

REPORT OF PROCEEDINGS BEFORE

PUBLIC ACCOUNTS COMMITTEE

INQUIRY INTO PUBLIC PRIVATE PARTNERSHIPS

At Sydney on Friday 17 February 2006

The Committee met at 9.00 a.m.

PRESENT

Ms N. Hay (Chair)

Mr G. J. Aplin
Ms K. K. Keneally
Mr J. H. Turner
Mr S. J. R. Whan

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.

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 will 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 witnesses wish to present any documents today, the Committee will consider whether these can form part of your submission and will formally ask whether 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 the "how" PPPs are managed, not whether or not they should be used. In 2005 the Committee held three hearings. It took evidence from such key players 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 New South Wales 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. Yesterday we heard from the University of Sydney School of Business, Leightons, PricewaterhouseCoopers and other government agencies.

MICHAEL NORMAL CUSH, General Manager, Asset Management, Department of Education and Training, 35 Bridge Street, Sydney, and

TERRENCE JAMES WHYTE, Project Director, PPP Schools II, Department of Education and Training, 35 Bridge Street, Sydney, affirmed and examined:

CHAIR: We welcome your submission as part of the New South Wales Treasury's whole-of-Government submission and the subsequent post-implementation review of the new schools project, which identifies opportunities to apply lessons learned to the second phase of the new schools project. We will be discussing these inputs further today. The procedure will be that I will ask the first questions of witnesses and then open it up to other members of the Committee.

I thank you both for appearing here today. The Committee is pleased to be hearing 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?

Mr CUSH: Yes.

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

Mr CUSH: It is.

CHAIR: Would you like to make an opening statement?

Mr CUSH: Thank you very much. The Department of Education and Training is delighted with the outcomes of the schools PPP project, as we call it. The first nine schools that were built are in operation and have been subject to various reviews, but perhaps the most telling review is the satisfaction of school communities and the staff. I am pleased to say that the satisfaction of the teachers, the teaching staff, support staff and the communities is very high. We have found that the success of the model is evidenced in perhaps releasing the school staff to concentrate on educational leadership, given that the model that we have in place provides for there being a handyman, if you like, at each school who takes care of any non-teaching issue that may arise in the school. I have spoken to some of the principals. Some of the examples that they have given me are quite surprising in the time that they have had freed up for them to concentrate on educational leadership. They have also conveyed to me that, because the schools have been completed and are in their totality, they are finding that a lot of the community is seeking to enrol their children at these schools and it is, I would have to say, a ringing endorsement of public education.

We have been so impressed with the model that we have proceeded to a second PPP and that is in the process of reaching a commercial close as we speak. We have been able to adapt the learnings and experience we gained from the first one to enable us to get the second tranche of schools up in a much quicker time.

CHAIR: Obviously you are delighted with the outcomes. You say it came in two years early?

Mr CUSH: Yes, the schools in the first PPP were generally delivered two years before they would have been delivered had they been built by traditional means.

CHAIR: This also included on-site management?

Mr CUSH: The on-site management by the handyman, if you like, or the site supervisor as they call them, has been excellent because any minor issue - and even when a school is brand new, because there are a number of buildings, it might be irritational issues like a leaking tap or a blocked drain, a blocked toilet - the site supervisor can attend to straight away and the school principals have

generally said that it allows them to get on with the job of providing educational leadership. At one particular school, the week before it opened there was a small fire on the boundary where some mulch from a neighbour's adjoining property caught fire. As it was January last year, there was summer warmth, and the fire brigade attended and extinguished the fire, but the advice from the principal was that he wrote one report that took one hour and he was finished with his involvement in that issue, the rest was taken care of by the site supervisor. He said that had it been a traditionally operated school it may have taken a week of his time, so the saving in that respect for him and being able to devote his time to educational leadership in the first week of operation of a new school to him was significant.

CHAIR: For the department itself with these new school projects, were there any particular problems experienced?

Mr CUSH: In the first ones I think that we were certainly feeling our way. It was the first time we had undertaken that type of project, but we had a team that certainly had looked into the provision of this type of procurement elsewhere and we had put together a very good team of independent advisers. I have got to say that would be also with the cooperation of the successful consortium. It was to everyone's benefit that the project was seen to be a success and we are very pleased to say that everyone worked cooperatively and the outcome I think has been most beneficial.

CHAIR: Given the length of the contracts with the contractor for operational services of 30 years, has the department given any consideration to risks, for instance, changes in demographics in a school catchment or changes in employment practices that might result in pressures on the department to renegotiate or take back operations?

Mr CUSH: The basis upon which the schools were built, and any school is built, allows us to retain some flexibility with accommodation by the provision of demountable accommodation, and, indeed, some of the schools as built were provided by us with demountable accommodation from the day that they opened and this is part and parcel of any government school. We do not build our accommodation to cater for the peak enrolment. We predict the long-term enrolment and we cater for that with demountable accommodation. In terms of other changes, we have a management regime in place. There is a regular reporting regime from the consortium and we are confident that the schools will be successful throughout the 30 year period.

Mr WHAN: I was pleased that in your submission you put in actual numbers next to the public sector comparative area, which was quite interesting. I was wondering how you go about monitoring that and checking back against other projects which have been delivered through traditional means and how you plan to monitor it over the life of the project?

Mr CUSH: Sorry, I do not have the figures in front of me that you are referring to. Are they enrolment figures?

Mr WHAN: No, the actual comparator of the PPPs where you are comparing the cost of undertaking the projects. Given it is over a 30 year life span, I am just wondering how you are comparing that over the timeframe or how you are comparing it with similar projects within the public sector?

Mr CUSH: What we did, and we are continuing to do certainly, in the public sector it is important, firstly, to establish a benchmark against which we are comparing the prices received and the prices accepted for the PPP. The public sector comparator was developed independently to be a true indication of what would be delivered, what it would cost if we were to deliver those skills traditionally. We are continuing to monitor that, as we do with all our projects.

Mr WHAN: Who developed that, when you say "developed independently"?

Mr CUSH: The public sector comparator was developed in conjunction with the Department of Commerce and it was audited independently and I will have to take advice and get back to you on who completed the independent review.

Mr APLIN: The PIR details many of the lessons that we learnt from the first phase of the New Schools Project. How does the department intend to ensure that those lessons are applied in subsequent PPP projects it conducts?

Mr CUSH: Certainly the first PPP was subject to a number of different reviews because it was so different from what we have done in the past. There is a monitoring team and a steering committee in place that has taken on board the post-implementation review comments. We adapted some of those recommendations and adopted some of those recommendations and we continue to look at trends, both in schools here but also in other jurisdictions, to try and see that we are adopting the most appropriate management regime and getting the best value for the public money.

Mr APLIN: Following on from that, Chair, if I could ask: What opportunities have you had to share those lessons with other government agencies?

Mr CUSH: Certainly there has been keen interest in the first PPP. The project director for the first PPP, who has subsequently retired from service with the department, visited other jurisdictions and spoke with them and, indeed, we have had other jurisdictions visit New South Wales and visit our schools. We annually hold a conference between the facilities managers in the other jurisdictions around the country and New Zealand; we have spoken to them and addressed them about our PPP model and indeed shown them the PPP schools. We have also consulted extensively with the Victorian Government, who are now proceeding to develop their own PPP model. So we are continuing to liaise and consult. There is a lot of information from overseas examples and we continue to search the internet and liaise through our independent advisers with other jurisdictions, particularly in the UK, on their experiences and their learnings.

Ms KENEALLY: Are there any advantages in having one contractor who is responsible for design, construction and operations and are there any disadvantages as well?

Mr CUSH: It is important to point out that there is a consortium that is doing this and there are in fact two contractors who are providing the construction phase of the project and different contractors provide other services in the contract. I think what is important is that given that the consortium has nine schools, they are able to benefit from the economies of scale of building more than one school at a time and having that work flow. They were also able to construct one of the schools in quite a compressed time compared to traditional delivery. Both the contractors are experienced school construction contractors and they were part of the Department of Commerce's best practice scheme, so that they were not novice school building contractors. They also took on board the learnings of the department in the way school buildings are constructed, the way buildings are oriented and the way schools operate from our experience and they concluded that the design that is traditionally used, and particularly the siting of buildings, was pretty close to optimal and they concluded that they could not significantly improve on our traditional designs but they were able to make economies in the fact that they had more than one school to construct. I might ask Mr Whyte if he has got any further comments on that.

Mr WHYTE: Leading back from that, a couple of the principals who come from other schools, some of which are reasonably new and were delivered under traditional procurement, have indicated that they believe there is better quality as well in schools, which would be logical as the consortium has to maintain those buildings. They feel there has been an emphasis on quality control during construction to ease potential risks subsequently for maintenance and management.

The comment about using the school facility standards and the learnings of the department over the past 20 years in school design is correct as well and they found that any suggestions that they made as to innovation in design had either been tried by the department and found to be wanting or tried and incorporated into the design largely. So those sorts of things were just basically continued in that respect.

Mr WHAN: You just mentioned innovation in design there. I notice in your submission there was a comment about innovation being perhaps not encouraged as much. Do you want to expand on that and why would the expanded government procurement process be different or is

innovation just a slow process in building schools?

Mr WHYTE: Yes, I started to touch on that in regard to school facility standards. We have a research committee in the Department of Education shared with the Department of Commerce. Standards in school designs have evolved over quite a number of years through teacher and learning practices, but that committee also not only looks at educational practice but they look at building materials, new things that come out, anything that has come into the building industry, the BCA, a whole lot of issues, and they research those things quite thoroughly.

Schools are an area where things have to be particularly robust as well with regard to students. So there is quite significant research done to ensure that appropriate materials are used, right down to even ensuring appropriate power point connections are in place. So when you talk about innovation, those sorts of things that would be involved in innovation from the design perspective have been looked at. If they are cost effective and robust they have been included. If they are not cost effective, as much as they are innovative, they largely have not been included because we are also responsible for delivering things in a cost effective manner. So we found that anything that the consortium has put up that was an innovation, as I said, either had been tried or in some instances they were cost prohibitive to include.

Mr WHAN: I take it from that there is quite a lot of intellectual property which the department is basically providing in this process.

Mr WHYTE: Yes.

Mr WHAN: How do you make that evenly accessible to all the groups, consortiums that are bidding for this process?

Mr WHYTE: We had a data room where all proponents were able to look at our facility standards, look at examples of design; we had photographs; they had access to go to look at recently built schools. So they all had access to look at that material and in some instances it was made available to them in detail if they requested it and we kept a record of any requests for additional information from any of them. If we deemed that the material was going to be of benefit to all bidders, if a question came in about some particular thing, we provided that information to all rather than just the one that asked.

Mr CUSH: Because we are talking about a long term contract - it was a lot of money and a significant investment by the State - it was important that our processes were open to scrutiny and beyond reproach. We had an independent probity auditor retained to ensure that all our processes and all the information and all the messages that we gave to the various bidders through the various stages were fair, transparent and everyone got the same information and no-one got an advantage over another party.

Mr APLIN: The post-implementation review identified extensive areas for improvement of the *Working with Government Guidelines*: for instance, speeding up the approvals processes; improving the contract summaries, etc. It recommended that the guidelines be updated. Can you give us some examples of areas where you feel that would be applicable?

Mr CUSH: The *Working with Government Guidelines* was a document controlled by Treasury and I think that they have certainly already made some improvements. There was a view that there needed to be greater transparency in what documents could be released, but I think one of the areas that we need to be careful of is the fact that we are dealing with commercially sensitive information and that, whilst there is a great need for transparency and public accountability, we need to preserve the integrity of the commercial relationship in not trampling over or disregarding the commercial sensitivities of the private sector but at the same time preserving the need for public transparency with the expenditure of public funds, and I think that is an area where we are certainly getting better, but striking the balance I think is difficult.

CHAIR: As a result of the contractor providing the on-site management, the PIR apparently

suggests that the Department of Education and Training should review the duties of general assistants. Is there a suggestion of removing general assistants?

Mr CUSH: Given that there are only nine schools in the PPP and we have 2,200 schools, can I say this: There is no suggestion that we are going to pull general assistants out of schools ad hoc. The suggestion is more to review the role of the general assistant in a school where you might have a site supervisor to ensure that there is no duplication of duties and roles and responsibilities and that is proceeding. I have to say that the enthusiasm that is greeted by the presence of the site supervisor - there have been plenty of other duties for the general assistant to proceed with, so I must stress that with such a vast network of schools we are not contemplating a wholesale change to the position of general assistant.

CHAIR: Who is responsible for setting the tasks of the site supervisor?

Mr CUSH: The role of the site supervisor and the role of the consortium is set out, but in terms of day-to-day activities there is liaison between the school principal and the site supervisor so that the site supervisor can be directed to a particular issue if there is an incident in a school, a photocopier breaks down or a door jams or a lock is loose, that the site supervisor can go and attend to.

Mr WHYTE: What has tended to happen with general assistants is that the workload in schools and the range of jobs that the general assistant was required to do largely got to not be done and principals would direct them to do things that were most outstanding and usually that ended up being the maintenance of the grounds and the maintenance of equipment whereas the original intent of a general assistant was also to support the teaching and learning in a school, such as moving of furniture, setting up desks for exams and a whole pile of other jobs: When supplies arrive, organising them, stacking them away and so on. A lot of those things then befell the teaching staff or any other staff that was free at that time and they largely ended up being the people that were mowing the lawns and cleaning the leaves out of the gutters. Now those sorts of jobs are entirely done by the site supervisor because it is part of Axiom's requirement as far as their outputs are concerned to maintain the school in a certain condition, so the general assistants are now able to move to those sorts of jobs that more support the teachers.

CHAIR: I would imagine that might result in some feelings of envy possibly from principals at schools that are not under these projects?

Mr CUSH: The advice is that the principals from the PPP schools tend to keep very quiet in meetings with their colleagues. They certainly do not have any maintenance issues to complain about and they are envied by their professional colleagues.

Ms KENEALLY: The PIR also indicates that there remain concerns about the accuracy of projected costs, particularly maintenance costs. How do you think the department can improve those in future contracts?

Mr CUSH: I think the issue of maintenance in schools has been a reasonably topical issue for a number of years. We projected our maintenance costs and we continue to review them. Our improvements with our asset maintenance contracts mean that we will increasingly get more data on our maintenance costs in schools, our maintenance regimes and the effectiveness of them, so we know what the consortia are charging, we know the standard that they are delivering. The balance is to reflect that against the standard and the condition of our other assets and to compare the two. It is complex, but it is a subject that we are keen to pursue as time proceeds.

Mr TURNER: You are saying you are comparing the PPP school with the ordinary school to get that comparison of maintenance costs?

Mr CUSH: Well, the question was, I believe, one of the complexities and one of the issues was in the post-implementation review, the costs of maintenance as we projected them versus the actual cost of the PPP, so now that we have the PPP running we can do an actual comparison of both

the costs and the condition of the schools. You cannot do one really without the other.

Mr TURNER: How much monitoring do you do in relation to maintenance costs? I think you contract out maintenance costs for the other schools. How much oversight do you have? I can give an example in my electorate where 30 louvres in a school were broken and your contractor charged \$190 per louvre to replace them. That school got independent quotes which were between \$8 and \$14 to replace them, so if you are going to be doing comparisons, which benchmark are you coming off?

Mr CUSH: Certainly the benchmark we would come off, and I don't know the particular example--

Mr TURNER: I can assure you it is a correct example.

Mr CUSH: I would like to clarify that we have entered into new maintenance contracts and they commenced in July last year. We listened to some of the stories and the comments of principals on issues such as you have referred to and, without going into a defence of the maintenance contracts, it is fair to say that the maintenance contracts that we had and we have in place also include a component where the maintenance contractor is providing safe systems of work, is ensuring that all their statutory requirements are met, and are otherwise qualified in terms of the child protection requirements that we require for workers. We have heard stories like this from principals - many of them - and indeed there was a task force that was in place a couple of years ago that made recommendations to the Minister for the way forward with maintenance. The prices that you suggest - some principals are keen to go out and get those prices. We have heard that, but we caution principals to ensure that they do have appropriately qualified contractors with safe systems of work, that we are not having - if I can use the vulgar phrase - "shonks" in schools.

Mr TURNER: I can assure you that the quotes were taken from fully qualified and reputable organisations.

Mr CUSH: We are very satisfied that the prices we have in the new contracts are more cost-competitive and we are increasingly dealing with schools and working on that feedback and we have a mechanism in the new contracts to address issues like that, but, in terms of answering your question, we will be benchmarking the cost of the PPP against the cost that we have received through our contracts and continuing to be vigilant. I would conclude that you are suggesting that there is an element of gouging?

Mr TURNER: It is more than an element of gouging. The school was told that they were over-quoting to offset under-quoters.

Mr CUSH: We have heard those stories and we continue to pursue them.

Mr WHAN: When you are looking at the actual costs of the nine schools involved in this process, you are actually comparing them against other new schools or--

Mr CUSH: We are comparing them against the cost of maintenance in similar schools and across our network.

Mr WHYTE: There is an output requirement too. For example, if there is a life cycle end to a roof that is 25 years, we are expecting, therefore, the consortium to replace those roofs before they hand them over at the 25-year period. Similarly, if there is an expected life term for carpet of X number of years, they do the replacement at the appropriate time so that we do not get back schools that are worn out. There is quite a specific inventory in the last five years that would indicate whether things have to be replaced before the hand-back as well, so there is a cost involved to the consortium to ensure that the schools are handed back in an excellent condition.

Ms KENEALLY: I would like to go back to the issue of the on-site manager and implications for the staff at the school. As someone from an electorate with a large number of ageing

schools, I am aware that principals in my electorate spend a vast amount of their time dealing with maintenance. I can imagine having an on-site manager releases significant portions of time, as you have indicated, for principals. Does that have implications for the duty specifications of the principals at the PFP schools or does it have implications for equity between the roles of principals? I guess the point I am getting at is that it would seem to me there are two different jobs, being a principal at a PFP school versus being a principal at a traditionally built school. Does the department recognise that, or would you agree with that statement and do you have any plans to address the difference in the positions?

Mr WHYTE: It is a bit hard to generalise I guess. Some schools certainly have their additional times of maintenance issues. Some principals will delegate that to a deputy. Some will have, as does everybody, better staff or better GAs than others who can manage these things. Some will have good connections with their properties officers or with their new maintenance contractors where they get some of that burden that is distracting them from teaching and learning taken away. So it is a little hard to generalise in that particular instance. What we have done is tried to optimise it for PPPs. A particular person, whether it is the principal or deputy or an authorised person that is nominated, rings the help desk. There is a 24/7 help desk line for PPP schools through the consortium. They have to register any issue there. Then it is picked up by the site supervisor and dealt with in that particular way. There is a different management regime and these principals feel that it has eased the distraction for properties issues for them. Admittedly it is early days because the schools have only been opened up to two years at this particular point in time, but you will equally find some principals in schools that are significantly older who have managed their properties issues in different ways. Some wish to take it on themselves; some wish to delegate it to other people. That is the way it is, I guess.

Mr CUSH: I think it is too early to tell. We have initial advice. We have a regime of regularly meeting both the Primary Principals Association and the Secondary Principals Council and the feedback from those representatives is that the new maintenance contracts are quite effective and they are taking some of the burden off principals. It is the same as if you have an older house or a new house. You have a different set of issues in an older house to a new house. That is a fact of life that goes with the territory. What we have done in the PPP schools, given that they are very new, we expect that there would be fewer property issues or asset management issues than in an older, more aged facility, but the indications are that the principals can concentrate on educational leadership and we are aware of that and we will continue to monitor it. We have no proposals at this stage that I can comment on or that I am aware of, but the new maintenance contracts are also intended to let the principals and the staff get on with the job of educational leadership rather than being property managers.

CHAIR: The Committee has heard that the cost of monitoring PPPs in many cases has proven to be a lot higher than anticipated. Have you found that in your experience?

Mr CUSH: No.

Mr WHYTE: We only have the nine schools at the moment, so our team is quite small. There is a self monitoring system built into it where we review what calls are being made to the help desk on a monthly basis and what different maintenance issues and whatever have come out. There is a report comes to us each month and I have one member of staff who as part of his duties oversights this at this stage. Certainly, if PPPs expanded, exponentially we would need to look at staffing and oversight a little more than we have to at the moment simply by the sheer numbers.

Mr CUSH: But our experience is not that there is an increased monitoring cost.

(The witnesses withdrew)

ROBERT DONALD MCGREGOR, Deputy Director General, New South Wales Department of Health, 73 Miller Street, North Sydney, and

GLENN WILLIAM MONCKTON, Project Director, Long Bay Forensic and Prison Hospitals PPP Project, New South Wales Department of Health, 73 Miller Street, North Sydney, sworn and examined, and

DAVID ALAN GATES, Director, Asset and Contract Services, New South Wales Department of Health, 73 Miller Street, North Sydney, and

ELSIE CHOY, Associate Director, Joint Sector Development, New South Wales Department of Health, 73 Miller Street, North Sydney, affirmed and examined:

CHAIR: I have been 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 McGREGOR: That is correct.

CHAIR: Have the New South Wales Treasury's *Working With Government Guidelines* been effective for you on the current PPP projects and are there any areas you have identified where you would like some changes to those guidelines?

Mr McGREGOR: I will start by responding and Mr Gates may wish to add some comments. I think that the guidelines have been particularly useful to us. We have followed them as best we can. The risk management component is particularly useful for us. I think the Treasury has acknowledged in its own submission that given that they were written in the early 90s they could probably benefit from further updating at the moment.

Mr GATES: If I could add, the major benefit I think is establishing consistency in the market place between agencies and also between States, in that the guidelines are derived or come from similar guidelines in other States. The further work that we are doing around the extension of the guidelines is around the protocols and practices of PPP Health projects.

Ms CHOY: Yes, the guidelines have been very useful in providing a framework for identifying projects which are appropriate for a PPP and their implementation. The areas that we are working on are in terms of consolidating current practices and we are working on that with Treasury.

Mr MONCKTON: Likewise, for the Long Bay Hospitals project the guidelines have provided a useful tool for the effective management of the project, being mindful of matters that need to be covered in managing a PPP project and particularly the risk allocation identified in the *Working with Government* guidelines to identify risks and how those risks should be treated within a PPP project.

CHAIR: In the executive summary of your submission you note that the department has just two PPPs under way. Is the department confident that it has the necessary expertise to manage PPPs in all their complexity or would a model like PartnershipsUK be useful for agencies to be able to tap into particular expertise?

Mr McGREGOR: I think within the department, given our experience with the two PPPs, I would have to say the two projects are probably more complex than one would normally experience within a hospital. For example, a forensic hospital inside of a prison, being built in conjunction with a hospital inside a prison where you have got two agencies involved, represents some challenges, particularly with issues such as security, et cetera.

In terms of the project in the Hunter, the Mater Hospital, we had involved the Sisters, the Order, we had the affiliated health organisation, the independent board of trustees, we had to address

issues such as canon law, alienation of land and a whole plethora of things. Having been through the experience of both those PPPs, I think we are pretty well suited now to be able to manage most health PPPs. It is not as though they are the only two projects we are managing. We have a history of PPPs on carparks. We were involved in the redevelopment of a former western suburbs hospital. That was again a barter arrangement, which is a PPP. Whilst I cannot say we were involved in the Hawkesbury Hospital one that was done in the mid 90s, or the Port Macquarie one, we were involved in the buy back of Port Macquarie Hospital. We have learned from all those experiences and while the Auditor General in particular was critical about the Port Macquarie arrangements entered into at the time, they have provided learning experiences for us. We have spent a lot of time studying the UK models and the changes that occurred there. We have introduced some innovations that are not present in some of the interstate and international arrangements, particularly around our labour agreements, which we think are, if not unique, very unusual. I am happy to detail those for you. And being a large organisation, with large projects we have built up I think a fair body of experience. We have worked closely with Treasury and their unit. They have been particularly helpful to us in our partnership with them. And we have used a whole range of private consultants and contractors to assist us through the process, probity lawyers for example, commercial lawyers, architects and the like. So I think we have built up a good body of experience.

CHAIR: I just want to take you back a couple of steps. I neglected to give you the opportunity to make an opening statement. Were you wishing to make an opening statement?

Mr McGREGOR: I think we can deal with the opening statement as we go through the questions. I have just dealt with part of it then by referring to the labour agreements. I will keep ticking them off as we go. No, that is fine.

CHAIR: It is your desire that the submission we received from your organisation form part of your formal evidence?

Mr McGREGOR: That is correct.

Mr WHAN: I was interested in the labour services agreement that you mentioned before. Have there been implications from that for Health? Could you just expand a bit on what the implications of that have been for existing workers and how that has been accepted by the private contractors who are involved?

Mr McGREGOR: I think if we were to attempt to do what we had done five years ago, I do not believe the private sector would be that responsive. However, it was made a condition of the arrangement that they enter into this labour agreement with us, which has the effect of ensuring that the clinical staff will provide the clinical services within the facilities, so they will be our staff. In terms of what have been called the back of house services, the cleaning and other arrangements, they will still be our employees but they will be managed by the private sector. So all the rights and conditions of our employees are protected; they are not transferred to the private sector as occurs in the UK model. We have no issues around superannuation, union membership and different rates of pay because they are all in the same award. The unions do not formally accept that because they do have an issue around PPPs generally, but we have had extensive negotiations with the Trades and Labour Council and the health unions here, and learning again from the experience of Port Macquarie where there was a lot of staff dissatisfaction about the arrangements there, I believe we have actually struck an ideal model. It is yet to be tested as we move forward over time but I think it is an interesting model.

CHAIR: I was just wondering how an employee is managed by somebody other than the employer. In other words, the definition of an employee or an employer is based on who directs the work, who controls what you do, when you do it and how you do it?

Mr McGREGOR: It is delegated, and that can be done and has been done.

Mr GATES: In a similar way that the Mercy Health Care Newcastle organisation has managed those staff in the past as a delegated right from the Hunter Area Health Service, we are

simply just further delegating to a private organisation.

CHAIR: I could lead on from that into some industrial questions, but I will resist.

Mr McGREGOR: Thank you.

Mr WHAN: I am interested in the way that works as well. If you are looking at the contractor doing maintenance and all those sorts of ongoing things, and paying for maintenance, how do you link that up with, for instance, the number of staff that you employ to do maintenance or cleaning or negotiating those sides of it?

Mr McGREGOR: Whilst the staff will be managed, those who remain in employment - and they will have other opportunities as well - the number and rosters of the persons that will be engaged on that site will actually be determined by the manager, that would be the private partner, so if there are efficiencies to be achieved, they will be achieved through that process. They will have the opportunity to select from the existing staff those that they believe they will need. Those that are not or do not wish to work in that arrangement will have opportunities in the greater Hunter and New England Area Health Service.

CHAIR: So you are saying that, as part of this process, you delegate the authority to manage and the delegated authority can determine who stays employed and who does not. I think that is going to be very interesting to see.

Mr McGREGOR: It does not have the power to terminate. That remains with the Hunter/New England Area.

CHAIR: Even though they are not their employees?

Mr McGREGOR: They [the private manager] cannot terminate them. Only the chief executive of the Hunter and New England Area Health Service can do that because they are still effectively their employees. We have delegated the day-to-day management of those employees who remain there, but at the end of the day they can only recommend termination to the chief executive officer who will ensure that procedural fairness has been complied with before acting.

Mr GATES: I think we need to bear in mind that in the preparation of this contract there was a lot of work done, first of all, researching what happens around Australia and overseas, so a very similar arrangement operates in the UK and similar arrangements also operate in Victoria. There was then a significant process gone through to, in effect, develop an agreement that would stand in the marketplace. In other words, give the private sector enough comfort that they can manage these staff effectively while still living within the performance regime that they have to achieve, and also with the unions establishing an understanding of the arrangements.

In the tender period and the construction period there is a requirement that the private sector in effect nominates how many staff they will use to operate the hospital and they base their tender on that number of staff. They then select, as Bob said, from the pool of employees and they have to, if anyone leaves from that pool as the project unfolds, replace that person from within the public sector, not from within the private sector.

Mr McGREGOR: And that is the difference that we have against the UK model. The UK model transfers people across, so they actually change employer. Certain rights are guaranteed, but if they leave they are replaced by people who are chosen by and employed by the manager, so ours is quite different.

CHAIR: We were given some evidence of experiences in the UK about having, in the earlier days of PPPs, not gone too far in terms of protection of employees.

Mr McGREGOR: They had no protection initially, I suspect.

CHAIR: No, and the protection of employees apparently is not just at the initial stage of contracting but also from contractor to contractor. That is some of the evidence that we have received.

Mr MCGREGOR: That is while they remain in employment. If they then leave, my understanding is that they can be replaced by people who are employees of the management under different arrangements and I think Mr Sturgess said that in his submissions to you.

CHAIR: The other thing that has interested me about this is the question of if the employee remains an employee of, say, the hospital, and covered one would assume by the Health Services Union, someone employed by the contracted management would not be part of that same process, so that is why I think the whole thing is going to open up into some very interesting stuff, but let's get back to the question of the PPPs and management.

Mr GATES: Could I make comment on that: One of the benefits of a PPP is that it forces you to go through the discipline of thinking through - and I think other evidence has been given to you about that - these issues up-front. There was a significant period of us collecting and placing into the private sector tender process all the guidelines, all the HR conditions that they have to comply with, so that was reviewed with the Hunter Area Health Service and put into the tender documents and they have to live within those guidelines.

Mr APLIN: I was wondering how the department currently shares its knowledge about PPP management with other agencies, including the library of reference documents being developed by New South Wales Treasury, to obviously benefit yourselves and share your information with others?

Mr MCGREGOR: I do not have all the details of that, but we certainly are involved in the national PPP consortium, if I can call it that. We are involved in discussions at an interstate level. As I said at the outset, we have certainly spent a long time learning from the experience of others. We have looked at case studies in the UK from a number of hospitals because they have a great deal more experience with this than we have, and I think we have learned a great deal from that. We actually came to this process somewhat late in comparison with others because our hospitals are very complex, so we spent a lot of time thinking and learning and, as David said, putting in up-front what we believed would be the appropriate arrangements, and I have to say that the industrial issues were - certainly in the Hunter - of some significance to us. The unions were opposed to PPPs as a matter of ideology, but also in terms of practical effect on workers, so we had to work through that. It will be for us I think not an experiment but a new way of thinking, a new way of doing things, but certainly as we understand it we have had no industrial disputation in recent time and we believe we can do it in a harmonious way with both the private partners and the workers. Now time will tell. We have had two very different arrangements about our early PPPs: We had the Hawkesbury Hospital run by a not-for-profit organisation, a harmonious relationship between the area health service, their employees and the order, and Port Macquarie run by the private for profit sector, a very different arrangement and not so harmonious.

Mr GATES: If I could add to that, your question goes to the issue of expertise as well, I think. The point I would like to make, first of all, is that Health is a major procurer of capital assets. We have a program over \$2 billion, we have over 30 projects over \$10 million, we have projects up to the figure of \$700 million, so we are a major procurer. We have a whole body of our own special Health guidelines and our own facility design standards and it is this body of knowledge that we have to make sure that our private sector project directors comply with. When we come to PPPs, the second point is that PPPs are in effect, as John Pierce said I think, another form of procurement - or Kerry Shott might have said it - so it is really a procurement decision. When we are working through these projects we have to deal with the issue of what is the form of procurement and then make sure that we are adequately resourced to handle that form of procurement. In PPPs we are developing our library in conjunction with the other members of our team, which is Treasury, so Elsie's job in effect is to develop the section of our knowledge base to do with PPP procurement.

Ms CHOY: We work with Treasury to look at the procurement, the implementation and issues during the procurement process, particularly capturing the body of knowledge that we have

dealt with in terms of dealing with the public sector comparator - a number of things - and to try to move towards a standard contract and template for use in future projects, so that work is ongoing and we are working towards a library of documentation.

Mr McGREGOR: If I could come back to your initial question about expertise and whether there should be a separate body, I think for organisations such as the RTA, as evidenced by Mr Sent, they have built up the expertise over a long period of time. I think we are in the same position, as David said, we are a large procurer, so I think that for us it is appropriate to maintain our own expertise, but for a small agency - and we do do it on a centralised basis in Health, we do not leave it to the area health services to do it themselves, so we work with them or for them, but smaller agencies who might procure one major project every ten years I do not think would have the necessary expertise to do that, so there may be a need for stronger central support from those in Treasury or whatever body would do that.

Mr APLIN: Could I follow-up the answers to that, and also it relates to a question asked by the Chair earlier: Given those approaches, have you contemplated at any stage a PPP arrangement cross-territory or cross-border?

Mr McGREGOR: David might give you some details of that. We have not undertaken, but we have certainly looked at, for example, a PPP around some equipment - looked at, have not moved on it yet.

Mr WHAN: Do you mean interstate?

Mr McGREGOR: No, we share information, but not across borders.

Mr GATES: I am the chair of a national body [comprising] all the directors of asset management across the Commonwealth and New Zealand get together every six months and compare learning around new projects and the ways we procure projects. Equally Treasury does that with the Victorian Treasury in terms of PPP contracts.

Ms KENEALLY: We have heard evidence that the public service is often too prescriptive, particularly in building the sort of facilities that you build. We have heard evidence from the private sector that the public sector is often too prescriptive and therefore inhibits innovation. I am wondering if you could comment on that and specifically if areas of innovation have occurred in your experience of PPPs.

Mr GATES: Innovation is a challenge in health projects generally and in PPP projects as well. One of the concerns in the UK PPP projects was that innovation was not really brought to the front. The approach taken in Queensland has always been that you define your project to what we call a project definition plan status - in other words, an exemplar design - and then you say to the private sector, "Can you do better than that?" That is, in effect, the approach we have taken, so we get it to the point where you can either deliver the project through a conventional design and construct, the private sector taking on the design and construct, or a PPP type procurement, and that is what is put to market. We ask the private sector in effect to come back and improve on that, and that is the bid against the public sector comparator. The process at the Mater was particularly effective at driving innovation and we followed a procurement process where, in effect, we were in negotiation with two parties. This was a controlled process with a probity auditor and involved them discussing their designs with us and us giving feedback on their designs, and the design did change and improve significantly through that period and the judgment of the best scheme was done at the end of that eight-week period. So I think we have been successful in building innovation. We have also learned from that [the tender process] and are building the same type of approach into our conventional procurement approach because, as Bob said, we have centralised the whole of our major works procurement and we have standardised our approaches. We are working hard to improve our approach to the market with similar kinds of learnings that we have got out of the PPP projects.

Ms KENEALLY: So you feel that that process actually encourages innovation from your private sector partners, you were able to do things you were able to bring on board that you might not

have?

Mr GATES: I think in both projects, the PPP projects, we have been successful in driving innovation. On the forensic project, the significant innovation of, rather than building in two stages, building in one stage was embraced within the tender process and so hence the steering committee, which is ourselves, advisers, Treasury and the ultimate clinical client work hard through that steering committee to in effect embrace innovation to the benefit of Health, so yes, I believe we have.

Mr MONCKTON: Can I make one comment in terms of the forensic hospital: I think it is important for the marketplace to understand what are the things that are a given and that can be around the facility's functional relationships of the hospital because that means how the clinical services can be delivered and where there are opportunities for them to innovate and we will get them in a different way. So we need to be clear that they understand that boundary and once they have that understanding that is when they can then focus their attention and efforts to get the best outcomes. The engagement process that David talked about is one way where we believe there has been a successful interface between ourselves and the private sector to understand where the opportunities lie and for them to explore those and to help those such that they can actually put an innovative bid on the table at the end of the period.

Mr GATES: We believe that it requires a mature agency to do that because the challenges of embracing innovation sometimes test the areas appropriate, and so you need to have that close working relationship with the experts in Treasury on an ongoing basis through the whole tender process, and you need to be able to manage that at a variety of different levels within government.

Mr WHAN: Have you had any feedback from the unsuccessful tenderer? If you were working with two over a period of eight weeks, then presumably they would have invested quite a lot of money in the provision of plans. Have you had any feedback from particularly unsuccessful tenderers as to whether or not they felt that was a worthwhile process or whether they felt that they were being asked to spend a large amount of money for no purpose?

Mr GATES: When we did debriefings of the unsuccessful proponents the feedback has generally been positive to the whole process. They stated at the end of the process that they welcomed the interaction and the ability to in effect learn from us and improve their bid.

Mr MONCKTON: In terms of what components you take forward, and being mindful of the cost in the market place, on the Mater we took two proponents through the process that David mentioned, on Long Bay we took one proponent through that process, and we made that as a judgment call based on the bids that were on the table and the ability to actually respond. I think the market place understood, from the feedback we have been given, the reasons why we took a different approach to the Mater than we did on Long Bay. Once again, it is a judgment call and it is very much driven by getting the outcome we are looking for without putting the market place to too much expense.

Mr WHAN: On a broader tangent, are you able to give us any idea or information on the comparison between what you feel you have been able to achieve on these two major projects and the traditional way of constructing a major project like this in terms of comparisons of costs, timeframes, planning, contracts and construction?

Mr McGREGOR: I will let David go into the detail of this, but in a general sense I think there is other evidence before you to say that we do spend a long time up front, on the planning and preparing, so that you can go to the market place with as much certainty as possible, rather than changing your mind half way through. Certainly with the Mater Hospital, with all the dealings that I mentioned, the complexities of that and the players involved, we spent a long time making sure that from our side, from the Sisters' viewpoint, from the Order's viewpoint, from the area health services' viewpoint, that we were all very comfortable with what we were going and there would be no surprises on our side, and that took a long time to negotiate. We spent sometimes weekends sitting around the table, talking through all these complexities, about canon law and so on. It is not my field of expertise I have to say, but these parties brought in experts on canon law to advise us and there was

a real issue about whether that land was being alienated and they had to work through that. That took months. If we had not worked it through upfront and we found out towards the end when we were out to tender that the land had been alienated and the Pope would not agree, we would have been enormously embarrassed. So yes, the evidence is we spend a lot of time planning these things.

It is also useful though that while you are doing that, you are also doing the services planning as well. So you are actually trying to do things in parallel at the same time, so one is informing the other. So again, you are actually going to the market place with a lot more certainty. The overseas experience again, and Victoria's, is that once you have done that, the time from execution of your contract to delivery of the project is quicker and it is delivered on time and within budget. That is the history; that is the UK experience. So we are hopeful that one of the major benefits for us will be just that, on time, within cost.

Mr WHAN: In terms of comparison of that planning process, and excluding canon law and things like that, for a normal hospital project there is obviously a fairly significantly lengthy planning process as well. How would the two compare?

Mr GATES: These two PPPs took more time on a couple of key issues. I will come back to the other parameters of your question in a second. The reason we took a long time to get to tender was the labour service agreement, coming to grips with making that work, both in the market place and for the unions, and the issue of maintenance, and particularly on Mater Hospital, not only maintaining the new hospital but the old hospital buildings, and then the affordability of the [maintenance] plans. One of the major benefits to the people of Newcastle on the Mater is that that hospital will be maintained at the level that it is built for the life of the deed. I could not say that about most Health assets because the pressures on the Health budget tend to force you to renew facilities rather than maintain the facilities. So dealing with the affordability of maintenance was a significant issue for Health and that took some time, but it has a benefit in the end.

In terms of the overall cost, there is no doubt that the contractors build a higher margin in for working for a bank than they do for working for government. There are savings in risk transfer but there is also a higher margin that they allow for in that the banks will not allow them to vary the contract, whereas there is a history of major works contracting in the government sector of in effect bidding low and claiming variations. So one of the benefits to us is that discipline and that is what we are working very hard now on within the public sector procurement or conventional procurement for PPPs.

Finally, as I think has been presented on the schools project, the time to get the projects defined into the market will be a lot quicker than we went through because we have the labour service agreement in place, we have the abatement regime in place and we have addressed the issue of how we fund maintenance.

Mr McGREGOR: And we have a set of standard templates. As I said at the beginning, we could not have chosen any two more complex projects on which to do a PPP but the learnings from that will be passed on and I am sure we will be able to fast track much more straight forward projects because we have all the documentation in place.

Mr APLIN: You mentioned standardised templates. Do you in fact use a standardised contract and are you contemplating applying that to any future construction contracts?

Mr GATES: We have standard contracts both for PPPs and for conventional projects. On PPPs the contract in effect has gone through an evolution of Victorian PPP projects, the schools projects, the New South Wales Health projects, and so there has been an evolution process through that. That is not to say that each project has not its own facets and changes that you need to make, particularly in areas of performance and the abatement payment regime. Those areas are evolving and we are getting smarter, like others, and so we get an evolution on each deal but there is no doubt there is a major effort to standardise new projects, and that standardisation is across Australia because fundamentally this government works in the national market, given the [relatively] small size of what we have put in the market in New South Wales.

Mr McGREGOR: And all the work in Australia around project deeds are based on the UK model anyway. The two project deeds that we have for our two quite different projects are very similar.

Mr MONCKTON: With both the Mater Hospital project and the Long Bay project we have made a conscious decision to closely work between the two projects so that the project deeds are as consistent as possible in the areas where they need to be consistent, and in areas where there are project specific issues raised, they respond to the specific project issues. The intention is that the market place, when they get the deed, will understand the commercial principles in that deed, they certainly know those commercial principles and therefore can price a very competitive bid and be mindful of what are the risks. If they are in a deed with which they are not familiar they will want to put a price premium on it. This is about the market place understanding the commercial principles. Those commercial principles get applied across future projects better and competitive bids are put on the table.

Ms KENEALLY: If I might ask about the carparks. That is one of the few examples of PPPs that has is similar to toll roads. Who assumes the risk on patronage and how are the fees determined?

Mr McGREGOR: Whilst hospitals tend to be social infrastructure, car parks within hospitals are more economical.

Essentially the risk in terms of patronage resides with the bidder or the contractor, but a lot of work goes into understanding what the patronage has been historically and that can be factored into their bids and the final contract.

Ms KENEALLY: And the fees?

Mr McGREGOR: The fees we largely dictate. We do have a good understanding of what the markets are.

Ms KENEALLY: So if the fees increase tomorrow at the Prince of Wales carpark, who is going to be fielding complaints?

Mr McGREGOR: The management.

Mr GATES: For any adjustment they have to seek our approval. There is a regime lined up. In the early carpark deals we had to give them an assurance, with the Prince of Wales carpark, that the Prince of Wales Hospital would stay there.

Mr McGREGOR: It is a reasonable risk.

Mr GATES: That is similar to North Shore. That was the issue. We would not given an assurance on numbers of staff, we would not give an assurance on patronage. So they have to take the risk.

Ms KENEALLY: So they have to take the risk that they may not be able to raise their fees if the Department of Health did not allow them to?

Mr McGREGOR: We would like to think that there would be some consistency between hospitals not too far distant from each other for the staff charges and the visitors, that they would give them some sort of reasonable arrangement, that they are not paying a huge sum over here and less over there. We try to get some equity into it. There are still some minor disparities between them but they are mostly more rational than they were historically. The unions have a great interest in car park fees for the employees, but they do also, as we do, have some concern about accessibility for visitors and people who are disabled and long term attenders at the hospital. So we try and do the best we can regarding hospital car parks.

Mr GATES: The issue with car parks has been do we spend all our scarce capital dollars on building car parks. Our policy position has been not to, unless there are extreme circumstances, but at the same time there are significant benefits in building a car park close to a hospital in terms of nurses' security, given shift work and that kind of thing. So it is a fundamental issue for the unions that we do provide car parks. So we have worked hard to get an acceptable position over the years.

Mr McGREGOR: I think the Australian health care system excels in providing community care, but I think we have demonstrated over the years we are not experts at managing car parks. So we leave that to the experts to do and I think they do it very well.

Mr WHAN: Coming back to building hospitals, the education department was telling us before about how their PPP arrangement with nine schools enabled them to bring those forward and build them ahead of when they would otherwise have been built under normal budgetary circumstances. Is the health department looking at using PPPs further to actually bring forward hospitals which are not currently on forward estimates, for instance, Bega Hospital where two existing hospitals need demolishing but because there are so many hospitals being built around New South Wales it is not currently on forward estimates?

Mr McGREGOR: One of the issues, of course, around PPP is that it has to be on the forward estimates to be put forward. Secondly, in terms of advancing the issues, for example, with the Mater in Newcastle, the plan for improving mental health services in that area was way out on the program. That has actually been brought forward, so the James Fletcher Hospital can actually be replaced and improved mental health service provided much earlier than could have been contemplated. The same issue is around the forensic hospital. It was a bit further down the track than the prison hospital, where we provide clinical services, but it is actually run by Corrective Services - they were out of alignment in terms of their timeline, so they have actually been brought together so that they can be done at the same time.

Mr GATES: Health is reasonably unique within the government sector in that we have a forward level of guaranteed funding, so Treasury actually says to us you can forward plan on the level of investment. If I use Bega Hospital as an example, Bega Hospital is on our forward plan, it is in the draft non-authorised forward plan within the overall funding caps that we get, but it is about three or four years away on that, so subject to a whole lot of other things that might occur, nevertheless, we can give people a reasonable assurance that it is on our priority list. The difference with PPPs is that, because of the funding arrangement, we do not start to pay the money until the facility is there. We can bring the project forward by, in effect, half its cash flow, so if you think of a project having a three-year cash flow period, if we start early enough and get approval early enough, we can bring a project forward by half that three-year period, so we can get a benefit, but we have to start the planning process early enough to get that benefit.

Mr WHAN: Are you currently planning for which projects you can bring forward using that or are you waiting until you see what happens with the Mater and--

Mr McGREGOR: We are presently reviewing a number of projects to see whether they would be suitable to take to the market. One of the issues we must also bear in mind, though, is the appetite of the marketplace. If we were to put our \$650 million we have to spend on capital works out to the marketplace, we might have a little bit of trouble chewing on that let alone swallowing it, so there are issues about the market taking these things on and it has to be done in a reasonably planned way. That is why Treasury is involved across the sector working out what the market can bear, so we are also to some extent governed by that, but yes, we are certainly looking at a number of projects at the moment that would in our view benefit from going through the PPP process. We are not just, having finished those two, sitting back and saying: Phew, that was hard, let's see what happens. We are actually trying to go forward again with all the experience that we have had from those two.

Mr GATES: The key issue is value for money in the procurement process, it is not about bringing a project forward. There is some benefit in that, but the real issue is what is the best way to get value. Because of that and because of the need to think these things through early in the planning

process, and Health has a standardised process of facility planning, we do a sieve test in accordance with the Working with Government guidelines in the very early days to say: Does this project look like it could deliver value through a PPP form of procurement?

Mr WHAN: When there are private sector proposal proponents that come to you with things, do you consider those or not?

Mr GATES: Unsolicited bids you mean?

Mr WHAN: Yes.

Mr McGREGOR: Yes, the Working with Government guidelines tend to deal with how you manage that. I am not sure that we have had too many.

Mr GATES: We have had a number over the years. The guidelines say I think that they should go to Premier's and Premier's coordinates a government review to see if there is a government benefit. My experience has been that unsolicited proposals really rarely get up because they do not meet a uniqueness test quite often and while they deliver a benefit, they do not tend to fit with our strategic objectives in most cases.

Mr McGREGOR: And they do not fit with the discipline of competition quite often, so once you put them to that test they quite often do not quite come up to the mark.

CHAIR: On behalf of the Committee, thank you very much for sharing your information with us. It has been very informative. Could I place on record the Committee's thanks to the Secretariat for all their hard work and also place on record our appreciation for the dedication and hard work of Hansard.

(The witnesses withdrew)

(The Committee adjourned at 10.40 a.m.)