Submission No 24

PROCUREMENT OF GOVERNMENT INFRASTRUCTURE PROJECTS

Organisation: Consult Australia

Name: Mr Matthew Trigg

Position: State Manager NSW

Date Received: 19/02/2016

CONSULT AUSTRALIA

Delivering Better Value:
Government as a 'model client'

Response to NSW Legislative Assembly Committee on Transport and Infrastructure Inquiry into the Procurement of Government Infrastructure

Friday 19 February 2016

CONTENTS

RECOMMENDATIONS

The following is a summary of recommendations from this submission:

1) *The Inquiry should recognise those areas of procurement in New South Wales that are done well and the positive changes that have already been made in recent years.*

2) *As part of a new policy on 'Best Practice Procurement for Government Infrastructure', the NSW Government should move away from practices that are currently based only on habit and set clear guidelines for the public sector on how to select the most appropriate procurement and delivery mechanisms for future infrastructure.*

3) Support creating a healthy procurement and risk management culture in the state, with the NSW Government and public sector tasked with being the 'model client' at all times.

4) *The NSW Government should ensure there is a consistent long-term pipeline of projects developed and rolled out in consultation with industry.*

5) *Infrastructure projects should be leveraged to develop and foster expertise within locally-based professional services firms that can then be exported to other states and internationally.*

6) *Infrastructure planning should be a transparent process undertaken in close consultation with industry, with long term infrastructure plans and pipelines publicly known and available.*

7) *Procurement NSW should prepare a publicly available assessment for the Committee on the range of contract types, terms, and variations currently used within New South Wales, including an analysis of costs, benefits and the wider impacts of these.*

8) The NSW Government should prohibit contracts from referencing 'unlimited liability' and promote a better understanding by all stakeholders on the limitations of liability and the need for good risk management.

9) *The NSW Government should prohibit contracts from referencing inappropriate standards of care for professional services firms and consultants.*

10) *The NSW Government should develop and apply limited liability guidelines to provide business with certainty when undertaking work and help ensure appropriate risk management.*

11) *The NSW Government should undertake an assessment of insurance as it relates to all stakeholders involved in the procurement of government infrastructure, with a particular focus on the understanding, costs and uptake of indemnity cover by professional services firms.*

12) *Greater consideration needs to be given to how third parties rely on the work of consultants and how this affects exposure to liability.*

13) *Independent verification requirements should be consistent wherever possible and avoided where they are providing limited value to the client or public.*

14) As part of a new NSW Government Policy on Best Practice Procurement of Government Infrastructure, set clear guidelines for the allocation of project risk.

15) The NSW Government should adopt a policy of using Australian Standard 4122-2010 General Conditions of Contract for Consultants for all professional services in the State on an 'if not why not' basis.

16) *A standard list of special attachments and additional or alternative contract terms should be managed centrally by Procurement NSW, in consultation with industry and guided by the principle that variations should be avoided.*

17) *To build an evidence base for future decision making, a public register should be maintained of instances where a standard contract was not used and the justification given.*

18) The NSW Government should immediately prohibit the contracting out of proportionate liability from all government contracts with professional services firms.

19) The Civil Liabilities Act 2002 must be amended to prohibit contracting out of proportionate liability for apportionable claims, notably through reform of Section 3A(2).

20) Pre-procurement consultation should be undertaken, where appropriate, to ensure project objectives are sufficiently clear and to support innovation before any tender process begins.

21) A separate consultation on the 'collection, use and integration of built environment data in New South Wales' should be commissioned to deliver better value and support innovation.

22) Invest more time and resources in the scoping of projects to assist in avoiding later-stage issues and conflicts.

23) Procurement NSW should be provided with oversight of a strategic Procurement Innovation Fund to allow them to work with specific agencies to trial more innovative ways of procuring government infrastructure without impacting negatively on project budgets and allowing for savings to be paid back into the fund.

24) Improve support provided to market-led (unsolicited) proposals, drawing on recent changes introduced in Victoria.

25) As part of a new NSW Government policy on Best Practice Procurement of Government Infrastructure, recognise the time, effort and costs assumed by industry in the preparation of tender documents and seek to reduce these wherever possible, and to provide compensation where appropriate to encourage competitiveness and innovation.

26) As part of a new NSW Government policy on Best Practice Procurement of Government Infrastructure, recognise the need to consider 'whole of life' costs that ensure appropriate consideration for future demand, later stage expansion, alternative uses, maintenance, operational and decommissioning costs.

27) As part of a new NSW Government policy on Best Practice Procurement of Government Infrastructure, set clear parameters on what is considered 'gold plating', how it can be identified and avoided.

28) Set up procurement teams throughout the NSW public service with a mix of practical, legal and procurement experience, ensuring they have the relevant skills and competencies to deliver.

29) The NSW Government should consider providing training to the public service on appreciating and manage the risk of government infrastructure projects based on guidelines agreed in consultation with industry.

30) The NSW Government should implement a 'two envelop' approach to tender consideration, allowing for the expertise and capacity of professional services firms to be considered separately from the tender price and independent price assessment, if undertaken.

31) That the NSW Government establish a practice of setting and disclosing selection criteria and weightings for all tenders, with this information centrally collated by Procurement NSW for future data analysis (e.g. by the Data Analytics Centre).

32) Standard practice in New South Wales should require that firms involved in unsuccessful bids are provided with feedback when requested.

33) As part of a new NSW Government Policy on Best Practice Procurement of Government Infrastructure, provide guidance on when it is appropriate to consider non-confirming bids and what should occur when issues or problems are found with the tender process or project brief.

34) The NSW Government should undertake an assessment of insurance, contract and risk literacy within the public service, using this to facilitate appropriate training in conjunction with relevant professional and industry associations.

35) Establish a Centre for Procurement Excellence to support development of infrastructure and procurement skills within the public service.

36) That care is taken to understanding and address the public sector culture as a key component to implementing existing and future reforms in the procurement of government infrastructure in New South Wales.

37) Consider how procurement performance indicators can be incorporated into measuring the leadership of NSW Government departments and agencies.

1 | EXECUTIVE SUMMARY

Consult Australia is the industry association for multi-disciplinary professional services firms working on cities, infrastructure and natural environments. Our hundreds of member firms provide vital services to the New South Wales economy, including through project design, engineering, architecture, surveying, project management, community engagement, and planning services.

Approximately 40 per cent of our industry's work is undertaken for public sector clients, and our member firms have played vital roles in the creation of some of Australia's iconic public infrastructure, including road, rail, hospital, airport, educational facilities, water and energy utilities, justice, aged care, sports stadia, and urban renewal projects.

Procurement of government infrastructure is therefore an issue of particular importance to Consult Australia, as well as the firms and wider industry we represent.

Our expertise and experience covers the full range of the Terms of Reference for this Inquiry, and our member firms rely heavily on optimal public sector procurement to deliver value for money and best project outcomes for their clients. As such, any policy reforms that arise from this inquiry have the potential to dramatically assist our industry's operations, while also achieving better infrastructure and value for money for the people of New South Wales.

Defining the procurement relationship

While every project is different to some extent, there is a significant role for the NSW Government to play in setting the type of relationship that businesses in our industry have with public sector clients and also the behaviour of private sector clients.

The ability of a Government to act as a 'model client', or not, is a key determinant of the efficacy of procuring government infrastructure.

As the party with the greatest bargaining power, how the public sector approaches procurement sets out the parameters of the relationship with industry, allocating risk and reward, and creating a series of incentives and disincentives for the work to be undertaken in a particular way.

A government that fails to act as a model client in its procurement practices is doing a major disservice to the public by supporting systemic issues associated with poor risk management and inefficient contracting. This failure places undue burdens on industry resulting in a less productive and competitive business environment.

Sub-standard practices in NSW

While procurement of government infrastructure is done well in some instances, in many others there is significant scope for improvement. Addressing this in New South Wales is especially important given the current wave of infrastructure development, limitations on industry capacity, expected population growth and the need to mitigate the negative effects of the cyclical nature of public infrastructure investment.

One of the biggest issues facing procurement in New South Wales is risk management. At present, risk is often being allocated not according to who is best able to manage it but according to bargaining power.

Professional services firms are very often the party with the least bargaining power in these transactions and typically often also the least able to absorb the insurance premiums associated with taking on disproportionate or 'unlimited' levels of risk. That assumes appropriate insurance coverage is available - at present this is possible in some cases, but is not guaranteed as local or international insurance markets inevitably tighten.

This poor risk management culture creates a significant disincentive to undertake work for certain public sector clients.

Poor risk management potentially invalidates professional indemnity insurance cover, leads to cost increases to account for the extra risk, and drives a range of behavioural responses that ultimately impact on a project's success. The consequence is systemic risks to the NSW economy and reduced business confidence.

The use of standard, fair contracts negotiated between industry and government, with input from relevant stakeholders, will reduce the need for costly legal

review or negotiations, and gives all parties the comfort of knowing that risk and reward is allocated fairly to help avoid some of the negative outcomes described here.

Risk is just one of the key procurement issues that offer an opportunity for improvement. The quality of project documentation is also a major source of inefficient cost increases, and is another opportunity to do things better. Other areas for improvement include in the choice of delivery mechanism, addressing the cost of bidding, and decision making processes that rely too much on inappropriate short term considerations.

Possible causes of these inefficiencies include a loss of procurement skills from the public service as many of its functions have been outsourced to the private sector. Similarly, investment in professional skills for those who remain in the public service has reduced. Finally, this has occurred within a public sector procurement culture that discourages relevant officials from trying new ways of doing things when the existing procurement methods are perceived as adequate.

Recognition of existing good work

This submission deals with those areas in need of improvement, but it is also important for the Inquiry to recognise those areas of procurement in New South Wales that are already done well, and the positive reforms that have been introduced in recent years.

Procurement policy can never be perfect; it is a constant balancing act between competing interests and objectives that shift with every project and as innovations bring new technologies and ways of doing things into the mix.

Recommendation 1

The Inquiry should recognise those areas of procurement in New South Wales that are done well and the positive changes that have already been made in recent years.

The solutions are well known

Consult Australia released two major pieces of research into procurement in 2015 concerned with the impact of sub-optimal procurement for project outcomes and value for money. Both reports contain recommendations directly relevant to the terms of reference for this Inquiry.

The first of these, *The Economic Benefits of Better Procurement*, is an economic study undertaken by Deloitte Access Economics, quantifying the potential cost savings to public sector agencies through improved procurement. It also analyses the benefits to the Australian economy, and discusses policy reforms that could lead to these benefits. *The Economic Benefits of Better Procurement* is attached to this submission as **Appendix A**.

The second report, *Better Buying, Better Outcomes*, is a qualitative study based on a series of interviews with industry representatives, together with contractors and public sector clients. It discusses areas of procurement where things are done well, and areas where different approaches may yield better results. This report is attached to this submission as **Appendix B**.

We would encourage the Committee to carefully consider both reports together along with the body of this submission.

Additional resources the Committee might find useful are contained in the bibliography to this submission.

2 | PROFESSIONAL SERVICES

As part of the complex web of stakeholders involved in delivering government infrastructure in New South Wales, professional service firms are vital.

These firms are responsible for the front end work of a project, from feasibility and scoping studies, to environmental impact and corridor analysis, through to technical advice on a project's challenges, preliminary and final designs, engineering, and management at the construction phase.

While these services on average account for 19 per cent of total project value for public sector built environment projects[1], the work of professional services firms greatly impacts on the final cost and quality of each project in their entirety.

Indeed, it has been noted in a number of external reports[2] that greater investment in the planning and design stages of a project will actually yield a positive dividend to clients.

Innovations such as Building Information Modelling (BIM), which seek to front-end project decision making and potential design issues to when they can be more cost effectively dealt with, are intended to deliver on such increases in early stage investment.

Challenges and opportunities from different project delivery methods

The means through which professional service consultants are engaged can vary greatly, according to the project at hand and the delivery mechanism used to undertake the project.

It is important here to distinguish between professional services firms as 'consultants' and those firms that are typically tasked with building or maintaining a piece of infrastructure, referred to here as 'contractors'.

In seeking to improve the procurement of government infrastructure in New South Wales, it is critically important to recognise the differences and similarities between the roles of a consultant and a contractor.

The different delivery mechanisms used to deliver government infrastructure in New South Wales generally include:

- **Construct Only** – public sector agencies separately and directly engage designers and contractors;
- **Design and Construct** – public sector agencies engage a contractor, who in turn engages a consultant to undertake design work independent of each other;
- **Managing contractor** – public sector agencies engage a managing contractor, who in turn is responsible for engaging all other parties, including designers and other contractors;
- **Construction Management** – public sector agencies directly engage designers, constructors and other service providers, while taking a project management role themselves;
- **Early Contractor Involvement** – A two stage process, whereby the public sector agency undertakes concept and design work in collaboration with consultants, before a second stage resembling 'design and construct' is used to construct the project;
- **Alliance** – A new entity is formed comprised of the client and service providers, whereby risk and reward is shared and collaboration is encouraged;
- **Public Private Partnership** – A range of structures are used, but essentially a private sector project vehicle is formed to undertake the project (including using the mechanisms described above), with that vehicle then retaining a concession that may own, operate or maintain the infrastructure in return for user charges or a government payment.

[1] Deloitte Access Economics, *Economic benefits of better procurement practices*, 2015, p5
[2] For example, Ashurst Australia with Australian Constructors Association and Infrastructure Partnerships Australia, *Scope for Improvement 2014: Project pressure points – where industry stands*, www.constructors.com.au, 2014

For a more comprehensive discussion of each of these, including relative pros and cons, and the most appropriate circumstances to use each, we recommend that the Committee consider the Australasian Procurement and Construction Council's *Building and Construction Procurement Guide*, published jointly with Austroads in 2014[3].

Nevertheless, a few points need to be made about the importance of selecting the appropriate delivery mechanism, and its impact on project success.

Delivery mechanisms play a crucial role in determining risk allocation between the parties, and in turn driving or creating a disincentive for innovation, while also driving the behavior of the parties as they interact and work together to develop a project.

The other important point to be made is that because the majority of project delivery mechanisms are ultimately a complex web of contractual relationships, project risk and reward are often allocated according to the respective levels of bargaining power, rather than with the most appropriate party.

Professional service firms are often presented with contracts treating them as though they are constructors, despite different legal standards for their work, and different models of doing business (for example, contractors generally take on a project and work to earn a profit, whereas consultants charge a fee for their service).

It is of vital importance that the appropriate delivery mechanism be used for each project, rather than sticking to a default method that might have been successful (or even partially so) in the past. In our experience, too often *Design and Construct* is used as a default delivery mechanism by public sector clients, who see the benefits offered by the service providers allocating risk between each other without taking on risk themselves – even where the public sector may be the most-suited to managing certain project risks.

In some cases, the bias towards this mechanism may be simply based on an individual or team's belief in its past success, even though that may have occurred under very different circumstances.

A better approach is for an unbiased consideration of the project's requirements and the objective use of the best suited delivery mechanism.

Recommendation 2

As part of a new policy on 'Best Practice Procurement for Government Infrastructure', the NSW Government should move away from practices that are currently based only on habit and set clear guidelines for the public sector on how to select the most appropriate procurement and delivery mechanisms for future infrastructure.

A poor risk management culture

The nature of contracting and project delivery has changed greatly over the past 30 years. Three decades ago, public sector clients employed more internal expertise. They were therefore better informed and experienced as organisations, with a clearer understanding of engineering risk, a healthier appetite for risk management, and a greater ability to document and clearly define their projects.

In short, in the past risk was borne by the public sector as part of their day-to-day operations, not shunned.

With 'traditional' contracting, particularly in the public sector, risks began to manifest themselves in the form of variation claims being against the client. The extent of these claims and the response to them by the public sector indicated an intolerance of what appeared to be uncontrolled risk outcomes being borne by government.

Conventional contracting has more recently, in some cases, been replaced by equity and partnership investment including Build Own Operate (BOO), Build Own Operate Transfer (BOOT) and other types of Public Private Partnership (PPP) schemes.

[3] Australasian Procurement and Construction Council and Austroads, *Building and Construction Procurement Guide: Principles and Options*, www.apcc.gov.au, 2014

Public sector risk allocation policies in such schemes tend to move risk away from the government. In other cases, alliances are developed, where the risks and rewards of the project are shared.

The various relationship models for the delivery of professional consulting services generally fall into one of the following broad categories:

(a) The firm is contracted directly to the owner as the owner's consultant for the provision of their professional services,

(b) The firm is sub-contracted to the owner's contractor who is the client for the provision of their professional services,

(c) The firm works in a joint venture, consortium or equity partnership with the owner or owner's contractor for the provision of their professional services, or

(d) The firm works in joint venture partnership with another consulting firm for the provision of their professional services.

In addition, private investors now have a more 'arms length' involvement in their infrastructure investments. Large institutional financial investors (such as superannuation funds) allocate their funds to low risk and low volatility investments which means that they are unprepared to knowingly carry risk themselves.

The result of all of the above changes is that there has been a shift of many project and risk responsibilities from public sector client organisations to construction companies who then contractually pass the risk on to professional services firms. This is based on the (often false) presumption that these consultants are better able to understand and therefore are most-suited to manage those risks, or simply because they are able due to having a stronger bargaining position.

Systemic risk to NSW Economy

Some public and private sector clients are using their market power to adopt a position that present systemic risks to the NSW economy and business confidence.

In having their own assumed best interests in mind, they often believe that risk should be transferred to a professional services firm (such as the consulting engineer or architect), even though they are unable to effectively manage those risks, if at all.

It is important here to highlight that technical capability and risk (e.g. is something designed correctly) is different from a firm's commercial capability to manage risk (e.g. having sufficient assets or capital).

A similar position is often adopted by the financial institutions and contractors, reinforcing a culture of inappropriate risk allocation where the burden is placed on professional services firms.

This culture can make a wide range of consultants liable for the entirety of the losses associated with the project, including in some instances economic loss which a court may not normally ascribe to professional liability.

This may have been reluctantly tolerated business practice in the past when insurance costs were moderate and availability relatively unrestricted. Today, and particularly in tougher insurance environments, this inappropriate transfer of risk drives the cost and availability of professional indemnity insurance beyond the capacity of some consulting firms to afford, obtain, and retain over the often long life of the liability exposure.

As a result, some professional services firms now choose to avoid government and public sector work where a poor procurement culture persists (such as the contracting out of proportionate liability described later in this submission).

Consultants, whose financial benefit from projects is a fraction of that derived by the client and contractor, are the contractual party who are least able to sustain the high costs and resulting increased exposure to inappropriate uninsured liabilities. Nevertheless, they often bear an onerous share of costs and risks because they have the least bargaining power – especially when compared to the NSW Government.

Acting as a model client

Practically being a 'model client' means working collaboratively with industry on projects, and achieving mutually beneficial outcomes rather than seeking to 'beat' industry.

There is already a commitment for government to act as a model litigant when acting as a party to litigation.

Being a model client in terms of procurement means that government's intent to do things better is followed through in practice, and the public sector is always looking out for better ways to do things.

Practically, this step will make government a more attractive client for industry to work with, with be a positive force on business confidence, and in turn will attract more and better quality tenders for work.

This also relates to each project and the individuals involved, with disputes normally due to up front and behavioural factors. For more information on ways the NSW Government can act as a model client and avoid disputes, refer to the Cooperative Research Centre for Construction Innovation, *Guide to Leading Practice for Dispute Avoidance and Resolution*.

Recommendation 3

Support creating a healthy procurement and risk management culture in the state, with the NSW Government and public sector tasked with being the 'model client' at all times.

3 | PIPELINE OF WORK

In parallel with considering how infrastructure is procured by government in New South Wales, it is important to ensure that the procurement demands of government are able to be effectively met by industry.

This relates to five principal areas:

- The number and timing of projects
- Project scale, partitioning and interfacing
- Industry capability, skills and workload
- Certainly of project funding
- Long term protection of infrastructure corridors

At present, New South Wales is undertaking an unprecedented level of infrastructure procurement with a significant impact on the availability of those skills required to ensure delivery as planned.

As evidence of how quickly the local market has heated, local expertise in some disciplines is now under pressure with some firms being unable to fill positions quickly enough.

Claims that such additional human resource needs can be readily filled from interstate and overseas are only partially correct. **An infrastructure boom increases the risk that major projects will be inefficiently procured at the taxpayer's expense.**

Recommendation 4

The NSW Government should ensure there is a consistent long-term pipeline of projects developed and rolled out in consultation with industry.

Building local capacity

Efforts to export professional services from New South Wales (often captured within terms such as the 'knowledge economy'), is dependent on local professional services firms having sufficient underlying work to sustain their local operations.

By using a consistent procurement pipeline to develop local capacities when funding is more readily available, New South Wales will alleviate the negative pressure placed on the professional services sector during quieter periods. This was an opportunity somewhat missed during the mining boom in other states.

Recommendation 5

Infrastructure projects should be leveraged to develop and foster expertise within locally-based professional services firms that can then be exported to other states and internationally.

Pipeline transparency is essential

A government having a pipeline of infrastructure projects is of limited value if industry is unaware of its existence or the detail of what will be being procured over time. Limited transparency restricts the ability of firms to undertake workforce planning and reduces the incentive to invest in staff skills and capacities.

Recommendation 6

Infrastructure planning should be a transparent process undertaken in close consultation with industry, with long term infrastructure plans and pipelines publicly known and available.

4 | RISK, CONTRACTS & LIABILITY

As we indicated in the previous part of this submission, too often project risk is allocated according to bargaining power rather than ability to manage risk.

Contracts are offered on a 'take it or leave it' basis, with little ability to negotiate around onerous terms that a service provider might not be able to meet or that unreasonable stress on their business.

Sometimes firms may be forced to enter into such unfair contracts because they are unable to walk away from a project for commercial reasons, even though it might place their business at risk, while in other situations, firms may not even be aware of the legal implications of certain contract terms, leading to reduced risk transparency.

Where this manifests in construction contracts, a number of undesirable outcomes may result. While public sector agencies may pass on risk under the (illusory) impression that they are protecting the taxpayer, their actions may actually serve to drive up prices, increase delays, and potentially invalidate the very insurance cover professional services firms rely on for their protection.

At a contractual level, professional services firms operating in New South Wales face a range of problematic issues, including but not limited to the following.

Excessive use of non-standard contracts and clause variations

Firms are spending an increasing amount of unnecessary time on contract negotiation, management and litigation resulting from a large number of projects needlessly avoiding the use of standard documents such as Australian Standard 4122-2010 General Conditions of Contract for Consultants (explored further in this submission).

Recommendation 7

Procurement NSW should prepare a publicly available assessment for the Committee on the range of contract types, terms, and variations currently used within New South Wales, including an analysis of costs, benefits and the wider impacts of these.

Onerous risk allocation through indemnities

A contractual indemnity requires one party to take responsibility for any loss that might be suffered by another party that they are indemnifying, even if that loss was caused by that other party's own actions. This can be further exacerbated through third party indemnities (discussed further later in this submission).

Generally, professional indemnity insurance will only cover consultants for loss resulting from their own acts or omissions. Broad indemnities, or those not relying on the fault of the insured party, are highly problematic because they often fail to align to actual risks or available insurance policies.

Disproportionate allocation of liability

Under the Civil Liabilities Act 2002, proportionate liability allocates liability between multiple parties according to the contribution to loss made by each. However, in NSW the ability to 'contract out' of proportionate liability exists, meaning that each party may be responsible for a much larger share of any loss than they were responsible for.

This issue is discussed in greater detail later in this submission.

The illusion of unlimited liability

A contractual limit on liability set with reference to a thorough risk assessment allows business to properly insure their work and provide certainty for themselves and their clients.

> *"A rigid application of unlimited contractual liability is an oppressive approach to contracting and risk allocation because it can require a consultant to place its whole business at risk for one government contract."*
>
> Tony Horan, LLB, BA (Hons)[4]

As liability is always limited to a defendant's assets, and their ability to pay for any loss realised, unlimited liability is illusionary and referring to it in contracts encourages poor risk management, as well as disincentivising settlement in the event of a dispute.

Recommendation 8

The NSW Government should prohibit contracts from referencing 'unlimited liability' and promote a better understanding by all stakeholders on the limitations of liability and the need for good risk management.

Inappropriate standards of care

The appropriate standard of care for a professional services firm is one of 'reasonableness,' with this determined by looking at what a similarly experienced consultant would do. This reflects the fact that consultants provide a professional opinion rather than a tangible item.

However, often the standard of care in consultant contracts will fail to understand this, and use 'fitness for purpose' warranties, which are appropriate for contractors, but not consultants.

Another inappropriate standard of care often used calls for an 'expert standard of care'. In both cases, a risk is created that the consultant's work might not be covered by their insurance as warranties and expert standards of care cannot be effectively judged under reasonableness comparisons.

[4] Horan, T., *Memorandum of Advice: Uncapped liability for consultants under Guidelines for the Limitation of Liability of Suppliers, Consultants and Contractors*, 2013, 4(d)

Recommendation 9

The NSW Government should prohibit contracts from referencing inappropriate standards of care for professional services firms and consultants.

Consequential loss and liquidated damages

These clauses typically impose penalties on consultants for delays. However, when delays are beyond the control of the consultant, this is problematic and unfair as insurance will not cover eventualities beyond which a consultant has no control.

Unreasonable insurance requirements

Contracts might set an unreasonable level of insurance cover or limit the ability of an insurer to defend claims on behalf of the insured by limiting their right of subrogation (the right for an insurer to pursue a third party that caused an insurance loss to the insured). In other cases, clients have demanded to see an insurance policy (which is commercial in confidence information), or be named on a professional indemnity policy inappropriately. This can present significant risks to the client, including the potential to be unable to make a claim under such a policy.

These requirements lead to a range of risks and increased premiums that are ultimately passed back to the client and taxpayers through increased fees or a lack of competitive bids.

Setting an appropriate limit of liability allows business to properly insure themselves, and makes government a more attractive client to do business with.

Recommendation 10

The NSW Government should develop and apply limited liability guidelines to provide business with certainty when undertaking work and help ensure appropriate risk management.

Termination for convenience

Terminating a professional services contract for convenience (without reason) is not something to be done lightly or without compensation for expenses incurred, as clients will incur reputational damage and the practice can present a real sovereign risk.

Insurance implications

Unlike other parties involved in infrastructure development, professional services firms are generally an asset poor class of business, with a majority being small and medium enterprises. Because the service they provide is professional expertise rather than a tangible good, they depend on professional indemnity insurance to cover liability risks that arise, including contract disputes or failures in the delivery of a final product.

Indeed, consulting firms generally take out broad ranging and often expensive insurance policies to cover liabilities arising from their work, and to protect their business and personal assets. For professional services firms, professional indemnity insurance premiums are one of their largest expenses.

As a general rule, professional indemnity insurance only covers consultants for loss arising out of their errors or omissions, and where a consultant has entered into a contract that takes on risk beyond what they would be responsible for in their common law position, insurance will typically not respond to any claim that results.

In situations where such a contract has been entered into, and a loss results, consultants must then meet any liabilities without insurance, from their personal assets. Where the consultant has insufficient personal assets (often the case given the asset-poor nature of most professional services firms) or have isolated them, then the loss will ultimately sit with the client – in many cases the NSW Government and taxpayers.

It is particularly important to note that where a contract forces onerous risk onto a particular party, some businesses will be unaware that the contract in question might not be covered by their insurance, which in itself is an undesirable outcome.

Other parties will take the risk by undertaking the work, knowing that they're not fully insured, while other parties will deem the risk of proceeding uninsured as too great, and will take the decision not to bid for the project in question.

Recommendation 11

The NSW Government should undertake an assessment of insurance as it relates to all stakeholders involved in the procurement of government infrastructure, with a particular focus on the understanding, costs and uptake of indemnity cover by professional services firms.

Insurance amounts

In recent contracts, requirements for professional indemnity insurance and public liability insurance amounts are unreasonably high and bear little relationship to the risk profile of the project. This has the effect of increasing costs for consultants to bid for projects given those additional premiums have to be absorbed by the consultant (ie. they are rarely passed on to clients who are unwilling to fund such policies).

The Committee should refer to the Australian Procurement and Construction Council's *Professional Indemnity Insurance Guidelines in the Building and Construction Industry* for more information on this particular matter.

Reliance to third parties

Increasingly, consultants are being required to give third parties, who are not parties to the contract, reliance on the consultant's professional services.

Third parties may include other government departments, financiers or other contractors engaged to carry out services on the project. At times it is unclear why third parties require reliance on our deliverables given there doesn't appear to be any bona fide rationale for doing so (other than to serve as a mechanism to rope in as many insurance policies as possible in the event of a dispute!).

In the absence of a contractual relationship with third parties, the consultant's liability for its services is extended beyond the limitations in the contract.

Recommendation 13

Greater consideration needs to be given to how third parties rely on the work of consultants and how this affects exposure to liability.

Independent verification

In our experience, it is common for the contractual obligations of independent verifiers to be ambiguous and conflict with the independent verifier requirements in other project documents. This makes it difficult to determine what the role of the independent verifier is.

Coupled with often onerous terms in these contracts (e.g. unlimited liability, indemnities not tied to the consultant's errors or omissions and higher standards of care) the ambiguity increases contractual risks and decreases industry's willingness to undertake independent verification work. It also increases our bid/project costs.

Recommendation 13

Independent verification requirements should be consistent wherever possible and avoided where they are providing limited value to the client or public.

Other consequences from inappropriate allocation of risk

Our experience is that on projects where all the risk is allocated to one party, there is less incentive for the parties to work together to properly identify and effectively manage project risks. In particular, it allows one party to easily 'pass the buck' when they could have managed a risk, as contractually it is no longer their responsibility.

When risk is more fairly allocated, a more collaborative approach is taken as each party has an interest in seeing the risks properly dealt with, and risks are allocated to those best placed to do something about them.

This in turn leads to better project outcomes, including better and more efficient delivery of the deliverables, as well as reduced disputation and consequentially a better experience for all participants.

Best practice risk management sees the parties work together in identifying possible risks and solutions to manage them.

Less desirable practices are generally focused on one party offloading responsibility to another and considering the risk has been managed, when in actual fact it has not (and indeed may be allocated to a party unable to manage that risk).

This approach also focuses on what might happen in litigation after a risk eventuates, including seeking out the 'deep pockets' of certain firms or individuals, rather than preventing the risk from eventuating in the first place.

Deters Innovation

While an innovative solution or design might not be appropriate for every piece of infrastructure, innovation nevertheless may offer a way of saving money or maximizing project outcomes and user experiences.

However, where the risk placed with a consultant or designer is onerous, it will often result in them over-engineering their design to make doubly sure that a risk does not eventuate, and will also deter innovation.

Price Increases

The Deloitte Access Economics report commissioned by Consult Australia, *The Economic Benefits of Better Procurement*, found that firms often respond to onerous risk by either pricing it into their bid, or deciding not to bid on a particular project, which in turn drives up price by reducing competitive pressure. The report found that savings of about 5.4 per cent could be made through better risk sharing and other improved practices.

This is aside from the cost of lengthy negotiation and managing an onerous contract, or indeed the cost of disputation and litigation. A 2009 study[5] by the Cooperative Research Centre for Construction

Innovation found the cost of disputation to be worth around $7 billion in that year in Australia, adding around 6 per cent to the overall cost of work done.

Further Delays

Delays could be reduced by 7 per cent through better procurement, according to *The Economic Benefits of Better Procurement*. Onerous contracting is more likely to lead to disputation, as well as lengthier negotiations in the initial phase.

Should a risk be realised and a liability eventuate, an onerous contract means there will be less incentive for the parties to settle instead of pursuing costly litigation.

Inferior Project Outcomes

Successive reports have established that a greater investment of resources in the conceptualisation, scoping and design of a project will ultimately yield a better project outcome, and may even save money over the life of the project. Inappropriate risk allocation reduces the incentive for professional services firms to do this.

Reputational Damage

Certain public sector agencies have over time developed a reputation for using onerous contracts and procurement processes.

Accordingly, many private sector service providers are reluctant to tender for work with that agency, knowing that it will be less collaborative and a riskier job.

Ultimately, this should concern any agency seeking the best solutions to their projects, including the best possible designs.

[5] Cooperative Research Centre for Construction Innovation, *Guide to Leading Practice for Dispute Avoidance and Resolution*, www.construction-innovation.info, 2009, p8

Viability
Reduced competition in the market will result in less choice, higher fees, and poorer value for money outcomes.

Recommendation 14

As part of a new NSW Government Policy on Best Practice Procurement of Government Infrastructure, set clear guidelines for the allocation of project risk.

5 | STANDARD CONTRACTS

Already a number of standard, fair contracts exist around Australia and have been used with great success by government agencies, including in New South Wales.

The use of standard, fair contracts negotiated between industry and government, with input from relevant stakeholders, reduces the need for costly legal review or negotiations and gives all parties the comfort of knowing that risk and reward is allocated fairly to avoid many of the negative outcomes described above.

While we acknowledge that standard contracts will not be appropriate on all projects (such as, for example, unique major infrastructure projects), we strongly recommend that government agencies use standard contracts on an 'if not, why not' basis, whereby the public service is required to use them unless there is an appropriate reason not to do so that is explained to their industry partners and recorded publicly.

One other issue frequently encountered with the use of standard contracts, including from certain NSW Government agencies is the attachment of special conditions. Where agencies do attach special conditions, they need to be aware that doing so undermines the benefit of using a standard contract, as otherwise-avoided further negotiation is often required as would be the case using a bespoke contract.

Some standard contracts already in use with great success include:

- **AS4122-2010**: The Australian Standard contract for engagement of consultants in the construction sector was developed through Standards Australia, with the input of industry and government representatives.

- **The Commonwealth Suite of Contracts** for projects valued at up to $200,000. This contract retains a fair allocation of liability, and leaves industry to determine the best insurance management process themselves.

There are also presently a number of similar state based standard agreements.

In New South Wales, Consult Australia began a lengthy consultation process with the Department of Finance and Services in 2012 to develop a new standard agreement for use across all public sector agencies with our industry. Unfortunately, that agreement has not yet come to fruition as the decision was taken to instead decentralise NSW procurement processes.

We believe that the NSW Government and our industry would benefit greatly from the use of a standard contract for professional services, offered on an 'if not, why not' basis. AS4122-2010 would be the best possible standard agreement to use in this situation.

In those circumstances where public sector clients deem this agreement inappropriate, they should always be prepared to explain to their industry partners why that is the case, and should also understand that **unnecessarily onerous contracts will result in less desirable project outcomes, higher costs and less certainty**.

Recommendation 15

The NSW Government should adopt a policy of using Australian Standard 4122-2010 General Conditions of Contract for Consultants for all professional services in the State on an 'if not why not' basis.

Recommendation 16

A standard list of special attachments and additional or alternative contract terms should be managed centrally by Procurement NSW, in consultation with industry and guided by the principle that variations should be avoided.

Recommendation 17

To build an evidence base for future decision making, a public register should be maintained of instances where a standard contract was not used and the justification given.

6 | PROPORTIONATE LIABILITY

As this issue has broader policy implications, this submission will deal with 'proportionate liability' as a separate issue to the other risk related issues outlined above, together with a legislative solution.

In response to the insurance crisis of 2001, a package of reforms including proportionate liability legislation was enacted to replace the doctrine of 'joint and several' liability. Under this old regime, multiple parties may have combined to cause loss to a plaintiff, but any one of them could have been held fully liable, and be required to pay the full cost irrespective of their individual contribution to the loss.

This disproportionate allocation of risk presents a significant issue to many professional services firms and limits their ability and willingness to do business in New South Wales.

Proportionate liability was introduced on the principle that any loss is divided among the parties according to their share of responsibility, as determined by a court.

Liability is therefore allocated to the parties according to who is able to manage the risk, rather than the party with the weakest defence capabilities, the deepest pockets, or away from the party(ies) with the greatest bargaining power.

While part of a national reform that sought to deliver a consistent approach, when enacting legislation was implemented at a state-level, a crucial difference emerged between the jurisdictions. While Queensland expressly prohibited the practice of not applying proportionate liability in a contract (known as 'contracting out'), the NSW Civil Liabilities Act 2002 allowed for it (along with its sister legislation in Western Australia and Tasmania, while the legislation in other states is silent on the issue).

Ensuring that proportionate liability is a feature of contracts will mean cheaper and readily available insurance for professionals, and better risk management.

Contracting out is a risk to the State

Allowing contracting out of proportionate liability to continue presents as significant systemic risk to the procurement of government infrastructure in New South Wales.

The current wording of the Civil Liabilities Act 2002 supports a culture of poor risk management that will see Government:

- Pay higher fees for professional services
- Continue to fail to manage project risk appropriately
- Be forcing many businesses to pay expensive additional insurance premiums, if available
- Support reduced competition from firms unable to obtain or afford insurance
- Support an environment where some firms proceed without insurance, often unknowingly
- Reinforce a culture of poor risk and contractor management, and of inappropriate risk offloading
- Unnecessarily expose the state economy to future tightening in local and global insurance markets

While New South Wales is currently presented with a robust global insurance market, insurance coverage for projects contracting out of proportionate liability has generally been unavailable.

Nevertheless, in recent years some policy extensions covering contracting out have been made available, but these are problematic for a few reasons:

- The additional premiums are expensive, at up to 25 per cent additional cost to already costly premiums[6], and often don't make commercial sense.
- The policy extensions aren't universally available, and smaller businesses in particular are often unable to obtain them.
- The policy extensions available now may not be available when the insurance market hardens. Thus, future claims made against current projects may not be insured, and often with little awareness that this is the case.
- Only 20 per cent of our industry have insurance cover for contracting out of proportionate liability, as found by the Deloitte Access Economics Study, while a further 36 per cent were unsure whether their policy covered contracting out.

A broader issue also exists in industry being unaware of contracting out of proportionate liability and its implications. The Deloitte Access Economics study, *The Economic Benefits of Better Procurement*, found that a large proportion (38%) of our industry was unsure whether they were contracting out of proportionate liability, given that its standard wording in contracts is often highly technical in nature (ie. "Part 4 of the Civil Liability Act does not apply").

Additional negative impacts

In addition to the various impacts of onerous contracts described above, contracting out of proportionate liability has a number of additional negative impacts:

- **Lack of certainty regarding insurance cover**. Firms entering contracts where proportionate liability does not apply are placed in a situation where their insurer most likely will not respond to claims. Even where a policy extension has been obtained, that may not cover a liability that arises in the future (see above).
- **Lack of awareness**. Firms are often unaware that they are contracting out of proportionate liability, or what the implications of doing so are. This means they may be under the impression they have taken steps to protect their business and client against liabilities, when in actual fact they are exposing

[6] Deloitte Access Economics, *op. cit.*

themselves to potentially significant losses. If such a loss does eventuate, the business in question will only become aware of the implications once it is too late.

- **Undermines the original policy intent of reform**. The original intent of the proportionate liability reform was to ensure that professional indemnity insurance remained affordable and available for industries such as ours that rely heavily on it. At the time of the HIH collapse, around 30 of Consult Australia's largest member firms were simply unable to obtain insurance.

  Should insurance not be available on commercial terms, a significant negative impact will be felt, not just by clients of industries that rely on it, but also on the broader New South Wales economy.

- **Focus on litigation rather than managing risk or successful project completion**. Contracting out of proportionate liability is predicated on making litigation easier for a plaintiff by making 'deep pockets' available to them, rather than driving better project outcomes, including better managing risk and preventing a liability from occurring in the first place. Anecdotal evidence has shown that proportionate liability not only drives better project outcomes, but also creates a significant incentive for parties to settle any dispute ahead of litigation.

NSW needs to act alone, for now

In the past, there has been a concerted effort to achieve a uniform national position where each Australian jurisdiction's legislation consistently prohibits contracting out of proportionate liability. This position was supported by expert advice presented to the Standing Committee on Law and Justice (previously the Standing Committee of Attorneys General)[7].

In October 2013, draft legislation was released to remove contracting out, although the draft contained loopholes that would have been used to bypass the reform. The NSW Government consulted extensively on that draft proposal, but never reported back following the consultation, and no legislative reform has been enacted.

Given the lack of impetus for a national legislative change, we strongly recommend that NSW act to remove the ability to contract out of proportionate liability from its contracts and the underlying legislation. This will further support efforts to attract the professional services sector to do business in NSW, and will also support small business, while furthering the original policy goals of proportionate liability.

To further understand proportionate liability and the October 2013 proposal, we recommend our submission to that consultation, included as **Attachment C**.

Recommendation 18

The NSW Government should immediately prohibit the contracting out of proportionate liability from all government contracts with professional services firms.

Recommendation 19

The Civil Liabilities Act 2002 must be amended to prohibit contracting out of proportionate liability for apportionable claims, notably through reform of Section 3A(2).

[7] Horan, T., *Proportionate Liability: Towards National Consistency,* DLA Phillips Fox, September 2007; and Em Prof Davis, J L R, *Proportionate Liability: Proposals to Achieve National Uniformity*, Australian National University, 2008.

7 | QUALITY OF DOCUMENTATION

Together with risk management, the quality of project documentation is the other major roadblock in the push for better procurement. When project documentation does not meet the required standard, it frequently becomes a major project risk in itself, leading to disputation, increased prices, or decisions for firms not to tender for certain projects.

Project documentation includes the scope of works, which sets out the client's requirement from the project. While the scoping of each project will vary on a case by case basis, there are several components that are generally common to all projects. They include:

- Outlining the broad objectives of the client to be realised through the project
- Specific project requirements, such as functional outcomes or benchmarks to be met in meeting the broad objectives
- Background information, including specific project risks
- Contractual method of delivering the project

There are many paths taken by clients to develop an initial concept into a scope, although these processes aren't always clear to the various service providers who will then rely on that documentation. What is clear is that the best quality scopes have a greater level of input from a wide range of stakeholders (including the potential for service providers such as consultants and contractors), contain realistic timeframes and budgets, provide an appropriate amount of background detail, and tailor the procurement process (including risk and delivery method) to the circumstances of the project.

Indeed, the level of clarity in the scope should be a deliberate factor linked to the delivery model and appropriate risk allocation in order to encourage innovative solutions. On the other hand, **poor project scopes lead to confusion and wasted efforts by all parties, and a greater likelihood of disputes and litigation.**

The key problems with project documentation highlighted in our various procurement studies include the following areas:

Unclear objectives and early engagement

Unclear project objectives create a challenge for tenderers in putting a bid together, when they are not sure of what the client wants, which should be set out as a minimum inclusion in a scope. In some cases, scoping documents are used by clients to clarify what they want, when they are deliberately vague, in the hope that a consultant will challenge the information provided in terms of "you have asked for X, but don't you really want Y instead?" This issue creates significant risk for consultants, who respond by pricing that risk into their bids, not bidding for work, or submitting a non-conforming proposal.

The Deloitte Access Economics study found unclear project objectives to be one of the most commonly occurring problems with procurement, with 37 per cent of projects being affected by this issue. Furthermore, only 20 per cent of bidders presented with this issue continue their work without adding a price premium, deciding not to bid, or submitting a potentially non-conforming bid.

While the level of detail required in a scoping brief will vary by project, the converse argument can also be made in some cases; that leaving certain aspects of a project open might in turn encourage innovation by testing the creativity of bidders. What is an imperative is that any lesser degree of detail should be deliberate, and not simply a planning oversight.

A possible solution to this issue might be early engagement to get industry feedback on the proposed project, or even to engage a consultant to reverse-engineer a project brief, on the understanding that they are then unable to further tender for its work. Under this arrangement, they are able to test out a range of assumptions, and use their technical knowledge to flesh out project objectives before it goes to market.

Recommendation 20

Pre-procurement consultation should be undertaken, where appropriate, to ensure project objectives are sufficiently clear and to support innovation before any tender process begins.

Explain "why"

When faced with practices that industry have an issue with (especially contract terms), public sector clients should be pushed to explain why that practice exists.

This will turn their mind to whether they're asking for something that's not really necessary for the project, but will come at extra cost to the client. In return, it will also increase empathy between the parties, increasing each side's understanding of the other's perspective and for our industry in particular will help understand exactly what it is that the client wants from the project.

Such deepening of understanding relates to many of the cultural issues discussed elsewhere in this submission that affect the quality of procurement.

Inadequate or unverified background information

Background information to a project is often included in project documentation, but it is common for public sector clients to refuse to verify any of that information, or provide inadequate information – requiring duplication and over-servicing by consultants participating in the tender process.

For example, this may include a geotechnical survey of land a building is to be built on, background financial data, or an environmental impact statement. As any inaccuracies in such information might mean a design is unusable, the accuracy of this information is vitally important. In each case, the refusal to allow bidders to rely on that information means that each bidder individually needs to duplicate that work.

The cost of verifying background information was found by the *Economic benefits of better procurement practices* by Deloitte Access Economics study to be $41,800 per firm, per bid on average. Given that in many cases, designs are based on that background information, this is a gross inefficiency. Furthermore, a 2005 report published by the Queensland Division of Engineers Australia,[8], found that between 60 per cent and 90 per cent of variations are due to poor documentation, with the ultimate cost to public sector clients totaling billions of dollars.

Government verifying brief information and even going so far as to hold the original provider of that information responsible for its accuracy could remove a major inefficiency of the procurement process.

This issue goes to a much broader challenge on how data relating to built environment projects in New South Wales is considered, held and utilised by government, industry and the public.

Recommendation 21

A separate consultation on the 'collection, use and integration of built environment data in New South Wales' should be commissioned to deliver better value and support innovation.

Form-based scope development

A standardised, form-based approach to developing the scoping document may be problematic, as it runs the risk of developing the scoping document for the sake of producing the document, rather than meeting project needs.

The best scopes are developed specifically for a particular project, and acknowledge project requirements and risks unique to that site, the relevant set of stakeholders, and the desired final outcome. Our industry reports having been presented with scoping documents that in some cases weren't even updated from their previous use for a similar project, such as a corridor preservation or traffic study.

Inclusion of unnecessary items

Linked to the previous frustration is the inclusion in the scope of items that aren't really required. For example, certain skills may be listed as a requirement from firms tendering for a particular job, or other requirements for the project may be prescribed when they are not necessary.

[8] Engineers Australia Queensland Division and Queensland Construction Industry Forum, *Getting It Right – The First Time,* www.qcif.com.au, 2005

Ultimately, demanding that a successful bidder meets certain unnecessary requirements or brings unnecessary characteristics will deter certain firms from competing for tenders, and will drive up the cost on the part of other firms. In both instances, needless additional costs are incurred and inefficiencies result, while at the same time stifling the potential for innovation on that project.

Improving project scoping

Our members have regularly reported receiving project briefs that appear not to have been reviewed for accuracy or where additional information released has been difficult to access. Some examples reported by members that reflect each of the issues canvassed here include[9]:

- The re-issue by the agency of an entire project brief, but without track changes, making it extremely difficult and time consuming for tenderers to ascertain where the changes have been made and the implications for a tender already underway
- Project briefs that do not correctly refer to known industry standards
- Project briefs in a 'state of flux' evolving throughout the tender period with additional information catering to changing client demands
- Tender advertisements referring to published information that is not available online
- Addenda being issued, sometimes the day before a tender deadline, with no time extension
- References to parts of a project that are not actually relevant to the project being tendered
- Project briefs that refer to construction phase services for projects where there is no need for such services
- Increased demands for building information modelling (BIM) without associated increases in time to prepare such requirements.

In the circumstances cited above, quality assurance has not been correctly administered and, in part, the costs of quality assurance have effectively been passed to the consultant where they choose to engage with the tender and raise issues of concern.

The time and costs associated with this process are substantial, and will either detract from resources spent on the preparation of the tender, or increase costs to the client and consultant alike.

Ultimately however, of greater concern to the taxpayer are the ongoing unmanaged risks to the Government that arise in the absence of robust quality assurance.

Investing more in scoping

Better quality project briefs will make it easier for consultants and others in the design phase to conceptualise a project. Multiple studies have shown that the quality of project briefs is a major source of inefficiencies in building infrastructure.

Reallocating procurement resources towards better specification of project objectives will ultimately save a project money, as potential problems are resolved before it's too late.

Recommendation 22

Invest more time and resources in the scoping of projects to assist in avoiding later-stage issues and conflicts.

[9] Some examples drawn from: Consult Australia, *QLD Government Procurement Review: Response to issues Paper*, www.consultaustralia.com.au, November 2012

8 | SUPPORTING INNOVATION

Innovation has the potential to save a client money, mitigate risk, or deliver a better project outcome. Most significantly, innovation in the procurement of government infrastructure is key to allowing New South Wales to maintain its edge as a preferred place to do business and to delivering the best value to taxpayers.

Public sector agencies are historically risk averse, which means they might not be as open to innovative solutions as they should be. The *Economic benefits of better procurement practices* report found that public sector agencies were generally reluctant to allow innovative solutions before a project commenced, with the major reasons cited being probity concerns, fears of negative budget impacts and delivery mechanism.

The Deloitte Access Economics report, together with *Better Buying, Better Outcomes* canvassed some ideas for encouraging innovation to the benefit of public sector clients.

One element of doing so in many cases will be to accept the potential for failure, either by quarantining a portion of funds for innovative projects, or to work collaboratively with the consultant to manage the risks in play. The scope of works, risk management process, contract terms and conditions, or delivery model will determine for a firm planning a bid, whether or not an innovative solution is suited to that project or not. A scope that isn't overly prescriptive in terms of the definition of the project outcome (as distinct from project aims) will encourage innovation, as will delivery models that share risk and support collaboration.

Clients who recognise the potential cost-saving benefits of innovation and seek them out, should be aware of this when developing their project documentation and delivery model. Industry recognises that these solutions won't always be possible, and also that innovation isn't always appropriate for every project.

Other suggestions include better early engagement of agencies with consultants, either as an early market sounding process or during the bidding process, and updating market led proposal mechanisms to account for the needs of consulting firms.

In the case of early engagement, our industry reports that this only occurs in around half of all projects, while the major challenge with market led proposals is that developing such a proposal is a costly exercise for consultants to undertake without the comfort of knowing the project will be approved. Currently, the Victorian Government is investigating mechanisms to support consultants in undertaking this work, and we would recommend that the NSW Government follow suit.[10]

To ensure that innovation is recognised for the benefits it brings, rather than being feared as a form of gold plating assets. It is important that clients select the appropriate projects to try innovative solutions on. For example, mature technology might be more appropriate for a large infrastructure project, such as a highway or hospital, while novel projects may emerge more innovative solutions.

Recommendation 23

Procurement NSW should be provided with oversight of a strategic Procurement Innovation Fund to allow them to work with specific agencies to trial more innovative ways of procuring government infrastructure without impacting negatively on project budgets and allowing for savings to be paid back into the fund.

Recommendation 24

Improve support provided to market-led (unsolicited) proposals, drawing on recent changes introduced in Victoria.

[10] Department of Treasury and Finance (Victoria), *Market-led Proposals Guideline*, www.dtf.vic.gov.au, November 2015

9 | COST OF BIDDING FOR WORK

Our industry frequently asserts that bidding for work is expensive, often to the point of being prohibitive. While the tender phase of a project is important for clients to evaluate the range of project solutions on offer, and use competitive pressures to achieve the best value for money, the nature of bid processes in New South Wales could be improved to save industry money, and in turn reduce the costs that ultimately is passed back to their clients and the taxpayer.

As well as the cost of the time spent putting a bid together, other expenses might include the cost of the intellectual property included as a possible solution to the brief, or the resources required to test any background information. Red tape type administrative hurdles are also fairly common through the tender process, as bidders are asked the same question multiple times through the different stages of the one tender, which can be costly to duplicate.

In other situations, bid documentation is required to address the bidder's compliance with a range of competencies, which ultimately will play little role in determining the final awarding of the contract. Meanwhile, some consultants report having been subject to tender processes that required them to "almost do the whole job" in the bid phase, but without the reward of a fee in return.

Appropriate client behaviour

Certain client behaviours further drive these expenses. For example, shortlisting has the potential to help save costs, but this purpose is defeated if too many bidders are shortlisted, as they continue to accumulate costs associated with their bid that ultimately have to be met (e.g. recoupled through other tenders for which they are successful).

On other occasions, consultants report being asked questions completely irrelevant to the work at hand, as the client is using a form approach to procurement, and answering those questions has a cost attached as well. Other factors, such as the requirement for bids to be fully compliant, undue complexity of the tender process, or lack of clarity surrounding project risk also impact on the cost of tendering.

Many in our industry recognise that the cost of bidding for work is the price of doing business, but ask that clients respect and consider the cost imposed on businesses through their approaches. For example, this means not calling for bids on projects simply to make up numbers, when there's already a preferred supplier, including at the second stage of a two stage process. The adage that a 'quick no' is preferable to a slow one is especially true in our industry.

Client recognition of the cost of tendering in and of itself is at the core of any solution to this issue. Clients rely on a viable consulting industry, and short term costs to the industry will have a longer term impact. By understanding the various costs that go into preparing a bid for work, clients can reduce the cost to industry by better focusing the questions they ask, and reducing duplication through the bid process for the one job.

The selection process could also be structured to prevent keeping bids alive when they have no realistic prospect of success, while the issue of reimbursing unsuccessful bids in return for the use of (part or all of) their intellectual property is also worth considering.

Pre-qualification schemes are useful

While government clients rightly ask industry to demonstrate that they meet certain competencies, a centralised database or even a pre-qualification scheme would be preferable to bidders filling out the same forms on multiple occasions.

In their report on public infrastructure, the Productivity Commission recognised[11] that the bulk of bid content was comprised of this type of paperwork, rather than proposals relating to the project at hand, that could usefully differentiate the bidding firms.

Any move to reduce the need for this compliance activity represents a significant opportunity for government to save on the cost of bidding, while also supporting industry.

[11] Productivity Commission, Public Infrastructure, Inquiry Report No. 71, Canberra, 2014

Quantifying the cost of bidding

We would also like to draw the Committee's attention to previous Consult Australia reports[12], which have cited the 1996 study by the Office of Building Asset and Building Policy in Victoria, which compiled some examples of bidding costs, including:

- For a $320,000 public facility, one tender submission by an architectural consultant cost $9,000 to prepare. 102 tenders were submitted. If each tender cost the same amount, potentially $918,000 would have been spent on the preparation of submissions by tenderers and the total cost of tendering equated to almost 3 times the project value;

- For another public facility, the client found that tender bid prices were too high so made minor changes to the tender documents and re-tendered the projects. The client was effectively bid-shopping, but this required the tenderers to put in extra work.

- For a $5-6million project a consultant spent $100,000 to prepare a bid. The successful bid was awarded a contract worth $180,000, meaning that the consultant only received $80,000 for the project and the rest covered their tender costs. The unsuccessful tenderers did not recoup any costs.

Consult Australia members have regularly reported that that these figures remain relevant today and are not by any means unusual.

Streamline compliance processes

The vast majority of tender documentation is not used to differentiate bidders, but to ask bidders to verify that they meet a range of competencies that might be relevant to the project at hand.

This practice is a major driver behind the high cost of bidding for work, which could be reduced through streamlined compliance processes, perhaps in the form of a central register of competencies held by various firms and individuals, in line with pre-qualification requirements.

Recommendation 25

As part of a new NSW Government policy on Best Practice Procurement of Government Infrastructure, recognise the time, effort and costs assumed by industry in the preparation of tender documents and seek to reduce these wherever possible, and to provide compensation where appropriate to encourage competitiveness and innovation.

[12] See www.consultaustralia.com.au/Home/Advocacy

10 | BETTER DECISION MAKING

One aspect of procurement often overlooked when policy makers consider areas for possible reform is the quality and nature of decision making.

The type of decisions relating to the procurement of government infrastructure generally fit into a small number of categories:

- Decisions around which project to undertake,
- Decisions around project specifications, and
- Decisions around selecting the winning bid(s) to work on the project.

While the first of these decisions is generally beyond the scope of this Inquiry, nevertheless we would like to take the opportunity to highlight the importance of independent advice to government based on expert opinion to optimise the quality of these decisions.

Consult Australia has welcomed the establishment of Infrastructure NSW as an independent agency to make recommendations to government, and we hope that its work is strengthened into the future.

In terms of decisions around project specifications, some important and competing considerations will determine what the agency responsible for the project will select.

Deadlines and budgets

As the system of infrastructure development currently operates, there is great focus placed on time and budget considerations. These are often used as indicators of project success by Cabinet, individual ministers, and the public service, and indeed are important factors in a project's success. However, they should not be pursued at the expense of the project meeting its original aims.

If a project fails to meet the original aims, it will not be a good use of taxpayers' money, and will likely require costly upgrades at an earlier time than might otherwise have been required.

Furthermore, the discussion around whether to focus on cost or value set out below with regard to bid decisions, also applies to project specifications overall.

Whole of life considerations

Consideration of 'whole of life' factors is an important element that should be considered in any decisions around project specifications. Often, infrastructure is built to specifications that allow it to be built, but without sufficient consideration for future demand and alternative uses (known as 'future proofing'), and in turn reaching capacity or the end of its useful life earlier than might otherwise occur.

In contrast to infrastructure procurement today, when the Sydney Harbour Bridge was opened in 1932 it had the capacity to allow every car in the state to drive it, simultaneously provided rail and tram access, with the capacity to also accommodate a future Northern Beaches Railway.

In other instances, the 'whole of life' specifications may not refer to capacity of infrastructure, but to the cost of operating, maintaining, and even decommissioning that infrastructure. It is important that such elements are factored into any decision making in regards to the procurement of government infrastructure.

We acknowledge increased future proofing of infrastructure comes at an additional upfront cost. That additional price tag in turn will have its own opportunity cost, in that it cannot be spent on other projects, or may lead to a project being rejected at the initial planning stage.

Nevertheless, coming back later to upgrade existing infrastructure will invariably cost significantly more than if the project had been built to its optimal specification in the first instance.

Ultimately, these competing considerations need to at least be considered by government, if not reconciled. Considering future use of an item of infrastructure, and whether it is worth constructing that infrastructure to a greater specification to save money over the long term is an important decision that must be made.

Recommendation 26

As part of a new NSW Government policy on Best Practice Procurement of Government Infrastructure, recognise the need to consider 'whole of life' costs that ensure appropriate consideration for future demand, later stage expansion, alternative uses, maintenance, operational and decommissioning costs.

Avoiding gold plating

The term 'gold plating' is a negative political and technical assessment that commonly refers to the notion of building infrastructure to a greater specification than is required, often in response to taking whole of life considerations too far and beyond simply achieving a better value outcome through appropriate future proofing.

However, the charge of gold plating our infrastructure is more complicated than its proponents might suggest. Designing a project to a specification that allows for 'future proofing' may in some circumstances be regarded as gold plating an asset, and in other situations as a prudent move to save money and disruption over the whole life of that item of infrastructure.

Innovation and relying on professional expertise are important aspects of this debate. In announcing a project, ministers often talk about innovation being involved in the final design, but the officials responsible for delivering that project are more likely to be concerned with overcoming risk related issues, reflecting a disconnect between the political decision makers and those on the ground in the public service responsible for delivering the project.

This suggests that the whole concept of gold plating may be problematic due to an inability to distinguish the necessary form the unnecessary and to effectively communicate this publicly.

Government agencies should be able to make the determination as to whether the additional value of an innovative solution, or a future proofed project design, is worth the additional cost and is appropriate 'for the project at hand, taking into account the cost of rectification or expansion at a later date. Some consultants however report that their clients ask for the best possible product when releasing their proposed scope, but without the willingness to pay for it. In other words, there is a desire for the highest standard product, but devoting the appropriate resources to achieve that.

The concept of gold plating however may not even go as far as the question of innovation or best practice. Simply doing the job to an appropriate standard may be considered 'gold plating' by some commentators, especially when factoring in the whole of life considerations discussed above.

Recommendation 27

As part of a new NSW Government policy on Best Practice Procurement of Government Infrastructure, set clear parameters on what is considered 'gold plating', how it can be identified and avoided.

Procurement teams

The composition of a procurement team is a critical element in delivering on the expectations set by government policy and within organisations. Teams should have a mix of practical, legal and procurement experience. This ensures that procurement teams have the relevant skill set to cover the various tasks that they'll face.

We acknowledge that this is already does occur amongst many government agencies, but it is still not universal, which it should be.

Recommendation 28

Set up procurement teams throughout the NSW public service with a mix of practical, legal and procurement experience, ensuring they have the relevant skills and competencies to deliver.

Measuring risk

Making decisions around project specifications often relies on understanding the risks associated with the project, and how to overcome those risks. In our experience, there is a strong bias amongst public sector clients towards regarding their project as riskier than it is.

This in turn will require service providers to unnecessarily carry more insurance than is needed (with the additional premiums being passed back to the client through a higher fee), and will also have an impact on project specifications.

The work of the Australasian Procurement and Construction Council (APCC) in particular should be considered in particular in addressing how the public service currently and should approach managing risk.

Recommendation 29

The NSW Government should consider providing training to the public service on appreciating and manage the risk of government infrastructure projects based on guidelines agreed in consultation with industry.

Bid selection: cost v value

The third category of decision making mentioned above is the decision around which bidder to select, and the rationale for doing so. One of the major issues faced here is whether a government agency should prioritise cost or value in selecting the winning bid.

For years, Consult Australia has advocated selecting best value bids, rather than simply the lowest cost.

Selecting just the cheapest bid invariably takes a short term approach to the planning and procurement of government infrastructure, and potentially creates risks where the lower priced bid has saved money by ignoring or being unaware of certain risks or other factors related to the project.

Often, a cheaper bid will end up costing more than a rival bid that was more expensive at the initial stage, as variations are added to the project, which steadily increase its cost.

From a client's perspective, the public service should understand their projects and their associated risks, and have an idea of the amount that an optimal bid will be made at. In turn, they should ask questions of any bid that deviates too far from this amount.

Bids that come in too low will likely have not accounted for some risks, and bids that come in too expensive may have a less efficient solution to managing those risks. While some clients already eliminate the cheapest bids from consideration, measuring bids against an optimal cost will support more informed decision making.

Suggestions as to the process of finding the best value bid are also worth consideration. Consult Australia has long advocated for the use of a 'two envelope' system: separating price and non-price information, evaluating each bid according to their ability to perform the work, before then moving to price considerations for those bids with the ability to perform the required tasks.

Consultants report an undue emphasis on price in tender selection rather than capacity to deliver, their experience, or value for money. Assessment criteria focus too much on requiring detailed information on costings and hours budgeted, rather than a qualitative assessment of deliverables. This is understandable, given that the quality of their output won't always be easy to assess or benchmark, while the level of their fee will be.

Recommendation 30

The NSW Government should implement a 'two envelop' approach to tender consideration, allowing for the expertise and capacity of professional services firms to be considered separately from the tender price and independent price assessment, if undertaken.

Clarity about selection criteria

Service providers in the built environment sector regularly report frustration at the lack of clarity around bid selection criteria. In *Better Buying, Better Outcomes*, our industry reported that clients weren't always open or able to tell them about the framework for selection or the selection criteria, including the relative weighting of each item throughout the tender phase.

On some occasions, they reported that the weightings changed after bids were submitted, which left some firms at a disadvantage.

These issues have the potential to waste the time and resources putting together a bid that didn't address the right issues, and or focused on less important aspects of the client's decisions.

Greater transparency around the selection criteria in the tender process is frequently requested as a means to ensure that firms only bid for work appropriate to them, and that they have proper awareness of what to address in their bids.

Tied in with transparent selection criteria and weightings is the idea that unsuccessful bids should get feedback. We acknowledge that this may create an additional administrative burden for agencies in the short term, but it has the potential to lead to savings over the longer term by improving accountability and probity, and in turn will drive improved decision making.

Recommendation 31

That the NSW Government establish a practice of setting and disclosing selection criteria and weightings for all tenders, with this information centrally collated by Procurement NSW for future data analysis (e.g. by the Data Analytics Centre).

Recommendation 32

Standard practice in New South Wales should be firms involved in unsuccessful bids are provided with feedback when requested.

Non-conforming bids

One particular challenge is how public sector agencies address non-conforming bids (those that do not align with requirements). Too often non-conforming bids are excluded from a tender process automatically, even when their non-conformity raises an important issue(s) the client should address. In particular, some consultants have reported experiencing problems when bids were submitted through portals, which have no flexibility to accept a non-conforming bid.

Where the public sector client asks for the wrong thing in their brief, consultants are challenged as to whether they should second guess what they actually wanted, or respond to the brief with the error factored in.

Clearly a better project outcome will eventuate when a non-conforming bid is considered that addresses the actual issue, but it does raise probity concerns towards other bidders who weren't aware they could do this.

Apart from improving the quality of project briefs, the solution to this issue lies in allowing bidders to challenge the assumptions in a brief where appropriate, and to address the associated probity concerns by adopting a policy making it clear that this is allowed.

While the 2014 *Scope for Improvement* Report identified the automatic rejection of non-conforming bids as a source of rising costs and inefficiency[13], this practice also has the potential to bypass a quality control element of the tender process. Although some guidelines would be required, considering non-conforming bids under certain circumstances could allow for errors in the scope to be identified, or for more innovative solutions to come forward that might save clients money through the procurement process.

[13] Ashurst Australia, *op. cit.*, p43

Recommendation 33

As part of a new NSW Government Policy on Best Practice Procurement of Government Infrastructure, provide guidance on when it is appropriate to consider non-confirming bids and what should occur when issues or problems are found with the tender process or project brief.

11 | UNDERLYING CAUSES

This submission thus far has looked at a range of procurement issues that present opportunities for improvement. However, any such discussion also needs to look at the underlying drivers of less desirable procurement practices.

In our experience, these underlying issues are significant, and without addressing them, any changes to procurement policy will be limited in their ability to achieve positive reform.

Procurement skills

As part of the trend towards government outsourcing over the last few decades, a critical and ongoing shortage of staff with relevant skills in procurement at all levels of government has arisen. Where previously in-house engineers at the Public Works Department may have undertaken the project or done design work internally, now private sector providers are contracted to do that work. A natural consequence is that certain skills which existed within an agency are now less prevalent.

An erosion in the skills base of the public sector means that the standard of procurement and value for money outcomes are reduced while some responsibility for procurement has shifted to the contractors. This is demonstrated in our members' ongoing concerns in relation to:

- Poor quality tender and project scope documentation,
- Poor risk management, and
- Poor quality contractual terms and conditions and undue reliance of external legal advice.

These are evident throughout the New South Wales public service, indicating a possible systemic procurement skills shortage at all levels.

This issue is increasingly of concern to State and Territory Governments, and one that has generally been recognised. It is incumbent upon government to take some responsibility for public sector procurement skills, as a small investment that could yield significant returns over the long term.

The Australasian Procurement and Construction Council (APCC) as part of their guide, *Developing the Government Procurement Professional* acknowledge that:

> *"Until now, procurement professionalism in Australia has not been clearly recognised or defined. Public procurement too often is undertaken without professional support which results in sub-optimal value for money decisions and unnecessary high prices being paid for goods and services."*[14]

Consult Australia believes that a concerted, whole of government focus on procurement skills would benefit those agencies responsible for procuring consulting services. To this end, we have promoted the concept of a *Centre for Procurement Excellence*, tasked with skills training and development for public sector procurement professionals, and sharing best practice between agencies. This would include training for new procurement officers, as well as ongoing training for those already in procurement roles.

The creation of this concept is not without precedent. Already, the United Kingdom Government has created a *Commissioning Academy* that has broadly the same mandate in terms of sharing best practice and improving procurement skills. Given the reluctance of government to create new agencies, a *Centre for Procurement Excellence* could easily sit within an existing agency established to support the development of infrastructure or procurement skills.

While ideally this should be a national body, its function is sufficiently important that New South Wales act alone in the immediate term.

Recommendation 34

The NSW Government should undertake an assessment of insurance, contract and risk literacy within the public service, using this to facilitate appropriate training in conjunction with relevant professional and industry associations.

Recommendation 35

Establish a Centre for Procurement Excellence to support development of infrastructure and procurement skills within the public service.

Public sector culture

The culture in which procurement decisions are made is also a vital driver of less desirable procurement practices. In our experience, the New South Wales public service (as elsewhere) has a tendency to be overwhelmingly conservative in its approach to procurement. While at one level, this is appropriate for those guarding the public's interests, including the appropriate spending of their taxes, it is also an approach that can be problematic when not properly applied. In particular, it is an approach that fails to take up new opportunities to do things better.

There is a common presumption within the public service that because something has 'worked well' in the past, that it will work well in the future. When suggesting procurement reform, one of our main challenges has been overcoming institutional inertia – asking agencies, and key procurement officials within them, to do things differently without an obvious project failure as justification for change.

This approach inherently makes government slow to adapt to new ways of doing things. Clients who only ever procure infrastructure a particular way will be unaware that they've paid too much, as the alternative methods that would achieve a cheaper price have never been attempted. Indeed, project success may occur in spite of poor procurement, provided that project risks do not eventuate.

In the course of the *Better Buying, Better Outcomes* study, a senior public servant offered the observation that, "in the public service, you're rewarded for not stuffing up, rather than for getting it right." In other words, the focus is on not making mistakes and on avoiding liability for any mistakes that are made, rather than achieving the best possible outcomes from a project.

[14] Australian Procurement and Construction Council, *Developing the Government Procurement Profession*, www.apcc.gov.au, 2006, p3

This culture is driven by a series of accountability measures connected with our political system, placing the entire apparatus of government on the defensive. For example, instead of looking for better ways to do things when ministers or their staff involve themselves in procurement issues, it's generally in response to claims of something having not worked, rather than to proactively drive positive change.

Generally, Consult Australia's experience has been that ministers and the leadership of public sector agencies say the right things and are committed to best practice procurement.

The challenge is that individual contract managers are generally the people responsible for managing the procurement practices around a specific project, and are also the people most acutely aware of the ramifications for them if things go wrong. The culture described above is most acutely felt by them, and they have little incentive to try new things. Indeed, through the public sector culture they are actively discouraged from attempting newer and better ways of procuring infrastructure, and are given little in the way of protection to specifically encourage them to do so.

The outcome of this culture is that opportunities for innovation and achieving better outcomes are lost, and approaches to risk and liability are reflexive rather than proactive.

A better approach would re-focus relevant personnel towards achieving successful project outcomes, rather than avoiding mistakes, and providing a level of protection for officials doing things differently than to how they may have been done before. This may be achieved through a whole client agency buying in to procurement outcomes, including its leadership.

Recommendation 36

That care is taken to understanding and address the public sector culture as a key component to implementing existing and future reforms in the procurement of government infrastructure in New South Wales.

Accountability of Agency Heads

The suggestion has been made that procurement performance indicators should be used for agency CEOs and Department Secretaries to overcome the problem that many agency heads say the right things about procurement to industry, but are not backed up by the actions of individual project managers.

This would ultimately serve to improve procurement by offering a significant incentive for agency heads to offer protection or encouragement to individual procurement managers to try new and better ways of doing things.

Recommendation 37

Consider how procurement performance indicators can be incorporated into measuring the leadership of NSW Government departments and agencies.

12 | CONCLUSION

New South Wales currently has an overall positive culture in the procurement of government infrastructure, but there remains a need to address poor risk management practices by prohibiting the contracting out of proportionate liability, the need for greater consistency in contracts, and the to address procurement literacy within the public service are particularly important issues that need to be addressed.

Consult Australia would like to thank the Committee for the opportunity to comment on this important issue.

We would welcome any opportunity to further discuss the issues raised in this submission. To do so, please contact NSW State Manager, Matthew Trigg on [redacted]

13 | BIBLIOGRAPHY

Ashurst Australia with Australian Constructors Association and Infrastructure Partnerships Australia, *Scope for Improvement 2014: Project pressure points – where industry stands*, www.constructors.com.au, 2014

Australasian Procurement and Construction Council and Austroads, *Building and Construction Procurement Guide: Principles and Options*, www.apcc.gov.au, 2014

Australian Procurement and Construction Council, *Developing the Government Procurement Profession*, www.apcc.gov.au, 2006

Australian Procurement and Construction Council, *Professional Indemnity Insurance Guidelines in the Building and Construction Industry*, www.apcc.gov.au

Blake Dawson Waldon with Australian Constructors Association, *Scope for Improvement: A Survey of pressure points in Australian construction and infrastructure projects*, www.constructors.com.au, 2006

Blake Dawson with Australian Constructors Association and Infrastructure Partnerships Australia, *Scope for Improvement 2008: A report on scoping projects in Australian construction and infrastructure projects*, www.constructors.com.au, 2008

Blake Dawson with Australian Constructors Association, Infrastructure Partnerships Australia and Energy Supply Association of Australia, *Scope for Improvement 2011: Project Risk – Getting the right balance and outcomes*, www.constructors.com.au, 2011

Consult Australia, *Australian Contract Law: Response to Discussion Paper*, www.consultaustralia.com.au, 2012

Consult Australia, *Better Buying, Better Outcomes*, www.consultaustralia.com.au, 2015

Consult Australia, *More for Less: The Benefits of Better Procurement – Summary*, www.consultaustralia.com.au, 2015

Consult Australia, *Proportionate Liability: Response to the SCLJ Model Provisions*, www.consultaustralia.com.au, 2014

Consult Australia, *QLD Government Procurement Review: Response to issues Paper*, www.consultaustralia.com.au, November 2012

Cooperative Research Centre for Construction Innovation, *Guide to Leading Practice for Dispute Avoidance and Resolution*, www.construction-innovation.info, 2009

Deloitte Access Economics, *Economic benefits of better procurement practices*, www.consultaustralia.com.au, 2015

Department of Treasury and Finance (Victoria), *Market-led Proposals Guideline*, www.dtf.vic.gov.au, November 2015

Em Prof Davis, J L R, *Proportionate Liability: Proposals to Achieve National Uniformity*, Australian National University, 2008.

Engineers Australia Queensland Division and Queensland Construction Industry Forum, *Getting It Right – The First Time*, www.qcif.com.au, 2005

Horan, T., *Memorandum of Advice: Uncapped liability for consultants under Guidelines for the Limitation of Liability of Suppliers, Consultants and Contractors*, 2013

Horan, T., *Proportionate Liability: Towards National Consistency*, DLA Phillips Fox, September 2007

Productivity Commission, *Public Infrastructure, Inquiry Report No. 71*, Canberra, 2014

APPENDICIES

Deloitte Access Economics, *Economic benefits of better procurement practices*, www.consultaustralia.com.au, 2015

Consult Australia, *Better Buying, Better Outcomes*, www.consultaustralia.com.au, 2015

Consult Australia, *Proportionate Liability: Response to the SCLJ Model Provisions*, www.consultaustralia.com.au, 2014

Deloitte Access Economics

Economic benefits of better procurement practices

Consult Australia

2015

Deloitte.

Contents

Charts

Tables

Figures

Acronyms

ABS	Australian Bureau of Statistics
ACIF	Australian Construction Industry Forum
ACT	Australian Capital Territory
AGS	Australian Government Solicitor
APCC	Australasian Procurement and Construction Council
APRA	Australian Prudential Regulation Authority
BMW	Building Management and Works
CGE	Computable General Equilibrium
D&C	Design & Construct
DAE-RGEM	Deloitte Access Economics Regional General Equilibrium Model
DPTI	Department of Planning, Transport and Infrastructure
EOI	Expression of Interest
FTE	Full Time Equivalent
GDP	Gross Domestic Product
GSP	Gross State Product
ICT	Information and Communications Technology
NPV	Net Present Value
NSW	New South Wales
NT	Northern Territory
PC	Productivity Commission
PPP	Public Private Partnership
QLD	Queensland
RFP	Request For Proposal
SA	South Australia
SCLJ	Standing Council on Law and Justice
TAS	Tasmania
VGPB	Victorian Government Purchasing Board
VIC	Victoria
WA	Western Australia

Executive Summary

Key Findings:

- Investments in public infrastructure account for a significant amount of economic activity in Australia, around $43 billion a year. A rising share (now 53% for engineering construction) is procured from the private sector, with almost 20% of this activity contributed by professional services, such as architects, engineers and surveyors. The value of professional services work for public infrastructure projects is estimated to be around $4.4 billion per year.
- However, some elements of current government procurement policy and practice are inefficient, adding unnecessarily to the cost of infrastructure. This includes cases where government clients have unclear project objectives, select inappropriate project delivery models, fail to guarantee the accuracy of information in project briefs and manage risk inefficiently through contract clauses, such as by contracting out of proportionate liability.
- In the bidding phase, firms respond to these practices in a number of ways. It is estimated that the total price impact of poor procurement practices is around 5.4% of total revenue obtained by professional services firms in public infrastructure projects. This comprises of direct price increases of 3.6%; indirect price increases of 1.5% from reduced competition; and inefficient costs of bidding worth 0.3% of project prices. Firms also report that with improvements in procurement, they could reduce delays to projects and improve project quality by 7%, respectively.
- The total price impacts borne by government as a result of poor procurement practices are estimated at around $239 million per annum. In addition, it is estimated that better procurement can lower the costs of rectifying design errors in construction, an annual saving of around $87 million.
- Assuming a five year phase in period, the net present value of these potential cost savings for government are estimated at $2.5 billion over the period to 2030. Using economy-wide Computable General Equilibrium (CGE) modelling, we find that better procurement can deliver around $5.1 billion in additional GDP between 2015 and 2030.
- Following consultation with government on the extent and causes of these issues, this report identifies seven next steps to shift the direction of procurement. This includes establishing procurement teams with a mix of skills, reallocating resources to better focus on project objectives, removing contract clauses that do not stack up, and developing and applying limited liability guidelines. While verification of brief information and streamlining compliance processes will remove inefficient bid costs, governments should also evaluate and adapt procurement frameworks to encourage innovation.

Introduction

Investments in public infrastructure account for a significant amount of economic activity in Australia, around $43 billion a year. A rising share (now 53%) is procured from the private sector.

While much of this activity is traditional construction work, professional services now contribute almost 20% to the overall value of projects. This includes the involvement of architects, engineers, designers, surveyors, project managers, lawyers and technology specialists from the private sector. These firms have the expertise and capacity to innovate to ensure that high value outcomes are achieved from public infrastructure investments.

However, there are some elements of current government procurement policy and practice that are inefficient, adding unnecessarily to the cost of infrastructure. This includes cases where government clients have unclear project objectives, select inappropriate project delivery models, fail to guarantee the accuracy of information in project briefs and use contract clauses to transfer responsibility for risks that firms are not best placed to manage.

In the bidding phase, businesses respond to these practices in a number of ways, by charging additional price premiums, recouping bid costs, accepting uninsurable risks and reducing competition. This has significant economic impacts over the longer term, constraining economic activity through a higher cost of infrastructure.

To better highlight the magnitude of these implications, Consult Australia commissioned Deloitte Access Economics to quantify the economic impacts of poor procurement practices, as it relates to professional services employed for public sector built environment projects. Here, the built environment includes all residential, commercial and public property, and supporting critical infrastructure such as utilities and transport facilities.

The key findings of this report are summarised in turn below.

Unclear project objectives

In any public infrastructure project, clarity around project objectives is critical to ensure that it is carried out in a way that cost-effectively achieves those goals. However, primary data collected from Consult Australia members indicates that unclear project objectives are encountered by firms for 37% of public sector RFPs.

Businesses frequently respond to the scope risk caused by unclear objectives by increasing prices or deciding not to bid. In particular, we estimate that unclear project objectives lead to higher prices, due to both direct premiums charged by firms and reduced competition, in 12% and 9% of government tenders respectively. These direct price premiums are estimated to be in the order of 25% of project value, leading to a 2.9% increase in project prices overall.

Unclear project objectives are the **largest driver of direct price premiums** identified in this study.

Contracting out of proportionate liability and other contract clauses

Contracts with the private sector are an important tool for government to manage the risks involved in public infrastructure projects. However, in order to achieve efficient management of risk at lowest cost, consistent with best practice, contract clauses must ensure that risks are borne by the party to the contract that is best placed to manage them. As noted by Infrastructure Australia, this may involve various risks being retained by government, transferred to the private sector, or shared by the parties (2008:29).

This report has considered the extent to which contracting is used by government to shift risk onto the private sector in procurement for built environment projects in circumstances where this risk allocation may not optimal, focusing on the clauses presented in Table i.

Table i: Common contract clauses

Clause	Description
Unlimited liability (52% of RFPs)	Unlimited liability clauses ensure that the liability of professional services firms to the public sector client is not capped. As 'unlimited' professional indemnity insurance is not provided in any insurance policies taken out by firms, the private sector is unable to fully insure against risks under contracts with unlimited liability clauses.
Specific insurance requirements (51% of RFPs)	Specific insurance requirements may include liability cap specifications that are higher than the optimal level necessary for a project, explicit naming of public sector clients in professional indemnity insurance (which is not technically feasible) and reductions in excess thresholds, among other terms.
Fitness for purpose (41% of RFPs)	This clause requires professional services firms to guarantee that the services provided achieve the intended result, and assume liability irrespective of negligence or fault. Liabilities assumed under a fitness for purpose clause are uninsured under standard professional indemnity policies.
Termination for convenience (36% of RFPs)	This clause allows public sector clients to terminate the contract for professional services at any time, for any reason. It will sometimes be accompanied by subclauses that reduce its risks for suppliers. Nevertheless these clauses can create labour cost risks for suppliers.
Expert standard of care (27% of RFPs)	Expert standard of care clauses increase the liability of professional services firms beyond that required by common law and under statute – greater than care, skill and diligence as would be accepted by peer professional opinion as competent practice. These liabilities are also generally uninsurable under standard professional indemnity policies.
Significant liquidated liabilities or abatement regimes (27% of RFPs)	These clauses impose penalties on professional services firms at the occurrence of particular events, such as delays, without the need for consideration of the causes of the event.
Contracting out of proportionate liability (26% of RFPs)	This clause waives state level proportionate liability legislation, such that firms can be held liable for 100% of the damages from negligence claims made by public sector clients, even if they were responsible for as little as 1% of the loss.
Novation provisions (26% of RFPs)	This clause allows for substitution of one party for another party without changing the rights and obligations under the original contract. In the context of this report, novation provisions allow public sector clients to designate a third party with which professional services firms must deal with under the terms of the existing contract. Sometimes there are subclauses that reduce its risks for suppliers.

Source: Business liaisons; AGS (2009); Consult Australia (2012); Planned Cover (2013)

The incidence of these clauses ranges from ¼ to ½ of RFPs. As shown in Chart i, we estimate that these clauses lead to higher priced proposals, reductions in competition and the implicit transfer of risks back to the government when firms proceed without adequate insurance. For example, while the impact of greater liability from 'contracting out' is absorbed by firms in around 20% of RFPs, the clause does trigger a reduction in competition (2.3% of RFPs) and generate higher project prices through risk premiums (1.6% of RFPs).

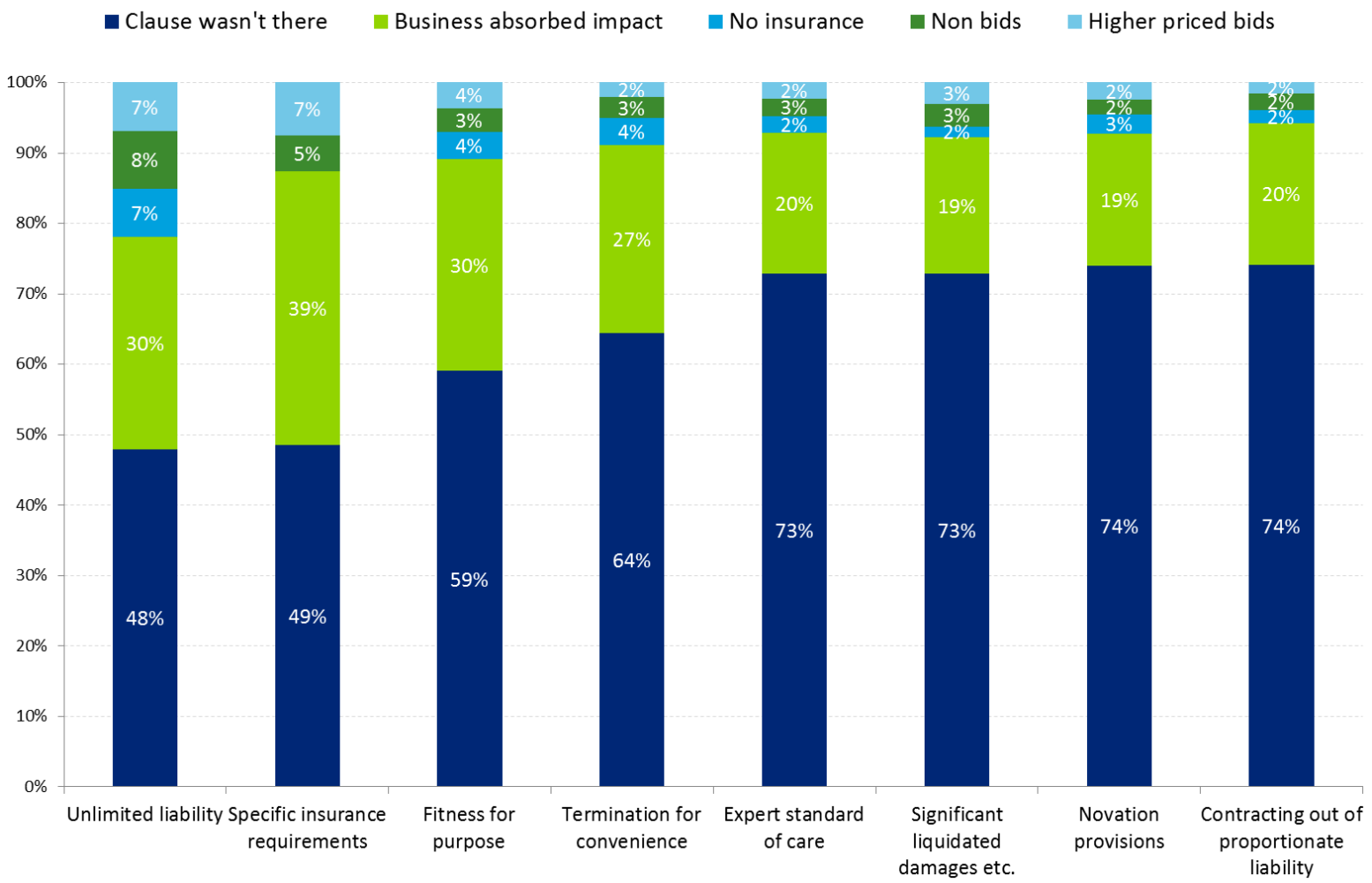
The premiums charged in response to these clauses also vary. For example, contracting out of proportionate liability and unlimited liability can increase project prices by around 0.1% and 0.2% respectively, when considering the additional premiums charged by insurers for extra cover.

It is important to acknowledge that while these estimates of the current insurance costs of such clauses are relatively small, they do not represent the full long term cost of these clauses for the public infrastructure market. For example, the price impact of contracting out of proportionate liability is likely to be higher during hard insurance markets that are characterised by low supply and higher premiums, compared to soft insurance markets, where premiums are lower as a result of high supply.

Further, the relatively immature market for providing insurance cover for 'contracting out' means that there is insufficient claims data at present to take into account the full impacts of shifting away from the proportionate liability regime. There are likely to be flow on effects of further price premiums and less competition in the future if governments fail to shift to an efficient risk management approach.

This report also finds that **delivery models play a role in contracting problems.** Between 3% and 19% of respondents reported the delivery model as a significant factor in the inclusion of the contract terms noted above. We estimate that the choice of delivery model accounts for around 22% of the price increases in public sector built environment projects caused by risk allocation and other contract terms.

Chart i: Business responses to onerous contract clauses



Skills of procurement managers

This report finds opportunities for improvement in the skills of public sector procurement managers – over one third of firms identified skills issues in traditional procurement models, and almost two thirds of firms in relation to privately financed procurement models.

Incentives for innovation

This report finds that around 45% of professional services firms find public sector clients to be non-responsive to innovative suggestions during tender processes. Practices for early market sounding process, during the bidding process, or unsolicited proposals exist but could be more widespread both in being offered and being used.

Bid costs and unverified brief information

An analysis of the primary data collected for this study suggests that **bid costs** for professional services firms involved in public sector built environment projects range between 0.6% and 2.9% of total project value. This is consistent with previous studies.

However, it is estimated that firms are required to undertake additional work in around 34% of tenders to confirm the accuracy of information provided by the public sector in briefs – such as geotechnical information, environmental impacts and financial data. The average costs of this additional work were reported at around $41,800 per firm per proposal.

Given that this work would ideally be undertaken once, by the public sector, inefficient costs per proposal are estimated at around 0.8% of total project value, using the average lifetime project value reported by firms.

Economic impacts

Overall, it is estimated that the total price impact of poor procurement practices is around 5.4% of total revenue obtained by professional services firms in public sector built environment projects. This comprises of:

- direct price increases of 3.6%;
- indirect price increases of 1.5% from reduced competition; and
- inefficient costs of bidding worth 0.3% of project prices.

This can be considered as a breakdown of the potential 6% reduction in project costs that firms report they can achieve through better procurement practices.

In addition, there are the improvements in quality and reduction in delays that firms will be able to achieve if these issues are addressed.

Potential cost savings from transforming procurement

Assuming that changes to procurement practices could be phased in over a five year period, the associated cost savings are presented in Table ii.

Table ii: Potential cost savings from transforming procurement practices ($m, real $2014), 2015 – 2019

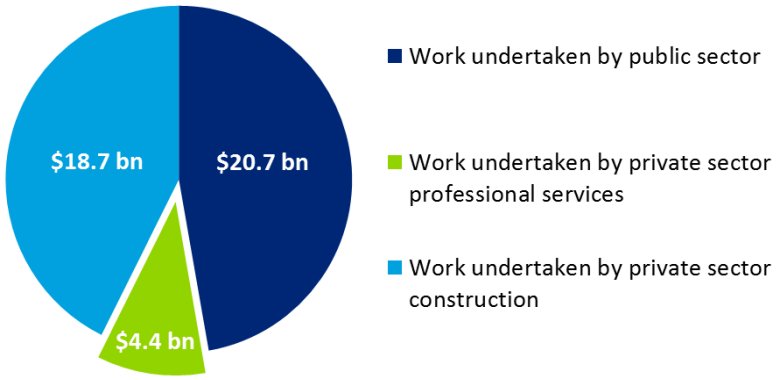
Input type	2015	2016	2017	2018	2019
Cost savings from reduced price impacts in professional service contracts	48	96	143	191	239
Cost savings from reduced design error costs in construction	17	35	52	70	87
Total cost savings	**65**	**131**	**196**	**261**	**326**

Source: Deloitte Access Economics

These cost estimates are based on the value of building and engineering construction work done for the public sector in 2013, of around $43 billion (ABS, 2014a & 2014b). In terms of engineering construction, around 53% of this work was undertaken by the private sector (ABS, 2014b). Assuming that a similar rate of procurement from the private sector could be applied to the total level of public sector building work, we estimate that around $23 billion of work was procured from the private sector for public built environment projects in 2013.

The value of professional services revenue from these projects is thus estimated at around $4.4 billion, based on the average contribution of 19% reported by firms in this study, and updating to 2014 prices using the Consumer Price Index. This implies that the revenue attributable to construction of public infrastructure was around $18.7 billion. This breakdown is illustrated in Chart ii.

Chart ii: Assumed breakdown of the value of building and construction work done for the public sector in 2013 ($bn, real $2014)



Source: ABS (2014a); ABS (2014b); data reported by Consult Australia members; Deloitte Access Economics assumptions

Accordingly, the total price impacts associated with poor procurement practices can be valued at around $239 million per annum. This comprises of around $161 million in direct price premiums, $67 million as a result of lower competition, and inefficient bid costs of $11 million.

In addition, the quality improvements associated with better procurement of professional services have the potential to reduce the costs incurred during construction to rectify design errors.

Assuming that the average direct design error costs in Australian construction and engineering projects of 6.85% (Lopez and Love, 2012) can be reduced by 7%, more efficient procurement can also deliver reductions in the cost of constructing public infrastructure by 0.47%. This cost saving is estimated at around $87 million per annum, in 2014 prices.

The dividend of transforming procurement practices is significant

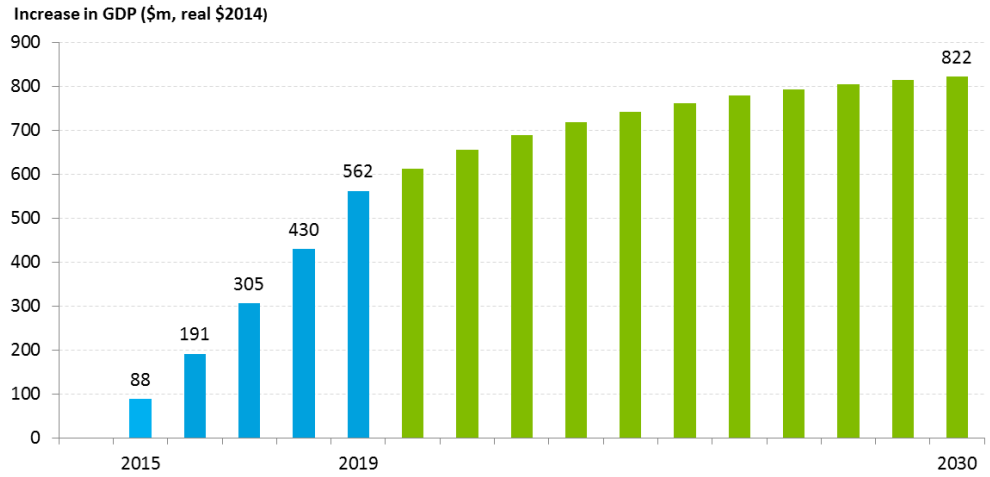
To understand the broader impacts of procurement practices on our businesses and economy, we use economy-wide Computable General Equilibrium (CGE) modelling to understand the impacts on GDP and employment. What we find is that while the dividend of transforming procurement practices is modest in annual terms, the benefits accumulate significantly over the long term, worth:

- around $2.5 billion in cost savings for government between 2015 and 2030; and
- around $5.1 billion in additional GDP between 2015 and 2030.

The profile of these GDP impacts is illustrated in Chart iii.

It is evident that the majority of the increases are achieved over the five year phase-in period, with smaller annual increases in additional GDP experienced out to 2030 due to continued benefits of the higher return on capital.

Chart iii: Impact of the potential cost savings on GDP ($m, real $2014), 2015 – 2030



Source: Deloitte Access Economics

A state-by-state breakdown of these additional GDP benefits is presented in Table iii.

Table iii: State breakdown of GDP impacts ($m, real $2014), 2015 – 2030

Increase in GSP ($m, real $2014)	NPV	2015	2019	2030
ACT	240	4	26	38
NSW	1,386	24	152	222
NT	100	2	11	16
QLD	1,379	24	151	221
SA	333	6	36	53
TAS	113	2	12	18
VIC	1,015	17	111	162
WA	565	10	62	90
Total Australia	**5,133**	**88**	**562**	**822**

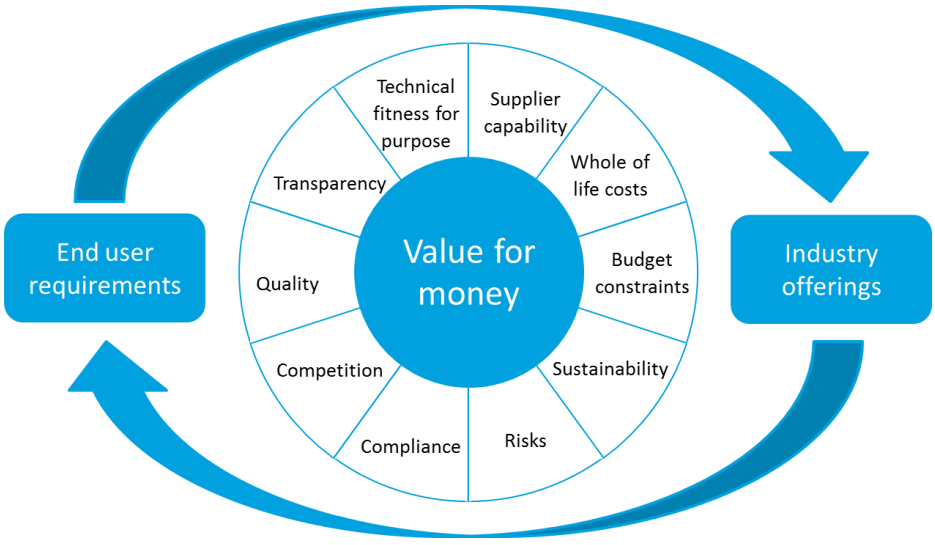
Source: Deloitte Access Economics

Overview of procurement policy and practice

Achieving these economic benefits requires consideration of government perspectives on the extent and causes of the issues raised by industry, taking into account the variations in procurement policy and practice across jurisdictions and departments.

The core objective of procurement policies across the Australian public sector is to achieve value for money. However, as shown in Figure i, the process of determining the optimal value for money solution through procurement is a careful balancing act. Rather than simply pursuing the lowest cost offering, government agencies must consider a range of factors in order to select the industry offering that best meets end user requirements. Managing this complex decision process efficiently requires a significant level of expertise.

Figure i: Factors to be considered in procuring value for money services



In addition, each jurisdiction of Australia has its own procurement policy and processes.

While there are similar policy structures across the states and territories, such as designation of responsibility for building and construction procurement policy to a specific agency and some centralisation of procurement management, there are differences in mechanics and implementation, such as agency culture and the existence of industry arrangements such as panels and prequalification schemes.

Government perspectives on areas for improvement

To provide further insight on the extent and underlying causes of the issues raised by industry, Deloitte Access Economics consulted with four government representatives holding different procurement-related positions within New South Wales, South Australia, Victoria and Western Australia.

While government representatives consider that the procurement arrangements in Australia are broadly effective in achieving value for money outcomes, it is acknowledged that improvements can be made.

Some of the drivers of unclear project objectives that were identified by government include difficulty of planning prior to cabinet approval, distinctions between end users and stakeholders for different infrastructure types and cultural differences between agencies in their approach to industry engagement.

In relation to contracting, government has expressed a willingness to pay for the transfer of risk to the private sector. However, it was acknowledged that government is uninformed about the costs incurred, particularly as they are often hidden by the competitive market. Inclusion of contract clauses is driven by legal advice, rather than economic assessments, and it was considered that the practical benefits of a standard approach offset the benefits of flexibility. However, this may not appropriately take into account the implications of shifting risks to the private sector which they may not be best placed to manage.

Next steps

This report highlights seven next steps to increase procurement efficiency, as summarised in the box below. While it will take time to implement these changes, this report demonstrates that the efforts should result in economic benefits. Above this, we note that achieving meaningful changes in a complex area such as procurement policy is unlikely to be delivered by any single action. It is a strategically significant area of government activity that needs more holistic consideration and cultural change to support that.

(1) Set up procurement teams with practical, legal, insurance and procurement experience: given the mixture of expertise required to undertake a successful procurement, governments should consider restructuring procurement teams to encourage the key players to work collaboratively. Together, legal experts that understand contracting, insurance specialists, practitioners with project experience and procurement experts can evaluate value for money and appropriately tailor procurement processes, contracts and delivery models to the objectives of a project.

(2) Reallocate procurement resources towards specification of project objectives: procurement policy should place a stronger focus on identifying the needs of public infrastructure end users, re-testing business case objectives in the procurement environment and taking advantage of opportunities to engage with industry in project scoping where appropriate. Without agreeing and documenting project objectives clearly, time spent on contracting will be less effective.

(3) Remove contract clauses that do not stack up: while this report has highlighted the costs of contracting out of proportionate liability and imposing expert standard of care on industry, these need to be evaluated with reference to the benefits of management of risk by industry, through a cost-benefit analysis. Where terms fail to meet a cost-benefit analysis, they should be removed from contracts unless justified by the specific circumstances of a particular project. This requires government to identify whether it intends to use clauses to cover their losses, or to actively mitigate risks.

(4) Develop and apply limited liability guidelines: while Professional Standards Schemes are one mechanism to achieve limitation of liability, these are challenging to implement and not viable for all professions. To enable a broader approach for efficient risk management, governments should develop and apply limited liability guidelines to assist agencies with ensuring that liability clauses do not add unnecessarily to project costs. Such guidelines should simplify the process of setting liability caps, while taking into account variations in market practice, project size, risk and the size of the supplier.

(5) Verification of brief information: it is more efficient for government to undertake the necessary work to verify the accuracy of information provided in a request for tender, rather than transferring the costs of that work to all bidders, creating duplication. Purchasing agencies should actively seek to minimise this burden.

(6) Streamline compliance processes: governments can also reduce bid costs for public infrastructure projects to more efficient levels by streamlining compliance requirements, particularly where the information provided by firms is rarely a differentiating feature of the successful tenderer. Options include development of standard form agreements for firms, or submission of compliance documentation as part of pre-qualification schemes.

(7) Evaluate and adapt procurement frameworks to encourage innovation: continuing to evaluate and adapt procurement frameworks with reference to changes in market offerings will help to maximise innovation in public infrastructure projects. Going forward, the public sector should be open to new delivery models, early market sounding options and continue to provide opportunities for unsolicited proposals.

1 Introduction

Professional services firms make a significant contribution to the development of public infrastructure in Australia. When procuring major projects, such as roads, bridges, public transport or water facilities, government departments and agencies frequently engage the services of architects, engineers, designers, surveyors, project managers, lawyers and technology specialists from the private sector. These firms have the expertise and capacity to innovate to ensure that high value outcomes are achieved from public infrastructure investments.

However, there are some elements of current government procurement policy and practice that are inefficient, adding unnecessarily to the cost of infrastructure. This includes cases where government clients have unclear project objectives, select inappropriate project delivery models, fail to guarantee the accuracy of information in project briefs and pass on uncontrollable risks through contract clauses.

In the bidding phase, businesses respond to these practices in a number of ways, by charging additional price premiums, recouping bid costs, accepting uninsurable risks and reducing competition. This has economic impacts in the form of higher prices, project delays and lower quality infrastructure, which in turn, flow through to the supply side of the broader economy, constraining employment and GDP through a lower rate of return on capital.

There are also longer term impacts of procurement decisions for public infrastructure. The costs of businesses choosing to absorb the costs of poor procurement can add up, impacting the longer term viability of the industry with unnecessary reduction in competition. Government procurement policies recognise the importance of fostering competition over the long term, while also seeking to achieve value for money on a project-by-project basis.

These issues are well documented in a number of previous reports and analyses. To better highlight the magnitude of these implications, Consult Australia commissioned Deloitte Access Economics to quantify and model the economic benefits of better procurement practices, as it relates to professional services employed for public sector built environment projects.

1.1 Outline of this report

This report approaches the task of quantifying the economic benefits of better procurement practices in four stages.

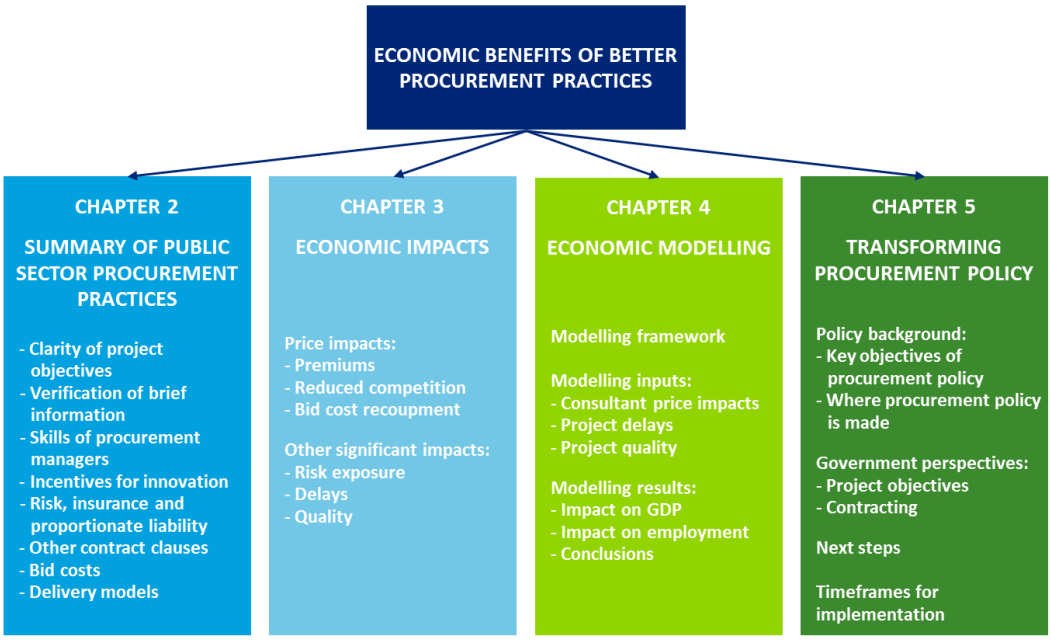
First, it considers the evidence for eight different aspects of poor procurement policy. It then produces estimates of the net costs to society of these practices, based on an analysis of business responses. Computable General Equilibrium (CGE) modelling is then used to estimate the economic outcomes that would be achieved if these supply-side costs were reduced over time.

The report concludes by considering government perspectives on these issues and identifies practical next steps to reduce the cost of infrastructure and increase productivity.

The structure of the report is as follows:

- **Chapter 2** summarises the evidence of poor procurement practices in public sector built environment projects, as they are encountered by professional services firms. This section covers eight aspects of procurement, highlighting opportunities for improvement – clarity around project objectives, verification of brief information, skills of procurement managers, incentives for innovation, risk allocation, use of contract terms, bid costs and choice of delivery model.
- **Chapter 3** analyses the economic costs that result from these poor practices. This encompasses price impacts, which manifest through premiums, recoupment of bid costs and reduced competition. Other impacts, such as public exposure to risk, project delays and lower quality deliverables are also considered.
- **Chapter 4** investigates how the potential cost savings from changes in procurement can impact on macroeconomic outcomes, such as employment and GDP. To model these broader economic impacts we have used our in-house Deloitte Access Economics Regional General Equilibrium Model (DAE-RGEM), a Computable General Equilibrium (CGE) model that represents the dynamic relationship between economy agents.
- **Chapter 5** outlines practical next steps to transform procurement practices and deliver benefits for the economy as a whole. These are informed by a review of the key objectives of procurement, the variations in policy and practice across jurisdictions, and recognition of public sector perspectives on the extent and causes of the issues raised by industry.

Figure 1.1: Report structure



1.2 Approach

To develop the evidence base for this report, the following five stage approach was undertaken:

- **Literature review –** to identify the key issues in public sector procurement, a literature review was undertaken with a primary focus on previous studies in the Australian context. The challenges within public sector procurement are well documented, with work undertaken from the perspective of academics, consultants, other businesses and government. At the same time, some gaps in the research were identified, particularly in that there has not been a single systematic review of the costs of various poor procurement practices in Australia. This evidence base in this report seeks to address this.
- **Workshop with industry leaders** – in May 2014, eight senior industry leaders, representing some of Consult Australia's member firms (with total employment of 32,683 full time equivalent workers), participated in a workshop at Deloitte's Sydney office. The workshop discussion centred on the key issues faced by firms in public sector procurement, and the nature of their responses. This was a valuable exercise as it gave firms an opportunity to challenge each other's assumptions regarding the nature of the issues, business responses and costs.
- **Business liaison –** both prior to and following the workshop, a number of business liaisons were undertaken to ascertain more detailed evidence from member firms and stakeholders in the insurance sector. These one-on-one interviews helped to clarify important nuances and understand the deeper causes of problems and business behaviours.
- **Primary data gathering –** two surveys were developed to collect primary evidence from Consult Australia's member firms. This included a survey of state branch managers of large firms, and a national level survey for small and medium sized businesses. The surveys were fielded from 18 June – 25 June 2014. In total, 55 responses were received.
- **Government consultation –** in order to better understand the extent of the issues raised by industry and the different arrangements used across Australia, Deloitte Access Economics consulted with four government representatives holding different procurement-related positions within New South Wales, South Australia, Victoria and Western Australia. These discussions highlighted some of the best practice features of public sector procurement and identified win-win opportunities to realise mutual gains for government, business and the broader community.

Figure 1.2: Developing the evidence base

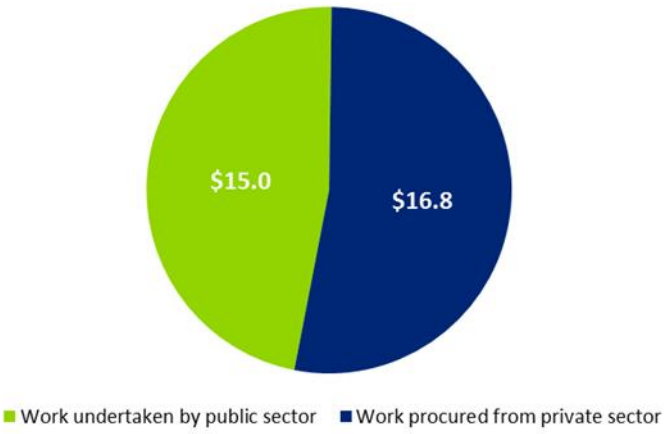
1.3 Procurement for public sector infrastructure

While some of the procurement practices discussed in this paper may also be of relevance in other areas, the scope of this report is limited to the procurement of professional services for public sector built environment projects.

The built environment encompasses all man-made physical structures that accommodate the needs of society. This includes residential, commercial and public property, and supporting critical infrastructure such as utilities and transport facilities. In 2013, the public sector building and construction work done was valued at $43 billion, 75% of which related to engineering construction. This captures physical infrastructure projects, as opposed to residential and non-residential building activity (ABS, 2014).

Focusing on public sector engineering construction, $16.8 billion worth of work was procured from the private sector in 2013, 53% of total activity (Chart 1.1).

Chart 1.1: Breakdown of public sector engineering construction work (2013, $bn)

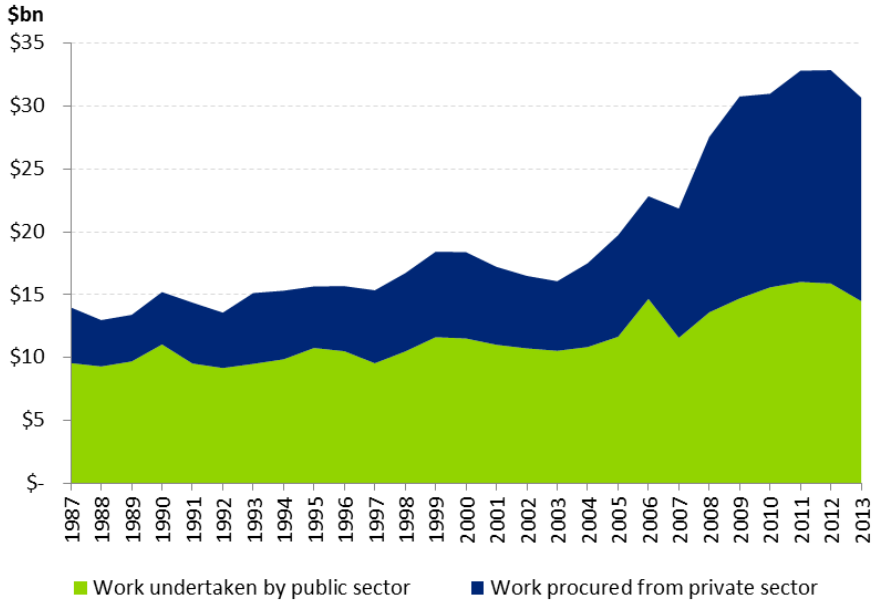


Source: ABS (2014) Cat. 8762.0 Engineering Construction Activity

Note: this data presents a lower bound estimate of the value of work procured by the public sector, as some Public Private Partnerships (PPPs) are classified as work for the private sector, even though the government may be the ultimate owner of the asset in the long term.

Furthermore, government procurement of private sector services for infrastructure projects has grown over time. As illustrated in Chart 1.2, share of activity procured from the private sector has also grown, from 32% in 1987 to 53% in 2013.

Chart 1.2: Value of engineering construction work done for public sector (1987 – 2013, $bn – chain volume measures)



Source: ABS (2014) - Cat. 8762.0 Engineering Construction Activity

Note: Values presented are measured in chain volume measures. This means that the changes from year to year reflect volume changes only, not changes in price.

Overall, the implications of this transition are that government will naturally seek to pass on more issues of uncertainty to the private sector. It is recognised that some level of transfer of risk from the public to the private sector will be optimal, to the extent that risks are borne by the party that is best able to manage them. Accordingly, this report seeks to quantify the net costs incurred by the taxpayer, as a result of poor procurement practices, rather than costs transferred.

Assuming that the private sector share of residential and non-residential building activity done is around 53%, the same for engineering construction, we estimate that the total pool of private sector building and construction work undertaken in 2013 for the public sector was around $23 billion in 2014 prices.

Professional services firms reported that, on average, the services they provide for public sector built environment projects accounts for 19% of total project value. This implies that professional services earned around $4.4 billion in revenue from public building and construction projects.

When interpreting this data, it should be acknowledged that the contracting arrangements for infrastructure projects can be particularly complex compared to other areas of government procurement. The box on the following page provides some background information in this regard.

Contracting in the built environment sector – it's complicated

Given the significant, long term investments associated with public infrastructure development, procurement of professional services from the private sector is just one component of a range of intertwined contractual arrangements between multiple parties.

The nature of these relationships will depend on the delivery model selected for the project. While these are discussed in more detail later in this report, this can range from direct engagement of professional service firms by the government, to indirect engagement through a government appointed developer that is also responsible for the construction, subsequent to the design phase. Alternatively, government, professional services firms, constructors and operators of infrastructure may form an alliance structure or partnership.

The contractual arrangements to which professional services firms are committed will therefore vary on a project-by-project basis. Accordingly, the full contribution of professional services firms towards public infrastructure projects may not be fully captured in the data presented in Chart 1.1.

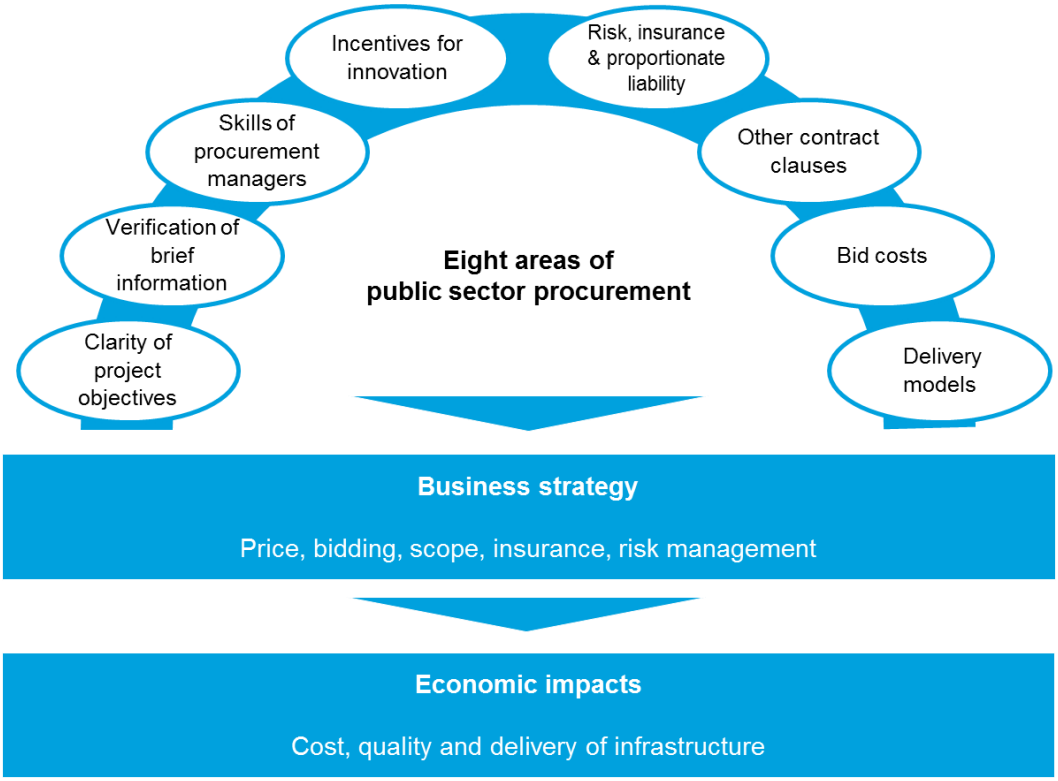
Nevertheless, the remaining 80% of work procured from the private sector highlights the broader flow on effects of inefficient procurement practices on the economy. Government make large investments into public infrastructure because they deliver essential services to society over the long term. When appropriately targeted, public infrastructure can drive improvements in economic welfare through increased productivity, greater competition and better quality of life for individuals (Productivity Commission 2014:50). Globally, it is estimated that strategic infrastructure projects have the potential to deliver economic returns of between 5% and 25% (World Economic Forum 2012:2).

Accordingly, a focus on achieving value for money from work procured from the private sector is a key objective. This takes into account issues of risk management during project delivery, but also requires consideration of incentives for innovation.

2 Summary of public sector procurement practices

This report summarises public sector procurement practices into eight key areas, as illustrated in Figure 2.1 below.

Figure 2.1: Eight areas of public sector procurement



Where issues arise within a particular area, the behavioural changes undertaken by firms in response can have negative economic impacts. While this typology of procurement into eight areas is useful to assess the issues in isolation, it is also the case that where poor practices occur in more than one area, there is a cumulative impact of dragging resources into public sector procurement, and away from other parts of the economy.

This chapter provides evidence on these opportunities for improvement, as they relate to public sector procurement of professional services for built environment projects.

2.1 Clarity of project objectives

Key Points:

- Unclear project objectives are encountered by firms for 37% of RFPs.
- This has led to higher prices in around 12% of projects due to direct premiums charged by firms in response.
- Unclear project objectives also lead to reduced competition in around 9% of public sector infrastructure projects.

In any public infrastructure project, clarity around project objectives is critical to ensure that it is carried out in a way that cost-effectively achieves those goals. As the purchaser of professional services, responsibility for clearly defining the purpose of a project lies with government departments and agencies during the initial planning and specification stage (Royal Academy of Engineering, 2014:5). It is difficult to conceive how a public infrastructure project can be successful when the aims of the project are not identified by government and consistently conveyed to the private sector from the outset.

Nevertheless, professional services firms claim to have frequently encountered requests for proposal (RFPs) from public sector clients with unclear project objectives over the last 12 months. This encompasses tenders which have insufficient detail on both the requirements and need for the project.

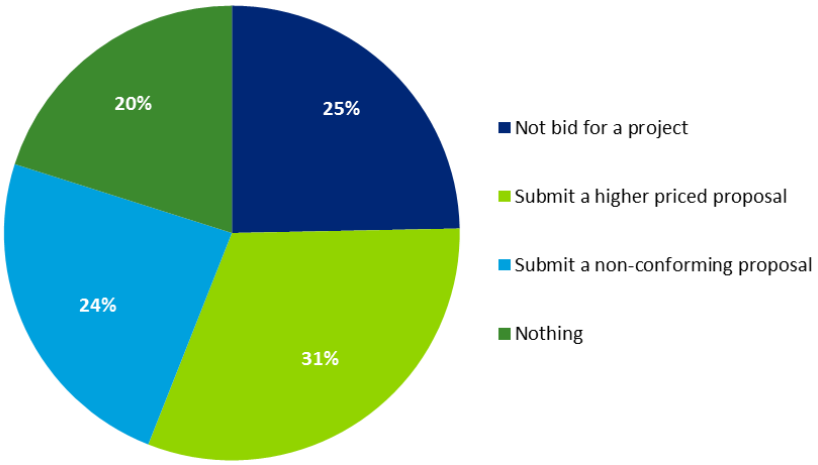
Specifically, primary data collected from Consult Australia members indicates that unclear project objectives are encountered by firms for 37% of RFPs.

This finding is similar to the evidence from a 2008 survey by Blake Dawson, where 32% of respondents identified inadequate definition of project objectives as a main cause of poor scoping in Australian construction and infrastructure projects.

Firms can respond to unclear project objectives in a variety of ways, including increasing bid prices to cover project risks, deciding not to bid and reducing competitive tension, or submitting proposals that do not conform to the specifications of the project brief.

Around a fifth of firms (20%) do not take any specific action. However, as shown in Chart 2.1, a common business response (31%) is to increase the price of the bid. Furthermore, firms have also responded by withdrawing from the bidding process (25%) or submitting a non-conforming bid (24%).

Chart 2.1: Business responses to unclear project objectives



Based on these results, we estimate that 12% of government tenders for professional services in the built environment sector have higher prices due to direct premiums charged by firms, as a result of unclear project objectives.

In addition, unclear project objectives lead to reduced competition in 9% of public sector RFPs. This is a significant issue. For instance, the data collected indicates that on average, firms choose not to pursue 17% of their opportunities to bid for public sector projects. While this reflects a number of business reasons, it is evident that unclear project objectives are a contributing factor to over half of firm's decisions not to bid.

2.2 Verification of brief information

Key Points:

- Firms are required to undertake additional work to verify the accuracy of information in around 34% public sector tenders.
- The costs of this additional work are estimated at around $41,800 per firm per bid.

Another issue identified by professional services firms in public sector procurement for built environment projects is potential unwillingness of government clients to verify the accuracy of information provided in the project brief. Examples include geotechnical information, environment information or financial information. This places a burden on prospective bidders.

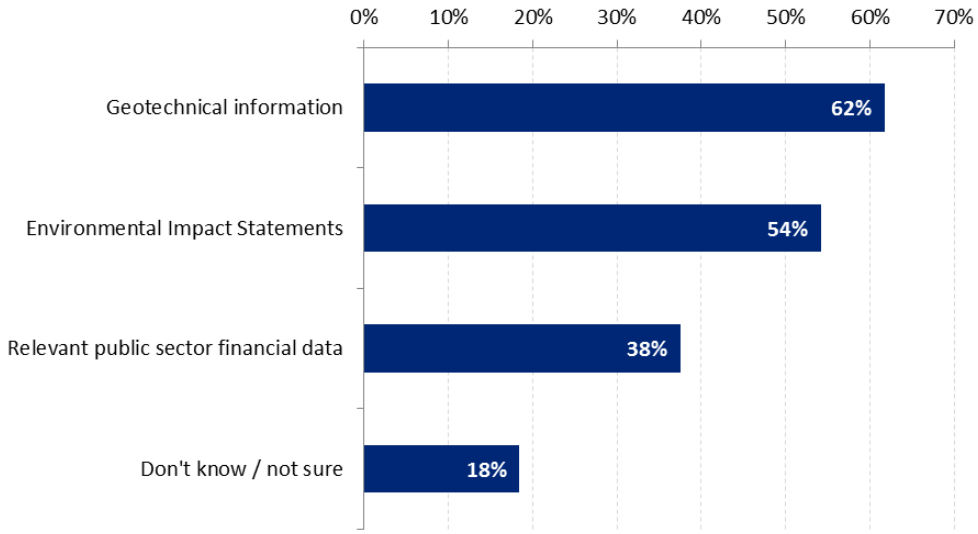
Again, this is not a new concern. In a 2006 survey undertaken by Blake Dawson Waldron, it was found that inadequate site information in market request phase restricted the quality and pricing of bids for around 20% of construction and infrastructure projects (2006:17).

Based on the primary data collected for this report, professional services firms are required to undertake additional work for 34% of public sector tenders, to verify the information provided in the brief. Furthermore, the average costs of this additional work were reported at around $41,800 per firm per proposal.

With multiple bidders undertaking verification work for the same projects, public sector clients are driving duplication and adding to overall project costs. To the extent that the costs of this additional work are greater than the costs to government in providing a guarantee, this practice is inefficient. This has been acknowledged by the Productivity Commission, which recommends that by undertaking site investigations and passing better information on to bidders, the public sector can avoid duplication and reduce project prices (PC 2014:479-480).

Many respondents agreed that provision of geotechnical information, Environmental Impact Statements or relevant public sector financial data as part of RFPs would improve the efficiency of bidding processes or the quality of proposals (see Chart 2.2).

Chart 2.2: Types of information which would improve the efficiency of bidding processes



2.3 Skills of procurement managers

Key Points:

- There are substantial opportunities for improvement in the skills of public sector procurement managers, despite widespread recognition of the issue in the literature.
- Skills shortages are identified by over one third of firms in relation to traditional procurement models, and almost two thirds of firms in relation to privately financed procurement models.

There is an inherent link between the quality of public sector procurement practices and the extent to which procurement managers are appropriately qualified to administer dealings with the private sector.

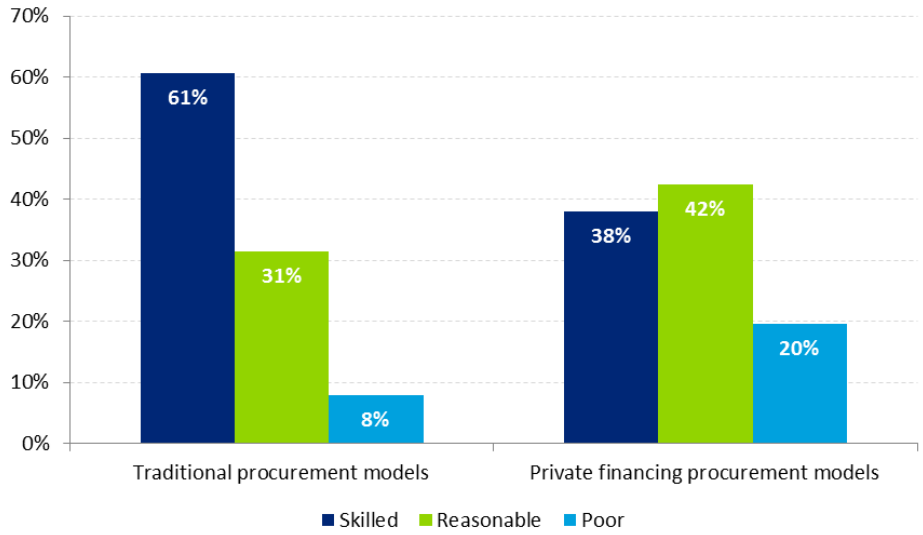
Over the last few years, a number of studies have identified the inexperience of procurement managers in the public sector as a causal factor of poor project scoping, documentation and disputes.

For example:

- the absence of a qualified, client appointed design manager to oversee projects from initiation to completion was identified as one of ten core issues contributing to poor design and documentation in an analysis released by Engineers Australia (2005);
- the lack of experienced and sufficiently competent personnel was highlighted as the biggest contributor to inadequate scoping in Australian construction and infrastructure projects in a survey undertaken by Blake Dawson (2008:14);
- educational and behavioural adaptations of individuals within the people system, such as poor communication, management, skills, experience and personality traits, have been identified as a key causal factor contributing to disputes in construction projects (Cooperative Research Centre for Construction Innovation 2009:14); and
- improvements in the skill base of public procurers can reduce infrastructure costs, if accompanied by a simultaneous focus on taking the time necessary to scope projects before going to market (Productivity Commission 2014:439,491).

The primary data collected for this analysis presents a mixed outlook on the skill levels of procurement managers in the public sector. As shown in Chart 2.3, government managers are rated as skilled by 61% of firms in relation to traditional procurement models such as D&Cs, and less than 40% of firms for private financing procurement models, generally used for larger and more complex projects.

Chart 2.3: Ratings on the skills of public sector procurement managers



This suggests that substantial opportunities for improvement remain, with over one third of firms identifying skills shortages in relation to the public sector management of traditional procurement, and almost two thirds of firms in relation to private financing procurement models.

In order to address these concerns, government agencies should consider a mix of initiatives that build the technical skills necessary to understand specific details of project design, as well as the capability necessary to manage tender processes efficiently.

2.4 Incentives for innovation

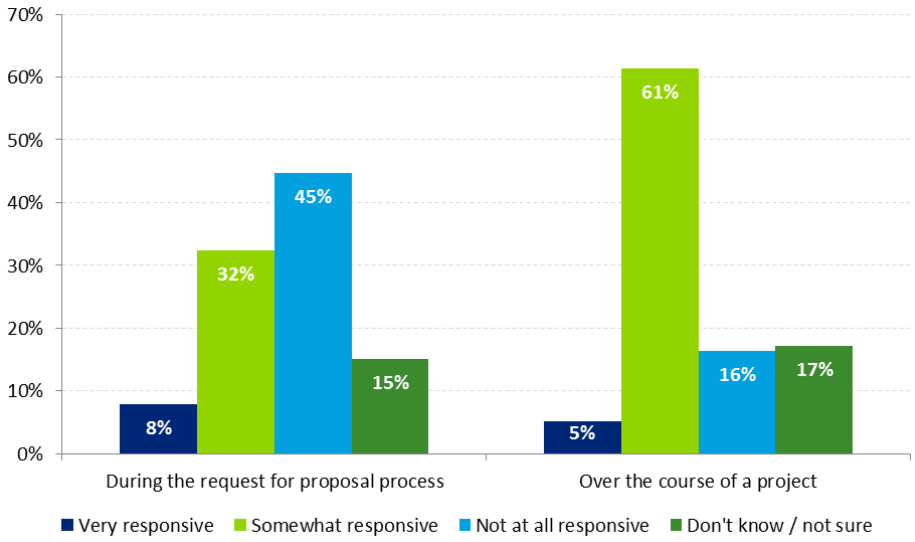
Key Points:

- 45% of professional services firms find public sector clients to be non-responsive to innovative suggestions during tender processes.
- Meanwhile, around one in six firms find the government to be non-responsive to innovation during the course of a project.
- Firms interact with public sector clients for just under 50% of tenders.
- Only 9% of firms have actively participated in the unsolicited proposals process.

In order to capture the full value for money offered by professional service firms in relation to built environment projects, it is necessary to ensure that procurement processes do not place unnecessary constraints on the opportunities and incentives for innovation.

As illustrated in Chart 2.4, only 40% professional services firms bidding for built environment sector projects consider public sector clients to be very or somewhat responsive to innovative suggestions during the RFP process. In contrast, almost half of the industry has found public sector clients to unwilling to take innovative suggestions on board.

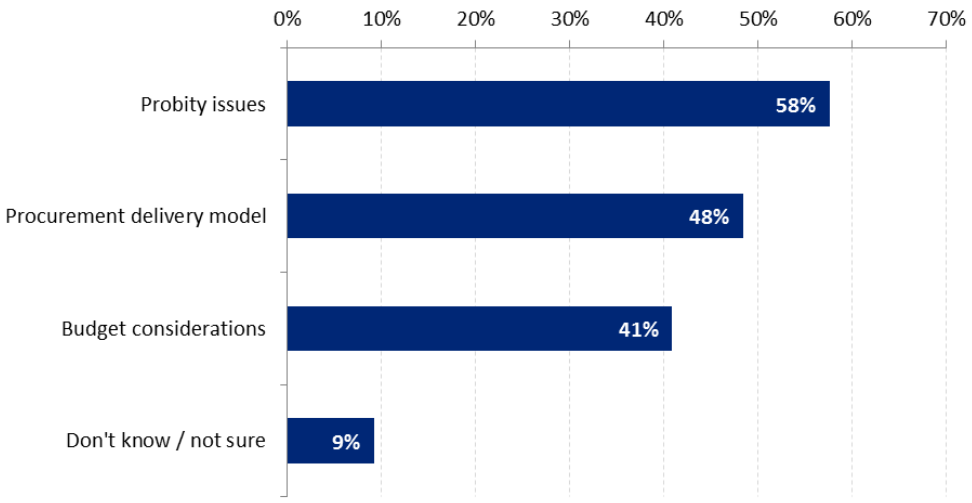
Chart 2.4: Responsiveness of public sector clients to innovative suggestions made by firms



Firms suggest that government is more responsive to innovative ideas once a project has commenced, however, around one in six firms consider that opportunities for greater innovation remain.

Some of the common drivers of non-responsive behaviours cited by firms are listed in Chart 2.5 below. Unsurprisingly, the most prominent drivers appear to be probity issues and the influence of the procurement delivery model.

Chart 2.5: Main drivers of non-responsiveness of the public sector to innovation

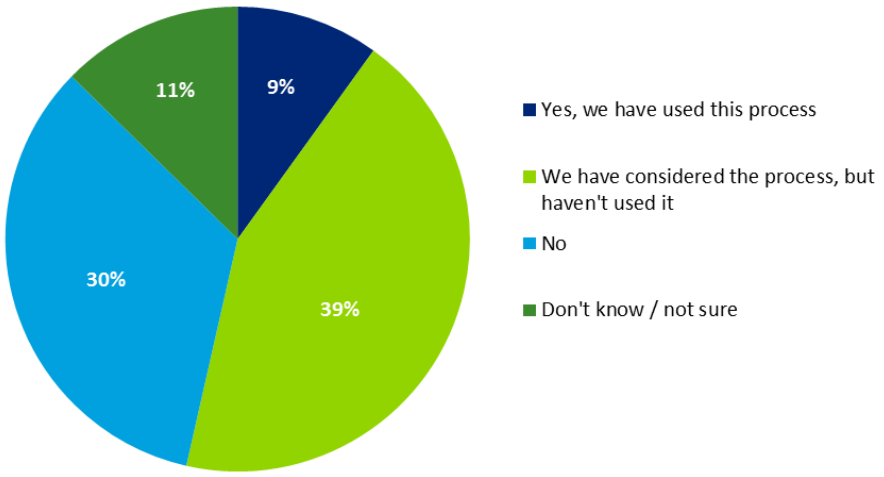


One method that the public sector can use to promote opportunities for innovation is to interact with firms, either as an early market sounding process or during the bidding process. The data collected for this report suggests that these interactions take place for just below half of all tenders for professional services in built environment projects.

Furthermore, each state and territory jurisdiction in Australia provides opportunities for the private sector to make unsolicited proposals outside of standard tender processes. These mechanisms are designed to promote innovation and often require proposals to be unique, to justify negotiation with government outside of a competitive market.

The primary data collected in this survey finds that while over half of firms have considered submitting unsolicited proposals to government, only 9% of firms have actively participated in the processes (see Chart 2.6).

Chart 2.6: Consideration of unsolicited proposal processes



Overall, this evidence suggests that while private sector professional services firms have reasonable opportunities to make innovative proposals to government, there is scope to improve the responsiveness of the public sector during the RFP process, through greater interactions with firms prior to the commencement of projects.

2.5 Risk, insurance & proportionate liability

Key Points:

- Around 26% of firms were required to 'contract out' of proportionate liability in public built environment projects over the last 12 months.
- This clause has triggered a reduction in competition for 2.3% of tenders, and has generated higher project prices through direct risk premiums in 1.6% of tenders.
- Almost half of respondents (44%) report that they do not currently hold insurance cover for contracting out of proportionate liability.

Best practice risk allocation prescribes that responsibility for risk should be allocated to the party that is best able to manage that risk. For example, Abrahamson (1983) proposed that "a party to a contract should bear a risk where:

- the risk is within the party's control;
- the party can transfer the risk, e.g. through insurance, and it is most economically beneficial to deal with the risk in this fashion;
- the preponderant economic benefit in controlling the risk lies with party in question;
- to place the risk upon the party in question is in the interests of efficiency, including planning, incentive and innovation;
- if the risk eventuates, the loss falls on that party in the first instance and it is not practicable, or there is no reason under the above principles to cause expense and uncertainty by attempting to transfer the loss to another" (in NPWC/NBCC Joint Working Party, 1990:6).

While discretion is required when applying these principles (Allens Arthur Robinson 2003; Molino Cahill Lawyers 2013), the core notion of efficient risk management is well established in the Australian context. For example, the Commonwealth Procurement Rules (Department of Finance, 2008) prescribe that "as a general principle, risks should be borne by the party best placed to manage them".

Nevertheless there is evidence that, in practice, government clients are involved in shifting risk onto the private sector in procurement for built environment projects even in circumstances where this risk allocation is not optimal.

This issue arises frequently in relation to distribution of liability. In particular, government departments and agencies commonly require professional service firms to 'contract out' of proportionate liability legislation, despite the fact that this was introduced to address the policy problem of rising liability insurance costs (AGS, 2013).

Prior to the early 2000s, firms were subject to the doctrine of joint and several liability, which meant that an injured party could recover its entire loss from any single concurrent wrongdoer in a negligence claim. In response to rising liability insurance costs,

proportionate liability legislation was put in place to revise this arrangement and limit the liability of any 'wrongdoer' to the share of the loss for which they are responsible.

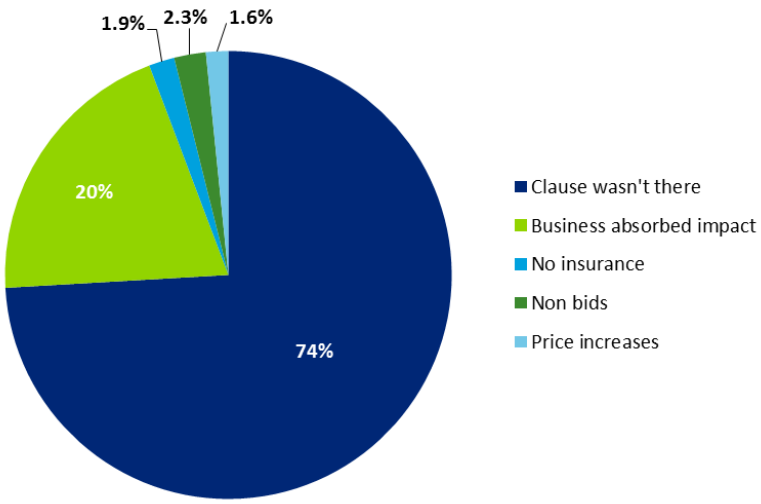
However, governments in most jurisdictions (apart from Queensland) have taken advantage of provisions to 'contract out' of proportionate liability, such that professional services firms can be held liable for 100% of damages claimed by public sector clients, even if they were responsible for as little as 1% of the loss. This limits the effectiveness of the legislation in achieving its original objectives – to support efficient management of risk and affordability of insurance.

The cost implications of contracting out of proportionate liability have been recognised. For instance, Lateral Economics estimated that the benefits from a prohibition on contracting out of proportionate liability ranged between $11 million and $151 million per year (2011). Furthermore, in 2013 the Standing Council on Law and Justice (SCLJ) released draft model proportionate liability model provisions which prohibit contracting out, except in certain circumstances involving indemnities (2013a). While ministers agreed to consider introducing these provisions in October 2013, the extent of progress to date is uncertain (SCLJ, 2013b).

According to the primary data collected for this study, 26% of firms were required to 'contract out' of proportionate liability in public built environment projects over the last 12 months. While this incidence is consistent with information reported through the business liaison process, it should be noted that a substantial share of respondents (38%) either chose not to respond to the survey question, or were unsure about how frequently this clause had been imposed by government.

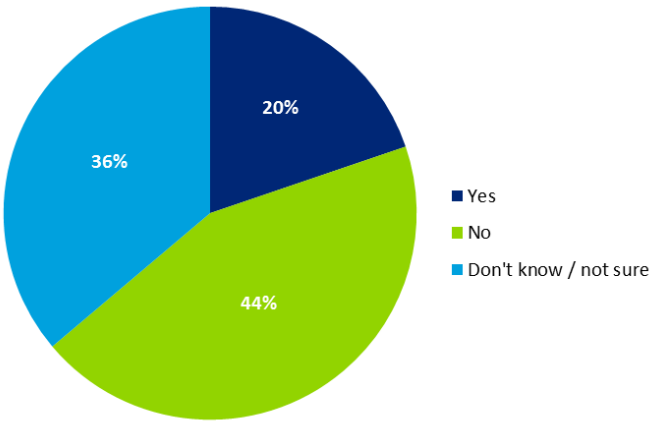
As shown in Chart 2.7, while the impact of greater liability from 'contracting out' is absorbed by firms in around 20% of RFPs, the clause does trigger a reduction in competition (2.3% of RFPs) and generate higher project prices through risk premiums (1.6% of RFPs).

Chart 2.7: Business responses to contracting out of proportionate liability



Furthermore, in almost 2% of RFPs, professional services firms proceed without insurance despite the significantly higher risks placed on them by 'contracting out' clauses.

Chart 2.8: Private sector insurance cover for contracting out of proportionate liability



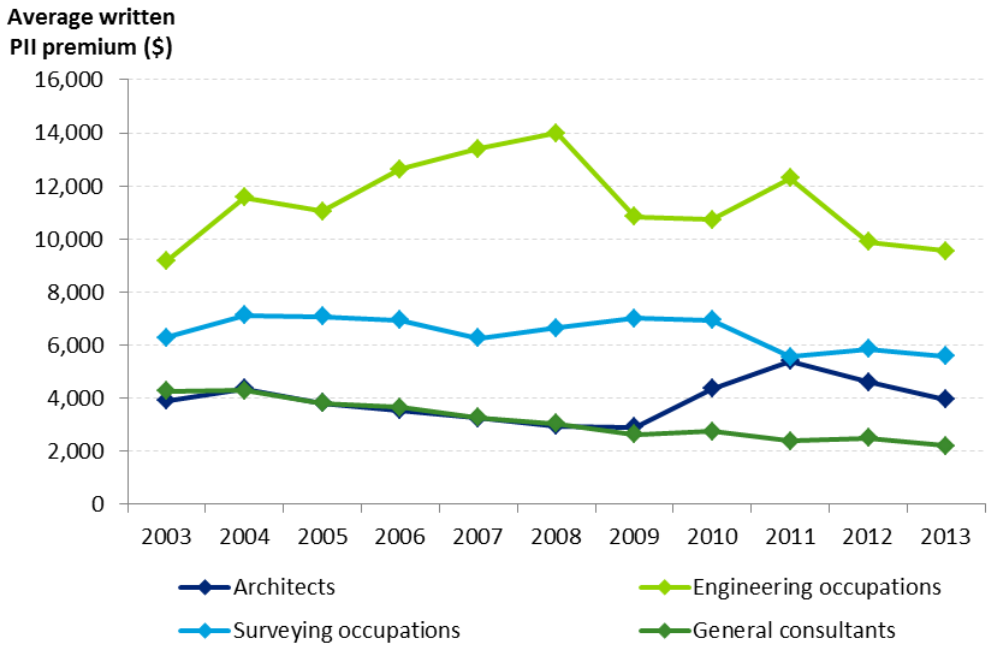
As shown in Chart 2.8, while around 20% of respondents indicate that they currently hold insurance cover for contracting out of proportionate liability, almost half of respondents (44%) indicate that they do not. Excluding respondents who were unsure, it is estimated that around one third of firms currently hold cover for contracting out.

Due to the 'claims made' basis of professional indemnity insurance, firms that do seek insurance for 'contracting out' must purchase cover on a year-by-year basis, even following the conclusion of a project, to continue to be covered for the additional liability imposed on them through these clauses.

As shown in Chart 2.9, the average professional indemnity insurance premium for engineers in Australia has fluctuated at around $10,000 per annum, while average premiums for surveyors and architects are slightly lower at around $6,000 and $4,000 per annum respectively. The variations in average annual premiums over time reflects both firm specific factors, as well as movements in the insurance cycle between soft markets, characterised by high supply with lower prices, and hard markets, where prices rise due to a reduction in supply (Lateral Economics, 2011).

Business liaisons suggest that, to obtain cover for contracting out, firms can be required to pay between 0-25% extra in insurance premiums. This varies for different reasons, but perhaps most significantly according to the size of the firm. It was indicated that smaller firms may find it more difficult to afford cover for contracting out of proportionate liability, with the increases imposed by insurance companies accounting for a greater share of their total premium relative to their larger competitors. This uneven distribution of the costs of contracting out across the industry may lead to further impacts on the level of competition over the longer term.

Chart 2.9: Average professional indemnity premiums, 2003 - 2013



Source: APRA (2014)

The broader economic impacts of higher priced bids, a reduction in competition and firms proceeding without insurance are explored further in Chapter 3.

2.6 Other contract clauses

Key Points:

- Public sector clients often seek to include onerous contract clauses in arrangements with professional services firms.
- These include unlimited liability (52% of RFPs), specific insurance requirements (51%), significant liquidated liabilities or abatement regimes (27%), novation provisions (26%) and clauses on fitness for purpose (41%), termination for convenience (36%), expert standard of care (27%).
- These clauses lead to higher priced proposals, reductions in competition and the implicit transfer of risks back to the government when firms proceed without adequate insurance – similar to the effects of contracting out of proportionate liability as discussed in the previous section.

Professional services firms often also face additional contract clauses when negotiating to undertake work for public sector built environment projects that can be inconsistent with the notion of efficient risk management, described in Section 2.5. The most common clauses include unlimited liability, specific insurance requirements, fitness for purpose, expert standard of care, termination for convenience, novation provisions, and significant liquidated liabilities or abatement regimes.

A description of each of these clauses is provided in Table 2.1 on the following page, along with an estimate of their incidence based on the primary data collected for this analysis.

The most common response of professional services firms when faced with these clauses is to absorb the impacts of the additional risks transferred on their business from the public sector. However, we estimate that these clauses lead to higher priced proposals, reductions in competition and the implicit transfer of risks back to the government when firms proceed without adequate insurance. The frequency of these responses, for each clause, is presented in Chart 2.10.

Overall, the evidence provided by firms suggests that unlimited liability clauses, specific insurance requirements and contract terms on fitness for purpose are particularly strong drivers of these types of business responses.

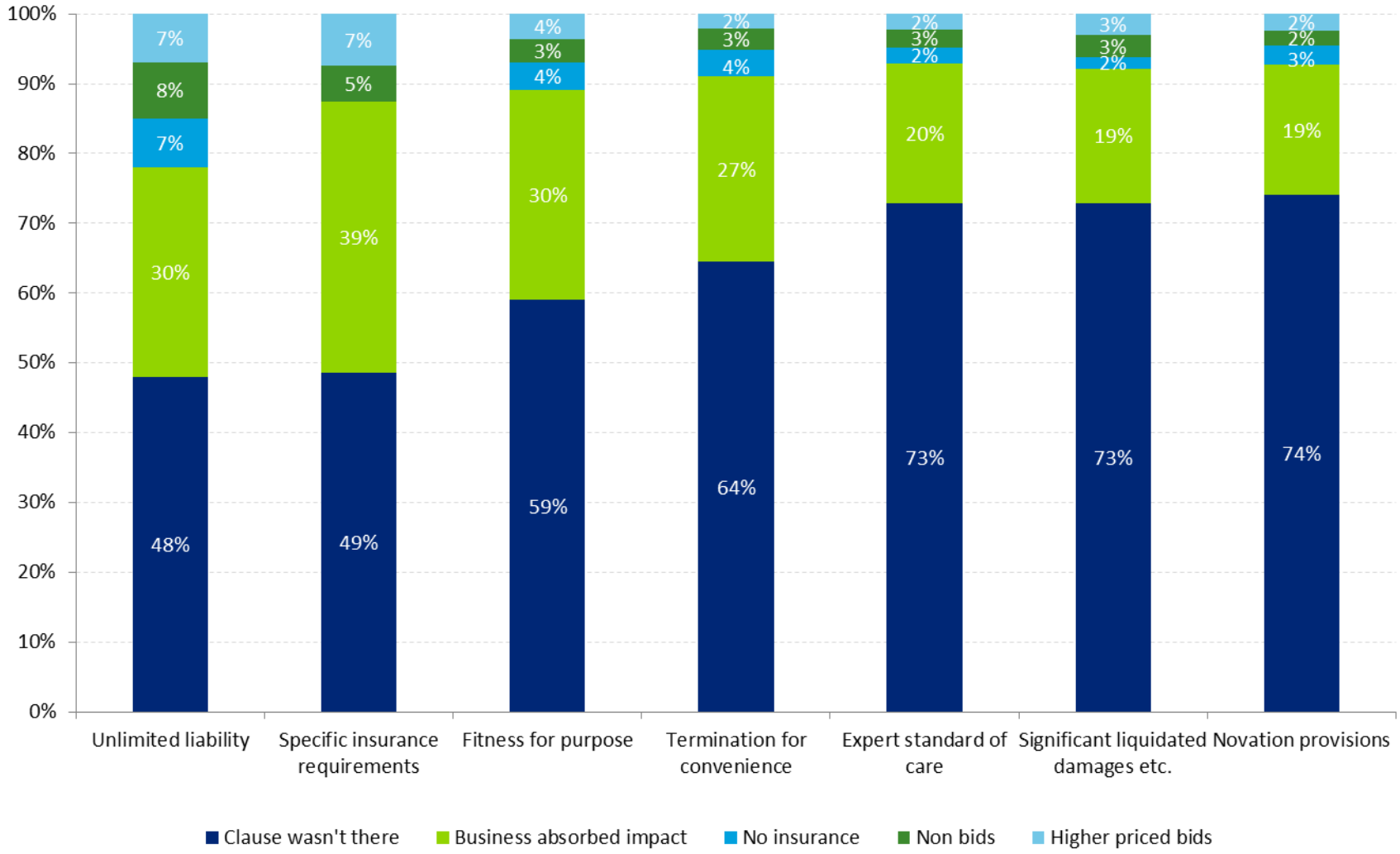
The economic impacts of these responses are examined in Chapter 3.

Table 2.1: Other common onerous contract clauses

Clause	Description	Incidence over last 12 months
Unlimited liability	Unlimited liability clauses ensure that the liability of professional services firms to the public sector client is not capped. As 'unlimited' professional indemnity insurance is not provided in any insurance policies taken out by firms, the private sector is unable to fully insure against risks under contracts with unlimited liability clauses.	52%
Specific insurance requirements	Specific insurance requirements may include liability cap specifications that are higher than the optimal level necessary for a project, explicit naming of public sector clients in professional indemnity insurance (which is not technically feasible) and reductions in excess thresholds, among other terms.	51%
Fitness for purpose	This clause requires professional services firms to guarantee that the services provided achieve the intended result, and assume liability irrespective of negligence or fault. Liabilities assumed under a fitness for purpose clause are uninsured under standard professional indemnity policies.	41%
Termination for convenience	This clause allows public sector clients to terminate the contract for professional services at any time, for any reason. It will sometimes be accompanied by subclauses that reduce its risks for suppliers. Nevertheless these clauses can create labour cost risks for suppliers.	36%
Expert standard of care	Expert standard of care clauses increase the liability of professional services firms beyond that required by common law and under statute – greater than care, skill and diligence as would be accepted by peer professional opinion as competent practice. These liabilities are also generally uninsurable under standard professional indemnity policies.	27%
Significant liquidated liabilities or abatement regimes	These clauses impose penalties on professional services firms at the occurrence of particular events, such as delays, without the need for consideration of the causes of the event.	27%
Novation provisions	This clause allows for substitution of one party for another party without changing the rights and obligations under the original contract. In the context of this report, novation provisions allow public sector clients to designate a third party with which professional services firms must deal with under the terms of the existing contract. Sometimes there are subclauses that reduce its risks for suppliers.	26%

Source: Business liaisons; AGS (2009); Consult Australia (2012); Planned Cover (2013)

Chart 2.10: Business responses to other onerous contract clauses



2.7 Bid costs

Key Points:

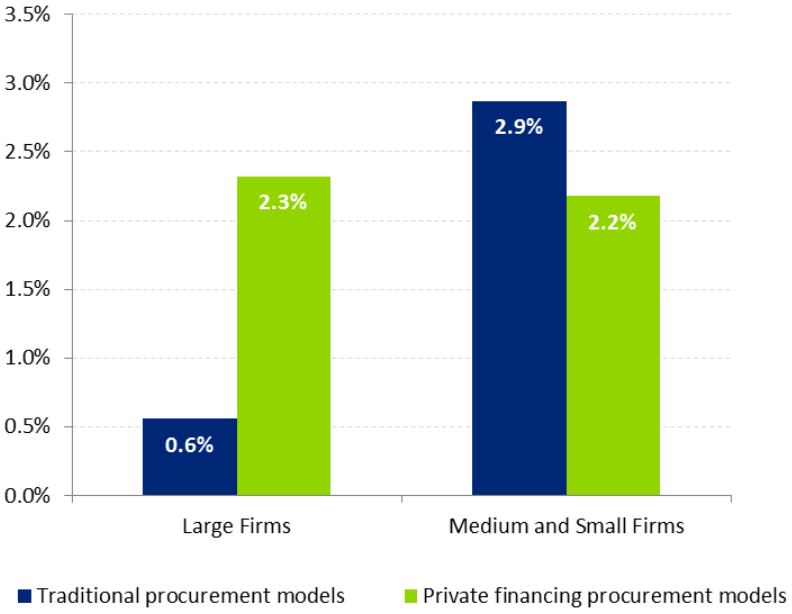
- Bid costs for professional services firms involved in public sector built environment projects range between 0.6% and 2.9% of total project value.
- Only 46% of firms support government reimbursement of proponents' bid costs from the perspective of industry, possibly reflecting concerns about changes to business models and intellectual property rights.

Professional services firms face transaction costs of preparing and submitting bids for public sector projects. While the cost of bidding is a natural feature of competitive markets, ensuring that bid costs are at a minimum efficient level should be a consideration for government in designing their procurement processes. As highlighted by the Productivity Commission (PC), high bid costs not only reduce the return on projects for firms, but can also add to the overall costs of projects as firms increase their bid prices to recoup their losses (PC, 2014:451).

An analysis of the primary data collected for this study suggests that bid costs for professional services firms involved in public sector built environment projects range between 0.6% and 2.9% of total project value.

As shown in Chart 2.11 below, large firms (classified as those with more than 200 employees) face higher costs as a share of project value for private financing procurement models (such as public private partnerships), compared to traditional procurement models (such as design and construct arrangements). However, bid costs as a share of project value are largely constant for small and medium sized firms, regardless of procurement model.

Chart 2.11: Bid costs as a proportion of total project value

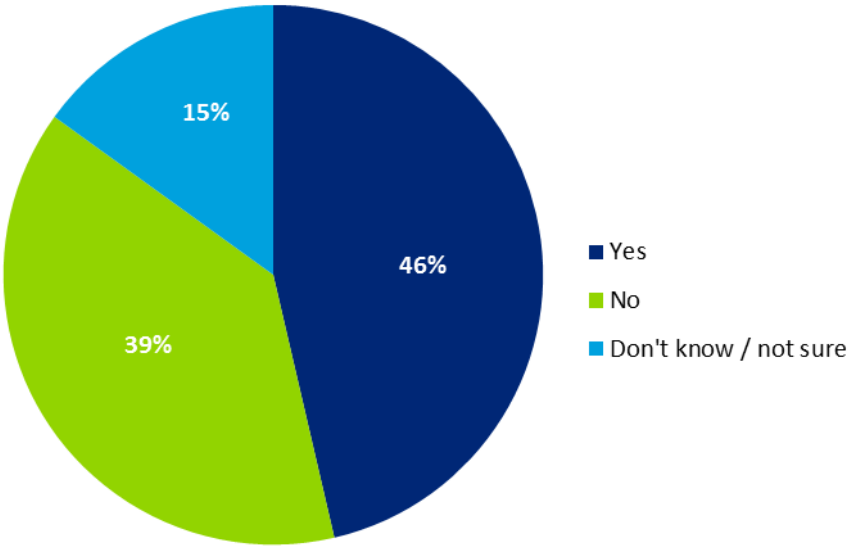


These estimates are broadly similar to those presented in Australian literature. For instance, a 2006 survey undertaken by Blake Dawson Waldron found that bid costs were less than 1% of project value for one third of respondents, but that almost one fifth of firms involved in projects valued over $500 million estimated bid costs at 3-5% of total project value (2006:18). More recently, the PC's Inquiry Report on Public Infrastructure found that bidding costs for large complex projects can be up to 1% of project value, with design costs accounting for around 50% of this expenditure (PC, 2014).

Drawing from this evidence, the PC has argued that bid costs appear "too high" in Australia (2014:26). One mechanism proposed by the PC to reduce this burden is for governments to contribute to the costs of proposals where innovation is of particular importance for the project. This would transfer the ownership of design material to the public sector, so that features of proposals from unsuccessful bidders could still be employed (PC, 2014).

However, according to the primary data collected for this report, only 46% of firms support government reimbursement of proponents' bid costs from the perspective of industry (see Chart 2.12). This may reflect concerns about changes to business models and intellectual property rights.

Chart 2.12: Agreement on government process for reimbursing some/all bid costs



Overall, it appears that there may be some scope to further reduce the transaction costs faced by professional services firms when seeking to be involved in public built environment projects. However, this issue appears to be less critical than some of the other features of government procurement highlighted in this report.

2.8 Delivery models

Key Points:

- The contractual arrangements for professional services firm involvement in public infrastructure projects varies by the type of delivery model selected by government.
- In particular, delivery models appear to be most strongly linked with the inclusion of novation provisions, unlimited liability and specific insurance requirements in contracts.
- The choice of delivery model accounts for around 22% of the price increases in public sector built environment projects caused by risk allocation and other contract terms.

Government departments and agencies have a range of delivery models available to them when undertaking public infrastructure projects and procuring services from the private sector. This ranges from construct only options, where design work has already been completed, through to arrangements where the private sector plays a key project management and financing role through public private partnerships (PPPs). A summary of the main delivery model categories is provided in Table 2.2 below.

Table 2.2: Summary of main project delivery models

Delivery model	Key features
Construct only	• Government agency has completed majority of design work (perhaps with assistance from consultants) • Government engages contractor to build, based on supplied design • Risks associated with design faults, changing requirements and adverse site conditions are typically borne by the government client
Design and construct (D&C)	• Government client provides a project brief • Contractor engages design consultants • Contractors bid on their developed design and lump sum construction price • Risks associated with errors or omissions in final design, and latent conditions typically borne by contractors and design consultants • Costs of directed variation typically borne by government client
Alliance contracts	• Government client and other alliance partners jointly develop design and share risks • Other alliance partners may include designers, consultants, management service providers, suppliers, construction contractors • Often considered to be of greatest value where the government client has had limited experience with the risks for the project

Managing contractor arrangements	• Contractor undertakes significant part of project management role, including:
	  ◦ obtaining development approvals
	  ◦ undertaking onsite investigations
	  ◦ finalisation of design
	  ◦ develop construction, commissioning and maintenance program
	• Design risks taken on by contractor where guaranteed construction sums are used
	• Contractors given incentives to manage project costs by sharing cost savings

Public private partnership (PPP)	• Contract between the public and private sector, which can reflect a number of different partnership models • Private sector delivers infrastructure and services over the long term • Some level of private financing for the project • Project may be funded by government, user payments or a combination of the two

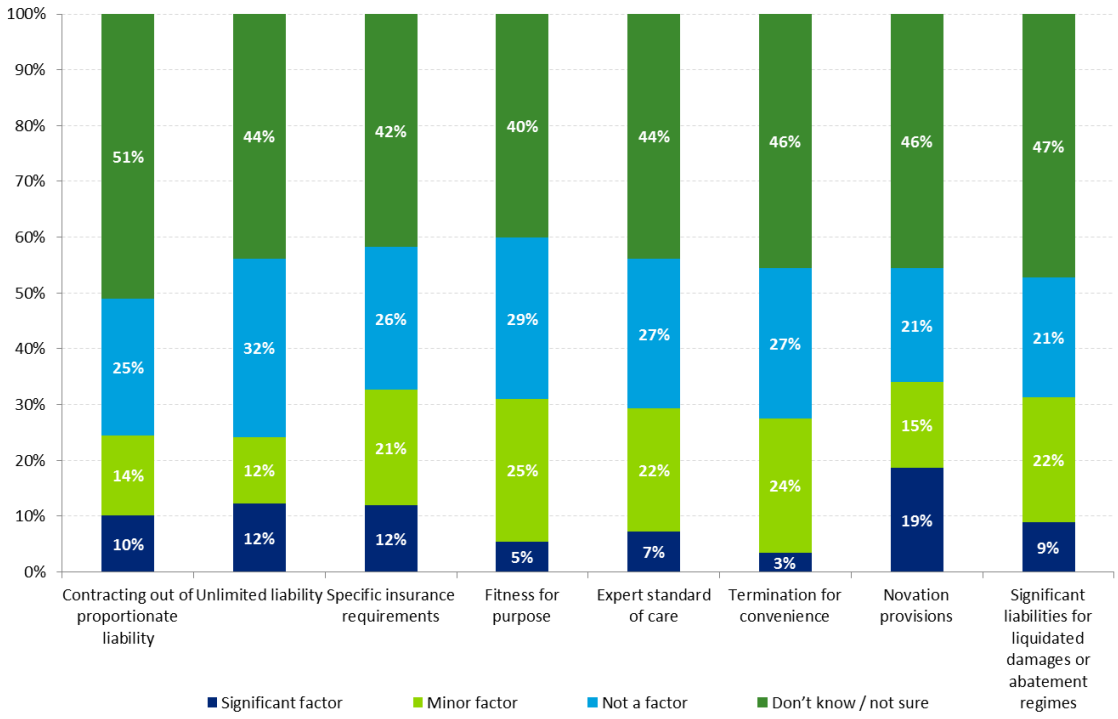
Source: Adapted from PC (2014)

Selection of the most appropriate delivery model is a complex process that requires consideration of a number of project-specific factors. One of the most important considerations in this regard is the risks associated with the project.

While is it is difficult to generalise on the implications of inappropriate choice of specific delivery models due the differences in context of individual projects, it is appropriate to consider the extent to which overall delivery model selection contributes to the inclusion of onerous risk allocation and other contract clauses faced by firms.

As illustrated in Chart 2.13, between 3% and 19% of respondents reported delivery model selection as a significant factor in the inclusion of the contract terms discussed in Sections 2.5 and 2.6. In particular, delivery model selection appears to be a particularly strong driver of the inclusion of novation provisions, unlimited liability and specific insurance requirements in contracts.

Chart 2.13: Extent to which delivery model was a factor in the inclusion of contract clauses over the last 12 months



Taking into account the incidence of these clauses and the extent to which firms respond by submitting higher priced proposals, we estimate that the choice of delivery model accounts for around 22% of the price increases in public sector built environment projects caused by risk allocation and other contract terms.

3 Economic impacts

As highlighted in the previous chapter, there are a number of significant opportunities to improve public sector procurement practices for built environment projects. To varying extents, these drive businesses to raise their prices, proceed without insurance, withdraw from bidding opportunities and reduce incentives for innovation.

This chapter analyses the economic impacts that result from these business responses. This is divided into two sections – quantification of the price impacts, supported by a discussion of other impacts, in terms of higher risk exposure, project delays and project quality.

3.1 Price impacts

Key Points:

- The total price impact of poor procurement practices is estimated at around 5.4% of total revenue obtained by professional services firms in public sector built environment projects.
- This is generated by direct price premiums, indirect price impacts through reduced competition and inefficient pricing from bid cost recoupment.

The evidence presented in Chapter 2 identified multiple opportunities to improve procurement practices which currently increase the costs of public sector built environment projects – unclear project objectives, unverified brief information, contracting out of proportionate liability and seven additional onerous contract terms: unlimited liability, specific insurance requirements, fitness for purpose, expert standard of care, termination for convenience, novation provisions and significant liabilities for liquidated damages or abatement regimes.

This section quantifies these impacts, taking into account direct price premiums, indirect price impacts through reductions in competition and duplication of bid costs that are ultimately recouped by firms down the track.

These calculations follow a three step, bottom-up calculation process:

- **Incidence** – identifying the frequency of the business response to the poor procurement practice;
- **Magnitude** – identifying the extent of the associated price increase; and
- **Impact** – calculating the overall impact on prices based on the combined effects of incidence and magnitude.

3.1.1 Direct price premiums

Key Points:

- Overall, poor procurement practices are estimated to directly contribute to project price increases of 3.6%.
- The main driver of price premiums is unclear project objectives, accounting for price increases in the order of 2.9%.
- In addition, expert standard of care clauses and novation provisions generate increases of 0.5% and 0.2% respectively.

The primary data collected for this study indicates that firms add premiums to the price of their proposals for public sector built environment projects in response to unclear project objectives, clauses for contracting out of proportionate liability and a number of other onerous contract terms.

Using a bottom-up calculation process, we estimate that these factors account for additional project prices in the order of 3.6%. The process of obtaining this estimate is described below.

3.1.1.1 Incidence – how often are premiums added to project prices?

Chapter 2 provided estimates of the extent to which price premiums are imposed by firms in response to a number of inefficient procurement practices. To recap, around 12% of projects have higher prices due to unclear project objectives, 1.6% of projects have higher prices due to contracting out of proportionate liability, and between 2-7% of projects have higher prices due to a number of other onerous contract clauses.

3.1.1.2 Magnitude – how large are the price premiums involved?

Estimates of the magnitude of premiums charged in response to five specific poor procurement practices have been obtained through business liaisons and the literature. These are summarised in turn below.

Unclear project objectives

Unclear project objectives typically involve price premiums in the order of 25% of project value. This value has been obtained from the literature on pricing for scope risks, comparing fixed price contracts to contracts for value and materials (Harrell, 2011).

Contracting out of proportionate liability

While there are broader costs associated with contracting out of proportionate liability, this analysis focuses on quantifying the current annual insurance cost associated with inclusion of this clause – based on the additional insurance premiums for inclusion of cover for contracting out in professional indemnity insurance policies.

As noted in Section 2.5, firms can be required to pay between 0-25% extra in professional indemnity insurance premiums to obtain cover for contracting out of proportionate liability. Lateral Economics estimate that professional indemnity insurance premiums are around 1% of firm revenue (Lateral Economics, 2011). Taking into account that around one third of firms hold cover for contracting out, the price premium passed on to government can be estimated at 0.1% of total project value.

While this estimate is relatively small, it is unlikely to represent the full long term cost imposed by the government practice of contracting out. This is due to a number of factors, including:

- **The relatively immature market for 'contracting out' insurance cover** – this means that there is currently insufficient claims data to take into account the full impacts of shifting away from the proportionate liability regime. There are likely to be flow on effects of further price premiums and less competition in the future as premiums rise, if governments fail to shift to an efficient risk management approach.
- **Fluctuations in the insurance market –** as noted in Section 2.5, the price impact of contracting out of proportionate liability is also likely to vary according to the stage of the insurance cycle, with higher costs incurred during a hard market, where prices are higher due to limited supply (Lateral Economics, 2011).
- **Longer term implications of reverting away from the objective of proportionate liability legislation –** contracting out limits the effectiveness of the legislation in achieving its original objectives: to support efficient management of risk and affordability of insurance. This is likely to create issues for both government and business over the longer term if this practice continues.
- **Indirect costs where firms proceed without insurance –** this estimate reflects the price premiums charged by firms that take out insurance for contracting out. It does not include the future costs likely to be imposed on government as a result of firms that choose to accept risks that they are not capable of managing. This is discussed further in Section 3.2.1.

As such, it is acknowledged that while the price impacts identified here are relatively small, this sole consideration of insurance-related price premiums is not an appropriate measure of the full impact of the clause on firms and firm behaviour, over the long term.

Unlimited liability

Similarly, the price premiums for unlimited liability also flow through higher professional indemnity insurance premiums. While unlimited insurance cover is not available to firms, they are able to respond to these risks somewhat, by increasing their level of coverage. Business liaisons indicate that this can add between 20-50% to insurance premiums. Accordingly, a conservative estimate of this price premium is in the order of 0.2%.

The magnitude of this price premium is also likely to vary over time according to economic conditions. When the market for professional services is strong, firms are more likely to withdraw from the bidding process when faced with unlimited liability clauses, rather than take on the risks that cannot be fully mitigated through insurance. The indirect price impacts that flow from reduced competition are considered in Section 3.1.2.

Expert standard of care

Expert standard of care clauses require firms to undertake additional work, so that they can demonstrate, if necessary, that they have exceeded the standard of care required under common law to comply with the contract. This involves dedicating more skilled staff and time towards a project than is necessary. Liaisons with industry suggest that the premiums associated with expert standard of care clauses are generally in the order of 20%.

Novation provisions

Novation provisions increase the financial risks for firms in projects. This is due to uncertainty around whether there might be a change in the party to which they are accountable for work, often from the government to a contractor, and who that party might be. Discussions with firms indicate that most often, they will attempt to include wording around these provisions in contracts to ensure that novation arrangements are only taken if mutually agreeable. Nevertheless, in these circumstances the premiums charged are often in the order of 10% of project prices.

Other onerous contract terms

Due to some difficulties in making generalisations, and to ensure that the price estimate produced here does not double-count the effects of similar clauses, the premiums for the other clauses noted in Chapter 2 are assumed to be zero.

For instance, the premiums charged for specific insurance requirements, the labour costs for termination for convenience, and the financial risks for liquidated damages and abatement regimes will vary from project to project. Similarly, as the risks transferred to firms through fitness for purpose clauses are closely linked to the risks from unclear project objectives, it is assumed that no further price impacts are passed on to firms.

3.1.1.3 Impact – how large are the price premiums involved?

By combining the estimates of incidence and magnitude described above, we estimate that:

- unclear project objectives generate a 2.9% increase in project prices;
- expert standard of care clauses increase project prices by 0.5%; and
- novation provisions increase project prices by 0.2%.

The price impacts described here are additive, such that overall, inefficient procurement practices are estimated to directly contribute to project price increases of 3.6%.

We did not identify a significant price impact for contracting out of proportionate liability and unlimited liability. However, it is acknowledged that the state of the insurance market, as well as the market for professional services, can have a big impact on the costs incurred by firms in relation to these clauses, and hence, the nature of their impacts on prices through direct premiums or reduced competition. The measures used here do not reflect the full magnitude of the impacts of such clauses on the efficiency of the procurement process.

The inputs to this calculation are summarised in Table 3.1

Table 3.1: Quantifying direct price premiums from inefficient procurement practices

Key drivers of price premiums	Incidence (higher priced bid responses)	Magnitude (price premium)	Impact on project prices
Unlimited liability	7%	0.2%	0.0%
Unclear project objectives	12%	25.0%	2.9%
Novation provisions	2%	10.0%	0.2%
Expert standard of care	2%	20.0%	0.5%
Contracting out of proportionate liability	2%	0.1%	0.0%
Total impact (project price increases)			3.6%

3.1.2 Reduced competition

Key Points:

- It is estimated that inefficient procurement practices by the public sector lead to reductions in competition for 13.2% of public sector RFPs.
- This leads to indirect price increases of around 1.5% on average.

In addition, there are also indirect price impacts of poor procurement practices caused by the decisions of firms not to bid. These are estimated at around 1.5% of project costs.

3.1.2.1 Incidence – how often do firms withdraw from bidding?

As noted in Chapter 2, firms make decisions not to bid for projects for a range of business reasons, some related to poor procurement practices, but others not. Overall, the primary data collected from firms indicates that, on average, professional services firms choose not to submit proposals for around 17% of public sector projects.

In practice, decisions by firms not to bid are triggered by number of factors. As such, double-counting issues make it difficult to isolate the reduction in competition caused by individual procurement practices.

Nevertheless, the data presented in Chapter 2 provides a guide on the incidence of reduced competition from poor procurement practices overall. As a starting point, the primary data collected for this study highlights unclear project objectives as the largest driver of no-bid decisions by firms, leading to reduced competition in 9% of public sector RFPs. This is followed by unlimited liability clauses, which lead to reduced competition in 8% of RFPs.

It is unreasonable to suggest that these two clauses would account for all no-bid decisions by professional services firms. Accordingly, we conservatively assume that 50% of the time, no-bid decisions by firms reflect both of these issues, and that collectively, these two issues overlap with all of the other no-bid decisions made in relation to other poor procurement practices.

This implies that overall, poor procurement practices by the public sector lead to reductions in competition for 13.2% of public sector RFPs.

3.1.2.2 Magnitude – what are the indirect price implications?

There is limited literature on the impacts of reductions in competition on project costs in Australia. Indeed, the relationship between the number of bidders participating in a tender process and the overall costs of the project is highly complex.

As a proxy estimate for the indirect price implications, we assume that project costs increase by 3.8% for each bidder lost. This estimate was produced by Carr (2005) through a regression analysis of data from 19 major public works educational construction projects in New York, in which 84 contracts were awarded following the submission of 438 bidders – an average of 5.2 bidders per contract.

This estimate has a number of limitations. For instance, it is based on data from a different, international market, and is simplistic in that it does not account for variations in price impacts as the total number of remaining bidders changes. Nevertheless, given the absence of relevant data in Australia, and the similarity in the average number of bidders in this context, it appears to be a reasonable proxy to use for this purpose.

3.1.2.3 Impact – how large are the indirect price impacts overall?

The price implications of reductions in competition are driven by the number of bidders in the market. In the context of procurement of professional services for public sector built environment projects, the average number of bidders per tender is difficult to ascertain, as the level of competition varies with the size of projects.

For example, the benchmarks for efficient procurement of major infrastructure published by Infrastructure Australia (2012) recommend that between two and three proponents should be selected from Expression of Interest (EOI) processes to participate in RFPs, depending on the delivery model for the project. However, where open tender arrangements are used, the number of bidders can be much higher. For instance, Ashurst (2014) report an example where principals receive 10 or more responses to a tender.

This analysis employs the estimate of 2.62 bidders per public sector RFP for professional services in built environment projects, obtained from the primary data reported by firms. Applying the incidence of reduced competition of 13.2% implies that, for each public sector project, 0.4 bidders are lost due to poor procurement practices on average.

Applying the average increase in prices of 3.8% then suggests that inefficient procurement leads to price increases of around 1.5% on average, through reduced competition.

3.1.3 Bid cost recoupment

Key Points:

- The inefficient costs associated with duplication of effort to verify the accuracy of brief information is estimated at around $68,000 per tender, around 0.8% of total project value.
- Based on the incidence of unverified information (34%), the price impact of this procurement practice is estimated at around 0.3% of total project value, on average.

There will also be price impacts on public sector built environment projects as firms seek to recoup the transactions costs involved in preparing and submitting proposals. While this will always occur to some extent, the duplication of effort in verifying brief information generates additional, inefficient costs in the system.

As outlined below, we find that these costs add around 0.3% to the costs of public sector built environment projects.

3.1.3.1 Incidence – how often do firms verify brief information?

As described in Section 2.2, firms are required to undertake additional work to verify the accuracy of brief information in around 34% of public sector RFPs.

3.1.3.2 Magnitude – what are the costs of this additional work?

Section 2.2 also notes that the average costs of this additional work are around $41,800 per firm per proposal. Applying the estimate of 2.62 bidders on average per proposal (as described above), each proposal generates costs of around $109,643. However, given that this work would ideally be undertaken once, by the public sector, inefficient costs are around $67,843 per tender. These costs constitute around 0.8% of total project value, using the average lifetime project value reported by firms of $8,936,406.

3.1.3.3 Impact – how large are the impacts overall?

Based on the incidence of 34%, and the magnitude estimate of 0.8%, the price impact of unverified brief information is around 0.3% of total project value, on average.

3.1.4 Summary

Key Points:

- The total price impact of poor procurement practices is estimated at around 5.4% of total revenue obtained by professional services firms in public sector built environment projects.
- Firms have reported that with improvements in project briefs, selection of delivery models and contracts, they could reduce the costs of projects by 6%.

This section estimates that inefficient procurement practices:

- directly contribute to project price increases of 3.6%;
- indirectly contribute to project price increases of 1.5%; and
- add inefficient costs worth 0.3% of project prices.

Overall, this suggests that the total price impact of poor procurement practices is around 5.4% of total revenue obtained by professional services firms in public sector built environment projects. The broader economic impacts of these costs are assessed in the following chapter.

3.2 Other significant impacts

Key Points:

- Beyond price impacts, there are additional economic impacts of poor procurement practices, including the implications of risk exposure, delays and reduced quality.
- The costs of risk exposure are estimated at around 0.8% of total project value.
- Firms report that they can reduce delays to projects by 7% on average, if project briefs, delivery model selection and contracts are improved.
- Firms also claim that they can improve the quality of public sector built environment projects by 7%, on average, through these improvements.

This section examines other significant impacts of poor procurement in terms of greater risk exposure, project delays and reductions in project quality.

3.2.1 Risk exposure

When faced with many of the poor procurement practices identified in this report, firms are unable to insure themselves against the additional risks transferred upon them from the public sector. For instance, insurance is not available for contract clauses such as fitness

for purpose, expert standard of care and novation provisions. Furthermore, while firms can increase the limit of their professional indemnity insurance policies in response to unlimited liability clauses, there will always be a gap between their level of cover and the unlimited damages that they are potentially exposed to. As noted in Chapter 2, there are also cases where firms absorb risks without purchasing available insurance, such as the risks from contracting out of proportionate liability.

In these cases, firms, and to some extent, governments, remain exposed to risks that have the potential to generate significant costs over the course of a project. A conservative estimate of these costs, by applying the price premiums described in Section 3.1.1 is in the range of 0.8% of project costs.

3.2.2 Project delays

The literature also identifies poor procurement practices as a driver of delays in project delivery. For example, where project objectives are not defined clearly from the outset, changes in scope that delay project delivery are common (Blake Dawson Waldron, 2006 & 2008).

It has also been suggested in discussions with industry that some other causes of delays attributable to poor procurement practice include inappropriate consultant selection on the basis of lowest cost, rather than taking into account quality aspects of value for money, or simply where the good or service sought by government is not suitable for their underlying requirements.

In addition, underinvestment in the professional services component of public infrastructure projects, through poor procurement practices can cause delays during construction. Some examples include where insufficient investigation of geotechnical issues or community consultation cause interruptions to construction activities.

Overall, professional services firms report that they can reduce project delays by 7% on average, if project briefs, delivery model selection and contracts are improved. This can deliver significant downstream benefits for society.

3.2.3 Project quality

Finally, poor procurement practices also have an impact on the quality of project deliverables. This flows through in terms of the value for money achieved from procurement of professional services from the private sector. Beyond the price impacts described above, unclear project objectives, duplication of effort in verifying brief information, inappropriate risk allocation and onerous contract terms each affect the capacity of firms to explore and propose innovative ways of delivering on Australia's infrastructure requirements.

Accordingly, it is important to emphasise the importance of consultant selection based on the principle of value for money, taking into account project objectives, rather than simply selecting on the basis of lowest cost. This is generally recognised by the public sector in theory, although it can be difficult to apply in practice. However, making improvements in procurement practices is a tangible way in which the public sector can better promote value for money outcomes.

Specifically, professional services firms claim that they can improve the quality of public sector built environment projects by 7%, on average, if project briefs, selection of delivery models and contracts are improved.

The flow on benefits for the Australian economy of these quality improvements are quantified in monetary terms through the use of CGE modelling, discussed in the following section.

4 Economic modelling

The analysis presented in this report so far has focused on the economic costs associated with specific aspects of procurement practice, in terms of what they can mean for business and what they can mean for government customers.

But above this there is a bigger picture. Our procurement policies can impact infrastructure delivery in Australia, productivity of businesses across the economy, and ultimately, the living standards of all of society.

In this chapter, we want to understand those broader impacts of procurement practices on our businesses and economy. Beyond the business and government impacts, we use economy-wide Computable General Equilibrium (CGE) modelling to understand the impacts on GDP and employment. What we find is that while the dividend of transforming procurement is modest in annual terms, the benefits accumulate significantly over the long term, worth:

- around $2.5 billion in cost savings for government between 2015 and 2030; and
- around $5.1 billion in additional GDP between 2015 and 2030.

4.1 Modelling framework

Key Points:

- This analysis employs the Deloitte Access Economics Regional General Equilibrium Model (DAE-RGEM) to simulate the economy-wide impacts of improving procurement policies.
- The model measures results by comparing a baseline 'business as usual' scenario with a policy scenario, where the cost savings from better procurement practices are phased in over a five year period from 2015.

At the core of the economy wide analysis is the Deloitte Access Economics Regional General Equilibrium Model (DAE-RGEM) which allows us to simulate the economy-wide impacts of improving procurement policies. The model is a large scale, dynamic, multi-region, multi-commodity computable general equilibrium model of the Australian and world economy. The model allows project analysis in a single, robust, integrated economic framework, projecting changes in macroeconomic aggregates such as Gross Domestic Product (GDP) and employment.

Underpinning the CGE model is a set of input-output or social accounting matrices, which describe how the Australian economy is linked through production, consumption, trade and investment flows. For example, the model considers:

- direct linkages between industries and countries through purchases and sales of each other's goods and services; and
- indirect linkages through mechanisms such as the collective competition for available resources, e.g., labour, that operate in a global, economy-wide context.

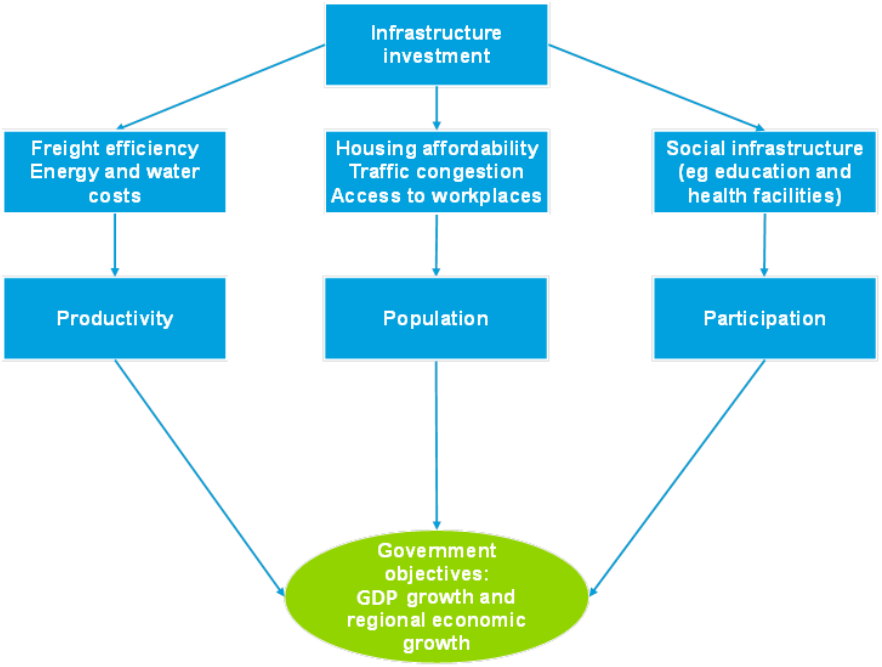
For further details on the CGE model please refer to Appendix A.

The CGE model measures results by comparing a policy scenario against a baseline case. In the context of this analysis, the baseline represents a 'business as usual' scenario, where there are no changes to government procurement practices. Under the policy scenario, the cost savings from changes in procurement practices are phased in over a five year period from 2015. This means that the results outlined below are, essentially, deviations from what would be expected given long term economic and demographic trends.

Before proceeding to the calculation of the inputs for CGE modelling, it is useful to understand the channels through which changes to macroeconomic outcomes are driven by reformed procurement practices which effectively lower the cost of investing in public infrastructure.

Previous work undertaken by Deloitte Access Economics has explored the relationship between infrastructure and economic growth. In one form or another, all growth in the economy is driven by one of the 'three Ps' - productivity, population and participation. Figure 4.1 shows how investment in infrastructure impacts on the 'three Ps' and in turn how they drive economic growth.

Figure 4.1: The relationship of infrastructure investments to broader economic indicators



Source: Deloitte Access Economics

For example, investment in transport infrastructure such as the freight rail network improves freight efficiency by reducing the time taken to transport goods to market. Similarly, investment in roads and rail can reduce traffic congestion and promote population growth in non-metropolitan areas, growing the economy in these regions. Finally, investment in social infrastructure, such as improvements health and education facilities, encourages greater participation in the labour force.

Accordingly, when the cost of investing in public infrastructure is reduced, the return on capital increases. This in turn increases the incentive for both the public and private sector to invest in infrastructure. This increased investment in infrastructure improves productivity, population and participation, all of which drive economic growth. Through CGE modelling, this chapter assesses the extent to which improvements in procurement can deliver better macroeconomic outcomes.

4.2 Modelling inputs

Key Points:

- Considering the costs associated with higher prices, delays and lower quality in the delivery of public infrastructure, that are attributable to poor procurement practices, inputs for the CGE model were developed.
- Overall, the net present value of the potential savings that can be delivered by improvements in procurement practices between 2015 and 2030 is over $2.5 billion, measured using a 7% discount rate.

For this exercise, we considered three economy-wide impacts attributable to inefficient procurement practices:

- higher prices associated with the professional services component of projects;
- delays in the delivery of public infrastructure; and
- reductions in the quality of public infrastructure.

Some of these impacts were not explicitly quantified for inclusion in the modelling, either because it was not clear that they were separate from other modelling inputs, or because they were difficult to estimate accurately.

This section describes the nature of these impacts and the process used to develop inputs for use in the CGE model. It is estimated that the value of cost savings over the period to 2030 that can be delivered by improvements in procurement practices is around $2.5 billion, in present value terms.

4.2.1 Higher prices

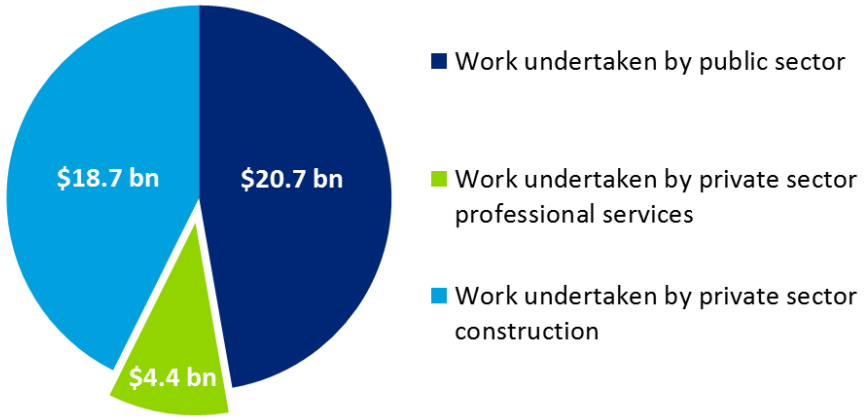
The previous chapter identified that the total price impact of poor procurement practices is around 5.4% of total revenue obtained by professional services firms in public sector built environment projects. In order to model the broader economic implications of these higher infrastructure costs, this price impact was converted into monetary terms using data from the ABS and the results of the survey of Consult Australia members.

In 2013, the value of building and engineering construction work done for the public sector was around $43 billion (ABS, 2014a & 2014b). In terms of engineering construction, around 53% of this work was undertaken by the private sector (ABS, 2014b).

Assuming that a similar rate of procurement from the private sector could be applied to the total level of public sector building work, we estimate that around $23 billion of work was

procured from the private sector for public built environment projects in 2013. The value of professional services revenue from these projects in 2013 is thus estimated at around $4.4 billion (in 2014 price terms), based on the average contribution of 19% reported by firms in this study and updating for changes in the Consumer Price Index. This breakdown is illustrated in Chart 4.1.

Chart 4.1: Assumed breakdown of the value of building and construction work done for the public sector in 2013 ($bn, real $2014)



Source: ABS (2014a); ABS (2014b); data reported by Consult Australia members; Deloitte Access Economics assumptions

Applying the price impact of 5.4% then implies that the total price impacts associated with poor procurement practices can be valued at around $239 million per annum in current prices. This comprises around $161 million in direct price premiums, $67 million as a result of lower competition, and $11 million worth of inefficient bid costs.

To the extent that professional services firms earn revenue from the public sector that are not included in the value of building and construction work done, these estimates should be interpreted as lower bound values.

That said, we note that there are other measures of the size of the sector which affect the size of the estimate. For example, firms reported that approximately 32% of their work has been undertaken for the public sector on average over the last five years. According to Bills (2014), the professional services industry, as it relates to building and construction, generated revenue of around $47 billion in 2012/13. This implies that revenue of around $15 billion was generated from the public sector. Depending on the assumptions made regarding the proportion of this revenue that is attributed to the provision of professional services for public infrastructure projects (as opposed to construction work or other services provided to government) the total price impacts of poor procurement practices could range from $82 million (assuming a 10% share) to $822 million (assuming a 100% share).

For the purpose of this analysis, the total cost estimate of $239 million has been employed in the economic modelling, to present a conservative estimate of the broader implications of better procurement for the economy.

4.2.2 Project delays

As noted in Section 3.2.2, professional services firms indicate that they can reduce project delays by a factor of 7% through improvements in procurement practice, particularly in relation to project briefs, selection of delivery models and contracts. These project delays have implications for all stakeholders, including:

- professional services firms;
- construction firms;
- government; and
- the ultimate end-users of the infrastructure.

These impacts are considered in turn below.

4.2.2.1 Impacts of delays on professional services firms

In consultations with industry, it was expressed that project delays can cause resourcing inefficiencies. For example, where a project is delayed, the staff involved will typically shift their attention to other work, creating additional costs through the process of bringing new staff onto the project once it resumes.

Firms have suggested that they take the risk of these inefficiencies into account when pricing their responses to public sector tenders. Accordingly, it is likely that these costs will be accounted for by the price premiums imposed on governments as a result of unclear project objectives.

4.2.2.2 Impacts of delays on construction firms

While construction firms are likely to experience delays during the delivery of public infrastructure projects for a range of reasons, the focus of this report is the impact of delays that occur with the professional services design stage of projects, attributable to poor procurement practices. For example, where governments do not clearly specify the objectives to be achieved from a project, the revisions of scope that occur as a result take time and can interrupt construction activities, or create additional work.

The costs incurred by construction firms as a result of these delays will primarily materialise through design error costs, which are considered separately in Section 4.2.3. Therefore, to avoid double counting, the costs of delays to construction firms are considered qualitatively in this section.

4.2.2.3 Impacts of delays on government and infrastructure end-users

Finally, project delays attributable to poor procurement practices also impact government and the ultimate end-users who are temporarily denied access to the infrastructure. However, it is difficult to determine the extent of the costs associated with the impacts on these stakeholders, given that government has the ability to make capital available for other investments during periods of delay.

While these shifts in investment will impact the end-user group affected by the project delay, at the economy-wide level, it is unlikely that there would be a substantial difference between the rate of return on capital generated from such other investments, and the

return received from the original project. As such, these impacts are also excluded from the economic modelling.

4.2.2.4 Conclusions on project delays

While it is evident that implications of project delays can be significant, it is likely that the costs borne by firms involved in professional services and construction will generally be priced into their contracts with government, and as such, captured under the modelling inputs described in Section 4.2.1 and Section 4.2.3. Similarly, it is likely that where delays in public infrastructure occur, it is likely that government would shift capital to other purposes, generating a similar level of return over the period of the delay.

For these reasons, the impacts of poor procurement practices on project delays are noted qualitatively, but not modelled explicitly in this analysis.

4.2.3 Project quality

Reductions in project quality as a result of poor procurement practices also have broader implications for the economy. As the benefits delivered by public infrastructure can vary significantly by type, it is difficult to measure the value of improvements in infrastructure quality in a general way.

Therefore, this analysis considers how improvements in the quality of professional services work can reduce the costs of rectifying design errors during the construction phase of projects.

According to Lopez and Love (2012), the average direct design error costs incurred by construction firms in a sample of 139 Australian construction and engineering projects was 6.85% of the value of construction contracts. While design errors can also generate indirect costs, such as those associated with resourcing inefficiencies, lower productivity and contractual litigations, this analysis focuses on the direct design error costs to present a conservative analysis. There are a number of causes of design error costs, including reduction in design audits, reviews and verifications as professional services firms compete to undertake work for the lowest price, or within insufficient timeframes.

As described in Section 3.2.3, professional service firms claim that quality improvements in the order of 7% can be achieved through better procurement practices. Assuming that these quality improvements would translate through an equivalent proportional reduction in direct design error costs, it is estimated that there is a potential to reduce the costs of constructing public infrastructure projects by 0.47%.

Following from the estimate that around $23 billion of work was procured from the private sector for public built environment projects in 2013, and the finding of the industry survey that around 81% of this work is attributable to the construction phase of projects, this cost saving is estimated at around $87 million per annum, in 2014 prices.

4.2.4 Summary of modelling inputs

The resulting modelling inputs are presented in Table 4.1 below. In recognition that it will take time for changes procurement practices to be implemented, these potential cost savings are phased in gradually over a five year period. On this basis, the savings are estimated to increase from $65 million in 2015 and peak at $326 million by 2019.

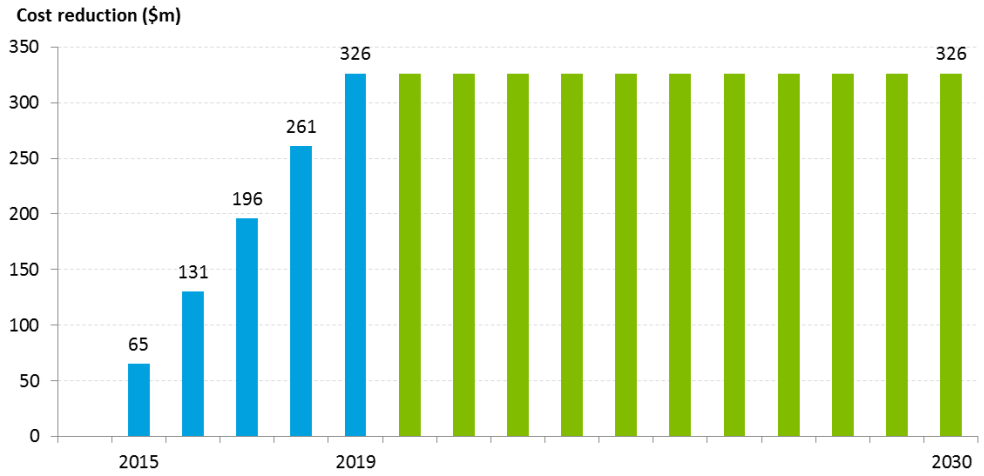
Table 4.1: Potential cost savings from improved procurement practices ($m, real $2014), 2015 – 2019

Input type	2015	2016	2017	2018	2019
Cost savings from reduced price impacts in professional service contracts	48	96	143	191	239
Cost savings from reduced design error costs in construction	17	35	52	70	87
Total cost savings	**65**	**131**	**196**	**261**	**326**

Source: Deloitte Access Economics

As demonstrated in Chart 4.2, these cost savings can deliver significant fiscal savings to government over the longer term. For example, the net present value of the potential savings that can be delivered by advances in procurement between 2015 and 2030 is over $2.5 billion, measured using a 7% discount rate.

Chart 4.2: CGE modelling inputs ($m), 2015 – 2030



Source: Deloitte Access Economics

4.3 CGE modelling results

Key Points:

- The cost savings associated with better procurement practices have the potential to increase the rate of return on capital in the economy. This flows through to significant long-term economic impacts.
- Specifically, reformed procurement practices are estimated to lift GDP by $5.1 billion in present value terms, measuring over the period to 2030.

This section demonstrates how changes in procurement practices can impact on broader macroeconomic outcomes. Essentially, achievement of the cost savings described above increases productivity on the supply-side of the economy, by increasing the rate of return on capital. This increases the attractiveness of capital inputs, stimulating economic activity and employment. In particular, we find that improved procurement can lift GDP by $5.1 billion in present value terms, measuring over the period to 2030, and generate a small increase in employment, peaking at 326 FTEs in 2019.

4.3.1 Impact on GDP

The impact of the potential cost savings on Australia's Gross Domestic Product (GDP) is shown in Table 4.2. The annual impact on GDP rises from $88 million in 2015, the first year of implementation, to $562 million by 2019, at the completion of the phase-in period. This is followed by gradual annual further increases in GDP, reaching $822 million by 2030.

Table 4.2: Impact of the potential cost savings on GDP ($m, real $2014), 2015-2030

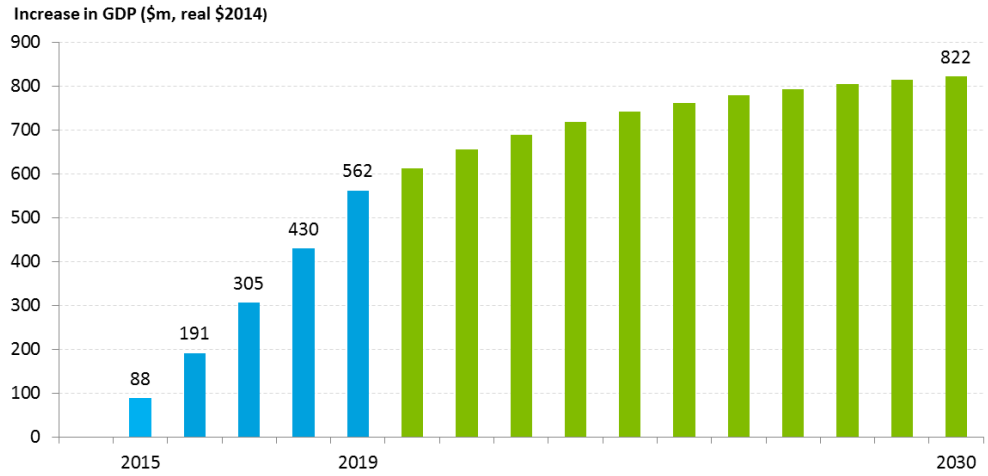
	NPV	2015	2019	2030
Increase in GDP	5,133	88	562	822

Source: Deloitte Access Economics

In net present value terms, strategic changes in procurement are estimated to lift GDP by $5.1 billion.

The impact of the cost savings from improved procurement practices on GDP over time is presented in Chart 4.3. It is evident that the majority of the increases are achieved over the five year phase-in period, with smaller annual increases in additional GDP experienced out to 2030 due to continued benefits of the higher return on capital.

Chart 4.3: Impact of the potential cost savings on GDP ($m, real $2014), 2015 – 2030



Source: Deloitte Access Economics

Implications for the states and territories

In order to understand what these results mean for different jurisdictions of Australia, a top-down approach was used to apportion these GDP impacts across the states and territories of Australia. This breakdown is presented in Table 4.3, and is derived from each state and territory's share of total public capital formation over the five years to 2012-13 (ABS, 2013).

Table 4.3: State breakdown of GDP impacts ($m, real $2014), 2015 – 2030

Increase in GSP ($m, real $2014)	NPV	2015	2019	2030
ACT	240	4	26	38
NSW	1,386	24	152	222
NT	100	2	11	16
QLD	1,379	24	151	221
SA	333	6	36	53
TAS	113	2	12	18
VIC	1,015	17	111	162
WA	565	10	62	90
Total Australia	**5,133**	**88**	**562**	**822**

Source: Deloitte Access Economics

Overall, the benefits of transforming procurement will be largely concentrated in states that experience the greatest level of public sector capital investment, with the present value of GSP improvements out to 2030 valued at over $1 billion in NSW, QLD and VIC. Taking into account the relative size of each state and territory economy, it is possible to achieve significant long term benefits from better procurement in every jurisdiction.

4.3.2 Impact on employment

As shown in Table 4.4 the cost savings from advances in procurement are estimated to have a small positive impact on employment. Employment is expected to grow gradually from 69 FTEs within the first year of improvements to procurement, peaking at 326 FTEs by 2019.

However, following the conclusion of the phase-in period, the additional annual employment attributable to improvements in procurement will fall slightly over time, reaching 303 additional FTEs by 2030. This tapering off effect can be attributed to a shift in the economy away from labour to capital inputs, triggered by the higher rate of return on capital that is delivered by a lower cost of infrastructure.

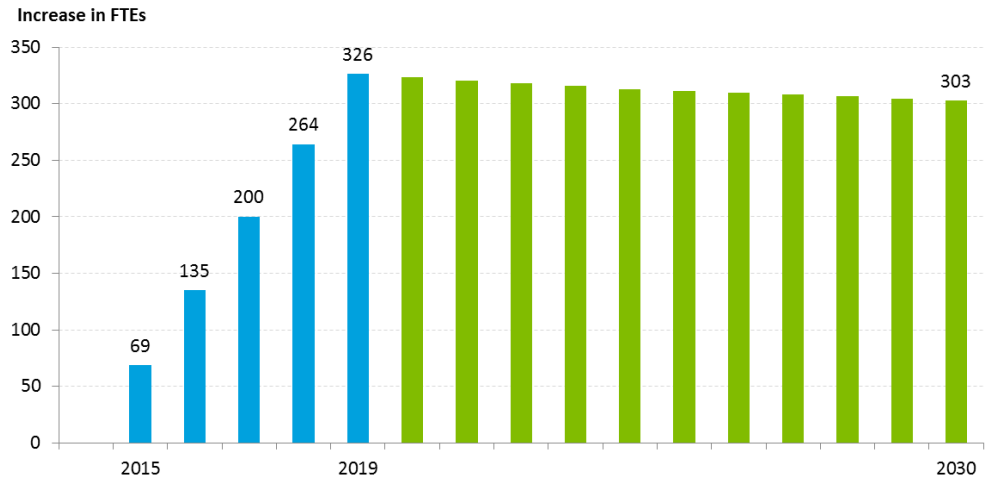
Table 4.4: Employment impact of the potential cost savings (FTEs), 2015-2030

	2015	2016	2017	2018	2019	2030
Increase in employment	69	135	200	264	326	303

Source: Deloitte Access Economics

The impact of the cost savings on employment over time is shown in Chart 4.4.

Chart 4.4: Impact of the potential cost savings on employment (FTEs), 2015-2030



Source: Deloitte Access Economics

4.3.3 Conclusions from the CGE modelling

Overall, these results suggest that while there are modest annual economic impacts associated with better procurement for public infrastructure projects, these have a significant long term cumulative effect. Between 2015 and 2030, the cost savings worth around $2.5 billion in present value terms are estimated to increase GDP by $5.1 billion.

5 Transforming procurement policy

The previous chapter has demonstrated how better procurement can deliver cost savings for government and generate higher employment and GDP. Achieving these outcomes requires consideration of government perspectives on the extent and causes of the issues raised by industry, taking into account the variations in procurement policy and practice across jurisdictions and departments.

This section discusses the objectives of procurement policies, outlines some of the main differences in the way that procurement policy is structured in different parts of Australia, and identifies some of the underlying causes of inefficiencies in procurement, based on consultation with government. Drawing from this policy context, it outlines practical next steps that will help to reduce the cost of infrastructure, delivering mutual gains for not only industry, but also government and the broader community.

5.1 Key objectives for procurement policies

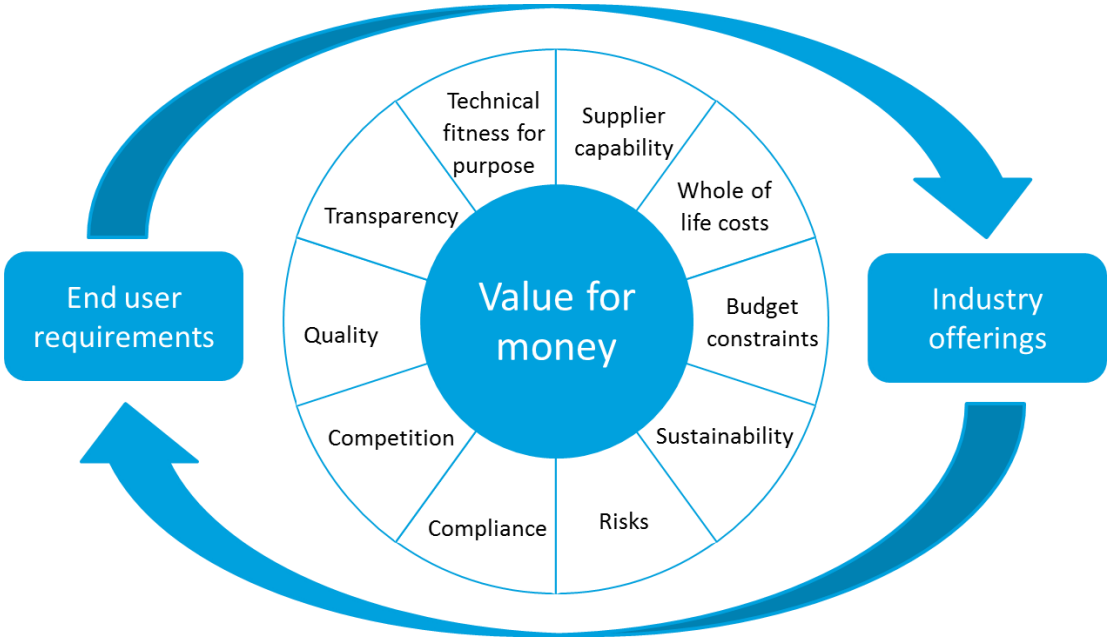
Key Points:

- Determining the optimal value for money solution through procurement is a careful balancing act, trading off a range of factors in order to select the industry offering that best meets end user requirements.
- Within government, ensuring the integrity of procurement through probity, accountability and transparency is also critical to minimise the scope for misuse of public funds.

The core objective of procurement policies across the Australian public sector is to achieve value for money. As the custodian of public funds, governments have a responsibility to carry out careful financial management, and as such, within the context of procurement, are required to ensure that the best return and performance is obtained for money spent.

However, as illustrated in Figure 5.1, the process of determining the optimal value for money solution through procurement is a careful balancing act. Rather than simply pursuing the lowest cost offering, government agencies must consider a range of factors in order to select the industry offering that best meets end user requirements.

Figure 5.1: Factors to be considered in procuring value for money services



The requirements of the end user are at the heart of the procurement decision making process. Understanding the motivation behind a request to market is critical to setting procurement specifications that clearly focus industry on the problem to be addressed. In turn, these specifications set the prime benchmark for assessing the bids put forward by industry. Where government is unclear internally on the outcomes to be delivered by procurement, they are at risk of paying for a good or service that fails to meet the business needs.

At the same time, procurement managers must identify and respond to the level of industry capability. It is important to recognise that government can only receive what businesses are able to deliver in terms of product, timing and cost. While industry capability will not always constrain procurement objectives, it is important to be flexible and work with firms when that is the case. As outlined in the box below, it is also important for governments to recognise the longer term implications of their procurement decisions on industry capability, given their significant market power.

Perhaps the most obvious factor for consideration when assessing industry offerings in procurement is cost. Here, procurement managers must identify not only the upfront prices proposed by firms, but also any relevant ongoing financial obligations, to capture whole of life costs. For example, Value for Money Policy in Western Australia prescribes that "assessment of cost needs to consider any ongoing costs that may accrue beyond the initial price, including the associated costs of holding, using, maintaining and disposing of the goods, services or assets" (Building Management and Works, 2013b).

Procuring public infrastructure – government monopsony power

As a major procurer of professional services for public infrastructure with many potential suppliers, governments have a degree of market power when setting the terms of an engagement. This means that government decisions about procurement can affect the industry over the long term. For example, choosing just one or two suppliers regularly can over the longer term erode the capability of other firms in the industry, leading to higher prices and reduced innovation. At the same time, governments have a responsibility to choose the firm that presents the best value for money on any given project.

Balancing the short term objective of choosing the right team for a specific project with the long term objective of maintaining market depth adds to the complexity of decision making in procurement. Procurement policies recognise the importance of fostering competition, that is, not only allowing for the best firm to be chosen for a particular project, but also allowing for the best firm to vary from project to project.

However, to appropriately compare the product or service proposed to be delivered by different firms, the cost elements of a bid must be interpreted alongside an assessment of quality and supplier capability. Determining whether price premiums for higher quality service are justified, affordable and necessary to deliver on the specifications of a contract is a day-to-day challenge for procurement managers.

Carrying out this process is not a simple financial calculation of costs and benefits. Other factors to be considered include transition issues, risks, and sustainability. Procurement policy, such as the NSW Procurement Board's Statement on Value for Money (n.d.) provides guidance on the relevant considerations for assessment. However, successful implementation of policy requires input from experienced practitioners that understand the nuances of the problem at hand, and the different ways of delivering on the ultimate objectives.

There is also an added responsibility in the public sector to ensure the integrity of procurement processes. The rules-based procedures within government procurement policy are set to minimise the scope for misuse of public funds, and as such, compliance with these requirements is a central part of bid evaluation and supplier selection.

For example, providing for ethical and fair treatment of participants, and ensuring probity, accountability and transparency in procurement operations are key principles within procurement policy in South Australia, that sit alongside achievement of value for money (State Procurement Board, 2014:5-6). Procurement policies in other jurisdictions place similar emphasis on integrity of process (Department of Housing and Public Works, 2013; NSW Government, 2005; Building Management and Works, 2013a). It is a challenge for government to ensure these outcomes are met at lowest cost, and to avoid imposing unnecessary requirements that do not add sufficient value to decision-making.

Efficient management of procurement therefore requires a significant level of expertise. The following section examines some of the features of procurement policies and practice employed across Australia to achieve value for money.

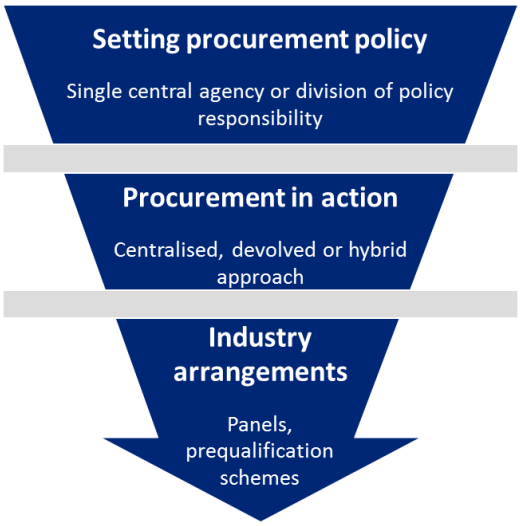
5.2 Where procurement policy is made

Key Points:

- Various jurisdictions have similar procurement policy structures including specific agencies responsibility for building and construction procurement policy and some centralisation, however, there are differences in mechanics and implementation, such as agency culture and the existence of industry arrangements such as panels and prequalification schemes.

Each jurisdiction of Australia has its own procurement policy and processes. While the core objectives of procurement policies are broadly similar, as discussed in Section 5.1, there are some differences in the way those objectives are implemented, for example, through variations in the level of centralisation. A number of jurisdictions are also in the process of delivering procurement reforms. This makes it difficult to generalise on the causes of inefficiencies raised by industry.

Figure 5.2: Moving from procurement policy to practice



To help understand the implementation of procurement policy in Australia, this section describes some of the main features of the flow from policy to practice in different jurisdictions and departments, as summarised in Figure 5.2. Given the scope of this report, focus is placed on procurement of professional service consultants for public infrastructure projects.

5.2.1 Setting procurement policy

Designation of responsibility for procurement policy varies across Australia. Given the close association with procurement and financial management objectives, described in Section 5.1, agencies or boards that set the policy frameworks and principles which guide procurement processes undertaken within their jurisdiction will often reside in, or be supported administratively by the relevant finance department. However, as outlined

below, there are often differences in the scope of procurement categories to which their policies apply.

The approach to procurement policy is most centralised within NSW, ACT and at the Commonwealth level. In these jurisdictions, responsibility of overall procurement policies lies with NSW Procurement within the Office of Finance and Services; the Infrastructure Procurement team within the ACT Chief Minister, Treasury and Economic Development Directorate; and the Business, Procurement and Asset Management Group within the Commonwealth Department of Finance respectively. That said, these policy units are supported by other areas of government. For instance, the Infrastructure Financing Unit within NSW Treasury also has a strong influence on building and construction procurement policy alongside NSW Procurement.

In some other jurisdictions, procurement policy responsibilities are more clearly divided between two lead stakeholders – one which focuses on building and construction, and another that sets policy for all other types of goods and services. For example:

- in Victoria, goods and services procurement policy is set by Victorian Government Purchasing Board (VGPB), while construction procurement policy is the responsibility of the Minister for Finance (VGPB, 2014; Department of Treasury and Finance 2013); and
- in Western Australia, the broader procurement policies set by the State Supply Commission are adapted to the context of building projects by Building Management and Works (BMW), also located within the Department of Finance (BMW, n.d.).

A similar approach is taken in South Australia, whereby the policies of the State Procurement Board apply to construction projects worth no more than $165,000. The Minister for Transport and Infrastructure and the Department of Planning, Transport and Infrastructure (DPTI) is responsible for setting procurement policy for all construction projects that exceed this threshold value (State Procurement Board, 2012; Department of Premier & Cabinet, 2011).

The Queensland approach to procurement policy is somewhat of a hybrid policy-setting model. Overall, the Department of Housing and Public Works is responsible for state-wide procurement policy. As part of the ongoing Procurement Transformation Program, the Department revised its procurement policy in 2013. This is then supported by more specific policies and guidelines produced by the leaders of the six procurement mega-categories identified in the Queensland Procurement Framework, including general goods and services, building, construction and maintenance, and ICT.

There are also a number of important cross-jurisdictional organisations that influence the direction of procurement policy. Infrastructure Australia, established under the *Infrastructure Australia Act 2008* to provide advice on a range of infrastructure-related matters, has released a number of papers on infrastructure procurement and delivery.

In particular, Infrastructure Australia funded a study between 2011 and 2012 to identify measures that contribute to efficiency in the procurement of major infrastructure projects. Two reports were released that summarised the findings of this work, providing benchmarks for best practice procurement, and outlining efficiency strategies for the different phases of the procurement process (Infrastructure Australia 2012a; 2012b). In 2013, Infrastructure Australia also commissioned a review of project governance effectiveness. This called for both short term and long term actions to improve governance

arrangements, which should in turn increase the proportion of projects that meet their baseline time, cost and quality objectives (Caravel, 2013).

The next steps outlined in Section 5.4 of this report seek to increase uptake of the features of best practice procurement advocated by Infrastructure Australia, in relation to stakeholder consultation, clarity of project requirements, engaging with industry and maintaining appropriate procurement teams.

Another leader in the development of procurement policy is the Australasian Procurement and Construction Council Inc (APCC) which consists of government representatives at the Commonwealth, state and territory levels in Australia, and representatives from government in New Zealand and Papua New Guinea. The APCC engages with industry and develops publications to advance procurement policy and practice, consistent with its strategic goals:

- enhanced management and performance of government assets;
- procurement capability development;
- procurement as a strategic function;
- smarter procurement and construction solutions; and
- enhanced jurisdictional collaboration (APCC, 2013).

5.2.2 Procurement in action

Separate from policy setting responsibilities, governments also have different arrangements for managing procurement processes. Some jurisdictions undertake procurement based on a centralised framework. This involves appointment of a lead agency to undertake procurement on behalf of other departments in a specific area, to allow for consolidation of expertise in relation to technical requirements, assessment of value for money and project risk management.

This model is used in South Australia, whereby the Building Management division of the Department of Planning, Transport and Infrastructure (DPTI) is responsible for the procurement and delivery of all government building construction projects, such as schools, libraries, hospitals and police stations. In this role, they work closely with the relevant purchasing agency, such as the education, health or justice department, to ensure that the requirements of the end user group are met (DPTI, n.d.).

Western Australia also has centralised procurement arrangements, whereby agencies are required to involve procurement staff within the Department of Finance for contracts valued at $250,000 or more (Department of Finance, 2014). In some cases, the Department has procurement staff located within key agencies. However, in regard to non-residential construction projects, the Building Management and Works (BMW) division manages procurement on behalf of other agencies, similar to DPTI in South Australia.

The Queensland Government is currently shifting away from an individual agency approach to procurement towards a more centralised, whole-of-government operating model (Department of Housing and Public Works, 2014). Under the current reforms, the leaders of procurement policy under the six specific mega-categories are also appointed responsibility for procurement practice.

For example, the Department of Housing and Public Works is responsible for procurement in the Building, Construction and Maintenance category, through its Building and Asset Services unit, while the Department of Transport and Main Roads is responsible for procurement within the Road, Construction and Maintenance category.

Meanwhile, the procurement reforms underway in NSW seek to place a greater emphasis on the devolvement of procurement responsibilities to the agency level, to allow for greater proximity to business needs (NSW Procurement, n.d.). At the same time, the reforms allow for appointment of agencies as leaders of whole-of-government procurement categories where appropriate, similar to other states. One of the aims of this reform agenda is to shift away from rules and process-based procurement, to a more flexible approach allowing for discretion and interpretation.

NSW Procurement is responsible for agency accreditation schemes that determine the extent to which an agency is permitted to undertake procurement without external support (NSW Procurement, n.d.). There are currently two schemes, one for goods and services, and the other for construction, which are to be merged from 1 January 2015. Some of the agencies currently accredited for both the planning and delivery phases of construction procurement include Transport for NSW, Roads and Maritime Services, Land and Housing Corp within the Department of Family and Community Services, and the Health Administration Corporation (NSW Government, 2014). These agencies are permitted to apply their own procurement systems, regardless of project value or risk.

5.2.3 Industry arrangements

At the ground level, procurement practices vary on a case by case basis, typically accounting for contract value, risk and complexity. In relation to the procurement of professional services for public infrastructure projects, some government agencies provide opportunities for firms to make standing offer arrangements, often as a member of a panel, which specify pricing terms for different types of services. For example, BMW in Western Australia manages six different consultant panel arrangements, including architectural services, engineering and building, and cost management (BMW, n.d.).

Agencies can then consider the options presented by the panel when seeking to procure low risk and medium value work. In contrast, high value contracts will generally be awarded through an open tender process.

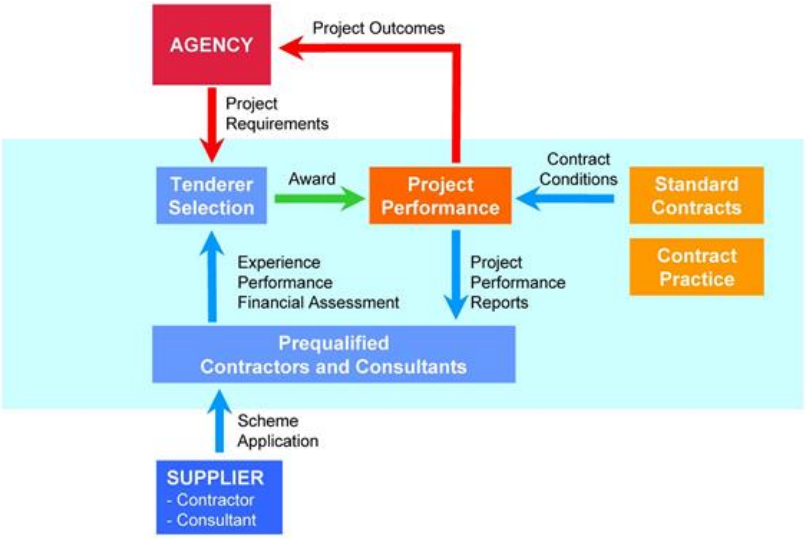
Most jurisdictions also utilise prequalification schemes for firms that offer consultancy services in relation to building and construction projects. To be listed on a prequalification register, firms must apply to the relevant government agency having documented their capability against the specified assessment criteria.

The prequalification register then provides the public sector with a pre-approved pool of suppliers that can be approached for proposals, based on the type of work required.

For example, VicRoads administers a pre-qualification scheme for consultants and contractors with experience in civil construction. The scheme identifies nine distinct work types, which are in turn split into categories and different levels of expertise (VicRoads, 2014).

Along with the information provided by firms in their initial application, the registers are usually updated to keep track of performance in subsequent engagements with the public sector. Such schemes are often used by government to streamline competitive tendering for high value or high risk projects, and can assist in the identification of potential suppliers with specific expertise. The relationship between the New South Wales prequalification scheme for construction consultants and the broader procurement process is illustrated in Figure 5.3, although these arrangements are currently under review.

Figure 5.3: Consultant prequalification within the NSW Government Procurement System for Construction



Source: NSW Office of Finance and Services (2013)

5.2.4 Conclusions

It is evident that there are many similarities in the approach to procurement of professional services for public infrastructure in various jurisdictions, through specific designation of responsibility for building and construction procurement policy and centralised procurement management responsibilities in particular areas. However, there are differences in the mechanics of how these approaches are implemented, often reflecting the variations in structure of departments and the relationships between them. Procurement reforms are also underway in a number of states. Cultural differences are another key driver of the way procurement is undertaken across Australia.

The following section provides further insight on these matters, drawing from consultations with procurement leaders in the public sector.

5.3 Government perspectives on opportunities for improvement

Key Points:

- While government representatives consider that the procurement arrangements in Australia are broadly effective in achieving value for money outcomes, it is acknowledged that further improvements can be made.
- Some of the drivers of unclear project objectives that were identified by government in consultation include difficulty of planning prior to cabinet approval, distinctions between end users and stakeholders for different infrastructure types and cultural differences between agencies in their approach to industry engagement. However, the price premiums or lack of competition associated with poor scoping was not frequently recognised by government.
- In relation to contracting, government has expressed a willingness to pay to shift responsibility for risk management to the private sector. However, it was acknowledged that government is uninformed about the costs incurred, particularly as they are often hidden by the competitive market. Inclusion of contract clauses is driven by legal advice, rather than commercial or economic assessments, and it was considered that the practical benefits of a standard approach offset the benefits of flexibility.

Government representatives consider that the procurement arrangements in Australia are broadly effective in achieving value for money outcomes, and recognise the importance of being flexible and responsive to the changing needs and requirements of the Australian economy, such as the ageing population, greater budget restraints and growing citizen expectations.

At the same time, it was acknowledged that procurement could be improved, and that open, direct and respectful dialogue with industry is a good basis for moving forward and acting on these opportunities.

This is also formally reflected in some current procurement reform agendas. For example, three of the seven strategic directions currently being implemented in NSW, following identification by the NSW Procurement Board in late 2012 include:

- simplification and reduction of red tape for suppliers and agencies;
- engaging with industry; and
- innovating the approach to government procurement.

Similarly, two of the five priorities within the Queensland Government Procurement Plan 2012-15 are to:

- improve engagement with internal stakeholders, supply markets and industry; and

- build procurement and contract management capability (Department of Housing and Public Works, 2012).

Accordingly, this section outlines the government perspectives on some of specific procurement issues that have been raised by industry. It covers two main areas in detail: clarity of project objectives and contracting.

5.3.1 Project objectives

In each of the consultations, public sector representatives agreed that proper scoping and documentation of objectives is critical to the success of public infrastructure projects. Where scoping is inadequate, there is a risk that professional services firms will under-bid for the work that is required, such that the outcomes of procurement are not achieved without cost overruns and delays. Poor scoping at the commencement of a project is also likely to lead to costly variations down the track.

Given the mechanisms that have been established by government to ensure that adequate investments are made during the brief preparation stage, some representatives considered that briefs with unclear objectives were less frequent than proposed by industry.

For example, some departments engage consultants to assist with the development of project scope, or have processes that can accommodate non-conforming bids where industry is able to make an innovative suggestion. Others recognise that there is a potential for greater flexibility, but that obtaining early industry involvement is somewhat constrained by probity requirements.

In addition, the price premiums or lack of competition associated with briefs that have unclear objectives are not obvious to the public sector. Instead of visible price increases from higher bids and less supplier interest, it was considered that poor quality of service was a more common outcome associated with scope inadequacies. This suggests that the price impacts reported by firms are often masked by the procurement process – limiting government incentives to address the underlying issues.

Nevertheless, a number of reasons were given to explain some of the incidence of unclear objectives in project briefs for professional services. These include:

- **Planning prior to cabinet approval:** it was acknowledged that it can be challenging for agencies to engage fully with an end user group before a project has received official cabinet approval. This can contribute to a situation where a project is inadequately scoped, due to a mismatch between the needs of the end user and the objectives of the agency. If not resolved prior to going to market, this political barrier can then flow through the efficiency of the procurement process.
- **Distinctions between end users and stakeholders for different infrastructure types:** it was also raised that there may be a more natural tendency for greater end user involvement in the delivery of certain types of public infrastructure, driven by differences in the level of conflict between end users and other stakeholders. For example, a road project is likely to be more complex and have broader stakeholder impacts, beyond the benefits accrued by end-users, compared to the construction of a school. This can impact the ability of governments to define project objectives with clarity from the outset.

- **Cultural differences in approach to industry engagement:** it was suggested that there were likely to be differences in the way that agencies engage with industry throughout procurement, even within the same jurisdiction. The culture within a procuring agency can have significant influence on whether a supervisory or co-operative approach is taken in project scoping stages.

5.3.2 Contracting

Public sector leaders recognise the challenges associated with contracting and efficient allocation and management of risk in procurement. A number of representatives recognised that their standard contracts contain most of the clauses identified in Section 2 of this report, including contracting out of proportionate liability, unlimited liability, expert standard of care and fitness for purpose. That said, in other cases, government agencies rely on the Australian Standard General Conditions of Contract (AS4122-2010), which addresses some of the issues encountered by industry in relation to risk allocation clauses. However, amendments of the Australian Standard made by governments can have the effect of returning to a state of less than optimal risk management from an economic perspective.

There are a range of underlying causes that drive the inclusion of these terms in professional service contracts for infrastructure projects. For example:

- **Focus on legal implications:** the approach taken by the public sector to allocate and manage risk is generally driven by legal advice. For example, despite the existence of proportionate liability legislation, some jurisdictions include contracting out clauses as a way of designating co-ordination responsibility to the lead consultant for a project. It was reported that this has been the traditional approach to risk management within government procurement.
- **Practical benefits of a standard approach:** standard clauses are often applied in contracts due to the costs involved in negotiating individual terms on a case by case basis. For example, one of the reasons given for use of unlimited liability clauses is the difficulty and time necessary to ascertain appropriate limits for individual contracts. While standard approaches can be effective when clauses are drafted to allow for appropriate risk management, this justification for use of unlimited liability clauses suggests that governments are unaware of the implications of unmanaged risks.

  That said, most jurisdictions do have arrangements whereby firms can register under a Professional Standards Scheme that limits their occupational liability in work performed for government. However, there are number of challenges associated with implementation of such schemes. Accordingly, some jurisdictions apply rules of thumb in other circumstances. For example, South Australia has a default liability cap of five times the contract value, for low risk contracts valued up to $1 million, where professional schemes do not apply.
- **Willingness to pay while costs are hidden by the market:** government acknowledges that price premiums from industry are associated with a risk-averse approach to procurement, and has expressed willingness to pay those costs.

  At the same time, government is uninformed about how much contract terms are adding to the cost of infrastructure, and whether this is greater than necessary. A common view is that the strong competition among professional services firms

contributes to lower prices, which masks the extent of price premiums charged in exchange for risk transfers.

However, there are examples of where the inclusion of clauses seeking to transfer risk to the private sector has led to specific premiums. One representative described a case where the removal of clauses transferring risks in relation to wet weather, industrial relations and latent conditions led to a reduction in prices quoted by industry of around $5 million.

- **Slower progress through cross-jurisdiction negotiations:** some representatives indicated that greater co-operation by government across jurisdictions could help to improve the efficiency of contract clauses in procurement. However, it was suggested that improvements in relation to the frequency of contracting out of proportionate liability at the state level have been stalled by the limited progress the Commonwealth level.

5.4 Next steps

Key Points:

- Increasing the efficiency of procurement requires action at all levels of the procurement process. This chapter discusses seven practical next steps relevant for policy makers through to procurement officers in government.
- While it will take time to deliver on these reforms, the significant long-term flow on benefits identified in Chapter 4 illustrate that the efforts may result in economic benefits.

Just as infrastructure projects can vary significantly, it is important that procurement practices are flexible to ensure that the right arrangements are made for the right project. However, there are a number of reforms that can transform the procurement of professional services and deliver public infrastructure more efficiently.

This report highlights seven practical next steps that will re-focus public sector procurement, as summarised in the box below. While it will take time to implement these changes, this report demonstrates that the efforts should result in economic benefits. Above this, we note that achieving meaningful changes in a complex area such as procurement policy is unlikely to be delivered by any single action. It is a strategically significant area of government activity that needs more holistic consideration and cultural change to support that.

(1) Set up procurement teams with practical, legal, insurance and procurement experience: given the mixture of expertise required to undertake a successful procurement, governments should consider restructuring procurement teams to encourage the key players to work collaboratively. Together, legal experts that understand contracting, insurance specialists, practitioners with project experience and procurement experts can evaluate value for money and appropriately tailor procurement processes, contracts and delivery models to the objectives of a project

(2) Reallocate procurement resources towards specification of project objectives: procurement policy should place a stronger focus on identifying the needs of public infrastructure end users, re-testing business case objectives in the procurement environment and taking advantage of opportunities to engage with industry in project scoping where appropriate. Without agreeing and documenting project objectives clearly, time spent on contracting will be less effective.

(3) Remove contract clauses that do not stack up: while this report has highlighted the costs of contracting out of proportionate liability and imposing expert standard of care on industry, these need to be evaluated with reference to the benefits of transferring risk to industry, through a cost-benefit analysis. Where terms fail to meet a cost-benefit analysis, they should be removed from contracts unless justified by the specific circumstances of a particular project. Where clauses are maintained, governments should be prepared to explain the justification of doing so. This requires government to identify whether it intends to use clauses to cover their losses, or to actively mitigate risks.

(4) Develop and apply limited liability guidelines: while Professional Standards Schemes are one mechanism to achieve limitation of liability, these are challenging to implement and not viable for all professions. To enable a broader approach for efficient risk management, governments should develop and apply limited liability guidelines to assist agencies with ensuring that liability clauses do not add unnecessarily to project costs. Such guidelines should simplify the process of setting liability caps, while taking into account variations in market practice, project size, risk and the size of the supplier.

(5) Verification of brief information: it is more efficient for government to undertake the necessary work to verify the accuracy of information provided in a request for tender, rather than transferring the costs of that work to all bidders, creating duplication. Purchasing agencies should actively seek to minimise this burden.

(6) Streamline compliance processes: governments can also reduce bid costs for public infrastructure projects to more efficient levels by streamlining compliance requirements, particularly where the information provided by firms is rarely a differentiating feature of the successful tenderer. Options include development of standard form agreements for firms, or submission of compliance documentation as part of pre-qualification schemes.

(7) Evaluate and adapt procurement frameworks to encourage innovation: continuing to evaluate and adapt procurement frameworks with reference to changes in market offerings will help to maximise innovation in public infrastructure projects. Going forward, the public sector should be open to non-conforming bids, new delivery models, early market sounding options and continue to provide opportunities for unsolicited proposals.

These are presented in more detail below, followed by a discussion around variation in time frames for implementing these changes.

5.4.1 Set up procurement teams with practical, legal, insurance and procurement experience

Given the range of factors to be considered when assessing value for money, successful procurement requires input from a range of disciplines, including legal expertise, an understanding of insurance markets, project management skills, technical expertise and experience in sound procurement processes.

This report finds that there is substantial industry recognition of the skills of public sector procurement managers, a notable achievement. That said, both government and business recognise that there are some skills gaps in procurement that need to be addressed, including:

- management of privately financed procurement models;
- technical knowledge in the assessment of service quality;
- understanding the implications of contract terms particularly in the context of insurance markets, the justification of standard form contract positions and where opportunities for flexibility can arise; and
- assessment processes to ensure efficient risk management.

In particular, there is a need to establish a role for practitioners with technical expertise within agencies that undertake procurement. Without an understanding of the spectrum of service quality available from professional services, and what is appropriate in the context of a particular project, it is very difficult to evaluate which industry proposal presents the optimal value for money. While it is not necessary that practitioners undertake or manage the procurement process, some level of technical oversight within government should be required.

It is also important to address cases where procurement officers do not have authority to negotiate changes to contract terms with industry, or use the time that it would take as an excuse for inefficient outcomes. Given the shift towards greater procurement of services from the public sector, it is critical that governments ensure that their procurement professionals have a strong understanding of the importance of combining technical, legal and commercial perspectives when developing a request for services and selecting a supplier.

For example, in drafting contracts it is critical to understand implications of risk transfer to consultants not only from a legal perspective, but also acknowledging the nature and availability of professional indemnity insurance for consultants, and the ability of consultants to manage those risks as they carry out their work. Access to specialists should be embedded within the procurement process.

Therefore, governments should consider broader structural change in the approach to procurement, by establishing smaller procurement teams that mix skills from different disciplines, rather than isolating them. There is an opportunity to achieve better outcomes from procurement if the key players in government, from the legal experts to engineering practitioners, work collaboratively to appropriately tailor procurement processes, contracts and delivery models to the objectives of a project.

Making this shift should also help to drive a culture of engaging with industry, rather than supervising, to ensure that everyone is on the same page.

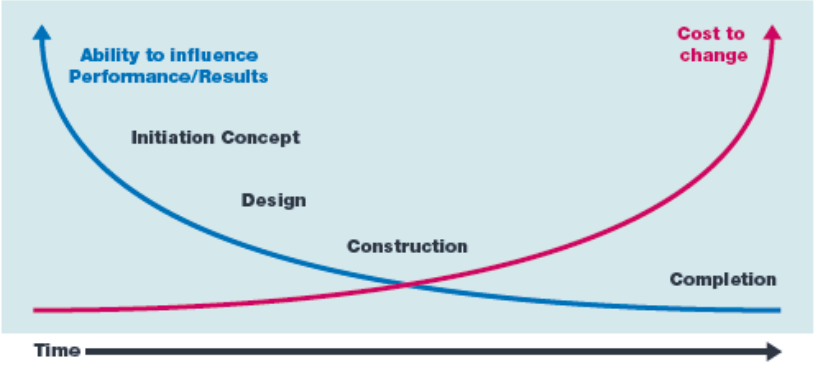
5.4.2 Reallocate procurement resources towards specification of project objectives

Proper investment into planning and scope development before a brief goes to market is a well-established foundation of good procurement practice.

Nevertheless, this report has found that over one third of requests for tender made by the public sector for professional services in the built environment sector have unclear project objectives. Although representatives from government have expressed that this may overestimate the extent of the problem, it is evident that pre-procurement planning requires greater focus.

Governments should assess whether there is an appropriate allocation of resources in procurement that balances the need to accurately specify project objectives and also draft contracts that efficiently manage project risks. It is important to acknowledge that without clearly defining the outcomes to be achieved from procurement, effort spent on contracting will be less effective. This is not to say that contracting is not important – indeed, this report demonstrates that there are substantial long term benefits to be achieved from improving all aspects of procurement. Rather, governments have a responsibility to focus on clearly identifying core objectives for a project from the outset which is just as important as ensuring efficient risk management. As illustrated in Figure 5.4, the ability to influence project outcomes are maximised in the early stages of planning, whilst the costs of making changes are simultaneously minimised.

Figure 5.4: Ability to influence performance/results over project time



Source: ACIF & APCC (2010:10)

As such, the primary focus of procurement should be on working as closely as possible with end users to identify and confirm outcomes to be achieved. There may be a number of parties involved in this process, from the end users that require the infrastructure, to the agency staff that is purchasing on their behalf, and, where centralised procurement is in place, the agency that is managing the procurement process.

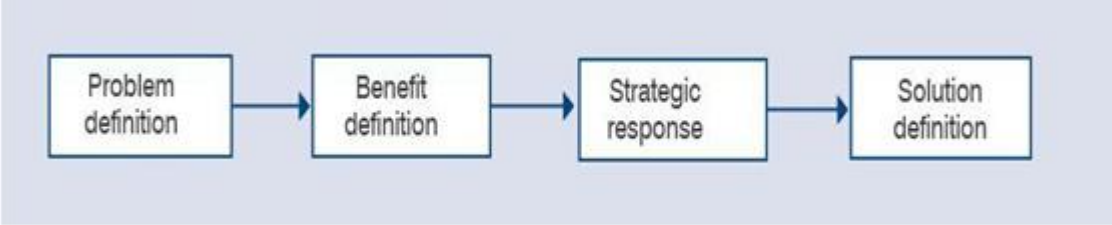
In order to request responses from industry that are relevant to the problem at hand, it is important that the expectations of each stakeholder on the demand-side of the transaction are consistent. Ultimately, this requires formal agreement among key stakeholders on project objectives before proceeding to market.

However, the political sensitivities associated with planning and consultation prior to formal approval must also be acknowledged and addressed by government.

To ensure that this does not lead to a mismatch of expectations, it is critical that agencies re-test business case objectives in the procurement environment.

Where appropriate, governments should consider using investment tools that focus attention on clearly defining the objectives to be achieved. The Victorian Government has made some progress in this regard, through the Investment Logic Map developed from the Victorian Government's Investment Management Standard. As shown in Figure 5.5, this provides a template for identifying how the benefits of a project will address the underlying problem. There is scope for further development of this framework as it relates to public infrastructure projects.

Figure 5.5: Investment Logic Map – shaping a new investment



Source: Department of Treasury and Finance (2012)

Furthermore, agencies should consider early engagement with industry in cases where the way to achieve project outcomes are particularly complex or uncertain. Employing industry expertise can help to inform government, and encourage innovative suggestions that may not have been considered otherwise.

By addressing scoping challenges from the outset of a project, governments will be well placed to realise cost savings through lower price premiums and improved competition, as well as higher quality services.

5.4.3 Remove contract clauses that do not stack up

The issues surrounding contract clauses and risk management are complex, and require a flexible approach on a case-by-case basis. However, at present, governments in Australia are not informed about the impact of the clauses they are including in contracts.

While understanding the impact of clauses from a legal perspective is an important responsibility of government when procuring from the private sector, it is just as important for governments to evaluate the costs and benefits associated with contract terms in the context of the market and the broader economic impacts.

As noted in the National Public Private Partnership Guidelines developed by Infrastructure Australia, in cases where neither party to a contract has full control over a risk:

> *"the risk allocation should reflect how the private party prices the risk and whether it is reasonable for government to pay that price, taking into account the likelihood of the risk eventuating, the cost to government if it retained that risk and the ability of government to mitigate any consequences if the risk materialises" (Infrastructure Australia, 2008:29).*

Accordingly, government should assess whether the benefits of risk transfer to the private sector achieved through contract clauses are sufficiently large to offset the costs transferred back by industry through direct price premiums, reduced competition and uninsured risk exposure.

When estimating these benefits, government must consider whether the purpose of including a particular clause is to provide cover for potential losses, or whether clauses are intended to provide incentives for firms to manage their risks appropriately. In general, it is noted that invoking contracts is rarely the solution when a project goes wrong. Further, transfer of risk does not ensure that the risk is being cost-effectively managed.

Where clauses do not pass a cost-benefit analysis, they should be removed from the standard form contracts used by government agencies, and only included where there is a strong case for inclusion in the context of a specific project. Contracting must balance the benefits of reducing negotiation time through standard forms against the benefits of providing opportunity for flexibility. Governments should also be able to reasonably justify why clauses have been included in contracts from an economy-wide perspective.

Overall, efficient risk sharing and management between the public and private sectors will not only reduce the cost of infrastructure in Australia, but will also promote better outcomes for government by reducing legal disputes and building more collaborative relationships with industry.

5.4.4 Develop and apply limited liability guidelines

This report has found that over half of all requests for proposal made to professional services firms for public infrastructure projects include unlimited liability clauses. However, firms are unable to fully insure against risks under contracts with such clauses, given that all professional indemnity insurance places a limit on the total payout available.

Accordingly, development and application of limited liability guidelines for purchasing agencies can help to reduce the costs associated with setting limits on a case-by-case basis, and in turn, reduce the costs charged by professional services firms. Such guidelines would outline a standard approach to setting limitations on liability for different types of market practice, taking into account variations in project size, risk and the size of the supplier.

While these guidelines would need to be accommodated within the policy of each jurisdiction, they could synthesise existing material, including the Commonwealth Government Liability Risk Assessment Guide for Financial Management and Accountability Act Agencies (2010), or approaches in other jurisdictions, such as the default liability cap for low risk contracts in South Australia.

While professional standards legislation provides a mechanism for limitation of liability through approved Professional Standards Schemes, this has not proved to be a viable option for all professions, including engineers, architects and other consultants within the infrastructure sector. There are significant implementation issues associated with development and administration of schemes under this framework, and in any case, schemes are much more difficult for smaller firms to partake in, creating a barrier to competition.

On this basis, it is considered that actions by government to develop and apply limited liability more broadly are likely to be more effective in improving risk management in procurement for public infrastructure.

5.4.5 Verification of brief information

This report finds that, within the context of procuring professional services for public infrastructure, around one third of requests for tender include information that must be verified by bidders. This leads to inefficient duplication of effort and contributes to project prices as firms attempt to recoup the costs incurred during the preparation of a bid.

Accordingly, purchasing agencies should actively seek to minimise this burden by undertaking the necessary work to confirm the accuracy of information before making an open approach to market. This is consistent with the recommendation of the Productivity Commission, that the public sector should undertake site investigations and pass on better information to bidders (PC 2014:479-480).

5.4.6 Streamline compliance processes

Another way in which governments can reduce the costs of bidding for public infrastructure projects, and indirectly contribute to lower project prices is by streamlining their compliance processes. In many projects, firms are required to submit detailed environmental plans, occupational health and safety plans and other compliance-related documentation as part of their proposals, despite the fact that government agencies rarely differentiate between firms on this basis.

The cost burden associated with these information requirements was acknowledged in the Productivity Commission's Inquiry into Public Infrastructure, supported by a number of submissions, including that of the Department of Infrastructure and Regional Development (PC, 2014:454).

There are a number of options available to government which can reduce these costs, such as:

- including submission of standard compliance-related documentation as part of prequalification schemes, so that firms are only required to provide the material once, rather than on a project-by-project basis; or
- replacing the requirement to submit detailed compliance documentation with standard form responses that firms can agree to as part of their proposals.

The Productivity Commission also recommended that non-design management plans be only required from the preferred tenderer (PC 2014:462). Overall, these options are relatively straightforward actions for government that can help to set bid costs at more efficient levels.

5.4.7 Evaluate and adapt procurement frameworks to encourage innovation

Encouraging innovation in public infrastructure through procurement can deliver substantial long term benefits. It is therefore important that governments continue to review and tailor their procurement frameworks in response to new opportunities presented by the market.

While most jurisdictions have mechanisms that allow for innovation in procurement of professional services for infrastructure, this report has highlighted that government responsiveness to innovation during tender processes could be improved. Some of the ways that this can be achieved is through:

- providing opportunities for submission of non-conforming bids;
- a flexible approach to procurement delivery models;
- seeking ideas from industry on complex projects through early market soundings; and
- supporting greater participation in unsolicited proposal processes.

It is acknowledged that government faces constraints when engaging with industry through procurement, due to the need to demonstrate transparency and accountability in decision making and fairness across competitors. Incentivising innovative solutions therefore requires flexibility to adapt both procedural and cultural aspects of procurement, a responsibility for both policy makers and procurement managers at the ground level. While many jurisdictions currently offer opportunities in this regard, such as the South Australian Guidelines for Assessment of Unsolicited Proposals (Department of Premier and Cabinet, 2014), these should be regularly reviewed and updated as required to account for changes in market offerings.

5.5 Time frames for implementation

Implementing these important changes will require action from stakeholders throughout the procurement process. Different parties will be required to take accountability for the areas of procurement policy and practice upon which they have control. However, it is important to acknowledge that the time frames for implementing these changes will vary.

Some changes will be achievable by government in the next 12 to 18 months, such as verification of brief information, streamlining compliance processes and re-allocating resources towards understanding end-user requirements during project scoping. However, policy and cultural change will require a more concerted effort over the medium to long term, such as restructuring procurement teams, revising default positions on contract clauses, implementation of limited liability guidelines and adaptation of procurement frameworks in response to changes in the market.

While it will take time to transform procurement, the significant long-term flow on benefits identified in Section 4 illustrate that the efforts should result in economic benefits.

References

Abrahamson, M 1983, *Risk Management* 1 ICLR 241.

AGS 2009, *Novation and assignment*, available at:
http://www.ags.gov.au/publications/commercial-notes/CN32.pdf

- 2013, *Proportionate liability*, available at:
http://www.ags.gov.au/publications/commercial-notes/CN38.pdf

Allens Arthur Robinson 2003, *Construction and Infrastructure Projects – Risk Management through Insurance*, available at:
https://www.allens.com.au/pubs/pdf/insur/ins6augs.pdf

Ashurst Australia 2014, *Scope for improvement 2014: project pressure points – where industry stands*, available at:
http://www.ashurst.com/resourcelib/PUB_Scope_for_Improvement_2014.pdf

Australasian Procurement and Construction Council Inc. (APCC) 2013, *Strategic Plan 2012-2017*, available at:
http://www.apcc.gov.au/ALLAPCC/APCC%20Strategic%20Plan%202012-2017%20Revised%20October%202013%20WEBSITE.pdf

Australian Bureau of Statistics (ABS) 2013, *Australian National Accounts: State Accounts, 2012-13*, Catalogue No. 5220.0, available at:
http://www.abs.gov.au/AUSSTATS/abs@.nsf/mf/5220.0

- 2014a, *Building activity, Australia, June 2014*, Catalogue No. 8752.0, available at:
http://www.abs.gov.au/ausstats/abs@.nsf/mf/8752.0

- 2014b, *Engineering construction activity, Australia, June 2014*, Catalogue No. 8762.0, available at:
http://www.abs.gov.au/ausstats/abs@.nsf/PrimaryMainFeatures/8762.0

Australian Construction Industry Forum (ACIF) & Australasian Procurement and Construction Council (APCC) 2010, *A guide to project initiation*, available at:
http://www.acif.com.au/documents/item/4

Australian Government (2010) *Liability risk assessment guide for FMA Act agencies*, available at:

Australian Prudential Regulation Authority (APRA) 2014, *National Claims and Policies Database – Average written premium by occupation and underwriting year*.

Bills, G 2014, *Economic Forecast: an economic forecast for consulting in the built and natural environment*, Report for Consult Australia.

Blake Dawson 2008, *Scope for improvement 2008*, available at: http://www.ashurst.com/listing.aspx?id_content=26&id_queryContent=6580&id_ContentType=13

Blake Dawson Waldron 2006, *Scope for improvement*, available at: http://www.ashurst.com/listing.aspx?id_content=26&id_queryContent=6580&id_ContentType=13

Building Management and Works (BMW) 2013a, *Probity and Accountability Policy: Procurement*, available at: http://www.finance.wa.gov.au/cms/uploadedFiles/Building_Management_and_Works/Policy/policy_probity_and_accountability.pdf?n=8902

- 2013b, *Value for Money Policy: Procurement*, available at: http://www.finance.wa.gov.au/cms/uploadedFiles/Building_Management_and_Works/Policy/policy_value_for_money.pdf?n=9595

- (no date), *New Buildings*, available at: http://www.finance.wa.gov.au/cms/Building_Management_and_Works/New_Buildings/New_Buildings.aspx

- (no date) *Procurement Services*, available at: http://www.finance.wa.gov.au/cms/Building_Management_and_Works/Policy/Building_Industry_Liaison.aspx

Caravel 2013, *A Review of Project Governance Effectiveness In Australia*, available at: http://www.infrastructureaustralia.gov.au/publications/files/CARAVEL_GROUP_Project_Governance_Effectiveness_March_2013.pdf

Carr, PG 2005, 'Investigation of bid price competition measured through prebid project estimates, actual bid prices and number of bidders', *Journal of Construction Engineering and Management*, pp. 1165-1172.

Commonwealth of Australia 2010, *Liability risk assessment guide for FMA Act agencies*.

Consult Australia 2012, *Australian contract law: response to discussion paper*, http://www.consultaustralia.com.au/docs/default-source/contracts-liability/Consult_Australia_Response_to_AGD_Discussion_Paper_on_Contract_Law_-_July_2012.pdf?sfvrsn=0

Cooperative Research Centre for Construction Innovation 2009, *Guide to leading practice for dispute avoidance and resolution*, available at: http://www.construction-innovation.info/images/pdfs/DAR_Guide.pdf

Department of Finance 2008, *Commonwealth Procurement Rules – Procurement risk*, available at: http://www.finance.gov.au/procurement/procurement-policy-and-guidance/commonwealth-procurement-rules/cprs-procurement-risk.html

- 2014, *Procurement Practice Guide*, available at: http://www.finance.wa.gov.au/cms/uploadedFiles/Government_Procurement/Guidelines_and_templates/Goods_and_service_procurement_practice_guide.pdf?

Department of Housing and Public Works 2012, *Queensland Government Procurement Plan*, available at:
http://www.hpw.qld.gov.au/SiteCollectionDocuments/ProcurementPlan2012.pdf

- 2013, *Queensland Procurement Policy*, available at:
http://www.hpw.qld.gov.au/SiteCollectionDocuments/QueenslandProcurementPolicy2013.pdf

- 2014, *Procurement Transformation*, available at:
http://www.hpw.qld.gov.au/aboutus/BusinessAreas/ProcurementTransformation/Pages/Default.aspx

Department of Planning, Transport and Infrastructure (DPTI) (no date), *Building Management Overview Fact Sheet*, available at:
http://dpti.sa.gov.au/BuildingManagement/home

Department of Premier and Cabinet 2011, *PC028 Construction Procurement Policy: Project Implementation Process*, Premier and Cabinet Circular 028, available at:
http://dpc.sa.gov.au/sites/default/files/pubimages/Circulars/PC028_Construction.pdf

- 2014, *Guidelines for Assessment of Unsolicited Proposals*, available at:
http://www.sa.gov.au/topics/business-industry-and-trade/doing-business-with-government/unsolicited-proposals

Department of Treasury and Finance 2012, *Investment Management Standard: A guide for Victorian government departments and agencies*, available at:
http://www.dtf.vic.gov.au/Publications/Investment-planning-and-evaluation-publications/Investment-management/Investment-management-standard-version-5

- 2013, *Public construction policy and resources*, available at:
http://www.dtf.vic.gov.au/Infrastructure-Delivery/Public-construction-policy-and-resources

Engineers Australia 2005, *Getting it right the first time: draft for comment*, available at:
http://www.qcif.com.au/Portals/0/PDF/0075%20Getting%20It%20Right%20The%20First%20Time%20JP.lr.pdf

Harrell, B 2011, *Overcoming Ambiguity*, Supply Chain Demand Executive, available at:
http://www.sdcexec.com/article/10362912/overcoming-ambiguity

Infrastructure Australia 2008, *National Public Private Partnership Guidelines: Overview*, available at:
http://www.infrastructureaustralia.gov.au/public_private/files/National_PPP_Guidelines_Overview_Dec_08.pdf

- 2012a, *Efficiencies in Major Project Procurement: Volume 1 – Benchmarks for Efficient Procurement of Major Infrastructure*, available at:
http://www.infrastructureaustralia.gov.au/publications/files/Procurement_Benchmarking_Volume_1_final.pdf

- 2012b, *Efficiencies in Major Project Procurement: Volume 2 – Consultation Outcomes Report*, available at: http://www.infrastructureaustralia.gov.au/publications/files/Procurement_Benchmarking_Volume_2_final.pdf

Lateral Economics 2011, *Identifying the cost of contracting out of proportionate liability: A Lateral Economics report for the Liability Reform Steering Group*.

Lopez R & Love PED 2012, 'Design error costs in construction projects', *Journal of Construction Engineering and Management*, vol 138, no. 5, pp. 585-593.

Molino Cahill Lawyers 2013, *What's your appetite for risk?*, available at: http://www.molinocahill.com.au/publications

National Public Works Conference and National Building Construction Council (NPWC/NBCC) Joint Working Party 1990, *No Dispute: Strategies for Improvement in the Australian Building and Construction Industry*.

NSW Government 2005, *Code of Practice for Procurement New South Wales Government*, available at: http://www.procurepoint.nsw.gov.au/sites/default/files/documents/code_of_practice_for_procurement_2013_ir_guidelines_0.pdf

NSW Office of Finance and Services 2013, *Consultant Prequalification Scheme 2013-2016 For Construction and Related Works*, available at: https://www.procurepoint.nsw.gov.au/before-you-buy/prequalification-schemes-0/construction/prequalification-scheme-consultants

NSW Procurement Board (no date) *About NSW procurement reform*, available at: http://www.procurepoint.nsw.gov.au/policy-and-reform/nsw-procurement-reform/about-nsw-procurement-reform

- (no date) *Agency Accreditation Scheme*, available at: http://www.procurepoint.nsw.gov.au/policy-and-reform/nsw-procurement-reform/information-agencies/agency-accreditation-scheme

- (no date) *Statement on Value for Money*, available at: https://www.procurepoint.nsw.gov.au/policies/nsw-government-procurement-information/statement-value-money

Planned Cover 2013, *Risk rule: fitness for purpose*.

Productivity Commission (PC) 2014, *Public infrastructure: Inquiry Report*, available at: http://www.pc.gov.au/projects/inquiry/infrastructure/report

Royal Academy of Engineering (RAENG) 2014, *Public projects and procurement in the UK*, available at: http://www.raeng.org.uk/news/publications/list/reports/procurement_report.pdf

Standing Council on Law and Justice (SCLJ) 2013a, *Proportionate liability model provisions: Decision regulation impact statement*, available at:

http://www.sclj.gov.au/agdbasev7wr/sclj/proportionate%20liability%20regulation%20impact%20statement.pdf

- 2013b, *Tort law: Proportionate liability*, available at: http://www.sclj.gov.au/sclj/projects/proportionate_liability.html?s=1001

State Procurement Board 2012, *Goods and Services or Construction Checklist*, available at: http://spb.sa.gov.au/sites/default/files/Construction%20checklist%20Dec%202012_201213201439356.PDF

- 2014, *Procurement Policy Framework*, available at: http://spb.sa.gov.au/sites/default/files/Procurement%20Policy%20Framework.pdf

VicRoads 2014, *VicRoads Pre-Qualification Scheme information sheet*, available at: https://www.vicroads.vic.gov.au/business-and-industry/tenders-and-suppliers/contractors-and-consultants/prequalification-scheme

Victorian Government Purchasing Board (VGPB) 2014, *Scope of policies*, available at: http://www.vgpb.vic.gov.au/CA2575BA0001417C/pages/home-about-the-vgpb-scope-of-policies

World Economic Forum 2012, *Strategic infrastructure – steps to prioritise and deliver infrastructure effectively and efficiently*, available at: http://www.weforum.org/reports/strategic-infrastructure-steps-prioritize-and-deliver-infrastructure-effectively-and-efficie

Appendix A: Detailed modelling methodology

Background on the DAE CGE model

A Computable General Equilibrium (CGE) model is a stylised representation of the real world economy which allows for analysis of how the economy might react to changes in external factors such as policy, technology, environment and population.

CGE models are based on real world economic data. The fundamental building block is a database which reconciles how goods and services flow from one industry to another. For example, this database could show how much road transport is used by the food and beverage industry or how much output from agricultural industries is used in food manufacturing. This database covers the entire economy. From this real world data information on key variables such as GDP can be calculated.

The second main component of the model is an extensive set of information on the preferences of consumers and producers. These preferences cover details such as how consumption of an item changes as its price increases, how likely consumers are to switch their consumption between different goods and how producers are best able to produce their output.

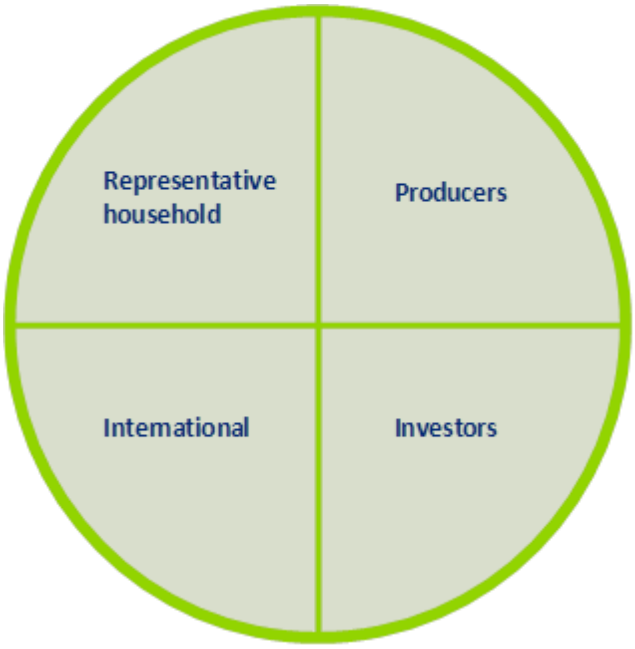
The model therefore represents a static picture of the economy (how goods and services are currently used) and a framework for measuring how changes to this picture will flow through the economy.

The Deloitte Access Economics – Regional General Equilibrium Model (DAE-RGEM) is a large scale, dynamic, multi-region, multi-commodity computable general equilibrium model of the world economy. The model allows policy analysis in a single, robust, integrated economic framework. This model projects changes in macroeconomic aggregates such as GDP, employment, export volumes, investment and private consumption. At the sectoral level, detailed results such as output, exports, imports and employment are also produced.

The model is based upon a set of key underlying relationships between the various components of the model, each which represent a different group of agents in the economy. These relationships are solved simultaneously, and so there is no logical start or end point for describing how the model actually works.

Figure A.1 shows the key components of the model for an individual region. The components include a representative household, producers, investors and international (or linkages with the other regions in the model, including other Australian States and foreign regions). Below is a description of each component of the model and key linkages between components. Some additional, somewhat technical, detail is also provided.

Figure A.1: Key components of DAE-RGEM



DAE-RGEM is based on a substantial body of accepted microeconomic theory. Key assumptions underpinning the model are:

- The model contains a 'regional consumer' that receives all income from factor payments (labour, capital, land and natural resources), taxes and net foreign income from borrowing (lending).
- Income is allocated across household consumption, government consumption and savings so as to maximise a Cobb-Douglas (C-D) utility function.
- Household consumption for composite goods is determined by minimising expenditure via a CDE (Constant Differences of Elasticities) expenditure function. For most regions, households can source consumption goods only from domestic and imported sources. In the Australian regions, households can also source goods from interstate. In all cases, the choice of commodities by source is determined by a CRESH (Constant Ratios of Elasticities Substitution, Homothetic) utility function.
- Government consumption for composite goods, and goods from different sources (domestic, imported and interstate), is determined by maximising utility via a C-D utility function.
- All savings generated in each region are used to purchase bonds whose price movements reflect movements in the price of creating capital.
- Producers supply goods by combining aggregate intermediate inputs and primary factors in fixed proportions (the Leontief assumption). Composite intermediate inputs are also combined in fixed proportions, whereas individual primary factors are combined using a CES production function.
- Producers are cost minimisers, and in doing so, choose between domestic, imported and interstate intermediate inputs via a CRESH production function.
- The model contains a more detailed treatment of the electricity sector that is based on the 'technology bundle' approach for general equilibrium modelling developed by ABARE (1996).

- The supply of labour is positively influenced by movements in the real wage rate governed by an elasticity of supply.
- Investment takes place in a global market and allows for different regions to have different rates of return that reflect different risk profiles and policy impediments to investment. A global investor ranks countries as investment destinations based on two factors: global investment and rates of return in a given region compared with global rates of return. Once the aggregate investment has been determined for Australia, aggregate investment in each Australian sub-region is determined by an Australian investor based on: Australian investment and rates of return in a given sub-region compared with the national rate of return.
- Once aggregate investment is determined in each region, the regional investor constructs capital goods by combining composite investment goods in fixed proportions, and minimises costs by choosing between domestic, imported and interstate sources for these goods via a CRESH production function.
- Prices are determined via market-clearing conditions that require sectoral output (supply) to equal the amount sold (demand) to final users (households and government), intermediate users (firms and investors), foreigners (international exports), and other Australian regions (interstate exports).
- For internationally-traded goods (imports and exports), the Armington assumption is applied whereby the same goods produced in different countries are treated as imperfect substitutes. But, in relative terms, imported goods from different regions are treated as closer substitutes than domestically-produced goods and imported composites. Goods traded interstate within the Australian regions are assumed to be closer substitutes again.
- The model accounts for greenhouse gas emissions from fossil fuel combustion. Taxes can be applied to emissions, which are converted to good-specific sales taxes that impact on demand. Emission quotas can be set by region and these can be traded, at a value equal to the carbon tax avoided, where a region's emissions fall below or exceed their quota.

The representative household

Each region in the model has a so-called representative household that receives and spends all income. The representative household allocates income across three different expenditure areas: private household consumption; government consumption; and savings.

Going clockwise around Figure A.1, the representative household interacts with producers in two ways. First, in allocating expenditure across household and government consumption, this sustains demand for production. Second, the representative household owns and receives all income from factor payments (labour, capital, land and natural resources) as well as net taxes. Factors of production are used by producers as inputs into production along with intermediate inputs. The level of production, as well as supply of factors, determines the amount of income generated in each region.

The representative household's relationship with investors is through the supply of investable funds – savings. The relationship between the representative household and the international sector is twofold. First, importers compete with domestic producers in consumption markets. Second, other regions in the model can lend (borrow) money from each other.

Some detail:

- The representative household allocates income across three different expenditure areas – private household consumption; government consumption; and savings – to maximise a Cobb-Douglas utility function.
- Private household consumption on composite goods is determined by minimising a CDE (Constant Differences of Elasticities) expenditure function. Private household consumption on composite goods from different sources is determined is determined by a CRESH (Constant Ratios of Elasticities Substitution, Homothetic) utility function.
- Government consumption on composite goods, and composite goods from different sources, is determined by maximising a Cobb-Douglas utility function.
- All savings generated in each region are used to purchase bonds whose price movements reflect movements in the price of generating capital.

Producers

Apart from selling goods and services to households and government, producers sell products to each other (intermediate usage) and to investors. Intermediate usage is where one producer supplies inputs to another's production. For example, coal producers supply inputs to the electricity sector.

Capital is an input into production. Investors react to the conditions facing producers in a region to determine the amount of investment. Generally, increases in production are accompanied by increased investment. In addition, the production of machinery, construction of buildings and the like that forms the basis of a region's capital stock, is undertaken by producers. In other words, investment demand adds to household and government expenditure from the representative household, to determine the demand for goods and services in a region.

Producers interact with international markets in two main ways. First, they compete with producers in overseas regions for export markets, as well as in their own region. Second, they use inputs from overseas in their production.

Some detail:

- Sectoral output equals the amount demanded by consumers (households and government) and intermediate users (firms and investors) as well as exports.
- Intermediate inputs are assumed to be combined in fixed proportions at the composite level. As mentioned above, the exception to this is the electricity sector that is able to substitute different technologies (brown coal, black coal, oil, gas, hydropower and other renewables) using the 'technology bundle' approach developed by ABARE (1996).
- To minimise costs, producers substitute between domestic and imported intermediate inputs is governed by the Armington assumption as well as between primary factors of production (through a CES aggregator). Substitution between skilled and unskilled labour is also allowed (again via a CES function).
- The supply of labour is positively influenced by movements in the wage rate governed by an elasticity of supply is (assumed to be 0.2). This implies that changes influencing the demand for labour, positively or negatively, will impact both the level of employment and the wage rate. This is a typical labour market specification for a dynamic model such as DAE-RGEM. There are other labour market 'settings' that can be used. First, the labour market could take on long-run characteristics with aggregate employment being fixed and any changes to labour demand changes being absorbed through movements in the wage rate. Second, the labour market could take on short-run characteristics with fixed wages and flexible employment levels.

Investors

Investment takes place in a global market and allows for different regions to have different rates of return that reflect different risk profiles and policy impediments to investment. The global investor ranks countries as investment destination based on two factors: current economic growth and rates of return in a given region compared with global rates of return.

Some detail

- Once aggregate investment is determined in each region, the regional investor constructs capital goods by combining composite investment goods in fixed proportions, and minimises costs by choosing between domestic, imported and interstate sources for these goods via a CRESH production function.

International

Each of the components outlined above operate, simultaneously, in each region of the model. That is, for any simulation the model forecasts changes to trade and investment flows within, and between, regions subject to optimising behaviour by producers, consumers and investors. Of course, this implies some global conditions must be met such as global exports and global imports are the same and that global debt repayments equals global debt receipts each year.

Limitation of our work

General use restriction

This report is prepared solely for Consult Australia. This report is not intended to and should not be used or relied upon by anyone else and we accept no duty of care to any other person or entity. The report has been prepared for the purpose of influencing the procurement policies of government departments and agencies, across the Commonwealth, States and Territories. You should not refer to or use our name or the advice for any other purpose.

Contact us

Deloitte Access Economics
ACN: 149 633 116

Level 1
9 Sydney Avenue
Barton ACT 2600
PO Box 6334
Kingston ACT 2604 Australia

Tel: +61 2 6175 2000
Fax: +61 2 6175 2001

www.deloitteaccesseconomics.com.au

Deloitte Access Economics is Australia's pre-eminent economics advisory practice and a member of Deloitte's global economics group. For more information, please visit our website www.deloitteaccesseconomics.com.au

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/au/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

Deloitte provides audit, tax, consulting, and financial advisory services to public and private clients spanning multiple industries. With a globally connected network of member firms in more than 150 countries, Deloitte brings world-class capabilities and deep local expertise to help clients succeed wherever they operate. Deloitte's approximately 200,000 professionals are committed to becoming the standard of excellence.

About Deloitte Australia

In Australia, the member firm is the Australian partnership of Deloitte Touche Tohmatsu. As one of Australia's leading professional services firms. Deloitte Touche Tohmatsu and its affiliates provide audit, tax, consulting, and financial advisory services through approximately 6,000 people across the country. Focused on the creation of value and growth, and known as an employer of choice for innovative human resources programs, we are dedicated to helping our clients and our people excel. For more information, please visit our web site at www.deloitte.com.au.

CONSULT AUSTRALIA

Better Buying, Better Outcomes

Procurement and the importance of getting it right

About Consult Australia

Consult Australia is the industry association representing consulting firms operating in the built and natural environment sectors. These services include design, engineering, architecture, technology, surveying, legal and management solutions for individual consumers through to major companies in the private and public sector including local, state and federal governments.

We represent an industry comprising some 48,000 firms across Australia, ranging from sole practitioners through to some of Australia's top 500 firms with combined revenue exceeding $40 billion a year.

Approximately 40 percent of our industry's work is undertaken for public sector clients, and our member firms have played vital roles in the creation of some of Australia's iconic public infrastructure, including road, rail, hospital, airport, educational facilities, water and energy utilities, justice, aged care, sports stadia, and urban renewal projects.

Acknowledgements

First and foremost, each of the participants in this study who either took part in an interview, or volunteered project details must be thanked. As interviews with subjects employed in the consulting industry were all undertaken on a confidential basis, tribute must be paid to our membership and in particular the members of Consult Australia's Infrastructure Roundtable who were generous with their time and feedback.

Outside of our membership, participation, feedback and advice came from a number of sources. Darren Pavic from Bovill Risk and Insurance Consultants (BRIC) and Wendy Poulton from Planned Cover have provided useful feedback about the workings of the insurance industry. David Hudson Former Executive General Manager, Risk Management, Leighton Holdings was very generous with his time and feedback, while representatives of public sector client organisations at the Australasian Procurement and Construction Council and NSW Department of Finance and Services also contributed their time and knowledge.

Robin Schuck, Senior Advisor - Policy & Government Relations at Consult Australia was the principal author and project lead for this study.

Cover: South Road Superway photo courtesy of GHD

Contents

Executive Summary

Introduction

This report is a snapshot of the Australian consulting industry's experience of public sector procurement. It reflects our success stories and frustrations, and most importantly, the areas where there are opportunities for reform of procurement policy and practice. While professional services make up a relatively small proportion of the total amount spent on delivering public infrastructure, it is well established that errors made in the early phases of a project can multiply significantly when that project reaches the construction phase.

This study was undertaken from October 2013 to September 2014, and is based on interviews with consultants, clients and constructors, as well as a review of previous studies conducted in Australia and overseas.

The Consultant

The role of the consultant in developing infrastructure is to provide professional expertise, whether through a feasibility study, valuations, surveys, developing an environmental impact statement, or design work. Consultants are engaged on a "fee for service" basis, which contrasts with contractors taking on a project for profit.

The main asset consultants can provide to a project is their professional expertise, and accordingly clients seek out the best possible skill-set from consultants tendering for work. Factors determining whether the best personnel are included on a project team, or whether the best individuals tender for the work include:

- The state of the market, and the imperative to win work;
- Commercial risk associated with a particular project or client, and its balance with the reward offered by that same project, relative to others available;
- Availability of insurance;
- The ease of working with a particular client;
- Particular challenges that a consultant may want to receive professional plaudits for having designed a solution to overcome.

A particular challenge facing clients in attracting the best skills for their project is the shortage of engineering skills in Australia. For their part, clients generally perceived consultants as skilled and offering important expertise, but sometimes overly conservative.

The Client

A frequent response to this study was that a model client is an informed client who understands their project and the commercial, legal and insurance risks relating to the project. A model client is in a good position to drive a *positive procurement culture*. Features of a positive procurement culture include:

- Procurement as a relationship rather than a process
- Checking aggression at the door and working together with other parties to solve problems
- The ability to answer questions and make quick decisions
- The willingness of each party to ask questions when required
- Preparedness of clients to leave their comfort zone, and be flexible where appropriate
- The right approach to risk
- Working towards a successful project outcome, rather than avoiding failure
- Continuity throughout the project
- Knowledge and involvement on the part of the client
- Understanding that "one size" does not fit all

Many of these factors can be overcome through the strengthening of procurement skills within an agency, but also require the highly risk averse culture of the public sector to be challenged. Ultimately, the cultural challenge of procuring infrastructure in a new way will need the support of an agency's leadership. A particular challenge is faced by the public sector in that it operates within a political environment that does not tolerate failure, and indeed political considerations sometimes drive poor decision making, including the fast tracking of projects where those projects are not ready for fast tracking.

Flexibility within and between agencies must be addressed and greater emphasis should be placed on managing risk rather than simply offloading it to the party with the least bargaining power.

The Role of Contractors

The different fee models of contractors and consultants drive different patterns of behaviour on projects. Contractors take on project risk with a view to maximising profit, while consultants operate on a "fee for service" basis. The challenge that often arises is how consultants should be reimbursed for work undertaken for contractors on bids that are unsuccessful. Where project risk is allocated by a client to contractors, that risk is often passed down to consultants, without proper consideration as to how appropriately placed consultants are to manage that risk. Clients need to be aware of this practice, and play their role in ensuring project risk is properly allocated.

Community Stakeholders

Early engagement with the community is every bit as important to a project as engagement with other stakeholders, including the service providers. Community opposition has the ability to either significantly change the nature of a project, or lead to its cancellation which are both costly options. Similarly, changes to planning and environmental regulations also have the ability to drive cost increases. Consult Australia's *Guide to Procuring Engagement Services*[1] is worth considering as a best practice report that comprehensively examines how to better engage with the community and avoid the pitfalls that may arise out of their opposition.

Decisions to Evaluate and Undertake the Project

Decisions regarding project specifications should ideally be made with regard to whole of life costs, from conception to operation and maintenance, to decommissioning. This offers the possibility of saving money over the longer term, even though a greater up-front cost may be encountered. The downside of making decisions with regards to whole of life considerations is that the funds needed to build a project to a greater specification may simply not be available, and even where they are, they carry an opportunity cost that may be significant.

Projects are also vulnerable to claims of "gold plating" when designed to a greater specification than first conceptualised. The challenge of meeting deadlines and budgets is particularly tricky when a project is being designed to the greater specification, and clients therefore need to be well positioned to make decisions as to the appropriateness of a project being "future proofed," with regard to time, cost and quality considerations.

Quality of Project Documentation

The quality of scoping documents is a major source of frustration and disputation to consultants. Major issues encountered in scoping documents include:

- Inadequate or unverified background information
- A standardised, form approach to developing the scoping document
- Inclusion in the scope of items that aren't really required
- Poorly defined scopes, where the project aims haven't been properly thought out

These issues have been canvassed in other studies, and are best addressed through early engagement between clients and industry, as well as hiring consultants to "reverse engineer" the project brief.

Tendering: An Expense That Must be Recognised

Tendering for work is expensive for consultants—something that isn't always recognised by clients. The process of bidding contains red tape type administrative hurdles and sometimes providing so much information as to almost complete the job without being awarded a contract. While industry recognises that the cost of tendering is the price of doing business, in return clients need to understand that this is an expensive process, and should avoid needlessly asking firms to bid for work they have no realistic chance of winning, or shortlisting firms when they already have a preferred supplier in mind.

Panels and Pre-Qualification

Panels and pre-qualification have been used as methods of increasing efficiency, and overcoming the expensive cost of tendering for work. Problems with both however arise when they are not used properly to meet their stated goals. Frustration arises amongst industry when they have spent great expense getting on a panel, and the panel is then bypassed. Clients should increase transparency as to how a panel is used, and should be careful to ensure that the appropriate skills are represented on a panel. Indeed,

guidance on how to use a panel would greatly assist industry's expectations when bidding to join a panel, and perhaps also allow for dynamism to address the changing needs of clients. One recent issue is the use of panels to force consultants to signal their prices, in an effort by clients to drive down prices without reference to a specific project. Such efforts are misplaced and will defeat the objectives the panel aims towards.

The Winning Bid: Selection Decisions

Discussion on selecting the winning bid for a project has for some time focusing on achieving best value for money, rather than simply the cheapest cost. However, the lack of clarity around achieving this aim is often frustrating to industry. As well as transparent selection criteria and weightings, whole of life factors need to be considered by those making selection decisions, including accounting for project risks. Too often, decisions around cost focus on the cost of construction, without adequately accounting for other phases of the project. Consideration should also be given to allowing bidders to submit bids that challenge assumptions in the brief, rather than instantly dismissing them as "non-conforming".

Procurement Skills

One consequence of government outsourcing of engineering and other technical capability has been the loss of procurement skills. As well as the technical skills required to work with industry, many of the less desirable procurement features described in this report are a result of inadequate procurement skills. In response, Consult Australia has called for the establishment of a Procurement Centre of Excellence to develop procurement skills for public sector officers.

Project Risk

Project risk assessments are too often conducted as "tick the box" exercises, rather than a bona fide attempt to understand all project risks and then collaboratively working towards addressing them. A particular complaint of the consulting industry is that risk is routinely offloaded according to bargaining power, rather than allocated according to who is best placed to manage that risk. While this is done in an attempt to protect taxpayers from financial loss, in reality it heightens the risk of the project not achieving successful outcomes. The bias of clients towards considering their project as being of greater risk than it actually is also drives inefficiencies, as inevitably it will lead to consultants taking out a greater level of insurance than is necessary and passing the costs on to the client.

Innovation

The concept of innovation is challenging to define, but it does contain the key elements of doing things a new way with a view to achieving better outcomes or saving costs. Encouraging innovation on public sector infrastructure projects however is difficult when the treatment of risk is overly conservative. Often cultural challenges need to be overcome to realise that innovation can actually save a client money, while in other cases, a particular agency might need to take specific steps to foster innovation from service providers otherwise scared off by onerous risk allocation.

Choice of Delivery Model

The choice of project delivery model sets out the relationship between each of the parties to a project, and is potentially a major driver of risk allocation, innovation, and how the parties relate to one another. Ensuring that the right model is used for each project is however a major challenge. The imperative amongst public sector clients to offload risk means there will be a bias towards particular models, such as "design and construct", which offers government the comfort of handing risk over to service providers without retaining responsibility themselves. Poor selection of delivery models may also be the result of inertia or biases of procurement officers who perceive a particular model to have worked well in the past, even if that project's circumstances were vastly different. Better decisions about delivery model could be made through more effective early engagement between clients and industry, and also through objective guidance, such as that offered through the *Australasian Procurement and Construction Council (APCC)/ AustRoads* Building and Construction Procurement Guide, referred to throughout this report.[2]

1. See www.consultaustralia.com.au
2. APCC & Austroads. 2014. Building and Construction Procurement Guide: Principles and Options. www.apcc.gov.au

Onerous Contract Terms and Condition: Implications

A range of onerous contractual terms and conditions are frequently used in response to public sector attitudes to managing risk. The problem of this approach however is that it is often based on legal advice to cocoon the client from any liability, without regard to the insurance or commercial implications of doing so. In particular, the practice of shifting contractual risk to consultants increases the possibility that insurance will not respond to a claim. Because contracts are typically offered on a "take it or leave it" basis, industry has limited ability to negotiate solutions to this issue. While improved contracts such as the Australian standard AS4122-2010 address many of the imbalances, clients should at the very least be in the practice of explaining why certain clauses are included in their contracts. This will serve to turn their minds to whether a particular term is actually required, and will increase empathy between the parties.

Collaboration Between the Parties

One of the features recurring throughout this report is the importance of collaboration between the parties. A key element of positive collaboration is trust between the parties. Consultants reported that their regular reporting requirements could be onerous, in terms of constant reporting, or being required to have their premises available for inspection around the clock. Better collaboration however focuses on each party supporting the other and working together to address issues. This means moving away from a rigid contract based approach to focusing on achieving the best possible outcome.

Variations to the Scope of Works

Changes to the scope of works are often a necessary part of developing infrastructure. They can, however, be quite costly to the client through the increase in cost that often results. Variations at the Request for Proposal (RFP) phase are often a result of a project being rushed to market without adequate time and resources devoted to ensuring the scope of works is right. Once a project is under way, variations may be unavoidable as new issues arise, including factors that change or clarify the nature of the project. However, a particular problem is that clients sometimes specifically exclude particular items from the original scope in order to save money, only to discover that they're vital later on. In these cases, the variations may cost more than including the item in the first place, and represent a major inefficiency.

Evaluating a Project: Lessons Learned

The opportunity to evaluate a project's success or otherwise following completion is an important opportunity for all parties to learn about what went well and what needs to be done better for the future. Public sector agencies are often reluctant to participate in such a process, lest a "what went wrong" document is created that could be damaging if made public. If a particular party is too defensive, then this process will also be frustrated. However, the process of reviewing a project does offer some important opportunities for the parties to learn how to do things better, and if done in a "no blame" setting, can be highly effective.

Findings & Recommendations

Findings

Finding 1: The ability of clients to attract the best consultant is a product of market conditions, project risk, skills supply issues, and the desirability of undertaking a particular project.

Finding 2: Best practice procurement can be achieved through a focus on the knowledge and skills of the relevant personnel, supporting the parties to work together collaboratively rather than in opposition, cultural issues, and the ability to make decisions.

Finding 3: Flexible approaches are preferable, and the leadership of an agency needs to ensure that this is understood consistently amongst procurement and project officers on the ground.

Finding 4: Decisions relating to the details of a project should balance time, cost and quality considerations over the whole of the life of that infrastructure, while also factoring in the opportunity cost of building infrastructure to cater for future needs. This has the potential to save money in the long term, and deliver better quality infrastructure.

Finding 5: Some discussion of gold plating assets is misplaced, and government needs to reconcile its desire for innovation with cost saving, while also accepting that building an asset to an appropriate standard may be more costly than anticipated.

Finding 6: Bidding for work is expensive, and clients need to recognise this, or they risk paying a higher price for consulting services over the long term.

Finding 7: Selection criteria are too frequently not transparent, and change after bids have been received. Increased transparency should apply to bid selection criteria.

Finding 8: There is a critical shortage of procurement related skills around Australia, which impacts on the outcomes of projects. This is especially the case with regard to risk and contract terms. We acknowledge that governments are increasingly aware of this issue, and are starting to take action to address it.

Finding 9: While most government agencies talk about allocating risk to the party best able to manage that risk, this frequently does not occur in practice.

Finding 10: Clients need to be involved in the risk management process throughout the project to ensure optimal outcomes. Collaboration between the client and the full range of service providers will yield the best responses to risk.

Finding 11: The risk averse culture within public sector clients doesn't easily lend itself to innovative solutions. This can however be overcome in most instances with the right risk mitigation strategy.

Finding 12: Innovative solutions can be encouraged by briefs that aren't overly prescriptive in terms of project outputs, and addressing the ownership of intellectual property to the satisfaction of consultants. However, it is important that such briefs are complete and developed as a deliberate strategy, and are still clear as to the project's aims.

Finding 13: Innovation has the potential to save money to clients in the longer term, but political discourse including allegations of "gold plating" assets might prevent those benefits from being realised.

Finding 14: The incorrect delivery model is used too frequently, owing to perceived advantages to the client relating to risk or cost, or otherwise owing to inertia, bias and poor procurement skills. Use of an inappropriate delivery model can result in less desirable project outcomes.

Finding 15: Many public sector agencies include onerous terms in contracts without understanding their implications for insurance cover, or the less desirable project outcomes they might drive.

Finding 16: Onerous contract terms are caused by a range of factors including procurement skills shortages, undue reliance on external legal advice, and cultural issues within public sector agencies. Failure to understand the differences between contractors and consultants and their respective business models may also be a driving factor.

Finding 17: Ongoing collaboration between the parties is preferable to a rigid, contract based, approach to reviews and reports back to the client. Reviews should be undertaken as required, with a view to the parties assisting each other to realise the best outcomes, rather than with the intention of finding fault with the other's work.

Finding 18: Changes to project scope at the tender phase create additional costs for the client, as well as creating probity risks.

Finding 19: Variations are an appropriate mechanism to allow project flexibility, but additional work undertaken must be properly compensated.

Finding 20: Reviewing projects following their conclusion is an important step to continually improve public sector procurement. However, political considerations provide a significant disincentive for government agencies to participate in such a process.

Finding 21: The existence of a "no blame" culture makes it easier for all parties to learn from each project how to do things better for the future.

Recommendations

Recommendation 1: Non-construction outcomes, such as disputation, safety, and level of engagement, should be included as measures of project success.

Recommendation 2: Government should commit to being a "model client", in line with its existing commitment to being a model litigant. This means that commitments to best-practice procurement are followed through in practice, and that agencies work with service providers to achieve optimal outcomes.

Recommendation 3: Project managers within agencies should receive support to try new and improved ways of undertaking procurements. This should be done through the entire agency committing to improved procurement, including the head of that agency being accountable for improved procurement outcomes.

Recommendation 4: Agencies need to better understand what they should ask for in legal advice. Effort should be made to ensure that the advice they seek goes beyond simply avoiding contractual liability, and addresses insurance, project and commercial considerations.

Recommendation 5: Government looks at acknowledging the forthcoming private sector pipeline of work to inform its own pipeline.

Recommendation 6: Public and private sector clients share knowledge and work collaboratively to achieve better procurement outcomes.

Recommendation 7: Additional investment in developing a quality project brief and early engagement with industry will yield improved outcomes.

Recommendation 8: Clients should consider engaging a consultant to assist with their development of the project brief.

Recommendation 9: Clients should avoid shortlisting firms that have no realistic chance of winning the work.

Recommendation 10: Clients should consider compensating unsuccessful tenderers for their bids where appropriate, in exchange for ownership of the intellectual property.

Recommendation 11: Panels and Pre-qualification schemes should be accompanied by guidance and transparency as to decision making processes and outcomes to ensure that consultants see value in their use. Otherwise their stated efficiency improvements may be lost.

Recommendation 12: Firms bidding to be on a panel should not be required to state their "best and final offer" in their tender. This practice harms industry and undermines the benefits a client might receive from a panel, while not considering the particular situation of a project.

Recommendation 13: Annual statements of tenders awarded would assist industry to understand how opportunities are being developed and awarded.

Recommendation 14: An industry reference group could assist dialogue between government and industry and provide a forum through which regular feedback could be provided with a view to improving the efficiency of the process.

Recommendation 15: Where panels are used, consideration should be given to setting up a "whole of government" panel, with a wide range of skills included, to save consultants the cost of tendering.

Recommendation 16: Clients should be aware of the optimal cost of their project, factoring in project risks, and should interrogate any bids that deviate greatly from this price.

Recommendation 17: Bid selection should focus on maximising value rather than minimising cost, and should do so taking whole of life considerations into account.

Recommendation 18: Governments should consider issuing guidelines allowing for non-conforming bids to be considered, where they identify errors in the scope, challenge assumptions, or provide an innovative solution to the problem at hand.

Recommendation 19: Government should investigate the establishment of a Centre for Procurement Excellence, along similar lines to the United Kingdom's Commissioning Academy.[3]

Recommendation 20: Other opportunities for skills training and professional development should be provided in the shorter term for procurement professionals.

Recommendation 21: Risk assessment, allocation and management processes and outcomes be included as a stand-alone item in the schedule of project briefs.

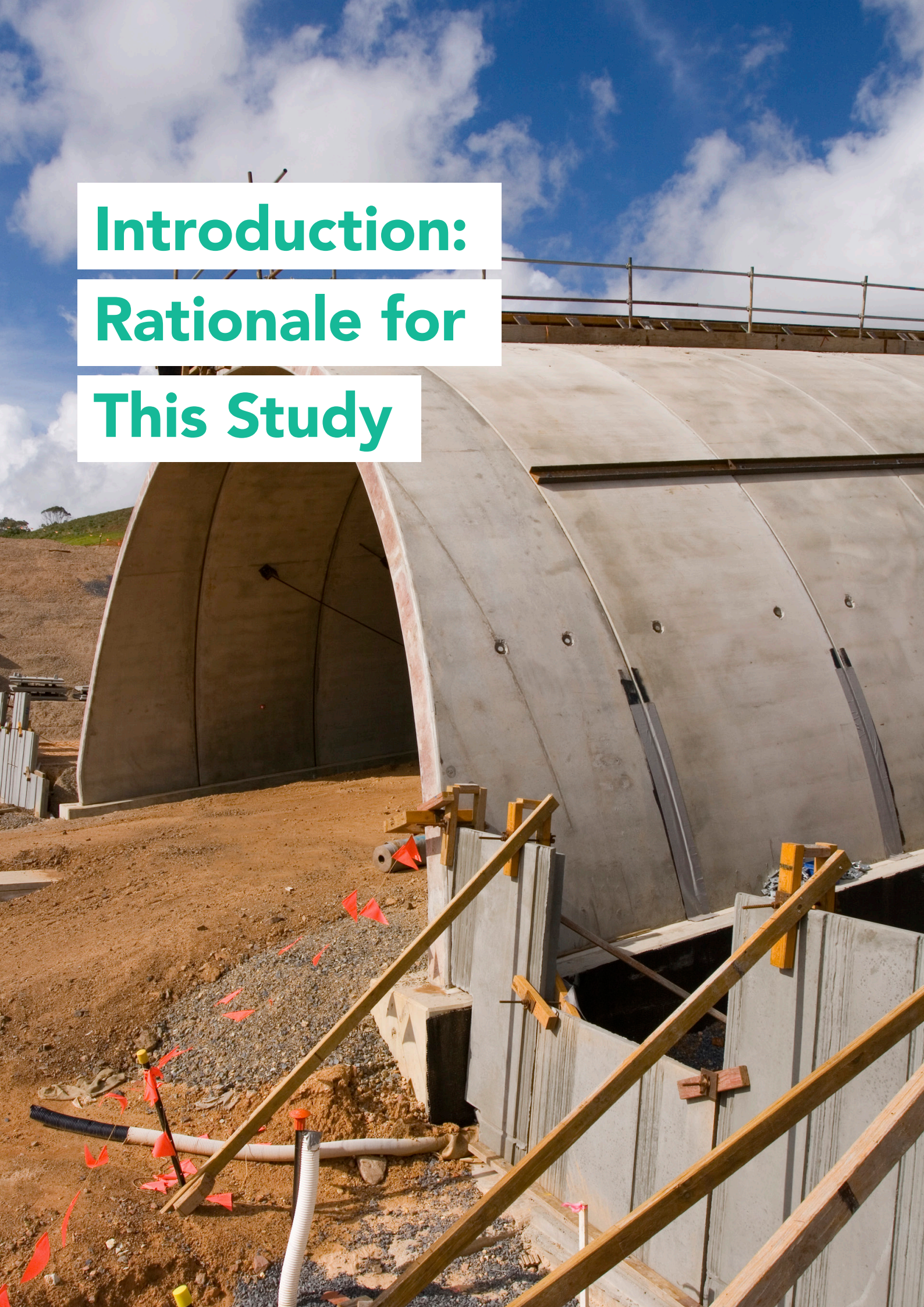
Recommendation 22: Consultants and other stakeholders should be included in workshops at an early stage, to help the client determine the most appropriate delivery model.

Recommendation 23: Clients should develop objective criteria against which to determine which delivery model is most appropriate for their project.

Recommendation 24: Agency heads should be accountable for their agency's procurement outcomes, to ensure that their positive rhetoric occurs in practice, and that protection is provided for contract managers being asked to take a less conservative approach to contracting.

Recommendation 25: Clients should routinely explain "why" they have included particular contract terms, with a view to eliminating unnecessary terms that simply cost the client more, and increasing empathy between the parties.

3. https://www.gov.uk/the-commissioning-academy-information



Introduction: Rationale for This Study

The construction and delivery of public infrastructure projects is today one of the key issues upon which governments are judged. Renewed focus is placed on decisions about which projects to proceed with and their benefits, and accordingly how to get the maximum output from a limited spend of public money. At the heart of achieving value for money for taxpayers lies procurement. Procurement policy and practice has the ability to shape the cost of service provision, influence the level of competitive pressure between rival service providers, and determine the quality of the final output.

This study focuses on the experience of consultants in the built and natural environment sector. While fees paid to consultants only comprise a relatively small share of the overall price of a project, their contribution is vital to project success. A number of studies in recent years have shown that there is a multiplier effect that flows to the remainder of the project, arising out of scoping studies, designs, and other pre-construction considerations. Small improvements to efficiency at the early stages of the project lead to greatly improved outcomes down the line. Indeed, those other studies have acknowledged that simply investing more resources and time into the early stages of a project will achieve a positive outcome with a far greater value than the additional expense.

Poor procurement has a significant impact on project outcomes. First and foremost is the cost impact described above, whether through higher fees paid to service providers or reduced competition. Delays and sometimes increased levels of disputation inevitably result from poor procurement, and ultimately the quality of the final product may not be at the high standard demanded from the public or the government. Impacts of poor procurement that don't have an immediate cost impact, but may drive cost indirectly include risk not being properly managed, procurement driving the behaviour of parties away from collaborating and reputational damage to the client as a preferred party to do business with.

The issues explored in this study are felt by consultants, but impact on all stakeholders. For example, a poor quality scope document will be a problem for consultants, as we highlight in this report, but will be just as much a problem for contractors also looking to have involvement in the project. Project risk is a perennial source of frustration, and if a consultant is unable to manage risks allocated to them, the implications will be felt by all other parties to the project. These are but two of the issues canvassed in this study, where there are opportunities for reform of public sector policy and practice.

This report is designed to be a snapshot of procurement in Australia for Consult Australia and our industry. It will allow us to understand where the pitfalls are to avoid, and where our industry needs to focus our attention in delivering better results. Most importantly, it will help focus our industry's efforts in dealing with individual clients, and collectively when Consult Australia engages with government to achieve best practice procurement. This in turn will support our industry to deliver the best possible outcomes to its clients, and allow taxpayers to get the best possible public infrastructure outcomes from a limited budget.

Methodology

This study represents the views of the consulting industry on public sector procurement and practices. Accordingly, the basis of this study is a series of interviews with key personnel from a range of Consult Australia member firms. This includes representatives of a number of larger member firms, collectively employing more than 18,000 employees, and whose expertise covers working with a range of public sector agencies across multiple states and the Commonwealth.

The views of other stakeholders in the construction sector are also important to this study, and to that end representatives of public sector agencies have also held informal conversations about Procurement with Consult Australia, while a former employee of a leading player in the contracting sector was also kind enough to provide a contracting perspective on the issues discussed in this study. These interviews provided important opportunities to verify areas where consultants share a common view with other stakeholders, and those areas where our views diverge.

All interviews were conducted by Consult Australia between October 2013 and September 2014, and all participants freely and generously volunteered their time.

The information drawn from those interviews has been compared to the findings of other similar studies relating to procurement4, and each set of findings are canvassed in this report.

4. As set out in the references throughout this study.

Chapter 1: The Consultant

Who We Are

The built and natural environment sector is uniquely complex from a procurement perspective, in that it involves a diverse range of business types, each contributing a different input, with different interests and drivers, and yet all required to work together to achieve the optimal outcome for the end client, while simultaneously serving their own business interests.

These stakeholders include providers of a range of professional expertise, covering everything from a survey to providing an opinion on feasibility, to environmental impact statements through to final designs. It also includes those firms that construct the final, tangible product.

Within government, one way in which the businesses are divided is to group them as either consultants or contractors. The Queensland Government, for example, defines a consultant as being an individual or organisation, that is a service provider, and for which the following apply[5] :

- They provide expert knowledge to analyse information, draw conclusions and make recommendations in the form of a written report or an intellectual product for future action, which the agency must then decide upon or take a certain course of action;
- The nature of the output is not necessarily predictable, but tends to be open ended and is more complex (for example, a range of recommendations which the agency must consider);
- They develop a new concept or process and where the agency requires critical judgement to consider the recommended course of action;
- The consultant is engaged for a fixed period of time at an agreed payment rate;
- Work is not directly supervised by the agency.

However, it should be noted that this very policy specifically defines the following forms of work as being undertaken by contractors rather than consultants:

- built environment design and production undertaken by architects and engineers;
- feasibility studies; and
- valuation services on land, buildings and other departmental assets or potential assets.

While the definition provided by the Queensland Government includes some important general definitions and aspects of the work consultants do, it is too narrow to include the full range of Consult Australia's membership and the work they do, and would specifically place some of their frustrations with procurement policy and practice beyond the scope of this report.

For that reason, this report will be defining consultants as all providers of professional expertise (including reports, scoping studies and designs), and where their output is provided to another party (generally a constructor or the end client) for their consideration and use.

One consultant who was interviewed for this study characterised our industry as "dedicated to the project, relishing the opportunity to take on a challenge and show off their technical skills," compared this to other service oriented industries where firms are more concerned with protecting or acting in their client's interests.

Business practices in the consulting industry are generally quite conservative, but the prospect of being able to produce an innovative solution to a complex problem is enticing for consultants. Consulting firms are typically asset poor, and engage in a "fee for service" model of doing business, rather than taking on a project with the potential to make a large profit based on how efficiently they can do the work. This becomes particularly important in the context of the complex web of contractual arrangements that often occurs when construction work is undertaken. These contractual relationships will be more fully explored in Chapter 13.

Engaging the Best Consultants

All clients want the comfort of knowing that when they engage a consultant, they'll get a quality service that meets their needs. As the ramifications of getting a design or scoping study wrong are serious, clients need to know they have protection from an inferior service, and are constantly looking for ways to attract the best possible consultants to work on their project, subject to the fee.

It should be noted that just as "one size does not fit all" with regard to clients (as discussed in the next chapter), the same principle applies to consultants. One bad experience should not be used to taint the entire industry, and appropriate due diligence should be applied to ensure the right consultant is engaged for the job at hand.

Depending on the nature of the work a consultant is being engaged for, their expertise can be highly specialised, generic, or multidisciplinary. When large firms are tendering for work, the question exists as to how they allocate their staff to project teams. Similarly, clients are constantly looking for ways to attract the best consultants through the tender process, and often seek out specific individuals known for their expertise relating to a particular challenge.

The answer to this question is complex. Factors determining who is available for work, including the personnel on a job, or whether a smaller firm tenders for work, includes:

- The state of the market, and the imperative to win work;
- Commercial risk associated with a particular project or client, and its balance with the reward offered by that same project, relative to others available;
- Availability of insurance;
- The ease of working with a particular client;
- Particular challenges that a consultant may want to receive professional plaudits for having designed a solution to overcome.

Skills Supply Issues

While this submission focuses on issues in procurement as the obstacle to clients receiving the best possible service from the consulting industry, other factors also inhibit our industry's ability to produce the optimal product. Chief amongst these is the availability of appropriately skilled personnel to work on the project(s) in question.

Skills shortages are often cyclical for the bulk of our industry. However, it has become evident that systemic issues have a significant impact on the frequency, duration and impact of skills shortages for the engineering professions.

The number of qualified engineers graduating from Australian universities was static for many years and is now increasing only gradually, despite fast-growing demand for their skills over the past decade. Fewer school students study maths and science, arguably because those subjects and the careers that rely on them have lost prestige in Australia, and are perceived to offer less competitive career paths relative to other disciplines.

The skilled workforce could also be more efficiently used, with greater use of engineering technologists and associates, and efforts made to retain qualified engineers within the engineering workforce. Workforce diversity, most notably with regard to gender, must also be addressed.

Employers, unions, professional associations, industry associations, educators and governments are all working together to address these issues. Consult Australia has proposed several solutions, and these were provided in a submission to the 2012 *Senate Education, Employment and Workplace Relations Committee inquiry* into the nexus between the demand for infrastructure delivery and the shortage of appropriate engineering and related employment skills in Australia[6]. In particular, robust and flexible skilled migration programs are essential to the health of engineering-based companies and the Australian economy as a whole.

Opportunities for Improvement in Consulting Services

As part of this study, perceptions of consultants from amongst their stakeholders in the contracting industry and their clients were collected. While the response was generally positive, areas for improvement were consistent with the impression of our industry set out above. Contractors looking for ground breaking, innovative solutions, found that consultants could be overly conservative in their designs, and weren't as quick to react to changes in project scope as others in the construction industry could be. These are potentially both symptoms of an overly siloed approach to construction, where the respective service providers aren't sufficiently empathetic to the other parties. Consultants need to understand that contractors bear project risk (as opposed to a 'fee for service' model of payment), while contractors need to understand how consultants will respond to having onerous project risk placed on them. Ultimately, the project's success is a shared responsibility, and the impact of increased procurement costs affects both sides of the construction equation.

Finding 1: The ability of clients to attract the best consultant is a product of market conditions, project risk, skills supply issues, and the desirability of undertaking a particular project.

5. http://www.hpw.qld.gov.au/SiteCollectionDocuments/PgDefinitionsConsultantsContractors.pdf
6. See the Parliament of Australia website for the Senate Standing Committees on Education, Employment and Workplace Relations at http://www.aph.gov.au/Senate/committee/eet_ctte/engineering/index.htm.

Chapter 2: The Client

The Perfect Client in the Ideal World

Consult Australia has argued for some time that governments around Australia should formally accept the obligation to be a model procurer, in line with the existing obligation to be a model litigant. This raises the question of what a "model client" looks like.

Over the course of conducting this research, the most frequent response was that a good client is an informed client. This refers to a range of issues that a procurer should be aware of, and involved with, spanning both technical knowledge, and a good awareness of the legal, commercial and risk elements to commissioning work. It means understanding the problem or issue they are seeking a solution to, and understanding the technical aspects of the bids that will be received in response. It also means knowing what steps need to be taken to trust the supply chain and have that trust reciprocated, while working in a collaborative manner.

Working alongside the idea of a "model client", is the concept of a **positive procurement culture.** A positive procurement culture has a number of elements at its foundation, including the technical and commercial skills held by the individuals responsible for procuring work. Other aspects include:

- **Procurement as a relationship rather than a process.** Too often, procuring goods and services becomes a "box ticking" exercise, rather than two parties working together to achieve a particular goal or outcome. This means sharing knowledge and collectively brainstorming solutions to issues encountered, rather than simplistically allocating responsibility in order to feel that the issue in question has been addressed because it's someone else's problem now. Even at the tender phase, the parties should work together to form a common understanding. When procurement is seen as a process, too often service providers are seen as adversaries rather than as a partner working towards the same end, and trusting in the other organisation(s) they are working with. The best outcomes have been reported as coming from projects where everyone is "accountable and working together in a collaborative manner".
- **Checking aggression at the door and working together to solve problems.** Building on the above notion that service providers and clients are partners, the tenor of that relationship is vital. Not only do aggressive contractual terms drive certain less desirable outcomes of a project, but they are also a statement about the nature of the working relationship being entered into. Indeed, signing an aggressive contract has been likened to signing a pre-nuptial agreement before getting married: you may receive protection if it doesn't work out, but it is also a statement that you don't expect the relationship to work, and can even serve the role of being self-fulfilling by eroding trust between the parties. A model client also understands that each business engaging in work needs to meet their own ends for participating. This means appropriate sharing of both risk and reward, and the ability for those businesses to continue to do work without risking their own bottom line.

Creating a non-adversarial environment

In the course of this study, some suggestions were made in terms of how to best create a non-adversarial environment. They include:

i) strong leadership;
ii) peer review of disputes before they occur (for example by using dispute resolution boards); and
iii) incentives for non-construction outcomes, such as no disputes, project safety record, and the level of engagement.

- **The ability to answer questions and make quick decisions.** The officer responsible should be able to answer questions about the project, whether from prospective bidders at the tender phase, or once the project is under way. This means that not only do they have the right technical knowledge of the work being undertaken, but they have also considered what the end result might look like, and with the flexibility to shift their goal if a better solution is proposed. It also means having the appropriate (generally "thin") decision making structures in place, so that when a service provider asks a question, they receive a timely, comprehensive and appropriate answer,

rather than being made to wait as lengthy processes, often by exhaustive committee structures, slow the receiving of an answer. The ability to make a quick decision relies on this knowledge base, and also requires a suitable level of confidence in the key personnel. This last point is a particular challenge, given the accountability measures and culture within large parts of the public service.

- **Willingness to ask questions.** A client that asks the right questions is more likely to get better answers. This also means being prepared to acknowledge gaps in knowledge, whether that knowledge relates to what the final product should look like, or relating to contractual terms and conditions. Particularly in relation to contracts, some less desirable behaviour occurs because a client is unwilling to listen to concerns and acknowledge gaps in their awareness of the impact of some terms and conditions. At the very least, a client should take pause to consider any objections raised by service providers. In practice, holding workshops and providing feedback at an early stage of the project will assist the client to listen to concerns raised without being held hostage to process.

- **Preparedness to leave their comfort zone, and be flexible where appropriate.** A model client should always be prepared to listen to concerns raised by other parties, and adapt where appropriate. Often, incorporating solutions put forward by stakeholders will lead to a superior end result. Where concerns raised at an early stage are ignored, there is the potential for greater cost and an inferior outcome to eventuate. On some occasions, potential solutions will require a client leaving their comfort zone. This may be due to an untested solution, an innovative design, or even just a different way of setting up a contractual arrangement. While it is not always appropriate to take risks, trying new solutions, whether at the technical level or the contractual aspects of a project, has great potential to achieve better outcomes. Clients should be prepared to occasionally leave their comfort zone, provided it is done in the right situations and is managed appropriately.

- **The right approach to risk.** This report will deal with risk in greater detail in Chapter 11. However, the right approach to risk needs to be mentioned here as a key component of developing a positive procurement culture. In less desirable procurement cultures, risk is simply offloaded by the party with the greater bargaining power, generally the client, to those parties with less bargaining power. A better approach to risk would be to collaboratively conduct a thorough risk assessment, and then allocate each item of risk to the respective parties best able to manage those risks. Risk management can be likened to a game of "hot potato" where it is offloaded as quickly as possible, while a better solution would be to get a pair of gloves and handle the risk, thus reducing its likelihood of being realised. Consultants have also raised the issue that often end clients don't understand the nature of the relationship that commonly exists between consultants and constructors, and their involvement could potentially smooth over issues that exist at that interface.

- **Working towards a successful project outcome, rather than avoiding failure.** A senior public servant offered the observation that, "in the public service, you're rewarded for not stuffing up, rather than for getting it right." In other words, the focus is on not making mistakes and on avoiding liability for any mistakes that are made, rather than achieving the best possible outcomes from a project. This culture is driven by a series of accountability measures connected with our political system, such as parliamentary question time, the budget process, freedom of information regimes, and media imperatives. When ministers and their staff involve themselves in procurement issues, it's generally in response to claims of something having not worked, rather than to proactively drive positive change. The outcome of this culture is that opportunities for innovation and achieving better outcomes are lost, and approaches to risk and liability are reflexive rather than proactive. A positive procurement culture would mean re-focusing relevant personnel towards achieving successful project outcomes, rather than avoiding mistakes, and providing a level of protection for officials doing things differently than to how they may have been done before. This may be achieved through a whole client agency buying in to procurement outcomes, including its leadership.

- **Continuity throughout the project.** It is vital that the procurement stage and development stage of a project are connected, and seen as a continuous passage towards the same end goal. That way, communication and expectations remain consistent, and the service providers are not frustrated by constantly changing requirements or behaviour. Maintaining a smooth process throughout will ensure

the more efficient delivery of the project, and a better working environment for all participants.

- **Informed clients: knowledge and involvement.** It has become something of a mantra that a good client is an informed client. The concept of an informed client in particular is worthy of further consideration. The range of issues a client needs to be aware of is wide, and realistically it is not always possible for new personnel to step into the role of the procuring officer with knowledge or experience in all these matters. What matters then, is their ability to understand the vital elements they need to, and learn the rest as they progress. Technical knowledge is essential in order to be able to develop a vision of the project and think holistically about the outcome (including peer reviewing solutions put forward by service providers), and while commercial and legal skills are also important, they are typically the skills that the relevant personnel are expected to learn on the job. Nevertheless, the required mix of knowledge is needed to recognise an inaccurate or underpriced tender that might end up costing more later on, either through variations, or through risk that has not been accounted for. Ultimately, ensuring that the relevant people in each agency have a mix of these skills is a major challenge for government to ensure they get the best outcomes from their procurement. Client involvement has also been raised in this study as a driver of positive outcomes, as clients actively participate in the development of a project, rather than standing back and leaving things to others. Clients and their key personnel are often uniquely placed to bring the various parties together to overcome risks and project challenges.
- **Understanding that "one size" does not fit all.** A positive procurement culture involves clients understanding that different consulting firms have different areas of expertise and different ways of doing things. It allows trust to be built as a client comes to understand that a previous bad experience should not taint an entire industry. This issue however is a two way street, and consultants also need to understand that not all clients are the same. Where working with one agency may have been a bad experience, the same characteristics should not be imputed on other agencies they work with.

In describing these features of a positive procurement culture, the challenge to implementing that cultural change must also be acknowledged. Many of these measures require individuals with direct responsibility for procurement to do things differently to how they or the officers in that role in their agency have done things over a period of many years. Organisational inertia, or the notion that things are done a particular way because that's how they have always been done, achieving successful outcomes, it a significant hurdle to overcome in asking clients to do things differently in the future. On the other hand, the perception of successful project outcomes in the past may be misplaced, as those projects could have been done cheaper and potentially with better quality outcomes that the officer is not appreciative of. Alternatively, it's also possible that successful project outcomes have occurred, but in spite of the procurement method, rather than because of it.

While there is clearly a long way to go, over the last couple of years many government agencies around Australia have acknowledged that they could be doing things better, and have taken steps to improve their procurement culture. However, where the procurement culture does not reflect these above characteristics, it is all too easy for new personnel to get sucked into a particular culture and way of thinking that makes less desirable practices endemic. A particular challenge is posed by government outsourcing, which has greatly reduced the impetus for public sector agencies to possess relevant procurement skills, as they are now largely the domain of private sector service providers.

Finding 2: Best practice procurement can be achieved through a focus on the knowledge and skills of the relevant personnel, supporting the parties to work together collaboratively rather than in opposition, cultural issues, and the ability to make decisions.

Recommendation 1: Non-construction outcomes, such as disputation, safety, and level of engagement, should be included as measures of project success.

See also our recommendations in Chapter 10 on "Procurement Skills".

Inconsistencies Within Client Agencies

Few aspects of procurement emphasise the sometimes bureaucratic nature of the process more than the inconsistencies often experienced in separate dealings with the one agency. Consult Australia members report that different branches of the one organisation have taken vastly different approaches to the same issue. For example, the local office of a roads agency in one geographic location may take a rigid approach to following rules and process, and refusing to entertain amendments to a contract, while another branch in another location may take a more flexible and collaborative approach. This practice does not necessarily mean that the former category is a less knowledgeable or more aggressive procurer. Rather, this may simply reflect that a particular policy may have flowed down to local branch offices differently, or that there is a different awareness between officers on the ground as to the level of flexibility allowed in engaging service providers and undertaking work. This experience is particularly felt when tenderers put forward solutions that do not fit neatly within organisational policy. The flexible approach is almost always preferable and leads to better outcomes for the client as well.

One other inconsistency that should be acknowledged is the approach of clients to "best practice". Our common experience has been that the leadership (including ministers) and relevant officers of a number of agencies talk about "best practice" procurement as being their goal. In some instances, the public sector's commitment to best practice extends little further than repeating this phrase, while using less desirable practices at the same time. In other instances, there is a solid understanding of what best practice entails in an abstract setting, yet when a live contract and project is before that same agency, many of the practices they endorse in a theoretical policy setting are abandoned in favour of conservative and aggressive behaviours, contradictory to their earlier statements, that drive less desirable outcomes.

A particular challenge for the public sector is for this commitment to flow down through an agency to the officer responsible for managing a particular project. Because that officer is the person most likely to be held responsible for any negative outcomes, they are also the person with the greatest disincentive to try new things, preferring to stick to highly conservative practices with a view to protecting themselves from any blame should something go wrong.

Accordingly, there is an imperative for the leadership of public sector agencies to provide protection for their personnel to try new things that may yield improved outcomes. Conversely, the leadership of the agencies also need to be accountable for the procurement outcomes of their organisation.

A major driver of this risk averse behaviour that needs to be acknowledged is the procuring of external legal advice, and then rigidly following that advice. This can lead to undesirable outcomes, as the legal advice is more concerned with covering loopholes and avoiding liability than it is with business considerations, insurance or the factors driving a collaborative working relationship. While legal advice is important on any project, the limitations of that advice must be recognised by the client for it to be useful, and clients need to be trained to ask the right questions of their lawyers, rather than simply seeking to avoid contractual liability.

From the lawyers' perspective, the role of their advice is concerned with designing a contract that shields the client to the maximum extent from any possible liability. It does not consider the behavioural impact of those contractual terms, the insurance implications, nor the additional cost that might result. In turn, its focus is on eliminating any liability to their client, but not necessarily ensuring that a project is successfully delivered, or that project costs are minimised.

At the very least, public sector agencies need to appreciate that cocooning themselves from liability comes at an additional cost, and may not actually serve to address project risk satisfactorily. From industry's perspective, consultants need to respect the political difficulties for a client to disregard any legal advice they have received. The challenge that needs to be faced to bring about positive change, is for public sector agencies to become more skilled in seeking appropriate legal advice that does not undermine the ability of insurance to cover losses, and addresses the commercial needs of the project.

Finding 3: Flexible approaches are preferable, and leadership of an agency needs to ensure that this is understood consistently amongst procurement and project officers on the ground.

Recommendation 2: Government should commit to being a "model client", in line with its existing commitment to being a model litigant. This means that commitments to best-practice procurement are followed through in practice, and that agencies work with service providers to achieve optimal outcomes.

Recommendation 3: Project managers within agencies should receive support to try new and improved ways of undertaking procurements. This should be done through the entire agency committing to improved procurement, including the head of that agency being accountable for improved procurement outcomes.

Recommendation 4: Agencies need to better understand what they should ask for in legal advice. Effort should be made to ensure that the advice they seek goes beyond simply avoiding contractual liability, and addresses insurance, project and commercial considerations as well

Public v Private Sector Clients

There are some crucial differences between public sector and private sector clients that help understand differences in procurement practices between the two.

Accountability

The first is the level and nature of accountability. Public sector clients are accountable to the wider taxpaying (and voting) public, under the leadership of the relevant minister. They are subject to scrutiny from the media and opposition politicians, with a wide freedom of information and watchdog (including for example, ombudsman, auditor-general, administrative law and other agencies) regime. In contrast, private sector clients are accountable to their shareholders through a board, with far less public scrutiny directed their way.

Imperative to succeed

The second difference is partially a factor of the first: determining what is an acceptable level of failure. Private sector organisations are able to try new things and fail, provided that overall their level of success outweighs their level of failure to a degree determined by their leadership. This allows for innovation, which in turn could yield greater long term outcomes. Public sector agencies, by contrast, are rarely if ever allowed to accept failure – with an eager opposition and watchful media constantly looking for examples of failure to be used to inflict political pain. This in turn has driven the culture, described earlier in this chapter, whereby individual public sector officers are generally rewarded for avoiding project failure rather than for achieving a successful project outcome.

Decision making structures

A third factor also draws on the nature of each client's accountability, and is that the private sector is able to allow a thin decision making structure, whereas public sector agencies are more likely to have a complex web of internal approvals required. It should be noted that this is not always the case, and may depend on the level of public interest in a particular project. These first three drivers however mean that the private sector is better able to make quick judgment decisions, as they are not bound by complex rules, and have less reason to be fearful of the repercussions if a judgment call turns out to be incorrect or lead to any kind of failure.

Market forces v politics as the driving force

The fourth difference between public and private sector clients, is that public sector clients are driven by a political decision making structure, while private sector clients are driven by market forces. In theory, both drivers should mean undertaking infrastructure projects that the public wants, but political imperatives mean that public sector projects may be announced or released to the market before they are ready. Public sector projects are subject to "gotcha" journalism that is part of a broader political-media culture of responding to problems, rather than working towards proactively achieving the right outcome. Attempts to find a scandal to attack political opponents may be used to undermine a particular project, and in turn might detract from its success.

Private sector projects however are also vulnerable to attempts at fast-tracking, as revenue will only start coming in upon completion. In both cases, project fast-tracking runs the risk of inadequately considering design and other "front end" considerations, which in turn can create problems for a project down the line. This issue was extensively canvassed in the recently released (2014) edition of *Scope for Improvement*.

Procurement skills shortage

Finally, the fifth factor identified as a key driver of difference between public and private sector clients is the notion of a procurement skills shortage in the public sector, owing to the ability of skilled professionals to earn a higher income in the private sector. Accordingly, the public

sector constantly faces the challenge of attracting and retaining the best possible professionals to take charge of their procurement activities. It should be noted that some government officials challenge this observation and point out that the challenge of public sector procurement, combined with a decent salary, has recently allowed for the attraction of appropriate personnel. Nevertheless, a number of procurement and engineering functions have been outsourced from the public sector, and a reduction in the number of skilled personnel is an inevitable consequence of that.

These distinctions between public and private sector have driven a range of practices that have been observed through this study. They include that the treatment of contractual risk is generally better by private sector clients. For example, private sector clients are far less likely to contract out of proportionate liability and more likely to include a contractual limit on liability. Private sector clients also generally are better able to innovate.

Conversely, government clients have other advantages, in that they have the ability to benchmark performance across a range of agencies, and there is often greater transparency and accountability as to how decisions are made.

Increasingly however, the issues faced by consultants are common to both public and private sector clients, with opportunities for both sectors to work together to remedy these. Private sector clients have been cited as observing public sector procurement practices, and following some of their worst behaviour, under the impression that a government agency doing something gives an imprimatur for a private sector organization to do that same thing. Issues in terms of understanding the pipeline of forthcoming work are also common to both, and if the public and private sector work together to inform the consulting sector of forthcoming work, our industry could be more efficient at ensuring the relevant skills and personnel are available for that work, increasing efficiency in the process.

Recommendation 5: Government looks at acknowledging the forthcoming private sector pipeline of work to inform its own pipeline.

Recommendation 6: Public and private sector clients share knowledge and work collaboratively to achieve better procurement outcomes.

Chapter 3: The Role of Constructors/ Contractors

While this report focuses on the experience of consultants, and the impact of poor procurement practices facing them, the role of contractors must be touched on. Whereas consultants provide professional advice, including design work, for projects, contractors are responsible for the construction elements of that project. Their contractual relationship with consultants is a crucial element of procurement, and indeed may be a source of frustration itself.

To appreciate the interaction between consultants and contractors, their respective business models need to be understood. While consultants provide their expertise on a "fee for service" basis, contractors take on project risk while aiming to maximise profit. The ability of contractors to earn a profit is maximised when they take on ownership for design elements, and conversely is reduced when they are engaged on a "construct only" basis. These models are appropriate, and indeed the Royal Academy of Engineering's study, *Public Projects and Procurement in the UK*, found that productivity increases when a large private contractor takes on project risk, and then allocates aspects of the projects to smaller sub-contractors or consultants[7].

This means that both sets of businesses are driven by different considerations, in addition to the conditions imposed by public sector clients. Further complicating the relationship is that under a number of different project delivery models, consultants are directly engaged by the contractors, rather than the end clients.

Accordingly, the relationship between consultant and contractor allows clients to pass off some difficult aspects of the relationship to the contractor. For example, risk might be contractually allocated by a client to a contractor, who in turns passes on the same conditions facing them to the consultant. This is a fairly standard practice, and reflects the levels of bargaining power of each party being used to offload risk (irrespective of whether offloading that risk is a sound risk management practice or not).

The treatment of risk is a major potential source of frustration to both consultants and contractors. From the consultant's perspective, risk should be allocated to the party best able to manage it, in accordance with *Abrahamson's Principles*[8]. Contractual terms are nevertheless frequently presented to consultants containing onerous risk allocation, often with terms identical to those in the original contract presented to the contractor. While this may be appropriate to a contractor, whose profitability depends on taking on risks, it is a harder outcome to accept for consultants whose business model is not based on risk taking, and are not in a position to either manage the risk in question, or absorb its impact on their balance sheet.

From the contractor's perspective, the consultant's approach to risk in response to this practice will drive certain behaviour types that will become separate sources of frustration. For example, when faced with having to bear a significant portion of project risk, consultants are less likely to innovate, and more likely to over-engineer their design solutions. In turn, this affects the contractor's profit, and their ability to develop an iconic project.

One other issue from the consultant's perspective merits consideration. When projects are procured under the "design and construct" model, contractors and consultants partner with each other to prepare a bid, and to complete the project if their bid is selected. For bids that aren't selected, contractors may be reluctant to pay consultants for their contribution to the bid. From their perspective, this is simply the cost of tendering for work, and investing effort into a bid that may not be selected (and hence not be compensated by the end client). From the consultant's perspective, they have been contracted to develop a design, and should be compensated for their work. Both perspectives in these instances are legitimate and need to be reconciled for the relationship between both parties to remain positive.

In undertaking this study, respondents indicated that many of the issues described above arose from client policies and practices, and the contractor then acting to protect their own interests. In turn, consultants have borne the brunt of practices and risks they are often ill equipped to manage or respond to. While the issues of risk, delivery model and the cost of tendering are dealt with in this study, the effects of poor client procurement practices will "flow on" from contractors to consultants. This outcome heightens the impetus for clients to ensure their procurement drives the right outcomes without unintended consequences.

Chapter 4: Community Stakeholders – Public as End User or Affected Community

Stakeholders not directly involved in developing a project may still have an impact on the outcome of the project. The concept of "social license" is emerging as an important concept in the development of major infrastructure, and in the case of public sector procurement, political considerations mean that community support for a project is vital.

Community support is needed through the planning and construction phase, in terms of property acquisitions and the impact of construction on their amenity, and then following completion, when the infrastructure itself affects the nature of the area. This may include, for example, traffic noise or pollution in the case of a new road.

Where community opposition exists, it may impact on a client's decision to proceed with a project (for example, the East-West Link in Melbourne or Tillegra Dam in the NSW Hunter Valley), or to substantially revise the proposal (for example, the Epping to Chatswood railway line). In these cases, reputational damage may result, and additional costs will be incurred. While community engagement is a necessary aspect of any major piece of infrastructure, it is advantageous to get the engagement process right, to save on costs and delays.

Indeed, early engagement with stakeholders helps ensure a project's success, and can reduce costs, by keeping project specifications in line with community expectations (eg. by not promising things that can't be delivered).

To this end, Consult Australia's recent *Guide to Procuring Engagement Services*[9] is worth considering as a best practice report that comprehensively examines this issue.

Beyond community engagement, planning and environmental factors also play their role. Changes to important regulations have the ability to cause frustration, as does the duplication of regulations between the different tiers of government. As with community engagement, these factors have the potential to lead to cost increases and delays. Indeed, some participants in this study reported that environmental approvals mean that the same road could cost 25-30% less to build in Queensland than in New South Wales. Nevertheless, there is a broad acceptance that these issues are a part of undertaking a project and to ensure the project caters for a broad range of needs, despite their potential to delay the works. While a range of further issues relating to both environmental and planning approvals exist and are open to investigation, they are beyond the scope of this study.

7. Royal Academy of Engineering (2014) Public Projects and Procurement in the UK: Sharing experience and changing practice. See http://www.raeng.org.uk/publications/reports/public-projects-and-procurement-in-the-uk-sharing#page=3&zoom=auto,-107,730 at pp19-21.
8. Abrahamson, M 1983, Risk Management 1 ICLR 241
9. See http://www.consultaustralia.com.au/docs/default-source/infrastructure/engagement/guide-to-procuring-engagement-services.pdf?sfvrsn=8

Chapter 5: Decisions to Evaluate and Undertake the Project

As this report has already mentioned, the decision making process for public sector infrastructure often occurs under the glare of media scrutiny, and subject to a range of political considerations. This dynamic has the potential to colour the nature and quality of decision making at times.

Oppositions often promise to build certain projects from opposition, without the benefit of expertise that is available to government, and priorities change with each change to the government of the day. The imperative to stretch each dollar of infrastructure spending further is a constant.

Two key decisions are heavily influenced by this dynamic:

1) Which projects to undertake (or whether to undertake them); and
2) Decisions regarding project specifications once the first decision is made.

In the case of the first, the decision making process is premised on the idea that governments want to build a range of public infrastructure, with budgetary factors being the prime limiting factor. The decision to proceed with a particular project is often coloured by political considerations, with costings then added to the equation. There is particularly incentive for an agency, or a politically conscious minister to deliberately downplay the cost with a view to keeping the project viable in Treasury's eye. This may also include the practice of highlighting the cost of construction, but downplaying the cost of planning, design, and then the cost of maintaining and running that particular infrastructure.

There is an increasing recognition of the importance of independent agencies providing expert and transparent advice to governments about project prioritisation to overcome political considerations. This was an important recommendation of the Productivity Commission's recent report into Public Infrastructure[10].

The focus of this report, however, is on procurement, which is more closely linked to considerations related to the second of these decision types. Accordingly, most of the decision making problems this report will highlight arise out of design specifications rather than the original decision to proceed with a project.

Once the decision to undertake a project has been made, the challenge of delivering that project within a set budget and timeframe to adequate specifications comes alive.

Agencies often face the challenge of turning a one line policy idea developed in opposition, into a deliverable project, under the gaze of the media and Treasury. There are a few issues they face, discussed below.

Whole of Life Costs

Government sometimes talks about wanting an innovative solution to a design challenge, but then chooses a cheaper and inferior option in order to save on costs. When the decision is made as to which option to proceed with, too often it's based on finding an option that fits within budgetary limitations. While government has warmed to the idea of procuring "best value" rather than "lowest cost" solutions, this concept is redundant if the cost of the best value option is beyond the means of that government.

One dynamic that needs to be considered as a part of the decision making process is viewing the various options in terms of their "whole of life" costs. Some pieces of infrastructure are built to a specification that allows them to be built, but without future proofing them. For example, the M5 East tunnel in Sydney was built between 1998 and 2001 as a two lane tunnel, with the option for ventilation shafts refused, as that was the cheapest option at the time. However, less than 20 years later, the tunnel has reached capacity, and projects to duplicate it are being proposed while the ventilation is being upgraded. The combined costs of both projects will be significantly more than if the tunnel had been built to a greater capacity in the first place. By way of contrast, when the Sydney Harbour Bridge was opened in 1932, it had the capacity to allow every car in NSW to drive it, and took many years to approach its capacity.

There is however also a significant obstacle to making decisions on the basis described above. Where projects are built with greater capacity, they will inevitably come at a greater up-front cost. Those additional funds have their own opportunity cost, in that government can't undertake other projects as those funds are tied up. Sometimes a decision will be made to undertake multiple projects to reduced specifications, to ensure that different communities are being served, while in other instances the larger specification means that project costs may pass the point at which their construction is no longer a desirable decision for government.

These competing considerations represent a significant challenge for government in their attempts to stretch infrastructure spending further, by constructing more projects and to greater specifications. However, when government makes the decision to undertake a project, it is important that they at least consider how that infrastructure will be used in the future, and what the costs of future upgrades might be.

Asking for the Right Thing: The Importance of Early Engagement

When a project isn't properly understood or conceived, there is great difficulty for agencies in explaining the project and asking for the right thing. If the client doesn't ask for the right thing, a range of other problems follow. Many of these will be explored in the section of this report looking at scoping briefs, but some basic considerations must be put forward here, as they also impact on the decision making process. When a client asks for the wrong thing, they will invariably receive non-conforming bids. For example, different works on the one site at the same time will save time and money, but are often not considered in putting together the scope of works.

One solution that has been put forward, and is sometimes considered, is the early engagement of consultants, whether through workshops or engaging a consultant to reverse engineer the brief. This allows the full scope of works to be more fully developed, and in turn may lead to greater clarity in the mind of the client. It serves to highlight to clients possible project risks, and what resources are available from industry in terms of personnel. From industry's perspective, it helps clarify exactly what it is that the client wants. In this context, something worth considering is opening projects up to contestability, whereby the consultant can challenge assumptions or indeed what is being asked for.

Gold Plating

A constant refrain from budget conscious politicians eager to build vital public infrastructure is that we should not be building "gold plated" assets. The term "gold plating" commonly refers to the notion of building that infrastructure to a greater specification than is required. However, the charge of gold plating our infrastructure is more complicated than its proponents might suggest. Designing a project to a specification that allows for "future proofing" may in some circumstances be regarded as gold plating an asset, and in other situations as a prudent move to save money over the whole life of that item of infrastructure.

Innovation is also an important aspect of this debate. In announcing a project, ministers often talk about innovation being involved in the final design, but the officials responsible for delivering that project are more likely to be concerned with overcoming risk related issues, reflecting a disconnect between the political decision makers and those on the ground delivering the project. This suggests that the whole concept of gold plating may be problematic. Without question, when external funding is being used to pay for a project, a moral hazard exists whereby there are a series of perverse incentives for proponents to over-specify the project's scope. However, agencies with an engineering background may be conservative regarding any innovative solutions, and discount the greater benefits realized from more expensive options.

An informed client should be able to make a determination as to whether the additional value of an innovative solution, or a future proofed project design, is worth the additional cost. They should also be able to make the judgement as to whether innovation or future proofing is appropriate for the project at hand, taking into account the opportunity cost of spending those additional resources on a particular project, and whether it would be more desirable to potentially be required to spend a greater sum of money on rectification or expansion down the track.

Some consultants however report that their clients ask for the best possible product when releasing their proposed scope, but without the willingness to pay for it. In other words, there is a desire for the highest standard product, but relevance devoting the appropriate resources to achieve that.

The concept of gold plating however may not even go as far as the question of innovation or best practice. Simply doing the job to an appropriate standard may be considered "gold plating" by some commentators, especially when factoring in the whole of life considerations discussed above.

Considering Deadlines and Budgets

When announcing the completion of works, governments regularly hail the work for being completed on time and under budget. Indeed, these two considerations are crucial indicators to government of success in developing a project. While these are doubtless signs of a successful job, it is important that decision makers don't blindly prioritise these ahead of "getting it right", and are realistic when setting both time and budget targets. There is also the risk that time and budget imperatives can stifle any innovation demanded by the client.

However, as discussed in Chapter 2, fast tracking projects runs the risk that insufficient work has been done in the design and scoping phases of the project. These risks have the potential to cause budget over-runs, and indeed the 2014 *Scope for Improvement* study found that additional time and resources spent on the initial stages of a project could result in large cost and time savings to the project[11].

Finding 4: Decisions relating to the details of a project should balance time, cost and quality considerations over the whole of the life of that infrastructure, while also factoring in the opportunity cost of building infrastructure to cater for future needs. This has the potential to save money in the long term, and deliver better quality infrastructure.

Finding 5: Some discussion of gold plating assets is misplaced, and government needs to reconcile its desire for innovation with cost saving, while also accepting that building an asset to an appropriate standard may be more costly than anticipated.

10. Productivity Commission (2014) Public Infrastructure, at Recommendation 7.1.
11. Scope for Improvement (2014) at p17

Chapter 6: Scoping the Work: Quality of Project Documentation

The quality of the scoping documents is frequently cited by consultants as a source of project disputes and inefficiencies, when they don't meet the required standard. Indeed, this issue may be the greatest source of frustration facing the consulting industry with public sector procurement policy and practices today.

Given this focus, some attention needs to be paid to understanding what a project scope is. Put simply, the scope is the documentation explaining the client's requirements from the project. While the scoping of each project will vary on a case by case basis, there are several components that are generally common to all projects. They include:

- Outlining the broad objectives of the client to be realised through the project
- Specific project requirements, such as functional outcomes or benchmarks to be met in meeting the broad objectives
- Background information, including specific project risks
- Contractual method of delivering the project

There are many paths taken by clients to develop an initial concept into a scope, although these processes aren't always clear to the various service providers who will then rely on that documentation.

What is clear is that the most successful scopes have a greater level of input from a wide range of stakeholders (including potential service providers such as consultants and contractors), contain realistic timeframes and budgets, provide an appropriate amount of background detail, and tailor the procurement process (including risk and delivery method) to the circumstances of the project. Indeed, the level of definition in the scope should be a deliberate factor linked to the delivery model and risk allocation in order to encourage innovative solutions. On the other hand, poor scopes lead to confusion and wasted efforts by all parties.

Sources of frustration include:

- **Inadequate or unverified background information**, requiring duplication and over-servicing by consultants. Many consultants reported that the scoping documents they were presented with contained inadequate or unverified information. Given that in many cases, their designs are based on that background information, this is a gross inefficiency. In some cases, clients provide a survey, which may already be publicly available (for example) but refuse to verify that it is current and factually correct (presumably on the advice of their lawyers). In other cases, the required background information needed to proceed with a design or report simply is not provided to an appropriate standard. In both cases, any consultant serious about providing designs has to undertake or procure their own survey of that same information at additional cost to the project, or otherwise test out the information provided to them to verify its accuracy. Needless to say, the quality of that data is vitally important, to the extent that any inaccuracies will generally render a design unusable. For example, a 2005 report published by the Queensland Division of Engineers Australia, *Getting It Right – The First Time*[12], found that between 60% and 90% of variations are due to poor documentation, with the ultimate cost to public sector clients totaling billions of dollars.

- A standardised, form approach to developing the scoping document, may be problematic, as it runs the risk of developing the scoping document for the sake of producing the document, rather than meeting project needs. The best scopes are developed specifically for a particular project, and acknowledge project requirements and risks unique to that site, the relevant set of stakeholders, and the desired final outcome. Consultants interviewed as part of this study report having been presented with scoping documents that in some cases weren't even updated from the previous use for a similar project, such as a corridor preservation or traffic study.

- Linked to the previous frustration is the **inclusion in the scope of items that aren't really required**. For example, certain skills may be listed as a requirement from firms tendering for a particular job, or other requirements for the project may be prescribed when they are not necessary. Ultimately, demanding that a successful bidder meets certain unnecessary requirements or brings unnecessary characteristics will deter certain firms from competing for tenders, and will drive up the cost on the part of other firms. In both instances, needless additional costs are incurred and inefficiencies result, while at the same time stifling the potential for innovation on that project.

- At the other extreme, many consultants have reported that **scopes are often not adequately defined or thought out**. This creates a challenge for tenderers in putting a bid together, when they are not sure of what the client wants, which should be set out as a minimum inclusion in a scope. In some cases, scoping documents are used to clarify what the client wants, when they are deliberately vague, in the hope that a consultant will challenge the information provided in terms of "you have asked for X, but don't you really want Y instead?" As an example, a city council called for bids to make their bus stops disability access compliant. However, the scope wasn't clear as to whether firms were tendering for the concept design, preliminary design, or detailed design stages of the project. Accordingly, bids ranged from $500k to $11.2m, reflecting the fact that firms weren't necessarily bidding for the same thing. In this case, the bid selection will likely have come down to the ability of a bidding firm to produce a conforming bid, with any differences between their bid and what the Council wanted in the first place then resolved through potentially costly variations.

The level of detail required in a scoping brief will vary by project, and the converse argument can also be made in some cases, that leaving certain aspects of a project open might in turn encourage innovation by testing the creativity of bidders. What is an imperative however, is that any lesser degree of detail should be a deliberate decision, and not simply a planning oversight.

One possible solution exists to these last couple of frustrations. Early consultation with and involvement of consultants and other service providers will help understand the issues that will be faced when a project is put out to tender, and will also clarify in the client's mind what they want at each phase of the project.

These frustrations were a repeated theme through this study, and have also been cited in other studies undertaken analyzing areas for improvement in the built environment sector, such as the *Scope for Improvement* series of reports, and Engineers Australia's report, *Getting It Right – The First Time*. While some clients are taking steps to improve their practices, those who aren't can be accused of not showing enough respect for the planning stage of a project, and little appreciation of this phase as being "real money". Strong evidence through this study backed up the findings of previous reports that more time, effort and resources need to be devoted to the development of a project's scope. As well as driving better outcomes in terms of the actual project, getting the scope right will also improve outcomes in terms of cost, delays and disputation, all the while improving efficiency.

Recommendation 7: Additional investment in developing a quality project brief and early engagement with industry will yield improved outcomes.

Recommendation 8: Clients should consider engaging a consultant to assist with their development of the project brief.

Improving project scoping

Consult Australia members have reported receiving project briefs that appear not to have been reviewed for accuracy or where additional information released has been difficult to access. Some examples reported by Consult Australia members that reflect each of the issues canvassed here include[13]:

- The re-issue by the agency of an entire project brief, but without track changes, making it extremely difficult and time consuming for tenderers to ascertain where the changes have been made and the implications for a tender already underway;
- Project briefs that do not correctly refer to known industry standards;
- Project briefs in a 'state of flux' evolving throughout the tender period with additional information catering to changing client demands;
- Tender advertisements referring to published information that is not available online;
- Addenda being issued, sometimes the day before a tender deadline, with no time extension;
- References to parts of a project that are not actually relevant to the project being tendered;
- Project briefs that refer to construction phase services for projects where there is no need for such services; and
- Increased demands for building information modelling (BIM) without associated increases in time to prepare such requirements.

In the circumstances cited above, quality assurance has not been correctly administered and, in part, the costs of quality assurance have effectively been passed to the consultant where they choose to engage with the tender and raise issues of concern. The time and costs associated with this process are substantial, and will either detract from resources spent on the preparation of the tender, or increase costs to the client and consultant alike. Ultimately however, of greater concern to the taxpayer are the ongoing unmanaged risks to the Government that arise in the absence of robust quality assurance.

12. See http://www.qcif.com.au/PublicationsReports/tabid/56/Default.aspx
13. Some examples drawn from: https://www.consultaustralia.com.au/docs/default-source/qld/qld-government-procurement-review.pdf?sfvrsn=2

Chapter 7: Tendering: An Expense That Must Be Recognised

Clients rightly understand that the tendering phase of a project is an opportunity to put a project to market, and to allow bidders to differentiate themselves from their rivals by either offering a superior product (in this case a service), or a similar product for a cheaper price. This process is the very essence of a competitive market, and is a vital mechanism to ensure that taxpayers are getting value for money.

This process, however, is not a cheap one for consultants who choose to tender for that work – something that is not always recognised by clients when designing it. As well as the cost of the time spent putting a bid together, other expenses might include the cost of the intellectual property included as a possible solution to the brief, or the resources required to test any background information. Red tape type administrative hurdles are also fairly common through the tender process, as bidders are asked the same question multiple times through the different stages of the one tender, which can be costly to duplicate. In other situations, bid documentation is required to address the bidder's compliance with a range of competencies, which ultimately will play little role in determining the final awarding of the contract. Meanwhile, some consultants report having been subject to tender processes that required them to "almost do the whole job" in the bid phase, but without the reward of a fee in return.

Certain client behaviours further drive these expenses. For example, shortlisting has the potential to help save costs, but this purpose is defeated if too many bidders are shortlisted, as they continue to accumulate costs associated with their bid that ultimately have to be met. On other occasions, consultants report being asked questions irrelevant to the work at hand, as the client is using a form approach to procurement, and answering those questions has a cost attached as well. Other factors, such as the requirement for bids to be fully compliant, undue complexity of the tender process, or lack of clarity surrounding project risk also impact on the cost of tendering.

Prior to this study, evidence has been collected identifying the cost of tendering as an issue. Previous Consult Australia reports have cited the 1996 study by the Office of Building Asset and Building Policy in Victoria, which compiled some examples, including[14]:

- For a $320,000 public facility, one tender submission by an architectural consultant cost $9,000 to prepare. 102 tenders were submitted. If each tender cost the same amount, potentially $918,000 would have been spent on the preparation of submissions by tenderers and the total cost of tendering equated to almost 3 times the project value;

- For another public facility, the client found that tender bid prices were too high so made minor changes to the tender documents and re-tendered the projects. The client was effectively bid-shopping, but this required the tenderers to put in extra work.

- For a $5-6million project a consultant spent $100,000 to prepare a bid. The successful bid was awarded a contract worth $180,000, meaning that the consultant only received $80,000 for the project and the rest covered his tender costs. The unsuccessful tenderers did not recoup any costs.

Consult Australia members have regularly reported that that these figures remain relevant today and are not by any means unusual.

Client recognition of the cost of tendering in and of itself is at the core of any solution to this issue. Clients rely on a viable consulting industry, and short term costs to the industry will have a longer term impact. By understanding the various costs that go into preparing a bid for work, clients can reduce the cost to industry by better focusing the questions they ask, and reducing duplication through the bid process for the one job. The selection process could also be structured to prevent keeping bids alive when they have no realistic prospect of success, while the issue of reimbursing unsuccessful bids in return for the use of (part or all of) their intellectual property is also worth considering.

Even where an appropriate number of bids are shortlisted, it has been suggested that the selection process could be strengthened by focusing on demonstrating that a firm is capable of doing the job, while listing their fee and people, rather than having to submit concept designs. Greater clarity on risk can be addressed through increased and better use of standard contracts, and making it clear that bespoke terms will not be included. Another suggestion to save costs at this phase of a project worth further consideration is that clients should, where possible, provide advance notice of work coming up to allow consultants to allocate resources for tenders, which might save costs over the long term. In any event, clients need to understand that helping resolve this issue has the potential to save them costs, as extra expenses incurred by consultants will ultimately affect them as the costs are passed on, or competition is reduced.

Finding 6: Bidding for work is expensive, and clients need to recognise this, or they risk paying a higher price for consulting services over the long term.

Recommendation 9: Clients should avoid shortlisting firms that have no realistic chance of winning the work.

Recommendation 10: Clients should consider compensating unsuccessful tenderers for their bids where appropriate, in exchange for ownership of the intellectual property.

14. See, for example: http://www.consultaustralia.com.au/docs/default-source/practice-procurement/12_ACEA_Paper_Successful_Procurement_Project_Delivery.pdf?sfvrsn=0

Chapter 8: Panels and Pre-Qualification

Traditionally, the establishment of panels has been a convenient method to improve efficiency, by overcoming the cost of tendering to firms, and saving clients the hassle and time of running a tender process. Pre-qualification operates on the same principles, but has some important differences to panels.

The Commonwealth Department of Finance defines panel arrangements as[15]:

> "... a tool for the procurement of goods or services regularly acquired by agencies. In a panel arrangement, a number of suppliers are selected, each of which are able to supply identified goods or services to an agency. A panel can be established by either open tender or prequalified tender and is usually established through deeds of standing offer (deeds) with contracts formed under those deeds when the goods or services are acquired."

In other words, a panel is formed as a procurement end in itself, with a finite number of suppliers selected following a tender process. Only those suppliers that represent value for money and can perform the work are selected, with the contract they will be subject to outlined throughout the process.

By contrast, pre-qualification arrangements are not a procurement end in themselves. Pre-qualification is the establishment of a 'gate' or 'hurdle', whereby potential bidders are able to prove they have certain skills to perform relevant works. There is no limit to the number of firms that may become pre-qualified, and when a procurement process does take place, it is up to the parties to negotiate a contract. Nevertheless, pre-qualification does simplify the tender process to the benefit of all parties.

Given the nature of panels and pre-qualification processes as streamlining bid selection processes, they are at face value, something that consultants should welcome. However, a number of concerns were raised as to their use and potential pitfalls if not used correctly.

These processes work at their best when used to improve efficiency from both time and cost perspectives. The first concern raised is that these arrangements often don't meet their stated goals, and in fact instances have been cited of clients running a panel arrangement where the procurement took longer than the length of time devoted to the actual work. One of the drivers of this lengthy period was alleged to be lack of clarity on the part of the client as to what they wanted, and that the panels were only being used to check the prices of bidders endlessly. This second use of panels warrants further exploration.

Needless to say, if a panel is only being used as a bargaining tool to drive prices down (for example, this issue was raised as a major concern in industry feedback provided to the Queensland Government in 2014 in response to its Procurement Transformation Program), it will defeat all the objectives it was designed to meet. As this report outlines elsewhere, better procurement outcomes result from focusing on "value" rather than price. By asking firms to present their "best and final offer" in their bids, client agencies are clearly favouring price over value as the determinant of who is awarded the work. The idea that a firm bidding for work could signal a price without reference to a specific project is also deeply troubling, as it doesn't account for project specific risks or challenges. Accordingly, where clients intend to use panels to drive down cost, they may actually serve to achieve the opposite effect. Requiring firms to indicate their best and final offer removes flexibility from their bids, and in turn is a significant disincentive to bidding for work which will reduce competitive pressure on the project. Where firms do proceed with bidding to be on a panel, it is likely that other mechanisms, such as variations, will be used to make up for the commercial risk they face and undermine the efficiencies a panel should provide. This practice is one that disadvantages industry, and in turn defeats the intentions of clients using it.

Even when panels are used correctly to achieve their stated aim of improved efficiency, the fact remains that panels are still costly to bid for a place on, and each firm doing so expects to earn that cost back in fees won from the arrangements. It follows then that firms who spend large sums of money winning a place on panels get quite upset when the panel is then bypassed, there's already a preferred bidder (assuming further rounds of tendering), or inadequate fees are won from being on that panel. Ultimately, these concerns reflect expectations and transparency. Consultants bidding for a place on a panel need to know exactly what they're bidding for, and subsequent decisions need to be transparent to allow unsuccessful panelists to understand why they might be missing out on certain jobs. Additional transparency might also serve to inform panelists as to the benefits they are realising by being on the panel, and assist clients in evaluating their procurement processes.

Indeed, the creation of each panel should be accompanied by guidance as to the use of that panel, and what the client hopes to get out of the panel. When should the panel be sufficient for a client to just pick a panelist to perform the work they need, when should a client call for further tenders from the panel, and when is it appropriate to bypass the panel altogether? In general, it is larger projects that justify a further tender process, while the requirement for highly specialized skills not already present justifies bypassing a panel. Similarly, industry feedback suggested that panels don't always encourage innovation, as there was no incentive to provide an innovative proposal to stand out from the competition. The need for innovation may therefore be a legitimate reason for not using panel arrangements. Nevertheless, transparent guidance should assist firms and client alike to understand the nature of the relationship being entered into, and why jobs are being allocated in the way they are.

As well as guidance and transparency, clients need to take care in selecting panels to ensure the right skills will be available to them. Consultants have reported clients assembling panels, only to discover they don't contain the skills required, and then using that as the justification for bypassing the panels. Other firms report having been invited to bid for a place on a panel when their participation was not appropriate for their skills. By selecting the wrong panelists, these arrangements actually drive inefficiencies arising out of the wasted resources spent bidding for selection on the panel.

Worth considering for the future is how panels can be dynamic to reflect the changing needs of clients. One suggestion is that a regular turnover of panel members allows clients to regularly review and update their requirements in terms of consultant skills and expertise, and have these reflected in the membership of the panels. Another option suggested by participants in this study is creating one larger panel to function across all government agencies, which assists industry by reducing the cost and effort of tendering, and could also be structured to include a wider range of skills to be available to individual agencies when called upon. If this action is to be taken, regard should be given to ensuring that smaller businesses have the ability to be included in the panel arrangements.
Recently there has been a shift amongst a number of governments around Australia, moving away from the use of panels and towards pre-qualification. This move reflects their understanding that clients want to preserve the benefits of a more efficient procurement process, but that pre-qualification provides a degree of flexibility and dynamism that panels do not. In particular, pre-qualification can greatly assist clients when grading applicants according to their specialist skills, and ensuring that they know who to approach when seeking those skills. Nevertheless, the issues of transparency and guidance remain to ensure these arrangements work to their optimal potential.

Recommendation 11: Panels and Pre-qualification schemes should be accompanied by guidance and transparency as to decision making processes and outcomes to ensure that consultants see value in their use. Otherwise their stated efficiency improvements may be lost.

Recommendation 12: Firms bidding to be on a panel should not be required to state their "best and final offer" in their tender. This practice harms industry and undermines the benefits a client might receive from a panel, while not considering the particular situation of a project.

Recommendation 13: Annual statements of tenders awarded would assist industry to understand how opportunities are being developed and awarded.

Recommendation 14: An industry reference group could assist dialogue between government and industry and provide a forum through which regular feedback could be provided with a view to improving the efficiency of the process.

Recommendation 15: Where panels are used, consideration should be given to setting up a "whole of government" panel, with a wide range of skills included, to save consultants the cost of tendering.

15. See: http://www.finance.gov.au/procurement/procurement-policy-and-guidance/buying/procurement-practice/panel-and-mul/principles.html

Chapter 9: The Winning Bid: Selection Decisions

Governments everywhere are concerned with minimising waste and getting maximum output for each dollar they spend. As developing vital infrastructure becomes a central feature of government policy platforms, the challenge for the officials procuring the development of that infrastructure is to minimise the cost in the process. In selecting winning bids however, the focus on "lowest cost" risks actually costing the client more in the long term, by ignoring risks or taking a short term approach to the project. Indeed, selecting the best bid for a project requires consideration of a wider range of factors than simply cost.

The inefficiencies found in bid selection processes can be attributed to both the process and the criteria itself.

Throughout this study, consultants and indeed constructors reported frustration at the lack of clarity through the process. They suggested that clients weren't always open or able to tell them about the framework for selection or the selection criteria, including the relative weighting of each item through the tender phase. On some occasions, they report that the weightings changed after bids were submitted, which left some firms at a disadvantage. In turn, these issues had the potential to waste their time and resources putting together a bid that didn't address the right issues, and focused on less important aspects of the client's decisions. Greater transparency was requested as a means to ensure that firms only bid for work appropriate to them, and had proper awareness of what to address in doing so.

Tied in with transparent selection criteria and weightings is the suggestion that unsuccessful bids should get feedback. We acknowledge that this may create an additional administrative burden for agencies in the short term, but has the potential to lead to savings over the longer term by improving accountability and probity, and in turn driving improved decision making.

As governments have recently worked on improving procurement policy and practices, there has been a growing realisation that bid selection should focus on achieving "best value" rather than "lowest cost". Already, most governments around Australia have formally adopted policies binding their agencies to achieve best value for the taxpayer, rather than simply the cheapest cost. This concept is also a central theme amongst the suggestions for improvements to bid selection in this study.

The achievement of best value, however, is more complicated than a mere statement of intent, and has several aspects to it. Decisions as to value will differ depending on whether they focus on the construction phase of a project, or encompass the whole planning phase, and indeed "whole of life" considerations. In the past, as this study has already outlined, decisions have been made to proceed with projects on the basis of their construction cost without taking into account whether they were being built to an adequate scale. If a whole of life approach is taken to procurement, it saves the client having to pay for variations during the works, or fixing defects as they are realised and just as importantly, prevents a range of inefficiencies from eventuating down the line, as the infrastructure reaches capacity or the end of its useful life. A whole of life approach takes into account the cost of operating and maintaining the infrastructure, its replacement value, and how long it can operate for. While this approach to decision making will often mean a higher up front cost, it has the potential to save government large amounts of money in later years. We note that already government policies have been released along this line, such as the Queensland Department of Housing and Public Works' *Procurement Transformation Program* released in early 2014[16], and to a lesser extent the *Commonwealth Procurement Rules*[17].

Seeking best value also encompasses selecting the bid that best understands project risks. A bid that hasn't properly appreciated the risks in play will invariably be for a lesser amount of money up front, but will require variations as the risks are encountered during works. As this study has already set out, an informed client will have undertaken a thorough risk assessment, and will understand their project risks well enough to be able to identify project bids that do not appreciate these risks. The informed client should have an idea of the amount that an optimal bid will be made at, and should ask questions of any bid that deviates too far from this amount. Bids that come in too cheap will likely have not accounted for some risks, and bids that come in too expensive may have a less efficient solution to managing those risks. While some clients already eliminate the cheapest bids from consideration, measuring bids against an optimal cost is an innovation worth considering. Suggestions as to the process of finding the best value bid are also worth consideration. Consult Australia has long advocated for the use of a "two envelope" system, separating price and non-price information, evaluating

each bid according to their ability to perform the work, before then moving to price considerations for those bids with the ability to perform the required tasks. Consultants report an undue emphasis on price in tender selection rather than capacity to deliver, their experience, or value for money. Assessment criteria focus too much on requiring detailed information on costings and hours budgeted, rather than a qualitative assessment of deliverables. This is understandable, given that the quality of their output won't always be easy to assess or benchmark, while the level of their fee will be.

Non-Conforming Bids

One particular challenge that merits special consideration is how clients address non-conforming bids. Too often non-conforming bids are excluded automatically, even when they raise an important issue the client should address. Indeed, some consultants reported experiencing problems when bids were submitted through portals, which have no flexibility to accept a non-conforming bid.

Where a client asks for the wrong thing in their brief, consultants are challenged as to whether they should second guess what the client actually wanted, or respond to the brief with the error factored in. Clearly a better project outcome will eventuate when a non-conforming bid is considered that addresses the actual issue, but it does raise probity concerns towards other bidders who weren't aware they could do this. Apart from improving the quality of project briefs, the solution to this issue lies in allowing bidders to challenge the assumptions in a brief where appropriate, and to address the associated probity concerns by adopting a policy making it clear that this is allowed.

While the 2014 *Scope for Improvement Report* identified the automatic rejection of non-conforming bids as a source of rising costs and inefficiency[18], this practice also has the potential to bypass a quality control element of the tender process. Although some guidelines would be required, considering non-conforming bids under certain circumstances could allow for errors in the scope to be identified, or for more innovative solutions to come forward that might save clients money through the procurement process.

Finding 7: Selection criteria are too frequently not transparent, and change after bids have been received. Increased transparency should apply to bid selection criteria.

Recommendation 16: Clients should be aware of the optimal cost of their project, factoring in project risks, and should interrogate any bids that deviate greatly from this price.

Recommendation 17: Bid selection should focus on maximising value rather than minimising cost, and should do so taking whole of life considerations into account.

Recommendation 18: Governments should consider issuing guidelines allowing for non-conforming bids to be considered, where they identify errors in the scope, challenge assumptions, or provide an innovative solution to the problem at hand.

16. See http://www.hpw.qld.gov.au/SiteCollectionDocuments/ProcurementGuideValueForMoney.pdf
17. See http://www.finance.gov.au/procurement/procurement-policy-and-guidance/commonwealth-procurement-rules/
18. Scope for Improvement 2014 op cit. at p43

Chapter 10: Procurement Skills

While Chapter 2 of this report has already discussed the characteristics of an informed client that gets the best value for money, it has only touched on a structural challenge facing public sector clients today: the shortage of effective procurement skills amongst the public service. Following the trend towards government outsourcing over the last couple of decades, exacerbated by the systemic skills challenges in engineering in Australia, a critical and ongoing shortage of staff with relevant skills in procurement at all levels of government has arisen.

Where previously in-house engineers at the Public Works Department may have undertaken the project or done design work internally, now private sector providers are contracted to do that work. It follows then that certain skills which existed within an agency are now less prevalent.

An erosion in governments' skills base in those aspects of engineering and construction critical to successful project management and procurement means that the standard of procurement and value for money outcomes are reduced while some responsibility for procurement has shifted to the contractors. This is demonstrated in our members' ongoing concerns in relation to:

- Poor quality tender and project scope documentation;
- Poor risk management; and
- Poor quality contractual terms and conditions and undue reliance of external legal advice.

These are evident throughout government indicating a systemic procurement skills shortage at all levels.
This issue is increasingly of concern to state and territory governments, and one that has generally been recognised. Solutions, however, have been harder to come by.
The Australasian Procurement and Construction Council (APCC) as part of their guide, *Developing the Government Procurement Professional* acknowledge that:
"Until now, procurement professionalism in Australia has not been clearly recognised or defined. Public procurement too often is undertaken without professional support which results in sub-optimal value for money decisions and unnecessary high prices being paid for goods and services."[19]

The APCC guide aims to raise the profile of procurement. It sets out the three main pathways to becoming a procurement professional and describes the characteristics of such a professional based on four levels of progression. Consult Australia believes that the guide is a useful tool in raising awareness about procurement in terms of it being a career within the public service.

Consult Australia however believes that a concerted, whole of government, focus on procurement skills would benefit those agencies responsible for procuring consulting services. To this end, we have recently promoted the concept of developing a *Centre for Procurement Excellence*, tasked with upskilling public sector procurement professionals, and sharing best practice between agencies. The creation of this concept is not without precedent. Already, the United Kingdom Government has created a *Commissioning Academy* that has broadly the same mandate in terms of sharing best practice and improving procurement skills. Given the reluctance of government to create new agencies, a *Centre for Procurement Excellence* could easily sit within one of the existing agencies established to support the development of infrastructure or procurement skills.

Such a Centre could in time play a role in advising government funding decisions by including the quality of procurement into decisions as to which projects to proceed with. While a *Centre for Procurement Excellence* is a medium term possibility, even in the short term governments should be focusing on providing professional development opportunities for procurement officers, and especially on providing the required new skills for staff moving from different roles into procurement positions. Together with strengthening the APCC *Building Government Procurement Capabilities* standard, there are a number of opportunities to improve the skills profile of procurement professionals around Australia.

Finding 8: There is a critical shortage of procurement related skills around Australia, which impact the outcome of projects. This is especially the case with regard to risk and contract terms. We acknowledge that governments are increasingly aware of this issue, and are starting to take action to address it.

Recommendation 19: Government should investigate the establishment of a Centre for Procurement Excellence, along similar lines to the United Kingdom's Commissioning Academy.[20]

Recommendation 20: Other opportunities for skills training and professional development should be provided in the shorter term for procurement professionals.

19. See: http://www.apcc.gov.au/ALLAPCC/APCC%20PUB_Developing%20The%20Government%20Procurement%20Profession%20-%20Nov%202006.pdf at p3
20. https://www.gov.uk/the-commissioning-academy-information

Chapter 11: Project Risk

At the core of many of the frustrations felt by consultants through the procurement process is the inadequate handling of risk by the client and potentially other parties as well. Poor handling of risk can lead to a range of negative project outcomes, but the headline inefficiency that arises is the additional cost faced by the client as they have to pay for increased insurance costs, risk priced into bids, and reduced competition through firms deciding not to bid for work, amongst other negative outcomes.

There are three key stages of processing risk through the procurement process:

- Risk assessment and analysis
- Risk allocation
- Risk management

An informed client should be in the best position to undertake a detailed risk assessment process. They will be aware of the site, the nature of works, and the conditions under which those works will be carried out. In particular, they will assess all of these with particular respect to the project at hand, and will in turn be aware of its likely value, which can then be factored into the initial budget for the project.

Consultants regularly report that there is no set way for conducting this process, if it occurs at all, which in turn means they don't have full confidence that such a risk assessment has taken place. Risk can't be managed unless it is first identified. Cultural issues within many agencies often means that risk is simply offloaded through the contract, which negates the incentive for the client to truly understand the risks and how best to deal with them. One suggestion that was made through this study that warrants further consideration is including the risk assessment that has been undertaken as a schedule in the project brief, with the subsequent allocation and management of that risk also included in the brief as a stand-alone item.

We are also aware that when risk assessments are undertaken, there is a bias amongst clients to consider their project more risky than it actually is. This is driven by their concern to ensure that the best possible outcome to that project is achieved, and the final item of infrastructure works as intended. However, practically, this bias means requiring greater levels of insurance, and other risk mitigation measures, which in turn will lead to higher costs and may deter potential bidders.

Throughout this study, consultants reported risk assessment being done as a "tick the box" exercise, without proper understanding of the issues, or appreciation for the consequences if those risks were realised. Another major complaint made at the risk assessment phase of the project is that clients did not adequately involve themselves in this exercise, as their involvement made risks easier to identify and address. Indeed, once a design is handed over to the contractor, risk becomes significantly more difficult to address. Without question, the best outcomes occur when all relevant parties are involved collaboratively throughout the risk management process. One example raised was the Brisbane AirportLink M7 Road, where the parties worked together to identify flood risk, as well as the complex design of off ramps, and then appropriately engineer solutions to address them.

The fundamental principle of risk allocation cited throughout the built environment sector is that each risk should be allocated to the party best able to manage it (Abrahamson's Principle). In practice, however, this seldom occurs. Risks are generally allocated according to bargaining power rather than the ability to manage that risk, often motivated by perceived political pressure on the agency in question. Once risk is identified, it can be transferred, accepted or engineered out. Government policy is generally to transfer risk away, under the guise of protecting the taxpayer. Better outcomes, however, result from engineering solutions to or accepting the risk, and the argument was raised in the study that surely it is unacceptable for a party who has transferred their risk away, to then "watch the world crumble around them with their arms folded, doing nothing".

Interestingly, not all projects are alike when it comes to risk management. It was commonly reported through this study that private sector clients have greater willingness to embrace risk, no doubt owing to different pressures placed on them through their governance structures.

As Chapter 2 of this report describes, there is a strong reluctance amongst public sector agencies to own and manage risks themselves, with the more common practice being to depend on service providers to do so. This means that risk is either offloaded to the party with the deepest pockets or the least bargaining power, even where that will ultimately cost the project more. A common refrain from public sector procurement officers is their concern at protecting the taxpayer from that risk, should it eventuate.

What they seldom consider is that by blindly transferring risk, the taxpayer is ultimately paying for that risk anyway, while good management can lead to shared rewards for all parties.

The consequences of incorrectly allocating risk, including simply offloading it, are potentially detrimental to all projects. Service providers will often include unrequired contingencies in their fee, driving up the price of the project. Many clients are unaware of the insurance implications of contractually allocating risks to the wrong parties, which will be discussed later in this report at Chapter 14. From the perspective of a potential service provider, the allocation of risk is a fundamental consideration in their decision as to whether to bid for work on a project, with a more expensive price when they take on greater risk, or conversely a cheaper price necessitating a greater sharing of risk. Indeed, higher levels of risk are a significant barrier for small and medium sized firms tendering for work, as they simply don't have the ability to absorb a potential loss of the scale in question into their balance sheet. Most importantly, perhaps, is that allocating risks to parties who aren't well placed to manage them means that the chances of those risks being realised greatly increase, potentially leading to a range of undesirable project outcomes.

Finding 9: While most government agencies talk about allocating risk to the party best able to manage that risk, this frequently does not occur in practice.

Finding 10: Clients need to be involved in the risk management process throughout the project to ensure optimal outcomes. Collaboration between the client and the full range of service providers will yield the best responses to risk.

Recommendation 21: That risk assessment, allocation and management processes and outcomes be included as a stand-alone item in the schedule of project briefs.

Chapter 12: Innovation

Some clients procuring consulting services often call for "innovative" solutions, while other clients prefer to move away from notions of innovation towards a more stock-standard solution. This begs the question, as to what innovation is in the context of procuring consulting services.

One suggestion is that innovation is delivering a better product, while bringing better value for money. Other suggestions bring risk into the equation, focusing on saving money in the final outcome by taking calculated risk. While there is no one accepted definition of innovation, the key elements appear to be:

i) A new way of doing things, often involving technological advancement, that presents a better way of doing things than previously;
ii) Saving cost, or at least achieving better value for money; and
iii) At least a degree of risk is most likely involved.

In conjunction with assessing the meaning of innovation, we also need to refer to our earlier discussion of "gold plating", which is the label frequently applied to innovative solutions that might not lead to the cost savings initially hoped for. When allegations of gold-plating are made, it generally alleges that a project is procured to a higher specification, or includes a cutting edge technology, that is not required to meet the final goal as this paper discussed earlier. Procurement officers calling for innovative solutions frequently run the risk of having their project labelled as gold plated.

When making decisions around the scope of a project, clients need to consider whether or not they want innovative solutions, what that means for the final project outcome, and the political risks of calling for an innovative solution.

Because of the political environment in which procurement decisions are made, innovation's good name is sometimes tainted. It is frequently seen as a risky or costly way of doing things, when the intention of innovation is precisely the opposite. In other instances, clients might not respect that an innovative solution will call for additional time spent on developing a design or output. The benefits of innovation must therefore be considered and prioritised.

Innovation has the potential to save a client money and mitigate risk. Sometimes, innovative solutions involve taking a particular risk in order to mitigate a much larger risk. Innovation has the potential for cost saving, bringing a new technology to fruition, and a wider business benefit to the client and service provider.

Without question, innovation sometimes carries risk, particularly when a nascent technology or process for doing things is being used. Where contracts contain onerous terms relating to the treatment of risk, innovation is either deterred or a solution will be over-engineered in other ways. While successful innovation ultimately brings the rewards discussed above, there is the possibility that the proposed solution might not work, and cost blowouts will occur. Public sector agencies have to deal with the very real issue of how to allow that risk, in the context of a culture that is highly risk averse, although private sector clients are often in a position to take a calculated chance on a new concept.

There are however ways in which public sector clients can encourage innovation, and in turn realise the possible benefits. One element of doing so in many cases will be to accept the potential for failure, either by quarantining a portion of funds for innovative projects, or to work collaboratively with the consultant to manage the risks in play. The scope of works, risk management process, contract terms and conditions, or delivery model will determine for a firm planning a bid, whether or not an innovative solution is suited to that project or not. A scope that isn't overly prescriptive in terms of the definition of the project outcome (as distinct from project aims) will encourage innovation, as will delivery models that share risk and support collaboration. Clients who recognise the potential cost-saving benefits of innovation and seek them out, should be aware of this when developing their project documentation and delivery model. Industry recognises that these solutions won't always be possible, and also that innovation isn't always appropriate for particular projects.

Beyond risk, another hurdle to overcome is the desire of consultants to retain intellectual property rights for their groundbreaking solutions. A recent practice that may encourage innovation is to pay unsuccessful tenderers for work for the intellectual property they have developed. It is also increasingly becoming common for public sector clients to seek a licence to use the intellectual property, rather than own it, in turn encouraging firms to provide their most innovative solutions.

To ensure that innovation is recognised for the benefits it brings, rather than being feared as a form of gold plating assets, it is important that clients select the appropriate

projects to try innovative solutions on. Mature technology is generally more appropriate for a large infrastructure project, such as a highway or hospital, while novel projects are generally better suited to the risk of innovation.

Finding 11: The risk averse culture within public sector clients doesn't easily lend itself to innovative solutions. This can however be overcome in most instances with the right risk mitigation strategy.

Finding 12: Innovative solutions can be encouraged by briefs that aren't overly prescriptive in terms of project outputs, and addressing the ownership of intellectual property to the satisfaction of consultants. However, it is important that such briefs are complete and developed as a deliberate strategy, and are still clear as to the project's aims.

Finding 13: Innovation has the potential to save money to clients in the longer term, but political discourse including allegations of "gold plating" assets might prevent those benefits from being realised.

Chapter 13: Choice of Delivery Model

The delivery model selected by the client effectively sets out the nature of the relationship between the various parties, including allocation of risk, and which parties will be responsible for engaging other parties. As a major determinant of risk, and whether service providers choose to bid for particular projects, it is vital that the appropriate delivery model is selected for each project.

There are a range of delivery models available for selection, ranging from simple arrangements, such as "design only", through to "design and construct" and then more complicated arrangements, such as public/private partnerships ("PPPs") and alliances. For a detailed discussion of each delivery model and their respective merits, a good outline is contained in the Australasian Procurement and Construction Council (APCC)'s *Building and Construction Procurement Guide*[8], developed jointly with AustRoads. Importantly, there is no one "best" delivery model, with each option more useful in certain situations compared to others. Conversely, each model has the potential to bring about negative consequences if used incorrectly. It is therefore incumbent on clients to evaluate which of these options best suits their needs and will bring about the best possible outcome.

The 2006 *Scope for Improvement report* identified that "choosing the right delivery method is essential to the ultimate success of the project"[9]. The report went on to identify the inappropriate choice of delivery model as a fundamental and frequently occurring error at the outset of procuring projects.

Meanwhile, a 2008 report by Consult Australia, then known as the Association of Consulting Engineers Australia, identified that certain delivery models were preferred over others according to biases of the client and their personnel, rather than project requirements[10]. This report identified that state government clients had a strong bias towards design and construct delivery, while the Commonwealth saw the dominance of the managing contractor option, following its successful use on a number of Defence Department projects.

There are a number of drivers leading to the selection of an inappropriate delivery model. The imperative of offloading risk figured strongly through this study as a driver to select certain delivery models over others. For example, using a design and construct contract allows a client to allocate a finite amount of risk to a principal contractor, who in turn allocates risk between themselves and the designer they engage. While this delivery model is appropriate for certain projects, there exists a bias towards it because of its perceived favourable treatment of risk from the client's perspective.

Even factors as arbitrary as the individual biases of a procurement officer could lead to an inappropriate delivery model selection. Whether through the treatment of risk, or perceived cost savings (even though those savings will most likely disappear over the life of the infrastructure if the wrong model is used), individual judgements and the factors most important to the procurement officer play a large role in how the infrastructure is procured.

Another driver of selecting an inappropriate delivery model is inertia. Some agencies have been found to have a default delivery model, based on the past success of that model, even if it occurred in a different situation or for a vastly different project.

In other cases, the poor selection of the delivery model is a simple lack of understanding on the part of the procurement officer. For example, following the success of a range of projects undertaken using the alliance model, it became more common for procurement officers to call for projects to be undertaken as a "competitive alliance". Given that alliances rely on the parties working together on the one team, without competitive tensions, this fails to understand when alliances are appropriately used. In other instances, the imperative of developing infrastructure without adversely affecting the budget bottom line runs directly contrary to the recent failure of certain PPP projects. This suggests that government needs to get better at understanding which projects to deliver by this model for the future.

There are solutions to these issues that should be considered. Aside from our suggestions already made in this report regarding addressing the procurement skills shortage, clients could make better decisions by involving stakeholders in the process at an earlier stage. Holding workshops where consultants and constructors evaluate the relative merits of different delivery models would greatly help public sector clients. The suggestion was made that selection of delivery models could be done through a two stage process, whereby clients canvass desired outcomes with service providers, and design the delivery model according to their desired output.

There is also a clear need for objective guidance to clients as to how they can select the most appropriate delivery model for their project. The APCC/ AustRoads guide referred to in this chapter is a good example of something that public sector agencies should include as part of their procurement and training policies. While Consult Australia does not view this particular guide as being perfect, it represents an important development, in setting out some objective criteria for procurement officers to use when making vital decisions about their projects.

Finding 14: The incorrect delivery model is used too frequently, owing to perceived advantages to the client relating to risk or cost, or otherwise owing to inertia, bias and poor procurement skills. Use of an inappropriate delivery model can result in less desirable project outcomes.

Recommendation 22: Consultants and other stakeholders should be included in workshops at an early stage, to help the client determine the most appropriate delivery model.

Recommendation 23: Clients should develop objective criteria against which to determine which delivery model is most appropriate for their project.

21. See http://www.apcc.gov.au/SitePages/Building%20and%20Construction%20Procurement%20Guide.aspx
22. 2006 Scope for Improvement, at p10.
23. Discussion Paper 1: Australia's Future Infrastructure Requirements. ACEA Submission to Infrastructure Australia, October 2008.

Chapter 14: Onerous Contract Terms and Conditions: Implications

Many of the topics of the previous chapters in this report are encapsulated for consultants in one document: the contract of engagement, which contains the terms and conditions that allocate risk and liability between the parties, and sets out a range of other arrangements. While this report has already looked at the issue of risk allocation, it has not yet covered the implications of onerous contract terms that give effect to that risk allocation. Many pages could be devoted to this issue, but for the purposes of this report, a broad summation will be used.

A range of onerous terms frequently appear in the contracts presented to consultants. Consult Australia has canvassed the full range of onerous terms in previous submissions to government, which can be found on our website[24]. The main ones, and the terms which lead to significant problems, can however be easily summarized:

- Terms relating to the standard of care
- Terms relating to the allocation of risk through liability and indemnities, including the treatment of proportionate liability
- Limits on liability
- Insurance requirements for service providers

Each of these terms carries implications for both consultants and their clients, often without one or both parties being aware of them. While larger consulting firms may have the benefit of in-house legal counsel, or a lawyer on retainer to provide legal advice, many smaller firms simply treat a contract as providing the mechanism for them to do the work in return for payment. From the client's perspective, they often believe they are protecting the taxpayer, without realising the implications of including such terms and the detrimental impact on the project's budget.

The most basic issue created by onerous contract terms is that they have the potential to create liabilities that the consultant's professional indemnity insurance will not respond to in the event of a claim. Professional indemnity insurance policies as a general rule will only cover a consultant for those liabilities that they would be responsible for at common law (that is, in the absence of a contract). This position is that in general, parties are responsible for their own errors, whether by act or omission. Where a contract assumes liability beyond this position, the insurance will generally no longer cover any liabilities realised.

Examples of assumed liability include raising the standard of care beyond the objective standard that could be expected of a consultant with that expertise doing that work to an expert standard of care. It also includes indemnifying the client for their errors, fitness for purpose warranties, and contracting out of proportionate liability. Each of these terms are onerous on consultants, assuming liability that won't be covered by insurance, and becoming responsible for the acts or omissions of other parties.

In some instances, project specific insurance is available to cover assumed liability, but consultants report that their clients seldom appreciate the additional cost of such a policy, which ultimately must be borne by either the consultant or client. Furthermore, such policy extensions are not always available to all consultants, and smaller businesses in particular may have trouble accessing such policies. Insurance brokers have also advised that this type of policy may not be available in the future when the market for professional indemnity insurance hardens.

Prescriptive insurance requirements in a contract also risk the level of coverage for a project. In these cases, clients need to be careful not to prevent the ability of an insurer to recover any losses through litigation or subrogation, as they may not respond to claims where their hands are tied.

Beyond insurance implications, onerous contract terms also drive less desirable project outcomes. They increase cost, delays and disputation through their impact on behaviour. Costs increase through firms either deciding not to tender for work (and hence reducing competitive pressure at the tender phase), or pricing the additional risk into their bid and passing it on to the client. If firms absorb the additional cost of the risk, it ultimately impacts on the viability of the consulting industry, which is in nobody's interests.

Onerous contract terms also drive increased delays and disputation, as they are effectively geared towards taking a "deep pockets" approach to litigation, rather than avoiding litigation in the first place through better project outcomes. They make it easier for one party to essentially wash their hands of a risk, because the contract has passed it on, even where their involvement would lead to better outcomes.

Limits to liability serve two vital purposes. The first is that they allow businesses to make a calculated decision as to the maximum possible liability their insurance could cover. It provides them certainty, and allows them to determine

whether they can absorb the level of risk the project would carry. The other purpose a limit serves is to remove an incentive for protracted litigation, by limiting the possible amount of damages won. Of course, limits do serve several other purposes, including providing an incentive for proper risk assessment and management to occur, although these relate more broadly to decisions about risk allocation.

There are a range of drivers for the use of onerous contract terms, often operating in combination. In some cases, they are an effect of the procurement skills shortage, with procurement officers not aware of these implications. In other cases, public sector agencies rely overly on external legal advice, where the providers of that advice draft aggressive documents, reflecting the practice of the legal profession to shield their client from all liability, but with less concern for the commercial impact of that document. The culture within many agencies is also problematic, in that it encourages risk to be offloaded, without proper regard to the impact this might have.

The perspective of the contracting industry on onerous contract terms should be noted, as it differs from that of consultants. As their business model allows for a greater acceptance of risk, insurance is viewed as protection to be used only for exceptional claims. However, bigger projects do provide greater incentive for clients to litigate, as there's greater project value, and in turn probably deeper pockets in terms of any remedy. When clients fail to understand the difference between consultants and contractors, it potentially drives clients to include onerous terms in their contracts with consultants, without realising the impact of doing so.

Some governments and their agencies have started to realise the impacts of this behaviour, and taken steps to address it. For example, the NSW Government released a policy document that requires agencies to not contract out of proportionate liability as a default position, and to listen to the objections of service providers when doing so[25]. Conversely, many government agencies have begun to say all the right things about risk, liability and contracts in an abstract setting, but when there is a specific project before them, much of that rhetoric falls away as entrenched cultural habits take over. This reflects a disconnect between decision makers, and those actually managing projects. One proposal suggested to overcome this issue is to make agency heads accountable for procurement outcomes, to ensure that their ideas are enacted throughout that agency, and to give protection to individual contract managers responsible for the contracts in the first instance.

While ultimately our industry argues that onerous contract terms should be reconsidered as a means to allow for industry to better protect itself and to save costs to the client, better consideration of the terms may be the best interim solution by explaining the rationale for their inclusion. Under this proposal, clients take up the practice of explaining why they include particular terms in a contract to service providers (which is not currently common practice). This has the effect of turning the client's mind to whether a particular term is truly required, and if it is not, whether it's something they would be prepared to pay extra for. It also has the benefit of increasing the level of empathy between the parties, and the consultant would come to understand why the client has included those terms, and what they're hoping to achieve (or avoid) by doing so.

Finding 15: Many public sector agencies include onerous terms in contracts without understanding their implications for insurance cover, or the less desirable project outcomes they might drive.

Finding 16: Onerous contract terms are caused by a range of factors including procurement skills shortages, undue reliance on external legal advice, and cultural issues within public sector agencies. Failure to understand the differences between contractors and consultants and their respective business models may also be a driving factor.

Recommendation 24: Agency heads should be accountable for their agency's procurement outcomes, to ensure that their positive rhetoric occurs in practice, and that protection is provided for contract managers being asked to take a less conservative approach to contracting.

Recommendation 25: Clients should routinely explain "why" they have included particular contract terms, with a view to eliminating unnecessary terms that simply cost the client more, and increasing empathy between the parties.

24. See for example the following submission: http://www.consultaustralia.com.au/docs/default-source/contracts-liability/Consult_Australia_Response_to_AGD_Discussion_Paper_on_Contract_Law_-_July_2012.pdf?sfvrsn=0
25. See http://www.procurepoint.nsw.gov.au/sites/default/files/documents/procurement_policy_framework_july_2013_0.doc at pp42-43.

Chapter 15: Collaboration During the Project

In Chapter 2, this study looked at a number of features of a positive procurement culture, focusing on characteristics that client agencies could adopt to foster such a culture. A number of those factors point towards developing a relationship that drives greater collaboration between the parties. This chapter will look at what that collaboration entails.

Throughout this study, a consistent theme amongst our industry was the importance of a collaborative and ongoing relationship to project success. Where less successful project outcomes have occurred, the relationship was more likely to have been characterised by a contract-driven schedule of meetings and reports being required, often without regard to the facts occurring on the ground. Clearly, from the perspective of the consulting industry, the foundation of a collaborative relationship is a flexible and ongoing relationship that revolves around the needs of the project, rather than a set of rules, reporting dates and scheduled meetings. This foundation is especially vital if work on the project is not going to plan.

While it is perfectly reasonable that a client should ask consultants and other service providers to report on their progress from time to time, the nature of how that reporting is asked for will impact upon the broader relationship.

Some consultants have described reporting requirements that have been onerous, in terms of providing constant reports, and especially with a focus on less relevant details. Contractually, some consultants have been required to make their premises available for inspection around the clock with minimal (if any) notice requirements. In other cases, while there may not have been onerous contractual reporting requirements, consultants found the client team had more people working on reviewing reports than on the actual project.

All of these examples reflect a lack of trust on the part of the client towards the consultant. Where regular reviews of work are based on mistrust, they are more likely to focus on finding fault with the other party's work than with each party finding ways to assist the other to complement their work and drive a better outcome. While specific errors may be rectified through this approach, it does not lead to the desired positive procurement culture, and will impact on the ability of the parties to maintain a collaborative working relationship.

Aside from the impact on the relationship between the parties, another outcome of mistrust is the likelihood of greater duplication of effort between the parties. Consultants have reported that some reviews continually cover old ground, including starting at the beginning of the project, when earlier content had already been agreed upon.

A positive, collaborative relationship need not be onerous to any one party and has the potential to address errors at an early stage while driving a positive procurement culture and project outcomes. A key feature is that the parties discuss issues as they arise, where the other party's concerns are listened to, considered and addressed. This is especially pertinent when a client is considering changing the scope of works, the terms of agreement, or another form of contractual variation. Where feedback or comments are presented and cannot be immediately addressed, the other party should seek to come back to them promptly, and where that might not be possible, keep them informed of the matter's consideration.

While clients may need to move away from their traditional approach to their relationships to achieve this type of relationship, doing so has the potential to reduce costs and drive better project outcomes. As an example, the London Olympics project reportedly saved around $1 billion out of an $8.1 billion budget, due to ongoing collaboration between the parties and investing in the early stages of project planning[26].

Finding 17: Ongoing collaboration between the parties is preferable to a rigid, contract based, approach to reviews and reports back to the client. Reviews should be undertaken as required, with a view to the parties assisting each other to realise the best outcomes, rather than with the intention of finding fault with the other's work.

26. Royal Academy of Engineering (2014) Public Projects and Procurement in the UK: Sharing experience and changing practice op cit. At p8.

Chapter 16: Variations to the Scope of Works

The first *Scope for Improvement* report in 2006 describes the changing of project scope as a major pressure point in the construction sector[27]. While that report refers to the changing of project scope at the tender phase, changes to the scope at that phase, or following project commencement in the form of variations will often impact upon the cost, quality and even probity of a project.

RFP Phase

When a project is put to market, it may be appropriate that the parameters of that project aren't tightly defined, and tenderers are allowed to put forward innovative solutions in their bids, particularly when the project aim is complicated. Certain delivery mechanisms, such as alliancing, are specifically suited to projects where the scope is not fully defined. However, where insufficient time and resources have been devoted to developing the scope and relevant supporting documentation, as has already been canvassed in this study, changes may be required to a project based on issues (such as errors or risks that weren't recognised) being identified in the scope, or clients changing their mind. The issue of external factors leading to the fast-tracking of projects, which has already been raised in this study and elsewhere, is a particular driver of variations at this stage.

Changes to the scope at this phase of a project have a couple of impacts on project success. The first is that the work being undertaken by consultants on their bids is frustrated, and additional work is then required to accommodate the changing goals of the project. It is unreasonable for a client to expect that the additional work undertaken to allow for this change won't have an impact, either in the fee they are charged for the service, or in the ongoing viability of the consulting industry they rely upon as firms are expected to absorb additional expenses without compensation.

There is also a probity aspect of this problem, which in turn leads to project inefficiencies. Once a project has been released to the market for tenders, any aspects of the scope that might be changed need to be done so in a way that keeps all potential bidders properly informed, and without disadvantaging certain potential bidders relative to other bidders. To do so may be costly, and presents practical challenges that would not have existed prior to the scope being put to market in the first instance.

Post Project Commencement

Variations once work on a project has commenced are inevitable as a project evolve, and new factors emerge that change or clarify the work required. Variations allow flexibility to achieve the best project outcome, rather than binding the parties to a solution made redundant by changing circumstances.

From the perspective of the consulting industry, these variations are part of the work they do, but often a source of tension where clients don't want to acknowledge or accept that extra work has been done, which in turn they should pay for. Indeed, in the course of this study, many consultants reported being asked by a client to undertake additional work without any additional fee agreed, and on the presumption that this additional work was covered by the original fee.

The nature and drivers of these variations warrant consideration to understand how to reduce unnecessary and potentially costly variations, relative to those that are needed to ensure project success.

In some cases, variations are a result of a client choosing a project option that excluded an item from the original scope in order to save money, only for that same item later to be found to be fundamental to the project. In these cases, the cost of the variation may exceed the additional cost of having included that project feature from the outset, with one consultant reporting that "an additional $2 million up front could have saved $20 million later on". Variations like this, driven by unsuccessful attempts to save on cost, reflect the need to invest additional time and resources into developing the project scope from the outset, and to factor in longer term considerations in decision making. Earlier recommendations to place greater weight on the quality of scoping documents, as well as favouring value over cost in bid selection help address this issue.

Variations also need to be recognised in the context of the relationship between consultants and contractors. For contractors, variations may present an opportunity to make additional profit, by finding a solution that saves them money, or allows them to charge an additional fee to the client. For clients, care needs to be taken to not set up a system of perverse incentives for additional variations to be claimed, while also allowing project flexibility and providing appropriate compensation for work undertaken.

Finding 18: Changes to project scope at the tender phase create additional costs for the client, as well as creating probity risks.

Finding 19: Variations are an appropriate mechanism to allow project flexibility, but additional work undertaken must be properly compensated.

27. Ashurst (formerly Blake Dawson Waldron) (2006) *Scope for Improvement*. At p10.

Chapter 17: Evaluating a Project: Lessons Learned

The opportunity to learn from mistakes, and to evaluate a project's success is an important step in its ability to continually advance the standard of procurement in Australia. For many consulting firms, the opportunity to participate in a "lessons learned" workshop is one they relish and gain from. Such workshops, however, are not always held, or aren't always as beneficial as they could be. The reasons for this being the case need to be understood by clients and consultants alike.

Government agencies are often reluctant to participate in lessons learned workshops, lest a "what went wrong" document is created that admits mistakes, and is then made public through Freedom of Information laws. The creation of such a document could be embarrassing to the political and public service levels of government, and could be misconstrued in the media to suggest a project was a failure, when in actual fact the documentation was only created to strive for even better outcomes in the future. From a consultant's perspective, this stage of a project is also an opportunity to acknowledge that we can do things better, and to gain a better appreciation for how this might be done.

Accordingly, project reviews are often undertaken individually by a consultant or the government agency, rather than through the two (or more) organisations jointly reviewing the project.

Even without the threat of a project's less successful elements finding their way into the media, other issues also prevent project reviews from being as effective as they could be. One issue is that the lines of responsibility within each organisation may be insufficiently clear to have influence over that whole organisation, and rather just that particular project team that might take away any lessons.

Another is that if any real and challenging issues were faced in the course of that project, the various parties may well be too defensive to acknowledge the potential for improvement on their part. Many participants in this study indicated that a "no blame" culture is vital to learning from a project, and ensuring the lessons are learned for the future.

Looking to the future, the ability to review a project and learn the lessons from its mistakes is a vital one. Procurement officers need to be able to discuss the opportunities for improvement in a frank and fearless manner, and clearly cannot do so when political considerations overshadow their ability to discuss these. This needs to be balanced with vital public scrutiny, to ensure that the taxpayers' money is being well spent. This represents a significant challenge for government, which will likely require creative thinking to resolve.

Finding 20: Reviewing projects following their conclusion is an important step to continually improve public sector procurement. However, political considerations provide a significant disincentive for government agencies to participate in such a process.

Finding 21: The existence of a "no blame" culture makes it easier for all parties to learn from each project how to do things better for the future.

Chapter 18: Conclusion and Next Steps

Many of the issues highlighted in this report are not new. A number of previous studies and papers have discussed the need for better quality project briefs and fairer sharing of risk. This study, however, has gained a deeper insight into the effect of those issues, through the eyes of consulting firms in the built and natural environment sector. It has also gained a new understanding of other issues relating to procurement policy and practice, which might also be addressed to achieve better outcomes for public sector clients, which making it easier for businesses in our industry to operate efficiently.

New areas for improvement include better understanding how clients can focus on creating a positive procurement culture, focusing on a positive working relationship, rather than a legalistic, "box ticking" approach to working collaboratively with service providers. A small amount of empathy throughout a project, including some understanding of what drives the other parties, as well as what hinders them, will go a long way. A degree of flexibility on the part of clients also has the ability to yield improved results.

Decision making, whether relating to project specifications or bid selection, can be improved through a longer term outlook that takes into account a project's useful life and whether bids have adequately factored risk into their proposal.

Issues raised previously in other reports remain of concern. The quality of project documentation is arguably the greatest driver of inefficiency throughout the procurement process. Risk management has improved in some areas, but there is still broad scope for practices to progress further.

The findings and recommendations of this report represent a significant opportunity for governments around Australia, at local, state and federal level, to do things better. With the focus on stretching each valuable dollar of taxpayers' money to develop the best possible infrastructure for the Australian public, we look forward to seeing these findings and recommendations adopted. This offers the possibility of improving procurement policy and practice to the benefit of the entire built environment sector, the government as managers of public funds, and the Australian public who will use that infrastructure.

Increasingly, governments talk about implementing "best practice" procurement. This report offers some direction as to how they might do that.

GPO BOX 56
SYDNEY NSW 2001
02 9922 4711
WWW.CONSULTAUSTRALIA.COM.AU

CONSULT AUSTRALIA

PROPORTIONATE LIABILITY

RESPONSE TO THE SCLJ MODEL PROVISIONS

CONSULT AUSTRALIA SUBMISSION TO THE NSW GOVERNMENT

Proportionate Liability
Response to the SCLJ Model Provisions

Driving Business Success for Consulting Firms in the Built and Natural Environment

CONSULT AUSTRALIA

About Consult Australia

Consult Australia is the industry association representing consulting firms operating in the built and natural environment sectors. These services include design, engineering, architecture, technology, survey, legal and management solutions for individual consumers through to major companies in the private and public sector including local, state and federal governments.

We represent an industry comprising some 48,000 firms across Australia, ranging from sole practitioners through to some of Australia's top 500 firms with combined revenue exceeding $40 billion a year.

Approximately 40 percent of our industry's work is undertaken for public sector clients, and our member firms have played vital roles in the creation of some of Australia's iconic public infrastructure, including road, rail, hospital, airport, educational facilities, water and energy utilities, justice, aged care, sports stadia, and urban renewal projects.

Liability Reform Steering Group

Consult Australia is part of the Liability Reform Steering Group (LRSG), a broad coalition of professional organisations and firms with a shared interest in liability issues as they impact on members of the professions in Australia. The LRSG was initially convened in 2002 to discuss the emerging evidence of market failure in PI insurance in Australia and the available options for reform to ameliorate this situation.

The LRSG currently includes representatives of the Australian Institute of Architects, Consult Australia, CPA Australia, Engineers Australia, the Institute of Chartered Accountants in Australia, the Institute of Public Accountants, the Law Institute of Victoria, Professions Australia, representatives of the large national accounting firms such as KPMG and Deloittes, actuaries and the large national law firms.

Since its establishment, the LRSG has been pushing for a uniform national position against contracting out of proportionate liability.

For Further Information

For further information or to discuss any issue(s) raised in this submission, please contact Robin Schuck, our Senior Policy Advisor, Policy and Government Relations. He can be reached at (02) 9922 4711 and by email at robin@consultaustralia.com.au. Consult Australia will be pleased to assist in promoting the successful resolution of this issue in any way we can.

Executive Summary

Proportionate liability was an important reform introduced in the wake of the insurance crisis over a decade ago. The move to proportionate liability from joint and several liability was designed to ensure the availability at commercial rates of professional indemnity and public liability insurance. However, as each jurisdiction drafted and passed its legislation to give effect to this reform, some states, including New South Wales, allowed parties to contract out of proportionate liability, while others either remained silent on the issue, or expressly prohibited the practice.

While contracting out of proportionate liability theoretically allows the parties to a contract to allocate risk between themselves to better manage that risk, our experience is that in reality the party with the strongest bargaining power simply offloads risk without regard to the consequences, including the ability of other parties to the contract to manage or bear that risk. In turn, this increases the probability of any one of a number of negative consequences being realised.

The first and most obvious is that contracting out of proportionate liability defeats the very policy intent that the reform was designed to achieve: namely ensuring that professional indemnity and public liability insurance will be available on commercial terms when the insurance market experiences its "hard years". Because the global insurance market is cyclical by nature, there will be times when the global pool of funds will be reduced, and Australia will be a less desirable market in which to sell policies and take on the associated business risk. While insurance is freely available at other times, when the market hardens, premiums dramatically increase, and a large number of parties will simply be unable to purchase insurance at all.

Other risks however also arise from the practice of contracting out. They include the possibility that professional indemnity insurance will not respond to claims where a contract has assumed risk beyond the common law position, including the contracting out of proportionate liability. Contracting out also drives less desirable project outcomes, including higher cost, more delays, and greater disputation. These arise as risks are not managed by the party best placed to manage each them, and hence are more likely to lead to a loss being realised. They also mean fewer firms will have the appetite to take on project risk and decide not to tender for work, reducing competitive pressures in the bid phase of project delivery. Conversely, proportionate liability moves parties away from a "deep pockets" approach to litigation, and instead towards working for the best project outcomes, ensuring certainty for business.

Aside from driving better project outcomes, proportionate liability also ensures fairer outcomes for all parties to the contract.

In making this submission on behalf of professional services providers in the built environment sector, the contracting and procurement practices of other parties our members work with need to be considered. It is common for risk to be offloaded rather than managed, often without understanding of the consequences. For the reasons set out in this submission, Consult Australia has argued for a nationally uniform position against contracting out of proportionate liability since its inception.

When evaluating the proposal in question, the merits of achieving uniform laws also warrant further consideration. By overcoming differences between jurisdictions, business certainty is increased, and issues that arise when parties to a contract exist in different states are also resolved. Nevertheless, when laws between states are harmonised, it is essential that the model legislation achieves the right outcomes.

The model provisions subject to this consultation represent a positive step that should be seriously considered by all jurisdictions. The new definition of an "apportionable claim" is likely to eliminate a major reason clients choose to contract out of proportionate liability, and limits its application primarily to the professional services sector, rather than building contractors, who warrant the outcome of their work on a "no fault" basis. However, the arbitration provisions are problematic as they offer a loophole that will be exploited by parties with strong bargaining power seeking to contract out of proportionate liability, while

other parties risk unknowingly contracting out of proportionate liability. These clauses threaten to undermine this entire reform.

Other issues have also been identified in the model provisions that warrant further consideration, although to a lesser degree than the arbitration clauses. The definition of consumer claims could be problematic, in that it may potentially exclude large claims between two businesses inadvertently, while the grandfather clauses should not be enacted in every state.

As well as modifying these aspects of the legislation, the NSW Government should also take a leading role in calling on other jurisdictions to prohibit the contracting out of proportionate liability, and to this end, Consult Australia calls on the Government to write to each other state or territory government, calling on them to amend their legislation to enact the prohibition on contracting out, and addressing the concerns we have raised through this submission.

Recommendations

Recommendation 1: Uniform, national legislation prohibiting contracting out of proportionate liability is essential.

Recommendation 2: That NSW pass the model legislation presented for feedback, subject to the adoption of Recommendation 3.

Recommendation 3: That the arbitration provisions at s3 and s12(3) be amended so that proportionate liability applies to arbitration, or otherwise these provisions be removed. If this Recommendation is not adopted, our position in Recommendation 2 will change.

Recommendation 4: While the model provisions make reference to "individuals," they could be strengthened by further limiting the exclusion to natural persons only, with the option of further qualifying the definition by imposing a transactional limit. Under the existing definition of consumer claims, business to business transactions worth millions of dollars fall within that definition.

Recommendation 5: The grandfather clauses at s12(1) and s12(2) are inappropriate in all jurisdictions other than NSW, WA and Tasmania. The NSW Government should write to the other jurisdictions to promote this issue.

Recommendation 6: That care be taken when the final draft Bill is revised to ensure that indemnities cannot be used as a means to overcome the prohibition on contracting out of proportionate liability.

Recommendation 7: That the legislation be reviewed in ten years' time, or following the completion of a full cycle of the insurance market – whichever occurs later.

Recommendation 8: The NSW Government should write to all other Australian jurisdictions urging them to adopt the same positions as outlined throughout this submission. This will ensure that the full benefits of harmonisation are realised.

Background – Context

In response to the insurance crisis of 2001, a package of reforms including proportionate liability legislation was enacted to replace the doctrine of "joint and several" liability. Under joint and several liability, several parties may have combined to cause loss to a plaintiff, but any one of them could have been held fully liable, irrespective of their individual contribution to the loss. Proportionate liability divides loss among the defendants according to their share of responsibility.

Under proportionate liability, liability is allocated to the parties according to who is able to manage the risk, rather than the party with the deepest pockets. However, when these reforms were implemented, the enacting legislation had a crucial difference between jurisdictions, with the ability to contract out of proportionate liability included in some states' legislation, but not others.

The express ability to contract out of proportionate liability legislation in New South Wales, Western Australia and Tasmania has encouraged poor risk management by a range of parties working across the building and construction industry. Contracting out of proportionate liability (PL) encourages the allocation of unmanageable risks and liabilities upon consultants that would otherwise be acceptable to clients as a normal part of project development. The consequences of this behaviour are far reaching with implications across jurisdictions. Conversely, contracting out of proportionate liability is expressly prohibited in Queensland, while the remaining jurisdictions are silent on the issue.

In making this submission, Consult Australia notes the overall objectives of government action as set out at p9 of the Regulatory Impact Statement (RIS). We strongly commend these objectives as worthy public policy goals, and note that they strongly align with our objectives. Indeed, the very position set out in this submission is premised on four of those five objectives[1].

Our Industry

Consult Australia represents professional services providers within the built and natural environment sector. Our members undertake a diverse range of activities, with the common factor being that they provide a service, based on professional expertise. Services include scoping studies, environmental impact assessments, through to designs, reviews and certifications. They are provided on a range of projects varying from mining and resources, through to the development of public infrastructure to designing residential houses.

Depending on the nature of the project, the engagement of a consultant may potentially form part of a complex web of contractual relationships. For major public infrastructure projects, for example, it is common for the client to engage a developer, who in turn will engage a consultant for design elements under the "design and construct" delivery mechanism. Other projects will see a client directly engage a consultant, while others still might see the formation of an alliance body where each party shares in the risk and rewards on offer. The interaction between consultant, client, constructor, and any sub-contractors or sub-consultants engaged is a major aspect of the environment in which our industry operates. Each has a distinct role to play in successful project delivery, with different roles, responsibilities, and mechanisms for resolving issues that arise throughout the project.

A common theme throughout contracting in the built environment sector is the contractual offloading of risk, often at the expense of proper risk management activity, and generally based around market power, rather than the ability to manage risk, determining where that risk falls. While we recognise the important role consultants play in successful project delivery, they are also often the party with the least bargaining power,

[1] Objectives 1, 3, 4, 5 as identified in Standing Council on Law and Justice, *Proportionate Liability Model Provisions – Decision Regulation Impact Statement* (October 2013) at p9.

and hence the party to whom most contractual liability is shifted. This has major implications for insurance coverage of their work, but also represents a major impost on the industry in terms of the risk burden, and resources allocated to resolve disputes.

Insurance and the Consulting Industry

Consulting firms that make up Consult Australia's membership play a crucial role in the built and natural environment sector. They provide the expertise used to scope potential infrastructure, to develop plans to build a project, and come up with solutions to overcome obstacles encountered along the way. Because they are not the final service provider, they are often involved in a potentially complicated web of contractual relationships with the client, contractors that undertake the actual works on site, and sub-consultants to whom specialist tasks may be outsourced.

The consulting industry as a whole is an asset poor class of people and organisations when compared to the parties they are contracting with. Because the service they provide is professional expertise rather than a tangible good, they depend on insurance to cover any liabilities that arise, including contract disputes or failures in the delivery of a final product. Consultants take out extensive and often expensive insurance policies to cover any liabilities that arise, and to ensure they and their businesses don't suffer financial losses.

What is often not appreciated, however, is the interaction between insurance policies and contractual terms and conditions such as those that allocate liability between the parties.

An important principle at the centre of this issue is that insurance will generally only cover a party for losses that they would be liable for at common law. Any contract that assumes liability beyond the common law position risks creating an uninsurable risk, and harming both parties to that contract. Contracting out of proportionate liability falls into this category, and represents a major risk to the ability of a consultant's professional indemnity policy to respond to any claim made against them.

Risk Allocation and Management

The allocation of risk between parties represents a significant issue impacting the cost and outcomes of procurement in relation to the built environment generally. Liability must be managed equitably, with regard to good risk management and the ability of professional indemnity insurance to respond to claims and cover losses. It is important to note that consultants generally have few assets beyond their insurance cover, and hence limited ability to cover liabilities that go beyond that level of insurance cover, or where insurance doesn't respond to a claim.

It is common practice amongst many clients (especially including public sector clients) to offload all risk and contractual liability to the service provider they are contracting, even where the impact of this move runs contrary to government policies. This includes contracting out of proportionate liability, as well as a range of other onerous terms that have been canvassed in other submissions to government.

One important consequence of clients allocating liability to service providers is that they believe they have managed the risk associated with their project, when in fact they have done the opposite by allocating it to a party less able to manage that risk for the overall benefit of the project.

Consult Australia is opposed to requirements of excessive liability contained in a contract on the basis that these requirements promote the acceptance of risks which are beyond the control of any consulting firm. Such practices threaten the sustainability of our industry, produce uncertainty and higher costs for clients and do not promote good risk management to the expectation of the community. This submission will outline some of the impacts of this practice in greater detail at pages 11-15.

The imposition of onerous clauses, including the contracting out of proportional liability legislation in contracts with these firms, put at risk the affordability and availability of professional indemnity (PI) insurance covering services provided by professionals and providing protection to the consumers of those services.

Such practices ignore good risk management and see the parties responsible assume unknown risks where insurance is not available to cover the liabilities sought. Such behaviour distorts the terms on which firms compete for work, and expose all parties to the possibility of project failure, unforseen costs and poor value for money outcomes.

Despite the insurance crisis of the early 2000s and the consequent passage of Proportionate Liability (PL), and Professional Standards Legislation (PSL) by Australian governments, public sector procurement practices, as well as many private sector client practices, have yet to reflect the policy intent of these legislative reforms.

Indeed, it can be argued that the reforms brought in at that time have not been fully implemented, as the crisis ended due to other factors, before the reforms were properly and uniformly rolled out. In the eyes of policy makers, the problem had been resolved and there was little impetus for further change. The challenge of this proposal is to bring about change ahead of the next hardening of the insurance market, in order to prevent a crisis from arising in the first instance.

Procurement Practices and Client Understanding

The tendency of clients to issue contracts with onerous terms, and to contract out of proportionate liability as a default position may also reflect a particular culture that exists amongst procurement professionals today.

We have already discussed the common practice of offloading risk rather than managing it, even though this practice generally leads to less desirable outcomes. Previous studies, such as the *Scope for Improvement* reports[2], as well as our own experience from our membership has found that while allocating risk is common, the best project outcomes are realised when the parties work together to address issues encountered, rather than taking a "standard form" approach to procuring services.

Another element of the culture surrounding procurement is knowledge and understanding of the ramifications of particular behaviours and practices, including the effect of particular contractual terms. Unfortunately, many of the people responsible for procuring professional services don't always have the required understanding of the impact on insurance of offloading contractual risk. In our experience, the knowledge amongst clients of the impact of contracting out of proportionate liability is particularly poor, or is based on less important considerations.

For example, we frequently encounter client organisations wanting to contract out of proportionate liability, to ensure that a sub-consultant who makes an error does not avoid liability for any losses that result from that error. However, this ignores that the sub-consultant would still be liable under the head consultant's proportion of the liability, and contracting out does not improve a client's ability to reach them.

Another oft cited reason for contracting out of proportionate liability is that the client would prefer to only lodge one claim and allow each of the parties to cross claim against each other. While this may appear to be a simpler solution for the client, the additional legal resources required for the various cross claims would very likely lead to a more expensive outcome for all parties.

[2] Three *Scope for Improvement* reports were prepared in 2006, 2008 and 2011 respectively by Blake Dawson Waldron (now Ashurst). They can be accessed online by following the links at: http://www.ashurst.com/expertise-detail.aspx?id_Content=6580&pageNo=1

In the public sector, we have encountered individual government agencies contracting out of proportionate liability as a default position, even where there are "whole of government" policies recommending they take a more considered position, and avoid contracting out by default[3].

These examples reflect a frustration frequently felt by our industry, that clients seldom properly understand proportionate liability, and are generally slow moving when it comes to adopting new and better practices.

Freedom of Contract and the "Level Playing Field"

In analysing contractual behaviour, many problems are derived from the premise of "freedom of contract," with the notion that all contractual terms are the result of negotiation and agreement between parties.

Unfortunately, this premise is seldom the case, as uneven bargaining power is common, and means one party tends to dictate terms, while the other is forced to accept those terms. Even where negotiations take place, the common outcome is that at best, only minor changes result.

Where parties to a contract have unequal bargaining power, the concept of "freedom of contract" is illusory. Most professional services firms are small businesses and even those that are not operate in very competitive markets where contracts are offered on a "take it or leave it" basis. Very few, if any, professional firms are in a position to "walk away" from work, even where the work is offered on harsh contractual terms. This is particularly the case in tougher economic environments.

The uneven nature of the negotiation process means that onerous terms which a consultant might be unable to meet often find their way into a contract. This especially includes contracting out of proportionate liability.

In Consult Australia's experience, many clients will generally make contracts as aggressive as the law allows them to. When taken together with the uneven basis of negotiations described above, this leads to highly aggressive contracts offered to our members with little ability to address those terms that might not be satisfactory, or could lead to harmful outcomes. The Regulation Impact Statement (RIS) makes a similar observation at p7, noting that contracting out of proportionate liability "predominantly occurs where there is a significant imbalance in the bargaining power of the contracting parties."

Thus, where the law operates on the theory that a free contract is being reached, providing options for the parties to agree to in terms of how they manage their risks and liabilities, the reality is quite different. This is particularly the case with the proportionate liability reforms that are the subject of this submission.

Harmonisation

A recent dynamic of policymaking around Australia has been the understanding that uniform or harmonised laws should exist across all Australian jurisdictions. Eliminating differences between the states, territories and Commonwealth is a positive move, removing costly red tape, and making it easier for business to function in multiple states without having to learn new sets of laws each time they grow.

In the legal context, greater uniformity also prevents forum shopping, a point acknowledged at p7 of the RIS. Another benefit is that by its very nature proportionate liability involves multiple parties, and there is a strong likelihood they will exist in multiple jurisdictions. Greater uniformity between the states and territories means that many of the complex procedural issues faced can now be overcome.

[3] See for example the NSW policy at: http://www.procurepoint.nsw.gov.au/sites/default/files/documents/procurement_policy_framework_july_2013_0.doc, with the relevant sections at pages 42-43.

The experience of other laws being harmonised or made uniform has also allowed the business community to learn lessons as to when such moves are beneficial. A recent lesson has been that laws should not be harmonised just for the sake of achieving greater uniformity, but should be used as an opportunity to achieve "best practice" across Australia. Harmonising bad law is less desirable than having piecemeal legislation across Australia where some states retain "best practice" laws.

In the context of considering this specific piece of legislation being enacted in NSW, uniform national legislation is ideal. We call on NSW to pass this legislation, making the changes suggested in this submission, and we further call on the NSW Government to approach other jurisdictions, urging them to do the same, as the benefits of doing so will be realised across Australia. However, even if other jurisdictions decide not to implement this legislation, the benefits of NSW "going alone" still outweigh the status quo position, where contracting out is allowed and leads to a range of negative consequences.

Removing the Ability to Contract Out

Public and private sector clients around Australia continue to apply pressure to consulting firms to contract out of proportionate liability legislation. As with other onerous contract terms, clients are seeking to make consulting firms liable for risks beyond those they would normally or reasonably expect to have within their responsibility, control or management.

In the experience of our members, where contracting out of proportionate liability is available, clients take up that option when drawing up their contracts. The uneven nature of contract negotiations, as canvassed already in this submission, means that consultants are generally unable to reinstate this term, a fact acknowledged in the RIS[4]. This action undermines the intent of the proportionate liability regime as it was originally designed, and risks a return to the situation that the original policy reform was implemented to avoid.

Even in Queensland, where contracting out of proportionate liability is explicitly prohibited in the legislation, our members have reported the use of indemnities attempting to override the protections granted in the legislation, with the client requiring the consultant to indemnify them for any liability apportioned to other concurrent wrongdoers under proportionate liability legislation.

Contracting out of proportionate liability, or circumventing it through the use of indemnities, not only threatens the sustainability of our industry and other similar professional occupations, but also potentially exposes the community to uncertain and unmanageable risk and liability. The ability to contract out of PL is of national concern, where it leaves the market for professional indemnity insurance vulnerable to the same kind of market failure as occurred during the insurance crisis of 2001: with the creation of exposure to uninsurable risks beyond the control of policy holders.

Ultimately the ability to contract out defeats the purpose of proportionate liability legislation, and the tort and liability reforms sensibly introduced in response to that crisis.

It is for this reason, as well as those listed below, that we strongly support moves to develop and implement nationally uniform legislation to prohibit contracting out of proportionate liability.

Recommendation of Expert Opinion

Two independent experts were engaged by the Standing Committee of Attorneys General (SCAG, now the SCLJ) in 2007 and 2008 to report on proposals to achieve national consistency in proportionate liability legislation[5]. After considering the arguments for and against contracting out of proportionate liability, both recommended that nationally uniform proportionate liability legislation should be enacted that expressly prohibits parties from contracting out. The RIS draws heavily on these opinions in reaching the conclusion it has, leading to the development of model legislation.

Affordable and Available Insurance for Our Industry and Professional Services Generally

Proportionate liability was introduced nationally to improve the availability and affordability of professional indemnity and public liability insurance in Australia following the insurance crisis of 2001.

[4] *Regulation Impact Statement* at pp7-8

[5] Tony Horan (2007), *Proportionate Liability: Towards National Consistency* and Professor Jim Davis (2008), *Proportionate Liability: Proposals to Achieve National Uniformity*

These reforms were positively received by local and international insurers. Anecdotal evidence indicates these measures have assisted in improving the allocation of capital to insure Australian professional indemnity (PI) insurance risk. However, insurers have also indicated that if the application of proportionate liability can be by-passed contractually the insurance market will price and allocate capital to Australian PI risk as if proportionate liability does not apply.

As a consequence, the key policy objective of proportionate liability – helping to ensure that PI insurance is available, affordable and dependable – will be undermined should contracting out be permitted.

It should be noted that where the RIS discusses the impact on the insurance market of these reforms[6], it focuses primarily on premiums as a measure of whether the reforms have worked, and whether a problem exists for further redress. Consult Australia urges extreme caution in reaching any conclusion that the problem has been solved, and we suggest that the price of premiums might not be the most appropriate measure to reach such a conclusion.

Firstly, the focus on premiums over the past decade avoids the issue that in hard market years, professional indemnity or public liability insurance may simply not be available for many professional services providers in our industry, as insurers move away from the Australian market to focus on other, less risky markets. While it is true that larger firms with an international operation and a global professional indemnity policy may be able to retain cover, other firms less appealing to insurers may struggle to find appropriate insurance cover at all in hard market years.

By way of example, during the insurance crisis of 2001, a number of our member firms reported premiums increasing by as much as 1000%, while other firms, including large or long established firms, were simply unable to obtain appropriate insurance cover. Amongst our membership at the time, 26 firms approached Consult Australia (then known as the Association of Consulting Engineers of Australia) to seek our assistance as they were unable to obtain any cover. We were able to assist 23 of those firms, but the remaining three simply closed down, unable to obtain insurance, with their assets taken over by rival practices.

Secondly, the insurance market is cyclical in nature, and hence a reduction in premiums over the past decade does not alleviate concern that when the market next hardens, the same problems experienced a decade ago might be realised again.

Business Certainty – Project Insurance

In the event that project risk is realised, consultants are dependent on insurance to meet any liabilities that will arise. Without that insurance, they are asset poor and have limited ability to meet any damages due. Accordingly, where their insurance does not respond to a claim, there is a strong risk that the consultant may become insolvent, while the client in turn will be unable to recover the loss.

Where a professional contracts to assume additional risk beyond what they would be liable for under common law by contracting out of proportionate liability, they may be exposing themselves (and their client) to the risk of uninsured liability. Indeed, depending on the terms of the insurance policy, in some cases assuming additional risk by contracting out of proportionate liability could invalidate the professional's insurance cover entirely.

Where insurance won't respond to a claim and a client wishes to recover monies from the professional to cover damages, the professional will need to directly pay for those damages without the use of insurance. In the most extreme cases, they could go into liquidation or become bankrupt and the client will have no recourse to recover monies owed. In this situation both parties are considerably worse off.

[6] For example, at p6

From Deep Pockets to Better Risk Management Practices

There is evidence that permitting contracting out encourages poor risk management, as both the client and other parties involved in the provision of services will have less regard to their own risk management in situations where a "lead" service provider has contracted to assume full liability. Where liability is shared, the parties have strong incentives to work together to develop collaborative solutions to managing risk. Furthermore, under proportionate liability, risk is allocated to the party best able to manage each risk.

It follows therefore that contracting out of proportionate liability is focused more on the (often illusory) ability to recover maximum damages in litigation than on the successful delivery of a project.

Given the desire of government for proportionate liability policy to both reduce the likelihood of litigation, and be workable in terms of commercial outcomes, the ability to contract out runs contrary to these important policy objectives. Indeed, without reference to the separate policy goals related to insurance issues or simple notions of fairness, contracting out of proportionate liability undermines the significant and important policy objective of supporting business to best manage risk.

The RIS at p4 correctly identifies that proportionate liability was designed to address "deep pocket" syndrome, and yet the move to contract out is made with the express purpose of allowing a client access to those same deep pockets. In doing so, clients with sufficient bargaining power are able to retain their focus on maximising damages awarded at litigation, rather than successful risk management, and hence successful project delivery.

Improved Project Outcomes – Lower Cost, Reduced Delay, Fewer Disputes

In the case of public sector clients, contracting out of proportionate liability serves to increase costs and is therefore a disincentive to tendering for government contracts. The unreasonable allocation of risk to a consultant means that they will need to purchase a greater level of PI cover (which may not be available) or otherwise price the additional risk they face, and manage risks without the support of other parties to the contract. Limiting liability has been shown to lead to reduced cost, time and disputation on a project.

When faced with taking out a higher level of PI cover or greater project risk, our member firms generally are faced with a small number of options:

- They can pass on the cost of that additional cover or risk to the client, meaning a higher fee will be charged for that work;
- They can decide not to bid for certain work, also driving up costs through reduced competitive pressures in the tender phase; or
- They can decide to absorb that additional cost or risk in order to win the tender, although this may affect the ongoing viability of that business in the longer term.

In each of these cases, greater project costs are the long term outcome, which is undesirable for all parties.

Other project outcomes are also affected when proportionate liability is bypassed, flowing from the increased likelihood of disputation and delays. As proportionate liability allocates risk management to the party or parties best placed to managed each risk, its use reduces the likelihood of a risk being realised.

Conversely, contracting out of proportionate liability increases the likelihood of less desirable risk management, as already discussed. The impact of that risk being realised, combined with the notion of "deep pockets," is that the probability of a resulting dispute is greater, and there is also less incentive for the parties to resolve the dispute prior to litigation. In turn, litigation is generally the most costly outcome for each party to the dispute in question, and the costs will have to be absorbed by both service providers and their clients.

While the RIS mentions that some stakeholders argued that litigation is more complex (and hence more costly) where proportionate liability applies, it can be argued in response that litigation is less likely to occur in those situations. Furthermore, this argument is an extension of the "deep pockets" approach, but focusing on the nature of litigation rather than successful project outcomes.

Where contracting out of proportionate liability occurs, additional costs will be realised in the form of higher insurance premiums (if cover is available), as well as protracted contractual negotiations, legal review, and reduced competition in supply of services where some suppliers decide not to tender for work. Where these costs affect service providers, they are invariably passed on to their clients. A Lateral Economics study (commissioned by the Liability Reform Steering Group) into the costs of contracting out of proportionate liability estimated the overall cost of contracting out to be as much as $151 million in hard market years.

Freedom of Contract and Allocation of Risk are Illusory

As already discussed in this submission, freedom of contract is illusory, owing to the uneven nature of bargaining power between the parties. Supporters of contracting out cite the principle of "freedom of contract" and argue that government should not interfere with this principle unless justified on public policy grounds.

In its discussion of the reasons raised for contracting out, the RIS identifies the argument that contracting out allows the parties who wish to do so to contractually allocate risk between themselves with certainty[7]. In reality however, risk is not so much allocated as offloaded, with the party who has drawn up the contract - generally the party with the most bargaining power - simply transferring all risk to other parties with less bargaining power, with little regard to their ability to manage that risk.

This issue is particularly felt in the construction sector, where complex contractual arrangements often exist. It is common practice for contractors to be paid in the form of profit, in return for taking a risk. Accordingly, they are able warrant their work on a "no fault" basis. Professionals, such as our membership, on the other hand charge an hourly rate to compensate them for the effort they make.

When the "design and construct" delivery mechanism is used by a client, the client engages a constructor, who in turn is responsible for contracting the consultant to undertake (for example) design elements of the project. Not only does unequal bargaining power exist between the client and consultant, but also between the building contractor and consultant. In such a situation, it is possible for constructor and consultant to be concurrent wrongdoers, but for a contractor to offload their risk to the consultant in the same way the client may have offloaded theirs. This issue was recognised at p49 of the RIS.

This submission has already raised the practice that the contracts presented to our industry by clients are generally as aggressive as the law permits, with little scope for amendment, even where this practice may lead to less desirable outcomes. This is particularly felt with regard to proportionate liability. Where the law allows a client (including government agencies) to contract out of proportionate liability, it will almost always do so.

The certainty cited as an advantage of this approach is illusory, owing to both the strong possibility that insurance might not respond to a claim, and the likelihood that risk is less likely to be properly managed. For both these reasons, risk is actually exacerbated rather than managed when contracting out occurs.

Where a policy such as proportionate liability has been implemented to prevent one party being overburdened with risk or to stave off a future insurance crisis, any legal methods included in the law to avoid that policy will inevitably be used, and defeat the policy intent behind those initiatives.

[7] *Regulation Impact Statement* at p48.

Consult Australia accordingly believes that in this case there are grounds for government to intervene and prohibit contracting out for the public policy ground of maintaining a viable, thriving professional community backed by adequate levels of PI insurance, as well as creating an environment to support better commercial outcomes.

Fairer Outcomes

Fairness is identified at p9 of the RIS as one of the objectives of government action, and as a general driver of government policy. Proportionate liability is inherently a fairer method of allocating risk between the parties to a project, as each party is only responsible for those risks they can control and manage, rather than being responsible for the risks others are better placed to control. Generally, where proportionate liability does not apply, the party to whom most liability will fall will be the party with the deepest pocket (through their insurance policy), and the party or parties with the least bargaining power. Consult Australia is of the view that as well as leading to less desirable project outcomes, the results of contracting out of proportionate liability fail a simple test of fairness.

Unintentional Contracting Out

While supporters of allowing parties to contract out of proportionate liability cite that better commercial outcomes may result if the parties are able to allocate risk between themselves, a flaw in this argument is that contracting out is not always a conscious decision reached between two consenting parties.

In some situations, language inconsistent with the legislation may be enough to contract out of proportionate liability, even where the parties are unaware that this is the effect of those terms. A recent case found that no particular form of words is required to contract out, including the possibility that no reference need be made to the specific legislation setting out the terms that contract out[8]. A subsequent case in NSW found that inconsistent language may be enough to give effect to the act of contracting out from proportionate liability[9]. These decisions will apply in NSW, Tasmania, and possibly also in Western Australia, where contracting out of proportionate liability is explicitly allowed under the legislation.

Given the need for certainty and the likelihood of PI insurance not responding to claims operating in these circumstances, this issue is a significant problem for businesses in assessing their potential liabilities and insurance requirements. It could also be argued that this outcome is not consistent with the policy intent when the relevant legislation was developed.

While Consult Australia is opposed to contracting out of proportionate liability generally, the ability for contracting out to occur without the knowledge of one or more of the parties seems unconscionable. This goes further than the other policy issues that form the basis for our opposition to contracting out of proportionate liability.

[8] *Aquagenics Pty Ltd v Break O'Day Council* [2010] TASFC 3 (Aquagenics), and cited in Frank Lawson and Mark Dodd, *Unintentional Contracting Out of Proportionate Liability. Brief*, July 2013, 40(6) at pp 37-38.

[9] *Perpetual Trustee Company Ltd v CTC Group Pty Ltd* (No 2) [2013] NSWCA 58, cited in *ibid*.

Opportunities for Change

We are of the view that of the five options for reform identified in the RIS at page 10, *Option 5* is our preferred option. This section of our submission discusses those options and the rationale for this being the best policy response to this issue.

Consult Australia has consistently sought positive reform to proportionate liability laws over the past decade, to improve business operating conditions, to allow better contracting outcomes for all parties generally, to support a viable professional indemnity market for our industry, and in pursuit of fair outcomes for our member firms, whereby risk and reward are appropriately shared between the parties.

The basis of our position in this submission is that contracting out of proportionate liability runs contrary to each of these motives, and should be prohibited. We have also consistently argued for harmonisation of proportionate liability laws across Australia, with the caveat that harmonising laws to increase the ability to contract out would represent a giant step backwards.

This is the lense through which we have considered each of the five identified options for reform, discussed at pages 10-19 of the RIS.

Given our support for proportionate liability explained throughout this submission, *Option 2*, which repeals proportionate liability legislation in each jurisdiction represents a massive step backwards and one that we cannot support.

Option 4 would achieve national harmonisation, but would expand the ability to contract out of proportionate liability from the three states where it is currently allowed (NSW, WA and Tasmania) to all 9 Australian jurisdictions, including Queensland, where contracting out is currently prohibited. By expanding the ability to contract out, this option also represents a move backwards and should not be supported.

Meanwhile, *Option 1* represents the status quo, which is less than ideal given that it both allows contracting out in some locations, and is not harmonised. It is preferable to *Options 2* and *4*, but less desirable than *Options 3* and *5*, which both represent moves forward.

Both *Options 3* and *5* achieve our stated aim of a nationally uniform position where contracting out of proportionate liability is prohibited, with the difference between the two proposals being their different definition of what constitutes an apportionable claim. Ultimately, Option 5 is our preferred option, owing to the new and narrow definition of an apportionable claim as one where a failure to take reasonable care is an element of the action. That new definition appears to address the concerns often cited by parties contracting out of proportionate liability, and acknowledges the unique challenges faced by the professional services sector, to whom the new definition will predominantly apply. This will be discussed in greater detail below.

Apportionable Claim

One challenge often faced by our industry in the drawing up of contracts to engage their services arises from a failure to recognise the fundamental difference between the services offered by each different party. Where builders produce a tangible item, an appropriate standard of care for them may be that the final product is "fit for purpose". Consultants however provide professional expertise rather than a tangible good, meaning that the appropriate standard of care for them is to have taken "reasonable care" in the provision of their expertise. Consultants cannot take responsibility for how their client may use the information or advice they have provided, or indeed if a structure is constructed to the specifications set out in their design. This is an issue that often gets lost in the complex contractual web in the built environment sector, particularly when the end client is less certain of which party will ultimately be responsible for each aspect of a project.

The model provisions move from a definition of "apportionable claim" that applies to strict liability for economic loss, to one where failure to take reasonable care must be an element of the claim in order for proportionate liability to apply. In doing so, the new draft legislation addresses a major concern raised with our members when clients seek to contract out of proportionate liability. The exclusion of strict liability claims means that proportionate liability will not apply where a party has represented in the contract that the product it provides will be "fit for purpose," as they essentially have represented in the contract that they will be responsible in its entirety for the fitness of that item. This will also provide comfort to clients entering contracts making this representation.

Accordingly, as acknowledged at p18 of the RIS, the prohibition on contracting out is also likely to have a narrower application, while ensuring that professional services providers receive appropriate protection.

In the built environment sector, this definition means that proportionate liability will not apply where a contractor has represented to construct a "fit for purpose" structure, but will apply where a claim is based on the negligence (for example) of a consultant together with concurrent wrongdoers. The definition ensures that PI cover will available to our industry and will drive appropriate contractual outcomes.

We note the concern raised in the RIS that this new definition of an apportionable claim is a new legal concept, and hence one without legal precedence which may give rise to a degree of uncertainty. However, we believe this issue is overcome by the benefits realised and the certainty provided by the very nature of the new definition[10], and further note that case law around this definition will develop in time to provide further the desired level of certainty to business.

In terms of uncertainty, a greater concern arises from the arbitration clause in the model legislation, which will be discussed at length in the next section of this submission.

Based on this definition of "apportionable claim", Consult Australia supports *Option 5* as the most appropriate path for reform.

[10] See p20 of the RIS for example.

The SCLJ Proposed Model Legislation - Legislative Loopholes that Defeat the Reform

As set out in the RIS, *Option 5* entails the passage of the accompanying model legislation by each Australian jurisdiction. The model legislation, while giving effect to this proposed change, also contains clauses that risk defeating the entire reform. Our attention now turns to each of these. It should be noted that while the arbitration clauses represent sufficiently great a risk that the whole reform could be defeated, the other issues represent opportunities for improvement, but not necessarily issues that would defeat the entire reform in the same manner.

Arbitration Clauses

One of the major defects of the model legislation is the inclusion of Clause 3 and Clause 12(3) regarding arbitration. These clauses as they stand are likely to become the "loophole" used by parties to a contract to overcome the very reform this legislation is designed to overcome, by providing a new back door avenue for parties to contract out of proportionate liability. Indeed, Consult Australia would go so far as to suggest that enacting the model legislation with these clauses as they currently stand would not only undermine the entire reform, but actually represent a backward step.

Through the inclusion of these provisions in the legislation, it is likely that all contracts subject to this legislation will by default include arbitration as a means to overcome the prohibition on contracting out of proportionate liability, undermining the very foundation of this proposed reform. In turn, the positive impact on the professional indemnity insurance market and improved business outcomes from these contracts that were the intended result of this proposal will be nullified.

Indeed, the inclusion of these arbitration clauses as a mechanism to avoid proportionate liability might lead to negative consequences more problematic than the status quo position. These include the possibility that future professional insurance policies exclude additional liability incurred as a result of contractual agreements to be bound by the determinations of arbitrators. This could be realised through the standard exclusion for assumed liability, but could also give rise to a specific exclusion for liability assumed by contracting out following an agreement to include arbitration in the contract.

Another possible consequence is that parties will be pushed into arbitration as a dispute resolution mechanism when another form of dispute resolution, including the option of litigation, is more appropriate.

If the arbitration clauses are included in the legislation, a further possible outcome is that many parties will find themselves in situations where they have unknowingly contracted out of proportionate liability by agreeing to arbitration proceedings. It is very likely that many parties will go down this path without being aware of, let alone supporting, the consequent outcomes. Other parties still may be aware of the consequences, but not disclose the effect of agreeing to arbitration to the party they are contracting with. We submit that any legislative mechanisms that can be used for a party to contract out of proportionate liability without the other party's knowledge, let alone consent, should not be supported.

We acknowledge the problem presented by arbitration to proportionate liability, namely the difficulty in joining other concurrent wrongdoers to an arbitration proceeding, especially in Victoria.

In response, Consult Australia is of the view that these Clauses are unnecessary in this legislation for a couple of reasons. Firstly, given the new definition of an "apportionable" claim which requires that a failure to take reasonable care is an element of the claimant's action, proportionate liability will not be a relevant factor in the majority cases that reach arbitration. Secondly, where this same failure to take reasonable care is an element of the claimant's action and the matter does reach arbitration, the arbitrator should be able to take proportionate liability into account when reaching their decision.

As providers of professional services, our industry generally does not use arbitration in the event of disputes, which can involve complex matters of law, and use other alternative dispute resolution methods. Furthermore, our industry should not be prevented from having access to the courts as the ultimate adjudicator of disputes as is likely to occur if the legislation is enacted as drafted, with arbitration becoming the default dispute resolution mechanism.

Accordingly, we suggest one of two options to overcome this problem. The first and our preferred option is that these clauses be amended to explicitly state that proportionate liability does apply to arbitration, with consideration given to accompanying reforms that might overcome the procedural issue of joining concurrent wrongdoers to an action subject to arbitration. The other option is that Clause 3 simply be deleted from the draft legislation before it is presented to Parliament. We note that the draft legislation gives each jurisdiction the option of enacting this clause. Given the gravity of this issue, we are of the view that this is insufficient to address the problem, and the NSW Government should consider raising this issue with other jurisdictions through the appropriate forums.

Consumer Claims

Under the proposed legislation, consumer claims are excluded from proportionate liability, on the grounds that parties may not have the resources to locate and commence litigation against a number of parties, or to negotiate separately with multiple parties[11]. Consult Australia accepts this rationale, and the ultimate intent of this move, subject to a couple of issues being resolved.

Under the definition used in this legislation, arising out of the ACT enactment of Australian Consumer Law, the term "consumer" has been applied more widely than simply "mums and dads", as presumably was originally intended. Given the $40,000 fee threshold, it is possible that disputes involving multi-million dollar fees between corporations could fall within the definition of a consumer claim, provided the relevant party charged a fee of less than $40,000. For example, in the case of *BHP Coal Pty Ltd v O & K Orenstein & Koppel AG*[12], the dispute was between two businesses over a sum greater than $50 million, based on a consultant charging a fee of $27,000. While this issue is addressed through the use of the term, "individual," the intent of using this definition should be further strengthened with a reference to "natural persons".

This definition also potentially prevents consumers from recovering in the event of a loss, by excluding them from the scope of an "apportionable claim". An argument can be made that this is the opposite effect to what was intended.

The other issue posed by excluding consumer claims is that there may be a small number of these cases where an action is for a large sum of money. For example, in our industry a consumer building a large clifftop house may wish to take action against a geotechnical surveyor for an error involved in the process of constructing the structure. While such cases are admittedly rare, there is still the potential to experience some of the same negative outcomes as realised in business to business transactions, such as increased cost and disputation.

Grandfather Clauses

Another issue in the drafting worth taking note of, but not relevant to the NSW context, is the inclusion of grandfather clauses at ss12(2) and 12(3), that allow existing contracts operating having contracted out of proportionate liability to continue to operate in that way until their conclusion. While it is appropriate to

[11] RIS at p38.

[12] *BHP Coal Pty Ltd v O & K Orenstein & Koppel AG* [2008] QSC 141 at para 263.

include these clauses in the states where contracting is currently allowed (NSW, WA, Tasmania), including these clauses in other jurisdictions risks opening a loophole to allow contracting out.

In determining its next steps, the NSW Government should be aware of this issue and raise it with other Australian governments as they consider and enact this legislation.

The SCLJ Proposal – Other issues

Concurrent wrongdoers

The procedural elements of joining concurrent wrongdoers warrant further investigation and discussion. The RIS discusses at great length which notification responsibilities should lie with the plaintiff, and which with the first defendant, as well as what constitutes appropriate notification.

The existing position that a defendant needs to inform the plaintiff of the existence of concurrent wrongdoers, before the plaintiff is then obliged to inform those parties of their status as a concurrent wrongdoer is a sensible position that has worked well.

In practical terms, further guidance will be required as to the appropriate form of notification between parties, as discussed at p31 of the RIS. It is important that the parties are able to provide the information necessary to ensure the practical application of proportionate liability, but there must also be understanding that parties will not always be able to assist the plaintiff in contacting a particular party, and such information may also be contained within otherwise confidential information. An issue worth considering in this context is that in some situations the plaintiff may have the best knowledge of who the concurrent wrongdoers are, and where they can be reached. The law needs to account for this possibility, and in these situations consideration should be given to relieving defendants of their notification obligations, as there is the risk this could become administratively burdensome.

Indemnities

The RIS, at pages 46-47, discusses the issue of indemnities between the parties, and how these operate under proportionate liability. The RIS notes that in most jurisdictions there is a prohibition on claims for contribution or indemnity between concurrent wrongdoers, such as at s26 of the *Civil Liability Act* 2002 (NSW), although this position is not uniform.

The use of indemnities, by definition, is a contractual mechanism to allocate liability other than through proportionate liability. It follows therefore that indemnities should not be allowed as a vehicle used to overcome proportionate liability when contracting out is prohibited. Such an allowance defeats the policy intent of the legislation, and hence risks the very outcomes the legislation is designed to prevent. Consult Australia has found that in Queensland, where contracting out of proportionate liability is expressly prohibited, some parties are now requiring other parties to the contract with less bargaining power to indemnify them for their share of proportionate liability. This practice is an attempt to manufacture a loophole, and all care should be taken to ensure it is not allowed when this legislation is enacted.

Review of Legislation

Consult Australia notes the suggestion in the RIS at page 24 that a review of this legislation take place in ten years' time, once the law has had the chance to operate. This proposal is a sensible one, although one clarification we suggest is that the Government specifically consider the cyclical nature of the insurance

market in determining the timeframe to review these laws, to ensure that an entire cycle passes. This will allow for a proper evaluation to take place against all relevant market conditions.

Conclusion

Following its introduction around a decade ago, proportionate liability has served an important role in ensuring that each party to a contract is only liable for those risks that they are best placed to manage, and those liabilities they are responsible for. Proportionate liability has served to ensure the availability of professional indemnity and public liability insurance, drives better contractual outcomes for all parties, ensures better risk management during the operation of a contract, rather than focusing on "deep pockets" through litigation, and supports the pursuit of fair outcomes for business where risk and reward are appropriately shared between the parties.

However, the ability to contract out of proportionate liability undermines these policy goals, and also runs the risk that a professional service provider's insurance policy might not respond to a claim. For these reasons, Consult Australia has consistently argued that reform has been needed to achieve a uniform national position whereby contracting out is prohibited. Even in the absence of other jurisdictions making this move, business would realise the benefits of NSW implementing this reform.

Accordingly, the draft legislation that is the subject of this consultation is a big step forward, subject to some changes being made to the draft before its introduction to Parliament. The inclusion of the arbitration provisions at Clause 3 and Clause 12(3) is highly problematic, as they offer a loophole that will be exploited by parties with strong bargaining power seeking to contract out of proportionate liability. These clauses should be amended to either ensure that proportionate liability does apply to arbitration, or should be removed altogether. If these clauses are not changed, the draft legislation actually represents a step backwards from the current position. However, if they are changed, this legislation will be a significant positive reform for NSW and the rest of Australia.

Other issues have also been identified in the draft legislation that merit further consideration, although they are less significant than the arbitration clauses. The new definition of an apportionable claim is a positive move that will narrow the application of proportionate liability to those sectors of the economy that most rely on it. The definition of consumer claims may lead to unintended outcomes, while the grandfather clauses should not be passed in other states that do not currently allow contracting out of proportionate liability. Meanwhile, guidance on the issue of notifying concurrent wrongdoers should be developed.

We also believe that the NSW Government should play a role in pushing for these reforms to be adopted in each Australian jurisdiction, and to that end we call on the Government to write to each other jurisdiction urging them to address the issues raised in this submission, and to pass the amended legislation.