

**REPORT OF PROCEEDINGS BEFORE**

**PUBLIC ACCOUNTS COMMITTEE**

**INQUIRY INTO PUBLIC PRIVATE PARTNERSHIPS**

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**At Sydney on Thursday, 16 February 2006**

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**The Committee met at 9.00 a.m.**

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**PRESENT**

Ms N. Hay (Chair)

Mr G. J. Aplin  
Ms K. K. Keneally  
Mr G. R. Torbay  
Mr J. H. Turner

**CHAIR:** I welcome you to the fifth in a series of public hearings being held by the Committee as part of its inquiry into Public Private Partnerships. I would also like to make some brief comments about the procedure for today's public hearing. Just before I do that I should probably mention that everybody should be aware of an emergency procedure that is on the door back there. I draw everybody's attention to the emergency procedure. I would also like to make some brief comments about the procedure for today's public hearing. The Committee prefers to conduct its hearings in public. If a matter is considered commercial in confidence you can request that that part of your evidence be heard in camera. The Committee will consider such a request, and would exclude the public and the media during this consideration and, if agreed, from that part of the hearing. Transcripts of evidence provided in camera are confidential.

Should any witness wish to present any documents today, the Committee will consider whether these can form part of your submission, and we will formally ask if you wish to do so. The tabling of documents is not an automatic right. I wish to emphasise that although it is a public hearing it is not an open forum for comments from the floor. Any person who makes comments from the floor will be asked to leave the hearing room.

The Committee considers that this inquiry is of great importance for ensuring that these projects are managed efficiently and effectively. We are particularly interested in how risks are allocated and managed and opportunities to share knowledge about such projects. This inquiry is about how PPPs are managed, not whether or not they should be used.

In 2005 the Committee held three hearings. It took evidence from key players such as the Treasury, the Auditor-General, unions, banks, academics, law firms and community groups. The Committee is also interested in other current inquiry processes such as the Select Committee on the Cross-City Tunnel and the Review of the future provision of motorways in NSW, conducted by the Premier's Department Infrastructure Implementation Group under Professor David Richmond, which reported in December 2005, but it does not want to overlap with these.

Today we look forward to hearing from more public sector agencies, the University of Sydney School of Business, Leightons and PricewaterhouseCoopers. I am pleased today to welcome Leightons, whose submission talked about their involvement in construction of toll roads, train stations and hospitals. The procedure will be that I will ask the first questions of the witness and then open it up to other members of the Committee.

**PETER HICKS**, Corporate Manager, Infrastructure and Investment, Leighton Contractors, 472 Pacific Highway, St Leonards, sworn and examined:

**CHAIR:** I am advised that you have been issued with a copy of the Committee's terms of reference and also a copy of the Legislative Assembly's Standing Orders 332, 333 and 334 that relate to the examination of witnesses, is that correct?

**Mr HICKS:** That is correct.

**CHAIR:** The Committee has received a submission from your organisation. Is it your desire that the submission form part of your formal evidence?

**Mr HICKS:** Yes.

**CHAIR:** Would you like to make an opening statement this morning?

**Mr HICKS:** Yes, thank you. Just apologies first. Mr Hatton, who was the author of this submission, I had to send to Western Australia yesterday on a PPP project, so I have stepped into his shoes. I am actually the manager of all Leighton projects which involve our own funds being invested. I have been with Leightons for over six years and, interestingly enough, previously I appeared before a Committee such as this as the General Manager Assets New South Wales Railways, so I have the opportunity of understanding both sides of the equation.

I am currently a member of the M7 board which runs the M7 motorway in western Sydney. I am heading up the Leighton bid on the north south bypass tunnel project in Brisbane, which is a five kilometre toll road in Brisbane. I am also heading up the Leighton bid for the new defence headquarters for the Commonwealth Government, so we have got a fair bit of experience from which to comment.

**CHAIR:** Mr Hicks, in your submission you express concern that because of the equity structure for toll roads, this leads to exposure by bidding consortia regarding returns because volume is not guaranteed. Can you comment further on this view?

**Mr HICKS:** It is not so much a concern. We were just trying to highlight in our submission the difference between toll road projects and perhaps hospitals or schools where, in those projects, the exposure is different. In toll roads we spend a lot of money and time understanding traffic forecasts. It is part of our business. In fact, my occupation prior to joining Leightons was about demand forecasting for the railways and for roads in New South Wales, so we have got a lot of expertise in-house and we know and understand it, so the submission was merely making the point that hospitals and schools and those sorts of social infrastructure are different from toll roads, and the private sector has a different way of approaching them.

**CHAIR:** You also indicate in your submission that there is a lack of understanding on the costs of delivering within a PPP bidding process. Whose understanding is deficient and how do you think this could be improved?

**Mr HICKS:** I think, generally speaking, when we bid for projects the Government has set a comparator which has been established by organisations that are not involved in delivery of projects. They are consultants, people who are highly professionally qualified, but they have never actually had to deliver a project for a dollar. They understand it all. They can sit on the sidelines but they have never had to suffer a loss or had to put their body on the line, so to speak, for a sum of money.

We have been very frustrated when we bid to Government three contractors, often four contractors, who are used to bidding the market, understand the risks of pricing, understand the risks

of pricing movements during the bid, and we all settle at a certain price and then the so-called expert has a different figure, often a lower figure, and we are harassed to get to that lower price, and it is just an impossible target. It is a mythical target established by someone who has actually not ever had to deliver to that price, so the sort of people who provide advice are quantity surveyors, and very reputable people, and they are the sort of people we use, but finally they do not have to take the risk on whether they win or lose.

**Mr TURNER:** When you get to that impasse what do you do? Do you renegotiate?

**Mr HICKS:** We pull out.

**Mr TURNER:** That is common in the industry?

**Mr HICKS:** Yes.

**Mr TURNER:** You do not put a non-conformity on it?

**Mr HICKS:** We do put non-conformity options but because of all the rules and regulations that are on PPPs there is limited flexibility. If you do not meet that public comparator, which has been artificially established, the rules are such that, generally speaking, we are forced to comply, and we are just not able to do that. I cannot put my shareholders at risk to come to meet a target that has been set by--

**Mr TURNER:** Name them; bureaucrats, politicians?

**Mr HICKS:** No, they are not set by bureaucrats or politicians, it is set by people they employ.

**Mr TORBAY:** Consultants.

**Mr HICKS:** Consultants, yes.

**Mr TORBAY:** I think you would be an interesting guy to ask in the sense of volume forecasting when these projections are done. We see some of the high profile disasters, if you like, but is it just poor planning and judgment, or is it trying to make the deal work so that you feed it back to a bottom line that actually creates value, or makes a deal stack up when in fact there is no real expectation that you are going to meet any of those things. I am also interested in risk. Is it really understood between the private and public sector?

**Mr HICKS:** There is a lot of questions there.

**Mr TORBAY:** You have a good background for it.

**Mr HICKS:** In terms of the planning, as you can appreciate, as the project develops the degree of investigation and understanding of the project develops as you go, so the price certainly develops. Often projects in Government are plus or minus 50 per cent when they come to Ministers or to politicians. That is frankly where it is because the money just has not been spent to do the designs or to understand the issues to work it up. Anyone who says otherwise, they are plus or minus 50 per cent. When they come to us, usually the bid, they are plus or minus 30 per cent.

Until we get architects, or engineers, or whatever involved we just sort of say you want - just say a three storey building, you just say a three storey building, you look up the standard text, you work it out and say a three storey building is x.

**Mr TORBAY:** It is a guesstimate at best?

**Mr HICKS:** It is plus or minus 30 per cent. Then it goes to bidders. Bidders do the detailed work. We all spend a lot of money, as you have probably heard from other people, do the work and we understand it is plus or minus 10 per cent. That plus or minus 10 per cent then is where we win or lose. We take into account our experience, our judgment. You do not know the price until you build it and anyone who thinks otherwise, if you are saying we know the price the day that we start--

**Mr TORBAY:** That is why all the estimates keep correcting themselves, sometimes significantly, throughout the process. It is not guess work.

**Mr HICKS:** It is the work is not done, the money is not spent. The problem is you have this many projects and this many that actually make it to the end. You cannot spend all of the money on this. Toll roads are very well publicised as far as how the price moves on those. When the RTA does an environmental impact statement they put a guesstimate price in. It just needs work to be done.

**CHAIR:** Could you provide further examples of how you see departments are too prescriptive in their requirements?

**Mr HICKS:** For example, we have just been short-listed to build the new Sydney Water headquarters in Parramatta. The department has told us that it wants a separate lobby entry. That may or may not be the cheapest thing to do or the most efficient thing to do or whatever, but it would have been better to say, "We would like a separate lobby", but tell us whether you would like to have a separate lobby entry to the building. This is not a do or die effort in terms of the success of Sydney Water. They want accommodation.

**CHAIR:** Isn't that general practice in the industry as a whole, though?

**Mr HICKS:** No. For example, we have just finished the Westpac building in the city, Kent, Erskine, Napoleon and Sussex Streets - you might have seen it on the flier. We worked with Westpac on that and we brought additional tenants in and changed the lobby configuration to suit the whole mix of people who are using that building. Westpac is not the only tenant. Our customers say what they would like to have, but they don't sort of say: Well, you must have these 25 things to succeed. Some things are obviously important. I mean the floor space that they need for their employees, that is obviously an important thing, but whether you have naming rights for the building or whether you have a lobby, those sorts of things - for example, Sydney Water has demanded naming rights on the building. Is that necessary? Could the private sector sell those naming rights, build a taller building or do other things?

**Ms KENEALLY:** On the point of being too prescriptive in their requirements, you seem to suggest that is different between Government and private industry. Is that because Government is process-driven; is it because Government is concerned about oversight by bodies like the ICAC? Why do you think that is?

**Mr HICKS:** I think they are nervous, which is another point we make in our submission, that we find we do not have the depth of experience in the public service to deal with us and often they rely on consultants and outside advisers, who are selected on price, not on capability often, so we are interacting with people who do not have confidence. They are not comfortable dealing with the private sector. They sort of say, "Well, you must meet this set of rules and don't vary from it". I think that is one of our main points in our submission, that there needs to be a build-up in internal expertise and a more flexible approach to using outside groups to advise Government so that you do not get the cheapest but the best advice.

**CHAIR:** Are you saying that you feel that the standards being set, so that everyone must meet those, need more flexibility?

**Mr HICKS:** No, we are very happy to meet minimum standards, there have to be minimum standards, but they have to revolve around the core needs rather than these sorts of extra things. For example, with Defence headquarters, they said we must within three minutes get people out of the lifts. Well, no one in the world can achieve that if a lift breaks. Industry standard is five minutes, but that is a non-conformance to the standard.

**CHAIR:** Is there no opportunity to raise that in part of the negotiations and say: Well, industry standards are five minutes. It is not doable?

**Mr HICKS:** We do raise these issues. All we are saying is that, instead of saying "You must achieve this", they could say, "In your submission tell us what your response time is for lifts", instead of going through this whole process that we go through--

**Mr TORBAY:** From the start?

**Mr HICKS:** From the start. The Sydney Water documents are this high (*indicated*). That is how much my team has to read before we even lift the pencil to start. It is just an office building.

**CHAIR:** What you are saying is that you want to receive a general requirement of what is wanted and then call on submissions to show how it would be delivered?

**Mr HICKS:** That is what we would do with a private sector group: How many floors do you want? What space do you want?

**Mr TORBAY:** Do you think it limits innovation?

**Mr HICKS:** That is the point I think we make in our submission. One of the things that we are trying to do is multi-skill employees and we are trying to be able to respond to each situation that we are faced with, and often those standards have been written by a consultant who has in his mind, okay, I want a separate cleaner and I want a separate person at the door, so the standards are written in such a way--

**CHAIR:** Looking at it from the other side of the equation, doesn't more innovation, which is a welcomed thing that you have in a process, make it difficult to assess them fairly?

**Mr HICKS:** Yes.

**CHAIR:** So how do you do that and still provide some sort of rationale that makes sense to the people bidding?

**Mr HICKS:** You are spot on. They have to have an apples and apples comparison, but if I could keep talking about the Sydney Water headquarters, they just want to find a place to seat their 800 people. What are the core requirements for that? Instead of thinking of a lot of stuff that is non-mission critical, let's compare the private sector bids against what they really need to do. Instead of having consultants telling you what the lift release time is, tell us how many people you want to employ? Is it A grade? Everyone in the industry understands what A grade offices are, it is a standard term. Don't give me the Sydney Water version of what an A grade office building is.

**Mr TURNER:** Is that Sydney Water bureaucrats or Government bureaucrats protecting their backside by giving you a high pile of papers to go through? Is that a culture that you have seen developing over a period of time?

**Mr HICKS:** Yes, I think it is people just not feeling comfortable with taking the time to evaluate the various bids.

**Mr TORBAY:** It is also risk, isn't it? They are so scared about allocating risk, given some of the high-profile disasters, they bring everything into rules--

**Mr HICKS:** I am not sure about the high-profile disasters. In our experience, the majority of projects are successful. If you look at our high-profile disasters, which I can talk about, Spencer Street in Melbourne was a commercial disaster for us, but I don't know if you have visited Melbourne lately, but it is just fantastic. It is the best railway station in Australia and we have stayed there, stood behind it, spent the money and done the work. It is not a disaster. From a Government point of view, it is fantastic. They have achieved the best railway station in Australia.

**CHAIR:** I think we understand that concept.

**Mr APLIN:** In the submission it is indicated that the Roads and Traffic Authority had learned efficiently, and that was through incremental experience basically in the process of managing and evaluating PPPs. What things, in your view, have they learned and how could this be extended to other portfolios?

**Mr HICKS:** I think one of the things that the RTA has done is implemented a team which is dedicated to this job of interacting with the private sector and delivering, so Les Wielenga and the team there, over a number of projects they were the same people learning themselves and building incrementally on that. They used the same private sector advisers, so they had various advisers and there was a consistency. They have had a large volume in terms of money going through. You parallel that with schools and hospitals where we have 50 million or 100 million - relatively small jobs for us - and every time there is a different person at the top, a different consultant team. I mean you just say, "Did you look at the last contract that we negotiated with the Government?" "Oh, where's that?" It is so frustrating because we have spent money and time - often three of us, three private sector groups have spent money and time - going through a process with a group of people, then we finish with that group of people, win or lose, and then we go to the next job and there is a new group of people.

**Mr APLIN:** That is something we have been picking up on, so thank you for expanding on it.

**Mr HICKS:** Of course, in my organisation, that is myself and three other people, we lead all the jobs in Australia, so we carry our experience through and bring some efficiency through that.

**Ms KENEALLY:** Are you familiar with the PartnershipsUK approach? Is that something you think could work here?

**Mr HICKS:** I think the one thing that the PartnershipsUK approach has achieved is the volume. That is where there big success has been. They have just had a volume of work that has been mapped out, that has come to the market and has enabled both public sector and private sector to orientate their resources to it, and I think if you asked me, "What is the big difference between the UK approach and Australian approach", it is that.

**CHAIR:** Plus, I would suggest, a lot of years of experience?

**Mr HICKS:** Yes, but it comes with volume.

**CHAIR:** They did not start with great volume.

**Mr HICKS:** But we were actually almost on the same timetable. What has happened is that obviously it is a larger country, larger money, but in New South Wales - the Cross-City Tunnel aside - we have had teams built up over many toll roads that were experienced and now there is nothing in New South Wales. We have all moved to Brisbane.

**Mr TURNER:** I mentioned non-conforming bids a moment ago. Could you give me a précis on the role that they play or could play or should not play?

**Mr HICKS:** There is always an opportunity for non-conforming bids and we would always encourage that. We almost always now do one additional bid to our conforming bid. We usually put

what we call a shopping list on that, which is a mix of additions or deletions. I suppose it is our view. On some of these projects we have up to 100 people working over twelve weeks. We get to understand the site, the project, very well. We suggest to the client opportunities to take scope off or add scope. The difficulty we have is when we finance and involve credit committees, you cannot get financial underwriting for a whole lot of projects, a whole lot of versions, because when we go to credit committees they just want to understand relatively simply the project, so usually we bid one conforming bid and one or two non-conforming bids, and they are usually a mixture of additions and deletions.

**Mr TURNER:** So what you are saying is that you run two parallel bids, you run the client's requirement bid and a non-conforming as a back-up?

**Mr HICKS:** You often win on the non-conforming bid. More often we win on the non-conforming bid.

**Mr TURNER:** The process of up-front fees - and I do not want to discuss the Cross-City tunnel, but there is controversy there about the up-front fee. Is that a practice that is prevalent or is it something new?

**Mr HICKS:** I think it goes back to my response on pricing. One of the difficulties is that if you set the revenue, if you like, the toll level, and you don't know the exact capital price and you don't know the exact traffic, you have to have some variation.

**Mr TURNER:** The Cross-City Tunnel--

**Mr HICKS:** Well, they could have reduced the toll.

**Mr TURNER:** I am not putting that in a comparative situation, but that was supposedly to cover the RTA's side of work on that project, to pay them for whatever they did. Is that creeping into bids where the State authority is saying, "Well, we've had our bureaucrats dong X amount of work"--

**Mr HICKS:** No, we haven't seen that in the PPPs. It is just toll-road specific.

**CHAIR:** In relation to the Cross-City Tunnel, I think it is appropriate to discuss anything that comes about on the side of the PPP, but there is a separate inquiry into that, so I would prefer that we--

**Mr TURNER:** Yes, it is the only example I have seen of the up-front fee, but I will leave it there. The other thing you mentioned was I think that the RTA works out a guesstimate at some stage for a project. That has always concerned me. The Cross-City Tunnel, I think from memory when the Minister announced it, it was \$600 million or something. I am not alleging any form of corruption or collusion, but that worries me when a Minister makes a statement "we think it is going to be this" and then goes off and asks the private sector to cost it, to do a PPP. Is there any subconscious influence when you get those public statements out there?

**Mr HICKS:** No.

**Mr TURNER:** In fact it came in more than that, as we know.

**Mr HICKS:** To be frank, we ignore those prices. They are irrelevant to us.

**Mr TURNER:** Do you think as a practice that there should be a pre-empting by public officials of possible costs of PPPs before you fellows have sat down and had a good look at it?

**Mr HICKS:** As I said, the price is what the price will be when we do the work. It is sort of irrelevant.

**CHAIR:** You actually gave an example of, in Melbourne, where you say a project was a great success.

**Mr HICKS:** The Spencer Street project. The end cost was substantially more than the Government estimate and our bid price. The price will be what the price will be.

**Mr TORBAY:** The point you make is no-one has done the work and yet everyone is throwing these figures around that are plus or minus 50 per cent, which could mean anything, quite frankly.

**Mr HICKS:** Quite frankly, it is not a criticism. Having been in the public service, it is just the way it is. You have the whole state in front of you. You have to do an infrastructure plan and you have to work out priorities. I interact with politicians now in my new position and we give them indicative prices on various projects which are of interest.

**Mr TORBAY:** To be fair, the first thing the media ask the Minister is how much is this going to cost. They have to give some sort of estimate, I suppose. I have a question in relation to a comment you made about skills when you are negotiating. I am particularly interested in your view, given that you have come from both sides of the tracks, skills in the public sector, whether or not they hang around long enough to develop those skills so that there is actually a proper negotiation and a good outcome for both parties, both public and private, or is poaching that we have heard of from the public sector to the private sector a reality, poaching those skills, and does it leave the public exposed to some of the problems that we have heard about?

**Mr HICKS:** I think the poaching issue is - there is a handful of people in senior positions who have moved from public to private. I think it is very minor. I do not think it is a significant issue. There is an issue generally of just trying to keep a skills base in the public sector. To be frank, the public sector will never be able to match private sector remuneration for highly skilled people. It is just a fact of life. The use of consultants has to be part of the equation. I know from my time in the public service that it is very difficult to get around a more expensive quote to provide consultancy services when there is a cheaper one available. It is very difficult. It is a difficult situation.

**Mr TORBAY:** What you are suggesting is that the quality of the outcome in the public sector is challenged. That is what you are saying. The quality cannot be there unless they buy in external expertise?

**Mr HICKS:** Yes.

**(The Witness Withdrew)**

**JAMES GUTHRIE**, Professor, Faculty of Economics and Business, University of Sydney, and

**LINDA ENGLISH**, Senior Lecturer, Faculty of Economics and Business, University of Sydney, affirmed and examined:

**CHAIR:** I would like to welcome the witnesses from the Faculty of Economics and Business whose submission outlines a proposed project investigating the valuation and monitoring of PPPs. The procedure this morning will be that I will ask the first questions of witnesses and then open it up to other members of the Committee. The Committee is pleased to hear your evidence. I am advised that you have been issued with a copy of the Committee's terms of reference and also a copy of the Legislative Assembly's Standing Orders 332, 333 and 334 that relate to the examination of witnesses. Is that correct?

**Professor GUTHRIE:** That is correct.

**CHAIR:** The Committee has received a submission from your organisation. Is it your desire for that submission to form part of your formal evidence today?

**Professor GUTHRIE:** Yes, correct.

**CHAIR:** Would you like to make an opening statement this morning?

**Professor GUTHRIE:** Yes, if I could take ten minutes. First I would like to say that we are very pleased to be here today in front of New South Wales Public Accounts Committee because we understand they have nearly a 15 year history of examining PPP type arrangements and especially in the early period they were actually ahead of government policy in establishing some of the criteria in terms of the evaluation of PPP. We welcome the New South Wales Parliamentary inquiry into the Government's management of PPP programs because, as we will present in our evidence, we believe there needs to be serious consideration given to oversight and review of PPP programs.

What we would like to bring to the Committee is a bit of an outline of our research project. I am afraid our project has just started. It is ARC linkage grant, which is quite a large grant. We have a number of industry partners, as you can see in our submission, including auditors general, and the purpose of the grant is to establish some sort of evaluation model that the parliamentary oversight and auditors general can use in terms of looking at PPP arrangements and especially what we call social infrastructure, and especially the management of social infrastructure as we go through the processes.

In terms of our grant and in terms of our research questions you have in front of you the four research questions. Clearly one and two are the ones that we are starting to give some attention to at the present time and that is what I will put my mind to today, and that is firstly what sort of post project evaluation systems already exist in Australia. Secondly, learn something from international practice concerning long-term PPP arrangements and our co chief investigators from England, from the University of London, Professor Jane Broadbent and Richard Laughlin are very well-known academics who have done a lot of work in PFIs and evaluations of auditors general and parliamentary oversight and other matters. We are learning from them and they are working with us on our project.

When we get to PPP type arrangements we focus in on the two types or arrangements that you are aware of. One is the infrastructure type arrangements where the user pays, such as tollways and second would be the social infrastructure and of course there would be some sort of specific performance criteria and some sort of cost of service provision and this of course would be some government transfer through the normal appropriation system. That is the area that we are very interested in and that is what we are trying to give attention to.

The sorts of social infrastructure that we are interested in is the arrangements associated with hospitals, prisons, schools and other sorts of public service activities, not just necessarily the provision of the infrastructure, but the services that go with it and the performance criteria and the management of that, not the contract, but the management of the actual PPP activity and that is the focus of our research.

As you are aware, private partnerships now in Australia are very significant. We, in our research, indicate that there is most probably \$35 billion of them at the moment already in place and another \$55 to \$70 billion have been announced. Once again, we are not that interested in the infrastructure, we are more interested in focussing in on the service provision and specifically we are spending our research energy looking at health and prisons and detention centres. They are the specific areas we are homing in on to get a feel for how this cost of service is handled and how specific performance criteria is managed.

If we focus then on some of the issues that come up for us, we are of the view that the management of PPPs has not been given that much attention, but there has been a lot of effort given to parliamentary oversight and later on we will talk about our recent research looking at performance audits by auditors general. That is in pre-contract stage. There is very little attention being given to post-contract stage and especially PPE. Therefore for us, what we think we need to focus our minds to is not necessarily to the pre-decision specifications and the pre-decision contracts and the performance criteria which is publicly available, the financial modelling that is going on there has been a lot of attention given to that, or the relationships of partners in the building of the infrastructure. What we are really interested in is the outcomes and an evaluation or an understanding of how we can measure the outcomes and manage the outcomes especially over the long-term.

What we are talking about here is that in this country long-term may be defined as 30 years. In the UK, I was at the London University where there was a 60 year contract for the provision of the university building and services, all services associated with it, and they are struggling with it. 60 years, to me, is a long time to try to define activities, and especially in service provision when the nature of hospitals, health care, and in prisons, the nature of the service actually will change. That is what we are trying to take our minds to. We are trying to take our minds to the evaluation of the effectiveness, the understanding of value for money and the managing and monitoring and evaluation of the post-contract activities, and then hopefully forming some view as to success or not. I do not think success can just be measured in terms of was it built on time, or was it built quicker than time, or was it built on budget. That to me is only part of the PPP game.

In terms of what we want to focus our minds on too, we want to take our minds to reviews by governments and other bodies of PPP arrangements. There is some evidence that auditors general have made attempts to monitor and evaluate PPPs. However, our research, which we will speak briefly to today, which is a paper we are just finishing at the moment, indicates that it is very much an immaterial activity in that they have only looked at a few PPPs and only looked at certain aspects of PPPs, so the auditors general have not really given a lot of public attention to PPPs. Also there is little evidence in Australia or elsewhere of a systematic attempt to develop some sort of post-period evaluation system capable of capturing this evaluation and reporting of the success of these complicated long-term partnerships and, let's face it, we are talking about very complicated relationships here. We are talking about very complicated contracts and complicated service provisions. Remember we are talking about replacing public services with private provision of public services in the name of public services and, especially when we get to health, education, prisons and other activities, these are not easy activities to provide and to manage.

Therefore, what we are putting forward to you is that we need to give attention to post-project evaluation. When we go to that, we start to say at the bottom of page 2 and the top of page 3 that this is where some of our work comes in, that is, clearly accounting - and when we use the word "accounting" we are not talking just about financial accounting, we are talking about accounting of intangibles and tangibles associated with service contracts. We are talking about the type of

information systems to be produced, the trust between the partners, the calculation of payments, how the key performance indicators are determined, and the managing of the key performance indicators in terms of service provision. So we are focusing our mind to what sort of accounting information is going to be provided in these PPPs to monitor the standards and to determine value for money. Most of the contracts and the public policy documents we read talk about value for money. These have been defined in various ways. We are very interested in understanding value for money in terms of service provision.

In terms of risk transfers, most of that happens at pre-contract stage. As we said, that is not really a focus of our research work and we would like to keep our focus very much on what we are trying to develop, that is, some sort of PPE evaluation system that auditors general can use.

Finally, if we are going to give you a bit of a flavour of where we are going, what we would like to do is take a couple of minutes to talk about two of our research papers, one of which we have here, which has been published. This research paper was our first attempt to get into the area and really started off our exploration. From that research paper we put together this ARC linkage grant with the auditors general and some councils and CPAs and other people. This may or may not surprise you: We reviewed the literature, as you do as academics; we looked overseas, reviewed the literature and tried to get some lessons from that.

The main finding, if you go to page 508 - and this is an overview, I mean academics generalise, and we have some specific cases there but we will not take you to those today - is that it just seems to Linda and myself that when we look at Victoria and New South Wales and what has happened in the last fifteen years, we have been a bit surprised at the micro level. State Governments and their proxies - and their proxies for us are Treasury and we identify Treasury as the key steering - are really the sole agenda setters, the rule makers, the implementers, the benefactors, the regulators and evaluators of PPP type activities. It just seems to us that there has been very little parliamentary oversight and inquiry. As I said at the beginning, of course, New South Wales is a leader in that and should be congratulated for their fifteen-year history of looking at this area. Auditors general have been fairly silent on it. There are little other government departments that have been actively in the public arena reviewing PPP type arrangements and it has been left up to Treasury or surrogates of Treasury to really make the running. That we thought left an accountability problem and a transparency problem and we document some of those in that paper.

**CHAIR:** Do you want this paper to form part of your formal submission?

**Professor GUTHRIE:** Yes, we would like that, thank you. The details of the paper lead to that proposition, of course, but I will not go to the details because, if you are interested, you can read the paper.

The second paper we have is the one we are just finishing at the present time to be presented at the European Accounting Association academic conference in Dublin in March. This paper has been the first part of our major project. It is called State Audit of Public Private Partnerships in Australia: A lack of Public Accountability. As is indicated by the title, we believe State Audit has been silent in terms of their examination of PPP type arrangements and what we did in this paper was look at all performance audits undertaken by State Audit in Australia. I am afraid that we have to report that it has been very patchy, performance auditing of PPP type arrangements, and that there are only a few areas being covered. In constructing that we actually did rely upon the New South Wales PAC 1993 report on public disclosure, which we found was one of the best documents around in terms of public disclosure of contracts and the issue of audit associated with that. The other documents we relied upon were Victorian documents to establish what we called policies and procedures of a PPP type arrangement. When we finished our examination of those performance audits we formed the judgment that audits were mainly about pre-contract arrangements, that very little attention had been given to post-contract arrangements and very little attention had been given to service agreements, so once again it is a black hole in that performance audits were not looking at service agreements of the current PPPs. They were not looking at the key performance indicators, the management of the contract, in terms of service provision.

**CHAIR:** Do you have an example of a current PPP?

**Professor GUTHRIE:** Yes, the one in Western Australia is an example where it was done.

**Ms ENGLISH:** Yes. Only really in Western Australia, the hospital there, there are two reports from the Western Australian Auditor General and in Victoria there was one report into the prisons, but in New South Wales the three performance audits have been on toll roads and the last of those was published in 1997. That is looking at value for money really and the accounting treatment.

**Professor GUTHRIE:** That is performance audits. I mean we could be naive and say that performance audits are the type of audits that look at value for money. Well, we are not because we have published in this area and read a lot of stuff. We then went to Victoria and looked at the other types of audits, which we would call traditional financial statements audit, and they have undertaken work into some of the PPPs but, once again, it is very silent on service provision and key performance indicators and contractual arrangements with service provision.

**CHAIR:** You say in New South Wales the three audits were on toll roads?

**Ms ENGLISH:** Yes, and very early. They were under Tony Harris essentially.

**Professor GUTHRIE:** And two of those were directed by parliamentary committees, so the Auditor General in New South Wales on his own bat has undertaken very little performance audits of PPP type activities.

**CHAIR:** Do you have a specific criticism in relation to the audits on those?

**Ms ENGLISH:** Criticism or just an observation?

**CHAIR:** Observation.

**Professor GUTHRIE:** Well, the observation is the type of PPP activity, i.e. infrastructure is only one aspect of the PPP type arrangement. The observation would be that we are surprised that the New South Wales Auditor General has not undertaken more performance audits per se of PPP type activities, especially service provision.

**Ms ENGLISH:** Well, even, for instance, the failed railway has not been looked at. The airport link has not been subject to performance audit. We find that the Auditor General, as in Victoria, does mention PPP arrangements in the course of his other audits, but as far as I can work out not in any great detail so there are fewer disclosures and certainly not in such depth as the Victorian Auditor General has done. Again, that is just an observation.

**Professor GUTHRIE:** And this paper is very fresh in the sense that we are bringing together three or four months of solid work and trying to form these observations.

**Ms ENGLISH:** We were surprised actually by what we found.

**Professor GUTHRIE:** I am going to try to bring the discussion to a conclusion, and I think our first proposition is that we believe that understanding value for money and claim benefits for PPP can only be assessable through monitoring and oversight after post-contracting stage. Once the contract is finished, then we start to think about the managing of the PPP activity. This has received little attention in Australia both in policy documents and the Auditor General and Public Accounts Committee and other inquiries. Also we believe that there is a case for auditing the outcomes of post-contracting stage, because remember that most of these service provisions are paid for out of appropriations, so there are significant appropriations now going to these in what we call locked boxes in the budget, so this is a locked box in the budget for the next 10 or 20 or 35 years, and we believe that there has been very little attention given to that in the pre-contracting stage. Thirdly, we believe that there needs to be a little bit more policy steering, as we call it, in terms of the development of performance agreements and key performance indicators and service agreements and

the management of these contracts and activities after pre-contracting stage. I think that is where we will bring it to a conclusion.

**CHAIR:** My first question was to be about your indication about poor disclosure of reviews. Do you think your statement has covered everything you want to say in terms of what you feel is poor disclosure of reviews?

**Professor GUTHRIE:** I think our statement highlights that we believe at the moment it is patchy, actual reviews and disclosure of reviews are patchy, and even when we looked at the Auditor General's ordinary financial statement audit, it is very difficult to find specific comments on PPP type activities. It is a real effort.

**CHAIR:** Is that how you see that they could be improved, by having more specific comments, or do you have--

**Ms ENGLISH:** Well, both. I think more specific comments so you could look at, for instance, what the Victorian Auditor General does - it is a different type of audit, it is more comprehensive - and also, even for them, it would be terrific if they then consolidated the comments, say, in chronological order, because you will find that they are in different types of reports, so you really have to make an effort--

**CHAIR:** To find them?

**Ms ENGLISH:** Yes, and also it is difficult to get hold of the reports I have to say. On the web site, the reports I think start at 1992<sup>1</sup>. If you are interested in this area you actually want documents that go right back to the beginning, which would take in Port Macquarie and Junee.

**Ms KENEALLY:** Would they not be in Parliamentary libraries?

**Professor GUTHRIE:** Yes.

**Ms ENGLISH:** Well, they are, but they are still more difficult to access than you would like.

**CHAIR:** You are saying prior to 1992 you could not access the information on the web site?

**Ms ENGLISH:** I would have to check but it is early nineties so it would be nice to get that.

**CHAIR:** Obviously there have been a number of comments about the role of the Auditor-General and you suggest that the Auditor-General be given greater powers regarding the reviews, do you have specific suggestions?

**Ms ENGLISH:** Could I just say something? They have the power. It is not a matter of power. The Audit Act provides for the fact that they can undertake performance audits, I think, so I would have thought that the power was there. I am not as familiar with the New South Wales act as I am with the Victorian act.

**CHAIR:** I am drawing from the submission and there was a suggestion there that the Auditor-General should be given greater powers.

**Professor GUTHRIE:** Yes. My view on that is that clearly one of the powers that the New South Wales Auditor-General should be given, if they do not already have it, is the power to perform audits of performance indicators and make judgments on those indicators.

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<sup>1</sup> Note: The date was later corrected to 1997.

**Ms ENGLISH:** They do not have that.

**Professor GUTHRIE:** They do not have that power here, where the Western Australian Auditor-General does. Secondly, they should have powers to access quasi organisational commercial organisations to make sure that the contracts are being fulfilled and if they do not have the powers they should then get a private sector audit to form a judgment as to the accounting information systems and the reliability of the service agreement's key performance indicators because it just seems to me that is the way these contracts are being run, through the key performance indicators and the accounting information systems associated with that, and thirdly, I suppose, the auditors general should focus their attention in a performance auditing of the post-evaluation and post-contracting of an actual service provision so then they can draw lessons from actual practice as to the future. That is what we are trying to do with the Victorian Auditor-General and the Western Australian Auditor-General who have agreed to work with us and take our model and put it in the field and try to draw out lessons

**CHAIR:** I draw your attention to your comments in your submission "It is advised that the Committee take steps to ensure that the New South Wales Auditor-General is given sufficient powers to review to the private parts of PPP arrangements".

**Professor GUTHRIE:** Yes, that is the private parts, and that is the whole debate about commercial in confidence and the problem of quangos.

**Mr TORBAY:** And disclosure.

**Professor GUTHRIE:** Disclosure and reliability of disclosure.

**Ms ENGLISH:** And funding would be another issue. Is it a problem of funding?

**CHAIR:** You have said a couple of times in your statement that you consider there to be very minimal parliamentary oversight and you recommend, or you suggest, that there be a view to a parliamentary oversight model. Are there specific things that you think that a parliamentary oversight model should include?

**Professor GUTHRIE:** The New South Wales Public Accounts Committee has taken the lead on this. In the early nineties before policy was formed they started to develop policy. In terms of disclosure their 1993 document was very important. I suppose in a sense the focus of this Committee now is on managing PPPs, which is the next step. The next step is because we have got 30 billion of these already in place we must work out some way of parliamentary oversight, because clearly there is significant yearly appropriations now associated with this. There are contractual arrangements. There is issues of public interest which need to be dealt with, and this needs to be given attention, especially if you believe our first paper in that we believe Treasury has been the only ones really making the running in all the documents. That is not saying it is good, bad or indifferent but I am just saying that most probably in our sort of system there is different interests.

**Ms ENGLISH:** I would also like to draw your attention to your report on Hawkesbury Hospital which actually occurred prior to the contract being drawn up. I have had some contact with Hawkesbury and I understand that is a PPP that is really working incredibly well and I would suggest that one of the reasons is as a result of your report actually, because one of the things you required was a lot of community consultation. That has worked extremely well in that hospital. If you look at Port Macquarie, which the Parliament was not happy with, and you look at Hawkesbury, you also made an inquiry into Port Macquarie.

**Professor GUTHRIE:** That was post.

**Ms ENGLISH:** That was post but the Hawkesbury one was terrific and had a very good outcome. Again, that has not been audited so it is very difficult to get information about it but that would be one that is a success story.

**Mr APLIN:** To follow up that point of success, in your submission you actually did mention the negative PPPs are frequently the subject of media coverage but less is known about successful PPPs and you followed up by saying that there is little evidence in Australia of a systematic attempt to develop theoretically an empirically informed post-period evaluation system. What would be your ideal model for the evaluation and modelling of PPPs?

**Ms ENGLISH:** If only we knew.

**Professor GUTHRIE:** In three years' time we will tell you that. That is why we are spending \$1 million.

**Mr APLIN:** It goes to the success.

**Ms ENGLISH:** We could table a UK document but there is work done by our partners in the UK which suggests, but it is very theoretical and vague.

**Professor GUTHRIE:** As I said at the beginning, we are only three months into a three year journey. As we try to show you, we are homing in on specific aspects of PPP and we believe that our model clearly will have at its heart the issue of public interest, of civil society, and then notions of how do we go about managing these types of activities. That is what we are trying to get to, but still it is very early days for us, so we are just trying to understand what has happened to now and that is what you are trying to understand too and it is a very confused picture because the numbers are huge on these things now. Somewhere I have been asleep for three or four years and all of a sudden they are jumping up everywhere.

**Ms KENEALLY:** Harking back to the parliamentary oversight and the role of the Auditor-General, in this paper you have given us you talk about the problematic nature of real time accountability. In your work will you be comparing the real time accountability of parliamentary oversight and Auditor-General of traditional procurement model versus PPPs.

**Professor GUTHRIE:** Very good question. One of our reviewers of our latest paper said you have looked at performance audit of PPPs, what about pre-PPPs? Was there more, less, or the same sort of attention given to it? All I can say is that my observation would be, and this is a chapter in my PhD when I did the parliamentary oversight, we used to have public works committees in New South Wales. It is a bit different now because they look at annual reports, but in the old days they used to actually look at capital works and you had to get approval for capital works. We are only talking about material items here but maybe we can learn a little bit about what happened in the past and maybe apply it to the future because, at the end of the day, what concerns me is that it is not only the infrastructure it is the service provision. The service provision we are tying up for 10 or 15 years.

We are just starting to interview a few people who provide the services, so when you talk to X company that provides a PPP, they talk about inside the organisation they have the build path and they have the service provision path. They are not giving much attention to this and that is where some of my people I am starting to talk to say that is where the real problem is. Even inside these companies, in the private companies, they have not given much thought to life cycle costing and performance indicators and to the funding implications. They are more concerned about the short-term. We will not say short-term profit but we will say the function of the organisation was always a building organisation, so even inside these organisations, they are starting to get a feel that there is going to be an issue they have to deal with but they have not confronted it.

**CHAIR:** Do you think that is a hiccup? When you talk about public works committees in the old days and in the old days it was the Public Works Department that basically carried out all the activities, do you think that is a hiccup from the transfer or the move away from that system?

**Professor GUTHRIE:** I think what we are trying to argue is that there is a role for parliamentary oversights in these activities. I am not quite sure what the role is. We are not quite sure how far the gaze should be, but clearly significant parts of the public sector now have been tied into partnerships where the Auditor-General may not be able to gaze inside, where the parliamentary committees may not be able to gaze inside, and these organisations are providing public services. They are getting paid out of appropriations. It is not user pays. It is out of appropriations for social infrastructure, whether it is prisons, hospitals or whatever it is.

**Ms KENEALLY:** If I can interrupt, you seem to be arguing that that sort of oversight is needed whether or not a project becomes - my colleague here used the phrase earlier.

**Mr TORBAY:** High profile.

**Ms KENEALLY:** Obviously at the moment we have a number of oversight processes going on, including a very notable PPP in the Cross-City Tunnel but your argument seems to be that there is not a lot of oversight.

**Professor GUTHRIE:** We are arguing for some sort of systemic reorganisation of the oversight in the audit and the budget arrangements associated with PPP type activity.

**Ms KENEALLY:** Say, for example, currently Treasury is doing a review of the PPPs, the school projects.

**Professor GUTHRIE:** Yes.

**Ms KENEALLY:** In your mind that is not sufficient enough and there should be more parliamentary oversight?

**Professor GUTHRIE:** As we argued in that paper, Treasury seems to be the one setting the policies, making the decisions, working out the funding, reviewing their own, reviewing the bloke next door.

**Mr TORBAY:** Welcome to the Westminster system of democracy. Treasury seems to run a lot of things in this place. I am interested in a general observation, given all the research that you have done, are we getting better at PPPs, in your general view, and I would not mind you touching on the concept of risk. Do we better understand the allocation of risk and the accountabilities or responsibilities of risk with the PPPs?

**Ms ENGLISH:** Most of my research has been done in Victoria. I have to say that I think Victoria is definitely understanding those things.

**Mr TORBAY:** Getting better at it?

**Ms ENGLISH:** I imagine that New South Wales is. I know we have had a big hiccup, but just forget about that one.

**Mr TORBAY:** There have been a lot of successes, as we say, but we do not get to hear about them.

**Ms ENGLISH:** Yes, forget about that one. Victoria is very much run by the Treasury (Partnerships Victoria). They have a lot of policies. It seems to me they are very top down, very

strong. They are now, after Bracks, quite cautious about what they are doing and I think that that probably, if they have had successes, helped. I cannot comment about New South Wales. I will not comment about New South Wales.

**CHAIR:** Any comments on the New South Wales experience?

**Professor GUTHRIE:** No.

**Mr TORBAY:** We are neutral.

**CHAIR:** I was interested in comparisons.

**Professor GUTHRIE:** Victoria by far is the largest.

**Ms ENGLISH:** The leader.

**Professor GUTHRIE:** When we say the leader, they are biggest in size, biggest in number, biggest in volume.

**Ms ENGLISH:** The policies in the other states tend to come since 2000 from Victoria. They are modelled on the Victorian policies but the question is in my mind - can I say this off the record?

**Professor GUTHRIE:** No, don't say anything. Risk transfer is a very complicated activity. Risk transfer can do with construction. We are not quite sure what is going to go on with risk transfer with service provision. The example I have on that is when I went to the University of London I walked into a lecture theatre and there was a big pole in the middle of the lecture theatre, so it was like: Oh, this is a strange lecture theatre. I said to my colleague Richard: "How come you've got a big pole in the middle of the lecture theatre? Why don't you get rid of it? He said, "Well, this was an M16 building. When they built it they didn't build it as a university. Someone bought it and turned it into a university for us. We can't remove that without significant cost. The problem is we've only got one person we deal with", i.e. in the contract the private provider is the one that makes all changes to the building and sets the price. He said, "The prices are so high, because there is no competition, that we just have to leave this in the middle of the lecture theatre". That is the part we do not really understand yet, how the service provision is going to go, especially in places like hospitals where in 10 or 15 years there may be significant technology advances, building advances.

**Ms ENGLISH:** Could I make a comment about the PSC? One thing that I did not realise and have just realised is that that is a sort of moveable feast, which makes it actually quite difficult to audit, so you start at the beginning of the process to try to work out what the cost - and this is just a hypothetical cost - of public provision is because we really we suspect the Government has no intention of private provision, but as they talk to the contractors that PSC is constantly developing, so it is not something that is easily graspable, I don't think, and I think that is a problem for auditors general and other people who are trying to work out how to monitor these things: What is it that you have actually captured in the PSC?

**Ms KENEALLY:** So public disclosure of the PSC?

**Ms ENGLISH:** Wouldn't that be lovely? I have sent in many FOI requests, I can assure you.

**Professor GUTHRIE:** And I suppose when we talk about risk, I mean I am a trained accountant and I always think of risk as a financial activity, but I would have thought that you at the other end of the table must think of risk as more than a financial activity, a political risk, and the problem is we are talking about public services.

**Mr TORBAY:** There are some risks you cannot transfer. We have learned that the hard way, I have to say.

**CHAIR:** That obviously goes back to your comments on risk being determined in the negotiations for the PPP pre-contract.

**Ms ENGLISH:** Absolutely. They have risk tables in these documents, so everything is supposedly pre-thought out. Also, even if it is perfect at the beginning, if we can agree, who knows what is going to happen down the track?

**Mr APLIN:** I was going to ask you about the PSC and I think you have covered that.

**Ms ENGLISH:** I can give you the name of an article that explains very well in lay terms how it has developed and what happens to it, if you are interested.

**CHAIR:** Please do. Are you going to provide that later?

**Ms ENGLISH:** I can give you the name of it now, I think I have it in this paper, otherwise I would be very happy to provide it. It was not written by me, but I am very happy to provide it.

**Mr APLIN:** You have mentioned your linkage partners, but how important are they and what were the reasons that you selected those particular ones?

**Professor GUTHRIE:** That is a good question. What we got was an ARC linkage grant, which is very prestigious. I think in accrual terms it is about \$1.3 million, so it is a very big research grant for us. What happened was that we had to be very careful. First, we approached people like Macquarie Bank, but we had to be very careful because they wanted to be a little bit more hands-on, so we had to find linkage partners who were willing to contribute in kind, help us with the contracts, that is the lawyers; we had to find some public sectors, and the local government was one that came forward, and we had to find some auditors general. We approached every auditor general in Australia and only two put up their hands because they have to commit in this to actually provide a lot of time and energy in years 2 and 3 to take our models and try to put them into audit processes and procedures, to actually undertake some special audits or performance audits using these evaluation models, and we learned from that.

**Ms ENGLISH:** We also approached PACs, we did actually approach the New South Wales Parliamentary Accounts Committee, and there was interest I think, but I understand you cannot fund this sort of activity.

**Professor GUTHRIE:** Yes, and for us, at the end of the day, the Victorian and Western Australian Auditors General stood up and said they were willing to be part of the process. It took about six months to negotiate those sorts of things because there are a whole lot of access issues, confidentiality issues once we get into the field, but this is a new way that they are undertaking research in this country now, industry partnerships, where we are trying to get academics and industry to work together in some sort of collaboration.

**CHAIR:** It has been very informative and interesting indeed and, on behalf of the Committee, I express our thanks.

**(The witnesses withdrew)**

**(Short adjournment)**

**GARRY JOHN ALFRED PAYNE**, Director General, Department of Local Government, 5 O'Keefe Street, Nowra, and

**ROSS KEITH WOODWARD**, Deputy Director General, Department of Local Government, 5 O'Keefe Street, Nowra, sworn and examined:

**CHAIR:** Thank you for your submission, which discusses the new PPP guidelines. The procedure will be that I will ask the first question and then open it up to the other members of the Committee. I am advised that you have received a copy of the Committee's terms of reference and also a copy of the Legislative Assembly's Standing Orders 332, 333 and 334 that relate to the examination of witnesses. Is that correct?

**Mr PAYNE:** Correct.

**CHAIR:** We have received a submission from your organisation. Is it your desire that the submission form part of your formal evidence?

**Mr PAYNE:** Yes.

**CHAIR:** Would you like to make an opening statement?

**Mr PAYNE:** No, what I would have said is actually in the letter, but what I would like to do is to table - and I am sure you have it, but I will table it - a copy of the Act, the relevant regulations, several brochures that we provide on PPP and details of the membership of the PPP committee.

**CHAIR:** Do you want those to form part of your formal submission?

**Mr PAYNE:** Yes, please.

**CHAIR:** While it is early days for the implementation of the department's PPP guidelines, do you have any comments about how you believe that they are being adopted by councils, including any identified difficulties or highlights?

**Mr PAYNE:** The guidelines, as you say, are only new. They were issued I think in September 2005 and the committee in the process itself has only seen several applications made to it, so it is reasonably early days, however, the guidelines were rigorously developed and in consultation with a number of key players, including the Local Governments Shires Association, so we are reasonably confident that they are appropriate and will in fact meet the needs of the legislation and the PPP committee. I might ask Mr Woodward, who has been dealing with the committee and the application of the guidelines, whether he would like to comment?

**Mr WOODWARD:** Yes. The response so far from councils and the private sector has been extremely positive because they see that there is clear guidance around how PPP should be developed and in fact they consider it a form of protection that they are not on their own in dealing with some of these matters.

**CHAIR:** The United Services Union indicated in its evidence that the current PPP arrangements could lead to local government ceding its power, employment and capacity. Can these concerns be addressed, do you think?

**Mr PAYNE:** I have heard this argument. The role of the legislation and the role of the committee is not to look at the merits or otherwise of the particular project. Our sole role is to see whether the proposal meets the guidelines and to assess whether the risks are in fact acceptable or unacceptable. At the end of the day we do not approve or not approve a project, so in that sense we do not have any role in saying whether a particular project is good, bad or indifferent, it is just the level of risk of the project. I think - and we have spoken to the union - there is a misunderstanding in

fact of what our role is in this regard.

**CHAIR:** But do you understand the concerns that the unions have raised?

**Mr PAYNE:** Well, that is a concern that they would need to raise at the council level at the time projects are being developed, not with the committee. As I said, it is not my role to vet a project.

**Mr WOODWARD:** If I can add to that perhaps, the way the guidelines work, it does not encourage or discourage either PPPs or the issue that the union has raised. The union has met with us about that issue plus some concerns about us not having strong enough comments about the industrial risks in the guidelines and we are in the process of reviewing and including some additional comments around that issue, together with other things. The guidelines are under constant review, so the next review will incorporate their concerns about that issue.

**CHAIR:** I think it is a fair enough concern. When the union gave its evidence about the industrial risks and the risk to employment in terms of where a PPP may be introduced we certainly had evidence from the British example where, in the early days they did not have a position, for instance, in terms of employment protection or transfer of employment, or even from one PPP to another PPP, but in latter years apparently, according to their evidence, they now address that as part of their guidelines and as part of the policy. I think the question comes about from the concern of the union which represents the employees as to the kind of industrial risk that you just mentioned.

**Mr PAYNE:** Chair, I think it is undoubtedly a factor but I have to be incredibly careful that the role of this Committee and the role of the legislation is not expanded into what I would call merit based issues. It is something we can write into guidelines to make sure councils consider, but at the end of the day the type of the PPP and the ramifications of the PPP and so on are really matters for the council and the department, not this Committee.

**CHAIR:** Do you mean not this Committee?

**Mr PAYNE:** No, the PPP Committee.

**CHAIR:** What kind of advice, if any, has been sought by councils about implementation of the guidelines?

**Mr WOODWARD:** There has been some informal request for clarification. Generally speaking, they do not come to us until they have got a serious proposal. We in fact discourage them from coming to us until they do have a formal resolution from council to proceed because we do not want to become involved in negotiations around a particular proposal before it actually comes to us formally, so we actually discourage that. We encourage questions around how the guidelines work and we have run a series of seminars across the State to address those issues. We do that on a regular basis.

**Ms KENEALLY:** Could I follow up on that? Are there types of projects that lend themselves to PPPs at a local government level and either as a department or a community you build up a bit of expertise in dealing with those sorts of things and, if there is, could you give us an example of the type of thing that would lend itself to PPP at local government level?

**Mr PAYNE:** We are only seeing the front end of this at the moment because, as I said, it is new. The type of thing that lends itself to PPP is the provision of infrastructure. Councils generally have sites but they do not have the funds. The private sector has the funds but they do not have the sites. In some cases the community, through the council, can achieve new facilities and so on.

**Ms KENEALLY:** Swimming pools, leisure centres, that sort of thing.

**Mr PAYNE:** Yes. That is where we will see, at least for the time being, the major

emphasis, all around infrastructure.

**Ms KENEALLY:** Rather than service provision?

**Mr WOODWARD:** It is mainly around infrastructure.

**Mr PAYNE:** I think service provision will come.

**Mr WOODWARD:** So far it has been all around infrastructure and the predominant type is where the council owns land in, say, the CBD and has run down facilities and wants to redevelop but does not have the funds to redevelop, so then in partnership with the private sector the proposals that are starting to emerge are around redevelopment and then handing back facilities to the councils as their contribution.

**Mr TURNER:** How many has your committee looked at so far?

**Mr WOODWARD:** Formally we have only looked at three and we are currently looking at two. We have a meeting on today, looking at another two.

**Mr PAYNE:** Can I make a point on that question, what happens is projects will be referred to the department. If they do not meet the threshold value or they are deemed to be low risk, they will be returned and away they will go.

**Mr TURNER:** What is the threshold?

**Mr PAYNE:** The threshold value is 50 million or 25 per cent of annual income. The 50 million is obviously the big councils and the 25 per cent will be the smaller councils, or we deem it to be high risk. We have received, I think, three so far that have been referred to us that we regarded as low risk or did not meet the threshold and they were returned to the council to do what they wanted to do, and they involved a commercial compost facility, acquisition of a road to improve traffic flow through a shopping centre and the redevelopment of a civic administration building. We were obviously satisfied that those three projects were low risk to the council.

**Mr APLIN:** Following on the Chair's question about advice being sought by councils, I was wondering whether any had sought clarification. You mentioned that approval is not part of the department's process, yet clearly within the guidelines it is made very obvious that submissions have to be approved at some point, whether it is the pre-contract signing stage, but it states that councils may not sign a contract until such time as the process has been endorsed and later that a council having negotiated an arrangement may not proceed to sign a contract establishing a PPP entity without the prior approval of the Minister. Is there some confusion in councils about the approval process?

**Mr PAYNE:** We issue a frequently asked question brochure which actually answers that, and it is a question that comes up often but we say here that the committee does not approve or refuse projects. It checks that the project has followed the processes set out in the guidelines. Its primary concern is to ensure that the project's risks are clear and well understood by all parties. The committee is not concerned with the project's vision or appearance, but rather with the risk exposure to ratepayers now and in the future. If it is not supported at the committee level there is nothing to stop the council going back and revamping it to conform with the guideline. That is all we are doing. I admit that it is often seen - we have to be very careful that it is not seen as approving or not approving the project, it is really the process.

**Mr APLIN:** In that situation how will the department's guidelines dovetail with New South Wales Treasury's Working With Government guidelines on PPPs?

**Mr WOODWARD:** They dovetail in that we used the principles in the Working With Government guidelines and we used the agencies who developed those guidelines to help us with our guidelines, so there are some small differences around definitions and so forth but, other than that, the broad principles are the same.

**CHAIR:** How has the process of risk assessment and allocation via a risk management plan worked to date?

**Mr PAYNE:** Can I clarify that? How it performs the process?

**CHAIR:** The process of risk assessment and allocation.

**Mr WOODWARD:** It is working very well. What we require is the council to get an independent assessment of the risk and our process is to check that that has been adequately done. If we suspect that it is not being done properly or has not been done properly we are able to engage independent bodies to review that process and then to start again and make sure it has been done properly. So far we have not had to do that. We have on our Committee Treasury people who examine the risk, and the financial risk particularly, and advise the committee on that. So far we have not had to go for independent advice other than what has been provided to us. The message is out there very clearly that you do need to not just shop around, for instance, and get the advice you want, but you need to make sure it is properly done and verified.

**Mr PAYNE:** Chair, we have a small allocation to actually engage expert consultants if we need to. I think that will be the case. Some of the proposals that are on foot now involve, for instance, retail space. We are not experts in retail space but we can engage an expert, an independent expert, which is sometimes difficult to get, which means we may have to go interstate. If we have any concerns we will engage somebody with that expertise.

**Mr TORBAY:** I am interested in when a PPP is being negotiated. The overseas experience was, particularly in the early days, at local government level that it was a pretty steep learning curve for them and the skills issue within the council was significant and they started off in some councils internationally adding some of these duties on to some poor person's duty statement and then finding there are so many issues involved that the private sector were too slick in those negotiations. I am interested in how you deal with that and are we, within our guidelines, letting councils know what is actually involved and some of the significant issues involved that cannot be just added on to somebody's job?

**Mr PAYNE:** That is a good question. The Liverpool council has to be the greatest example of the private versus the public sector. The message we have been sending out with all of these - bearing in mind some of these start with a phone call saying: We have got a really good proposal here. A guy has just arrived in town and he can do a really good thing for the town. That is the first cause for concern.

**Ms KENEALLY:** That sounds like the basis of "The Music Man".

**Mr PAYNE:** We get them all the time. A lot of these projects are actually headed off before they start. I think you are right, it is not core business for councils. When they do have a serious proposal or they want to be serious about it we ask them to go off and get some other advice. One of the things that I think will happen over time is that we will be able to learn from the experience of this Committee and refer them to other councils that have been burnt perhaps. It is difficult. You really cannot buy the expertise in. What they tend to do is hire a consultant. You have to be careful of that process as well, that the council does not get captured by the consultant.

I can recall a meeting where I had a council, the mayor and staff and I was asking questions and the consultant kept answering the questions and I actually wanted to hear from the mayor and the

general manager. It was fairly clear that the mayor and the GM did not really understand what they had hold of. That is also cause for concern. A lot of our work is informal and is communication backwards and forwards. In fact, that is the way that the department generally works any way.

**Mr TORBAY:** It is good to know that you are on to that because it is an issue in my opinion.

**Mr PAYNE:** It is a major issue.

**Mr WOODWARD:** Because of that we have included in the legislation that the general manager has to certify that the guidelines have been followed. That makes them pay attention because they have to actually sign off on it and it has to be by council resolution, which makes the councillors have to pay attention as well because they need to understand it and we have actually enforced that. We have also put in the guidelines a requirement that the council capacity has to be one of the issues that is addressed to make sure that they are not being walked all over by the private sector. The private sector in fact likes that too because they do not want to go into partnership with a body that cannot deliver.

**Mr TORBAY:** What I saw was horrific over there, but the private sector was just shredding them and the public sector was incapable of responding. It was like dolphins swimming with sharks, as they say. The private sector was saying it would be better if the public sector could come up because it would be better and there would be more PPP deals if they could get the formula right.

**Mr PAYNE:** The private sector say, and quite rightly so, that it costs them money to in fact develop proposals. They do not want them to fall over.

**Mr APLIN:** Having developed these guidelines, do you see an opportunity for the department and local councils to share their knowledge of PPP management across other agencies and therefore use the work that you have undertaken?

**Mr PAYNE:** I think the answer is yes. My first port of call would be interstate local government entities and we do get questions from interstate on this. Basically the guidelines are common sense and they could apply anywhere, so I think they should be shared at the State and perhaps Federal level and so on, yes.

**Mr APLIN:** Other agencies of the departments as well?

**Mr PAYNE:** Other state agencies?

**Mr APLIN:** Yes.

**Mr PAYNE:** Yes. Everything we do will be open and will be included in our annual report. Equally I would like to know what they find as well.

**CHAIR:** A criticism that the Committee has heard of PPPs in the government sector relates to perceived lack of capacity to manage PPPs. What is your view of the capacity in the Department of Local Government to address PPP management issues and within local governments themselves?

**Mr PAYNE:** I think, as my deputy said, we have undertaken a fairly intensive education campaign around this PPP legislation, and we have had state-wide seminars, and the point we are pushing is that councils need to develop that expertise or have that expertise available, but probably more importantly to recognise when they do not have it. The department will work with any council at any time to ensure that they in fact approach PPPs on a reasonable basis. They are not things that are going to happen over night. One of the criticisms we often get is that the process may be too slow. I always get nervous if they want to fast track a process. I make no apology for that. We will

go through the guidelines as we need to. The difficulty for councils, as I said earlier, is that they may only come across a PPP once in a lifetime, a major one. How do you develop expertise in-house on that basis?

What is possible though - and I would like to see - is local government share their expertise, so if, for instance, one council has been through a major exercise successfully, the staff in that council make themselves available for other councils, so there should be some networking, just to ask questions. There are a lot of pitfalls in this.

**Mr TORBAY:** It is an opportunity for someone as well?

**Mr PAYNE:** Yes.

**CHAIR:** What do you say about evidence we heard earlier about what is a perceived lack of evaluation post-PPP? In other words, all the emphasis at the moment seems to be on the pre-PPP.

**Mr PAYNE:** Well, project management is something we look at, but at the end of the day, once it gets the tick, the management of that project from then on really has to fall with the council. Where we do capture it though is, if there is a significant variation, it has to come back to the committee. There will always be variations of contracts but if, for instance, they are going to double the size of something, we would expect that project to come back in and be regarded perhaps as a new project. That was designed also to make sure there was no PPP splitting. In other words, you have two projects at 45 million rather than one at 50 million. We have the right to call back in any project or call a project in irrespective if we deem it to be high risk. Once it is under way and contracts are signed it becomes a little more difficult, of course, but maybe there would be other ways to approach that through a more investigative or inquiry process, but we hope this will not happen.

**Ms KENEALLY:** Trying to understand your process, if you were the RTA you would use a public service comparator to evaluate a proposal. Is there a PSC process in your assessment of a PPP proposal?

**Mr WOODWARD:** We require them to go through the same process as the Australian Standards, and we have referred to that in the guidelines, so it is identical in that sense, and Treasury, being our committee, would make sure that that has been covered properly.

**CHAIR:** Thank you very much for taking the time to give your evidence today.

**(The witnesses withdrew)**

**ANTHONY JOHN POULTER**, Project Finance Adviser, PricewaterhouseCoopers, 201 Sussex Street, Sydney, sworn and examined:

**CHAIR:** Thank you for your comprehensive submission, which includes reference to PPP transactions internationally as well as social infrastructure PPPs in New South Wales. The procedure will be that I will ask the first questions and then open it up to other members of the Committee. Thank you for coming in today. The Committee is pleased to hear your evidence. I am advised that you have been issued with a copy of the Committee's terms of reference and also a copy of the Legislative Assembly Standing Orders 332, 333 and 334 that relate to the examination of witnesses. Is that correct?

**Mr POULTER:** That is correct.

**CHAIR:** The Committee has received a submission from your organisation. Is it your desire that that submission form part of your formal evidence?

**Mr POULTER:** Yes, please.

**CHAIR:** Would you like to make an opening statement?

**Mr POULTER:** Very briefly, if I may. We do a lot of work in the PPP sector. We think PPPs are very often attractive solutions to infrastructure and other problems, but not always, and they need to be done properly obviously. What I have tried to do in this evidence is set out some of the issues that we think bear on that from our experience and I hope they address the terms of reference. I will not give a longer introduction than that, but would be interested to try to answer questions.

**CHAIR:** Could you expand on your view that the Working with Government guidelines need to be updated in terms of standard commercial principles and for setting the terms of payments?

**Mr POULTER:** Yes, thank you. The Working with Government guidelines are now a few years old. There are lots of good principles in them, which are well understood and observed, but there has been a learning curve in a number of jurisdictions, including in New South Wales, over the last few years with new deals being completed, and some not being completed, and I think that experience could usefully be codified in some areas to give guidance rather than rely on people understanding what is being done in those precedent deals, I think that is a natural process and that is what we were referring to in the evidence.

**CHAIR:** You identify the need for further improvement in assessment of preliminary costing for projects. How do you think that can be improved?

**Mr POULTER:** Well, I think it is perhaps important to make a distinction between capital costs and ongoing operating costs or through-life support costs, as they are sometimes called. I think most people would say that, although forecasting capital costs is difficult and there is always a margin for error, and that you are more likely to get it right on a portfolio basis than you are to be absolutely right on a particular project, despite those qualifications I think most people would say that certainly with assets like schools and hospitals there is a reasonable degree of confidence in the public sector's ability to cost. I think it is sometimes more difficult on longer-term operating and maintenance costs. Sometimes the public sector is asking the private sector to apply standards which have not previously been applied or which, if they have been applied, have only been applied recently; and there must therefore be a greater degree of uncertainty about the ability to forecast. That matters in terms of the public sector comparator, but I think it also matters in terms of the public sector's degree of confidence in the numbers it is forecasting for the commitments it will be entering into under the contract, however it is procured, which can be important to everybody, because if you enter a procurement process and then find that, for maybe understandable reasons, there has not been a full understanding of the long-term operating costs, you can have budgetary problems and need to revisit the specification or look at the way the project is going to be funded. So it is particularly in the area of through-life costs that I think more work could sometimes be done on what the long-term estimates

are.

**Mr TORBAY:** We heard some evidence that some of the projections given earlier were plus or minus 50 percent, which pretty much I think was a guess, quite frankly, in terms of capital. Are you referring to that as well? How do you tighten up those examples, because often the capital costs are far greater than the Minister or Government originally announces. It is just relevant to that point you made.

**Mr POULTER:** On capital costs the degree of confidence you can have in estimates obviously increases the further you get along the process, so if some preliminary design work or at least a detailed specification has been done I think most people would say you can get a much greater level of accuracy than plus or minus 50 percent. I think the question is whether it is plus or minus 10 percent or 20 percent and it is very difficult to generalise about that. It depends on the nature of the asset and the amount of work that has been done.

**Mr TORBAY:** And that tightens up as the work goes on?

**Mr POULTER:** Typically, yes.

**CHAIR:** We had some observations made earlier about the perceived lack of evaluation processes post-PPP.

**Mr POULTER:** Yes.

**CHAIR:** Does that tie in with your terminology of "through-life costs"?

**Mr POULTER:** I think that is an important but separate point. If you have a 30-year contract there will usually be construction costs, but then maintenance and operating costs over a 25 or 30-year period. I was referring to the ability to forecast those costs before the contract starts and how accurate those forecasts are. There is then a question about, once the contract has been let into, how well are you supervising the performance of the contract operationally and the costs that actually come out of the formulae under it, which is a slightly separate question, but an important one.

**CHAIR:** The other point that was made earlier was the question of what is a long-term project, whether or not in this country 30 years is deemed to be a long term project whilst apparently in the UK there are 60-year projects, which I imagine would double your example of through-life costs?

**Mr POULTER:** It would double the period, certainly.

**CHAIR:** Maintenance would increase?

**Mr POULTER:** Yes. I think there are probably three things determining the appropriate length of a contract. One is the nature of the asset and the service. Generally speaking, the more capital intensive the asset, the more potential there is to have a long-term contract to spread the cost and allow optimal spreading of maintenance and so on. The second thing is predictability of those costs. To ask the private sector to commit to costs for 30 or 60 years in terms of maintaining a simple building might be quite easy, but in some other more complex service areas it could be pretty difficult. The third question is: Do the financial markets help to spread the cost? Can you get long enough finance to spread the cost? I think, generally speaking, the reason there is a 30-yearish norm in contracts internationally is that in most mature financial markets you can often get finance of 30 years or a bit more. Generally speaking, I think there are diminishing returns in contracts longer than 30 or 35 years, but there are exceptions to that.

**CHAIR:** Can you expand on your alternative model for toll road funding?

**Mr POULTER:** Yes, certainly. There are models that have been applied elsewhere in the

world where the private sector designs, builds, finances and operates a toll road but gets their income not purely, or not necessarily at all, from tolls paid by users. The alternative payment streams that can be put in place are called availability payment streams, which essentially means that there are standards of availability and performance specified in the contract and the government pays according to that performance. So, for example, if a road is operating with the right surface condition and the right number of lanes open there is payment for providing that asset and that service, irrespective of the level of traffic using it. There have also been models which are not now so common or so popular of what is called 'shadow tolling', where cars and vehicles are still counted when they use the road and a payment is made according to vehicle numbers, but it is made by government rather than by the user. I am not particularly advocating that second model.

I think the advantage of the availability payment stream is that it allows government to hold the private sector to performance but to retain its own policy responsibility for what happens with traffic management and surrounding roads, and also to take the risk (which arguably it is in a slightly better position than the private sector to absorb), of what happens generally to traffic patterns and economic growth and traffic levels, particularly in a city.

My general view would be that in urban areas there is a case for considering the alternative payment mechanism that I am referring to. It may be that on relatively simple point A to point B roads that are not in complex urban traffic patterns that a toll road is fine. That is what I was referring to, Chairman.

**Ms KENEALLY:** In the case that you have just described is that not simply a build, own and operate scenario? All the risk still resides with government in that regard. I don't know if you would necessarily class that a PPP.

**Mr POULTER:** I think it is a PPP in the sense that the private sector is taking performance risk on whether the asset does what is intended, so they would be taking the risk of not having lanes available, having to spend more time on maintenance. You can also structure it so they take risk on surface condition, on certain aesthetic considerations and even on, to some degree, safety track record. There are contracts in the UK where some elements of payment depend on safety.

The private sector is taking risk where it can control it. What it is not doing is taking the risk on traffic levels, and of course there are hybrid structures you could create where they are to some extent taking risk on traffic levels but also taking risk on availability. It is a spectrum, it is not a black and white option. As I tried to set out in the submission, there are arguments against, in some circumstances, the public sector delegating all traffic risk if either traffic risk is part of a complex traffic management pattern or there is not any traffic risk because it entirely depends on economic growth not the performance of the road. Is it efficient for the private sector to take that risk? I think that is questionable.

**Mr APLIN:** Do you believe there is sufficient expertise in agency PPP teams to manage and monitor projects and how could that be improved, if improvement is required?

**Mr POULTER:** I think it is growing. I do not think we are yet at the level where you would say it is adequate in every agency that might be considering PPPs. I think that is inevitable. It is part of a learning curve. If you look at jurisdictions where very many deals have been done, the same situation would have applied when only five or six had been done. I think it is being addressed in some ways by bringing expertise into the central agencies, particularly of Treasury and the infrastructure implementation unit, and I think that is the right thing to do. I think a little more could be done by way of having secondments into the public sector from the private sector. I do not know whether that is planned in New South Wales, but it is certainly something which has succeeded in other jurisdictions.

**Mr TORBAY:** Can I add to that? The differentiation between the skills within the private and the public sector, how do you think that is measuring up? Some of the evidence we have seen is

that the public sector struggles a bit in terms of its expertise when compared with the private sector.

**Mr POULTER:** I think there are two ways to look at that. There is basic competence and ability. In the central agencies there is no doubt that the ability of the public sector people is as high as the ability of the private sector people and as high as you would see in the best jurisdictions internationally. You might say that there are only 10 or 15 such people, and it would be nice if there were 50, but the 10 or 15 I am referring to, I do not think there is any doubt about their ability. The second thing is when you try to disseminate information and experience to actually allow people other than those few to negotiate deals, how well is that done? I think it is a common syndrome around the world that the private sector is better at making sure that, if it has done deals like this before, it applies that experience in New South Wales, even if the previous deal was in Victoria or the UK. I guess that is partly to do with the structure of the private sector being more innately international than government by definition, and maybe it is to do with fleetness of foot. That is something that can be overcome by transferring people, by training and by deliberate efforts to transfer knowledge. I think that is being done.

**Mr TORBAY:** On the point about secondment from the private to the public sector, which I think is a good thing but does create some potential conflict issues, is this allegation we have heard about poaching from the public real, the private sector poaching the public sector, a lot of skills shifting around in that area? Is that real? Have you come across that?

**Mr POULTER:** There are cases of people who have been in the public sector going into the private sector. There do not seem to be very many here compared with what I am used to seeing. Perhaps I should declare an interest. I used to be a civil servant in the UK so I am an example of that. By all means question me if you want to come back to that. On the conflict of interest issue that you referred to, my own view is that it is overstated. In any industry where the public sector is contracting to the private sector there is a panoply of arrangements to discipline conflicts of interest and probity, which I think work very well, and the very fact that even if everyone stays in the same sector you can have advisers and participants on one side of a deal working with the private sector, and then on the other side working with the public sector means there is not a complete divide between them. So I think it is sensible to try to access the best experience and get it into the public sector to do the deals, subject to the normal controls. I think there is potentially too much reticence about that in New South Wales. There is a very strong focus on probity and conflict of interest, which is desirable, but I think it does not need to lead to this being so compartmentalised.

**CHAIR:** What sort of information about contract performance do you believe should be made public?

**Mr POULTER:** I think information about metrics that are relevant under the contract such as availability measures, key performance indicators, whether they are to do with availability of assets, performance of catering, performance of other aspects of maintenance, or support services in buildings. Under a railway PPP, such as the one that is being negotiated here at the moment, I think you would expect to see the metrics under the contract for key performance indicators on maintenance performance and making trains available - all the things that go to the commercial obligations of the private sector supplier.

**Ms KENEALLY:** I would like to look at your comments on the need for standard frameworks for quantifying risk. I would like to see you flesh that out a bit more. What elements should be included in that framework? This is on page six.

**Mr POULTER:** This is not an easy subject and I am not pretending that it is. The guidance at the moment that is published on public sector comparators is pretty high level. There has been quite a lot of experience about how to do risk workshops, how to quantify risk uplifts, how to take account of the way in which those risk uplifts should be aggregated across a project. Clearly you do not add them all up, you have to look at scenario analysis, and also the relationship between risk

uplifts and discount rates. There is not a lot published on that and I actually think that providing guidance on this, so that people doing projects understand what the lessons have been in more detail, and so that private sector people bidding understand more what the approach is going to be, would be desirable for all parties.

I do not think this needs to be a huge tome or operations manual. I think taking principle down two levels to how you do this and some examples of how it has been done in the past would be helpful for everybody.

**Mr APLIN:** What sort of detailed guidance would you envisage should be provided regarding the public sector comparators?

**Mr POULTER:** That would be one of the examples. I think there is already enough guidance on discount rates. The key thing is the underlying costings which we discussed 10 or 15 minutes ago, particularly whole of life costs and the risk elements within those, how they can be estimated and quantified using statistical techniques in some cases. Those are the two most important areas.

**Mr TORBAY:** You have touched on it, but risk allocation generally, how would you improve the understanding of risk, the allocation and the expectation of who is ultimately responsible with these projects?

**Mr POULTER:** I think there is a pretty good understanding of the principles now on both sides.

**Mr TORBAY:** There has been an improvement, is what you are saying?

**Mr POULTER:** It has certainly improved over the last three to five years and that is natural. I referred in our submission to the fact that the principles are not always applied in practice. And this is not because people determinedly ignore them. It is because you will always get posturing and game -playing in negotiation, and a lot of the complaints that one hears - about bid costs and reinventing the wheel and not following standard contract terms - are a function of that. People will say "I know that is what the guidance says but before that guidance was fully understood there were two or three other deals where we did something different and if we take the best parts of all of those we would have a better deal, and even if we are not going to get it, it is arguably better to put that on the table so we have got some negotiating margin". Then the other side does exactly the same and you end up with a process which is work intensive and costly. I think the real issue is not the understanding of principles of where a risk should be allocated.

**Mr TORBAY:** It is the practicality.

**Mr POULTER:** The real issue is the practicality of game playing on deals, of which both sides are guilty.

**Ms KENEALLY:** Would standard contract terms be useful? That is an argument we have heard.

**Mr POULTER:** I think standard contract terms are useful but it is more important to have a consistent application of the principles. The trouble with standard contract terms is that it is very easy to write standard contract terms that are of universal application on the easy bits. It is more difficult to do that in a way that is productive on things that are unique to particular sectors, whether it is a new sort of road, or a hospital, or a rail scheme. I think people in the UK, where there have been standard contracts now for five or six years and several generations of them, would say they are useful but you can put too much emphasis on them. To go into a vortex of standard contract drafting is not necessarily within everyone's interests.

**CHAIR:** Some of the evidence we have been given would suggest that the lack of standard terms leads to a lack of clarity in what is required. What would you say about that?

**Mr POULTER:** I think it is true that you can only be 100 per cent clear about what is required when you have written it down and negotiated it. I have nothing against standard contracts. I think sometimes they can be quoted as the reason for the problem because this is an easy thing to quote, whereas what is really important is the clear principle on how you allocate risk in termination scenarios, for example; not having the drafting, which you need to put out to tender to avoid any ambiguity project by project. If you have standard contract drafting it will need amending project by project anyway, so it is the application of principles that is important.

**Mr TORBAY:** One of the major reasons for standard contracting which has been put up is that we are trying to reduce legal costs which have been enormous in some of those projects, and what you are saying is that is fine but every time you have to amend something you have still got to get in there and make those amendments.

**Mr POULTER:** Yes. Just so that I am not misleading the Committee, I think standard contracts are important. They are valuable but they do not solve everything. Yes, you generally have to tailor them.

**(The Witness Withdrew)**

**(Luncheon adjournment)**

**DAVID THOMAS RICHMOND**, Special Adviser, Infrastructure Implementation Group, Premiers Department, Governor Macquarie Tower, 1 Farmer Place, Sydney, sworn and examined:

**CHAIR:** Thank you for agreeing to appear before the Committee today. The Committee is aware of the Review of Future Provision of Motorways in New South Wales, which the Infrastructure Implementation Group prepared in December 2005. Its recommendations for Government policies and processes for future motorway projects (insofar as they are PPPs) and requirements for public disclosure have relevance for this inquiry. We welcome the opportunity to discuss these matters with you. The procedure will be that I will ask the first questions and then open it up to other members of the Committee. I am advised that you have been issued with a copy of the Committee's terms of reference and also a copy of the Legislative Assembly's Standing Orders 332, 333 and 334 that relate to the examination of witnesses. Is that correct?

**Professor RICHMOND:** It is correct.

**CHAIR:** In what capacity do you appear before the Committee?

**Professor RICHMOND:** I am a part-time adviser to the New South Wales Premier on infrastructure issues and it is in that capacity that I am here today.

**CHAIR:** The review recommends that the policy of motorway procurement at no cost to Government should be abandoned. Could you please expand on why this approach was recommended and should that policy extend to all PPPs?

**Professor RICHMOND:** The basic thrust of the review's recommendation in respect of the issue of no cost to Government was to move away from a situation where the primary focus of a motorway project became the objective of achieving no cost to Government. In my view and the view of others who worked on the review, that had obscured some of the important policy issues which were thrown into sharp relief by the Cross-City Tunnel. In the effort to achieve no cost to Government, important public policy issues such as the way in which the urban domain improvements in William Street were funded, the issue of the extent to which roads were closed, all of which were issues which required deliberation in their own right as policy issues, were obscured by this overriding concern to achieve a no cost to Government outcome and that, in my view, is at the heart of many of the issues that have arisen from the Cross-City Tunnel in particular. It was therefore the very strong view that it would be better if governments did not have that as the starting point but rather they had specific objectives for a project. If they decided that it was a project worth proceeding, the project was then approved. If it was then determined, on the basis of various criteria, that it would be appropriate for it to be a PFP or PPP, that process would then determine the extent to which Government had to contribute to the project and that process is one which is relevant to motorways but is also relevant to all projects.

The answer to the second part of the question is that it should be the character of the project, the financial arrangements, the assessment of the benefit and the costs that determine how much the Government is prepared to put into a project, which is primarily being offered to the private market as an investment vehicle. Obviously there is always an onus on Government to get best value for the taxpayer, but best public benefit may sometimes involve a Government contribution, as has been the case in a number of other projects, not including one road project - the M2 - but in a number of other projects where it has made sense to provide a relatively modest Government contribution that has actually leveraged quite substantial private sector contribution, but it has meant that the policy issues stay in the control of the Government.

**CHAIR:** Evidence was given earlier from PricewaterhouseCoopers on a suggestion that perhaps Government should maintain the payment. In other words, that the number of road users be monitored and that the Government actually make the payment so that it maintains control. Do you subscribe to that view?

**Professor RICHMOND:** The issue is that increasingly in a modern city like Sydney we are

looking at a series of important infrastructure networks. Roads, of course, are very obvious and we all experience the impact of that network, therefore, it is imperative that Government controls the network because what happens in one part impacts users in another section of the network, so a central thrust of the report was that that control should be reaffirmed and the Government not do anything, even though it might be financially beneficial, which gives away that control.

The issue of how you then engage private sector investment is a second issue and that can be done in different ways. It can be done, as has been done quite successfully with some of the road projects such as the Westlink M7, where you have contribution from two levels of Government and a very substantial private contribution of equity in debt and tolls, and that has worked in that situation. It suits the characteristics of that project. But it could also be the case that the Government could seek to have the private sector build, own and operate roads and then charge an availability fee to the Government for a period of a concession and that would be vetted and tendered against in the process. That is quite a viable way of getting private financing into the system and it is something that has been done in other countries, particularly in the UK. I know that PricewaterhouseCoopers has looked at that because they have strong experience in the UK.

**CHAIR:** What is your view of the New South Wales Treasury's Working with Government guidelines? Should they be strengthened? Should they be, as others have indicated, requirements rather than guidelines?

**Professor RICHMOND:** Well, obviously the guidelines will now be strengthened because the Premier and the Cabinet have adopted the 32 recommendations of the Review of Future Provision of Motorways that we undertook in December. The way in which a number of those recommendations will be given effect is to change the guidelines and that will impact in a number of areas, including the guidelines for public disclosure and also areas in relation to the decision-making process in Government where we make some very specific recommendations about a more hands-on approach by the Cabinet subcommittees in making sure that through the life of the project there is much more strong whole-of-Government accountability for key decisions. So that when projects are commissioned and opened there are, at a minimum, no surprises and there is a very clear accountability that there has been proper discussion, so the guidelines do need strengthening in regard to implementing our recommendations and that will occur progressively.

In terms of the general issue of guidelines, my memory of the documentation is that there are parts of it that probably could become mandatory. I think there does need to be some discretion available to agencies because the difference between projects can be quite significant and some things make a great deal of sense for one project and not for another. I think there is a case for looking more closely at sections of the guidelines that should be mandatory. For example, some of the recommendations that we have made about the Government deciding on which points will the project come back to the Budget Committee of Cabinet and then mandating that that happens - I think that is the kind of thing. Similarly in relation to our recommendations on public disclosure, which would be dealt with both in the guidelines and in directions to be issued by the Premier. We would certainly see that our recommendations about contract summaries and the like should be mandatory, and directions from the Premier, not just guidelines. That would be my view. But I would still suggest that there are many issues in the guidelines where flexibility is required because projects are different and also because the classes of assets that come into this area of using project finance for the funding of public infrastructure will change over time and there will be different considerations, so my answer is really that some of it should be mandatory, but it still should stay generally as a guidance document with some clear sections that are mandatory.

**CHAIR:** You have also indicated that the review generally supports new draft Treasury guidelines in relation to public disclosure. How do these differ from existing guidelines? What is the current status of those guidelines? What is your understanding of how they would apply? Would they be legally binding in your view?

**Professor RICHMOND:** The recommendations about disclosure are recommendations about government policy. I have not suggested and would not suggest at this stage legislation. I think

we are still in a very steep learning curve on this issue on the release of detailed documentation, but essentially the priority policy recommendation is that all of the contract documentation should be released and that that should be a matter of government policy and something that agencies have no choice in relation to.

At the same time I am very conscious that in certain circumstances there is material in the contract documentation which, if it were released at a time when negotiations are still going on, for example, you may well have selected a consortium to do a project but they may still be negotiating with subcontractors and release of some of the information that is contained in the documentation may disadvantage the consortium, given that they, by virtue of you signing a contract with them are your partner, it would be inappropriate to do that and it only puts pressure on the government to exchange the contract at prices much higher than they should be. I think we have to be careful about that.

My suggestion is that the contracts should be released but the timing ought to be agreed with the Auditor-General and an agency should make a case for saying there are a hundred documents however this part of this document, or this document, should not be released at this time but it can be released in, say, three months time when we have finished the negotiations or the consortium has so they are not disadvantaged by that. The government itself has within that framework of disclosure critical commercial information which might influence some of the government's ongoing relationships and if some of that were to be released in a contract when you are in the process of or about to negotiate another contract that, in my view, would not be in the public interest because the government could probably end up paying perhaps more than it should. There needs to be some discretion there.

The suggestion was that that kind of sequencing as a matter of principle should all be released, a timetable set, but if there is an argument about certain things not being released that that be put to the Auditor-General and you agree a timetable when they would be released. The other area, of course, is the discretion of the Parliament. It is always open to the Parliament to call for the contract documentation in its own time rather than the time of the government. There our concern was again that some more emphasis be placed on some of these potential pieces of information which might compromise the government in doing the best for the taxpayer, perhaps in the next deal, and that there is a more mature process where that is considered a bit more by the arbitrator who looks at these things in the Parliament.

The very strong recommendation is that it becomes mandatory to release all the contract details but there is some sensible approach with the Auditor-General about some of the areas where it would be a case for not being in the public interest by providing information which could result in the government and its partners paying more than they should.

The other issue is the contract summaries and it is very important when we look at these contracts, which are massive, that we do not lose sight of the very important role that the contract summary plays. It is the window into the contract. It is probably for 95 per cent, perhaps 99 per cent, of the population enough to help them understand the essence of the contract. For those who want to go further it is a wonderful guide for going into the detailed documentation. It is also an opportunity to describe the contract in prose form, which I think is very important for public accountability and for taxpayers and voters being informed, so we again stress the importance of maintaining the contract summary concept, making that a mandatory requirement from the Premier, not just saying you may issue one but that you must issue one and again, that should be the process and the timing of that should be agreed with the Auditor-General because whilst it would be easy to impose an arbitrary timeframe again that may or may not make sense in the case of some contracts.

The other variation that we have recommended there is that it is not just the contract, the primary initial contract, but it is the subsequent formal amendments and the variations that also ought to be released and summarised because these are living documents. The 30 year contracts, and

sometimes longer, will change and it is very, very important that there is built into the process an opportunity for the public to be informed of the changes, again in a good plain English fashion, and then of course the opportunity to look in detail at the document. That is a further enhancement of the current policy.

**CHAIR:** We had observations made earlier that perhaps there should be more evaluation post the PPP and more ongoing evaluation over the long-term in terms of the outcome and delivery and the ongoing costs, but there was also an observation that the Auditor-General at this stage has no role to play in reviewing the private component of a PPP. Do you have any comment on that?

**Professor RICHMOND:** I think that relates to the notion that perhaps there would be some benefit in the Auditor-General looking at some of the financial modelling and areas within the bid put by the private consortia. I do not think that is an appropriate role for the Auditor-General. With all due respect to the Auditor-General, who does a wonderful job, I do not think that he has the expertise -or she if it was a female in the future - has the expertise to do that. They would have to engage people who review that.

The way in which the PFP process works is that under the Treasury guidelines and with the guidance of the Treasury the proponent agency does have access to the highest level of financial and commercial advice on its retainer retained by it, and they are the best people to review those kinds of documents and to make an informed commercial judgment. I do not really think it is the responsibility of the Auditor-General. There is a broader policy issue that notwithstanding what the financial models may say, there are still issues about judgment. Just because there is a good and sound financial model does not mean that the judgments that have to be made are not still very much value judgments, so if you have two good proposals there still may be policy judgments that have to be made. The way in which the review addresses that is to encourage much stronger review in the budget committee so that there is much more regular review. That is decisions about, if you like, which financial model and therefore perhaps which proponent should be made by a cabinet subcommittee, in my view, so they are accountable for that then. It is not something that the Auditor-General can be held accountable for. The Cabinet committee then has the advice of the portfolio Minister, the agency, the specialist advisers, and I think they are in the best position to make that because some people would argue that sometimes the proposals have not been realistic, notwithstanding the quality of the modelling and perhaps others might have come to a different conclusion. I think that at the end of the day that is the job of Ministers and that is where I would put that.

**Ms KENEALLY:** In the context of the processes you have just described, perhaps you can tell us where the infrastructure implementation group fits in and particularly we have heard a lot of positive comment about PartnershipsUK model, is it the intention that the Infrastructure Implementation Group would be something similar to that?

**Professor RICHMOND:** On the first question, the IIG was set up by the Premier, as one of his first acts as he assumed the role of Premier, to assist him in facilitating implementation of infrastructure, unblocking some of the road blocks that sometimes occur both within government and within the planning system, and the way in which we operate is that we have a small number of projects where we are asked to assist agencies with the implementation of the project.

**Ms KENEALLY:** Asked by the Premier's office?

**Professor RICHMOND:** By the Premier. We would suggest some that we perhaps should do, but a number of the projects are projects where he has decided very clearly he wants our hands on the shoulder of the agency. The way in which we operate is that we stay very close to the agency and the management processes around that procurement, and if there are steering committees and project control groups we will make sure that we have a very appropriately skilled person, usually a person with both private and public sector experience representing us, and therefore there is a direct

communication to the Premier when issues arise.

If the project is still in its early stages we would be very involved in the concept work and we are working on a short list of projects, which includes the Port Botany expansion, the Enfield freight terminal, the Royal North Shore Hospital, Liverpool Hospital Stage 2, and they are all in different phases of progress, plus we are doing some more general work on a motorways review, on freight strategy for Sydney and we support the Infrastructure Planning Committee of Cabinet. We are very much a facilitator. We are not a primary policy agency.

In terms of the management of the partnership projects which involve particularly private financing, the responsibilities centrally there largely rest with the Treasury and Office of Infrastructure Management under Dr Kerry Schott and that is a capability that has been very much strengthened in the last two years, particularly by Dr Schott's appointment and again, though, their role is very much guiding and advising departments and agencies particularly on the financial aspects of projects, making sure that when the Treasurer and the Cabinet subcommittees sign off on projects they are fully cognizant of the financial and economic implications, and there has been a lot of work to strengthen that role.

I am not familiar in detail with the UK approach but I would be very, very wary of over-centralising these things. Coming back to the point I made before, we are dealing with quite complex sets of infrastructure and if you take, say, the roads system, the RTA was running, not quite in parallel but close to being in parallel, three massive projects; the M7, the Lane Cove Tunnel and the Cross-City Tunnel. Each of those projects has hundreds of stakeholders. Each project has many, many contracts, many, many subsidiary contracts. Each one affects that network. It is very difficult for that kind of process to be run centrally away from the portfolio agency running the network. You have to be very, very careful about that.

The better position, it seems to me, is that the Treasury behaves, as they increasingly are, very much as the Government's banker. When the private sector is putting its proposal in its banker is going through every detail. That is the role that the Treasury plays and then it advises the Treasurer and there is the capability under the legislation that the Premier brought forward late last year, I think, an Infrastructure Implementation Corporation which is really the Infrastructure Implementation Group in a statutory form, there is a capability there, if one decided, to actually take over a project and run it centrally. I would tend to use that as a last resort and I would caution against trying to centralise too much. What you need at the centre is good policies and procedures, updated guidelines and a good Cabinet process to make sure the right questions are asked, both of a policy and of a financial nature.

**Mr APLIN:** You mentioned during that answer skilled consultants or personnel within the private and the public sector. The Committee has been told of concerns in previous hearings that there is a skills imbalance whereby the private sector can better afford to employ those experienced PPP managers whereas the public sector cannot. Does the New South Wales public sector have sufficient expertise in its agencies to manage PPPs?

**Professor RICHMOND:** The short answer is at any time there is a shortage of that expertise. The capability is of two kinds. There is, if you like, the general ability to manage a complex process: tendering, environmental assessment, construction and the proposal for the private sector to bid. There is that level of capacity. That, I think, has improved a lot in recent years and I think a lot of what we learned from the Olympics has been transmitted across to other agencies. I think that in that area we have some sound capacity, but I would be very foolish to suggest that we could not do with more. So there is that general capacity to manage, which is one of the reasons the Premier set up the Infrastructure Implementation Group and one of our roles is to work with an agency and actually inject high-level expertise into the project delivery phases, whether it is early planning or not, so I think there is that kind of expertise.

The next level of expertise is the very complex expertise that is needed in terms of commercial, legal and financial issues. That is rarely going to be available in the public sector. You

are just not going to be able to get that on staff and increasingly the agencies that have been most active in this area have made sure before they have gone too far with the project that they have brought the best people for their side. What has happened is that there are a number of firms which have made quite conscious decisions to ensure that part of their strategic business is working with Government, so over the last decade the Government, in my view, has been able to put together teams which are comparable to the private sector teams in terms of the legal, financial and commercial expertise, but they are not on staff, they never will be, and the Government I think has realised that it does have to pay appropriate rates to get those people and I have not seen any evidence that the technical details of the positions negotiated by the public sector are inferior to the private sector. Indeed, there are some very clear examples where it has been the private sector that has had to come to Government and beg for help, not demand it. If they begged for help on such things as the airport rail link, it is a pretty clear indication that the power was in the hands of the Government in the way the contract was written and I do not think that technically that is an issue. There are still issues about whether the right policy has been adopted, and there was a concern when we looked at the motorways review, but the Government does have to pay for those kinds of services and we have built up the expertise.

Having said that, however, Australia is a very small market; we are in strong competition across the nation, and one of the challenges at the moment is to make sure that other governments in Australia do not bid up all those resources, and there is always going to be a shortage. So it is quite a challenging task. When I look at the teams, they have been very, very high quality teams. The public sector has done, by and large, quite well, particularly in the contracts negotiated in the last five or six years. That says nothing about other issues about policy and whether you would be better off borrowing money, all those sorts of policies, but that is not the point. The point is getting access to the best advice in the private sector and the Government I think has learned that lesson and is applying it.

**CHAIR:** In developing legislative and policy frameworks for PPPs and taking into account the public interest, how much weight should be given to the question of intergenerational equity?

**Professor RICHMOND:** Intergenerational equity, it seems to me, is a prior question. It is the question that arises when the Government is contemplating initially how much it will invest and, therefore, how much it will borrow for the funding of infrastructure. It seems to me that that is the point at which that issue is addressed. In other words, the decision to think about intergenerational equity is very much a decision about how much you borrow and how much you expect people to pay from the current budget or from the fees - the tolls in the case of motorways - that they pay at the moment. I think that is a broad issue that needs to be looked at in terms of the Government's overall position on how much it is prepared to borrow and what makes financial and economic sense in the long term for the wellbeing of the State. I think that when you get to a particular project the issue is still relevant, but by then you have, if you have gone down a PFP, which involves user charges, already taken a decision that a significant proportion of the capital will probably be recouped by users and that will mean both present and future users.

The point that I think we have made, perhaps briefly, in the motorways report is that some of the major public domain investments, the public spaces - the William Street boulevard and those sorts of things - you really have to see as a long-term investment and that is the kind of thing that perhaps the Government should put its own funds into rather than asking the user of the road to pay for. I think it is an ongoing issue that constantly is looked at, but fundamentally it does come back to that initial decision as to how much of this do you want to fund from the Government's borrowing, how much do you want to fund from its recurrent income. If you are going to look at the borrowing, well, you are making a decision about people paying in the future. A fundamental characteristic of most of these assets is that they are very long-term assets, so it is almost a contradiction in terms not to expect people to pay in the future for some of their share. It is a question of what the balance is of their share and indeed it is a pessimistic view of the future if you do not think that they can pay their way too. So there has to be a balance, but the overall situation is very much an overall budget position that you strike a sensible balance between how much the Government borrows and that in itself puts an imposition on the future. It is a judgment call and people will always have different views about that, but the critical thing is that you maintain a basically healthy State economy and with the State budget

and balance sheet position, but at the same time you try to strike a reasonable balance between current users and future users paying. Some things lend themselves easily to that; others are much more complex where it is very difficult to predict who will be major beneficiaries. These are long-term projects. We do not know on some projects whether most of the benefit will be - if you assume that something had a 50-year life, sometimes notwithstanding the best guesses of people it is not always clear that the major beneficiaries will be the people using it from year 40. Parklands are a classic example. If you invest in massive parklands, well, you don't do it just for now because that is self-defeating, but it may well be that the greatest beneficiaries are going to be in 20 years' time. So that is a constant judgment for Government.

**Ms KENEALLY:** When Treasury appeared before the Committee it made a clear distinction between investment decisions and procurement decisions and argued that there should be two separate processes for Government. This would seem to be consistent with your report. I was just wondering if you could comment on that?

**Professor RICHMOND:** It is totally consistent. I think, as I said before, the decision that a project is worth doing is the first decision. That decision is a considered decision and the Treasury has substantially enhanced its processes for reviewing projects and what we recommend is that there should be that rigorous evaluation before the project goes on to a forward infrastructure plan. Then the issue really should be considered as to how it will be funded and part of the consideration of how it will be funded will be the feasibility of different methods of funding. Some things simply do not work as private projects because it is a very difficult project and the product could turn into something that can be funded through some private arrangement, but the decision to procure the project and, in particular, to procure it using the method where there is private funding - the PFP method - is a subsequent decision and that needs to be aligned with other policy considerations but also whether or not other techniques are better. I think it comes back to the no cost to Government. Some people think: Well, this will be easy, it won't cost the Government very much. Indeed the classic sort of unsolicited proposal from the private sector is always: This is not going to cost you anything. However, often by the time you come back with the third version you have discovered that it is going to cost you quite a lot. So again it is really important: The project must stack up in economic terms and in social and policy terms. The next step is the procurement method, whether it is a technical discussion about the design and construction or whether it is a project where it makes sense to bring in private finance.

**Mr APLIN:** The Committee has heard that for some PPPs the cost of monitoring has proved to be higher than anticipated. Would you comment on what was your experience with PPPs with which you were involved and how is the cost of monitoring being translated into calculating transaction costs for subsequent PPPs?

**Professor RICHMOND:** We recognise that issue and I think one of our primary recommendations made the point that you really have to be able to justify the transaction costs in the process because the transaction costs are quite high and our first recommendation about continuing to use PPPs and PFPs had a number of qualifications. One is the scale of the project would warrant the transaction costs involved in procurement using this method because they are higher. They are partly higher because you are actually trying to sum-up in year one all the costs, so in a sense you took everything into account and one of the great benefits of these kinds of projects to the public sector has been greater discipline which has been translated into other kinds of projects. When you sit down to negotiate with the private sector you must have funding assignments for all of the foreseeable costs, so yes, it is going to be more costly, but also you are entering into a series of complicated contractual arrangements where you must have the best advice available, as we talked about, so the costs may be going to be higher. Part of the assessment as to whether you do it should be what will be your costs in managing the project to get it to completion and then, if it is going to be operated by the private sector, to operate it? For example, in 1995 when I was given the wonderful opportunity to head the Olympic Co-ordination Authority, the previous Government had decided that a whole lot of the small Olympic projects should be PFPs and we had to go back to the Carr Government and get that decision reversed because we did our calculations, we used our expert advisers, and in some of the projects the administrative costs, the transactions costs, were actually higher than the revenue we would achieve from the project. So yes, it is important criteria and hence that recommendation, you need to reflect

that, and that is one of the things that the Treasury evaluation needs to look very closely at, that you can justify the transaction costs, and the only way to deal with the transaction costs is to internalise them in the benefit/cost ratios for the project.

[Report tabled]

**(The witness withdrew)**

**RONALD EDWARD QUILL**, General Manager Asset Solutions, Sydney Water Corporation, 115-128 Bathurst Street, Sydney, sworn and examined:

**CHAIR:** Thank you for your submission in which you discuss alliance projects and innovation introduced by the private sector through PPPs as well as sharing lessons learned. The procedure today will be that I will ask the first questions of yourself and then open it up to other members of the Committee. I am advised that you have been issued with a copy of the Committee's Terms of Reference and also a copy of the legislative Assembly's Standing Orders 332, 333 and 334 that relate to the examination of witnesses. Is that correct?

**Mr QUILL:** Yes, I have.

**CHAIR:** In what capacity do you appear before the Committee?

**Mr QUILL:** I am Sydney Water's General Manager Asset Solutions. I am appearing before the Committee as Sydney Water's representative in response to the Committee's Terms of Reference. My role in Sydney Water is I am responsible for the delivery of Sydney Water's capital investment program and also procurement.

**CHAIR:** The Committee has received a submission from your organisation. Is it your desire that that submission should form part of your formal evidence?

**Mr QUILL:** Yes.

**CHAIR:** Would you like to make an opening statement?

**Mr QUILL:** No, I do not. I think it is pretty self-explanatory. I hope it is.

**CHAIR:** In your submission you indicate that a key objective of Sydney Water's involvement in PFPs has been to use innovative private sector technical solutions. Could you provide a brief overview as to how effective Sydney Water believes it has been in tapping into innovative solutions in this way?

**Mr QUILL:** We have done it in a number of ways, not limited to PFPs, and I might add that our involvement with a so-called PFP was very early in the piece, I think in 1993, where we undertook to construct four water filtration plants under a design, build, operate model. In those days the guidelines had not been established so we worked with consultants and also people in Treasury, I understand, to develop the commercial terms and conditions. In terms of innovation I think that the involvement where we have had or have worked with the private sector, particularly in alliances and I can talk more, I suppose in an informed way, about those because they are more recent. I was not directly involved in the procurement of the build, own, operate water filtration plants, but what we have found is that the private sector have particularly brought to bear methods and systems and also some technologies that they have, where they have been able to increase the efficiency at which projects have been delivered and also reduce the risks particularly of various elements of project delivery.

In particular I guess I should refer to some outstanding results in regard to safety. One of our alliance projects won a national safety award and we have had, certainly I think, very good results on all other KPIs that have been developed around those projects.

**CHAIR:** Your letter and submission draw the distinction between alliancing and other contract types that form the basis of PFPs. However, the Australian Constructors Association cites the Sydney Water Sewerfix alliance as a PPP good practice example, describing how project partners worked together on issues and made commitments which led to better outcomes, including on-time

delivery, 15 per cent under the target cost estimate. Are there lessons that alliancing can offer to PPP management about developing effective partnerships?

**Mr QUILL:** The nature of the contracting methods are fundamentally different. Essentially under a PFP or PPP arrangement the risks are, by and large, transferred to the constructor or the vehicle that is actually undertaking the work and it tends to be a consortium because they tend to be big projects, complex, short time lines and so forth. The nature of an alliance contract differs significantly in that there is explicit sharing of risks amongst the alliance partners, including in our case Sydney Water, and the structure of the alliance is developed around understanding what those risks are, who is best to actually undertake or manage those risks, and developing the framework, the contracting framework, around that. They are fundamentally different methods of undertaking work.

**Mr TORBAY:** In your submission you refer to the need for maximising the inter-agency knowledge sharing, I assume cooperation.

**Mr QUILL:** Yes.

**Mr TORBAY:** I would be very interested in that and I imagine there would be some enormous benefits and touching on how Sydney Water currently contributes to the process.

**Mr QUILL:** We have, I will not say regular contact but occasional contact with the Department of Commerce, Treasury in particular, and also the private sector obviously who are working with us. We attend workshops, conferences, present papers, to share what we have learnt from our experience and particularly in more recent times, because it is somewhat new in the marketplace, the alliancing experience that we have had. Sydney Water was the first public sector organisation, certainly in Australia and we think in the world, to actually enter into a pure alliance model after the north side storage tunnel, so there is a lot of learning came out of that and subsequently with other alliances we have developed the methodology further and refined it, and we obviously have been sharing that in various fora in and around Australia.

**Mr APLIN:** In your submission you indicate that private sector financing can provide real financial benefits from off balance sheet funding. Could you please expand on that view?

**Mr QUILL:** I suppose it is a bit of chicken and egg in some respects, because I think that either way the community or our customers have to pay for the costs involved. Whether it is on balance sheet or off balance sheet I do not think is particularly the issue. I think it is more about the structure of the actual contracts themselves and I suppose in our case - I am going back a little in time now because the only experience we have had is with water filtration plants - my understanding of that was that we were able to obtain funding from the marketplace at a time when Sydney Water was not able to borrow in the marketplace, so that gave us an opportunity to construct or deliver a packaged program of work that we may not otherwise have been able to do in the timeframe that was required.

**Mr TORBAY:** Can I clarify a point? Off balance sheet funding is really no longer an issue, given we now have accrual accounting.

**Mr QUILL:** That is what I was trying to say, in other words yes, although I must say in Sydney Water's case the costs associated with the water filtration plants are still off balance sheet and still need to be provisioned and they still need to be serviced and, to me, it is just really an accounting treatment that differentiates the two.

**Mr TORBAY:** That is right.

**Ms KENEALLY:** In your description of alliancing you spoke about allocating risks to those who are best able to manage it.

**Mr QUILL:** Yes.

**Ms KENEALLY:** How might Sydney Water typically conduct a risk assessment for an infrastructure project?

**Mr QUILL:** It is actually quite a rigorous process. We go through a risk assessment workshop. Generally it is facilitated. We have a risk framework.

**Ms KENEALLY:** Do you do that with the private sector?

**Mr QUILL:** Yes we do, essentially because we are in partnership with them. We have a pretty good idea up front what risk we are best able to manage, for example, commissioning risks, particularly on a brown field site, commissioning risks are something that Sydney Water can actually assist greatly in reducing the risk at the interface between the new work and the existing work. Also with community relations, what we have learnt, I suppose, through this experience, particularly with the north side storage tunnel which was the first one, that the community actually expects Sydney Water to be the face of the project, not the alliance being the face of the project, particularly when issues get elevated and in that sense we once again have developed a framework whereby essentially the day to day front line issues are best managed by the construction team on the ground.

When the issues start to escalate Sydney Water needs to be seen as the accountable body, if you like, in the public's mind and respond to the public about, let us say, larger scale community angst and concern around a particular aspect of the project. That is the sort of process that we go through. It is quite a structured process but, generally speaking, and it is accepted practice that with the alliance partners, the construction risk is normally taken by the construction party. The design risk is taken by the design party and so forth, and sometimes within that, particularly within the private sector arrangements, because they have risk sharing that is, let us say, not explicit, it is not open to us, but they have separate risk sharing arrangements that they enter into themselves between the respective parties.

**Ms KENEALLY:** If I might jump in and ask, the sorts of infrastructure projects we are talking about, are they ones where there would be a risk about patronage levels?

**Mr QUILL:** No. The thing is that the projects that lend themselves best to alliancing - and I mean this is not an absolute rule but if you read the textbooks on this, the nature of the projects tend to be large in scale. They tend to be complex and have short timeframes and a lot of unknown risk associated with them. However, having said that, we have used alliancing methodology on a particular program, such as the pumping station alliance program that the Chairman referred to earlier, where the risks were fairly well-known but because we had a large program of work to undertake in a very short timeframe to meet licensing requirements of the Department of Environment and Conservation that we recognised that going to the market with packages of work was not going to enable us to meet the time line. There was also a risk going with packages of work we would not get the benefits of learning from each contract to the other.

There was also risks associated with standardisation of equipment but we could have mandated that, so what we decided to do was enter into an alliance. There also were risks around safety because the construction industry at the present moment is extremely busy and the risks around safety at the present time are of concern to anyone in the construction industry, so it is important that you try to get some stability into your project team. So what we went out to the market with was a certain package of work, a big package of work, there was \$300 million worth of work, and what we did was develop the alliance in tranches, so each tranche of work was scoped, it was clearly known by the alliance partners, it was costed and there was a fixed cost associated with each tranche. There were KPIs developed around the tranche and that process continued over time in a series of three tranches. What we got was, over time, progressive improvement and reduction in risk along the way.

I guess the lesson learned by us was that the textbook application of alliances does not always provide you with the best way of applying alliances.

**CHAIR:** The Auditor General recommended a post-implementation review of the Northside Storage Tunnel project.

**Mr QUILL:** Yes.

**CHAIR:** Was it undertaken and, if so, what did it find? Is it possible to provide a copy of the review to this Committee?

**Mr QUILL:** Certainly, I can provide a copy of the review to the Committee. Essentially the review was undertaken by an independent company and they interviewed all alliance partners. We looked at what went right, what went wrong, and also we tried to establish whether or not the alliance method had reduced cost. The outcomes of that review were, well, there was a lot of learning associated with it that we have taken forward to other alliance projects and the assessment on costs was that we had saved a substantial amount of money by proceeding on that project by an alliance contract. I can provide the report.

**CHAIR:** We would appreciate that.

**Mr APLIN:** Does Sydney Water encounter any intellectual property issues in infrastructure projects involving private sector investment?

**Mr QUILL:** Yes, intellectual property has come up from time to time. Essentially our position on that is that where we buy intellectual property it is up front, it is open, it is known, and the parties understand that we have purchased that intellectual property and can use it. Where a contractor wants intellectual property protected, we protect it, so that is essentially our position.

**Mr TORBAY:** The PartnershipsUK model, if there is in-house expertise but not sufficient in-house expertise with PPPs - I would just be interested in your view of that.

**Mr QUILL:** I don't know. I mean PPP essentially started in the UK, that is where it has flowed from - the Thatcher Government - and I suppose the methodology was picked up in various places around the world, including Australia. I do not have any direct knowledge or experience of any particular contract where the Public Private Partnership was entered into, so it is better if I do not comment.

**Mr TORBAY:** What about your general view of in-house expertise versus perhaps organisations that may be too small? How do they access that expertise?

**Mr QUILL:** Even a big organisation like ours, I think we have recognised that there is a need to continually test the marketplace and invite innovation or try to capture innovation in what you are doing. Sydney Water had a history way back of building everything itself with its own workforce. It has moved almost diametrically opposite to that now where just about everything is contracted out in a contestable way and we have moved away from prescriptive forms of contract - not entirely - more to outcomes based contracts to allow innovation. We do not profess to know everything that is going on in the marketplace. Having said that, we still have a good team of experienced people within Sydney Water who can pass their eye across a particular proposal from the private sector and make an informed assessment of it.

**CHAIR:** On behalf of the Committee, I thank you very much. We appreciate your time and effort today. May I place on record my thanks to the Secretariat for their hard work and our appreciation to Hansard for their dedication.

**(The witness withdrew)**

**(The Committee adjourned at 2.05 p.m.)**

