modify current policy documents and evaluation process to cater for delivering projects using approaches based on relationship contracting (such as alliancing or greater risk sharing (where appropriate) in PFI PPPs), and in particular, the risk transfer focus under the existing PSC framework.

- It is important that proper governance process be put in place to ensure that there is transparency in the delivery of the projects.

- Government parties need to be active participants when adopting relationship contracting structures. It requires the public and private sector partners to work together from the outset to facilitate a win-win approach. There needs to be a focus on good risk management (rather than risk transfer) and aligning agendas and communicating effectively between the public and private sector partners, overcoming any polarised perspectives on risk and have clear positions on what risks have been transferred and be prepared to assist the partners to overcome those risks that are agreed to be shared between the parties. Government parties need to have a realistic view on what type and how much risk can be transferred to the private sector.

- Relationship contracting is not suitable for all projects and should be considered for higher risk and more complex projects where the method of procuring the project or developing the sponsors’ capability are not well defined and exceptional results may be achieved in terms of schedule, cost and technical innovation and which are not likely to be achieved using a traditional delivery method.
In complex PFI PPP projects, there should better risk identification and appropriate allocation of risk and greater risk sharing if appropriate. Government bureaucrats and their advisers should attempt to overcome inherent bias towards "greater" risk transfer to the private sector (instead of adopting better risk management). Experiences in recent PPP transactions only highlight the natural inclination by the government authorities to use PPPs as a means of risk transfer (rather than risk optimisation) and raise issues as to whether government has achieved value for money in those transactions.

Consideration should also be given to encourage governments and financiers to finance PPP projects using a relationship contracting approach (such as alliancing, etc). This may require governments to take a more aggressive stance on providing financial loans or guarantees for the initial PPP projects delivered on an alliance basis and project financed (from both a funding and project risk taking positions) until those financiers are comfortable with the risks involved, or separating the award of the construction and financing packages of a PPP project. This last area would be the most novel development in Australia if it would to occur.8

8 See section 22 for discussion on trends in financing in PPPs and use of credit guarantee financing.
Part A: Public Private Partnerships

1 Development of PPPs in Australia

Over the last 10 years, there has been a marked increase in Australia in co-operation between governments and private sector for the development, financing and operation of an array of infrastructure ranging from toll roads, water and sewerage treatment plants, sewerage outfall tunnels, power stations, hospitals, schools, prisons to defence-related equipment. These Public-Private Partnership (PPP) projects were primarily driven by governments trying to implement projects without recourse to public funding, and to improve the quality and efficiency of delivering these infrastructure projects and on-going services to the public. The demand for infrastructure spending is growing. A recent survey by the Australian Council for Infrastructure Development found that Australia is suffering from a deficit in infrastructure spending totalling $24.8 billion\(^9\). There will only be a greater need for transport (rail and road), energy (gas and electricity) and water infrastructure in the coming years.

In Australia, PPP projects to date have been generally based on the Build-Operate-Transfer (BOT) model\(^10\) and have been essentially project financed by the private sector. They are more commonly known as private financing initiatives or PFIs or PFI PPPs or PFPs.

In more recent times, governments at both Commonwealth and State levels have increasingly used other forms of delivery structures (such as alliancing) to deliver major complex projects.\(^11\)\(^12\)\(^13\)\(^14\) Alliancing is a form of relational contracting and is generally in the form of performance-based contracts.\(^15\) It involves greater risk sharing (rather than risk transfer) between the parties.

\(^9\) "Roads, rail need more funding, study finds", Sydney Morning Herald, 9 August 2004

\(^10\) In theory, there is a spectrum of Public-Private Partnership options. See figures 1 and 2 below. The sources are from the Northern Territory Government: Territory Partnerships Policy Framework 2003 (which is based on an extract from a paper by Doug Jones on PPP policies 2002)

\(^11\) The Commonwealth government have entered into the Project Dhimindji alliance for the delivery of the airwarfare destroyer project, anti-submarine warfare lightweight torpedo project and the ANZAC ship master alliance whose objectives range from the maintenance of the design integrity of the ANZAC class ships to ensuring work is allocated on a "best for project" and "value for money" basis (see Defence Materiel Organisation website www.defence.gov.au/dmo/fsd/alliance/alliance.cfm), the NSW Government (via Sydney Water Corporation) on various alliances for the Northside Storage Tunnel and the priority sewerage projects in the northern suburbs of Sydney, and (via Roads and Traffic Authority of NSW) for the Windsor road expansion project, the Queensland Government (through the Main Roads Department, Port of Brisbane Corporation and Gladstone Water Services) for various road seawall and dam projects, the Western Australian Government (via the Water Corporation of WA) for the Woodman Point WWTP treatment plant and the Perth desalination projects, and the Victorian Government is delivering various railway electrification projects (Sydenham and Craigieburn) and Port Phillip Bay deep channeling project using alliancing.

\(^12\) See Keynote address "The Road Map for the Defence Public Private Partnership" by the Hon Fran Bailey MP, Parliamentary Secretary to the Minister for Defence at the Defence Summit in February 2003.

\(^13\) The NSW Government Codes of Practice and Implementation Guidelines for the Codes of Practice and Codes of Tendering have generally encouraged co-operative contacting approaches such as partnering and alliancing.

\(^14\) Ross, J 2003, "Introduction to Project Alliancing", Paper presented at Alliance Contracting Conference, Sydney, Alliance contracts are generally performance-based contracts where the owners pays the non-owner participants for their services based on an open-book compensation model. The non-owner participants will be paid their direct costs with their profit and margins put at risk based on the performance of the actual project outcomes. See paper by Ross, J 2003, "Introduction to Project Alliancing", paper delivered at Alliance Contracting Conference, Sydney
It also involves the government providing the financial sponsorship of these projects. Some commentators have called these alternative project delivery methods as non-PFi PPPs or publicly-financed PPPs as the government (rather than the banks) have funded these projects.\textsuperscript{16}  
\textsuperscript{17} \textsuperscript{18} \textsuperscript{19} \textsuperscript{20} However, not everyone has embraced these types of delivery structures as forming part of the PPP family.

\textsuperscript{16} See article by Jones, D 2003, "Evaluating what is new in the PPP pipeline", 19 BCL 250
\textsuperscript{17} The definition of Public Private Partnership can be very broad and can range from passive investments (such as government bonds, etc), traditional public contracting, service contracts, joint ventures, BOT projects, etc. (see Figure 2). A useful discussion of the PPP concepts is set out in Bennet, G 2003, "Public-Private Partnerships for the Urban Environment", PPPUE Working Paper Series and European Commission, "Guidelines for Successful Public Private Partnerships"
\textsuperscript{18} Australian Council for Infrastructure Development 2002, "Inquiry Into Private Sector Investment in Public Infrastructure"
There is still a raging debate as to what constitutes a PPP.

The Victorian Department of Treasury and Finance (VDTF) which is responsible for running the Partnerships Victoria PPP program, appears not to consider alliancing in any government funded projects as a form of PPP. In August 2005, the VDTF released a separate policy for government entities using alliancing as a form of project delivery for projects funded by the government. In an interview with Wayne Sharpe who was responsible for delivery the VDTF’s project alliancing manual, Sharpe clarified that the Treasury’s views are that project alliancing is outside

---


22 The VDTF is finalising the “Project Alliancing Framework Practitioners’ Guide” for use in rolling out alliancing projects. It does not form part of the Partnerships Victoria PPP program.
the PPP spectrum of delivery structures. The project alliancing manual was not released under the Partnerships Victoria structure.

Whilst the prevalent view is that governments use PPPs as a way of using private finance for developing infrastructure projects, there are views posited by governments that PPPs do offer other benefits (such as lower delivery costs) and encourage better delivery outcomes and innovation.

It is important for State and Territory governments to clearly articulate what are the principles behind the intended delivery methods under each State’s or Territory’s “Public-Private Partnerships” policy. For example, the NSW government clearly considers its PPP policy as focussed on private financed projects. Unlike other States and Territories policies which are intended to cover a wider ambit of projects, its policy is aptly named “Working with Government for Privately Financed Projects”.

Some of the questions to be answered in identifying what constitutes a PPP include:

- does PPP projects require private sector finance?
- depending on which view one takes as to whether non PFI projects come under the PPP classification, are relationship contracting structures appropriate for delivery of complex projects or long term outsourcing contracts?
- what constitutes “partnership” in PPP?
- are existing approaches to risk transfer complementary or working against delivery of PPP projects?
- are existing PPP policies adequate to ensure efficient delivery of PPP projects?

These questions go towards answering some of the arguments for and against the hypothesis.

2 Background to development of PPPs

PPP have now been used to deliver a wide range of infrastructure projects and services across the world (including hospitals, transport, prisons, schools, water, and defence projects but in most countries have been dominated by road projects in most countries). The best developed program is United Kingdom’s Public Private Partnerships Program, which had its genesis in 1992 as the Private Finance Initiative (PFI).

---

23 Telephone interview between the author and Wayne Sharpe, Executive Manager, Gateway Unit, Victoria Department of Treasury and Finance conducted in February 2007.
It is difficult to give a generalised definition for a PPP as there are a variety of PPPs being used. Some definitions used by various agencies internationally and in Australia include:

"The transfer to the private sector of investment projects that traditionally have been executed or financed by the public sector" - European Commission

"Public private partnerships (PPPs) are a generic term for the relationships formed between the private sector and public bodies often with the aim of introducing private sector resources and/or expertise in order to help provide and deliver public sector assets and services. The term PPP is used to describe a wide variety of working arrangements from loose, informal and strategic partnerships to design build finance and operate (DBF) type service contracts and formal joint venture companies." - 4Ps, UK local government procurement agency.

"A Public-Private Partnership is a partnership between the public sector and the private sector for the purpose of delivering a project or a service traditionally provided by the public sector. PPPs come in a variety of different forms, but at the heart of every successful project is the concept that better value for money may be achieved through the exploitation of private sector competencies and the allocation of risk to the party best able to manage it." A Policy Framework for PPPs, Department of the Environment and Local Government, Ireland

"A co-operative nature between the public and private sectors, built on the expertise of each partner, that best meets clearly defined public needs through the appropriate allocation of resources, risks and rewards. The characteristics that are central to public-private partnerships are the co-operative pursuit of shared or compatible objectives, their operation for mutual benefit, an emphasis on risk sharing and value for money, and finally, the joint investment of resources and a sharing of authority within the partnership" - Canadian Council for Public Private Partnerships

"In the Northern Territory context, a PPP is described as encompassing a range of contractual relationships between the public and private sectors to provide or maintain infrastructure or deliver a related ancillary, non-core service; including publicly financed partnerships and partnerships involving private financing.....The Government has taken the view that a flexible approach to PPPs is appropriate. Flexibility may apply to the precise nature of the public/private collaboration and to the potential application of the policy to both economic infrastructure projects, such as transport links, power reticulation and water supply, and social infrastructure, such as schools, hospitals, and justice facilities. This is consistent with the principle of the Government contracting for services and outputs, rather than just for physical
assets and the ownership and control of infrastructure; the scope of a project being decided on a case by case basis. Accordingly, a variety of partnership arrangements can be included, and subject to public interest and value for money results" - Territory Partnerships, Northern Territory Government.

“A Public Private Partnership (PPP) is a risk-sharing relationship between the Public and Private Sectors to deliver timely public infrastructure and related non-core services. The specific nature of each partnership will be defined through a contractual agreement covering the delivery of infrastructure facilities over a period of time. The scope of the PPP Policy encapsulates the delivery of “hard” and “soft” infrastructure facilities, including the services required to operate and maintain those facilities. The Policy does not apply to the provision of “core” public services that involve direct delivery of community services to the public or the exercise of statutory power” - Queensland Value for Framework Policy

The author’s observations (based on his experience and having regard to the views expressed by players in the market24) are that in Australia most government PPP policies embrace the concept of private sector finance in the development of PPP projects. This is not too different from policies adopted by most countries in the European Union25, North America26, Asia27, Africa28 or Latin America and is supported by policies issued by international organizations such as the World Bank,29 and the International Monetary Fund30.

3 Private sector capital in PPP projects

A confusion created in the market place as to what constitutes a PPP is that whilst some participants embrace the wider family of delivery structures as under the PPP umbrella, most government agencies (both Australia and internationally) and international funding organizations (such as the IMF and the World Bank) consider that the deployment of private sector capital is fundamental in the delivery of PPP projects.

---

24 Refer to survey findings in Part F.
25 In its guidelines for PPPs, the European Commission has identified 4 principal roles for the private sector in PPP schemes namely, to provide additional capital, to provide alternative management and implementation skills, to provide value added to the consumer and the public at large; and to provide better identification of needs and optimal use of resources.
26 Nova Scotia Department of Finance 1997, "Transferring Risk in Public/Private Partnerships"
28 See South African National Treasury Manual on PPP projects and various regulations.
29 Ter-Minassian, T & Allen, M 2004, "Public Investment and Fiscal Policy", International Monetary Fund
30 In a paper prepared by the International Monetary Fund (in consultation with the World Bank and the Inter-American Development Bank), it considered that one of the basic features of PPP as follows: "A typical PPP takes the form of a design-build-finance-operate (DBFO) scheme. Under such a scheme, the government specifies the services it wants the private sector to deliver, and then the private partner design and builds a dedicated asset for that purpose, finances its construction, and subsequently operates the asset and provides the services deriving from it."
The Western Australian Partnerships for Growth policy document states “PPPs are in many ways similar to “Build Own Operate” and “Build Own Operate Transfer” models of procuring infrastructure. The main difference with PPPs is that the Government continues to deliver the core services traditionally associated with a facility (such as teaching in schools and medical services in hospitals) while the private sector may deliver the ancillary services which support the infrastructure (such as security and maintenance).”

The final report by Peter Fitzgerald into the Partnerships Victoria policy\textsuperscript{31} pointed out that “the policy focus in recent times is represented as moving from a focus on overcoming fiscal restraints and Australian Loan Council limitation, through a focus on increasing the extent of private participation to stimulate growth and efficiency, to one of achieving value for money in the public interest.....The apparent purpose of [Partnerships Victoria policy] is to ensure that particular measures are adopted where private investment in public infrastructure is planned. That is, it seems concerned primarily with ensuring that various principles and practices are observed, to achieve optimum outcomes when private parties are invited to invest in infrastructure.”

This is further reinforced by the Standard Commercial Principles detailed guidance material issued by the Victorian Department of Treasury and Finance for Partnerships Victoria PPP projects.

Some of the views taken in supporting the above include the following:

- the provision of private sector capital can result in greatly improved value for money for the government because of the risk transferred to the private sector and private sector incentives for the long-term delivery of reliable public services;

- there is much improved value for money because when private sector capital is deployed and is at risk, the right commercial decisions are made about design, operating regime, whole-of-life costing and so on;

- the private sector is better able to coordinate and provide innovative approaches to managing these closely related activities and the risks associated with them.

\textsuperscript{31} Fitzgerald, P 2004, “Review of Partnerships Victoria Provided Infrastructure”, Final Report to the Treasurer, Victoria
• the infusion of private capital and management not only leads to a higher level of infrastructure investment and increased efficiency, but also allow governments to spread the cost of these investments over time.\textsuperscript{32}

There are concerns regarding the accounting of these PPP investments and how governments treat contingent liabilities. For example, in Victoria, a PPP project is treated as a public investment and reflected on the government’s balance sheet. It does not account for any contingent risks if the contracts fail. However, accounting for the likelihood of termination and consequential follow up costs would not be straightforward.

In addition, promoting PPPs because of their favourable balance sheet treatment may have the detrimental effect of biasing government agencies in the design of the PPP procurement (and in particular, a greater emphasis on risk transfer (rather than exercising proper risk analysis and management)).

4 Risk allocation patterns used in PFI PPPs

In the delivery of any project, important considerations are risk allocation and project management. These give rise to the form of contract types to be adopted by the parties.\textsuperscript{33}

The risk allocation package will depend on the nature of the project and the particular circumstances affecting that project. Factors important in selecting the most appropriate delivery structure and contract form will include:

• whether there is expected to be strong competition for the service provision (and ready substitution of service provider at the end of the contract period);

• the contract management skills and market power of the government buying the services; and

• the complexity of the contract and of the interface between government and provider (eg for the London Underground PPP infrastructure contracts, anticipating all possible circumstances between the infrastructure operators and rail service provider over 25-30

\textsuperscript{32} An interesting point to note at a macro level is that an internationally accepted accounting and reporting standard for PPPs is currently lacking and this is a source of uncertainty and arbitrariness in their treatment in the fiscal accounts.

Concerns have been raised that there is a danger that PPP investment will be treated either as public investment or private investment. In the former case, this could overstate the impact of PPPs on the overall fiscal deficit and public debt which could produce a bias against PPPs that are more efficient than traditional public investment - this could lead to unnecessary compressions of public investment looking forward.

If PPPs are treated wholly like private investment, their impact on the overall fiscal deficit and public debt could be understated, and there may be an incentive for the government to use PPPs simply to spread the impact of public investment on the fiscal accounts over time, rather than to maximise efficiency gains.

years is an immensely complex contract interface task and the likelihood that unanticipated circumstances will cause the parties to renegotiate the contract terms after signature – that is, the risk transfer to the private sector may well be eroded).  

The key point is that the desired relationship between the government and seller can be provided in a set of contracts which introduce management discipline and risk transfer into the business relationship irrespective of who is providing the finance.

In circumstances where the public finances are not strongly constrained, other delivery methods (such as alliances, DCM or DBO\textsuperscript{35}) may be more cost-effective, quicker and easier than PFI. Why then is PFI used and DBO not?

The reality is that PFI was adopted by the previous governments in Australia in the mid 1980s and early 1990s when public finances were constrained. It was seen as an additional finance for public investment. Times have changed and the logical conclusion is that PPP should change as well - from a heavy dependence on PFI to a more balanced approach.

This is precisely the conclusion reached by the Irish Government. Flush with funds but with an urgent need to invest heavily and rapidly in physical and social infrastructure, they have launched a major DBO procurement programme (rather than relying on PFIIs as the main form of delivering major projects).

Although the PFI model is an improvement over conventional contracting, it is by no means a panacea for delivery of public infrastructure. Some issues and trends have emerged with the growth of PPP projects\textsuperscript{36}. They include the following:

- **Complex interfaces and rigid structures**

In the United Kingdom, there has been strong criticism of healthcare PFIs and in particular, the complex interfaces and rigid structures in the health sector. For example, the provision of clinical services was included as part of the earlier PPP healthcare projects, but this created conflicts in prioritising cost efficiencies and quality patient care.

Another area of criticism is with major IT PPP contracts, where the contractors have failed to perform. This has raised widespread concerns about whether risk is effectively transferred to the private sector.

\textsuperscript{34} Palmer, K, “Contract Issues and Financing in PPP/PFI (Do we need the ‘F’ in “DBFO” Projects?), Cambridge Economic Policy Associates Ltd

\textsuperscript{35} DBO means Design Build Operate; DCM means Design Construct Maintain

\textsuperscript{36} Banks, Bill 2005, “Australian PPP survey : Issues Facing the Australian PPP Market”
Increasing demands on contractors

Construction companies involved in PPP projects generally play 2 roles:

- the prime contractor carrying out the design and construction of the facility (and operation of the facility where it has the necessary expertise); and
- one of the initial equity sponsors of the bidding consortium.

These companies have an increasing need to increase their capital (by raising debt) to enable them to provide equity and also to maintain adequate credit facilities to support the provision of security under the construction contracts. This has resulted in a 2 tier structure in the PPP industry.

In Australia, the top tier structure would comprise of the larger and financially stronger companies such as Leighton Holdings (whose subsidiaries include Leighton Contractors, Thiess and John Holland), Bilfinger Berger AG (controlling Baulderstone Hornibrook and Abigroup), Bovis Lend Lease, Multiplex and Laing O’Rourke (controlling the renamed Barclay Mowlem – Laing O’Rourke Australia). A second tier comprising smaller construction companies generally perform the subcontractor roles for the first tier companies.

In addition, delivery of PPP projects in various States and territories are not well co-ordinated, and each government’s investment program sometimes places unreasonable demands on the construction market and the private sector’s ability to successfully deliver these new projects. For example, for PPP road projects in Australia, there are 3 large tollroad projects currently being constructed or will be constructed in 2007-2010. They include the Mitcham-Frankston Freeway in Victoria, and the North South Bypass Tunnel and the Airport Link projects in Brisbane, Queensland. There are also more than 3 additional tollroads in the planning stage in Sydney, Melbourne and Brisbane. 37 There are concerns raised regarding the availability of experienced resources for these projects in the coming years.

In addition, the experience of contractors on recent PPP projects has pushed contractors to focus their risk management controls and to call for changing the current structure of PPPs towards “equivalent sharing of risk, efficient procurement processes and true partnership”. 38

High transaction costs and lack of competition

An issue identified both in the UK and Australia is the high transaction costs associated with PPPs. 39

37 M4 East Tunnel, Sydney; East-West Link, Melbourne and the Northern Link, TransApex project, Brisbane
On the Mitcham-Frankston Freeway project, there were only 2 bidders with each consortium comprising of construction subsidiaries of Leighton Holdings. A third bidder (Bauldstone Hornibrook) "had its fingers burned" in the first round and did not proceed with the bid for the final rounds.\(^{40}\) Anecdotal discussion in the market place indicates that the bid costs for each bidder exceeded $30 million.

Similarly for the North-South Bypass Tunnel project in Brisbane, there were only 2 bidders. In the Airport Link project in Brisbane which is currently in the bidding phase, the 3 bidders involve 4 construction companies who are either subsidiaries of Leighton Holdings or Bilfinger Berger AG.

In another recent project, the Newcastle Mater Hospital project, there were only 2 bidders short-listed to submit proposals. A third bidder, Leighton Contractors withdrew from the bidding process for a range of reasons including complex and costly probity arrangements, delays in getting bid information and the States’ requirement that bidders take over the current hospital staff under their current term of employment.

The industry as a whole has been critical about the high bidding costs involved in PPP projects.\(^{41}\) As pointed out in the Fitzgerald inquiry into Partnerships Victoria, it is not uncommon for bidders to incur bid costs exceeding $2-3 million and the number of players who can afford to put at stake those types of costs is increasingly very small and in an immature PPP market like Australia. This will affect (if not lessen) the market for competitive bidding for PPP projects.\(^{42}\)

- **lack of management skills in government**

The theory of the firm\(^{43}\) suggests that an economic actor would participate in a partnership if the benefits outnumbered the costs. However, there are also costs involved that stem from the interaction between the partners which, depending on the divergence between the partners, can be of considerable size. The economic actor will take into consideration that finding the right partner, negotiating the conditions of collaborative work and the monitoring of the partners compliance with the contract may take much energy and bind resources that, in case of non-partnering, may be used for carrying out the activity internally or by sub-contracting - that is,

---


\(^{40}\) “Capital projects hit a brick wall”, The Australian, 10 July 2004

\(^{41}\) Williams, M 2003 “Bidders face high entry costs”, CFO May

\(^{42}\) Fitzgerald, P 2004, “Review of Partnerships Victoria Provided Infrastructure”

\(^{43}\) Microeconomics is traditionally constructed from two branches, the theory of the firm and the theory of the consumer. The former studies the supply of goods by profit-maximizing agents, and the latter studies consumption by utility-maximizing agents.
there are transaction costs to be considered which relate to negotiating, establishing, supervising and making partnerships work.

Governments need to have the commercial skills to manage the PPP procurement process (and in particular, to carry out proper risk management so that the right decisions can be made). It also needs to be able to effectively manage its transaction advisors. These are important issues to be overcome so as to avoid any bias that government or their advisors may have towards a particular approach in the delivery of PPPs.

Governments also need to analyse its future policies when implementing PPP projects and ensure that there is a national co-ordinated approach towards delivery of PPP projects in Australia.

For example, Alan Stockdale, the Executive Chairman, Infrastructure - Investment Banking Group, Macquarie Bank, one of the major investment funds in the world made the following comments: 44

"Government needs a high level of commercial skill and understanding in defining what it is buying. This involves an understanding of the best way to specify the service or outcome sought, the dynamics of competitive discipline for the particular project or class of project concerned; defining the trade off involved in fixing the length of the contract, .... Government will need to understand the likely future development of demand and other variables to determine whether they will be able to predict the change and accommodate that change in the initial contracts or whether the contracts and commercial relationships need to build in a flexibility to cope with future changes. Government also needs to understand not only its own policy objectives but how suppliers and prospective suppliers will see commercial reality in the project concerned."

As an example, in Victoria, the Justice Department significantly underestimated the impact of policies like mandatory sentencing on the future level of its prison population and as a result, whilst the per-prison cost of private delivery was substantially below the public sector benchmark, the impact on the State budget massively exceeded expectations and had to be accommodated into future budgets.

1. Inflexible nature of long term contracts

Depending on the nature of the project, most PPP projects have concession periods in excess of 20 years. Long-term contracts are inherently inflexible. Moreover, there is an inevitable trade-off between flexibility and risk transfer. The more the contract contemplates variations over time to adapt to changing circumstances (whether arising from developments in technology, social expectations or policy) the greater the scope for the contractor to reopen the pricing provisions and to convert a fixed price into a higher one.

In more recent times, the "at no cost" mantra adopted by most State governments used in the development of tollroads is being reconsidered in light of the public outcry at the tolling regime for the Cross City Tunnel project in Sydney.\textsuperscript{45} A review by a Joint Select Committee on the provision of motorways in NSW recommended that governments should pay a bigger role in the provision of infrastructure (including financing).\textsuperscript{46,47,48} The Joint Select Committee, whilst agreeing that competition and innovation are desirable aspects of private sector participation in the provision of public infrastructure, believes that toll levels should be based on a range of considerations including financial objectives, strategic transport objectives and government policies on the reduction or management of vehicle movements. The Committee also considered that not enough attention was given to strategic planning at an early stage of the project, despite agencies that gave evidence to the Inquiry indicating that they followed Government policy in the consideration, planning and assessment of the CCT project.

At the planning stage of any project, it is difficult for governments to take all of these functions into account these factors (such as vertical fiscal imbalance, COAG, etc).

The issue of flexibility is as important as price. Technology is changing very rapidly, new ideas on managing and motivating resources emerge frequently, and government policies change. If there is pervasive adoption of inflexible, long-term contracts then this will complicate massively, and slow substantially, the responsiveness of the public sector to a changing world. In the London Underground PPP project, the contracts provide for the renegotiation of fees and scope.

In addition, governments need greater skills in managing the relationship post award of the contract. Experiences on recent PPP projects only highlight the risk positioning that both government and the private sector parties will take (resulting in an inherent bias in risk allocation) if the parties do not approach the PPP project on a partnership basis.\textsuperscript{49} Whilst it could be argued that comments by the private sector are seen to be pushing the private sector interests, anecdotal evidence through the Fitzgerald report and failure of or claims.

\textsuperscript{45} "Report gives NSW room to manoeuver" Australian Financial Review (9 December 2005)
\textsuperscript{47} Hewett, J 2005, "Tunnel fiasco takes toll on public-private model", Australian Financial Review, 21 November
\textsuperscript{48} "Iemma told : Fix the rot", Daily Telegraph, 7 November 2005,
\textsuperscript{49} See sections 13 and 14 for further discussion
from projects such as Cross City Tunnel, the Spencer Street station projects can only support any naïve notion that such comments are without merit.

Part B: Value for money framework

5 VfM - general principles

The underlying rationale for PPPs is that they must offer value for money. This is the thrust of the arguments that governments have used for choosing the delivery of projects by PPPs. Value for money is an expression of the economy, efficiency and the effectiveness in which the public sector bodies operate.

There are many management approaches to achieving the VfM objective. Generally, the major factors considered when assessing value for money in PPP programs are:

- **risk transfer** - relieving the government of the substantial, but often undervalued, cost of asset-based risks;
- **whole of life costing**, fully integrating up-front design and construction costs with on-going service delivery, and operational, maintenance and refurbishment costs;
- **innovation** - providing wider opportunity and incentive for innovative solutions as to how service requirements can be delivered;
- **flexibility** - allowing sufficient flexibility to allow for changes in service requirements over time whilst giving enough certainty to bidders to facilitate innovation;
- **asset utilisation** - greater opportunities to generate revenue from use of the asset by third parties (which may reduce the cost that government would otherwise have to pay as sole user);
- **output based specification** - services are specified as outputs and payment is linked to the quality and timing of their delivery;
- **performance measurement and incentives** - these act as a means of securing the delivery of the services;
- **private sector management skills** - ability of the private sector to deliver management and operational efficiencies; and

---

competition - the value for money of a project is easier to demonstrate where there has been an effective price-led competition.51 52 53 54

These features are not too dissimilar when compared to various government procurement policies:

"Value for money is the basis for comparing alternatives so buyers can choose the most cost-effective outcome. This requires careful comparison of costs, benefits and options... Price alone is not often a reliable indicator of value for money. Best value for money means the best available outcome when all relevant costs and benefits over the procurement cycle are considered. Buyers will not necessarily obtain the best available value for money by accepting the lowest-priced offer that meets mandatory requirements." - Source: Extract from Commonwealth Procurement Guidelines: Core Policies and Principles, p. 3.

"Value for money - benefit compared to whole of life costs". - Source: NSW Government Procurement Policy.

"Value for money" is determined by considering all the factors which are relevant to a particular purpose, for example: experience, quality, reliability, timeliness, service, initial and ongoing costs, can all make a significant impact on benefits and costs. Value for money does not automatically mean the "lowest price". It is important to be clear about how value for money will be determined in any particular set of circumstances prior to assessing bids" - Source: NSW Government Code of Tendering

"Vfm: value for money in relation to a PPP means that the partnership agreement results in a net benefit to the awarding authority, defined in terms of cost, price, quantity, or risk transfer, or a combination thereof" - Source: South Africa National Treasury PPP manual

"Government Accounting defines value for money as "the optimum combination of whole life costs and quality (or fitness for purpose) to meet the user's requirements" - Source: "Government Accounting", HM Treasury 2000

51 In Partnerships Victoria projects, bids are assessed against benchmarks to ensure value for money, as compared with the cost to government to deliver the project itself. The Public Sector Comparator benchmark can be used to calculate the full, risk-inclusive cost of providing the service over the life of the project. Other factors such as non-quantitative risks in the proposed service levels and capabilities are taken into consideration in the overall assessment.
53 National Audit Office 1999, Examining the value for money of deals under the Private Finance Initiative,
54 Li, Bing and Akintoye, A, "Developing a risk management culture", School of Built and National Environment, Glasgow Caledonian University
6 Value for money and risk transfer in a PFI PPP framework

There are 3 overriding considerations when designing the risk allocation structure for a privately project-financed deal (PFI PPP) for delivery of projects\textsuperscript{55, 56}.

- the cost of the project in its entirety - whilst the government wants to transfer most of the risks to the private sector and the private sector wants to reduce its risk exposure, the main consideration is the efficiency gains and costs for the project in its entirety;
- all substantial projects risks have to be identified and allocated, and managed by a combination of financial resources and firm contractual commitments; and
- the risk allocation structure has to be sufficiently sound (or sensible) to cope with a combination of worse case scenarios for the project.

Every project will have risks specific to that project having regard to the nature and type of project, technical challenges, financing structure and other commercial imperatives. Some examples are:

- tollroads - the risks associated with a tollroad will depend on whether it includes the construction of a road tunnel and the quality of ground conditions, potential native title claims, risk of changes in tunnel ventilation requirements, etc.
- hospitals - the risks associated with provision of soft facilities management, such as human resources to run the hospital and related industrial relations problems, and risks associated with taking over government’s employees to run the hospital etc
- water treatment and desalination water projects - the risks associated with new process technology, the quality of the raw water intake, use of existing infrastructure, changes in regulatory framework dealing with the supply of water, etc

The nature and extent of a project, and the circumstances and risk appetite of individual sponsors and their project financiers, will affect how each project risk will be managed and priced. The views of the project financiers will determine the mix of debt and equity to be used, the risks that they will allow the project sponsors to assume under the concession agreement, and the creditworthiness and the bankability of the project will depend on the set of inter-related agreements between the project parties.

\textsuperscript{55} UNIDO BOT Guidelines, Chapter 8, Risk Identification and Management
\textsuperscript{56} See also discussion on risk management in section 8
Traditionally, in major projects or projects involving project financing, the most common approach is for project owners to enter into fixed time/fixed price “turnkey” contracts for the delivery of the project so that the risk of cost overruns, delay risks and technology risks (depending on the technology used in the project) are passed to the contractor. The owner would normally effect insurance for those risks that the parties are unwilling to assume.

The transfer of risks to other parties inevitably leads to increases in the project costs because contractors seek a higher return on investment for assuming a “higher” level of risk, or because of increased insurance premiums.

Banks are reluctant to provide finance in some developing countries for various reasons including political risks (such as currency convertibility, war, civil disturbance, and the like). Commercial insurance to cover political and foreign exchange risks are very expensive. This is partly overcome by international agencies, such as the World Bank, Multilateral Investment Guarantee Agency (MIGA), and the International Finance Corporation (IFC), underwriting those risks by providing guarantees for those risks.  

Similarly, banks have been reluctant to provide finance for projects developed on an alliance basis as there is a “level of discomfort” about the closeout of the risk transfer to the contractors and potential cost and time blow-outs.

In a recent survey carried out by the Victorian government, respondents ranked the following 3 factors as having the most important impact on the actual (final) risk allocation for PFI PPP projects. They were:

(i) commercial requirements;
(ii) bargaining power; and
(iii) the financiers’ requirements.

Rational risk allocation and the government’s preferred risk regime were ranked fourth and fifth respectively.

As that report stated, the importance of commercial requirements indicates that sponsors do expect a risk premium in return for risk bearing. Respondents also indicated that bargaining power was seen as the next most important factor as the bargaining power largely rested with the government (at least until the selection of the preferred proponent). Whilst it is considered that

---

57 In Australia, the Export Finance and Insurance Corporation (owned by the Commonwealth government) performs a similar role.
58 Department of Treasury and Finance 1999, Private Provision of Public Infrastructure, Risk Identification and Allocation Project, Survey Report
it is essential for governments to retain competitive tension in the bidding process to gain the best outcomes, it is also argued that governments need to ensure that they do not use this bargaining power to transfer risks to the private sector which cannot be reasonably managed by them. This will result in higher risk premiums or "projects may fail if these risks arise and cannot be well managed".

Financiers' requirements are a major influence on final risk allocation. This is the case for PFI PPP projects. The financiers must be comfortable with the risk to which their funds are exposed. Anecdotally, financiers frequently rely upon the reputations of the engineering, procurement and construction (EPC) contractor or the project sponsor as a proxy for technical risk.

If project finance is required for complex PPP projects where risks cannot be reasonably managed by the private sponsor and contractors, it is important for governments, sponsors and financiers to recognise and consider alternative forms of delivery structure (including alliencing), or adopt a risk allocation structure that reflects greater risk sharing, where risks can be better managed without the government having to pay higher risk premiums.  

Interviews with transaction advisors have indicated that government bureaucrats and their advisors have adopted an increasing conservative approach to risk management in delivering PPP projects. There could be a number of reasons. For example, it is observed that individual governments tend to use specific legal or financial advisors. Those advisors may adopt a conservative approach which suits the bureaucrats' bias towards greater risk transfer to the private sector (whether it is appropriate or not). This can be evidenced by an analysis of recent PPP transactions.

This greater emphasis on risk transfer also has a significant influence on whether delivery through a PPP is more efficient and cost effective than the government investing in the project itself.

In the United Kingdom, there have been key lessons learned from the large number of PFI PPP deals done over the last decade. Some of these lessons include:

(a) decisions taken by politicians or public servants (and their advisors) have a marked impact on future PPP deals and more importantly, on the subsequent generations who are affected by those decisions. Those decisions must be built around the management of any future impact;

---

58 See discussion at section 7.
60 See sections 13 and 14 for further discussion
61 Ter-Minassian, T 1004, "Public Private Partnerships", International Monetary Fund
(b) implementation of PPP deals must be focussed on the delivery of outcomes. Implementation procedures need to be more practical, and less complicated and time consuming to establishing. It should not create constraints that increase transaction costs or impact the competitiveness of the bids.62

(c) risks must be carefully apportioned between the public and private sectors depending on the ability of each party to manage and control risk. As one commentator correctly pointed out, "Just because one party is willing to take a risk, it does not mean that they should".63

The experience in the United Kingdom indicates that the traditional PFI PPP structures cannot be applied to all types of projects, and there is a trend to move away from buying specific solutions to an approach where the public sector creates a relationship with the private sector. That experience has highlighted the reality that wholesale transfer of risk has not necessarily been rewarded with value for money. The United Kingdom has been exploring these alternate delivery options in their Defence procurement, programmes in healthcare such as NHS Lift and in education such as Building Schools for the Future.

62 This observation is also supported by studies in Australia - see Allen Consulting Group 2004, "Financing Public Infrastructure in Victoria. A comparison of approaches"; Fitzgerald, P 2004, "Review of Partnerships Victoria provided infrastructure"

63 Stone, Tim 2004, "PPP/PFI - a key reform catalyst", KPMG Corporate Finance Advisory Note, May
Box 7.2: Three stages in VfM appraisal

Appraisal: Which is VfM Option?

<table>
<thead>
<tr>
<th>PFI Option</th>
<th>Conventional Option</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment Programme Assessment:</td>
<td>PFI not appropriate / Good VIM</td>
</tr>
<tr>
<td>Government's approach</td>
<td></td>
</tr>
<tr>
<td>Key characteristics of successful PFI i.e. Evidence on sector</td>
<td></td>
</tr>
<tr>
<td>A Proposed PFI Project:</td>
<td>Conventional Procurement Option</td>
</tr>
<tr>
<td>Outline Business Case</td>
<td></td>
</tr>
<tr>
<td>Project stage PSC Assessment:</td>
<td></td>
</tr>
<tr>
<td>Cost/benefits</td>
<td></td>
</tr>
<tr>
<td>Optimism bias, tax, Risk adjusted</td>
<td></td>
</tr>
<tr>
<td>(Start Final Procurement Assessment)</td>
<td></td>
</tr>
<tr>
<td>Invitation to Bid</td>
<td></td>
</tr>
<tr>
<td>Conventional Procurement Option</td>
<td></td>
</tr>
<tr>
<td>Final Business case</td>
<td></td>
</tr>
<tr>
<td>Final Procurement Assessment:</td>
<td></td>
</tr>
<tr>
<td>Quality of competition</td>
<td></td>
</tr>
<tr>
<td>Market capacity</td>
<td></td>
</tr>
<tr>
<td>PFI is VIM</td>
<td></td>
</tr>
<tr>
<td>Contract Award</td>
<td></td>
</tr>
<tr>
<td>PFI not VIM</td>
<td></td>
</tr>
<tr>
<td>Conventional Procurement Option</td>
<td></td>
</tr>
</tbody>
</table>

By applying this appraisal process throughout the competitive process, public sector clients will safeguard value for money by:

- ensuring there is no inherent preference for a particular procurement option;
- making the quality of the competition an explicit part of evaluation;
- encouraging intelligent management of market capacity as part of procurement and pre-tender dialogue;
- feeding information back into projects and programmes in earlier stages of procurement. This will be supported going forward by the improved signed deals list and the adviser database; and
- providing an early warning of when competitive tension may be reducing, and how this can be remedied.

PFI procurement will only be pursued if these assessments show that it will deliver value for money.
Optimal risk allocation

To optimise risk allocation, where a party is able to control a risk, either by limiting the likelihood that it will occur or limiting the consequences if it does, it may be better for that party to assume the risk than a party with no control over it. For both pricing and management reasons, optimal risk allocation dictates that particular risks are allocated in line with the capacity to control and manage at least the costs associated with the risks.

In the various policy guidance documents issued by the various State and territory governments, the consistent theme is that PPP projects must meet the value for money test.64 Annexure I sets out a brief comparison of the value for money policies adopted by various State and Territory governments in Australia and in some overseas countries.

Whilst theoretical risk allocation has been reflected in the PPP policy frameworks issued by most of the State and Territory governments, a large component of the evaluation of the value for money concept is based on risk transfer to the private sector.

---

Models for infrastructure delivery

Source: Public Private Partnerships: A Private Sector Perspective - Mick Lilley
Macquarie Bank, December 2003

64 The guidance materials issued under Partnerships Victoria state that "As with the Private Finance Initiative in the United Kingdom, Partnerships Victoria requires a total shift in mind-set to see PPP as an opportunity to procure services, leaving the risks of ownership of the asset with the private sector."
Putting aside each State or Territory government's agenda on funding new projects, it is useful and important to point out that transfer of risk and funding of new projects are only aspects of the VFM test.

There is a very strong focus on risk transfer by the State and Territory governments:

"Improved risk management - more rigorous risk evaluation and transfer to the private sector of those risks it is best able to manage..."\(^{65}\)

"Risk transfer and mitigation - relieving the Government of substantial, and often undervalued, costs of risks associated with asset ownership and management and the provision of specified services".\(^{66}\)

"Value for money is maximised by allocating risk optimally. In very general terms, this means allocating each risk to the party best able to manage that risk. In theory, this reduces individual risk premiums and the overall cost of the project, because the party in the best position to manage a particular risk should be able to do so at the lowest cost."\(^{67}\)

"Under this policy, the governing principle of a project’s risk allocation is that risk will be allocated to whichever party is best able to manage that risk, taking into account the public interest considerations. It is not the Government’s intention under this policy to necessarily attempt to transfer all project risk to the private sector, as it fully recognises that the inappropriate transfer of risk will generate and carry a significant premium.

Government recognises that it is inappropriate to seek private sector involvement in public infrastructure provision unless all significant project risks are identified and the Government has quantified what risks and costs, if any, it is prepared to retain and what risks and costs it expects can be justifiably transferred to the private sector."\(^{68}\)

Anecdotal evidence in the United Kingdom\(^{69}\)\(^{70}\) also suggested that calculations under the PSC evaluations, projecting whether a project will deliver value for money, is entirely dependent on the risk transfer valuation.

\(^{65}\) see section 2.1.5, Working with Government Guidelines for Privately Financed Projects, New South Wales Government.

\(^{66}\) Territory Partnerships - Policy Framework

\(^{67}\) Partnership Victoria - Risk Allocation and Contractual Issues

\(^{68}\) Public Private Partnerships Guidance Materials - Policy, Queensland Government

\(^{69}\) Arthur Andersen and Enterprise LSW 2000, "Value for Money Drivers in the Private Finance Initiative, a report commissioned by the Treasury Taskforce, 17 January 2000", see section 5.
There will be projects where the nature of the inherent project risks will make it uneconomic to transfer that risk. Transferring risk to the private party who may not be able to manage that risk also means that the private party will charge a premium for accepting such a risk, thereby reducing value for money.

Actual practices in the Australian construction industry show that principals (both public and private sector) have a bias towards risk transfer. In a survey carried out by the Institution of Engineers, Australia and the Chamber of Commerce and Industry, Western Australia on risk allocation in major projects in Western Australia, 67% of all contractor respondents responded that risks that have been allocated to them were "impossible to manage". This begs the serious issue as to whether principals (including governments) are achieving value for money in delivering major projects.

Some examples of delivery of public infrastructure using alternative delivery structure with greater risk sharing include:

- Sydney Water's Northside Sewerage Outfall project where an alliancing approach was used, rather than a conventional design and construct delivery option, in light of the requirement to complete the project in a very tight deadline before the Sydney Olympics. There was also a range of technical and community issues (such as difficult ground conditions, disposal of spoil in the sea and setting benchmarks to meet safety, environmental and community expectations).

- Department of Transport, Victoria use of project type alliances for the delivery of a number of major rail electririctification projects in Melbourne and for the deep channelling project at Port Philip Bay.

- The Commonwealth Government use of various forms of alliancing ranging from project type alliances to hybrid versions of project and strategic type alliances for delivery of major defence projects such as frigates, torpedoes and air warfare destroyers, as well as for the National Museum of Australia involving complex design and construction challenges.

- Rail Infrastructure Corporation (NSW) use of alliancing in the outsourcing of major capital and periodic maintenance works. This was decided as the better approach to achieve optimised delivery of the infrastructure as RIC was constrained by fluctuating annual budgets and priorities over the whole rail network in NSW. In this alliance,

---
KPIs were used to measure cost reduction, customer service, safety and production rate.

- Sydney Water is using an alliancing delivery structure for the delivery of the pipeline transmission component for the desalination water project in Sydney.

The various policy documents do not deal with the delivery of PPP projects by an alliancing approach where risks may be shared between the project parties (other than a reference in the Northern Territory policy document which contains a diagram referring to alliancing as part of the PPP family). Based on the existing risk valuation framework, it can then be argued that because the risks cannot be or are not transferred, then there is no (or less) benefit (or value for money) obtained.

But as the Queensland Government policy document suggests, it is important to recognise that an inappropriate transfer of risk will generate and carry a significant premium. As one commentator stated, beliefs based upon traditional approaches and rules can impair the development of effective solutions for the future provision of services.

These views are supported by other agencies throughout the world.

The Chief Executive of Partnerships UK, PLC stated in a recent interview that, "it is not feasible to transfer all the risk on a PPP deal because the residual obligation always remains with the public sector to provide the public service. "PUK's role is to ensure that there is sufficient risk capital in the deal to provide incentive for management and shareholders in the private sector to manage away the risk over the life of the contract and ensure that the deal never reverts back to the public sector"…

"PFI contracts work at their best when there is some give and take on both sides. For the public sector, however, give and take can be a difficult concept, largely because of the accountability and transparency under which the sector operates"

He advocates that successful contracts represent win-win scenarios. "If the private sector performs well, the public sector gets a good service and should not begrudge higher performance payments. If the private sector does not perform, it will lose money, and the ultimate threat is termination."

---

72 It is interesting to note that the NSW Government has not introduced a PPP policy framework document but only one for project financed initiatives. The Partnerships Victoria Guidelines issued by the Victorian government does not make any clear distinction on delivery of PPP projects on a PFI or non-PFI basis.
73 Price Waterhouse Coopers 2001, "Value for money in public/private partnerships - A Briefing for Local Authorities", p 12
74 Standards and Poor 2003, "Credit Survey of the UK Private Finance Initiative and Public Private Partnerships"
Other interesting perspectives on risk transfer in PPP projects by various members of Ministry of Public Works, France are set out below: 

"In basic terms, the project itself must dictate how risks are to be divided to best ensure maintaining overall equilibrium - it must be kept in mind that any assumption of risk necessitates some type of payment - the sharing of risks is not be considered likely a transfer of risk free of charge from the authority to the private partner, but rather a more optimal allocation of risks among partners based on their respective risk-bearing capacities - this features also signifies that the cost associated with a given level of risk assumption is sometimes the factor being minimised in a public-private partnership set-up.

On the other hand, the commercial risk is often quite significant and the costs of its assumption by the private partner may prove to be rather high (which would engender a high contract price and an even higher subsidy should the project happen to be unprofitable).

In the end, the sharing of risks is not a miracle solution but instead a means for optimising a project with respect not only to the technical and serve quality options, but to the costs of protecting against inherent risks as well."

In consequence, when risks are being allocated among relevant parties, it is necessary to consider both their ability to bear a particular risk and the value each party attaches to carrying that risk. For example, it has been observed that the financing of the early PPPs in Canada required the payment of significant premiums over the cost of government bonds - in the case of the Highway 407 project, the potential premium was sufficiently great to cause the provincial government to abandon its original intention to having the private sector partner undertake the financing.

The Efficiency Unit which is responsible for implementing PPP projects in Hong Kong pointed out in its guidance materials that:

"Appropriate allocation of risk between the public and private sectors is a key requirement for the achievement of value for money in PPP projects. Experience elsewhere indicates that risk transfer should be optimal, not maximum. If the government seeks to impose excessive risk transfer to the private sector this will result in the private sector charging an excessively high premium; simply refusing to accept

---

75 Perrot, Jean-Yves and Chatelus, Gautier (French Ministry of Public Works) 1999, Financing of major infrastructure and public service projects, Public-Private Partnership, Presses de l'ecole nationale des Ponts et Chaussees
the risk altogether (ie they will not put in a bid); or failing to meet contract obligations”.

It is therefore imperative to understand that it is not risk transfer per se that is important, but rather the effective management of risk - this requires that each risk be allocated to the partner best able to manage that particular risk - one of the sources of gains from the use of PPPs is that such arrangements typically require the explicit identification, quantification, allocation and management of major project risks.77

8 Risks management for PPPs

Risk management requires the identification, analysis, quantification, allocation, and mitigation of the risks associated with a particular PPP. The analysis process may be complex, possibly requiring considerable research, including simulations of various possible outcomes associated with the project.

Generally, the major categories of risk are as follows:

- design and construction risks;
- commissioning and operating risks in connection with availability, operating costs, performance and maintenance;
- demand risks relating to utilisation;
- risks in connection with residual values;
- risks resulting from obsolescence or changes in technology;
- regulatory risks including changes in taxation; and
- financing risks.

Once project risks have been identified and quantified, they should be allocated to the partner best able to manage them. This may involve their reduction or elimination. This may also be transferred to a third party (possibly a contractor or insurance company) or may be absorbed or pooled.


77 Allan, JR 1999, Public-Private Partnerships: A Review of Literature and Practice, Saskatchewan Institute of Public Policy
However, there are also other classes of “intangible” risks. Whilst delivering projects and services through alliancing can bring significant benefits and help bring about successful innovation, there are also risks if the alliance partners cannot align their agenda and do not communicate effectively, it can lead to a higher level of uncertainty and introduce new and unfamiliar risks. Individual players belonging to each alliance partner may have polarised perspectives on risk allocation, and a lack of understanding and clarity on the types of risks being transferred can lead to “unhelpful” behaviour when risks materialise. It is therefore common and prudent for owners and contractors to “check” each other out through a series of pre-contract workshops to establish that alignment before commencing on the alliance journey.

9

Evaluating risk in the PPP framework

The economic analysis of projects is necessarily based on uncertain future events. Sensitivity analysis assesses risks by:

- identifying the variables that most influence a project’s net benefits and quantifying the extent of their influence;
- helping to identify design/construct design options and pinpoint the need for obtaining additional information on some variables; and
- helping to convey some idea of project risk.\(^7\)

The various State and Territory governments have adopted the Public Sector Comparator (PSC) as the benchmarking tool in carrying out the cost-benefit analysis of risk transfer. The analysis takes into account a series of different options and considers the alternative PPP delivery options.

The PSC is essentially prepared by identifying key project risks and pricing those risks, taking into account the probability of each risk occurring and determining who is best able to manage them. The components of the PSC are:

- transferable risks;
- competitive neutrality;
- raw PSC (base costing); and
- retained risk.

---

\(^7\) World Bank 1996, Operations Policy Department, Handbook on Economic Analysis of Investment Operations,
Under the existing PSC framework, the value for money test of a project is improved each time a risk is transferred to the private sector because that it will manage the risks better than the public sector. A risk that is transferred which the private sector either which is unable to manage, or is no better able to manage than the public sector, will tend to reduce the value for money of the project.  

The PSC framework requires input into both qualitative and quantitative elements. Whilst it essentially involves a bottom line consideration of the pricing risk that the private sector submits for a range of factors including risk transfer, innovation and pricing, the isolation of risk pricing is one of the many factors that go into the comparison.

It is not intended to cover the mechanics of the PSC process in this paper, However, it should be said that the case studies and theory in the various policy documents do not sufficiently inform PSC users how to evaluate a project delivered on a non-traditional delivery structure such as alliencing (where the risks are shared between the parties than transferred to the contractor).

In a recent report, the National Audit Office made the following observations of PPP projects in the United Kingdom:

“Yet the PFI is too often seen as the only option. To justify the PFI option, departments have relied too heavily on public sector comparators. These have often been used incorrectly as a pass or fail test; have been given a spurious precision which is not justified by the uncertainties involved in their calculation; or have been manipulated to get the desired result. Before the PFI route is chosen, departments need to examine realistic alternatives and make a proper value for money assessment of the available choices”.

Jeremy Colman, the author of that report also considered that these problems often hindered the understanding of the drivers for value, and that too much emphasis was given to the results of PSCs, especially in the late stages of the procurement process. He was of the view that it was not rational to base a decision solely on costs (which the PSC is based on).

In another recent report on the London Underground PPP, the National Audit Office stated that the “Public Sector Comparators were subject...to considerable inherent uncertainty and therefore gave only limited assurance about the reasonableness of the prices quoted by the bidders”.

80 National Audit Office 2003, “Delivering better value for money from the Private Finance Initiative”

9200663_1
This statement would also apply in Australia. Government agencies should give greater consideration to the best way to deliver a project based on the specific nature and risk profile of that project (rather than rely on a structure that has been designed more specifically for PFI PPPs).

This view is also supported by criticisms by a number of leading PPP experts in the United Kingdom (including from within national audit offices) regarding the use of the PSC and suggestions that the PSC framework is not necessarily the best framework for decision making when looking for the best procurement method.  

82 The National Audit Office in the UK in a recent report on the construction performance of PFI projects also suggested that there are other different procurement routes (other than PFI) which can also deliver value for money in construction.  

83 84

Other research has also indicated that not all PFI PPP projects offer value for money. It has been suggested that PFI PPPs do not been deliver value for money in health projects where core services are still operated by the public sector.  

85

The UK government has highlighted the need to reform the PSC to ensure an economically rigorous appraisal of a project's outline business case prior to its procurement, and to allow an alternative route to be chosen at that stage if it offers better value for money. Similar criticisms have come out of the Fitzgerald inquiry into Partnerships Victoria.  

86

Value for money through efficiency or risk transfer is difficult to substantiate. 87 As a NAO report into the London Underground has shown, value for money comparisons are of limited use in assessing complex projects.88 The recent Spencer Street Station PPP project is another example where it is possible to list the risks after the event but is difficult to ensure that the estimated risks are transferred in practice or to enforce rights through the contractual arrangements where risks are inappropriately allocated for a range of reasons89. Other examples include the IT PFI/PPP projects and the failed hospital and prison projects in Victoria.

10 Move away from a PFI PPP approach and why risk transfer may not be optimal value for money for governments

82 PFI Intelligence Bulletin 2002, "Private sector backs PSC attack"
83 National Audit Office 2003, "PFI: Construction Performance"
84 Mott MacDonald 2002, "Review of Large Public Procurement in the UK"
86 Fitzgerald, P 2004, "Review of Partnerships Victoria Provided Infrastructure"
88 National Audit Office 2004, "London Underground PPP: Were they good deals?"
89 See section 12.2 for further discussion on the Spencer Street Station experience

9200063_1
The current United Kingdom government has recognised the need to move away from a narrow focus on PFI to a broader interpretation of PPP. However, until recently, most effort has gone into operationalising PFI and into developing guidelines for PFI implementation.

The relatively easier changes include a greater use of medium term (5-10 years) risk and transferring outsourcing contracts for a wider range of services currently provided by the public sector (or procured on a conventional basis). A major refurbishment programme for groups of old and sub-standard State assets (eg schools) could be achieved rapidly and cost-effectively using competitive PPP contracting eg property management services could be procured on an incentivised basis. All public sector property assets could be managed through a PPP vehicle which accessed private sector property management skills on a risk sharing basis.

The UK government has released various guidance documents dealing with the assessment of value of money. The policy and guidance documents adopted by various State and Territory governments have not extended its approach to the extent done by the UK government.

It is time for governments to consider extending the PPP framework to delivering projects on project delivery structures other than PFI PPP structures (which emphasises risk transfer). From a policy perspective, consideration of alternative delivery structures under the PPP framework will demonstrate the government’s ability and commitment to achieve the best value for money approach in delivering key infrastructure projects.

11 Risk sharing in PPP projects

As one commentator pointed out, PPPs are intended to be collaborative partnerships between the public and private sectors and which are defined by “a commitment to shared planning and decision-making, a serious effort to redefine these relationships as collaborative partnerships would change the way public decisions are made and implemented - in the end, a picture emerged of collaborative partnerships as a management tool that could be used to re-engineer governance.”

In recent NAO reports on PPP projects, a constant theme is that the partnership means not pursuing contractual disputes that have little merit. The partners in a PPP relationship work together to reach swift operational and financial solutions, including managing the contract robustly through astute project management, adopting a flexible and proactive approach to problem resolution, clearly prioritising of critical projects and bringing in the requisite management experience. A common recommendation is for good risk management practices to

---

91 Armstrong, J and Lenihan, D, “From Controlling to Collaborating: When Governments Want to be Partners”, Institute of Public Administration of Canada
include a full cycle of proactive activities: risk identification, evaluation of probability and impact of risks, risk mitigation, monitoring and review.\textsuperscript{92}

Another recommendation in these reports is that parties should take a whole of business approach - this requires partnership decisions to be based on what is best for the business as a whole, rather than what is best for the private sector or government. Industry leaders have also expressed the view that "the PPP model has to be modified to reflect a more realistic sharing of risks".\textsuperscript{93}

Over the last 15 years in Australia, various forms of relationship contracting (ranging from partnering to alliancing) have been used by various governments to deliver projects. However, they are still relatively new notions in the public sector.

As set out in the section on relationship contracting, they involve sharing risks, losses, gains and decision making authority - shared vision and goals also often characterise successful partnerships.

For complex PPP projects, governments may be able to achieve better value for money by considering which party is better able to extract the best value in respect of the risk to be undertaken. It may be that rather than the "concession style" of delivery that has been adopted for most of the PPP projects delivered to date in Australia, government agencies should look and consider some of the more recent developments in the United Kingdom. It may be appropriate, for example, to adopt different risk allocation and contracting styles for different risks in a single project.

One of the recommendations coming out of the Fitzgerald review\textsuperscript{94} is that the present approach to risk assessment and the use of discount rates should be unbundled into separate components, and for the PSC to be reformed so that it becomes just one factor in the procurement decisions and conclusions as to value for money. The review also recommended that the PSC should not be used in some circumstances and that the analytic comparison should be against a reference case or a range of benchmarks.

\textsuperscript{92} NAO 2004, "London Underground - Are the Public Private Partnerships likely to work successfully"

\textsuperscript{93} "Off the Rails", Australian 12 August 2004

\textsuperscript{94} Fitzgerald, P 2004, "Review of Partnerships Victoria Provided Infrastructure", Final Report to the Treasurer, Victoria
Part C: Overview of Australian and international PPP policies and experiences

12 Australian PPP policies

The Commonwealth and State and Territory governments have released various policies and guidance materials for PPPs or PFI PPPs. They are:

- Commonwealth - Commonwealth Policy Principles for the Use of Private Financing 2002;
- New South Wales - Working with Government: Guidelines for Privately Financed Projects, 2001;
- Victoria - Partnerships Victoria, 2000;
- Queensland - Public Private Partnership Guidance Materials 2002;
- Western Australia - Partnerships for Growth: Policies and Guidelines for Public Private Partnerships in Western Australia 2002;
- South Australia - Partnerships SA: Private Sector Participation in the Provision of Public Services, 2002;
- Northern Territory - Territory Partnerships Policy Framework, 2003;
- ACT - Statesmen of the Objective and Principles for the Private Provision of Public Infrastructure, 2002; and

The Commonwealth and New South Wales PPP policies are specifically developed for PFI PPPs or PFPs. The New South Wales government has intentionally not developed policies for the broader category of PPP projects (including publicly financed PPPs) and has relied on its recently released New South Wales Government Procurement Policy to manage non-PFI PPPs.

Despite these policies, various governments have entered into a number of projects involving publicly financed PPP type project, or projects that are both publicly and private financed.

---

9200063_1

9 These projects include a number of alliancing projects such as Sydney Water’s Northside Storage Tunnel Project, the National Museum of Australia Project and various large Defence projects (Project Djimindji, ANZAC frigate, etc), and DCM (Design, Build and Maintain) projects such as the Pacific Highway Upgrade Program.
• In the Alice Springs-Darwin railway project (which involved the construction of a 1420km new standard gauge track), the Commonwealth, South Australian and Northern Territory governments contributed over $550 million, and the remainder of the $1.3 billion project was financed by the private sector. The Commonwealth Government also agreed to lease the 830km line between Alice Spring and Adelaide to the consortium. In addition, the governments had to support additional contingent funding (principally provided by the project sponsors) designed to ensure financial support for over 3 years of operations following construction. The governments also adopted a more balanced allocation of risk giving the consortium various protections against native title and Aboriginal land right risks, pre-existing contamination, extensive cure rights to allow the consortium and financiers the ability to continue attempting to remedy any complications that may arise (such as impact of the wet season in the north), and establishment of an effective access regime (including access rates and calculation methodology).96

• The Central Sydney Area Health Service, the Catholic Health Care Service and Bovis Lend Lease entered into an “innovative partnership” to develop a one-stop health services centre (providing early childhood, nutritional, general counselling, dental and women’s health services). This replaced the delivery of community services from dispersed locations. An integrated aged care service was also incorporated as part of the project. Bovis Lend Lease was responsible for the construction and operation of the centre. This arrangement has many of the advantages of a PPP but without private financing.

The Victorian, Queensland and Western Australian PPP policies are also more inclined towards the PFI PPP model whilst the PPP policies of the other states and territories appear to have a broader focus.

The Victorian Government has used, or will be using alliancing, to deliver a number of projects including the Sydenham Rail Electrification, the Craigieburn Rail Electrification, the Port Phillip Bay Deep Channelling and the Tullamarine-Calder Interchange projects. Yet these projects are not considered to be part of the Partnerships Victoria program.

The West Australian government has used alliancing to develop a $340 million desalination plant project in Perth. However, there was no mention of delivering the project under its PPP policy.

The NSW government has awarded a contract for the delivery of a $1.3 billion desalination plant project in Sydney on a DBOM basis, but has used an alliancing approach to deliver the pipeline

96 Royal Bank of Scotland 2001, "Transport fuels project finance in Australia", Asiamoney July
transmission works under Botany Bay as it involved higher delivery risks involving underwater construction and community and environmental risks which would requires significant risk pricing from contractors. It had previously considered delivery of the whole project on an alliance or PPP basis, and the contract documentation reflected drafting based on a PPP structure.

This lack of a clear and consistent approach among the various governments towards non PFI PPPs does not allow the market to understand each government’s objectives (including the delivery model) in procuring a project.

Each government has left the relevant individual state agency to call for tender submissions for each project based on what that agency considers to be appropriate.

Recent Australian PPP experiences

Success in delivering PPP projects

The recent Fitzgerald report into infrastructure provided under Partnerships Victoria found that the first 8 Victorian PPP projects show credible evidence of benefits. Those benefits include design and other technical innovation, timely delivery of projects, and equal or better value for money returns than the public sector comparator calculations.

In New South Wales, the government has successfully delivered a number of tollroads, schools, hospital, and waste recycling projects.

Western Australia, Queensland and the Northern Territory have also recently signed new PPP deals for convention centres, court facilities and teaching facilities. The results of those projects are yet to be seen.

Spencer Street Station Redevelopment

However, recent events regarding the Spencer Street Station Redevelopment indicate how the “partnership” can potentially go off its rails.

On that project, the Victorian government granted a concession to the Civic Nexus consortium to carry out the Spencer Street Station redevelopment. The project comprise of the development of the transport interchange, modification and upgrading of certain existing rail infrastructure and signalling system, and carrying out commercial development adjacent to the interchange.
facility. The key stakeholders included the Victorian government, existing transport operators and users/consumers. The project was not a “greenfields project” and involved the construction of an imposing wave form roof structure over existing operational rail lines. It was a key requirement for the project that the existing station remained operational at all times, as the interests of the Victoria’s private sector rail operators were paramount to the Victorian government. This meant that construction work could only be carried out in very limited time gaps at night when the trains were not running. Another challenge for the parties was to complete the interchange facility and have it ready for use before the 2006 Commonwealth Games in Melbourne.

The construction contract was awarded to Leighton Contractors (part of the Civic Nexus consortium). Under the concession agreement, the majority of the construction risks associated with the transport interchange were allocated to the Civic Nexus consortium who in turn transferred those construction risks to Leighton Contractors.

It was reported in the press in an interview99, that the contractor took on risks that it should not have accepted. Whilst it is widely accepted that the Victorian government has successfully managed to transfer substantial risks to the private sector, a question is raised regarding the approach taken by the Victorian government in working collaboratively with the private sector in solving problems on the project and the nature of the partnership. As the chief executive of the construction sponsor puts it, “If you take a high-level perspective of PPPs ...they have not necessarily been embraced by bureaucrats because they see implementation of these facilities as encroaching in their traditional domain....In terms of the construction of the model, in terms of the risk-sharing and equity and reasonableness of it, it’s completely skewed towards the government or the government agency. There’s a huge embedded bias in the issue. The bias is against the provider.”

On the other hand, one could argue that the government had achieved its objectives in managing clear risk transfer and any potential for unplanned cost blow outs.

Following weeks of “media warfare” (including expression of lack of co-operation from the government), the parties finally managed to come to a comprise whereby the government undertook to provide greater access for the private sector consortium to carry out the works (including providing additional platforms and re-routing trains). This solution does not address questions such as whether there was clear understanding of the challenges facing the project delivery, whether there was proper assessment of project delivery methods and risks, whether

the government did in fact get value for money, and whether the risks the contractor assumed were priced in its bid, etc.\textsuperscript{100}

The recent problems at Spencer Street Station Redevelopment only highlight further the need for government agencies to have processes in place to properly identify and manage risks (instead of taking the simple approach of getting the private sector parties to price and assume that risk regardless of whether it can be managed properly). It also test the maturity of the Australian PPP market and contractors have become more aware and cautious of the risks that they are prepared to assume on future PPP deals in Australia.\textsuperscript{101}

A question to pose is whether the real driver behind the use of PPPs is the delivery of large capital projects with the aim of ensuring that there is no risk for budget overruns and minimising the political risks associated with the any perceived failure or delay in delivering the projects, rather than the selection of a PPP structure after proper assessment and allocation (including sharing of risks where appropriate) of risks and responsibilities.

\textbf{Prison projects in Victoria}

The Victorian Government had to step in and buy out the contracts for the Metropolitan Women’s Correctional Centre and the Port Phillip Prison after persistent operational problems (such as drug abuse, excessive lock downs, lack of proper security systems, etc) and failure by the private sector companies to rectify the defaults. Some of the issues highlighted by the Victorian Auditor-General, and a separate independent inquiry commissioned by the State, included the inflexible contractual arrangements for the government to change operational matters and adopt new initiatives, deficiencies in the structure of performance linked payments and like emphasis on selection based on financial evaluation criteria (rather than the ability for the private sector party to effectively manage and operate the prisons).\textsuperscript{102}

\textbf{Hospital projects}

Whilst the contract for the Latrobe Regional Hospital was not awarded under the current Partnerships Victoria PPP policy, it highlights some of the potential problems where the government has to step in to fulfil its policy responsibilities to the public. In that project, the 257 bed public hospital was owned and operated by the private company, Australian Health Care Ltd (AHC). AHC sued the government alleging that the government failed to pay appropriately for a range of services. The hospital was transferred back to the government with the Minister for Health stating that the losses suffered by the private company meant that “it

\textsuperscript{100}“Leighton’s Spencer St gravy train”, Australian Financial Review, 6 August 2004
\textsuperscript{101}Standards and Poor’s, Public Private Partnerships Global Credit Survey 2005 pp 23-24
\textsuperscript{102}Efficiency Unit, Hong Kong, “Case summary - Prisons operated by Public Private Partnerships, Victoria, Australia.”
could no longer guarantee the hospital’s standard of care". Other examples of failed hospital projects include the Port Macquarie Hospital in NSW and the Modbury Hospital in South Australia.  

14 UK PPP policies and experiences

In the United Kingdom, the original PPPs were implemented as privately financed projects. The UK government has achieved substantial success in implementing these projects. There are over 400 PFI contracts currently in force with commitments to expenditures in excess of £100 billion. A recent NAO audit survey found that over 88% of PFI PPP projects were delivered on time with no cost overruns.

In mid-2000, the government embarked on a rebadged Public Partnerships program named "Public Private Partnerships: the Government’s Approach". This has been extended to include the 4Ps program that has been introduced for local government agencies. In addition, other government organizations such as the Ministry of Defence have its own PPP program.

Some observations of the PPP deals in the UK are set out below:

14.1 On-going reforms

The HM Treasury conducted a review of the progress of PFIs and their role in the delivery of projects. The report claims that smaller PFI projects while delivering the benefit of larger PFI projects, derive a diminished overall benefit because of the high transaction costs in relation to the perceived benefits of the projects. This concern has also been highlighted by local government agencies using PPPs to deliver projects The HM Treasury report called for the introduction of reforms to improve the value for money appraisal by the public sector, to ensure there is no bias in favour of any one procurement option and to ensure decisions are made on the basis of best value for money. It also endorsed reforms to the Public Sector Comparator to ensure that a value for money assessment of both PFI and conventional procurement options are fully taken into account prior to the procurement of a project.

The report also identified the difficulties encountered in the delivery of IT PPP projects These difficulties include:

• inability to establish long term targets with any degree of certainty due to fast pace of technical change;

104 Bennett Jones LLP 2001, "Public-Private Partnerships for Ontario Hospital Capital Projects"
105 See for example, the 4Ps, an agency set up to assist local government agencies.
106 International Financial Services, "PFI in the UK: Progress and performance, PPP Brief"
• inability to clearly delineate areas of responsibility due to the close integration of IT with client’s other business systems;
• a lack of a market for third party finance;
• differing cost structures with costs dominated by running costs rather than large up front capital investment.

14.2 More direct participation in delivery of services

In some recent PPP deals, the UK government has adopted a more involved participation in the risk management and control of the private sector parties. Two examples are the PPPs for the National Air Traffic Services (NATS) and the London Underground.

NATS

In the PPP for the National Air Traffic Services, the UK Government entered into the Strategic Partnership Agreement with the private sector entity whereby the Government transferred a controlling interest in NATS to the private sector. Under that arrangement, day-to-day control of the business was conferred on the strategic partner but significant actions will require the consent of the Government as a shareholder before they can be taken and the Government also had the right to appoint a number of non-executive directors to the board of NATS. The PPP will consequently ensure that there is an alignment of the strategic partner and the Government’s objectives as co-investors in NATS.

London Underground

In the London Underground PPP, London Underground Limited (LUL) signed three 30 year PPP contracts with private sector organizations (Infracos). LUL retained the ultimate ownership and responsibility for the daily operation of trains and stations and for safety, while the Infracos were responsible for the maintenance and asset renewal of the infrastructure (including stations, trains, track and signalling).

The complex deal resulted from the scale of the work required to modernise the Tube, the decision to have innovative output based contracts and limited knowledge of the condition of the less accessible infrastructure. The Infracos stand to receive nominal returns of between 10-17 to 18-20 percent a year, depending on the level of performance. The payments to the Infracos are covered by annual grants from the Department of Transport (which provided a stable funding regime) and income from passenger fares.

The PPP contracts are reviewed every 7 1/2 years with the assistance of an independent arbiter (if called upon) where the parties may re-specify requirements within the PPP scope and where
re-pricing may take place. The re-pricing is also subject to the Department of Transport agreeing to adjust the annual grants it pays to LUL. If the Infracos require additional funding for each subsequent 7 1/2 period, the existing lenders do not have an obligation to provide it but there are a number of options such as reduction in the scope, LUL providing additional equity or using new forms of financing.

LUL does not have a right to terminate for its convenience to discourage lenders from increasing their price because of political uncertainty.

A Partnership director also sits as an independent, non-executive director on the boards of the three Infracos and is required to act for the good of the Infracos but with a view of protecting the public interest.

Some of the recommendations made by the National Audit Office included the following:

- LUL undertook an extensive exercise to analyse the extent of risk and uncertainty faced in implementing the investment programme for the Tube. In proceeding with the PPP, the cost uncertainty, and the uncertainty of the infrastructure condition were dealt with by building appropriate incentives into the Infracos contracts, eg a mechanism to ascertain that future costs (where unknown at the outset) would be re-based on the economic and efficient price for the outputs and aligning payment with delivery of desired outputs.

- The PPP design was based on an open and transparent sharing of the profits and losses of the business. The Department of Transport and other government agencies explored the scope for sharing risks, and how to share the rewards, before entering into detailed contact negotiations.

- Good corporate governance calls for maximum transparency. Public sector bodies should insist that contracts include strong provisions for open book monitoring of both special purpose company and the prime contractor performance. There should be scope for LUL and the Infracos to develop working relationships that improve on contract arrangements.

- Government departments should negotiate commercial terms that are broadly neutral in respect of unforeseen and unforeseeable asset condition, because seeking to transfer too much risk is likely to over-compensate the private sector on grounds of uncertainty.

14.3 Use of outsourcing, alliancing and partnerships
The Ministry of Defence in the United Kingdom embraces (in addition to PFI) outsourcing, alliancing and strategic partnerships as part of the PPP delivery mode. The main driver for Defence is the better use of resources in defence and the maintenance or enhancement of operational effectiveness. Projects must take that aspect into account before proceeding with other issues, such as the impact on the chain of command and service discipline.

14.4 Managing the relationship to secure a successful partnership

The NAO conducted a major survey of PFI projects in progress to see whether the public sector achieved value for money and the private sector received a reasonable return. While the survey found that most authorities considered that their PFI are good value for money, and were satisfied with the risk allocation in the contracts, one third of the private sector parties did not agree with the authorities’ views that the risk had been appropriately allocated. The survey showed an emphasis to build a successful long term partnership with the private sector.

However, as the United Kingdom experience shows, the survey found that most authorities have limited experience of the contract management phase of the projects. The major areas where authorities would like more guidance include contract management, performance measurement, change procedures and legal issues and achieving and maintaining value for money.

The latest PFI report issued by the H M Treasury suggests that the contractual relationship in a PFI project should be overlaid with “a partnership agreement or shared vision document” that sits outside the actual PFI contract. That partnership agreement will not be legally binding but would set up the framework for the public and private sectors working relationship.

15 Other international PPP policies and experiences

Europe (other than United Kingdom)

Recent reports showed that while most member states of the European Union show interest in PPPs, there is varied experience in developing PPPs. The United Kingdom stands out as being the longest and most experienced country in delivering projects using PPP. Some countries have successful implemented PPP projects, some countries are reviewing the use of

---

107 NAO 2001, “Managing the relationship to secure a successful partnership in PFI projects”
109 This is similar to the partnering structures that have been used in the United States of America and Australia for construction projects. However, there are a number of legal issues (such as implied obligations of good faith, the parties’ fiduciary duties, estoppel and waiver, and other actions possible under the Trade Practices Act for misleading and deceptive contract and misrepresentation, etc) that will render the intent of the “non-binding” nature of the partnering agreement ineffective.
110 It is not the intention of this paper to do an analysis of PPP frameworks across the world but to indicate the widespread development of this model of delivery.
111 Freshfields Bruckhaus Deringer 2005, PPP in Europe: An overview
PPPs, others have developed pilot procurement programs while others have only recently introduced PPPs.

France recently promulgated the Order in France establishing partnership contracts (contrats de partenariats) which are a form of PFI PPPs.

Portugal passed a PPP law in August 2003, which allows PPP projects if they involve a significant transfer of risk to the private sector.

In the Netherlands, public-private partnership is a term which describes a variety of structures, the two principal ones being facilitatory PPPs and PPPs which are designed to spread risks. In a facilitatory PPP, the government takes no more than a facilitating role eg using the instruments available to it to expedite preliminary planning for a project which is to have at least a partially public function. The collaboration between the public and private sectors is then regulated by a contract. The funding and risks of the actual development of the project are left entirely to the private sector. The government merely acts as a facilitator and runs no financial risk.

In a risk sharing PPP the government has a financial interest in the commercial exploitation and how it is conducted. There are 2 forms - the first of these is the public-private joint venture (or public private development corporation) in which both the private sector and the government have a risk bearing stake. That means that, depending on the results of operational management, the government is entitled to part of the profit or bears some of the risk where a loss is incurred. The second is the concession model, in which the government sells the right to operate the project for some kind of remuneration.

Asia

Most Asian countries (eg. China, Hong Kong, Thailand, Malaysia, Philippines, Indonesia, Singapore, Vietnam, Japan) have been delivering projects on a BOT basis for a number of years. The experiences vary across the countries with successes and failures of projects depending on a variety of reasons. Although a number of these countries have introduced laws or policies on delivery of BOT projects or PFI 113, only Hong Kong has formally issued guidelines for implementation of PPP projects114.

In Japan, contractual arrangements between the public and the private sectors are far less detailed than in the US, UK or European civil law regimes. Historically, Japanese business has

113 Anukret on Build-Operate-Transfer (BOT) Contract (Cambodia); Private Finance Initiative Promotion Act 1999 (Japan); Federal Roads (Private Management) Act 1984 (Malaysia); Republic Act 7718 Amended BOT Law (Philippines); Act on Private Investment in Social Overhead Capital Facilities, 1999 (South Korea); Decree on providing investment regulations on BOT (build - operate - transfer), BTO (build transfer - operate) and BOT (build - transfer) contracts involving foreign investment in Vietnam

114 Efficiency Unit, Hong Kong 2003, 'An Introductory Guide to Public Private Partnerships'
been conducted on the basis of trust in relationships rather than strict contracts, and companies have not felt it necessary to document what will happen if the public sector wants to change its requirements, if there is a dispute, or if a contract has to be terminated for poor performance.\(^{115}\)

In Japan, risk transfer tends to take place at the completion of construction with the private partner providing services in what is effectively a public building. One of the reasons for this is that it is tax efficient; but it also seems to reflect the prudent approach that Government entities have taken to transferring control over the assets to the private sector.

The interesting question is whether the contracts are performed in the way that is expected. In other economies the big issue is not whether the procurement appears to deliver value, but whether the contract works in the long term. Often the public sector has to intervene if things go wrong. The Japanese tradition may mean that projects will not be allowed to fail.

**Africa**

South Africa is the most advanced country in Africa in terms of delivering PPP projects. Its PPP initiative has been based on the private sector providing financing for infrastructure projects.\(^{116}\)

**Americas**

There have been a significant number of PPP projects (ranging from roads, hospitals, airports, rail and court facilities) delivered in Canada.\(^ {117}\) Various provinces in Canada have issued PPP policies and guidelines but the PPP projects have been based on the PFI model to date. The experiences have also been varied.

In the United States, there is no formal PPP policy but the provision of infrastructure based on PFI has been in place for a long time.

In Central and South American, BOT type projects have been used to deliver a range of infrastructure projects since the 1980s. Again, the experience has been varied. Chile has embarked on a PFI PPP program to deliver roads and healthcare projects.

---

\(^{115}\) Poulter, T “Japan’s PPP experience - lessons for Europe?”, Price Waterhouse Cooper

\(^{116}\) PriceWaterhouse Coopers, “Contract management - making the deal work for the South African Government and the private sector”.

\(^{117}\) Parker, J 2003, “The PPP and infrastructure market in Canada”, PFI March
Part D: An overview of relationship contracting

16  Relationship contracting

16.1 General

Alliance contracting and other forms of relationship or relational contracting have been used to delivered complex projects in Australia. They depart from the traditional approach to contracting with respect to risk allocation. Recently, there has been an increase in the use of alliancing to deliver complex projects in Australia.\(^\text{119}\)

The Australian Constructors Association has defined “relationship contracting” as “a process to establish and manage the relationships between the parties that aims to remove barriers, encourage maximum contribution and allow all parties to achieve success”\(^\text{120}\). It identifies a number of key issues relating to alliancing:

- “clients and contractors are best served when the delivery strategy utilised suits the project requirements”;

- “Many clients still utilise project delivery systems structured to alter the allocation of risk and neglect the opportunities to be gained through improving the relationship between the contracting parties”

- “For larger projects, where there are many unknowns and uncertainties, the client can better manage its risks through a more cooperative approach where the risk is embraced rather than transferred”;

- “Where an examination of the risk allocation indicates that a risk embrace approach will be more suitable, an alliance offers the parties a technique to ensure that the goals of the client and contractors are more closely aligned within a gain-sharing/pain-sharing framework that balances risk and reward and focuses all parties on an optimum project outcome”; and

- “An alliance requires the parties to become result focused and willing to challenge conventional standards. The focus is on a cooperative endeavour to improve project

\(^{118}\) Chew A 2004, “Alliancing in Delivery of Major Infrastructure Projects and Outsourcing Services in Australia – An overview of legal issues” ICLR 319, 321-322

\(^{119}\) There is limited data on the number of projects using alliancing as a form of delivery structure. In a preliminary research by John Davies into alliance contracts and public sector governance, he identified 80 projects using alliancing in Australia to date (15 February 2007). Source: Internet search. An association (Australian Alliancing Association) of organization interested in alliancing was formed in 2005 but have not published any data on the use of alliancing in Australia. There has similarly no publication of the Australian alliancing experience by the Victoria Department of Treasury and Finance who published the Project Alliancing Framework Guide.

\(^{120}\) Australian Constructors Association 1999, “Relationship Contracting - Optimising Project Outcomes”
outcomes rather than establishing a legal regime to penalise non-conformance”. (all bold for emphasis)

Some other reasons given as perceived advantages of the alliancing approach include:

- flexibility to vary development concepts while maintaining schedule and cost;
- joint owner/contractor approach to safety and environmental objectives;
- non-adversarial approach with common, rather than conflicting, project objectives;
- reduced project management costs due to fewer contracts and interfaces, and an integrated team;
- reducing bidding time and costs; and
- flexible access to the contractor’s resources, avoiding the need for the owner to develop a large in-house engineering group.⁻¹

In addition, the performance measurement for these alliancing projects allows non-cost objective performance (with quantitative measures for environment, safety, industrial relations and community expectations) to be linked with the risk reward structure.

In “straight-forward” projects where the risks are traditionally manageable, alliancing is probably not appropriate.

16.2 Is it a cure for all projects?⁻²

The following has been taken from various industry sources:

“"It took a lot of effort to get the management of the four companies in our alliance to think the same way....It sounds simple and everybody thought it was a good idea, but there is a considerable amount of management time and effort required to make an alliance work. If you don't commit the time, it doesn't work. If you do commit the time, it is still hard work.". Robert Jones, Woodman Point Project.⁻³

“Alliancing is not the next saviour of the world....The challenge for the industry in the new millennium is how we take the behaviours that make alliances work - things like trust,"
commitment and respect - and get them back into our more traditional delivery strategies." Jim Barrett of the Australian Construction Association124

In an article on a prominent project in Australia, it was stated that "one of the critical issues uncovered is that contract alliances work well when progress is good. However, when a contract falls behind and any bonuses (or penalties) have been used up, the incentive for a contractor to perform at optimum pace is lost."125

These quotes emphasise the importance of putting the right risk profile for a project in place, choosing the right alliance co-participants and having a well drafted contract which clearly articulates the risk allocation and/or sharing negotiated by the parties and on which the parties can rely as a safety net to protect their respective rights.

A party to a new alliance relationship should never underestimate the cultural changes likely to be required of it to achieve the more open relationship inherent in an alliance and the transition from a principal/contractor relationship to work as part of a "blended" team.

16.3 Types of alliances

Alliancing was first used in Australia in the 1980s on the Wandoo and East Spar offshore gas projects. The operator of the Wandoo oilfield constructed and installed the Wandoo B platform using an alliance with 4 construction and design companies. In the East Spar project, there was an alliance between the operator and engineering/construction contractors for the design and construction of two subsea wells, a subsea gathering system and multiphase pipelines. Since those offshore projects, alliancing has been used on other infrastructure and service areas including process plants, roads, water and sewerage treatment plants.

Broadly speaking, alliancing can be categorised into the following:

- "pure" or "project" alliances, which include projects such as Sydney Water's Northside Storage Tunnel Project and Priority Sewage Project, the Queensland Clean Fuels Project, the National Museum of Australia Project Western Australian Water Corporation's Woodman Point project and a number of road projects by the Queensland Department of Main Roads including the Georgina River Bridge and the Port of Brisbane Motorway. These alliances are increasingly being used in New Zealand including in the Freeflow Alliance road project in Auckland and the Project Aqua hydro-electric project; and

“impure” or “strategic” alliances, which include outsourcing major rail infrastructure capital and maintenance works by the then Rail Infrastructure Corporation, Australian Rail Track Corporation, State Rail Authority of NSW and BHP Steel, facilities management by NSW Police, Alcoa, Incitec, EPC and maintenance services by Santos and the TVR telecommunications project in New Zealand.

16.4 “Pure” or “Project” alliances

A “pure” or “project alliance includes the following key features: \(^{126}\)

- the parties are collectively responsible for performing the work and generally assume collective ownership of all risks associated with delivery of the project;

- the project owner pays the non-owner project participants for their services on a 100% open book compensation model which covers the project costs and project specific overheads, a fee to cover corporate overheads and “normal” profit, and an equitable share of the “pain” or “gain” depending on the project outcomes compared with the parties’ joint targets. The downside to the non-owner project participants is limited to the loss of the corporate overheads and normal profit;

- the project is governed by a joint body (typically called the Project Alliance Board or Alliance Leadership Team), comprising the project owner and non-owner project participants, where all decisions are unanimous;

- day-to-day management of the project is by a seamless integrated project team where all project members are chosen allocated tasks on a “best for project” basis; and

- the parties agree to resolve issues or disputes within the alliance with no recourse to litigation except in the case of “wilful default”. \(^{127}\)

Pure project alliances are generally best suited for projects which display some or all of the following characteristics:

- complex projects that are subject to significant internal and external change as they develop;

- technology which is the state of the art and involves research and development;


\(^{127}\) Wilful default is commonly defined in the project alliance contracts as a wanton or reckless act or omission which amounts to harmful and avoidable consequences and having disregard to those consequences. This concept is one of the main differences between strategic and pure project alliances.
- external factors such as government regulations and the physical environmental are likely to constrain management;

- the physical and financial size of the projects exceed previously established threshold for the industry, technology or enterprise;

- the project is aiming to set new benchmarks for early completion;

- the required project works consist in whole or part of maintenance or augmentation activities which can be improved or made more economical by integration of the principal and the contractor into one team;

- the principal does not require the w to be market tested; and

- the principal is prepared to enter into a risk sharing arrangement where most risks are shared and where the other project participants cap the shared risk, the principal accepts the downside risk. \(^{128}\)

16.5 “Impure” alliances

These are similar to the “pure” alliances in terms of management structure (such as use of alliance boards, alliance management teams and integrated project teams), remuneration structure (such as performance based payment structure based on use of key performance indicators (KPIs)) and obligations of the parties to work co-operatively and in good faith.

However, in “impure” alliances, the non-owner alliance participants (rather than all alliance participants) assume liability for breach of their obligations under the alliance contract, and are specifically obliged to discharge their obligations under the alliance contract. In these and other respects, these types of alliances retain more of the features of traditional contracting, relying on the management and remuneration structures adopted to drive alliance style behaviours, but with a less radical approach to risk assumption and liability.

This type of alliance is generally used more for projects where the parties are better able to identify, assess and quantify the risks assumed. They are more generally used for conventional construction projects (as compared to the more “risky” projects such as offshore platforms or where the project alliance participants are working under severe time and delivery constraints) and for outsourcing of services (such as plant maintenance, facilities management, and rail infrastructure maintenance).

\(^{128}\) See Appendix 3 of the NSW Auditor-General’s Report Performance Audit on the Northside Storage Tunnel Project
16.6 "Strategic" alliances - long term

A strategic alliance is a business relationship between organizations in which they share risks, pool strengths or integrate business functions for mutual benefit but remain distinct entities. These alliances are becoming more common.

Principals see these alliances as a means by which they can reduce their reliance on in-house resources by utilising the expertise of contractors in the principal’s business plans (allowing them to concentrate on their core business) but allowing principals to have a more significant input into the non-core activities than would be the case with traditional, "arms-length" outsourcing. In addition, the parties normally apply the principal’s life cycle objectives to evaluation and decision making during the implementation of the project.

For contractors, strategic alliances provide a mechanism by which they can forge closer, longer term relationships with customers, often on more sensible, lower risk terms that still provide the opportunity for good profits as a reward for excellent performance.

The development of strategic alliancing can be viewed in part as an enhanced outsourcing arrangement, where the relationship strengthens over time as communication improves and trust is enhanced between the alliance partners.

The structure of strategic alliances is more aligned towards an "impure" model, as a number of the risks can be more easily assessed and quantified allowing contractors to assume these risks without putting a "high premium"

16.7 Risk spectrum

The diagram below shows the risk spectrum for the different forms of alliancing.

---

Fig 1. Risk Spectrum – alliance contracts

---

120 Chew A, Ibid p324
16.8 Structure of alliencing contractual arrangements\textsuperscript{130}

Contractual arrangements for alliencing projects can be based on one of the following structures:

- an all-encompassing alliance contract which covers all the project alliance participants' rights and obligations. A variant of this is for the alliance participants to initially enter into an interim alliance agreement during which the participants get together to carry out a survey of risk, value engineering and management studies and establish the key performance indicators (including the cost and targets). Following resolution of those targets and other commercial issues, the participants then enter into a final alliance agreement for the delivery of the project; or

- an umbrella alliance contract which deals with certain key alliance matters, but anticipates separate works contracts between the owner alliance participant and each of the other non-owner project alliance participants. The latter form of contracts deal with each parcel of work for the project (whether design or construction).

The former contractual structure is more commonly used. The latter contractual structure has been used on the East Spar project, the Queensland Clean Fuels project and the Asset Control Enhancement project by Santos.

16.9 Structure of alliance contracts\textsuperscript{131}

Alliance contracts generally have the following features:

- a management, reporting and issues resolution structure comprising an alliance board, an alliance management team and an integrated process/development team;

- an obligation on the alliance participants to act reasonably and in good faith;

- for project alliances - no liability for alliance participants (or no liability except for willful default);

- a performance based remuneration structure comprising a “cost plus fee” approach on an “open book” basis;

- a right for the owner/principal to terminate for its own convenience; and

- a force majeure clause.

\textsuperscript{130} Chew A, ibid p327-328
\textsuperscript{131} Chew A, ibid pp327-328
When drafting an alliancing contract, the following issues should be considered:

- fair and equitable risk sharing (having regard to the nature of the project, outsourced services and type of alliancing structure);
- common objectives;
- a closer party/party relationship than that assumed by standard general conditions of contract;
- ensuring the contract is a management tool allowing, where possible, better management of the contractual/business relationship; and
- risk allocation in the context of delivering increased value for the alliance project participants if the performance standards are met.

An alliance contract should be drafted in a way which allows joint collaborative effort to reach mutually rewarding goals. They should emphasise the positive aspects of the relationship and attempt to relegate strict legal issues to the background.

However, the fact remains that the contract creates legal rights and obligations which are important to understand.

The core of any alliance contract is a series of commitments to behave in a manner consistent with the alliance principles set out in the contract itself or in an associated alliance mission statement.

These principles may include commitments similar to the following:

- "to produce outstanding results in the successful execution of the work in the Project Alliance Agreement";
- "to establish and maintain an environment which encourages honest, open and timely sharing of information and a willingness and desire to consider and implement new ideas in order to create a mutual winning position for the Project Alliance Participants";
- "to share and transfer such behavioural aspects to all persons associated with the work under the Project Alliance Agreement in order to achieve maximum success in all respects";
17 Use of alliancing in privately financed projects or PFI PPPs

Project financiers inevitably undertake a detailed analysis of the risks associated with the project and the financiers try to create, to the maximum extent possible, a closed circuit of risk by allocating all the project risks between identifiable parties and putting a detailed mechanism in place to manage those risks. Inevitably, that involves a transfer of major risks to the contractors in delivering the project.

Alliancing is generally used in those projects where risks are more difficult to quantify and allocate. In alliancing projects, the alliance project participants generally share the risks and rewards in accordance with a pre-agreed structure (rather than being allocated responsibility for specific categories of risks).

This difference in risk management strategies has been one of the major obstacles to the use of alliancing in project financed deals, particularly where there is no "deep pocket" sponsor.

In conventional project financing involving a single project sponsor, the project sponsor would own the project directly or, more likely, hold the project through a special purpose vehicle. Historically, in resources projects, the sponsor has participated directly in the project with recourse limited to the project assets.

However, in infrastructure project financing, the project sponsors generally participate through special purpose vehicles so as to insulate the project sponsor from liabilities associated with the project. Project financiers are concerned with the use of alliancing for project delivery because of the uncertainty of no guaranteed contract price and completion dates, the lack of the standard protections such as liquidated damages and performance undertakings, the lack of a "deep pocket" sponsor and because of the limited recourse nature of project financing deals.

Whilst project sponsors may be able to convince the relevant risk managers of the project financiers of the use of alliancing in delivering the design and construction of the project and entering into separate long term alliancing operation and maintenance agreements for the project, the author’s experience and discussions with relevant risk managers of project financiers are that the credit committees of banks providing the finance are very conservative and are not prepared to diverge from traditional approaches taken in respect of risk management of project

132 Extract from an alliance mission statement in an actual alliance contract.
133 Chew A, Ibid pp350-351
financed deals. The questions or concerns for these credit committees are who is taking the gap risk between the risk allocation between the government and the project sponsors as allocated under the concession agreement, and the actual downstream contractual risk allocation under the design and construct contract and the operation and maintenance agreement.

It may be time that project sponsors (including governments) and project financiers of major complex projects reconsider their risk management approach towards alliancing projects. It may be that in complex projects with substantial "unknown" risks, the more appropriate form of project delivery structure (such as alliancing) is one that can manage those risks so as to achieve timely and cost-effective delivery targets (rather than transferring risks which will involve paying a risk premium to the contractor for taking those risks, and hence increase project costs) and where a "deep pocket" sponsor or government gives financial guarantees to support that delivery strategy. This also adds support to the "value for money" proposition discussed in sections 5 and 6.

In a recent report\(^{134}\), the HM Treasury reviewed the performance of PFI PPPs and found that while most PFI PPPs delivered value for money there were sectors (specifically the IT sector) where PFI procurement did not offer the benefits that had been expected. It found that many aspects central to IT procurement did not fit well with the core requirements of PFI PPP. A summary of the findings is set out below:

- the fast pace of change in the sector make it difficult for the public sector to effectively define the outputs it requires in a long term contract;
- the high level of integration of IT infrastructure into the other business systems of the procurer makes it difficult to clearly delineate areas of responsibility to the client and the contractor, and so makes an appropriate sharing of risk more difficult to both discern and enforce;
- the lack of a market for third party finance in IT PFI removes a powerful driver ensuring appropriate and effective risk allocation in a project. This detracts from PFI’s ability to secure value for money for the public sector;
- the nature of the capital investment, with costs in IT dominated not by large up-front investment but by running costs; and

\(^{134}\) HM Treasury 2003, "PFI: meeting the investment challenge"
the duration and phasing of investment, where IT projects have a short life and include significant asset refresh, makes defining and enforcing long-term service needs more problematic.\textsuperscript{135}

It would seem that alliancing may be appropriate as an alternative delivery structure for delivering these IT projects.

In the Fitzgerald report\textsuperscript{136}, one of the recommendations is for the Victorian government to seek to pilot new financial and partnership structures that combine the benefits of private sector risk taking with the Government’s comparative advantage in securing funds. In addition, in structuring long term contractual arrangements, the government should not assume that they will be dealing with the lead equity investors beyond the medium term.

The report recommended that the PSC should be reformed to become just one of the factors in procurement decisions in the calculation for value for money - for example, in ICT projects, the reference case for the PSC should be more often an off-the-shelf technology benchmark rather than a hypothetical version of a public sector created solution.

Criticisms have also been made that PSC evaluations were made based on costs but did not give adequate consideration to “optimum combination of whole-life costs and quality to meet user requirement”.\textsuperscript{137}

18 Price competition in the selection process for an alliance project

The remuneration structure of alliancing projects involved an incentivised cost plus structure. There are differing views as to whether such a structure will be sufficient to protect the public’s interests in getting the most competitive price. On the other hand, alliancing advocates argue that competition will discourage the win-win behaviours that alliancing is seeking to achieve.

The alliance participants generally establish the target out-turn cost of the project. This is intended to be a reasonable estimate of what it should take to deliver the agreed scope of work taking into account delivery schedules, performance and quality specifications and other non-financial performance indicators (such as environmental, safety, industrial relations and community expectations). In some projects, this target outturn cost is established after the alliance contract has been awarded (or established during an interim alliance agreement).

One view is that until the target outturn cost of the project is established, the commercial objectives of the owner/principal and the other project alliance participants are not aligned.

\textsuperscript{135} See section 4.43 of the report.

\textsuperscript{136} Fitzgerald, P 2004, “Review of Partnerships Victoria Provided Infrastructure”, Final Report to the Treasurer, Victoria

\textsuperscript{137} Nisbett, J, “PFI: Are PFI/PSC Comparisons Reliable?”, Construction & Engineering Law, Vol 8, Issue 4
The claimed benefits of price competition are set out below in the following diagrams that were in the Auditor-General’s report into the Northside Storage Tunnel project. However, it is important to consider whether the price competition will compromise the co-operative elements of alliancing.

Fig 2. Overview of price competition v non-price competition in alliance contracts

Without Price Competition

Client/Owner

Other Alliance Partners

Seek to have the Target Direct Cost as high as reasonable in order to ensure that risk is catered for and returns which are based on the Target Direct Cost are maximised.

Similarly seek to negotiate other commercial criteria to maximise returns, within acceptable limits, to the Other Alliance Partners.

Also other commercial criteria (profits, overheads, risk/reward structure) to be at an acceptable level to the client.

Seeks to have the Target Direct Cost as low as practical but still sufficient for providing a “fit for purpose”, functional outcome in which projects risks are managed.

Increasing Target Direct Cost and other commercial criteria.
With Price Competition

<table>
<thead>
<tr>
<th>Client/Owner</th>
<th>Other Alliance Partners</th>
</tr>
</thead>
<tbody>
<tr>
<td>2 Alliance Groups in 'Competitive Target Direct Cost' phase</td>
<td></td>
</tr>
<tr>
<td>Seeks to have the Target Direct Cost as low as practical but still sufficient for providing a fit for purpose, functional outcome in which project risks are managed. Also other commercial criteria (profits, overheads, risk/reward structure) to be at an acceptable level to the client.</td>
<td></td>
</tr>
<tr>
<td>Whereas both alliance groups wish to have the Target Direct Cost as high as reasonable they are now in competition with one another and therefore will need to consider what their acceptable commercial position is without 'losing' to the other alliance group. Similarly, there will be some 'downward' pressure on other commercial criteria.</td>
<td></td>
</tr>
</tbody>
</table>

In the United Kingdom, the Ministry of Defence uses non-competitive procurement to procure complex military equipment where there are “compelling reasons”. It also pursues partnering and other forms of collaborative relationship contracting in its procurement management, as it has found that these approaches promote more co-operation between the contracting parties and encourage innovation, reduce costs and improve incentives to perform.

The Ministry uses processes already place which aim to replicate the pressures in private business competition. These processes include a long standing agreement between the government and industry bodies which sets out the rate of profit that contractors should earn on non-competitive contracts placed by government departments, requires open disclosure of data relevant to the agreement of a fair and reasonable price, and allows the parties to refer a contract to an independent review board if a party believes that there has been inequality of information that may have led to an excess profit or substantial loss. This may be a useful platform for designing PPP policies for projects using alliancing.

Will the Commonwealth, State and Territory governments consider a similar approach for non-competitive arrangements? This challenge raises a number of contract procurement issues, including transparency in awarding of contracts, probity issues and the ability to determine the best value for government.

139 National Audit Office 2001, "Non-Competitive Procurement in the Ministry of Defence"
18.1 Choosing the right alliance co-participant

One of the most important challenges for an alliance to succeed is to choose the right alliance co-participant.

The Partnerships Victoria document states that one risk which cannot be allocated to the private sector is that government may contract with an unsuitable partner. The primary issue in choosing a co-participant is whether a relationship between the government and the private sector can be sustained over the long term. The ingredients of a successful relationship include:

- planning and specification - so that the government's desired outcomes and output specifications are clear to the market;
- a genuine and viable business opportunity for the private sector;
- certainty of processes - so that tender conditions are clearly understood before the project proceeds;
- balanced bid evaluation - based on more than simple financial comparison. Non-financial goals such as environmental, safety and community expectation are also evaluated;
- clear contractual arrangements - centred on key performance indicators so as to promote performance and minimise disputes; and
- recognition of the partnership - to encourage good faith and goodwill between the government and the private sector in all project dealings.

19 Comparison of risk allocation under a PPP delivery structure and an alliance contract

Not all PPP projects are suitable for delivery on an alliance basis. Alliancing tends to suit high risk and complex projects where the project scope is not clearly defined, and where decisions should be based on a critical assessment of how risks and opportunities can be managed (including appropriate risk transfer or risk share) compared against delivery using a traditional delivery model.

As an example, the Commonwealth government has been increasingly using alliancing to deliver complex projects for defence equipment. Unlike infrastructure projects such as roads, schools, hospitals and prisons, the defence sector projects range from relatively straightforward projects such as accommodation to highly complex projects involving high technology and customised requirements (such as submarines, ships, fighters, etc). The size and complexity of
those projects increases the risk of delay and default, especially where the technology is new and untested.\footnote{Standards and Poor 2003, "Credit Survey of the UK Private Finance Initiative and Public Private Partnerships"- see section on "Unique risks posed by UK Defence Public Private Initiative Partnerships" See Keynote address "The Road Map for the Defence Public Private Partnership" by the Hon Fran Bailey MP, Parliamentary Secretary to the Minister for Defence at the Defence Summit in February 2003}

The following table sets out a typical risk allocation regime under a PPP structure, a pure alliance structure and a strategic alliance structure. Whereas under the PPP model, generally the private party will assume most of the risk. Under the alliance model, most risks are shared except in the case of a wilful default (under the pure alliance version) or a contractor’s breach (under the strategic alliance version). The comparison also reflects the very different approaches in risk management by the two delivery structures.

Table 1: Comparison of Risk Allocation Structure

<table>
<thead>
<tr>
<th>Risk</th>
<th>PPP preferred allocation</th>
<th>Alliance “Pure”</th>
<th>Alliance “Strategic”</th>
</tr>
</thead>
<tbody>
<tr>
<td>Site risks (site conditions,</td>
<td>Private party</td>
<td>Shared except in the case of wilful</td>
<td>Shared except to the extent caused by the contractor’s</td>
</tr>
<tr>
<td>approvals, environmental)</td>
<td></td>
<td>default</td>
<td>breach</td>
</tr>
<tr>
<td>Design, construction and</td>
<td>Private party</td>
<td>Shared except in the case of wilful</td>
<td>Shared except to the extent caused by the contractor’s</td>
</tr>
<tr>
<td>commissioning</td>
<td></td>
<td>default</td>
<td>breach</td>
</tr>
<tr>
<td>Financing</td>
<td>Private party</td>
<td>Government</td>
<td>Government</td>
</tr>
<tr>
<td>Tax</td>
<td>Private party</td>
<td>Government</td>
<td>Government</td>
</tr>
<tr>
<td>Operating and maintenance</td>
<td>Private party</td>
<td>Shared except in the case of wilful</td>
<td>Shared except to the extent caused by the contractor’s</td>
</tr>
<tr>
<td></td>
<td></td>
<td>default</td>
<td>breach</td>
</tr>
<tr>
<td>Market</td>
<td>Private party except to</td>
<td>Government</td>
<td>Government</td>
</tr>
<tr>
<td></td>
<td>the extent of any</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>specific government</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>commitments (such as</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>availability payment,</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

\footnote{Standards and Poor 2003, "Credit Survey of the UK Private Finance Initiative and Public Private Partnerships"- see section on "Unique risks posed by UK Defence Public Private Initiative Partnerships" See Keynote address "The Road Map for the Defence Public Private Partnership" by the Hon Fran Bailey MP, Parliamentary Secretary to the Minister for Defence at the Defence Summit in February 2003}
<table>
<thead>
<tr>
<th>Area</th>
<th>Responsible Party</th>
<th>Ownership Model</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industrial Relations</td>
<td>Private party</td>
<td>Shared except in the case of wilful default</td>
<td>Contractor</td>
</tr>
<tr>
<td>Legislative and Government policy</td>
<td>Private party except for changes in law/policy of the State directed specifically at the project</td>
<td>Shared except in the case of wilful default</td>
<td>Shared except to the extent caused by the contractor’s breach</td>
</tr>
<tr>
<td>Force Majeure</td>
<td>Private party except government holds some risk of service discontinuity subject to insurance availability</td>
<td>Shared except in the case of wilful default</td>
<td>Shared</td>
</tr>
<tr>
<td>Asset Ownership</td>
<td>Private party</td>
<td>Government</td>
<td>Government</td>
</tr>
</tbody>
</table>

**20 VfM in non-PFI PPP projects**

In the performance audit report on the Northside Storage Tunnel Project\(^{141}\), the New South Wales Auditor-General stated that “the concept of an alliance offers the promise of a successful outcome. But it brings its own risks. One is the risk of not getting the incentives and sanctions right. Another is that the parties become too close. The 'owner', the party who initiates, and will ultimately own the project, needs to ensure that the alliance delivers **value for money**. An alliance should not compromise the principles of accountability and transparency that are so integral to the public sector.”

**What is VfM for non-PFI PPPs?**

In working up the case for a particular PPP project (whether project financed or not), it is important to identify how additional value can be created. In a typical PFI PPP project, value is created by transferring risk to the private sponsor, leading to increased risk premium costs which in turn diminish value otherwise created.

\(^{141}\) Auditor-General’s Report 2003, Performance Audit, Sydney Water Corporation, Northside Storage Tunnel Project
In an alliancing PPP contract, value may be created by the asymmetry of interest between the government and the private sector. This means structuring the risk sharing and compensation mechanism so that higher returns can be achieved by both parties by the private sector not having to put a high risk premium on a risk where it may not be the party able to best manage it.

Demonstrating value for money for a project is not just simply a mechanical PSC comparison. It may include achieving the following:

- effectiveness and quality in the service provision;
- involvement of the relevant stakeholders (including environmental and community);
- review process and performance measures;
- creating a learning culture and training program for the public sector - skills transfer;
- governance arrangements for both public and private sectors (through performance, accountability and transparency, rather than just risk transfer);
- value management and value engineering; and
- robust, demonstrable and auditable financial analysis through open-book auditing.  

However, it is important to note that the set-up costs for an alliance are high, and accordingly, PPP projects with lower project values may not be suitable to ensure value for money for the government sponsor through alliancing.

For a complex high value project, it may be possible to establish the “value for money” proposition for delivering that project on an alliance basis.

Some recent examples of alliancing projects where independent audits have stated that those projects provide value for money include the National Museum of Australia and Sydney Water’s Northside Storage project. Both projects were publicly financed.

---

142 Price Waterhouse Coopers 2001, "Value for money in public/private partnerships - A Briefing for Local Authorities"
Part E: Can governments obtain better value for money in adopting principles from relationship contracting or greater risk sharing in delivering complex PPP projects.

21 Risk sharing

Risk sharing is not new for governments in Australia.

In the Sydney Harbour Tunnel project, the first BOT infrastructure project, the NSW Government underwrote the revenue stream for the private sponsors.\(^\text{143}\) Even in existing PFI PPP projects, there are a number of risk sharing regimes incorporated in the concession agreements.

A common approach is the “Material Adverse Event” or MAE approach. It provides for the parties to negotiate a commercial outcome if a specifically defined event occurs, such as a force majeure type event, native title land claims, or a change in government policy. If the event occurs, the sponsor receives an agreed return on their investment. The form of redress may vary from financial compensation by the government to non-financial redress such as extension of the concession term.

Since the Sydney Harbour Tunnel project, government has entered into alliance agreements with the private sector for the delivery of projects with special challenges.\(^\text{144}\)

As most PPP projects involve long term relationships between the public and private sectors, the long term contracts governing them should be flexible enough to adapt to changing circumstances including amendments to performance measurement, and changing risk profiles and performance, regular measurement of costs so that they may be compared against the market to maintain competitive pressure for value for money.

The main differences between this procedure and other forms of collaboration lie in the method for selection of the private partner, and in the fact that the “Partnering” or “Alliancing” technique requires the public authority to be an active participant. It favors in-depth dialogue between the parties from the outset, and facilitates a win-win approach for all of the partners. This procedure would be useful in PPP projects.

With “Partnering/Alliancing”, the government party reduces the risk associated with the contractors’ capacity. This approach is the opposite of solitary, arbitrary and theoretical determination of characteristics, functionality and services, which the contractor must carry out without either party creatively determining appropriate responsibilities. On the contrary,

\(^\text{143}\) See the Ensured Revenue Stream Agreement in the Sydney Harbour Tunnel (Private Joint Venture) Act 1987

\(^\text{144}\) See footnote 10.
"Partnering/Alliancing" promotes innovation, and competitive and transparent dialogue, in order to jointly determine the best means to fulfill these objectives. 145

The government gains detailed knowledge of each contractor throughout the project definition phase and is therefore provided with the necessary information to assess the risks associated with the concerned contractors. It can also break its ties with the contractors at any time on predefined terms. “Partnering/Alliancing” is a transparent and competitive mode for defining and attributing projects, which allows for real competition between the various parties. For complex projects it is the best system to:

• clearly express the concept of value and to promote innovation;

• efficiently help with optimum risk allocation;

• demonstrate that the performance of the public service mission by the private sector produces quality and lowers costs.

It is also interesting to note that the concept of risk sharing is not novel in other civil law jurisdictions. Under French administrative law, the private sector may claim for compensation from the public sector if there is an occurrence of an unforeseeable event (that is not linked to the parties’ conduct), which affects the overall economic balance of the contract. This “theorie de l’imprévision” allows losses to be apportioned between the public and private party so as to permit the continued performance of the contract. 146

22 Trends in financing PPPs

Increasingly, governments are also seeking to develop new innovative ways to deliver services. There is also pressure on greater use of government debt. 147

One example is the separation of the financing and the actual construction and operational elements of a PFI PPP project. In the United Kingdom, the financing for the new Treasury Building project was procured on a competitive bidding process, separate to the bidding for the delivery elements of the project. 148

This approach suggests that it may be also possible for governments to procure financing for alliencing projects by managing the financing and delivery aspects of those projects separately that is, by separating delivery of the project from the financing of the project.

145 SEFI Association of French International Contractors, For New Public-Private Partnerships in Infrastructure
147 The Allen Consulting Group 2003, "Funding Urban Public Infrastructure - Approaches Compared", August
148 See the National Audit Office 2001, Innovation in PFI Financing: The Treasury Building Project
Another development in the United Kingdom is the use of strategic partnerships. In the area of delivery of local government and health services, the Department of Health introduced the NHS Local Improvement Finance Trust (LIFT) initiative\(^{149}\), which is based on an incremental strategic partnership where a partner is engaged to deliver a stream of accommodation and related services.

This model adopts elements of various procurement methods including joint ventures, alliancing and strategic partnering and project finance. A local LIFT company (which is a joint venture company in which the private sector partner holds 60% of the shares) will be established to work with health authorities, primary care trusts, local authorities and other stakeholders in the local health and social care economy (which will hold the remaining shares). The LIFT company will have a long term partnering agreement with the core statutory health and social care authorities, and is responsible for delivering property related investment, services and facilities to end users (including managing and implementing services and requirements identified for the purposes of the initial procurement competition (that is, the initial selection process) as well as helping to plan future estate services to meet the needs of the local health and social care economy over the agreed period (20-25 years)). The LIFT company will have an exclusive right to provide those future services provided they meet the participants' requirements, are affordable to the affected budget holders and demonstrate good value for money.

A similar strategic partnership program called Local Education Partnerships (LEPs) was set up to develop a strategy for upgrading secondary school infrastructure.\(^{150}\)

Another recent development in the UK is the introduction of the development of a secondary market for financing PFI projects including the piloting of the Credit Guarantee Fund (CGF) at Leeds Health, North Swindon and Portsmouth, and the further development of funding competitions.\(^{151}\) Under the CGF structure, the government will provide financing to the project by way of cash advances under a loan agreement between the government and the private sector (such loans will be repaid after completion of the project). The loan will be guaranteed by an independent guarantor (a private financier) instead of the private sector. The structure of the CGF separates the risk and pricing for funding and project risk, thus saving the cost of the private sector securing funds, which is separate from the cost of it taking risks. The private financiers (through the guarantor) will still retain control over the project. However, this is still in the pilot project stages and does not extend to government assuming greater risk taking in the project.

\(^{149}\) 4ps Guidance 2003, NHS LIFT and Local Government, Understanding the Options: Considering the Opportunities
\(^{150}\) H M Treasury, "PFI: strengthening long-term partnerships", March 2006
\(^{151}\) H M Treasury, "CGF Technical Note 1, http://www.hm-treasury.gov.uk/documents/public_private_partnerships"
What does it mean for project financiers providing finance for projects using alliancing as a delivery structure? Various commentators have indicated that project financiers may provide finance for certain types of PPP projects using alliancing. However, it will require a comprehensive and structured risk identification (including detailed due diligence on technical and engineering issues, cost plans showing adequacy of cost and time contingency allowances, track record of the alliance participants) and review by the project financiers' engineers and risk assessors so as to allow the financiers to have a robust understanding of those risks and costs framework. Insurers providing project specific insurance (including first party indemnity insurance policies) for alliancing projects have always required such risk assessment arrangements to be put in place before agreeing to underwrite them.

However, PPP projects with tight completion requirements will be unsuited for delivering on an alliancing approach. This response is supported by the views of various legal practitioners in major law firms including Mallesons Stephen Jaques and Allens Arthur Robinson, and leading project financiers.

22.1 Greater focus on partnership

In the Newcastle Mater hospital project, the NSW government asked the private sector bidders to assume employment of various government employees as part of the PPP project. This has created concerns among bidders.

This problem highlights a similar issue recently encountered in the United Kingdom in delivering educational facilities under the PPP banner.

Part of the problem is a confusion of objectives that the government is setting. It is probably not feasible to bring about the improvements in service delivery that many local education authorities need and desire, and which at school level are essential and urgent, without maintaining or indeed increasing the capacity of the organization as a whole to deliver. The expectation that arranging a partnership with the private sector will in itself deliver improvements is a fallacy. The instinct of industry partners is to drive forward efficiency measures, and this can manifest itself in the pattern and number of staff employed, either directly or through TUPE transfers.

---

152 Dredge, G 2007, "What does alliancing mean for project finance?", presentation at International Project Finance Association seminar, 16 May
153 Beeley, M, 2006 "Alliance Contracting – Is it Bankable?", presentation at International Project Finance Association seminar, 16 May
156 Lipson, M, Local Education Partnerships, Public Private Finance Magazine, Education Supplement
Often this drive for efficiency measures can only be done over time, but there are numerous instances of local authorities disappointment at the way in which their partners seek efficiencies to maintain or improve their margins - or so it seems to the local authority which finds itself not having the quality of service they had anticipated. However, this disappointment is often not the fault of the industry partner, but has its roots in a mistaken view that such partnerships will intrinsically result in financial savings for the authority. It comes perhaps from the difficulty in moving from the old culture of lowest price to that of best value, where the best solution may in fact cost more. The budget available for these education partnerships to develop and grow is therefore at the heart of this difficulty.

What is needed in these partnerships is a joint approach to change management, a “no blame culture” where risks are shared openly. Perhaps it is inevitable that the public sector ethos of democratic benefit will always get in the way of collaboration with the private sector, where shareholder interests are paramount. However, there are enough examples of public/private meetings of minds to encourage optimism. A lot depends on the leadership and character of key individuals involved in the procurement and delivery of these projects.

PPP has the potential to redefine the boundaries of public sector service provision without moving away from the principle that many services should continue to be free (or highly subsidised) at the point of use.

22.2 Case Study - Northside Storage Tunnel

The Northside Storage Tunnel was the first major public sector construction project in Australia using an alliance approach.

The Audit Office of NSW conducted a review of the Northside Storage Tunnel project in Sydney and identified the following:

- The alliance agreement promoted an open, honest and co-operative culture in pursuit of project objectives;

- Sydney Water and its alliance partners shared the cost overrun, and a number of cost-saving initiatives were implemented during construction which mitigated overrun;

- Unpredicted, severe construction problems were encountered and worked through co-operatively, whereas serious disputes could have arisen over the allocation of responsibility for these latent conditions under a conventional contract;

- Whether the cost of the project represented value for money was less clear as it was more difficult to quantify the benefits (such as capability to meet deadlines rather than
costs, difficulty in quantifying additional construction costs to achieve the deadline, lack of formal re-evaluation of the project costs, etc)

- The approach gave the alliance partners greater capacity to respond to specific challenges arising during the course of the project, although this flexibility may give rise to risks that need to be managed.

The Audit Office formed the opinion that an alliance approach, when applied to a suitable project and managed appropriately, can support positive project outcomes. It recommended the adoption of effective governance, oversight, and a new approach in managing major projects.
Part F: Survey findings

This part presents the findings of a survey of government, private sector sponsors and project financiers and legal advisers on their perceptions of the use of relationship contracting in the PPP framework.\footnote{157} Survey questionnaires were sent to several key players at a senior management (general manager level upwards). Responses were only received from 3 government agencies, 3 sponsor/construction companies and 1 financier institution. Whilst the sample is very limited, the quality of the respondents are at very senior management level and reflects the views of the key players in the PPP market.

In Part B, we indicated that there is still a widespread debate as to what constitutes a PPP. Recent events in the development of PPP projects in Australia only highlights the importance for State and Territory governments to clearly articulate what are the principles behind the intended delivery methods under their respective PPP policies. Some of those issues identified include:

- does PPP projects require private sector finance?
- depending on which view one takes as to whether non PFI projects come under the PPP rubric, are relationship contracting structures appropriate for delivery of complex projects or long term outsourcing contracts?
- what constitutes “partnership” in PPP?
- are existing approaches to risk transfer complementary or do they work against delivery of PPP projects?
- are existing PPP policies adequate to ensure efficient delivery of PPP projects?

These questions go towards answering some of the arguments for and against the hypothesis.

The survey involves the respondents completing a questionnaire, which has been designed to capture their views on answering some of the above questions.

Significant findings from the questionnaire included:

Whilst the government respondents answered positively on a number of PPP issues, the responses from the financier and the sponsor/contractor respondents were negative. For example, the financier and sponsor/respondents

\footnote{157} The survey was targeted at a core survey base who are considered as key decision makers in their organisations. For example, the respondents include Glen McGuire and John Fitzgerald from VDFT, Danny Graham from NSW Treasury and various senior executives at general manager and vice-president level from construction and service companies and ABN Amro. A number of senior government executives from other states and other organisations declined to participate in the research survey.
• did not consider that the Public Sector Comparator as an appropriate form of evaluation for complex projects where risks are not easily ascertained;

• did not consider that governments carried out adequate risk evaluation in the selection of delivery structures for complex PPPs;

• did not consider that the Value for Money Framework adopted for PPP have a balanced approach to risk transfer to the public sector for complex projects.

The government respondents indicated:

• PPPs do not cover alliancing;

• governments’ risk management capabilities range from moderate to poor;

• certainty of risk transfer to the private sector is paramount in delivering PPPs;

• government would consider alliancing as a form of delivery but not for PPPs.

The financier and sponsor/contractor respondents also thought:

• the level of risk sharing in PPPs either reflects the pricing agreed between the parties or are not balanced, and the winning sponsors are “forced” to assume risks that is not appropriate to be assumed by the private sector;

• governments’ risk management capabilities range from moderate to poor;

• governments’ consideration of risk transfer is paramount in delivering PPP regardless of the complexity of the project, value for money considerations and forcing the private sector sponsors being required to assume risks that are not best assumed by them;

• alliancing should form part of the PPP delivery structures.

Not all the government respondents supported the following statement made by the National Audit Office on the London Underground project, whereas the statement was supported by all private sector sponsor/contractor respondents.

"A traditional partnership means sharing opening and transparently in the profits and/or losses of a business equally, without special advantage to either partner. In the case of London Underground, this principle has been applied to tackling major procurement challenges in a non-adversarial way. As attempted in this case, departments and agencies should explore the scope for sharing risks and design how to share the rewards before entering detailed contract negotiations."

9200063_1
Whilst the market place seems to indicate that there are 2 types of PPPs, namely, publicly financed partnerships and privately financed partnerships, most government respondents (or their advisors) consider that PPPs are privately financed projects.

Accordingly, the PPP policies issued by most of the State and Territory government do not expressly include alliancing as a form of PPP. This is supported by the responses given by the government respondents in the survey.

The project financier respondent also stated that financiers may be prepared to fund alliancing projects on a project financed basis.
Part G: References

1) Akintoye, A, "Risk and Value for Money Management in the UK PPP/PFI Projects", School for Natural and Built Environment, Glasgow Caledonian University


3) Allen Consulting Group 2003, "Funding Urban Public Infrastructure - Approaches Compared"


8) Armstrong, J & Lenihan, D 2001, "From Controlling to Collaborating: When Governments Want to be Partners", Institute of Public Administration of Canada

9) Arthur Andersen and Enterprise LSW, "Value for Money Drivers in the Private Finance Initiative, a report commissioned by the Treasury Taskforce, 17 January 2000".

10) Australia National Audit Office 2000, “Construction of the National Museum of Australia and Australian Institute of Aboriginal and Torres Strait Islander Studies”


17) Bennett Jones LLP 2001, "Public-Private Partnerships for Ontario Hospital Capital Projects"


19) Brown, R, "What should Private/Public Partnership Mean?", PA Consulting Group, London


21) Carstairs, Jamie 2002, "Future directions in the private provision of public infrastructure" in Mead, Margaret & Glenn Withers (eds), "Privatisation: A review of the Australian experience", Melbourne, Committee for Economic Development

22) Carter, JW & Peden, Elisabeth 2003, "Good Faith in Australian Contract Law" 19 JCL


29) DLA Legal Group 204, "European PPP Report 2004"

31) Efficiency Unit, Hong Kong, "Case Summary: Prisons Operated by Public Private Partnerships Victoria, Australia."

32) European Commission, Directorate-General, Regional Policy 2003, "Guidelines for Successful Public-Private Partnerships"


39) Freshfields Bruckhaus Deringer 2005, PPP in Europe: An overview

40) 4ps Guidance 2003, "NHS LIFT and Local Government, Understanding the Options: Considering the Opportunities"


43) H M Treasury, UK 2004, "Draft Value for Money Assessment Guidance"


45) H M Treasury, UK 2003, "PFI: meeting the investment challenge"

46) H M Treasury, UK 2006, "PFI: strengthening long-term partnerships"

48) Institution of Engineers, Australia and Chamber of Commerce and Industry of Western Australia 2001, "Effective Risk Allocation in Major Projects: Rhetoric or Reality?"

49) International Financial Services 2003, "PFI in the UK: Progress and Performance, PPP Brief"


51) Jenkins, A 2006, "Partnering - Was Marriage so Bad after all?" Society of Construction Law

52) Jones, D 2002, "Keeping the Options Open: Alliancing and Other Forms of Relationship Contracting with Government", 17 BCL 153

53) Jones, D 2003, "Evaluating what is new in the PPP pipeline", 19 BCL 250

54) Jones, D 1999, "Good Faith in Building and Construction Law: Where is it headed?", UNSW Faculty of Law Continuing Legal Education Seminar


56) KPMG 2002, "Review of HEFCE's PPP and PFI Activity"

57) Leahy, P 2004, "Corporate Governance in PPPs", paper presented at INTOSAI Working Group, Sifia

58) Lipson, M 2003, Local Education Partnerships, Public Private Finance Magazine, Education Supplement


60) Mallesons Project Update 2003, "Alliancing"

61) Manley, Karen, "Partnering and alliancing on road projects in Australia and internationally", A RRB Transport Research
62) McDowall, E, "Risk transfer in PPP projects", Turner & Townsend Management Solutions


64) McMorrow, P 2004, "Partnering points the road ahead", Leighton News


67) Ministry of Finance, PPP Knowledge Centre, Netherlands 2001, "PPP and Public Procurement Guide"


69) Mott MacDonald 2002, "Review of Large Public Procurement in the UK"

70) National Council for Public-Private Partnerships, "For the Good of the People : Using Public-Private Partnerships to Meet America's Essential Needs"

71) National Audit Office 2003, Delivered better value from the Private Finance Initiative

72) National Audit Office 1999, Examining the value for money of deals under the Private Finance Initiative

73) National Audit Office, "Non-Competitive Procurement in the Ministry of Defence"


75) National Audit Office 2004, "London Underground : Are the Public Private Partnerships likely to work successfully?"

76) National Audit Office 2004, "London Underground PPP: Were they good deals?"

77) National Audit Office 2001, "Managing the relationship to secure a good partnership in PFI projects"

78) NSW Audit Office 2003, "Performance Audit: Sydney Water Corporation: Northside Storage Tunnel Project"

79) NSW Audit Office 2006, "Performance Audit: The New Schools Privately Financed Project"
80) NSW Department of Public Works and Services 1998, "Project Alliances in the Construction Industry"


82) Nisbett, J, "PFI: Are PFI/PSC Comparisons Reliable?", Construction and Engineering Law, Vol 8, Issue 4

83) Nova Scotia Department of Finance 1997, "Transferring Risk in Public/Private Partnerships"


85) Parker, J 2003, "The PPP and infrastructure market in Canada", Project Finance International


87) Perrot, Jean-Yves and Chatelus, Gautier (French Ministry of Public Works), "Financing of major infrastructure and public service projects, Public-Private Partnership", Presses de l'eco le nationale des Ponts et Chaussees


91) Poulter, T "Japan's PPP experience - lessons for Europe?", Price Waterhouse Cooper

92) Price Waterhouse Coopers 2004, "Developing Public Partnerships in New Europe"


94) Price Waterhouse Coopers 2002, "Local Authority Strategic Service Partnerships: Some Key Issues to Consider"

95) Price Waterhouse Coopers 2001, "Value for money in public/private partnerships - A Briefing for Local Authorities"

97) Richmond, D 2005, "Review of Future Provision of Motorways in NSW", Infrastructure Implementation Group, The Premier's Department


100) Rooney, G, "Project Alliancing and Relationship Contracting - Conflict Embracing Project Delivery Systems"

101) Royal Institute of Chartered Surveyors 2004, "Project management and the private finance initiative"

102) SEFI Association of French International Constructors 2001, "For New Public-Private Partnerships in Infrastructure"


106) Standard and Poor 2003, "Credit Survey of the UK Private Finance Initiative and Public Private Partnerships"

107) Standard and Poor 2004, "PFI Projects Reshape the Credit Profile of Europe’s Construction Companies"


110) Ter-Minassian, T & Allen, M 2004, "Public Investment and Fiscal Policy", International Monetary Fund
111) Thatcher, A 2003, "Spencer Street Station Redevelopment Project - A case study", Paper presented by the BFSLA Conference, Queenstown


113) Thompson, G 1997, "Project Alliances", AMPLA Yearbook


122) Whitehead, T, "PPP/PFI in Principle and in Practice", Strategic Investment Board, Northern Ireland


125) World Bank, "Toolkit for Public Private Partnerships in Highways"
Annexure 1 Brief comparison of the value for money policies set out by some of the State and territory governments and in some overseas countries.

<table>
<thead>
<tr>
<th>New South Wales</th>
<th>Victoria</th>
<th>Queensland</th>
<th>Northern Territory</th>
<th>UK</th>
<th>Ireland</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.1.5 Value for money</td>
<td>1.6 The value for money question</td>
<td>Value for Money</td>
<td>Value for Money</td>
<td>The objectives of PPPs</td>
<td></td>
</tr>
<tr>
<td>All PPPs are to be the subject of a comprehensive economic appraisal.</td>
<td>Partnerships Victoria requires a full cost-benefit analysis of a proposed project before government determines whether the project should be undertaken. Where government approves the project, and where it seeks to involve the private sector through the undertaking of a public-private partnership, private sector bids are assessed against public sector.</td>
<td>Implementation of the policy will be vigorously pursued where it is likely that a better outcome can be achieved when measured against the traditional infrastructure or service delivery methods. To make this assessment of whether or not private sector involvement will deliver value for money on a particular project, it is essential that a thorough and</td>
<td>Deployment of the Territory Partnerships policy will be pursued where it is likely to deliver better value for money than traditional delivery methods. A Public Sector Comparator (PSC), which estimates the cost of the most efficient form of public sector delivery, will be constructed as the primary quantitative test for value for money. Section 4 provides detailed coverage for</td>
<td>19 Central to the Government's approach is to use PPPs where they provide better value compared to public sector investment. Under PPPs, the public sector specifies the outputs required from the investment, but the responsibility for, and many risks associated with, delivering those outputs is transferred to the private sector partner. This can offer better services, delivered.</td>
<td>5.1 The key objectives to be realised through the use of Public Private Partnerships are summarised in the paragraphs that follow:</td>
</tr>
<tr>
<td>By working together, industry and government can provide improved service delivery and significant cost savings. The Government aims to maximise the value for money it achieves over the life of PPPs.</td>
<td>The major value-for-money</td>
<td></td>
<td></td>
<td></td>
<td>5.2 Cost Effective Delivery – the net present cost of a service delivered under a Public Private Partnership should be lower than that achieved under traditional procurement, reflecting the benefits of competition.</td>
</tr>
<tr>
<td>New South Wales</td>
<td>Victoria</td>
<td>Queensland</td>
<td>Northern Territory</td>
<td>UK</td>
<td>Ireland</td>
</tr>
<tr>
<td>-----------------</td>
<td>----------</td>
<td>------------</td>
<td>-------------------</td>
<td>----</td>
<td>---------</td>
</tr>
<tr>
<td>drivers are:</td>
<td>benchmarks to determine value for money. The quantitative benchmarking tool is the Public Sector Comparator (PSC).</td>
<td>detailed analysis be undertaken of all of the project's costs and potential revenue streams available under the traditional methods of project delivery. It is essential that all risks associated with the traditional development, construction and operation of the project are also identified and qualified. This assessment is called the Public Sector Comparator, and provides the basis upon which value for money can be tested.</td>
<td>construction and use of the PSC. Additionally, other qualitative factors, such as economic and environmental impacts, non-quantifiable risks and differences in proposed service levels and capabilities, and costs and risks not included in the PSC or bids, will also be considered in the overall assessment of value for money. The PSC is a vital component of determination of a project's potential under Territory Partnerships throughout the course of its development and evaluation. It also represents the primary benchmark in determining the</td>
<td>more efficiently and providing better value for money for the taxpayer than public sector investment, provided the outputs can be clearly specified from the outset and that both parties fully understand the risks they are taking on. In addition, PPPs encourage innovative approaches, as the private sector partner is given flexibility over the design of the assets and operational procedures.</td>
<td>whole life costing, design innovation, improved efficiency and risk transfer;</td>
</tr>
<tr>
<td>• improved risk management - more rigorous risk evaluation and transfer to the private sector of those risks it is best able to manage, including those associated with providing specified services, asset ownership and whole-of-life asset management</td>
<td>Value for money is maximised by allocating risk optimally. In very general terms, this means allocating each risk to the party best able to manage that risk. In theory, this reduces individual risk premiums and the overall cost of the project, because the party in the best position to manage a particular risk should be able to do so at the lowest price. (Optimal risk allocation and its application in public-private partnerships are explored in detail in</td>
<td>Value for money may be achieved on infrastructure and service delivery projects where:</td>
<td>• the project size justifies the transaction and</td>
<td>5.3 Good Quality Services - the quality of service delivered under a Public Private Partnership should be equivalent or higher than that achieved under traditional procurement, reflecting the benefits of competition, innovation, performance incentives and planned life cycle maintenance;</td>
<td></td>
</tr>
<tr>
<td>• ownership and whole-of-life costing - efficiency is improved because design and construction become fully integrated upfront with operations and asset management. Ongoing service delivery, operational, maintenance and refurbishment costs become a</td>
<td></td>
<td>• the project size justifies the transaction and</td>
<td></td>
<td>5.4 Clear customer focus - a Public Private Partnership arrangement should help the public sector to focus more clearly on the services people want, rather than on the management of existing forms of service delivery.</td>
<td></td>
</tr>
<tr>
<td>New South Wales</td>
<td>Victoria</td>
<td>Queensland</td>
<td>Northern Territory</td>
<td>UK</td>
<td>Ireland</td>
</tr>
<tr>
<td>----------------</td>
<td>----------</td>
<td>------------</td>
<td>-------------------</td>
<td>----</td>
<td>---------</td>
</tr>
<tr>
<td>single party’s responsibility for the length of the concession period</td>
<td>Chapter 4.</td>
<td>management costs;</td>
<td>decision for the Government to contract within the private sector.</td>
<td>Government’s Public Service Agreements, ensuring that the additional investment announced in the Comprehensive Spending Review delivers substantive improvements in public services.</td>
<td>The shift in focus from service inputs to outputs can create the scope for innovation in service delivery and enhance customer focus overall;</td>
</tr>
<tr>
<td>innovation—wider opportunities and incentives for innovative solutions to deliver service requirements. Opportunities may include:</td>
<td>The PSC is used to estimate the hypothetical risk-adjusted cost to government of delivering the proposed project using the most efficient form of government delivery. The PSC is then compared against private bids. Care should be taken, however, to ensure that the comparison is between genuinely comparable items. There is a strong possibility that bids will not be identical to the proposed service specifications and risk allocation outlined in the bid documentation on which the PSC is based. To compare such a bid with the PSC without appropriate</td>
<td>there is a defined measurable service delivery function or output mechanism;</td>
<td>The PSC is not, however, the Government’s own internal bid for a project, and does not mean that the Government is competing with the private sector by preparing a PSC. Should all private bids for a project cost more on a risk weighted, value for money basis, than the Government’s PSC, the Government would reserve the right not to proceed with all private sector bids. However this does not mean that the Government would then proceed with the project through accepting the PSC and entering into an internal</td>
<td>5.5 Enhanced service diversity — by exposing the provision of public services to competition and diversity, Public Private Partnerships should help enable the quality and cost of such services to be benchmarked against market standards, thereby helping to secure productivity improvements within the economy as a whole;</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>there is scope within the project delivery for the optimisation and the allocation of manageable risk to the private sector, delivering a cost effective outcome;</td>
<td></td>
<td>5.6 Enhanced incentive — by allocating risk to the party best able to manage it and by linking service payments to</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>there is scope for sector private sector innovation, value adding and/or cost reductions in the delivery and operation of the service;</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New South Wales</td>
<td>Victoria</td>
<td>Queensland</td>
<td>Northern Territory</td>
<td>UK</td>
<td>Ireland</td>
</tr>
<tr>
<td>----------------</td>
<td>----------</td>
<td>------------</td>
<td>-------------------</td>
<td>----</td>
<td>---------</td>
</tr>
<tr>
<td>reducing costs to government, as a sole user, through more efficient design to meet performance (i.e. service delivery) specifications and by creating complementary opportunities to generate revenue from use of the asset by others</td>
<td>adjustments would therefore be misleading. If the bids are more expensive than the PSC, and the level of service delivery and the risk allocation in the bids is similar, in the absence of other significant offsetting qualitative benefits, the project would be best delivered as a public project. The concept of value for money is dealt with in more detail in Chapter 15 of the Practitioners’ Guide, and the role of the PSC is discussed further in Chapter 2 of the Public Sector Comparator</td>
<td>maintenance phase of the project to the private sector; and • there is an identifiable market of private sector bidders prepared to compete for the opportunity to deliver the project. Following the development of the Public Sector Comparator the Government will then develop the project contractual relationship model, based predominantly on the appropriate allocation of risk. In this model the Government will also determine the benefits of contract for the project. Rather the government reserves the right to proceed with the required services through whatever mechanisms it chooses. The major value for money drivers underpinning the Territory Partnerships approach are: • Risk transfer and mitigation - relieving the Government of substantial, and often undervalued, costs of risks associated with asset ownership and management and the provision of specified services.</td>
<td>performance, Public Private Partnerships should provide a clear incentive to deliver capital projects on time and to budget and then to ensure that service standards are being met on an ongoing basis; 5.7 Better asset utilisation – by allowing the private sector to generate third party income from the commercial utilisation of public sector assets, Public Private Partnerships should reduce the cost of public service provision while maximising the wider social and</td>
<td></td>
<td></td>
</tr>
<tr>
<td>New South Wales</td>
<td>Victoria</td>
<td>Queensland</td>
<td>Northern Territory</td>
<td>UK</td>
<td>Ireland</td>
</tr>
<tr>
<td>----------------</td>
<td>----------</td>
<td>------------</td>
<td>-------------------</td>
<td>----</td>
<td>---------</td>
</tr>
</tbody>
</table>
| determined by evaluating the project’s costs and benefits. A key quantitative tool in this evaluation is the PSC (see Section 7). However, to ensure objective evaluation a range of technical, economic and social criteria will also be used (see Section 3.4.2). 4.3.1 Value for Money | effective competition in the tender process, and any other project specific management or operational efficiencies and other benefits this policy approach may provide. Under this policy the governing principle of a project’s risk allocation is that risk will be allocated to whichever party is best able to manage that risk, taking into account the public interest considerations. It is not the Government’s intention under this policy to necessarily attempt to transfer all project risk to the private sector, as it fully recognises that the inappropriate transfer of risk will generate and carry a significant premium. | party, up-front design and construction costs, with ongoing service delivery, operational, maintenance and refurbishment costs;  - **Innovation** - providing wider opportunity and incentive for innovative solutions as to how service requirements can be delivered; and - **Asset utilisation** - developing opportunities to generate revenue from use of assets by third parties, reducing the costs to the Government as a sole user. Together, in the context of competitive bidding processes, these have the finance where it is considered appropriate, Public Private Partnerships should promote the accelerated delivery of the public capital programme by enabling more infrastructure projects to be carried out within a defined period of time and by enabling the public sector to proceed with projects at times when capital budgets are constrained; and 5.9 Wider economic benefits - by allowing major investment projects to proceed at times when capital budgets are constrained, Public Private Partnerships should help to stimulate the private sector and contribute to increased employment and
<table>
<thead>
<tr>
<th>New South Wales</th>
<th>Victoria</th>
<th>Queensland</th>
<th>Northern Territory</th>
<th>UK</th>
<th>Ireland</th>
</tr>
</thead>
<tbody>
<tr>
<td>automatically mean the lowest price.</td>
<td>Government recognises that it is inappropriate to seek private sector involvement in public infrastructure provision unless all significant project risks are identified and the Government has quantified what risks and costs, if any, it is prepared to retain and what risks and costs it expects can be justifiably transferred to the private sector.</td>
<td>cost savings for the Government while also providing opportunities for innovative and improved service delivery. Consistent with the previously identified preferred attributes of Territory Partnerships projects, real potential to deliver value for money exists where the Government need has been clearly defined in measurable output terms and projects structured to optimise risk allocation in order to generate the incentives for cost-effective, high quality services. Also essential in achieving value for money is an identifiable market of bidders prepared to</td>
<td>economic growth.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>New South Wales</td>
<td>Victoria</td>
<td>Queensland</td>
<td>Northern Territory</td>
<td>UK</td>
<td>Ireland</td>
</tr>
<tr>
<td>----------------</td>
<td>----------</td>
<td>------------</td>
<td>--------------------</td>
<td>----</td>
<td>---------</td>
</tr>
<tr>
<td>must be sufficient to cover the extra cost of private sector financing. These savings could arise from changes and innovation in the delivery of services. True value for money needs to compare the end costs of service delivery options that include all costs associated with government administration and the provision of services. It needs to fully consider the whole of life costs of the various options that include, where appropriate, the rectification of possible maintenance backlogs. The costs of risk acceptance also need to be evaluated as well as the possible potential value of</td>
<td></td>
<td></td>
<td>compete for the opportunity to undertake a particular project and scope for their demonstration of particular skills and innovative capacities. While value for money will vary between projects, the size of the project should be sufficient to justify the transaction and ongoing management costs, and partnership terms should be long enough to enable value for money savings to be generated while not being so long that competitive pressures are reduced. As a component of submissions for the Government’s approval to seek Expressions of Interest</td>
<td></td>
<td></td>
</tr>
<tr>
<td>New South Wales</td>
<td>Victoria</td>
<td>Queensland</td>
<td>Northern Territory</td>
<td>UK</td>
<td>Ireland</td>
</tr>
<tr>
<td>----------------</td>
<td>----------</td>
<td>------------</td>
<td>-------------------</td>
<td>----</td>
<td>---------</td>
</tr>
<tr>
<td>delivering a service at an earlier date. The determination of value for money is a very complex equation. The benchmark cost comparison discussed in Section 4.4.1 is central to this process.</td>
<td></td>
<td></td>
<td>or to release a Project Brief, the value for money assessment should clearly demonstrate the potential for private parties to add value. Such demonstration may, for example, give evidence of the capacity of such parties to better manage particular risks, create operational efficiencies and provide the benefits inherent in the Territory Partnerships approach, whilst maintaining the standard of services or deliverable in accordance with the agreement.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The achievement of value for money relies heavily on the expertise of public sector employees being able to specify the outputs required and to negotiate effectively. The level of services needs to be specified in sufficient detail to ensure that the bids received are comparable but still allow scope to maximise innovation.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Competition in the bidding process is an important</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New South Wales</td>
<td>Victoria</td>
<td>Queensland</td>
<td>Northern Territory</td>
<td>UK</td>
<td>Ireland</td>
</tr>
<tr>
<td>----------------</td>
<td>----------</td>
<td>------------</td>
<td>--------------------</td>
<td>----</td>
<td>---------</td>
</tr>
<tr>
<td>element in achieving value for money. However, the maintenance of competition in the bidding process may be difficult to achieve because the costs of bidding for BOOT projects by private firms are considerable and, at the end of the process, firms may not wish to commit more resources without some assurance of success.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The private sector have the potential to produce efficiencies by:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- being innovative in design, construction, maintenance and operation over the life of the contract</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- creating greater</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New South Wales</td>
<td>Victoria</td>
<td>Queensland</td>
<td>Northern Territory</td>
<td>UK</td>
<td>Ireland</td>
</tr>
<tr>
<td>-----------------</td>
<td>----------</td>
<td>------------</td>
<td>-------------------</td>
<td>----</td>
<td>---------</td>
</tr>
<tr>
<td>efficiencies and synergies between design and operation</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• investing in the quality of the asset to improve long-term maintenance and operating costs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• managing risk, in some areas, better than the public sector.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The long term value for money of these arrangements will depend on how well the private sector manages the risks that have been transferred and how well the public sector manages the contracts over their duration. The UK Government has reported that their privately financed projects are, on average, delivering savings of
<table>
<thead>
<tr>
<th>New South Wales</th>
<th>Victoria</th>
<th>Queensland</th>
<th>Northern Territory</th>
<th>UK</th>
<th>Ireland</th>
</tr>
</thead>
<tbody>
<tr>
<td>17 percent over traditional forms of service delivery. Savings range from 10 percent for prisons to 20 percent for defence projects. Savings of similar magnitudes may present a challenge in NSW because of the large amount of competitive outsourcing already undertaken by government agencies.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Annexure B: Survey Questionnaire

Australian Centre for Public Infrastructure

Melbourne University Private

Survey questionnaire for Masters research into Public-Private Partnerships

April 2005
Survey questionnaire:
Delivering PPP projects on a relationship contracting structure

Purpose: This survey questionnaire is carried out as part of a masters research thesis into delivery of public infrastructure using relationship contracting. The hypothesis of the research is:

*Governments may be able to obtain better value for money delivering complex Public Private Partnership projects (with critical cost and time project imperatives) using a delivery structure based on greater risk sharing (including principles based on relationship contracting) rather than traditional risk transfer methods*

Instructions: Please tick the appropriate boxes and post the form to Andrew Chew, Australian Centre for Public Infrastructure, Melbourne University Private, c/- Mallesons Stephen Jaques, Level 60 Governor Philip Tower, 1 Farrar Place, Sydney NSW 2000, or e-mail to andrew.chew@mallesons.com

Please tick the box or write in the answer (multiple responses are acceptable)

Please contact Andrew Chew, Mallesons Stephen Jaques, Tel: 02 9296 2429 e-mail: andrew.chew@mallesons.com if you have any questions in relation to this survey questionnaire
Part A  General

Question 1: Do you work for:

☐ Government authority responsible for delivery of project
☐ Government treasury
☐ Construction company
☐ Financier (including debt/equity providers and advisory)

Question 2: Have you been involved or participated in the decision making of selection of delivery structure for a project?

☐ Yes
☐ No

Question 3: What is the level of your expertise and experience?

☐ Senior management
☐ Consultant
☐ Advisor
☐ Technical expertise

Question 4: Which industry sectors did you participate in?

☐ Oil and gas
☐ Railway infrastructure
☐ Road
☐ Process and industrial plants
☐ Water and wastewater treatment plants
☐ Airports
☐ Schools
☐ Hospitals
☐ Prisons
☐ Courts
- Major civil works infrastructure (eg dams, etc)
- Mining

Question 5: Have you been involved in a project using a Build-Operate-Transfer delivery structure?
- Yes
- No

Question 6: Have you been involved in a project using alliancing?
- Yes
- No

Question 7: If yes, please state what type of alliancing structure did you use:
- project type alliancing
- strategic type alliancing

Alliances generally fall into two categories:

(a) project type alliances where there is greater risk sharing between the alliance partners;
(b) strategic type alliances where the contractor (rather than all alliance partners jointly) retains discrete liability for performance of its obligations under the alliance contract.
Part B  Public-Private Partnerships

Question 1: Do you consider that Public Private Partnerships comprise of:

☐ Publicly financed partnerships
☐ Partnerships involving private financing
☐ Both of the above

Question 2: Do you consider that the Public Sector Comparator used in evaluating Public Private Partnerships by governments is an appropriate form of evaluation for complex projects where risks are not easily ascertained?

☐ Yes
☐ No

Question 3: Do you consider that governments should participate in greater risk sharing in complex Public Private Partnership projects where risks cannot be easily ascertained or managed by the private sector parties?

☐ Yes
☐ No

Question 4: Do you consider that governments have carried out adequate risk evaluation in selection of delivery structures for complex Public Private Partnerships?

☐ Yes
☐ No

Question 5: Do you consider the Value for Money framework adopted for Public Private Partnerships have a balanced or imbalanced approach to risk transfer to the public sector especially for complex projects?

☐ Balanced
☐ Imbalanced
Question 6: Do you agree that Public Private Partnerships should be a co-operative nature between the government and the private sector?

☐ Yes
☐ No

If you represent government, please answer the following questions:

Question 7: If you represent government, will you consider adopting alliancing as form of delivery under Public Private Partnership and provide financing to the project if there is less than "full" pass through of risks that you would expect under normal project financed situations?

☐ Yes
☐ No

Question 8: If you represent government, to what extent does annual government appropriations influence your choice of delivery structure?

☐ Significant
☐ Important but not significant
☐ Not significant
☐ No influence

Question 9: A main tenet of good risk management is that the party best able to assume a risk should be responsible for assuming that risk. If you represent government, do you consider that principle is followed closely in practice?

☐ Yes
☐ No

Question 10: If you represent government, certainty of risk transfer to the private sector is paramount in delivering Public Private Partnerships regardless of the complexity of the project, value for money considerations and even if it means getting the private sector sponsors to assume risks that is not best assumed by them:

☐ Yes
☐ No
Question 11: If you represent government, even if you do not consider that the private sector contractor is not the best party to assume a particular risk, you would still require the private sector to assume that risk under a competitive procurement process.

☐ Yes
☐ No

Question 12: If you represent government, how do you consider the government’s risk management capabilities:

☐ Good
☐ Moderate
☐ Poor

“A traditional partnership means sharing openly and transparently in the profits and/or losses of a business equally, without special advantage to either partner. In the case of London Underground, this principle has been applied to tackling major procurement challenges in a non-adversarial way. As attempted in this case, departments and agencies should explore the scope for sharing risks and design how to share the rewards before entering detailed contract negotiations.” NAO Report, London Underground PPP: Were they good deals.

Question 13: If you represent government, do you agree with the above statement:

☐ Yes
☐ No

If you represent project financiers, please answer the following questions:

Question 14: If you represent project financiers, will you consider alliancing as a form of delivery that can be project financed?

☐ Yes
☐ No
Question 15: If you represent project financiers, if the project sponsors can demonstrate that using alliancing is value for money having regard to the risks of the project, will you consider alliancing as a form of delivery that can be project financed?

☐ Yes
☐ No

Question 16: A main tenet of good risk management is that the party best able to assume a risk should be responsible for assuming that risk. If you represent project financiers, do you consider that that principle is followed closely in practice:

☐ Yes
☐ No

Question 17: If you represent project financiers, do you consider that the government's consideration of certainty of risk transfer to the private sector is paramount in delivering Public Private Partnerships regardless of the complexity of the project, value for money considerations and even if it means getting the private sector sponsors to assume risks that is not best assumed by them:

☐ Yes
☐ No

“A traditional partnership means sharing openly and transparently in the profits and/or losses of a business equally, without special advantage to either partner. In the case of London Underground, this principle has been applied to tackling major procurement challenges in a non-adversarial way. As attempted in this case, departments and agencies should explore the scope for sharing risks and design how to share the rewards before entering detailed contract negotiations.” NAO Report, London Underground PPP: Were they good deals?

Question 18: If you represent project financiers, do you agree with the above statement:

☐ Yes
☐ No
If you represent project sponsors (including contractors), please answer the following questions:

Question 19: If you represent private sector sponsors, do you consider that the level of risk sharing in Public Private Partnership project:

☐ Is Balanced
☐ Reflects the pricing agreed between the parties
☐ Is not balanced and the winning sponsors are "forced" to assume risks that is not appropriate to be assumed by the private sector as a result of the competitive tendering process

Question 20: A main tenet of good risk management is that the party best able to assume a risk should be responsible for assuming that risk. If you represent private sector sponsors, do you consider that that principle is followed closely in practice:

☐ Yes
☐ No

Question 21: If you represent private sector sponsors, do you consider that the government's consideration of certainty of risk transfer to the private sector is paramount in delivering Public Private Partnerships regardless of the complexity of the project, value for money considerations and even if it means getting the private sector sponsors to assume risks that is not best assumed by them:

☐ Yes
☐ No

Question 22: If you represent private sector sponsors, would you undertake a complex project regardless of the onerous risk allocation under the project agreement?

☐ Yes
☐ No

Question 23: If you represent private sector sponsors, how do you consider the government's risk management capabilities:

☐ Good
• Moderate
• Poor

"A traditional partnership means sharing openly and transparently in the profits and/or losses of a business equally, without special advantage to either partner. In the case of London Underground, this principle has been applied to tackling major procurement challenges in a non-adversarial way. As attempted in this case, departments and agencies should explore the scope for sharing risks and design how to share the rewards before entering detailed contract negotiations." NAO Report, London Underground PPP: Were they good deals?

Question 24: If you represent private sector sponsors, do you agree with the above statement:

• Yes
• No
Part C: Alliacing

Question 1: Please state the type of alliancing projects, type and project value of those projects

Project name: __________________________________________

Type of alliance:

☐ Project type alliance
☐ Strategic type alliance
☐ Combination of project-strategic type alliances

Project Value:

☐ <$10 million
☐ Between $10 million and $50 million
☐ Greater than <$50 million

Industry Sector: Please identify the industry sector by circling one of the numbers below. The index to the industry sectors is set out at the end of this question.

1 2 3 4 5 6 7 8 9 10 11

Project name: __________________________________________

Type of alliance:

☐ Project type alliance
☐ Strategic type alliance
☐ Combination of project-strategic type alliances

Project Value:

☐ <$10 million
☐ Between $10 million and $50 million
☐ Greater than <$50 million
Industry Sector: Please identify the industry sector by circling one of the numbers below. The index to the industry sectors is set out at the end of this question.

1  2  3  4  5  6  7  8  9  10  11

Project name: ________________________________

Type of alliance:

☐  Project type alliance
☐  Strategic type alliance
☐  Combination of project-strategic type alliances

Project Value:

☐  <$10 million
☐  Between $10 million and $50 million
☐  Greater than <$50 million

Industry Sector: Please identify the industry sector by circling one of the numbers below. The index to the industry sectors is set out at the end of this question.

1  2  3  4  5  6  7  8  9  10  11

Index to industry sector:

•  Oil and gas
•  Railway infrastructure
•  Road
•  Process and industrial plants
•  Water and wastewater treatment plants
•  Airports
•  Schools
•  Hospitals
•  Prisons
•  Major civil works infrastructure (eg dams, etc)
•  Mining
Question 2: Please tick which of the following considerations influence you in selecting alliancing as a delivery structure

☐ Tight time deadlines
☐ Cost considerations
☐ Level of risk of project
☐ Availability of materials
☐ Availability of labour resources
☐ Complexity of project
☐ Interface issues
☐ Risk premiums that you would receive in the bids
☐ Remoteness of site

Question 3: How was the alliancing project financed?

☐ Government
☐ Principal (if private sector)
☐ Project finance

Question 4: Was the type of financing available a dominant factor in selecting alliancing as the delivery structure

☐ Yes
☐ No

Question 5: If the project was not project financed, do you consider that that project financiers will likely finance such a project?

☐ Yes
☐ No

Question 6: Do you consider alliancing as a form of delivery structure under a Public Private Partnership project

☐ Yes
No. If you answered No, please state the reasons.

The remuneration structure of alliancing projects generally comprise of a cost plus structure with the contractor alliance participant being compensated for 100% of its direct costs and its fees and corporate overheads put at risk for performance achievements.

Question 7: If you represent project financiers, will you be prepared to finance a project using alliancing where the "cost plus remuneration commonly adopted in alliancing projects be changed to a guaranteed maximum price structure:

- Yes
- No
Annexure C: Summary of survey findings

<table>
<thead>
<tr>
<th>Item</th>
<th>Government respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>3</td>
</tr>
<tr>
<td>Participation in decision making of selection of delivery structure</td>
<td>Yes (3)</td>
</tr>
<tr>
<td></td>
<td>No (2)</td>
</tr>
<tr>
<td>Level of expertise and experience</td>
<td>Senior Management (3)</td>
</tr>
<tr>
<td></td>
<td>Senior Management (3)</td>
</tr>
<tr>
<td>Involvement in BOT projects</td>
<td>Yes (3)</td>
</tr>
<tr>
<td></td>
<td>Yes (3)</td>
</tr>
<tr>
<td>Involvement in alliencing projects</td>
<td>Yes (1)</td>
</tr>
<tr>
<td></td>
<td>No (2)</td>
</tr>
<tr>
<td>Consider that PPP comprise of partnerships involving private</td>
<td>Yes (3)</td>
</tr>
<tr>
<td>financing</td>
<td>Yes (3)</td>
</tr>
<tr>
<td>Consider that PSC is an appropriate form of evaluation for complex</td>
<td>Yes (3)</td>
</tr>
<tr>
<td>projects where risks are not easily ascertained</td>
<td>No (3)</td>
</tr>
<tr>
<td>Governments should participate in greater risk sharing in complex</td>
<td>Yes (3)</td>
</tr>
<tr>
<td>PPP projects where risks cannot be easily ascertained or managed by</td>
<td>Yes (3)</td>
</tr>
<tr>
<td>private sector parties</td>
<td>No (3)</td>
</tr>
<tr>
<td>Governments have carried out adequate risk evaluation in selection</td>
<td>Yes (2)</td>
</tr>
<tr>
<td>of delivery structures for complex PPPs</td>
<td>No (3)</td>
</tr>
<tr>
<td>ViM framework have a balanced or imbalanced approach to risk transfer</td>
<td>Balanced (3)</td>
</tr>
<tr>
<td></td>
<td>Imbalanced (3)</td>
</tr>
<tr>
<td></td>
<td>Imbalanced (1)</td>
</tr>
<tr>
<td>Question</td>
<td>Option 1</td>
</tr>
<tr>
<td>------------------------------------------------------------------------</td>
<td>------------</td>
</tr>
<tr>
<td>PPP should be a co-operative nature between government and private sector</td>
<td>Yes (3)</td>
</tr>
<tr>
<td>Representing government</td>
<td></td>
</tr>
<tr>
<td>Will you consider adopting alliancing as form of PPP delivery structure and provide government financing if there is less than full pass through of risks</td>
<td>No (2)</td>
</tr>
<tr>
<td>Does government appropriations influence choice of delivery structure</td>
<td>Important but no significant (1)</td>
</tr>
<tr>
<td>Consider that basic tenet of risk management where a party best able to assume a risk should be responsible for assuming that risk</td>
<td>Yes (3)</td>
</tr>
<tr>
<td>Consider that certainty of risk transfer to private sector is paramount regardless of complexity of project, value for money considerations even if it means getting the private sector sponsors to assume risks that is best not assumed by them</td>
<td>No (3)</td>
</tr>
<tr>
<td>Require private sector to assume risk under a competitive procurement process even if you do not consider that the private sector is not the best party to assume it</td>
<td>Yes (1)</td>
</tr>
<tr>
<td>Level of government's risk management capabilities</td>
<td>Moderate (1)</td>
</tr>
<tr>
<td>Question</td>
<td>Yes (2)</td>
</tr>
<tr>
<td>-------------------------------------------------------------------------</td>
<td>---------</td>
</tr>
<tr>
<td>Do you agree with statement that &quot;A traditional partnership means sharing openly and transparently the profits and/or losses of a business equally, without special advantage to either partner. In the case of the LU, this principle has been applied to tackling major procurement challenges in a non-adversarial way...Departments and agencies should explore the scope for sharing risks and design how to share the rewards before entering detailed contract negotiations&quot;. NAO report</td>
<td></td>
</tr>
<tr>
<td>Representing financiers, will you consider that alliancing can be project financed</td>
<td></td>
</tr>
<tr>
<td>Representing private sector, the level of risk sharing in PPP projects is:</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Governments and project financiers may achieve better value for money in adopting alliancing as a form of delivery structure in delivering PPP projects in Australia (rather than the traditional risk transfer methods).

Date: 2007

Citation: Chew, A. G. (2007). Governments and project financiers may achieve better value for money in adopting alliancing as a form of delivery structure in delivering PPP projects in Australia (rather than the traditional risk transfer methods). Masters Research thesis, School of Enterprise, The University of Melbourne.

Publication Status: Unpublished

Persistent Link: http://hdl.handle.net/11343/35521

File Description: Governments and project financiers may achieve better value for money in adopting alliancing as a form of delivery structure in delivering PPP projects in Australia (rather than the traditional risk transfer methods)

Terms and Conditions: Copyright in works deposited in Minerva Access is retained by the copyright owner. The work may not be altered without permission from the copyright owner. Readers may only download, print and save electronic copies of whole works for their own