



Australian Government

Department of Infrastructure and Regional Development

# National Public Private Partnership Guidelines

## Volume 2: Practitioners' Guide



October 2015



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## Components of the Guidelines

National PPP Policy Framework

National PPP Guidelines Overview

National PPP Detailed Guidance Material

Volume 1: Procurement Options Analysis

**Volume 2: Practitioners' Guide**

Volume 3: Commercial Principles for Social Infrastructure

Volume 4: Public Sector Comparator Guidance

Volume 5: Discount Rate Methodology Guidance

Volume 6: Jurisdictional Requirements

Volume 7: Commercial Principles for Economic Infrastructure

Roadmap for applying the Commercial Principles

## Document Updates

This Policy will be updated from time to time to reflect evolving best practices and lessons learned.

Version control	Last updated	Updated sections
1	December 2008	Original publication
2	March 2011	New chapter 16 Post-tender Debriefing Principles. Updated Appendix E.1 Interactive Tender Protocols
3	October 2015	New content throughout Part One to reflect updated practice and Productivity Commission recommendations. Revised chapter 7 on contract management and a new chapter 9 on modified funding and financing options.

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# 1 Introduction

## 1.1 The National PPP Guidelines

Australian governments are committed to investing in infrastructure and delivering improved services to the community. Infrastructure investment is critical to our economic prosperity and governments across jurisdictions currently seek the participation of the private sector in the delivery of infrastructure and related services to the public. Public Private Partnership (PPP) arrangements are one way of delivering infrastructure investment.

The National PPP Guidelines (the Guidelines) have been prepared and endorsed by the State, Territory and Commonwealth Governments as an agreed framework for the delivery of PPP projects. The Guidelines provide a framework that enables the public and private sectors to work together to improve public service delivery through private sector provision of infrastructure and related services.

These Guidelines set a framework for the procurement of PPPs on a national basis and apply across State, Territory and Commonwealth arrangements.

As a general principle, it is expected that a high degree of uniformity and agreement has been achieved in these Guidelines. However, specific requirements of individual jurisdictions, where different from or in addition to the Guidelines, will be detailed in *Jurisdictional Requirements Documents*. These will need to be read in conjunction with the Guidelines to detail the framework relevant for the procurement of PPP projects in individual jurisdictions.

Further guidance on how these Guidelines are to be applied to PPP projects within individual jurisdictions (in terms of when the Guidelines will need to be adopted) is detailed in the *National PPP Policy Framework*.

## 1.2 The Practitioners' Guide

The *Practitioners' Guide* is one of the detailed guidance documents that form part of the Guidelines. It provides guidance to government departments and agencies across jurisdictions on how PPP processes should be implemented in a consistent manner.

The *Practitioners' Guide* is specifically drafted to apply to the implementation of a project from the point of a government decision to proceed with a project as a PPP. It does not attempt to address issues related to the process for government approval of the project or the process for assessing different procurement options.

Once government has approved the project to proceed as a PPP, the Procuring Agency must deliver the project consistent with these Guidelines. However, given these Guidelines must be applied to a wide range of different types of projects, there may be cases where it is appropriate to depart from the processes set out in these Guidelines. Where this is the case the Relevant PPP Authority should be consulted about any departures.

## 1.3 Structure of the Practitioners' Guide

The *Practitioners' Guide* has been structured in two parts:

- **Part One** provides an overview of the PPP implementation process from the point following the investment / procurement decision through to the end of the contract term. It identifies a range of specific issues that are likely to arise at the various phases and provides guidance on methods to address these.
- **Part Two** provides more detailed information and guidance on specific issues that have been identified within the PPP process overview in part one of the document. For example, part two provides detailed guidance on project structure and resourcing, the interactive tender process, and conflicts of interest.

## 1.4 Supporting material

The suite of publications comprising the Guidelines is as follows:

National PPP Policy Framework

National PPP Guidelines Overview

National PPP Detailed Guidance Material

- Volume 1: Procurement Options Analysis
- Volume 2: Practitioners' Guide
- Volume 3: Commercial Principles for Social Infrastructure
- Volume 4: Public Sector Comparator Guidance
- Volume 5: Discount Rate Methodology Guidance
- Volume 6: Jurisdictional Requirements
- Volume 7: Commercial Principles for Economic Infrastructure
- Roadmap for applying the commercial principles

*Jurisdictional Requirements Documents* will provide details of individual jurisdictional requirements and will need to be read in conjunction with the Guidelines.

In addition, there is a *National PPP Policy Framework* that details the scope and application of the Guidelines across jurisdictions.

## 1.5 Updates

Updates to the *National PPP Guidelines* will be published, on the [Infrastructure Australia website](#).

This third version of the Practitioners' Guide was released in October 2015 to reflect updated practice and recommendations from the Productivity Commission. This version contains a new Chapter 9 on modified funding and financing options and a revised Chapter 7 on contract management.



# **Part One: PPP Delivery**

## 2 Key phases of PPP delivery

### 2.1 Government approval processes

Government will be responsible for approving the initial project investment as well as the decision to procure the project using a PPP process. Government funding should be appropriated prior to pursuing procurement through a PPP process. This demonstrates to the market and the public that government is committed to undertaking the project.

Individual jurisdictions will determine the level of government approval required for using a PPP process. This may vary on a project-by-project basis.

There are a number of key milestones in the PPP process at which governments should approve various actions before the project proceeds to the next phase. In particular, these key project milestones involve the:

- release of EOI;
- release of RFP;
- selection of a preferred bidder; and
- execution of the contract.

Governments should also be notified of and/or endorse the outcomes at the selection of the short-listed bidders following the EOI phase and the final negotiated outcome.

Additional approvals should also be required in certain situations such as:

- where there is a material change to the project including an amendment to the key project objectives, scope of services or where the conclusions or major assumptions of the business case (including the economic and financial appraisals) change significantly;
- if there is any material change in the risk allocation from that which was last approved by government;
- if an amendment to the budget funding is required; and
- where issues relating to the public interest arise.

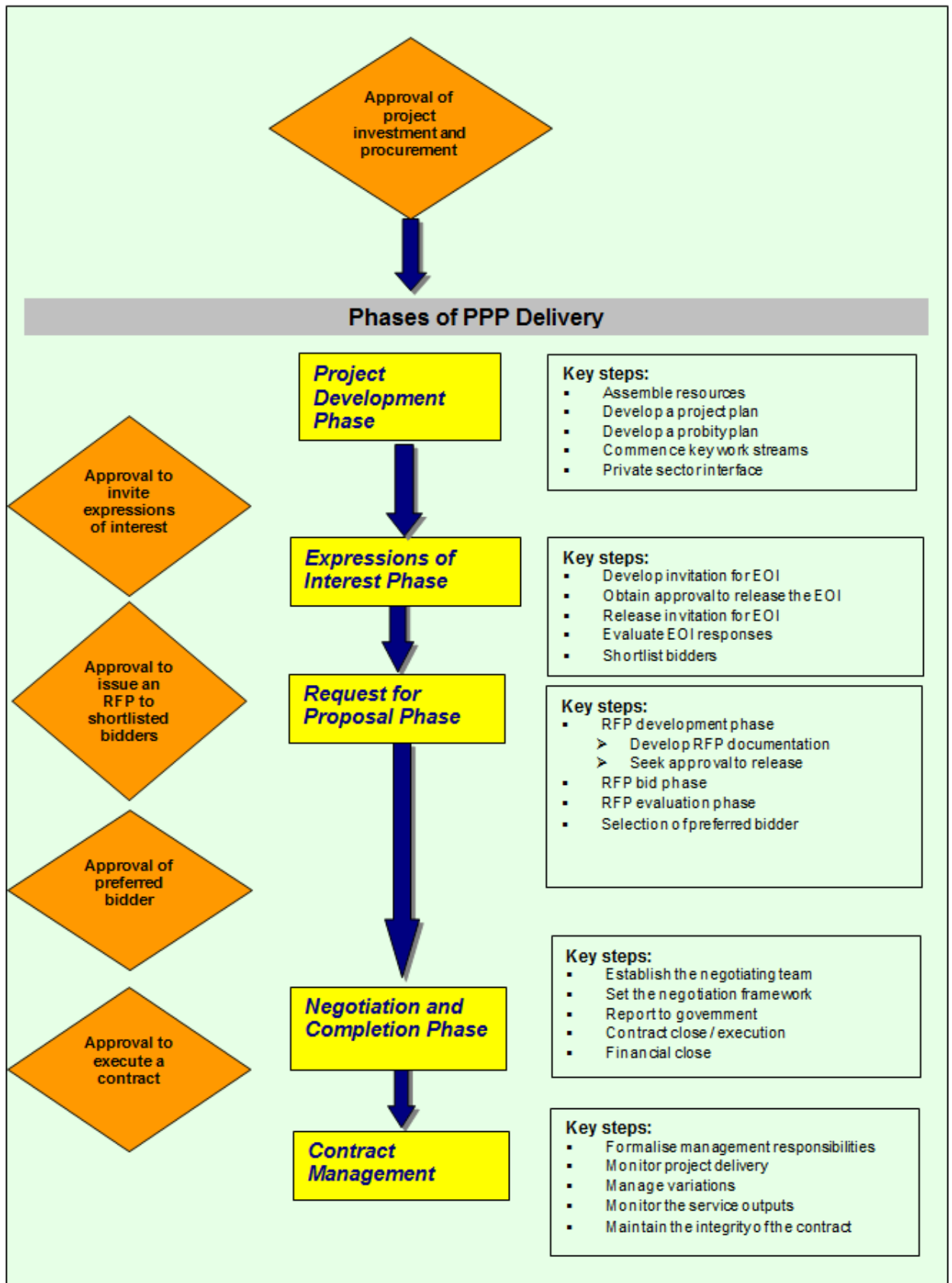
Planning approval processes will vary between jurisdictions but should ideally occur concurrently with the PPP procurement tender and negotiation phases.

Furthermore, if the Procuring Agency wishes to renegotiate any area of a PPP contract after it has been approved and signed by government, the agency should be required to obtain approval prior to commencing renegotiations from the Relevant PPP Authority.

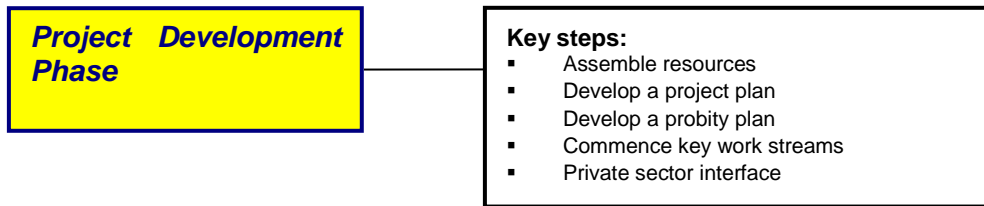
### 2.2 Key phases in the process

The following flow chart outlines the key phases in delivering a PPP project. Each of these phases is expanded upon in this guidance material.

Figure 2-1 Phases of PPP delivery



## 3 Project development phase



Following endorsement by government of the project and approval of the funding and procurement method, the project is further developed. This requires the assembly of resources and development of the project structure, scope and commercial principles, in readiness for seeking formal market interest.

### 3.1 Assemble resources

While some resources will have been devoted to developing the business case, a full team is generally not assembled until the proposal has been endorsed by government. Once government approval is obtained, a team is needed to develop and deliver the project.

The complexity and scale of PPPs requires a team-based management approach to ensure all the required skills are effectively applied. Teams must have clear lines of accountability and sufficient flexibility to optimise the input of a diverse management team. In this way the public sector will reflect the breadth of skills brought to the project by a private sector consortium. Key aspects include:

- a Project Director responsible for delivery of the project;
- a Project Steering Committee to direct the development of the project and deal with strategic and/or policy issues; and
- a dedicated project team comprising both internal staff and external advisors to develop and implement the PPP project, comprising commercial, financial, legal, design, operational, planning and environmental approval and other expertise.

The quantity and quality of the project team will be critical to the success of the project.

Section 8 provides further detail on assembling resources.

### 3.2 Develop a project plan

One of the key initial tasks for the project team is to develop a detailed project plan including an overall project timetable. This plan needs to take into account all the key steps in the process including document development, stakeholder consultation, private sector interface and the government approval process. Each project requires separate consideration of the timetable appropriate to the transaction.

The success of the project will be materially influenced by the quality of the up-front work on developing and structuring the project. It is important to recognise the value of this investment and not attempt to rush the early stages of the process.

### 3.2.1 Timetable management

Timetable development and management is a key factor in successfully delivering the project. Significant attention should be paid to the procurement timetable and to ensuring all parties adhere to the timetable. Bidders are required to meet certain timeframes and this discipline should be matched by the Procuring Agency in document development, the project review process (i.e. Gateway), bid evaluation and approval processes.

Additionally, consultation with key stakeholder and community groups is a key aspect of ensuring the project will deliver its goals, objectives and ultimately, the desired services. Sufficient time for this consultation should be built into the timetable. This consultation will need to be carefully planned. Section 16 provides further details on communication during the PPP process.

Practical experience also demonstrates that time spent in preparing the RFP to a high standard can reduce the time and volume of issues required to be addressed as part of the negotiation phase. Likewise, time spent running an efficient and tight procurement process can lead to efficiencies in the construction phase.

The project lifecycle stages and approximate timelines are outlined in the table below.

**Table 3-1: Project lifecycle stages and timelines**

Project stage	Duration (approx.)
Project development <ul style="list-style-type: none"> <li>• Assemble resources</li> <li>• Develop a project plan</li> <li>• Develop a probity plan</li> <li>• Investigate site and approval issues</li> </ul>	3+ months
Project tendering/procurement <ul style="list-style-type: none"> <li>• Expression of interest</li> <li>• Request for proposal</li> <li>• Evaluation and negotiation</li> <li>• Contract execution</li> </ul>	12-18 months
Design, construction and commissioning <ul style="list-style-type: none"> <li>• Design</li> <li>• Construction</li> <li>• Commissioning</li> </ul>	1 - 5 years
Operational service delivery <ul style="list-style-type: none"> <li>• Ongoing contract management</li> <li>• Maintenance and upgrades</li> </ul>	25+ years
Contract expiry or termination <ul style="list-style-type: none"> <li>• Handover</li> </ul>	6-12 months

### 3.2.2 Gateway Reviews

The project plan and timetable may need to include quality assurance reviews such as Gateway Reviews. Gateway Reviews consist of a series of structured reviews that examine procurements at key decision points (or gates) in the procurement cycle, and are used to improve on-time and on-budget delivery of major projects. Gateway Reviews are undertaken in meeting individual jurisdictional requirements and should be completed as required.

## 3.3 Develop a probity plan

With government being the custodian of public money, it is imperative that a transparent process is followed throughout the procurement process. Accordingly, a Probity Practitioner (i.e. advisor and/or auditor) should be appointed to ensure that a transparent and robust process is followed at all times. The Probity Practitioner must be an objective monitor of the tender process throughout and provide advice to the project team and the Project Steering Committee.

To ensure that probity concerns are addressed early in the process, the upfront development of a probity plan endorsed by the Probity Practitioner and approved by the Project Steering Committee is vital. Other probity issues, such as identifying any conflicts of interest, should be dealt with through the probity plan when the team is first established.

Probity issues are discussed further in Section 14 and conflict of interest is discussed in Section 14.6.

## **3.4 Commence key work streams**

During the project development phase the project team should start the processes that will continue to be addressed as part of the invitation for EOI and RFP development including the further development and refinement of:

- the design requirements;
- the operational and service requirements, including the scope of the core and non-core services;
- the key project-specific commercial principles;
- the project risks and preliminary allocation; and
- the public sector comparator (PSC).

As the EOI and RFP documentation depends on the information derived from these work streams it is important to start these as early in the process as possible.

In addition, three specific issues that should be addressed during the project development phase are: undertaking site investigations; obtaining planning/environmental approvals and considering any relevant public interest matters.

At this stage it is important to confirm the scope of the project in terms of core and non-core services.

Developing design requirements is a key early work stream. It is critical to inform the reference project costing. Design is also an important input into the planning and environmental approval process that may commence parallel to the project development and the tender phase.

### 3.4.1 Site investigation reports

Government will indicate whether it intends to specify a preferred site, nominate a definite site or leave the question of location open to bidders (i.e. the site is a hospital project – need to service a particular locality). The adequacy of the site will have important implications for delivering the project.

Factors that can affect site adequacy include:

- suitability;
- issues arising in site acquisition;
- environmental liabilities arising from site features; and
- native title issues.

Governments will usually appoint independent consultants to undertake due diligence on the proposed site and relevant site conditions and prepare a site assessment report. This information will usually form information provided in the invitation for EOI and RFP documentation and the reports will usually be provided to short-listed bidders during the RFP phase.

Given the significant time often involved with undertaking these investigations and the requirement for this information to be available to develop key aspects of the RFP documentation, this work should be undertaken early.

In order to reduce bid costs, the Procuring Agency may commission site due diligence reports and make them available to all bidders. If this approach is adopted, it is important for the Procuring Agency to ensure the reports can either be novated or relied upon by third parties (i.e. bidders). In the project development phase it may also be useful to seek and incorporate feedback from the market on the extent of site testing and the organisations conducting the site testing, to ensure the due diligence can be relied upon by bidders. This information may be updated throughout the EOI and RFP phases prior to bid submission.

Further information on how specific site risks are allocated between government and the private party can be found in the *National Commercial Principles for Social Infrastructure*.

### 3.4.2 Planning and environmental approvals

Requirements relating to planning and environmental approvals can have a significant impact on project deliverability. As a general principle, government will undertake to obtain planning and environmental approvals where they are fundamental to the use of the site for the project.

Given the significant time often associated with obtaining these approvals and the importance of this information to the development of RFP documentation, this work should be undertaken early in the project.

Further information on how planning and environmental approval risks are allocated can be found in the *National Commercial Principles for Social Infrastructure*.

### 3.4.3 Public interest matters

Governments consider the public interest in all investment evaluation decisions and subsequent project procurement decisions. Each jurisdiction will have its own method for considering public interest matters.

Once an infrastructure project is approved for PPP delivery there may be processes for assessing and maintaining oversight of public interest matters. Considering public interest matters such as access, accountability and consumer rights is an important part of the PPP planning and project development. Ongoing monitoring of public interest matters during procurement will be useful in ensuring that the project continues to be in the public interest.

Further guidance on public communication activities is contained in Section 16. Reference should also be made to individual Jurisdiction Requirement Documents for any further guidance on public interest matters.

## 3.5 Private sector interface

Prior to the release of the invitation for EOI and as part of the development and refinement of the project scope, it is useful to engage with the private sector. This engagement has a range of benefits for both government and the private sector. For example, this interface can assist the government in ensuring a common understanding of the project requirements and encouraging market interest and participation. In addition, it can enable the private sector to assist in the shaping of the project specifics to ensure that an optimal outcome is achieved.

There is a range of issues that may be discussed at this phase based on project specifics. Some examples include:

- the scope of the project;
- design or constructability issues (including likely planning and environmental approval conditions to the extent they can be foreseen);
- project timelines;
- project-specific issues and requirements; and
- market interest and capability.

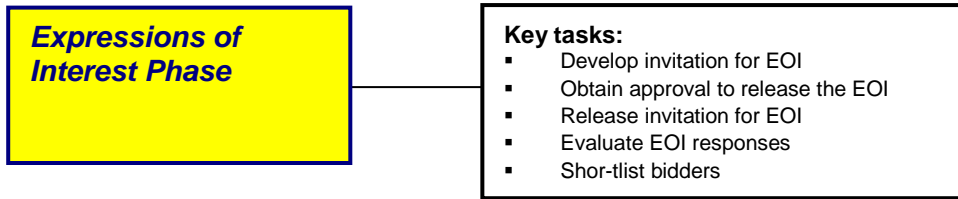
For larger and more complex projects market sounding could also test the potential packaging of the project and the scale of discrete elements. This could inform how the Procuring Agency considers interface risk and structures the project to take to market.

For a smaller project, market sounding could also include the potential bundling of sites or elements to test market appetite for a bundled approach.

Engaging with the private sector is normally subject to probity considerations relevant to each jurisdiction.



## 4 Expressions of interest phase



Comprehensive project development leads to the next stage of issuing an invitation for expressions of interest (EOI) to the marketplace.

As discussed in the project development phase section, while some consultation with market participants and marketing of the project is expected (and encouraged) to precede this stage, the EOI phase is the first step in the formal bidding process.

The purpose of the invitation for EOI is to:

- formally advise the market of the project and the services that government seeks to have delivered;
- communicate to the market the proposed timeframes, evaluation criteria and hurdles to be met for the project to move forward;
- confirm the level of market interest in the project and provide an avenue through which potential EOI respondents can comment on the proposed project structure; and
- gain EOI responses from the market which allow government to short-list bidders to proceed to the RFP phase who are most capable of meeting project objectives over the project term.

### 4.1 Develop the invitation for EOI

The invitation for EOI typically draws upon much of the work already done in the business case and during project development. While it is not intended to set out the detailed service delivery specifications, it contains sufficient information to allow potential EOI respondents to form a view on whether they have the necessary capabilities and to identify both the parties they may need to join with to develop a viable bid and the likely project risks.

The invitation for EOI should not require potential EOI respondents to expend significant resources in preparing an EOI response.

### 4.1.1 Contents of the invitation for EOI

The contents of the invitation for EOI should include the following.

#### ***Background***

- a brief description of the Procuring Agency's background, function and purpose;
- an overview of the project, its objectives and how it fits into the government's strategic plan; and
- the identity and, where appropriate, the source of power of the public sector party to enter the contract.

#### ***Project scope and timetable***

- details of the infrastructure likely to be required to meet government's needs;
- details of the services that the private sector is being invited to deliver (e.g. in a hospital project, the invitation for EOI may indicate that the private sector is expected to deliver the accommodation, catering, security and some administration, but not core clinical services); and
- the proposed timeframes for the project, including dates for all key milestones.

#### ***Financial and commercial information***

- the proposed risk allocation and high-level commercial principles that will apply, including details of the proposed payment mechanism (to the extent it has been developed) and the manner in which site issues will be dealt with; and
- specific constraints, including the funding available from government where a cap exists.

#### ***Evaluation criteria***

The evaluation criteria at the EOI stage will need to be specifically tailored to each project. However, the following provides an overview of the issues common to the evaluation of most PPP projects:

- General:
  - understanding of project objectives and the government's requirements for the project;
  - understanding of the key project issues and challenges, and identification of proposed solutions;
  - experience and capability in managing project interfaces including with government and key stakeholders;
- Experience & Capability:
  - experience and capability of the sponsor in leading PPP projects;
  - local or international experience and capability in successfully designing, constructing, financing, maintaining and operating major infrastructure including

projects specifically relevant to the infrastructure and services being procured, and projects of a similar size and complexity;

- the experience of the consortium members in working together;
- Commercial & Financial:
  - proposed commercial structure, intra-consortium risk allocation and financial support provided by parent company, associates or financial institutions;
  - proposed funding structure;
  - demonstrated understanding and acceptance of the proposed risk allocation and commercial principles;
  - financial capacity to meet the likely contractual obligations associated with the project; and
- Other:
  - confirmation of no conflict of interest.

### ***General terms and conditions***

- a statement that government retains the right to amend the process or not to proceed with the project;
- a statement that no costs associated with preparing a response to the EOI will be reimbursed by government under any circumstances;
- details of the manner in which intellectual property contained in the EOI responses will be treated. Typically, this provides assurance that information provided by an EOI respondent will not be released. However, government retains the right to accommodate comments made in the EOI phase in revisions to the proposed RFP;
- advice that government is not required, and does not intend, to release any details regarding the evaluation process after it has occurred; and
- the format, date and place of receipt of EOI responses.

## ***EOI response requirements***

The requirements of the EOI response should be tailored to match the specific evaluation criteria to ensure that the project team receives the information it requires to measure responses against stated criteria. Information should only be requested where it is directly relevant to the evaluation. Based on this and the indicative evaluation criteria identified above, some of the information that is likely to be required includes:

- General information:
  - an overview of the EOI respondent's understanding of the project objectives and government's requirements for the project;
  - details of the key issues identified by the EOI respondent and the proposed solutions;
  - outline of the proposed process for project interface including with key project stakeholders;
- Experience:
  - details of the experience of the consortium sponsor in leading PPP projects;
  - information on the EOI respondent's (including each key consortium member) expertise and capability and why it considers it can satisfy the requirements of the project;
  - information on past projects where the consortium members have successfully worked together;
- Commercial & financial information:
  - details of the EOI respondent, including details of each participating organisation if it is a consortium, the formal nature of their agreement to bid as a consortium and indicative terms of arrangements of any special purpose vehicle;
  - details of the proposed funding structure;
  - demonstration of an understanding and acceptance of the proposed commercial principles/risk allocation;
  - details of the financial position of each consortium member and proposed parent backing, if relevant; and
- Other information:
  - confirmation that neither the bidder nor any member of the consortium has any actual or potential conflicts of interest.

Importantly, the form of response for non-project-specific requirements, such as the financial position of the companies involved, should be consistent as far as possible with the EOI submission requirements for PPP projects in the same and other jurisdictions.

## 4.2 Obtain approval to release the EOI

Government approval of the EOI document should be obtained prior to release of the EOI. Any changes to the key project parameters previously approved (e.g. risk, scope, funding, public interest considerations, etc.) should be highlighted.

## 4.3 Release of the invitation for EOI

The invitation for EOI is typically advertised publicly to provide an opportunity for all interested parties to respond. Specific jurisdictional requirements may require making the EOI available through certain procurement websites or may otherwise require the application of prescribed advertising guidelines. The timeframes for responses vary depending on the scale and nature of the project, although a typical period for responses is around four to six weeks.

Where it is considered relevant, depending on the nature of the project a briefing session may be held for parties interested in responding to the invitation for EOI. This can add value to the project by more clearly communicating and/or reiterating the requirements of government.

## 4.4 Evaluation of EOI responses

Prior to the receipt of the EOI responses, a clear and transparent EOI evaluation plan should be developed and endorsed by the Probity Practitioner and approved by the Project Steering Committee. The Probity Practitioner is independent of the Project Steering Committee and is responsible for monitoring the bidding process at critical stages, such as the receipt of EOI responses, and is responsible for assessing and reporting whether the process has been conducted to the required standards of probity.

The purpose of the EOI evaluation plan is to provide an evaluation framework to assist the evaluation panel in short-listing an appropriate number of bidders to participate in the RFP phase of the tender process. In particular, an evaluation plan should detail:

- the objectives of the evaluation process;
- an appropriate evaluation team structure, including protocols on interaction with specialist advisors and bidders during the evaluation process;
- an evaluation methodology that covers how proposals will be assessed and the relative importance of particular evaluation criteria; and
- a clearly documented approvals process, including the role of government and the Project Steering Committee.

As part of the evaluation, bidders may also be invited to an interview, or to give presentations of their proposals to the evaluation panel and separately to the Project Steering Committee.

The evaluation will outline a process that is fair and equitable so that EOI responses are objectively evaluated in accordance with the criteria set out in the document.

EOI responses will be evaluated by an appropriately qualified evaluation panel chaired by the Project Director. External financial, legal and technical advisors will usually support the panel.

Further information on key aspects to consider in evaluating EOI responses is found in Section 13.

## 4.5 Short-list bidders

Based on the evaluation process, the evaluation team will choose a short list of bidders who are invited to participate in the formal bidding process, known as the RFP phase.

The short-listed bidders generally include two or three parties to ensure there is adequate competition and the risk of a party withdrawing is covered. Certain instances (such as the presence of related parties bidding or a specific need to increase competitive tension) may require a short list of more than three parties. However, a short list of more than three can potentially lead to some short-listed bidders losing interest, as the chance of success may not warrant the significant investment of time and resources in preparing a bid. In instances where there are only a limited number of private sector parties capable of bidding, a short list of fewer than three bidders may be considered appropriate.

Approval or endorsement of the proposed short list should be sought before notifying EOI respondents.

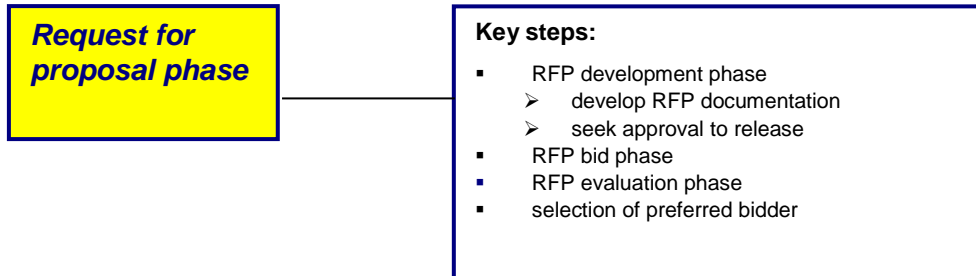
As a pre-condition to short-listing, bidders should be required to execute a probity and process deed or similar document which outlines the probity, confidentiality, security and other processes applicable to the RFP phase.

The probity and process deed should be issued either as part of the invitation for EOIs, or to those parties that submit an EOI, immediately following receipt of their EOI.

The opportunity for a debrief should be provided for the parties not short-listed. These debriefs can assist all parties in their response to future projects.

## 5 Request for proposal phase

Following the short-listing of bidders during the EOI phase, the request for proposal (RFP) phase is the next key phase in the PPP process and involves the release of the RFP and evaluation of proposals to select a preferred bidder.



### 5.1 RFP development phase

#### 5.1.1 Develop RFP documentation

Development of the RFP should be undertaken concurrently with the development and evaluation of EOIs. This enables the project to proceed in the most efficient manner and will require the project team to be sufficiently resourced to manage the multiple project components concurrently.

The RFP is the formal bid document issued by government. Its purpose is to outline the specific requirements of government (including the design, operational, commercial and legal aspects) and to seek fully committed and binding responses from the short-listed bidders. This makes the RFP the single most important document in the PPP process. It is therefore important that sufficient time and expertise are invested in its development. Short-listed bidders expend considerable time and money on the bidding process and a poorly structured definition of the project requirements, lack of clarity about the hurdles to be met, or subsequent amendments to the RFP are likely to draw criticism and adversely affect the timeframes.

The RFP documentation is often extensive and can contain multiple sections. The quality of the RFP documentation is a key factor in running an efficient tender process and managing bid costs. An example of the RFP document structure for a social infrastructure project is shown in the table below.

Table 5-1: Example RFP documentation

Volume	Description
Volume 1	General information and instructions to proponents
Volume 2	Commercial framework summary
Volume 3	Evaluation criteria and proposal schedules
Volume 4	Design brief
	Part A Functional brief
	Part B Architectural principles and specifications
	Part C Technical specification
	Part D Equipment list
Volume 5	Draft contractual documents
	Draft project agreement
	Service specifications
	Schedules inc. payment mechanism and direct deeds
	Annexures
Volume 6	Other information

The following sections detail key components that should be included in RFP documentation.

### **General information**

This section provides general information and instructions to short-listed bidders on the project and the tender process. The general information section should contain details of the following key aspects:

- overview of the RFP – should provide an overview of the RFP structure and content;
- background – including details of the project objectives and rationale, site details, government's role, responsible agency and key stakeholders;
- project scope – should provide a high-level summary of the project scope and key elements;
- tender process – should provide details of the formal tender requirements and processes which will apply throughout the RFP bid phase and during the RFP evaluation phase. This will include requirements for communication, such as the interactive tender process requirements; and
- PSC - details of the public sector comparator including disclosure of the raw PSC and/or risk-adjusted PSC.



## Commercial framework summary

As noted in the contractual documentation section above, the RFP will often include a commercial framework summary that provides a plain English summary of the proposed risk allocation issues and key commercial principles of the project. This document should be developed by the project team in advance of the contractual documents to ensure the key principles are agreed prior to commencement of legal drafting.

The commercial framework summary should address all key commercial principles including:

- **term** – details the duration of the project, expected project commencement and termination dates, and any extension or renewal periods if applicable;
- **payment mechanisms** - sets out how the services delivered will be paid for. This is based on a principle that government starts making payments only when service delivery commences (i.e. post-commissioning) and that payments cease or reduce if key performance indicators are not met at the specified level. Payment mechanisms also support the risk allocation set out in the contract;
- **site issues** - refers to the principles of risk allocation regarding site suitability and includes issues that may arise in site acquisition, environmental liabilities arising from site features (including contamination), heritage considerations, requirements related to planning and other approvals, and native title issues;
- **force majeure** - sets out the regime for dealing with an event outside the control of either party, which prevents the private party from complying with its obligations under the contract;
- **change in law** - refers to allocation of the risk that the agreed legal, policy and regulatory framework will change during the contract term which has a financial impact on the project;
- **modifications** - sets out the regime through which government can make modifications to the project throughout the term, including the mechanism for appropriate reimbursement;
- **termination and step-in rights** - sets out the circumstances and conditions under which government can terminate the agreement, or step in and assume service delivery obligations; and
- **end of term arrangements** - covers the proposed arrangements at the end of the contract period in relation to assets owned by the private party. These arrangements could vary from a scenario where government and the private party are not subject to any predefined arrangements, to a defined transfer price for which government can purchase the assets.

Further information on the principles of risk allocation including the payment mechanism and further information on key commercial principles are contained in the guidance documents, *Roadmap for applying the commercial principles*, *Commercial Principles for Social Infrastructure* and the *Commercial Principles for Economic Infrastructure*.

## ***Evaluation criteria & proposal schedules***

The RFP should set out the basis upon which bids are to be evaluated, including the categories to be assessed and the evaluation process that will be followed. Evaluation criteria should be developed by reference to the requirements of RFP responses. The RFP must also outline the information required to be submitted by short-listed bidders (in the form of proposal schedules) in response to the requirements of the RFP and in a form specifically tailored to address the individual evaluation criteria. This alignment of the proposal schedules with the evaluation criteria will ensure that the evaluation panel receives the information that it requires to evaluate the proposals and generate significant efficiency in the evaluation process. It also provides a clear framework for short-listed bidders to understand how the information contained in their proposals directly addresses each evaluation criterion.

### **Evaluation criteria**

While the criteria will vary for each project, the key categories for assessment typically include:

- design – including a master plan, architecture, functionality, technical performance and likelihood of receiving planning and environmental approval;
- operational/services – including the proposed solutions for the delivery of the required services during the operating period;
- project management – including the proposed process for design, construction and completion including strategies for minimising the impact on the surrounding environment;
- commercial – including the commercial structure and the extent of contractual departures;
- financial – including the funding structure, certainty of finance and other financial assumptions;
- interface management – including the proposed processes for interfacing with other consortium members, government and key stakeholders throughout the life of the project; and
- risk adjusted cost – the financial ‘price’ of the proposal appropriately adjusted for risk.

The evaluation criteria are a mix of qualitative and quantitative criteria. Further details on the RFP evaluation are contained in Section 5.3.3.

### **Proposal schedules**

As noted above, the RFP will set out the information each short-listed bidder must provide in its proposal to enable government to assess responses against each evaluation criterion. The Procuring Agency should develop the response schedules so they directly relate to the information required to differentiate bidders using the evaluation criteria. This is important to manage bid costs. In developing the proposal schedules, the Procuring Agency should consider what information is necessary for evaluation purposes and what information could be deferred to the preferred bidder phase and be submitted prior to executing a contract.

The specific proposal schedules will vary depending on the requirements of each project however the following provides a range of information likely to be required for most projects:

- Design:
  - master plan and architectural plans outlining the proposed design;

- perspectives and images of the proposed design;
- diagrams/plans demonstrating the functionality of the design;
- details of the engineering solution;
- Operational/services:
  - details of the management structure for the operating phase;
  - details of the proposed operational practices and method statements for the delivery of the operational services;
- Project management:
  - An overall project management plan encompassing the proposed approach to the refinement of design, management and implementation of the construction, commissioning process, mitigation of business continuity issues and environmental management;
- Commercial:
  - details of the consortium structure including intra-consortium risk allocation;
  - a description of the ownership/equity structure of the entity that will enter into the partnerships with the public sector;
  - details of any aspects that involve a proposed departure from, or variation to, the provisions of the contractual documents;
  - third-party revenue opportunities;
- Financial:
  - details of the proposed funding structure and level of commitment;
- Interface management:
  - details of the proposed approach to interface with other consortium members, government and key stakeholders;
  - outline the manner in which the interface with government will demonstrate a partnership approach; and
- Risk adjusted cost:
  - the audited financial model that clearly outlines all key project cash flows, treatment of tax and progressive profit and loss data.

The Procuring Agency should consider the level of detail required when developing the proposal response schedules. There is a balance between achieving a more streamlined process and having sufficient certainty to evaluate bids. Some examples of streamlining requirements that have been implemented to reduce bid costs include:

- requesting marked up project documents or departure schedules, but not both, as this can lead to reconciliation issues;

- including outline plans in submissions and deferring fully developed plans until the preferred bidder stage; and
- deferring some plans, such as communications and stakeholder management, to the preferred bidder.

### ***Output specification***

The output specification in the RFP should clearly set out the outputs that the Procuring Agency is seeking. The requirements should be expressed, as far as possible, in output terms and not in prescriptive input terms. Prescribing a solution based on inputs may result in a viable alternative solution and potential risk allocation being discounted too early in the process. It also discourages innovation.

The output specification defines the outputs for construction and services for the project and outlines the Procuring Agency's minimum design, functional, technical and furniture, fittings and equipment requirements for the project. In particular, the output specification is likely to comprise the following:

- **functional brief** - outlines the government's key design principles for the project, the understanding of and approach to design that forms the basis of the design requirements, and detailed accommodation requirements for the facilities;
- **architectural specification** - details the minimum accommodation building and fabric performance standards that the private sector must provide to all the facilities, as well as the site constraints and compliance matters that the private sector must meet when undertaking the works on each site;
- **technical specification** - details the minimum performance standards for each element of the building engineering services, civil and structural requirements, utility, ICT and communication requirements that the private sector must provide to all facilities;
- **furniture, fittings and equipment (FF&E) specification** - details the FF&E requirements for the project; and
- **services specification** - provides details of the facilities management services to be provided during the operating term, including the scope of service, responsiveness and service quality to be provided. The services specification should ultimately be attached as a schedule to the contractual documents. The service specification should also include details of how the performance of the private party will be monitored and measured and the relationships between performance and payments. The proposed payment arrangements must support the risk allocation being sought.

An output based design or architectural specification enables maximum flexibility and opportunity for design innovation by bidders, however it can lead to high bid costs if not appropriately managed. During the interactive tender process, early scheduling of master planning and design workshops ensures design issues can be tested with the Procuring Agency.

### ***Contractual documentation***

While this section refers to a contract, it is likely that there are a number of contractual documents associated with each project. The contract is a comprehensive document which includes certain schedules to be completed based upon information from the successful RFP response. Some of the potential contractual documents to be included as part of the RFP are:

- the project/concession agreement;

- services specifications;
- direct/tripartite deeds with financiers, builders and operational service providers; and
- security documents providing government with rights over the assets of the project.

The issue of the contract as part of, and concurrently with the RFP, ensures that all parties are aware of the specific contractual terms that government is seeking and have enough opportunity to raise any issues of concern. It also limits, where relevant, subsequent negotiations to clearly identified and fully drafted departures.

Prior to the drafting of the contractual documentation, the key commercial principles should be agreed. These are often summarised in a commercial framework summary and included as part of the RFP (as well as being used to instruct the legal team in its drafting).

As part of the RFP response, bidders should be asked to provide a departure schedule which identifies all instances where they have departed from the draft contractual documents included as part of the RFP, including the rationale and cost for each departure.

Jurisdictions may also require a fully marked up contract and schedules outlining any instances of departure from the draft contracts.

### **5.1.2 Public Sector Comparator (PSC)**

In a PPP project, the PSC forms a key part of the evaluation process. In the absence of other factors, if no bid offers value for money, government may elect not to proceed with the project as a PPP. The PSC should be finalised prior to issuing the RFP and only altered following receipt of bids for the purpose of comparison with RFP responses (where variances occur and are permitted), or to rectify an error. Timing, with respect to the approval of the PSC, will be determined on a jurisdictional basis.

Further information on the compilation of the PSC is contained in *Public Sector Comparator Guidance*.

### **5.1.3 Private sector interface**

As discussed earlier in the document, continued interface with the private sector throughout the project can be beneficial to both government and the private sector. During the RFP development phase this interaction can assist government in discussing project scope and other issues with the short-listed bidders to obtain their input prior to issuing the RFP.

### **5.1.4 Complying proposals**

Government will generally identify in the RFP documentation the parameters and requirements of the RFP to which the private sector must conform to be deemed a complying proposal. This will usually identify which requirements are mandatory (i.e. no variations will be allowed) and those where certain departures may be considered (providing these departures are in accordance with the RFP instructions) and will still result in the bid being considered as a complying proposal.

The definition of a complying proposal will be determined by each jurisdiction on a case-by-case basis. Each jurisdiction is responsible for identifying how a non-complying proposal will be treated.

### **5.1.5 Obtain approval for issue**

Approval for the release of RFP documents should be obtained before issuing the document to short-listed bidders. Key aspects that should be included in any approval at this stage include:

- confirmation of the project scope and objectives;
- any adjustment to the PSC; and
- any departures from the standard commercial principles.

## 5.2 RFP bid phase

This is the phase following release of the RFP to the short-listed bidders when they are preparing their RFP responses. A key aspect during this phase involves communication protocols, and in particular, the conduct of interactive tender processes.

### 5.2.1 Interaction with short-listed bidders

During the RFP phase there will be a number of avenues to provide short-listed bidders with opportunities to obtain additional information and address queries, which are outlined below.

Section 16 provides further details on communication during the PPP process.

#### ***Data room***

The efficiency of the process can be enhanced by making available to short-listed bidders all relevant information the Procuring Agency has that may aid in the preparation of a response to the RFP. Such information, including any analysis of legislative and regulatory impacts, feasibility studies, land use considerations, geological information, demand estimates and the like, should be made available, with appropriate disclaimers, in a data room.

This data room may be a physical room and/or an electronic equivalent. Alternatively, the information could simply be provided to bidders as part of the RFP documentation.

Short-listed bidders should be advised of the information available and of administrative arrangements for access to and use of the data.

#### ***Query processes***

Short-listed bidders will be able to ask questions of the Project Director through a formal process. Questions should be submitted to the Project Director who in turn will provide responses as soon as practicable.

#### ***Interactive tender processes***

Shortly after the release of the RFP, the Procuring Agency may elect to conduct a single briefing with all short-listed bidders, outlining content and the intent of the RFP, providing guidance on key project issues and emphasising key messages.

Governments should also use an interactive tender process that involves holding a series of individual interactive workshops with short-listed bidders during the RFP bid phase.

An interactive tender process provides short-listed bidders with an opportunity to discuss the development of their concepts and designs and to seek clarification and feedback in the context of the government's output requirements, before lodging proposals. The workshops will also minimise the risk of any misunderstanding of the government's requirements.

The objective is to improve the quality of bid submissions and ultimately deliver better outcomes for the public, through clear communication of the government's requirements to ultimately influence the overall quality of proposals received from short-listed bidders.

Critical to the success of workshops is the level of preparation and willingness to be interactive. An efficient approach is to have the same people attending the workshops from both the bidding party and the Procuring Agency. In certain projects, design may be a key focus of the interactive process, and therefore early scheduling of master planning and design workshops is desirable. An interactive tender process typically involves a series of

presentations and workshops. The workshops are resource intensive. Each will normally involve representatives of both the project team and a short-listed bidder. The workshops are held with individual bidders to enable open communication of the individual intellectual property.

An interactive tender process is appropriate where there is a high level of interface risk between the government (as operators) and the private sector infrastructure providers and/or where there is a potential for misinterpretation of the RFP requirements. A good example is in social infrastructure projects, where the infrastructure is generally designed and constructed by the private sector but substantially operated and managed by the public sector. In this instance, it is in both the government's and the bidder's interest to ensure that the proposed design appropriately addresses the functionality requirements.

The RFP should specify the procedures, timetable and protocols for the interactive tender process. Protocols or ground rules for the workshops should be established and provided to short-listed bidders before the workshops. Short-listed bidders should notify government in writing of their acceptance of the procedures and protocols.

Further guidance on the detail of the interactive tender process is provided in Section 15 and interactive tender protocols are in Appendix E.



## 5.3 RFP evaluation phase

An evaluation panel will undertake a full assessment of the detailed RFP responses submitted by short-listed bidders against the evaluation criteria and will aim to recommend a preferred bidder.

Bids should be evaluated in line with the evaluation criteria detailed in the RFP and in accordance with the details of the evaluation plan. Further details on bid evaluation are provided in Section 13.

### 5.3.1 The evaluation team

As with the EOI phase, an evaluation plan should be developed, before the lodgement of RFP responses. Typically at this time a decision is made on the appropriate structure of the evaluation team. It is common for separate teams to be established to assess the service delivery, design solution and commercial elements of proposals. However, for less complex projects it may be appropriate to establish only one evaluation team which will develop a methodology to ensure all elements are properly assessed.

### 5.3.2 Bid clarification and presentations

The magnitude of information supplied as part of a proposal is likely to generate a range of issues that require clarification with individual short-listed bidders. These questions or issues should be documented and reviewed by the Project Director before being forwarded to the short-listed bidder. The Short-listedshort-listed bidder should provide responses in writing. A formal meeting to discuss the responses may be appropriate and this meeting should be confined to the issues already raised. Care needs to be taken not to convey information on any other proposal.

Depending on the nature of the project, it may be appropriate to invite short-listed bidders to make presentations on the key parts of their RFP responses. If this opportunity is made available, it must be extended to all short-listed bidders. Presentations should observe procedures set out in the probity plan and may take place only after all RFP responses have been lodged. This timing also provides the project team with some time to review the RFP responses and identify any issues that they would like short-listed bidders to clarify. The Probity Practitioner should receive advance notice of presentations.

These presentations should cover the key aspects of their RFP response and clarify matters identified in writing by the Project Director. This reduces the risk of misinterpretation and allows the project team to get a better feel for the basis on which the RFP response has been developed and understand specific aspects in more depth before the detailed evaluation process begins.

### 5.3.3 RFP evaluation

As in the EOI phase, the project should have a clear and transparent evaluation plan that is approved by the Project Steering Committee before receipt of proposals.

The purpose of the evaluation plan is to provide an evaluation framework that details a clear process for evaluating proposals, the evaluation methodology, the approvals process and the evaluation team structure.

While there are a number of important factors to consider in evaluation, the key focus should be on the value for money provided by the proposal. This should be assessed in terms of both the quantitative and qualitative aspects.

Further details on bid evaluation are provided in Section 13.2.

### **Value for money**

The PSC is used as a quantitative benchmark against which to assess the bids. Proposals are assessed against the PSC to determine whether they offer value for money based on the quantitative analysis. However, this quantitative assessment is only one component of the evaluation process.

Every evaluation will consider a range of quantitative and qualitative factors. The PSC is the key management tool in the quantitative assessment of value for money during the procurement process and the evaluation and comparison of bids. However, a complete value for money assessment requires consideration of qualitative factors along with the quantitative assessment. Therefore, identifying the best outcome requires a flexible valuation process and therefore consideration of the qualitative factors associated with the bidders' proposals that have not been explicitly valued.

Further guidance on the value for money assessment is provided in Section 13.2.1.

### **5.3.4 Evaluation reports**

The evaluation process must be the subject of a detailed report(s). The format of these reports should be specified in the evaluation plan which is agreed before proposals are received.

Where the evaluation panel is supported by a range of sub-panels, separate evaluation reports would normally be compiled by each sub-panel. These should then be combined into an overall evaluation panel report to the Project Steering Committee, ranking the bids from most attractive to least attractive. Evaluation reports are discussed in greater detail in Section 13.3.

The evaluation process and report should also include a confirmation from the Probity Practitioner that the evaluation process was undertaken in accordance with the evaluation plan and probity plan. This report should confirm that the probity plan has been followed and that all processes have been conducted fairly and equitably. It would be expected that any issue of concern to the Probity Practitioner would have been communicated to the Project Steering Committee at the time the issue arose.

## **5.4 Selection of a preferred bidder**

Based on the evaluation process, the evaluation panel, in consultation with the Project Steering Committee, should nominate a single preferred bidder as soon as practicable.

If a single preferred bidder cannot be identified after the evaluation phase but the Project Steering Committee believes a value for money solution can be achieved, the Project Steering Committee may agree to an alternative approach to resolve a preferred bidder through:

- short-listing two bidders and undertaking a best and final offer (BAFO); or
- short-listing two bidders and undertaking a structured negotiation process where a greater level of interaction is required to address the outstanding issues.

### 5.4.1 Structured negotiation process

In certain circumstances it may be preferable to undertake negotiations concurrently with two or more bidders prior to finalising the evaluation process and selecting a preferred bidder, rather than undertaking a BAFO.

Pre-selection negotiations should be used where the evaluation panel believes that greater interaction than is usually present in a BAFO, is required with bidders to develop their proposals to a standard which justifies their appointment as preferred bidder.

These circumstances usually arise when a higher level of interaction than would be present in a BAFO is required with bidders to resolve the outstanding issues. This level of interaction may be required because of the nature of the issue (design, commercial or otherwise) and will require interactive discussion.

To maintain competitive tension and minimise bid costs, pre-selection negotiations should be undertaken within a tightly defined timeframe.

Negotiations should address all areas of deficiency in a bidder's proposal (design, construction, services, financial and contractual).

Given the high level of interaction during the pre-selection negotiations, agencies may elect to negotiate with each bidder on different risk allocation and contractual terms, reflecting the issues which are most important to that bidder. Advice should be sought from the Probity Practitioner on the proposed process.

### 5.4.2 Best and final offer (BAFO)

Ideally, after the outcome of the evaluation process, a preferred bidder is selected. If a single preferred bidder cannot be identified but the Project Steering Committee believes a value for money solution can still be achieved, a BAFO may be used. Providing a value for money outcome can still be achieved, BAFOs may be appropriate to use when:

- costs submitted by all bidders are too high; or
- a preferred bidder cannot be clearly determined based on the evaluation of RFP responses against the evaluation criteria in the RFP; or
- all RFP responses are deficient in one or more areas.

To minimise costs to the private sector and government:

- only those bidders believed capable of delivering the desired results should be invited to participate in the BAFO;
- the BAFO should be completed within a short, well-defined period; and
- agencies should request only one BAFO.

The bidders selected for the BAFO process should be provided with detailed questions relating to their proposals and/or informed of the deficient parts of their proposal. The bidders are then given the opportunity to revise their bids and eliminate any unacceptable conditions contained in their original proposals. The amended sections are then re-evaluated and re-scored according to the evaluation process defined in the RFP.

### 5.4.3 Government approval

Government approval may be required before:

- proceeding with a preferred bidder to the final negotiation phase where there is a clear preferred bidder following the evaluation phase; or
- undertaking a BAFO or structured negotiation phase where it is decided to further short-list in order to select a preferred bidder.

The application to government for approval should detail key features of the proposal and highlight the extent to which the bids have achieved value for money against the PSC benchmark and the qualitative criteria.

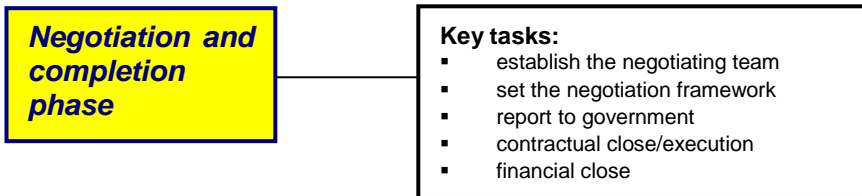
When seeking approval for a BAFO or structured negotiation phase, the application to government should outline a framework for the finalisation of outstanding issues as part of the negotiation phase. Depending on the policies approved by government at the expression of interest and request for proposal stages, specific approval for a BAFO may not be required. However, this should be clarified when considering a BAFO process.

Consideration should be given to whether any public announcement is appropriate at this stage or at the conclusion of negotiations.

### 5.4.4 Reimbursement of reasonable bidding costs

In normal circumstances, government would not contemplate the payment of any part of the bid costs incurred by unsuccessful bidders. While government is never obligated to contribute towards bidding costs, in very limited and clearly defined circumstances government may consider a contribution towards reimbursing reasonable bid costs. These circumstances will be determined on a case-by-case basis.

## 6 Negotiation and completion phase



Once a preferred bidder has been identified, plans should be made to move the contract negotiations forward as quickly as possible.

### 6.1 Establish the negotiating team

Negotiations are typically led by the Project Director. As a general rule, smaller teams lead to more efficient negotiations. Note that the negotiating phase can significantly extend the project timeframe and budget if not well-managed.

The project's legal and commercial advisors play a key role in supporting the negotiations. However, it may be appropriate to hold initial negotiations to identify key issues without legal advisors present. This enables negotiations around commercial issues rather than detailed points of law or contractual terminology. Once the commercial issues are agreed, reflecting this in the contract should be relatively straightforward.

### 6.2 Set the negotiation framework

The negotiating team and the preferred bidder need to work together to set terms for negotiations, as a framework for contract negotiations. The terms usually feature the following:

- **definition of negotiating issues.** The issues to be negotiated should be clearly set out, together with the government's position on each of them. Without this structure, the negotiations could move into areas which are otherwise settled. The issues that the preferred bidder seeks to negotiate should be confined to departures from the contract provided with the RFP, as reflected in the proposal.
- **control of drafting.** The drafting process should be managed by the legal advisors to the procurement team, including management of version control and assessing which parties need to review changes. The Project Director must ensure that amended documents are only circulated to parties with a direct interest, to avoid unnecessary discussions and delays. For example, there may be matters of interest to the preferred bidder's builder or its legal advisors which do not need detailed discussions or comments from the operator.
- **recording of agreed matters.** All matters agreed upon during the negotiations should be recorded in meeting notes and agreed at the end of each meeting. This reduces the risk of issues being revisited and provides clear instructions for contract drafting purposes.

- **do not revisit agreed issues or introduce new ones.** The Project Director should not admit any new issues into negotiations (i.e. issues not raised previously in bids) and the parties should agree not to re-open issues already agreed.
- **agree to a timetable for the negotiation.** This is important to prevent delaying tactics and ensure the overall timetable for project implementation is upheld.
- **agree to a dispute resolution process.** An agreed process for overcoming any impasse in negotiations typically involves seeking resolution from senior management. The parties need to ensure that the appropriate senior managers are accessible throughout the negotiations.
- **authority to commit.** Both negotiation teams need to appoint members with the authority to make decisions on behalf of their organisations (although in certain instances approval of government may be required before the Project Director can agree on these issues).

If the preferred bidder's circumstances change and require the project to proceed on a materially different basis from the initial bid, the procurement team must undertake a full re-evaluation. This re-evaluation should then reconsider other bidders' proposals. Should the re-evaluation indicate a worse position for government than the reserve bid, the government should be advised and a determination made about whether to proceed with the preferred bidder or another bidder. The Probity Practitioner should be involved in discussions where the preferred bidder's circumstance materially changes.

## 6.3 Report to government

At the end of the negotiations, a report should be prepared by the Project Director to the Project Steering Committee and for approval or endorsement by government. This should set out any material changes to the details of the proposal and confirms that the proposal provides a value for money outcome. It should also confirm that adequate funding is available and that the department or agency recommends that a contract is entered into.

## 6.4 Contract close/execution

Once the approval process is complete, the contract is awarded to the successful bidder. A suitable date and venue are nominated for contract execution, where the government's representative signs the contracts after all other parties have signed.

It is common practice for a public announcement of the contract and the successful bidder to be made when contracts have been executed.

It is good practice for the Project Director and a member of the Project Steering Committee to offer to meet losing bidders to discuss their bids after contract execution. Such discussions are an essential courtesy and make a contribution to development of the market. The Project Director should make appropriate preparations for the debrief that reflect the effort spent in preparing and evaluating bids. Further information on post-tender debriefing principles can be found in Chapter 16.

## 6.5 Financial close

At contract execution there may be a small number of matters that financiers need to resolve before unreservedly committing their finance to the project. Such issues may include approvals from the Australian Competition and Consumer Commission, the Australian Taxation Office and the Foreign Investment Review Board. Generally, final approval will be forthcoming from these bodies only once the executed contractual documents have been sighted.

It is important that the matters left outstanding at contract execution are kept to an absolute minimum to prevent an unacceptable delay between contract execution and financial close. When these matters have been resolved, financial close can occur.

At financial close, the service charges under the contract can also be finalised. Usually, the level of charges depends on changes in interest rates in the period between bid submission and financial close.

### **6.5.1 Cost of finance**

Bids normally assume that the cost of debt finance reflects an agreed margin above a reference rate rather than a prescribed interest rate. This is because the timing of the drawdown of funds is difficult to determine while interest rates move on a daily basis.

The risk allocation reflected in an RFP normally indicates that the risk of movements in interest rates between the submission of bids and financial close are to be borne by government. This means that the service charges reflected in the contract can be settled only at, or following, financial close. Recalculation of services charges is performed within the financial model that was provided with the bid. The means of applying the model for this purpose needs to be agreed with the private party prior to financial close. At financial close, the service charges can be recalculated using the actual interest rates before inserting these charges into the relevant contract schedules.

Given that the risk of interest rate movements generally remains with government until financial close, the length of time from the submission of proposals to financial close can have a material impact on the ultimate price of the proposal. This is further incentive to ensure that the process from submission of proposals is as time-efficient as possible.

### **6.5.2 Finalise accounting treatment and reporting requirements**

Departments and agencies must assess the likely accounting treatment to be adopted for PPP projects. Section 9 provides details about accounting issues and reporting requirements.

It should be noted that the achievement of 'off-balance-sheet' transactions is not a motivation for the government to deliver PPPs. The government's key drivers are improved value for money in service delivery and appropriately balanced risk allocation.

### **6.5.3 Review and disclosure requirements**

Each jurisdiction will also have its own specific review and disclosure requirements. Review requirements can cover Auditor-General reviews and/or others such as a Gateway Review or Post-Implementation Review. Good record keeping throughout the procurement process greatly assists these reviews.

As a general principle, requirements for transparency mean that disclosure issues need to be considered and addressed as appropriate throughout the procurement process.

#### ***General disclosure principles***

Accountability of the executive government to the legislature and freedom of information for citizens are key principles of the Westminster system of government operating in the Commonwealth, State and Territory jurisdictions.

As a general principle, this requirement for visibility and accountability means that full disclosure should be the default position for a PPP contract with the private sector, except for consideration of voluntary disclosure of the following:

- trade secrets;
- genuinely confidential business information; and
- material which, if disclosed, would seriously harm the public interest.

Government must weigh up the public interest in maintaining confidentiality of the above matters against the public interest of disclosure. Confidentiality is particularly important during the bid stage where bidders supply confidential and sensitive commercial information and the disclosure of cost structures would compromise the competitive bidding process. However, transparency of the bid process is paramount to give bidders certainty and to meet public procurement probity requirements.

When drafting contracts, government must ensure that appropriate information on the project's performance is available for release during the service period. To facilitate this, contracts should include an acknowledgment by private parties that disclosure by government of information relating to the contracts under Freedom of Information (FOI) Acts will not breach confidentiality under the contracts. Furthermore, private parties should provide contractual undertakings to use reasonable endeavours to assist government to meet its obligations under the relevant FOI Acts.

All PPPs will be subject to a government's specific disclosure requirements arising from tenders and contracts as determined by individual jurisdictions.

### ***Contract summary***

Adequate and timely disclosure is essential in ensuring an open procurement process. In addition to disclosure of the actual contractual documentation, contract summaries on PPP projects outline key project information and better inform the public about the nature and outcomes of these projects in practice.

### ***Project reviews***

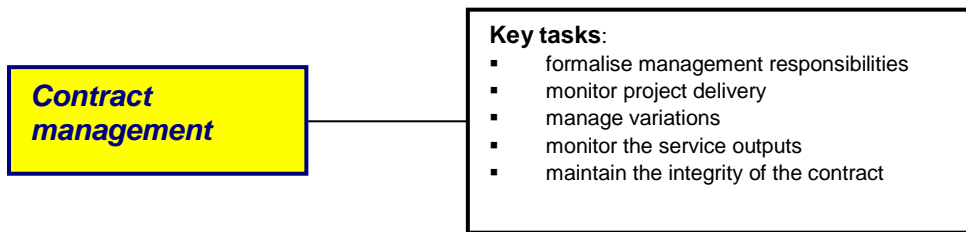
A post-implementation review may be undertaken on a PPP project to evaluate project outcomes against the expectations set out in the business case. A post implementation review aims to measure the learnings and benefits of a project using a consistent measurement framework. A post implementation review can be a valuable tool in refining the processes used in developing private sector infrastructure projects. Outcomes of the review can also be fed into service planning to ensure lessons learnt assist future planning. A post implementation review will normally be undertaken jointly by the agency initiating the project and the relevant PPP authority.

A post-implementation review may be conducted internally via a lessons learned workshop involving the project team and key advisers. It is also useful to incorporate any bidder feedback arising from a debrief process. The post implementation review is an internal project assurance for the Procuring Agency.

A review may also be conducted by an independent party. Some jurisdictions may conduct a post implementation review through jurisdiction specific Gateway Review Processes. This usually involves an external peer review to check a project has delivered its intended outputs and benefits. The review may be repeated throughout the life of the service contract.



## 7 Contract management



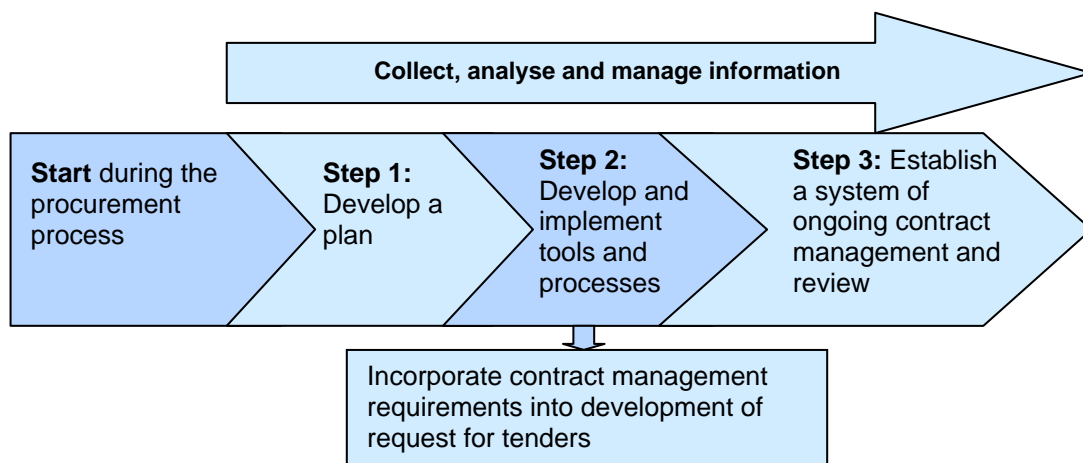
The construction and implementation phases, when the private party is making its major investment, are critical to project success. While the bidding process is very important, the conversion of the contract into delivery of outputs is essential to meeting the overall project objectives.

Contract management requires particular skills which need to be procured before the contract is executed. Timing may be critical, as both the public and government are looking forward to delivery of the service outputs from new infrastructure.

For risk to be managed effectively the foundations for contract management must be incorporated into the RFP and the draft contract provided to bidders, then maintained through further development and finalisation of the contract. This ensures that:

- a sound contractual basis for effective contract management is incorporated in the contract;
- there is adequate knowledge transfer from the procurement team to the contract management team; and
- the contract management strategy for the project is in place as soon as practical after the contract is executed.

**Figure 7-1: Three steps for developing and implementing the contract management strategy**



Further details on contract management are provided in Appendix H.

## 7.1 Contract management through the project lifecycle

Contract management is a key activity for the relevant agency after the contract is executed. Implementation of effective contract management practices will assist government to achieve broader project objectives, maintain risk transfer and value for money outcomes.

For each lifecycle stage, there is a range of contract management activities that should be conducted by the relevant agency if the contract is to be managed effectively. The key activities in each lifecycle stage are summarised in Figure [7.2].

PPP contracts are long-term and the operating environment will change over the project lifecycle. In addition, the project itself will pass through a number of stages and significant events. Each lifecycle stage and significant event involves risks and opportunities for the government party to implement control and mitigation strategies. The relevant agency's contract management strategy will evolve over the project lifecycle.

Effective contract management must take account of and adapt to changing circumstances and significant events through the project lifecycle.

It can be the case that the Project Director in the procurement phases is different to the Project Director in the contract management phases. To facilitate transition it is ideal to engage a contract management Project Director a number of months prior to contract signing.

Figure 7.2 Contract management issues and the project lifecycle

PROJECT PREPARATION	PROCUREMENT	CONSTRUCTION	SERVICE DELIVERY	CONTRACT EXPIRY
<b>Resourcing</b> <ul style="list-style-type: none"> <li>Identify and obtain approval for contract management resourcing</li> </ul>	<b>Resourcing</b> <ul style="list-style-type: none"> <li>Appoint Contract Director</li> <li>Confirm budget for contract management resources</li> </ul>	<b>Manage performance</b> <ul style="list-style-type: none"> <li>Manage performance by relevant agency</li> <li>Monitor construction progress and management quality</li> <li>Consider detailed designs</li> </ul>	<b>Manage performance</b> <ul style="list-style-type: none"> <li>Manage performance by government</li> <li>Monitor private party's performance</li> <li>Manage any legacy issues</li> <li>Seek user feedback</li> </ul>	<b>Manage performance</b> <ul style="list-style-type: none"> <li>Manage performance by government</li> <li>Monitor private party's compliance with obligations on expiry/termination</li> </ul>
<b>Planning and development</b> <ul style="list-style-type: none"> <li>Identify required planning development approvals</li> <li>Develop service needs and broad KPIs</li> </ul>	<b>Planning and development</b> <ul style="list-style-type: none"> <li>Develop contract management plan</li> <li>Collect and analyse relevant information</li> </ul>	<b>Manage relationships</b> <ul style="list-style-type: none"> <li>Continue communications and strengthen relationships</li> <li>Establish working groups or committees</li> <li>Ensure appropriate delegations are in place</li> <li>Manage stakeholders</li> <li>Ensure relevant agency and service provider have resources ready</li> </ul>	<b>Manage relationships</b> <ul style="list-style-type: none"> <li>Maintain communications and strengthen relationships</li> <li>Manage stakeholders</li> <li>Ensure the right participants are involved in committees</li> </ul>	<b>Manage relationships</b> <ul style="list-style-type: none"> <li>Maintain strategic relationship with sponsors</li> </ul>
	<b>Develop tools</b> <ul style="list-style-type: none"> <li>Develop performance monitoring</li> <li>Develop contract administration manual template</li> <li>Develop other tools and processes</li> </ul>	<b>Manage change</b> <ul style="list-style-type: none"> <li>Manage transition from procurement to contract management</li> <li>Manage contractor claims</li> <li>Manage State and PCo variations</li> <li>Manage commissioning issues</li> </ul>	<b>Manage change</b> <ul style="list-style-type: none"> <li>Manage any changes to output specifications and scope of services</li> <li>Manage automatic contractual changes, such as indexation of payments</li> <li>Assess changes in service requirements and technology that impact project service delivery</li> </ul>	<b>Manage change</b> <ul style="list-style-type: none"> <li>Manage asset transfer (including transfer of necessary information and records) if assets are transferred to government</li> </ul>
	<b>Integrate contract management with key contract requirements</b> <ul style="list-style-type: none"> <li>Integrate reporting and KPIs</li> <li>Integrate dispute and issue management mechanisms</li> </ul>	<b>Manage contingency events</b> <ul style="list-style-type: none"> <li>Ensure funding sources available for potential/likely risk events</li> <li>Maintain contingency plans and review prior to commencement of service delivery</li> <li>Respond to defaults and disasters</li> </ul>	<b>Manage contingency events</b> <ul style="list-style-type: none"> <li>Maintain and review contingency framework</li> <li>Scan environment for potential impacts</li> <li>Respond to defaults and disasters</li> </ul>	<b>Manage contingency events</b> <ul style="list-style-type: none"> <li>Maintain and review contingency framework</li> <li>Scan environment for potential impacts</li> <li>Respond to defaults and disasters</li> </ul>
	<b>Governance</b> <ul style="list-style-type: none"> <li>Project Director ensures that: <ul style="list-style-type: none"> <li>the Contract Director has access to resources and information required to prepare the plan</li> <li>the contract management plan is prepared</li> <li>governance, reporting arrangements are in place for commencement</li> <li>appropriate delegations in place consistent with the Project Agreement</li> </ul> </li> </ul>	<b>Governance</b> <ul style="list-style-type: none"> <li>Project Director continues in role</li> <li>Project Director ensures that contract management plan for the project is approved</li> <li>Contract Director implements the contract management plan</li> <li>Contract Director reports to senior management</li> </ul>	<b>Governance</b> <ul style="list-style-type: none"> <li>Contract Director continues in role, applying and regularly reviewing contract management tools and processes</li> <li>Contract Director reports to senior management and DTF</li> <li>Government entity plans succession</li> </ul>	<b>Governance</b> <ul style="list-style-type: none"> <li>Contract Director continues in role</li> <li>If required, accountable government entity provides or procures replacement services or assists in transfer of facilities and knowledge to government</li> <li>Contract Director reports to senior management and DTF</li> </ul>
	<b>Other issues</b> <ul style="list-style-type: none"> <li>Is the Contract Director credentialed?</li> <li>Do reality checks. Can the KPIs be measured etc.?</li> </ul>	<b>Other issues</b> <ul style="list-style-type: none"> <li>Populate contract administration manual</li> <li>Manage knowledge and project records</li> <li>Review contract management practices</li> </ul>	<b>Other issues</b> <ul style="list-style-type: none"> <li>Update contract administration manual</li> <li>Manage knowledge and project records</li> <li>Review contract management practices</li> </ul>	<b>Other issues</b> <ul style="list-style-type: none"> <li>Manage knowledge and project records</li> <li>Review contract management practices</li> </ul>

## 7.2 Key elements of effective contract management

### Developing the contract management strategy

Effective contract management requires developing a strategy before the completion of the procurement stage and its ongoing review and development over the life of the contract.

### Resourcing, governance and probity

The relevant agency must dedicate adequate resources to contract management activities. This will ensure that the value for money outcome obtained in the initial contractual allocation of project risks is not compromised and risk is managed over the life of the contract.

Contract management by the relevant agency involves managing the contract and relationship with the private party and ensuring that appropriate governance, probity and compliance practices are established. The resources required for good contract management include adequate budget and experienced personnel.

The agency should also ensure that the private party has resources ready to transition into contract management, ideally some months prior to or at contract close.

### Relationship management, dispute resolution and issue management

Given the long term of PPP projects, it is imperative to maintain a strong relationship between the relevant agency and the private party. Good relationship management enables the parties to anticipate risk events more effectively and deal with risks that materialise.

### Planning, information collection and analysis

Planning, information collection and analysis are integral for effective contract management for PPP projects. Developing a contract management strategy assists in determining the information required and helps refine the contract management plan and identify, understand and manage project risks.

### Contract administration manual

A contract management plan sets out the key steps and requirements for effective contract management for the project. A plan is updated as necessary during the construction phase and finalised prior to the beginning of the operations phase.

Following the plan, a more detailed contract administration manual is recommended to be developed as a central source of all relevant information for administering the contract. A contract administration manual will evolve over time as the project moves through different phases.

### Knowledge and information management

The Contract Director will implement a knowledge and information management strategy tailored to the project ensuring the information collected in relation to the project is maintained, periodically reviewed and organised for easy retrieval.

An effective knowledge and information management strategy in a PPP project ensures that information relating to the project can be easily retrieved, enabling the government party to undertake its activities efficiently and comply with obligations relating to information retention, disclosure and protection.

## Contingency planning

Effective contingency planning in a PPP project ensures the relevant agency can respond to unplanned events and control the impact of these events on service delivery budgets and value for money.

Funding for any contingencies, either within the agency or centrally, should be identified prior to contract signing.

## Ongoing review

Contract management processes will need to adapt over the lifecycle of a PPP contract and should be reviewed on an ongoing basis. In addition the following specific events should be considered:

- divergence between each party's expectations and actual project outcomes;
- changes in the project itself through change events, contingency events, or as a result of the project moving from one stage to the next in its lifecycle; and
- changes in the operating environment.

## 7.3 Contract performance

### Planning and environmental approvals

These would have commenced during procurement but may not have been finalised prior to contract/financial close.

There will be a need to manage stakeholder relations, community consultation, request for information from the planning approval authority, and fund and/or manage any planning approval conditions.

### Construction stage

Specific contract management issues can arise during the construction stage that can impact future service delivery or value for money. Relationships with the private party are developed and governance and reporting arrangements are established during the construction stage.

The period of design development requires due diligence by the contract management team to ensure the government party receives the facility that meets requirement and that the private party is likely to have the capability to provide the contracted services. The Technical Completion and commissioning tests leading up to Commercial Acceptance are key milestones during this stage.

## Service delivery stage

Contract performance during this stage focuses on monitoring provision of contracted services, addressing related performance risks and issues and broader performance management issues.

With respect to the regular provision of contracted services, the contract management team must have robust arrangements for monitoring outputs and a clear strategy around key contentious matters such as paying invoices and abatement of service payments. Clear and well-structured lines of communication between those managing the contract and agency staff directly involved in facility operations are critical to effective performance monitoring and management.

An effective performance monitoring and reporting strategy is built upon the following elements:

- The Procuring Agency understanding the business environment and the objectives of government in entering into the contract. Performance measures lie at the heart of performance management and it is important that performance measures are linked to strategic objectives and desired outcomes;
- The Procuring Agency understanding the private party's internal operating environment, such as its cash flows. It is through this understanding that the government party can derive an awareness of the private party's strengths and weaknesses, including financial performance;
- The Procuring Agency monitoring indicators of the management quality of the private party, looking for weaknesses or trends that may provide an early indication of risks to the project; and
- The Procuring Agency regularly reviewing the quality of the service against the key performance indicators and output specifications. Following monitoring, the government party acts to mitigate or control any risks that are materialising and to maximise value for money from the project.

Effective performance monitoring in a PPP project involves diligent monitoring of provision of contracted services and having access to relevant information to assess and mitigate any risks that are materialising.

## 7.4 Specific contract management events

### Change management

Changes during the lifecycle of a PPP project require proper management. Changes may be contemplated at the time of procurement and provided for in the contract, or not contemplated during procurement but seen as desirable or necessary alterations to services or the contract. In either case, change events are both a source of risk and a potential opportunity to extract additional benefits from the project.

The relevant agency should ensure there is no unintentional take-back of risk allocated to the private party.

### Government initiated modifications

Government initiated modifications are likely to occur during the life of most PPP projects to change the facilities constructed and managed or maintained by the private party. Typically an owner modification will involve the government preparing a change proposal to submit to the private party for design and costing.

### Refinancing

Refinancing refers to any change to a project's financing arrangements. Government consent may be required prior to implementing a refinance. Refinancing may give rise to a range of risks including increased government liabilities in the case of different termination scenarios, changes in lending markets increasing the private party's debt servicing costs, impacts on the private party's gearing, changes to the amortisation profile of debt, recognition of the costs associated with the refinance, capture of government's share of refinancing gains and/or amount and timing of revenue sharing arrangements (particularly in the case of economic infrastructure). These issues need to be carefully considered to ensure that the government does not unintentionally take back risks and the risk profile underpinning the Project Agreement is preserved.

### Change of ownership / control

Government consent is usually required for changes in ownership/control. A change in control refers to a material change in the private party's ownership arrangements whereby a different entity assumes effective control. The Project Agreement will outline the relevant agency's consent rights and obligations.

### Reviewable services

Throughout the long-term of the PPP contract there are likely to be multiple reviewable services intervals. Reviewable services are usually labour based services such as cleaning, and security. Reviewing and market testing the cost of reviewable services is designed to keep service costs competitive over the long life of the project and ensure government achieves value for money. The review points are set in the Project Agreement and the relevant agency needs to prepare for reviews and either benchmark or market test costs.

### End-of-term arrangements

A PPP contract can conclude at expiry of the contract term or earlier through mutual agreement or provision of early termination arrangements due to force majeure, private party default or government termination for convenience.

Planning for the end of term must occur well in advance and an end-of-service strategy be developed to set out the approach and steps to be taken by the relevant agency.

# **Part Two: Detailed Technical and Process Issues**



## 8 Project structure and resources

### 8.1 Overview

This section outlines a suggested project management structure for the delivery of a successful PPP project.

The public sector procurement team should reflect the breadth of skills brought to the project by a private sector consortium. Experience and knowledge need to be captured, retained and shared to enhance the likelihood of success of future PPPs.

The quality of project resources is one of the most important factors in the success of the project. Therefore, an appropriate team structure with clear lines of accountability should be in place and quality resources applied. The investment in quality project resources will add significant value to the project, beyond the cost, through more sophisticated and efficient project implementation.

The Project Director is a key resource and is responsible for delivering all critical elements of the project.

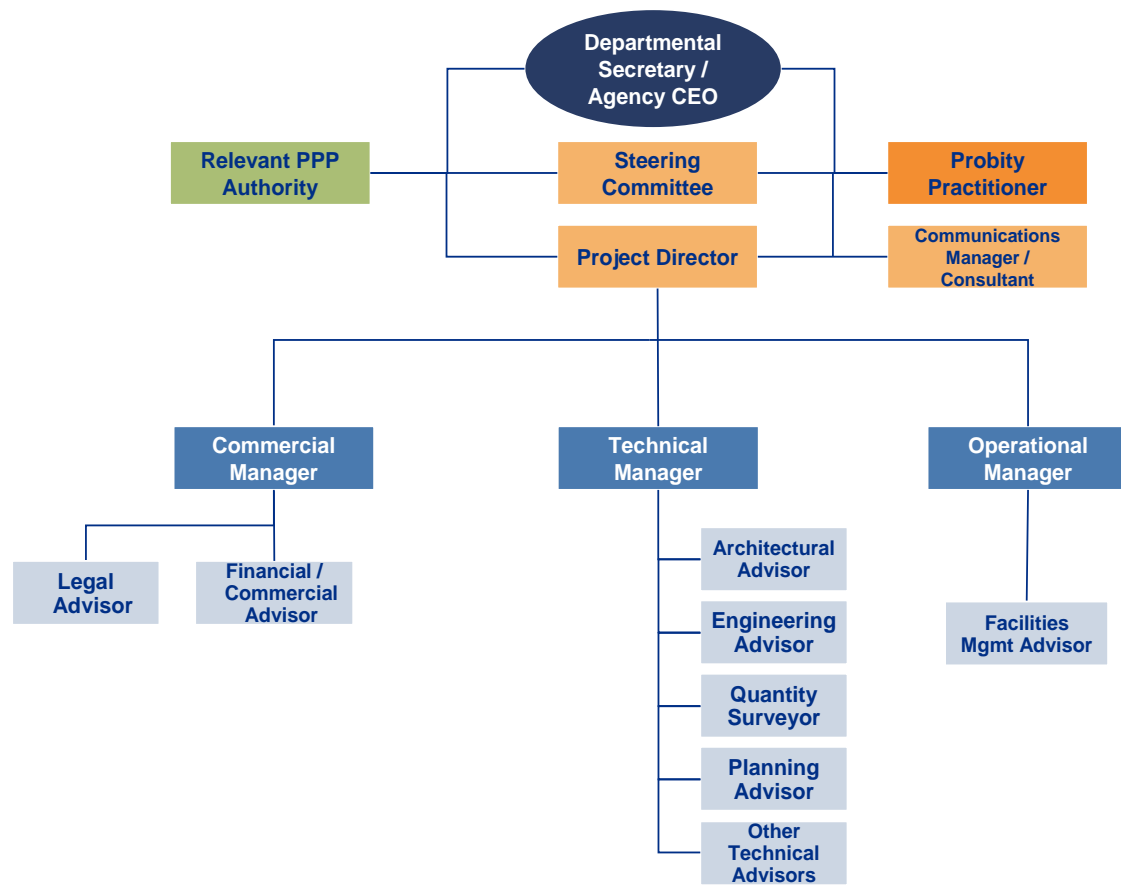
The specialist expertise required for the project includes financial, technical, operational and legal skills. The mix of skills and experience will vary by project type.

Internal resources may fill some specialist roles, or they may be seconded to the team. However, external advisors are likely to be required to provide specialist advice and to supplement the internal team. Figure 8-1 outlines a typical project management structure, although details will vary depending on the nature of the project.

The skill sets also differ according to the phase of the project. Different skills are required for the procurement phase, versus the construction management phase, versus the contract management phase during operations.

It is important that adequate funding be allocated to project management of PPP projects.

Figure 8-1: Project management structure for the procurement phase



## 8.2 Project Steering Committee

A Project Steering Committee should be established by the delivery agency to direct the PPP project and deal with key issues. Terms of reference should be drafted and agreed at the outset. The Committee's brief may differ depending on the project phase:

- **Procurement phase** - to guide project development and deal with key issues; and
- **Contract management phase** (that is, the construction period and at least the first two years of operations) - to provide high-level oversight of implementation and management of the contract.

The composition of this Project Steering Committee is at the discretion of the department or agency. However, the relevant PPP authority should be invited by the department or agency to make an experienced officer available to contribute knowledge of the handling of commercial, financial and process issues in PPP projects and to facilitate government approvals. Key tasks during the procurement phase will include guiding the content of key documentation and overseeing the evaluation and selection of a preferred bidder.

## 8.3 Project Director

The role of the Project Director is integral to the success of the project. This is a dedicated role, with overall responsibility for delivery of the project and management of the procurement team, including external advisors and consultants.

The skills needed include project management, well-developed commercial skills applicable to developing and negotiating contractual arrangements and knowledge of government processes.

The Project Director may be a member of the Project Steering Committee or may just report to the committee.

## 8.4 Probity Practitioner

A Probity Practitioner (either an auditor or advisor) should be engaged to ensure a transparent and robust process. The Probity Practitioner must be capable of bringing an objective viewpoint to the project and is required to endorse a probity plan and monitor the bid process throughout.

## 8.5 Project team

A typical project management structure includes the Project Director and other specialist team members. Specialist knowledge required for the project, including financial, technical, operational, communication, environmental, contractual and legal skills will vary by project type.

### 8.5.1 Commercial manager

The commercial manager has oversight of, and responsibility for, the commercial, financial and legal aspects of the transaction. This role is generally supported by the following key external advisors:

- **Legal advisor.** PPP arrangements involve complex contractual arrangements between government and private providers. For this reason, it is important that the procurement team includes legal expertise. The advisors should have proven experience and a demonstrated track record in advising on public-private partnership projects. The legal advisors play a key role in developing the risk allocation matrix, preparing a contract for release with the RFP, structuring the project, analysing departures from the RFP and contract and documenting final contractual requirements; and
- **Commercial/financial advisor.** Given the complexity of a PPP transaction a financial and commercial advisor provides significant benefit in the procurement phase including the development of the commercial framework and proposed commercial arrangements, bid evaluation and contract negotiations. The advisor will also generally provide continuing advice on market engagement strategies and assist in consulting with industry parties as necessary. The commercial/financial advisors will often provide significant input into, and will generally be responsible for the development of, the PSC.

### 8.5.2 Technical manager

The technical aspects of a complex infrastructure project are important for the project's success. An experienced technical manager is required to manage this aspect to ensure the physical aspects of the project are developed in accordance with government's requirements. This role includes development of the output based performance specifications for the design and the evaluation of design. A key requirement for the role is an understanding of the interface between the technical elements of the project and the overall PPP framework. Given the complexity of this area, this role is generally supported by a range of specialist advisors including:

- **Architectural advisor.** The architectural advisor can assist with the development of the reference project and the functional/architectural output specifications;
- **Engineering advisor.** The engineering advisor can assist with the development of the reference project and the functional/technical output specifications;
- **Quantity surveyor.** The quantity surveyor can assist with the costing of the project for the purposes of the PSC and the evaluation of proposals; and
- **Other technical advisors.** Subject to the specific requirements of each project, a range of other advisors may be required including traffic, planning, geotechnical, security etc.

### 8.5.3 Operational manager

The operational manager has primary responsibility for ensuring that the project's operational requirements are addressed, including the services to be provided by the private sector. This role is often supported by a facilities management advisor who will develop the output specifications for the services to be delivered. They will play a key role in ensuring that users are sufficiently involved with the specification development, interactive tender process, and evaluation.

### 8.5.4 Communication

Communication is a key aspect of any PPP project. The responsibility for this aspect may be undertaken by an in-house team member or may be provided by an external communication advisor. This role will generally report directly to the Project Director and may provide advice to the Project Steering Committee.

### **8.5.5 Business process and administrative support**

The project team will also need business process and administrative support to enable efficient delivery of the project.

### **8.5.6 Contract director**

For the effective ongoing management of contract risk, it is good practice to involve contract management personnel during the procurement phase of the project. The Project Director is responsible for ensuring that the contract director works with the procurement team to develop an effective contract management strategy, and that the procurement team provides practical help to the contract director in understanding the project and its inherent risks and ensures a smooth transition from procurement through construction to operations.

## **8.6 Relevant PPP authority**

The relevant PPP authority will be the focal point for economic and financial assessment and advice on all PPPs and will assist government agencies more generally. It will ensure application of these Guidelines.

The relevant PPP authority will also promote best practice PPPs by absorbing and disseminating the lessons of experience and consulting with other governments on their experiences and practices.

The relevant PPP authority should be consulted early in the development of a PPP proposal. It will normally draw on expertise from across the public sector and seek advice of private sector consultants when required.

## **8.7 Management structure during contract management phase**

After the contract becomes effective, management of the project will normally be transferred to an implementation team and ultimately to an ongoing agency for service delivery arrangements.

For many projects, it may be useful for the Project Steering Committee to oversee the implementation of the project during the initial delivery phase (that is, during construction and at least the first two years of operations). The Project Steering Committee should meet at least quarterly.

For projects with a number of construction phases over many years, it may be appropriate for the Project Steering Committee to continue until the final constructed facility has been operating for at least two years.

In addition, government may require regular progress reports for major projects so that it can monitor implementation. This should be determined on a case-by-case basis.

Further information on the contract management phase can be found in Appendix H.

## 9 Modified funding and financing options

This section discusses the difference between funding and financing. Various modified financing strategies are outlined. This section outlines the principles and assessment criteria that underpin the selection of the strategies. These strategies are options only and should not be considered mandatory as part of any PPP project.

Typically construction cost of PPPs is fully privately financed and effectively repaid by government over the concession life. An alternative approach more recently adopted by many jurisdictions is for partial public finance through a capital contribution or other modified financing options. Modified financing options may be used on specific projects where there are value for money considerations that preclude full private finance (i.e. capital market constraints), or to address refinancing risks. Options should be assessed against their impact on risk allocation and other considerations set out in this chapter and be tested through market sounding.

### 9.1 Terminology

For the purposes of these National PPP Guidelines, it is important to distinguish between the funding and financing of PPP infrastructure:

- **Funding** is how infrastructure is paid for, either from general government taxes or other general government revenue sources or through user/beneficiary charges. PPPs impact on the timing of funding provided by government for infrastructure projects with funding usually provided over time through availability payments or through capital contributions. Funding from user charges is usually provided over time by users during the operational phase of projects; and
- **Financing** is how the required money to deliver the infrastructure is raised upfront through the mix of private and public sector debt and equity to enable the infrastructure to be built. The finance component relates to debt and equity that addresses timing differences as to when cash outlays are required to deliver the infrastructure and when the funding is made available for the project.

When Government makes a decision to invest in a particular piece of infrastructure, it makes a funding provision for developing and constructing that infrastructure. The funding decision determines whether the infrastructure is to be paid for from:

- government revenue from general taxes, other general government charges and returns on investment;
- user and beneficiary charges – i.e. charges to users or beneficiaries of the infrastructure; or
- a combination of the above sources.

The decision on how to procure the infrastructure is made separately by Government on the basis of a procurement options analysis after the funding decision has been made.

## 9.2 Financing constraints

The investment decision to fund and build infrastructure is independent of the decision on procurement methodology. Unless the infrastructure generates sufficient third party revenue through user charges, the cost will impact on net debt and rating agency metrics regardless of how the project is financed.

Broader use of specific revenue raising measures such as direct user charges and value capture opportunities may help to provide alternative funding sources for suitable infrastructure projects.

Continued use of direct user charges such as toll roads can also assist with funding infrastructure investment by alleviating the pressure on general government revenue sources and can enable infrastructure investment to be brought forward. However, the ability to directly charge users of the infrastructure is limited to certain types of assets.

PPPs represent an appropriate procurement and financing mechanism however they do not necessarily provide a funding source for infrastructure projects, particularly in the case of social infrastructure. Funding responsibility remains with government, whether by granting a concession to charge, for example toll roads or water treatment plants, or through direct payments, for example availability charges or shadow tolls.

Infrastructure financing will have a direct impact on the state budget and net debt. The impact will depend on risk allocation, accounting treatment and the ability to use network financing approaches.

The need to consider modified financing options has arisen as a response to achieve value for money in challenging market conditions and the much larger scale and cost of public infrastructure. There may be instances where there is a lack of private financing liquidity in the market. Any reductions in the level of tenor provided for debt (when it is available for investing in projects), affect refinancing risk. Governments have tended to look to match private sector debt with commensurate risk borne by the private sector over the project lifecycle and have looked to reduce private sector debt during lower risk post construction stages of projects.

## 9.3 Private financing considerations

A fundamental principle of PPP projects is that there can be significant benefits in using private finance to finance infrastructure projects (and the related whole of life costs). Provision of private finance provides the necessary incentives to enable the effective transfer of appropriate risks to the private sector (in particular design, construction and general fitness for purpose) as payments are only made by government once the asset becomes available for use in a prescribed manner.

Private financing should be considered where:

- the government can achieve value by transferring infrastructure delivery and operations risks to the private sector, which can manage the exposure in a more efficient manner and justifies the private financing premium; or
- the government can create performance and/or outcome incentives that provide better value for the public and therefore justify the private financing premium.

PPP procurement uses private finance, comprising debt financing and equity investment. The due diligence as well as risk taking role of debt and equity in a PPP procurement can add value in mitigating risk and incentivising performance, driving enhanced outcomes through innovations and efficiencies.

PPP financing is often achieved by three types of private sector finance:

- **Debt finance** has a set stream of repayments and will be repaid before equity in the event of project difficulties;
- **Equity finance** is first in line to bear losses if a project encounters serious difficulties but receives the residual gains after repayment of debt; and
- **Hybrid instruments** include subordinated debt and convertible bonds and have characteristics similar to both debt and equity.

Standard risk allocation in a PPP contract ensures risks are allocated to the party best able to manage the risk and private finance ensures risks transferred to the private party stay with that party.

Private finance is readily available for government projects but can be affected by prevailing market conditions. For example, the global financial crisis (GFC) of 2007-08 impacted the availability, cost, tenor and appetite for providing private finance to PPP projects. In Australia the GFC resulted in tighter debt terms, reduced tenor of lending and increased fees and margins however market conditions improved in subsequent years with increasing lending appetite, increased loan tenors and reduced fees and margins. These considerations will affect the use of modified financing strategies.

## 9.4 Modified financing options

Modified financing options should not alter the underlying risk allocations that are the basis of the success of the PPP model. The modified funding or financing strategies will require detailed consideration by governments of the project risks and potential impact on value for money for particular PPP projects.

Assessing modified financing options should occur on a case-by-case basis taking into account the following factors:

- the preference for the private sector to provide committed finance as part of a competitive bidding process;
- PPPs still need to demonstrate value for money to proceed. The value for money assessment will include the use of the Public Sector Comparator as well as other factors such as risks to the budget and time over-runs;
- the use of modified funding or financing strategies will require careful examination of a number of issues, including project risks and market conditions, as part of the decision making process;
- analysis of suitable options will depend on individual project characteristics;
- it is important to consult the market when analysing different options including through market sounding in project development; and
- decisions on modified PPP financing strategies should be made early and clearly communicated to the market however the flexibility to adapt and respond to changing market conditions should always be maintained.

Government approval for the modified PPP financing strategies for individual projects should be sought at various key approval points in the procurement process.

Modified financing arrangements generally include capital contributions or a form of concessional debt finance, debt subsidy or debt guarantees from government. A decision by government to provide concessional debt finance or debt subsidy is generally made for broader policy purposes and can apply to a number of infrastructure delivery and ownership models including PPPs.



### 9.4.1 Government capital contributions

Government capital contributions can be considered where there are opportunities to reduce project costs. For example, this may be by reducing the level of private capital at risk during the operations period or addressing liquidity constraints. It is important to maintain sufficient private sector capital at risk to absorb the remaining risks the private party is taking and to incentivise desired performance.

A capital contribution can be made by government at various stages in the project lifecycle, depending on the outcomes that are sought:

- 1) as milestone payments during construction; and/or
- 2) as a lump sum payment once construction is complete; and/or
- 3) as a payment in the early stage of operations once steady state service delivery has been achieved.

Examples of capital contributions

Where	Project	Capital contribution amount in millions or percentage of capital cost	Timing
Queensland	Airport Link	\$267m	Post completion
Queensland	Gold Coast Rapid Transit	\$464m (QLD Govt) \$365m (Aust Govt) \$120m (GC City Council)	During construction
Queensland	Sunshine Coast University Hospital	\$820m	During construction
Victoria	Victorian Comprehensive Cancer Centre	30%	During construction
Victoria	New Bendigo Hospital	75%	Commercial Acceptance
Victoria	Ravenhall Prison	40%	Commercial Acceptance
NSW	Convention Centre	80%	Between two and four years after construction
NSW	North West Rail Link (Operations, Trains, and Systems)	50% during construction 50% post construction	During construction and again between two and four years after construction
NSW	Northern Beaches Hospital	100%	Operational readiness
NSW	Sydney Light Rail	50%	Between two and four years post construction
WA	Perth Stadium	60%	During construction (pro-rata once 20% completed)

## 9.4.2 Criteria to assess modified financing options

Relevant assessment criteria to determine if a modified finance structure could deliver value for a specific PPP project either for liquidity or broader value for money reasons include:

- risk allocation;
- cost and complexity;
- preservation of the benefits of private finance;
- competitive tension;
- alignment of the tenor of finance with the project's risk profile; and
- potential for innovation.

The following table can assist in the analysis of financing options.

<b>Criteria</b>	<b>Questions to ask as part of analysis</b>
Risk allocation	How does the option affect the allocation of risk between parties, both explicitly and implicitly?  How might the change in risk allocation change value for money?
Cost and complexity	What will be the impact of the option upon the cost of finance of the project?  What changes, legislative or other, will be required for the option to be implemented?  What additional processes will private sector providers of finance have to complete for the option to be implemented?  What delays are likely to be caused by the implementation of the option?
Preservation of the benefits of private finance	How does the option affect the project's potential to capture the benefits of private finance?  What changes will there be to the incentives of private sector providers of capital and between consortium members?
Competitive tension	How does the option affect the level of competition achievable during the procurement process?  Is it likely that the option will encourage a greater or smaller number of participants in the procurement process?  Will the option encourage or discourage particular groups of investors?
Alignment of the terms of finance with the project's risk profile	How does the option affect the tenor of private finance to be provided?  How does the option affect government's flexibility and its ability to exit if required and manage residual risk?  How does the option affect the flexibility of private sector providers of finance and their ability to exit if required?
Potential for innovation	How does the option affect the appetite and ability of the private sector to innovate within the project?

# 10 Tax and accounting issues

This section discusses some of the key tax and accounting issues associated with PPP projects.

## 10.1 Taxation issues

Tax is an area of Commonwealth law that has undergone substantial review and reform since the Ralph Review of Business Taxation (RBT) in 1998. While projects are taxed at the national, State and Local Government levels, (Commonwealth) income tax is generally the most significant tax cost to the private parties involved in, or considering, large infrastructure projects under PPP arrangements. Accordingly, government officers seeking to establish the potential viability of a project, or involved in evaluating bids, require a sound working knowledge of relevant tax provisions (or access to such knowledge).

### 10.1.1 Taxation

Given the consequences of a poor tax outcome, it is expected that for all PPP projects, both bidders and the government's PPP project team will be supported by professional tax advisors.

The tax consequences of a procurement alternative (other than government-financed and government-owned) need to be fully understood by both sides to a PPP project for the following reasons:

- **commercial risk.** If a bidder has incorrectly evaluated the project's tax liabilities to such an extent that the going-concern status of the arrangement is compromised, the State/Commonwealth could be left bearing the financial risks of the project;
- **reputation risk.** If a PPP arrangement is structured in a way that generates substantial tax liabilities and/or the operation of the infrastructure asset is adversely affected, this could damage the reputation of the project in the public domain and compromise future projects. Reputation risk is also important to the government counter-party. For example, a state sponsor will not wish to support an overly aggressive tax structure. Among other things, this may adversely affect a jurisdiction's negotiations for funding under the Commonwealth/State revenue sharing arrangements; and
- **fair comparison of bidders.** Tax analysis is important to ensure the tax profiles of rival bidders are fairly compared.

### 10.1.2 General tax principles

In Australia, income tax is imposed on "assessable/taxable income" and the amount of tax payable is reduced to the extent of allowable deductions. Examples include:

- normal business outgoings such as salaries and wages incurred in earning taxable income are deductible when the liability is incurred;
- capital allowance deductions are calculated with reference to the effective life of a depreciating asset;
- other expenses are deductible over statutory periods such as five years (e.g. certain finance costs like underwriting fees); and

- immediate write-off is generally allowed for some costs such as re-instatement of the site, charitable donations etc.

Australian tax rules are very complex on both the revenue and expense accounts. The derivation of actual tax payable in any year depends on the interplay of many variables: the nature of the income; the ability to carry forward tax losses; deductions which may be influenced by various taxpayer electives (e.g. depreciation methods); thin capitalisation rules limiting interest deductions; the operation of the tax consolidation regime and so on. As a result, it is not wise to generalise on tax.

Overlying the general principles of income tax that regulate any business operation, including PPP projects, infrastructure project sponsors are also subject to the specific anti-avoidance provisions concerning asset leasing/use/control by tax-exempts of taxpayer property (Division 250). Australian tax law also includes integrity measures that can apply to any transaction or part transaction – the general anti-avoidance measures embodied in Part IVA of the 1936 Act.

### **10.1.3 Principal income tax issues for PPPs**

Some of the more important tax issues that tend to arise with any PPP are briefly outlined below in summary form – certainly well short of expert opinion and not sufficiently comprehensive to constitute reliable guidance.

#### ***Entity level taxation issues***

##### **Choice of entity /characterisation of entities**

A PPP arrangement may use various forms of corporate vehicles including a company, trust, partnership or joint venture.

From an entity level perspective, tax analysis should be performed to ensure the chosen project vehicle is taxed in the intended capacity. For example, the payment of an unfranked dividend to a shareholder, especially in the early years of the project, may not be efficient (as such payment could generate taxable income in the hands of the shareholder). Given that it is common for infrastructure assets to generate tax losses in the early years, the tax treatment of project entities as a trust or partnership (which have the ability to distribute pre-tax amounts) could be important.

##### **Choice of corporate vehicle – Division 6C**

Generally speaking, a trust is treated as a flow-through vehicle for tax purposes. It is common for assets (especially property assets) to be held in trusts due to the ability of a trust to distribute non-assessable tax-deferred distributions to investors i.e. to distribute cash in excess of taxable income due to, inter alia, up-front tax deductions and higher rates of tax depreciation when compared with accounting depreciation. Therefore, the application of the public trading trust provisions of Division 6C (where the trust is used as the contracting entity in a PPP project) should be considered as these provisions will deem a flow-through trust to be treated as a company for income tax purposes. In this case, the trust will bear tax at the corporate rate of 30 per cent and distributions will be characterised as dividends for tax purposes.

## Managed Investment Trust provisions

The proposed amendments to the Managed Investment Trust (MIT) provisions will allow an Australian MIT to repatriate Australian-sourced net income of an MIT (other than dividends, interest and royalties) to foreign residents at concessional tax rates (i.e. after a three year transitional period, foreign residents will be subject to a final withholding tax liability of only 7.5 per cent). It is likely that foreign entities will consider the use of MITs to invest in PPP projects due to the favourable tax rates. Should an MIT be incorrectly characterised for tax purposes, the entity may fall outside the MIT provisions and be subject to the general trust provisions of Division 6 (with a substantially higher tax rate imposed on distributions to foreign residents).

## Non-resident capital gains tax implications

Broadly speaking, a non-resident investor will be subject to capital gains tax (CGT) only on the ultimate disposal of interests in a PPP arrangement to the extent that the non-resident maintains a 10 per cent or more interest in an entity, and 50 per cent or more of the underlying market value of the entity is attributable to 'taxable Australian real property' (TARP). TARP is defined to mean real property situated in Australia or mining, quarrying or prospecting rights etc. situated in Australia. As the market valuation of TARP can change throughout the duration of a PPP arrangement, the potential capital gains tax implications to non-resident investors should not only be considered at the outset of the PPP arrangement, but should also be monitored throughout the arrangement to ensure any non-resident CGT liability is fully considered.

## Recoupment of tax losses

PPP arrangements generally incur income tax losses in the early years, due to inter alia, interest deductions, initial costs and accelerated depreciation deductions. Therefore, project participants are likely to use structures which allow the tax losses to be carried forward and used. Tax losses are quarantined in both a trust and a company, yet losses can flow to partners in a partnership. Furthermore, companies and trusts may lose the ability to carry forward and use any tax losses where there is a change in the majority underlying ownership of that entity.

## Indirect taxes

### Goods and services tax

Goods and Services Tax (GST) is levied on the supply of goods, services or activities rather than directly on income. As the ultimate burden of a GST liability will be incurred by the end-user, it is important in a PPP arrangement that analysis is performed to confirm whether the contracting entity is entitled to an input tax credit for any GST liability incurred. If the contracting entity is the end-user of a taxable supply and is ultimately liable for the GST, it is important that the GST exposure is fully identified.

## State taxation

### Land rich duty

Certain disposals of interests in land rich landholders are liable to land rich disposal duty. The terms and rates of land rich duty differ by state. Generally an entity with a sufficient ownership in a land rich company may be subject to land rich duty on transfers of ownership in the land rich company calculated on the disposal consideration (the rate of land rich duty may be 5-6 per cent). Therefore, should a change in ownership or restructure occur in a PPP arrangement, the potential land rich duty implications should be considered.

## 10.1.4 Financing issues

### *Debt/equity*

The correct characterisation of an instrument/financing arrangement (instrument) within a PPP arrangement as debt or equity for tax purposes is fundamental. The tax legislation has specific rules which consider, based on the substance of the instrument, whether it is debt or equity for tax purposes. While a payment of interest on a debt instrument is generally deductible to the borrower for tax purposes, payments to equity holders (e.g. dividends) are generally non-deductible (yet frankable for tax purposes).

### *Thin capitalisation*

As most PPP arrangements are highly leveraged, access to interest deductions is generally crucial to the viability of the arrangement. The deductibility of debt interest may be affected by the application of the thin capitalisation provisions which may deny interest deductions should certain materiality thresholds be breached. As the thin capitalisation position may change, it should also be considered throughout the life of the PPP arrangement.

### *Withholding tax*

While interest paid to a non-resident investor is generally subject to interest withholding tax (IWT) at the rate of 10 per cent, interest on certain publicly offered company debentures or debt interests can be excluded from the IWT regime under the provisions of section 128F. A failure to fall within section 128F, or other withholding tax exemptions, may have a material adverse tax cost on the project.

An unfranked dividend paid to a resident investor in the early years of a PPP arrangement may not be efficient as it will generate taxable income in the hands of the investor. Furthermore, an unfranked dividend paid to a non-resident investor will be subject to the statutory rate of dividend withholding tax (DWT) of 30 per cent, unless the rate is reduced by an international tax treaty (which generally reduces the DWT rate to 15 per cent or less). As no DWT is payable by an entity on a fully-franked dividend repatriated to non-resident investors, the availability of franked profits and the timing of the payment of a fully-franked dividend to foreign investors is important. Should an entity have insufficient profits to pay a fully-franked dividend to non-resident investors, this may have an adverse tax cost on a PPP project.

### *Dividend streaming*

Should a franked dividend be repatriated to a resident shareholder, the potential application of the various dividend steaming provisions must be considered. While resident investors will generally benefit from the full amount of company tax (30 per cent) imputed on a franked distribution (subject to certain anti-avoidance provisions such as the 45-day rule), a non-resident investor may be entitled to only a proportion (e.g. 15 per cent) of the franking credits attached to a fully-franked dividend. Irrespective of the tax advantages of streaming franked dividends to resident investors, if dividends are not paid *pari passu* to all shareholders in an entity, the dividend streaming provisions may deny the franking credits to investors and/or debit the entity's franking account.

## 10.1.5 Tax treatment of project operations

### *Access to depreciation deductions*

The amount of depreciation deductions allowable on the depreciable assets in a PPP arrangement will generally have a significant impact on the commercial viability of a PPP

project. Analysis should determine the availability of depreciation deductions, including the tax cost base of the depreciable asset and the rate of tax depreciation.

The tax benefits of a trust vehicle may be further amplified in an environment where tax depreciation deductions are allowed over the assets of a PPP arrangement, as the discrepancy between tax and accounting depreciation rates may facilitate the payment of a tax-deferred distribution.

Another important issue for consideration in a PPP arrangement is the impact of Division 250. The object of Division 250 is to deny or reduce capital allowance deductions to a taxpayer in relation to an asset that is, at a particular time, put to a tax-preferred use under an arrangement where the taxpayer is not exposed to sufficient economic risk in the asset (refer to Section 10.1.7 below).

The limited-recourse debt provisions (Division 243) may also include an additional amount in the relevant entity's assessable income upon the termination of a limited-recourse debt arrangement where capital allowance deductions that have been obtained for debt-funded expenditure are excessive (having regard to the amount of the debt that was repaid).

Where an asset previously owned by the government (a tax-exempt entity) has been acquired by a taxpayer, consideration should be given to the calculation of depreciation deductions and the tax cost base of the asset in light of the provisions of Division 58 which can have the effect of limiting the taxpayer's tax deductions to those that would have been available to the prior (tax-exempt) owner, had the tax exempt party been a taxpayer.

### ***General deductibility***

Consideration should be given to the general deductibility of expenses within the corporate structure and whether any anti-avoidance provisions (such as the general anti-avoidance provisions of Part IVA) may apply to defeat the tax benefits sought by the taxpayer. Analysis should also consider whether certain expenditure is deductible in the year the expense is incurred, or alternatively deductible over a period. In a PPP arrangement, it is likely that finance-related expenses are incurred and such costs should be treated as deductible over the term of the loan or five years, whichever is less. Similarly, black-hole expenses should be treated as proportionately deductible over five years.

### ***Treatment of government contributions***

It is not uncommon for privately provided public infrastructure to generate only minor "own sourced revenues" directly to the owner/taxpayer. However, there may be good policy reasons why the government has decided the project should proceed (e.g. to fill a service gap). In such cases, to ensure investors receive a sufficient rate of return, the PPP arrangements might be part funded by government contributions. If the contribution is a subsidy payment, this could be regarded as ordinary income of the taxpayer or otherwise included in the taxpayer's assessable income as a 'bounty' or a 'subsidy'. In this case, upon receipt of the subsidy, the taxpayer would incur a tax liability at the relevant marginal tax rate (i.e. 30 per cent for a company). Therefore, the nature of government contributions needs to be considered.

## **10.1.6 Tax risk**

The overarching principle should be that all tax risks are allocated to the private party, so that among other things, government does not become entangled in the tax affairs of private businesses or individuals. Further, government should not provide indemnities to bidders and contractors for tax-related risks. Bidders are responsible for effectively structuring their bids to provide value, after taking account of tax obligations.

However, government must consider the impact that the tax assumptions underlying a bid may have on the project's:

- **value.** How has tax been priced into the outcome, and what benefit sharing (if any) is offered;
- **risk profile.** Including the implications for contract variations; and
- **sustainability.** Is the bid deliverable?

Tax rulings are not universally required at the bid stage. However, where government has concerns about tax risks and their significance to the project, it may be prudent to require short-listed bidders to obtain a non-binding ruling (advance opinion) or administratively binding advice (if available) before contractual execution. The RFP should indicate that government may require this. Some jurisdictions have a policy of requiring an appropriate tax ruling as a condition precedent to financial close (with the preferred bidder).

The denial of claimed tax deductions or bringing to account revenue amounts not returned by the taxpayer are the most serious issues and are discussed in the overview below. Income tax is a specialist field and only a summary of the key features of the new Division 250 is provided. An adverse tax outcome can also result from the application of the general anti-avoidance tax law (Part IV A) as well as the Commissioner's interpretation of general tax provisions relating to specific revenues or expense claims. Some general principles follow.

### 10.1.7 Anti-avoidance provisions

After years of debate and consultation, new laws now govern the availability of capital allowance deductibility in relation to a PPP infrastructure project. On 25 September 2007, Tax Laws Amendment (2007 Measures No. 5) Bill, 2007 received Royal Assent. While there are complex transitional arrangements, essentially the old law (Section 51AD and Division 16D) was replaced by new law (Division 250). Division 250 has an element of "backcasting" – it regulates infrastructure projects post 1 July 2007 i.e. both the signing of a binding agreement and first tax preferred asset use starts after 1 July 2007.

Division 250 essentially continues the policy intent of the old provisions i.e. it aims to discourage arrangements being entered into for tax advantage. The main target is arrangements that seek to transfer asset/infrastructure tax deductions from entities that cannot use them to those that can, when the underlying assets are committed to a tax-preferred use.

If a project (asset) was captured by "old" Division 16D, the arrangement was treated as a loan with only the deemed interest component of any revenue derived from the project assets being assessable to the private owner/lessor, and capital allowance deductions connected with ownership, such as amortisation of buildings, depreciation and other capital allowances, being denied. Similar to the application of Division 16D, where Division 250 applies there is also a timing difference, with capital allowances denied, but financial benefits provided under the arrangement by the tax exempt party to the taxpayer for tax-preferred asset use are to be assessed on a compounding accruals basis (rather than assessing just the interest component of the arrangement payments on a cash flow basis as they are made).

Also similar to Division 16D, Division 250 will not apply where its application would result in a lower present value income tax obligation than the amount otherwise assessable.

The net impact of the infrastructure capital allowances reforms is that the application of Division 250 could give rise to a more favourable tax timing result to the Commonwealth than under the former Division 16D. However, Division 250 will not have the severe consequences of the former Section 51AD.



On balance, the new law is an improvement on the old law, and in particular, the effective switching off of Section 51AD is most welcome and long overdue, having being recommended by the RBT (refer to page 392 of "A Tax System Redesigned", July 1999).

While complexity and uncertainty exist in relation to the practical application of Division 250, at the very least, Division 250 reduces the potential draconian outcomes of the former Section 51AD. Division 250 will cast a similar net to the old law, and thus all forms of infrastructure provision (above threshold limits) will need to be considered/tested for tax compliance – hospitals, prisons, transport infrastructure, water treatment plants etc. (refer to Appendix F for more details on Division 250).

## 10.2 Accounting issues

The accounting for PPP projects is complex and does not fall easily within the existing scope of commercial arrangements considered under the current Framework of the Australian Accounting Standards Board (AASB). As a result, this issue has been subject to considerable public debate.

Generally, Treasury and/or Finance departments across jurisdictions are responsible for accounting policy guidelines and should be consulted by the Procuring Agency when the accounting treatment for any particular PPP transaction is being considered. Ideally, the accounting treatment should be determined prior to committing to the PPP contract (even though the project assets are usually not constructed at this stage).

Treasury and/or Finance departments must be kept informed of the likely balance sheet status of PPP projects. Early consultation with Auditor-General offices on PPP accounting is also desirable to ensure that the correct accounting framework and any relevant accounting standards are appropriately considered and applied.

### 10.2.1 Accounting framework

The AASB Framework sets out the concepts that underline the preparation and presentation of financial reports and assists preparers of financial reports in dealing with specific financial reporting topics. However, PPP accounting by the public sector is yet to form the subject of the Australian accounting standards. As a result, the accounting for PPP transactions by the public sector has generally relied on guidance provided by international accounting bodies. Specific AASB standards have been consulted as appropriate and are typically used in instances where concepts considered by the Australian accounting standards are, in substance, relevant to procurement using a PPP approach.

AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors requires that transactions and other events are accounted for in accordance with their substance and economic reality, and not merely their legal form. It is important to note that in certain circumstances, the accounting for several transactions shall not be determined in isolation, especially if they have been negotiated as a single package and are performed in a continuous sequence.

The following guidance is currently in place for accounting for PPPs:

- Guidance issued by the Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) for government bodies, based on a predominant economic ownership model, using seven risk and reward categories. The predominant owner's balance sheet should recognise the property;
- Australian Interpretation 12 issued by the AASB in February 2007 applicable for financial reporting periods commencing from 1 January 2008. It applies specifically to private operators (not government grantors). Private operators should not recognise property controlled by a government body; and
- A consultation paper ITC 16 of the International Public Sector Accounting Standards Board (IPSASB) on Accounting and Financial Reporting for Service Concession Arrangements, which proposes that a public sector party (referred to as a grantor) that controls the property underlying the PPP arrangement should recognise that property as an asset in its financial statements.

Further details on the current and proposed guidance are included in Appendix G to this guidance.

### **10.2.2 Approaches currently applied in practice to determine whether a grantor should recognise the property**

The fundamental accounting issue for PPP contracts in general is how the property that underlies the arrangement is accounted for. This is a difficult issue, because in substance both the grantor (usually government) and the operator (generally the private sector party) are associated with the property, regardless of which party has legal title. There are a number of approaches considered by the AASB for addressing the recognition of the subject property, such as an approach based on assessing the risks or rewards arising from the property for each party or a control approach.

Under the risks and rewards approach a party which bears the majority of risks and rewards recognises the property underlying the PPP arrangement. This approach is used in AASB 117 Leases and is adopted in the HoTARAC guidance.

Under the control approach, the entity that controls the property would recognise it as an asset. This approach is embedded in AASB 116 Property, Plant and Equipment. A range of factors have to be considered under this approach to determine if a grantor controls the property. The factors may include, for example, restrictions on the operator to use the property for other purposes or provide services to other parties.

Another permissible approach seen in practice is a rights and obligations approach. Under this approach the property is viewed as a bundle of future economic benefits controlled by the parties to the arrangement. Both parties would recognise assets that arise from their association with the property. Certain concepts of this approach are embedded in AASB 139 Financial Instruments: Recognition and Measurement and AASB 138 Intangible Assets.

### **10.2.3 Initial recognition and subsequent measurement of the property and the corresponding liability**

Where a grantor pays the operator, the above assessment may result in a grantor applying the following possible accounting policies in respect of the property and the liability underlying the PPP arrangement:

- The property is recognised as an asset under AASB 116 with a corresponding financial liability under AASB 139;
- The property is recognised under AASB 117 as a finance lease asset with a corresponding finance lease liability;
- The property is not recognised until a grantor starts operating the property, but the residual interest in the property is recognised (under AASB 116 or AASB 138) with a corresponding liability or unearned revenue. The residual interest asset is recognised either at inception or over the operation period or at the end of the operation period; and
- The grantor might conclude that it has no assets or liabilities to recognise before payments that it incurs to the operator. Payments incurred would be recognised by the grantor as expenses for the services obtained through the arrangement.

In respect of the PPP arrangements, where a grantor provides an operator with a licence to charge the users, the assessment in Section 10.2.2 above may result in the following possible accounting policies of a grantor:

- The property is recognised under AASB 116 with a corresponding financial liability under AASB 139 and various revenue or unearned revenue approaches could be applied;
- The property is not recognised until a grantor starts operating the property, but the residual interest in the property is recognised (under AASB 116 or AASB 138) with a corresponding liability or unearned revenue. The residual interest asset is recognised either at inception or over the operation period or at the end of the operation period; and
- The grantor might conclude that it has no assets or liabilities to recognise. If a grantor does not pay for the services provided by the operator using the property, there may be no accounting recognition of the arrangement, but disclosures in the notes to the accounts.

Measurement of the underlying assets and liabilities is prescribed by the standards applied for their initial recognition. For example:

- An asset recognised under AASB 116 may be measured after initial recognition using either the cost or the revaluation model. If a not-for-profit grantor recognises the asset under AASB 116, it is required to measure it at fair value if it is acquired at no cost or nominal consideration;
- The subsequent measurement of a financial liability at amortised cost using the effective interest method under AASB 139 may result in the recognition of interest expense. Fixed payments made by a grantor may be divided into repayment of the liability and interest;
- The value of the residual interest may be measured by reference to the fair value of the interest; and
- The credit side of the residual interest asset varies according to the grantor's policy. If a liability was recognised, then it will be reduced by future related payments. If unearned revenue was recognised, then it will be recognised as revenue over the period of the arrangement with the related payments being expensed.

## **10.2.4 Disclosures**

The Australian Interpretation 129 Service Concession Arrangements: Disclosures applicable for annual periods beginning on or after 1 January 2008 requires specific PPP disclosures by grantors. In particular, a grantor shall provide a description of the arrangement detailing its significant terms, the nature and extent of rights to use specific assets, obligations to acquire the property, renewal and termination options, the amount of revenues, profits and losses recognised in the period.

# 11 Risk allocation

This section provides a high-level overview of the key risk allocation issues and commercial principles that are involved in a PPP project. This section is divided into two components, being those issues in relation to social infrastructure projects and those in relation to economic infrastructure projects.

Further information including an indicative risk allocation table is included in Appendix B.

Specific guidance on risk allocation and commercial principles is provided in the documents *Roadmap for applying the Commercial Principles*, the *Commercial Principles for Social Infrastructure* and the *Commercial Principles for Economic Infrastructure*.

## 11.1 Social infrastructure

The following provides details of the key risks in a PPP project that may arise as part of a social infrastructure project.

### **Site risk**

Site risk is the risk that:

- the project land will be unavailable or unable to be used at the required time, or in the manner or the cost anticipated; or
- the site will generate unanticipated liabilities;

with the result being that the contracted service delivery and/or projected revenues are adversely affected.

Specific examples of site risk include:

- the risk of unanticipated geo-technical conditions increasing the cost of construction;
- the risk of unanticipated contamination;
- the risk of delays in obtaining statutory approvals;
- the risk of delays caused by the discovery of indigenous and non-indigenous artefacts;
- the risk of native title claims being made on the land; and
- the risk of unanticipated planning constraints on the use of the site, such as threatened species and offset requirements.

Generally site risk will be allocated to the private party. However, in certain circumstances it may be appropriate for government to accept some site risk. For example, government will usually accept site acquisition risk.

### **Design, construction and commissioning risk**

Design, construction and commissioning risk is the risk that the design, construction or commissioning of the facility (or certain elements of those processes) is carried out in a way that results in adverse consequences on cost and/or service delivery.

Specific examples of design, construction and commissioning risk are:

- the risk that the facility as constructed is unsuitable for the delivery of both the contracted services and the core services provided by government;
- the cost of complying with environmental and planning conditions and ensuring that construction and commissioning of the project does not inadvertently cause environmental harm;
- the risk of defects arising in the facility; and
- the risk of delays to the completion of construction.

These risks are particularly salient in relation to the facility's fitness for purpose. To minimise a government's exposure to such risks (except where the Procuring Agency has statutory responsibility for design and operating standards), the Procuring Agency should avoid heavily specifying or formally endorsing a design. However, the private party does not necessarily have unencumbered design freedom, particularly where a government's facility guidelines exist (e.g. hospitals).

Design, construction and commissioning risk should generally be allocated to the private party. This includes the requirement to complete and commission the facility to the required standards and by the required dates.

In certain cases government may consider accepting certain aspects of design, construction and commissioning risk by granting relief to, or compensating, the private party with respect to certain events.

### ***Sponsor risk***

In establishing a project consortium, the sponsor typically establishes the private party in the form of a special purpose vehicle (SPV) which contracts with government. The SPV is simply created to act as the legal entity of a project consortium. Because the arrangement is financed through non-recourse debt, creditors have access to the project's cash flows but limited recourse to the sponsors' balance sheets. Sponsor risk is the risk taken by government that the SPV, or its sub-contractors, will not fulfil their contractual obligations and that:

- government will be unable to either enforce those obligations against the sponsors, or recover some form of compensation or remedy from the sponsors for any loss sustained by it as a result of the SPV's breach; or
- the sponsor(s) will prove to be inappropriate or unsuitable for delivery of the project; or
- the major equity partner is also a prime contractor to the SPV resulting in a possible reduction in the partner's incentive to enforce the owner's obligations under the contract.

The exposure of the Procuring Agency to sponsor risk can be mitigated both contractually and through the operation of the evaluation process.

### ***Financial risk and benefits***

Financial risk includes the risks that:

- private finance will not be available;
- the project will not prove financially robust; and
- changes in financial parameters will alter the bid price before financial close.

If a project fails to gain finance or fails financially later, government is affected because it must obtain alternative services. These risks may be lessened by requiring bids to be fully

underwritten for both debt and equity, and by government not automatically accepting the lowest bid.

Further risks associated with changes in financial parameters before financial close may be assumed or shared by government depending on the circumstances (e.g. by agreeing to accommodate interest rate changes during that period). During the term, the private party may also receive benefits from refinancing the project. Where a refinancing creates a financial benefit through lower interest margins (mature markets) or benchmark interest rates, government will usually share 50 per cent in those benefits. Arrangements for sharing in refinancing gains need to be clearly established in the contract.

### ***Hard and soft facility maintenance operations risk and the payment mechanism***

Government will normally predetermine the level and type of hard and soft services to be provided by the private sector. Generally this will exclude core services but include soft non-core services such as cleaning, garden maintenance, security and catering and hard facility maintenance services like routine and major periodic building maintenance. Government may also include energy management and cost into the payment package.

The private party should bear the risk that the contracted services are not delivered according to the agreed specifications and/or within the projected costs.

This risk allocation is reflected in both the contractual provisions and the payment mechanism. The larger the size of hard and soft facility maintenance service packages, the more effective is the payment mechanism in influencing service performance.

### ***Market risk***

Market risk is the risk that:

- demand for a service will vary from that initially projected; and
- the price for a service will vary from that initially projected, so that the total revenue derived from the project over the project term will vary from initial expectations.

With social infrastructure projects, government generally takes downside demand risk by making payments based on availability rather than use. Price risk is generally borne by the private sector, but limited price risk is often accepted by government through indexing the service fee and benchmarking certain services.

A government also generally takes upside demand risk, that is, the risk that demand will exceed the size of the facility provided. In the case of schools, government may assume the risk of enrolments exceeding base load school design by incorporating the provision of temporary classrooms into the payment mechanism. In other cases, for example, a desalination plant, government may activate an option of a pre-agreed expansion plan with a pre-agreed cost estimate. Government would take the risk on the final cost.

### ***Network and interface risk***

Network risk arises where the contracted services or method of delivery of those services are linked to, rely on or are otherwise affected by certain infrastructure, inputs and other services or methods of delivering the contracted services. Interface risk is the risk that the contracted services will not be compatible with the delivery of core services.

While network risk is often within the control of government, its community obligations can be in competition with the goal of efficient network management. Therefore, government generally accepts network risk only where there is a change in the network which actively

discriminates against the project and directly affects project viability. Provided government does not materially change its service delivery, the private party should be responsible for, and bear the risk of, ensuring that the contracted services are compatible with the government's services.

### ***Industrial relations risk***

The private party will generally take and manage the industrial relations risk relating to their workforce, in a manner consistent with that party's obligations under employment legislation.

### ***Legislative and government policy risk***

Legislative and government policy risk is the risk that government will exercise its powers and immunities, including but not limited to, the power to legislate and determine policy, in a way which negatively impacts or disadvantages the project. Government will generally accept some aspects of this risk by agreeing to accept the risk of certain changes in law.

### ***Force majeure risk***

Force majeure risk refers to the risk that events may occur which will have a catastrophic effect on either party's ability to perform its obligations under the contract. Force majeure risk is generally outside the control of both government and the private party. Accordingly, for social infrastructure projects, force majeure risk is often shared.

### ***Asset ownership risk***

Asset ownership risk is the risk:

- of maintaining the asset to the requisite standard, including the risk that the cost of maintenance may increase during the term; or
- of premature obsolescence; or
- that the construction of competing facilities will occur.

The result of this type of risk is that the economic value of the asset may vary, either during or at the end of the contract term, from the value upon which the financial structure of the project was originally based.

In social infrastructure projects, asset ownership risk is generally allocated to the private party (except for technology risk). The risk that competing facilities may be constructed is not generally relevant to social infrastructure projects, as government pays a fixed service fee based on the availability of the facility. However, where a private party's bid is predicated on a third-party revenue source, government may consider, on a value for money basis, accepting the risk that construction of competing facilities may adversely affect that third-party revenue source.

### ***Tax risk***

Tax risk is generally the responsibility of the private party.

### ***Interest rate risk***

For social infrastructure, government usually takes interest rate risk up until financial close (in relation to the reference rate). Subject to the financing structure of the project (e.g. CPI-indexed bonds), government may accept CPI risk on the bond while the private party takes interest rate risk.



Both government and the private party may manage this risk by hedging interest rates.

## 11.2 Economic infrastructure

A number of the above areas generally apply to both social and economic infrastructure. However, there are a number of differences between economic and social infrastructure. The major differences are outlined below.

An economic infrastructure PPP typically involves a user-pays structure rather than a service charge structure which is most often relevant to social infrastructure. Typically, the user-pays structure involves the payment of tolls, fares or user charges for use by the public or by the business community of facilities such as roads, bridge, tunnels and potentially, ports, airports and trains/trams.

The revenues earned through user charges are expected to be sufficient to enable the private party to pay back, or substantially offset, the capital raised to fund construction of the facility, meet operating costs, pay the interest on the debt raised and give the required equity return.

### ***Market risk***

In an economic infrastructure model, market risk (price and demand risk) is usually transferred to the private sector operator. However, the price may be regulated either via the contract or by a government regulatory body.

Typically, this risk allocation is appropriate where the facility constructed has an open market use and where there is likely to be consistent demand. It is more difficult for the private party to take demand risk where the use of the facility is exclusively by the contracting Procuring Agency or depends on the actions of that Procuring Agency.

A government will generally share in any excess revenues above an agreed threshold that the private party may earn from user charges. For example, a sharing mechanism may be based on a sliding scale for revenues in excess of 100 per cent of the revenues anticipated in the base case financial model.

### ***Network risk***

Given the private party bears market risk, it is likely that the allocation of network risk will receive greater attention for economic infrastructure projects because changes to the network could have a direct impact on the private party's ability to generate revenue.

### ***Asset ownership risk***

Similar to social infrastructure projects, government will often transfer asset ownership risk for economic infrastructure projects. However, government may, on a value for money basis, retain the risk that competing facilities may be constructed reducing the economic value of the asset.

# 12 Payment mechanisms

The payment mechanism is at the heart of the contract, as it puts into financial effect the allocation of risk and responsibility between government and the private party. It determines the payments that government makes to the private party and establishes the incentives for the private party to deliver the service required in a manner that gives value for money. Payment mechanisms are the prime means of providing incentives to the supplier of services, and fulfilling the financial obligations of government.

## 12.1 Features of the payment mechanism

In general terms, the key features of a payment mechanism are:

- no payments should be made until the contracted service is available. For example, in a water treatment project, no payments would begin until the plant has been commissioned and water of the required quality is being received;
- there should be a unitary charge for the service, not separate charges for elements relating to availability or performance. The service charge generally comprises a number of separately identifiable elements however government prefers these to be converted to a single project obligation;
- the unitary charge should be paid only to the extent that the service is available (e.g. proportionate to the number of available places or units);
- the payment mechanism should seek to make abatements for sub-standard performance so that the private party's financial motivators coincide with those of government;
- in some circumstances (for example, a package of schools), unavailability of one whole facility (school) may result in no payment for that one facility rather than no payment for the whole package. Abatements should reflect the severity of failure, so that no service should lead to no payment, but a minor failure to a lower level of abatement;
- performance measurement should be linked to an agreed set of standards or key performance indicators, which generally will relate to quality, timeliness or other service delivery requirements; and
- arrangements should allow government adequate flexibility to require, and reward, changes in the nature or volume of services to be delivered over time.

The basis of PPPs — the receipt of specified outputs and services — requires that payment should not be made up of sub-elements related to delivery of any inputs (e.g. the completion of stages of construction, cost of materials or labour).

The payment mechanism must relate to the services being provided and not contain a fixed element which the private party always receives irrespective of performance (e.g. which covers the private party's debt service obligations). The debt providers should have confidence (taking into account, where relevant, advice from their technical advisor) in the ability of the private party (i.e. their borrower) to perform or to remedy defective performance and in their ability to change the operator, if necessary.

The payment may in some cases be determined by usage or volume. Complete allocation of usage risk is appropriate only where the private party can reasonably forecast or influence future usage. This may be the case where the private party is satisfied with predictions of the level of demand for the service or where there is significant third-party revenue which the private party's performance can affect. In many projects, demand or scope for generating significant third-party revenue is not possible to predict and so it is unlikely that allocation of significant volume risk to the private party will achieve value for money. A part of usage risk, however, can be allocated in most contracts, particularly that relating to third-party usage, in circumstances where the availability and quality of the service will influence demand.

## 12.2 Direct financial or indirect non-financial incentives

If the private party fails to perform, both direct and indirect incentives through the payment mechanism can be applied to remedy the failure.

The direct approach involves immediate reductions in payment. In a project with an availability-based payment mechanism, the whole of the payment is subject to abatements for unavailability. For example, when considering a hospital project, the reduction could be an hourly rate that differs according to the private party's ability to manage the risk, illustrated in Table 12-1.

**Table 12-1: Sample scale of payment abatements for unavailability (availability-based contract)**

Category A failure event level					
		Functional Unit Category			
		Clinical Care	Clinical Support	Amenities General Support	Administrative
Functional Unit Weighting	Critical	\$500	\$300	\$100	\$60
	High	\$200	\$100	\$60	\$30
	Medium	\$100	\$75	\$40	\$30
	Low	\$50	\$40	\$30	\$20

Failure Event Level	Response Time	Rectification Time
Level A	5 minutes	30 minutes
Level B	30 minutes	2 hours
Level C	60 minutes	24 hours
Level D	60 minutes	4 days

This structure motivates the private party to proactively manage those risks which it can manage, on a basis which delivers best value to government.

The indirect approach depends on the level of performance of the available service. It involves the award of performance points for substandard performance — the number of points varying according to the severity and regularity of the breach (if a ratchet mechanism is used). When the private party accumulates a certain level of performance/abatement points, a range of other incentives can be imposed, from formal warnings to financial penalties or, in extreme cases, eventual termination for breach of contract.

Other indirect measures may include public reporting of performance against agreed benchmarks. If implemented sensibly, this can be a strong motivator for the contractor to perform or risk public pressure. In constructing points-based performance payments (for incentives and penalties), care needs to be taken that unintended consequences do not arise whereby incentives cancel out sub-optimal performance.

## 12.3 Structuring the payment mechanism

The structure of the payment mechanism is critical in implementing the risk allocation and in providing the correct incentives to the private party.

Depending on the nature of the project, the payment mechanism may contain elements that relate to:

- availability of the service;
- performance of the service;
- usage of the service;
- quality of the private sector's processes; and
- wider defined benefits.

Many PPP projects use a combination of two or more of these elements. For example, a court services project may use an availability component for payment associated with the physical courtrooms and a service delivery component for operational services, such as court reporting and prisoner movements. It is important that these elements do not have their own independent payment regimes. They need to be part of a unitary payment which reflects overall service performance. This way, payment for usage, for instance, is not made without regard to whether availability or performance standards were met for the service.

### *Unitary charge approach*

Combining different charge elements into a single consolidated payment by government to the private party is an important feature of PPP projects. Government is procuring an integrated range of services from the private party. The unitary charge approach lessens the potential, and incentive, for the private party to cut back on the less profitable services. The unitary charge approach should also be maintained in bundled or aggregated service contracts, for instance, where the private party has responsibility to provide infrastructure and ancillary services for a number of educational facilities. This unitary charge approach should be mirrored in the default provisions where default on a particular service constitutes a default on the project as a whole.

The most appropriate combination of payment elements differs from project to project and is influenced by factors such as whether the government is the customer, the extent to which demand risk can be efficiently allocated to the private party, the nature of the services provided and government's objectives for the project.

### *Service availability*

For many PPP projects, the provision of available services is very important. That is, government needs the facility to be available and ready to use, regardless of the extent to which it is actually used. Available services may comprise accommodation places or units (such as courtrooms, prison cells or hospital beds) or peak capability levels (such as for a water treatment facility). Where the government requires available services, it is appropriate for a payment element to directly relate to this service.

Availability is measured not simply by the accommodation or capacity being available but also by its being available at the specified performance standards — such as a courtroom being clean, with available air-conditioning and all audiovisual systems ready and in working order. In accommodation service projects, debt financiers will typically seek to align the accommodation service element with the private party's debt repayments.

In such cases, it is important that a suitable payment abatement arrangement be in place so that if the accommodation services are not provided at the required time, to the required level or at the required standard, and the failure in service amenity is material, the debt repayments are not quarantined.

### ***Service performance***

For PPP projects where services other than availability are being provided (such as transport services or the treatment of raw water), or where ancillary services such as cleaning and security are being provided, it is appropriate for the performance of these services to be measured. Where the service performance level is less than specified, there should be scope for suitable abatement of payments.

### ***Service usage***

Payments based on usage or transaction level may be appropriate where the level of usage is a strong indicator of the service benefits being provided. Service areas where such a payment element may be used include transport (through the use of fares in rail projects and shadow tolls in road projects), water and wastewater treatment services, and some information technology services which provide transaction-based services. Usage-based payments can expose the contractor to significant levels of demand risk however, this can provide strong motivation for maintaining and enhancing service delivery where demand can be affected by the private party (for example, in an education accommodation project where the facilities can be leveraged to generate revenue from users such as sporting clubs or private education/training businesses).

### ***Quality of processes***

The payment mechanism will usually include a mechanism to capture and abate for failures that are not specifically referable to service delivery. Instead, the mechanism is based on KPIs which measure the private sector's internal processes (e.g. reporting and record-keeping, preparation and updating of required plans, etc).

### ***Wider service benefits***

In some projects, there may be some broader service benefits which government is willing to pay to have provided. This may occur, for instance, where improvements in safety or community access are important government objectives for the project. If such benefits are measurable, they can provide a suitable basis for payment.

## **12.4 Securing finance**

A payment mechanism should not ring-fence or guarantee the private party's finance charges. The relatively weak risk allocation created by such a structure would not usually give good value for money and government would be taking the risk of the interfaces between, say, the availability and the service delivery elements.

Experience has shown that payment mechanisms based on availability benefits or usage, or a combination of them, are capable of being financed, provided the payment mechanism fits the project, the risk allocation reflects a commercial position, reasonable cure periods are included and abatements are appropriately weighted. Financiers typically expect reductions for availability payments, performance abatements, or (with usage being an element of the payment) likely downturn in usage, all to be accommodated within their financial models. Their aim is to achieve minimal risk of losing the whole payment.

# 13 Bid evaluation

Bid evaluation is a critical element of the PPP process, from the perspective of both government (with the objective of securing the best value for money outcome available) and the bidders who expect the evaluation process to be clear and consistent.

Bid evaluation takes place at two stages in the process, when EOI responses are received and when final proposals are lodged in response to the RFP.

## 13.1 Evaluating expressions of interest

The objective of evaluation of EOIs is to determine whether the parties have the financial capacity, technical capability, demonstrated understanding of government requirements and resources to deliver the project. Responses to an invitation for EOI do not normally require any indication of price.

The key evaluation criteria to be applied to EOIs generally include:

- General:
  - understanding of project objectives and the government's requirements for the project;
  - understanding of the key project issues and challenges, and identification of proposed solutions;
  - experience and capability in managing project interfaces including with government and key stakeholders;
- Experience & Capability:
  - experience and capability of the sponsor in leading PPP projects;
  - experience and capability in successfully designing, constructing, financing, maintaining and operating major infrastructure (this may be local or international experience);
  - the experience of the consortium members in working together;
- Commercial & Financial:
  - proposed commercial structure, intra-consortium risk allocation and financial support provided by a parent company, associates or financial institutions;
  - proposed funding structure;
  - demonstrated understanding and acceptance of the proposed risk allocation and commercial principles;
  - financial capacity to meet the likely contractual obligations associated with the project;
- Other:
  - confirmation of no conflict of interest.

Some of the specific issues associated with the above criteria that should be considered as part of the evaluation include the following.

- **Understanding of the project.** The invitation for EOI should call for bidders to outline indicatively and briefly their proposed approach to delivery of the project and services over the life of the contract. The EOI response should be reviewed and an assessment made as to whether it demonstrates an understanding of project objectives and the service delivery outcomes required, as well as any key issues that should be considered.

It is important that the opportunity to demonstrate ability and to ensure scope for innovation is defined. Bidders must not be induced to spend significant sums in preparing a response to an invitation to express interest. The EOI document should express a limit on what is expected.

The invitation for EOI usually allows or encourages bidders to propose innovative solutions to the service delivery objectives. Accessing good ideas is a key objective of PPPs and innovative approaches with the potential to deliver improved value for money or improved service outcomes should be regarded positively. However, while an innovative approach may prima facie deliver high value, the risks associated with its implementation should also be evaluated.

- **Experience.** The bidder's experience and track record in delivering projects of a similar nature (recognising that a number of parties are likely to be involved in each bidding consortium for the project). This assessment criterion needs to take into account not only the bidder's ability to deliver against the physical aspects of the project (for example, development of a hospital facility) but, importantly, its ability and track record in delivering outputs under long-term contractual arrangements.

However, track record should not be narrowly defined nor over-weighted to the extent that it is a barrier to the development of smaller firms, unnecessarily reducing competition. Track record should also not be limited to local experience, instead allowing evidence of overseas experience for similar scope of projects to be considered.

A lack of demonstrated track record in delivering projects of this nature does not necessarily mean that a bidder should not be considered. However, in the absence of a specific track record, it is particularly important to consider the organisation's broader experience, wider track record and management team and form a view on its ability to structure, deliver and service a PPP arrangement.

- **Composition of consortium.** The composition of the consortium proposing to deliver the project is important. The EOI responses should clearly define the roles of each participant and demonstrate how the relationships between the parties are proposed to operate. To the extent that the proposed organisations have not worked together previously, the evaluation team should particularly consider how the members of the consortium will collaborate to deliver the necessary outcomes.
- **Financial position and financing.** PPP projects normally require the successful bidder to finance a substantial capital cost for the project. It is therefore important to consider the ability of the private party to secure this finance. This requires an examination of the financial position of the members of the consortium and consideration of financiers' perception of the organisations and the risks associated with their operations generally. There is little point in inviting a bid from a private party with marginal profits and a weak balance sheet, as it is unlikely that the required finance could be secured on competitive terms or terms acceptable to government.

Consideration of the financial position should also take into account the bidder's ability to support the contractual arrangements over the term. Financing the initial development of the project is clearly critical, but it is just as important that the private party's financial outlook is

sufficiently robust to give government comfort that the service delivery requirements and government's rights under guarantees can be supported over time.

The evaluation process should also have regard to the indicative financing structure reflected in the EOI, which should be reviewed to assess its deliverability and the likely economic outcomes.

### **13.1.1 Short-listing expressions of interest**

The evaluation of EOIs should lead to a short list of parties to be invited to continue in the process and to whom the RFP will be issued.

The evaluation process is focused on forming a view on whether the parties have the requisite capability to deliver the project. This process will usually result in some parties being advised that they will not be invited to move forward in the process. The number of parties short-listed will vary from project to project. However, the objectives of the process should be to:

- only short-list parties which government genuinely believes have the capability to deliver the project — parties should not be short-listed to make up the numbers; and
- short-list an appropriate number of bidders to both maintain competitive tension and protect against the risk of a withdrawal while also maintaining the motivation for bidders to invest in the process by not short-listing too many.

As discussed in Section 4.5, in most instances a short list of three represents an appropriate number of parties to be invited to participate in the RFP phase. However, this must be determined on a case-by-case basis.

## **13.2 Evaluating final bids**

Evaluation criteria need to be developed to suit the characteristics of each project. The criteria may often fall into three areas: commercial issues; building/infrastructure issues and service delivery issues. In some projects, other issues may require consideration, such as contribution to regional development.

The basis on which bids are evaluated must be clearly communicated in the RFP (there may be some limited reference also included in the invitation for expressions of interest) so that bidders can develop bids recognising the key issues of the evaluation process. The evaluation process is also set out in the RFP.

### **13.2.1 Value for money and the PSC**

One aspect of the value for money of PPP projects is calculated through a financial comparison with the Public Sector Comparator (PSC). The primary purpose of the PSC is to provide a financial benchmark against which to form a judgment on the quantitative elements of the bids.

In most instances, certain adjustments will be required to ensure that the financial comparison of the PSC and individual bids is on the same basis.



### ***Value for money and quantitative assessment***

The PSC is the key management tool in the quantitative assessment of value for money during the tender process and the evaluation and comparison of proposals. The proposals will be assessed against the PSC to determine whether they offer value for money based on quantitative analysis.

An important first step in the RFP evaluation process is to undertake a preliminary quantitative comparison of the proposal to the PSC to identify any potential funding issues.

Proposals will be ranked according to their risk-adjusted net present cost (NPC) relative to the risk-adjusted PSC. Adjustments may be made to the NPC of individual proposals according to their preferred risk allocation.

As considered in the *Commercial Principles*, all risks not explicitly taken by government will be borne by the private party. The financial impact of the risks taken by government (e.g. retained risk) should be added to each proposal to show the total project delivery cost.

The evaluation report should include the financial analysis of the proposals and their comparison to the PSC.

In circumstances where none of the bids offer value for money compared with the PSC, further analysis may be required, but in the absence of other offsetting net benefits, government reserves the right to terminate the PPP procurement process and procure the project through other methods.

Government may choose to proceed with a PPP option even where, based on single-figure estimates, little or no value for money is evident (and vice versa). For instance, it is possible that a bid above the single figure PSC estimate could be considered to offer value for money compared with the PSC, because the PPP delivery mechanism provides greater cost certainty and decreases government's risk exposure.

Further details on value for money considerations are provided in Section 9 of the *Public Sector Comparator Guidance*

### ***Value for money and qualitative assessment***

A complete value for money assessment requires consideration of qualitative factors along with the quantitative assessment (including the infrastructure and services solution). Identifying the best outcome requires a flexible valuation process and the consideration of the qualitative factors associated with the proposals that have not been explicitly valued.

Examples of qualitative factors that may be considered include:

- service delivery and operational requirements;
- interface/relationship and project management; and
- a range of design considerations.

For further detail on the PSC, refer to Section 9 of the *Public Sector Comparator Guidance*.

## 13.2.2 Commercial and financial issues

Some issues that may arise as part of the commercial/financial evaluation include:

**Certainty of finance.** The certainty of the financing should be assessed as material outstanding issues may cause significant issues to arise as part of the final negotiations phase of the project. The review should be approached from the financiers' perspective and not just government's. In reality, financiers can usually find a basis for withdrawal from the project despite the presence of commitment letters (although their credibility with government subsequently suffers). The evaluation should therefore focus on whether the project cash flows and sponsor support show a proposition likely to meet the requirements of debt providers.

**Sponsor (i.e. equity and key subcontractor) support.** The financing structure proposed by bidders must indicate some equity contribution and the commercial arrangements with key subcontractors (e.g. builder and FM provider) should include appropriate security arrangements (i.e. bonds and guarantees). A highly debt-funded structure may give a lower bid price, but unless sufficient recourse to the sponsors exists, the project will lack a mechanism to achieve the necessary risk allocation. Contribution of equity funds or security/guarantees from the sponsors means that, if the services are not delivered and service charges are reduced completely or partly, the sponsors have a genuine commercial motivation to overcome the problem. Without this support, the risk allocation proposition is totally dependent on the financiers acting to rectify the problem. These issues need to be reviewed in detail, but generally debt financiers require sponsor support to protect them from the same risks that concern government.

**Performance based charges.** The evaluation should particularly consider any proposed changes to the payment mechanisms that would increase the payments due for above-specification outputs (where there is reason to make additional payment for above-specification outputs). A signal may be a bid with a low service charge against the standard requirements but higher hurdles for abatements. The outcome could be a lower price against the base payments, but higher costs to government over the contract term.

**Cash flow profile.** The profile of payments outlined in bids should be assessed for any solvency issues for the private party. Bidders sometimes desire to back-end payments so that service charges start at a low level and escalate during the term of the contract. This may reflect a value for money financing structure, but assessment is needed of whether sufficient cash flow is available in the early years to support operating costs and debt. Back-ending may also have tax and balance sheet implications.

**Residual value/debt amortisation profile.** The bid evaluation process should specifically assess the rate at which debt finance is to be amortised. This allows the procurement team to understand the level of debt outstanding at each stage of the contract term. Assumption of residual value risk by the private party may give a lower cost for services to government during the term, but this structure may also result in debt levels giving a higher step-in cost at any stage.

**Tax assumptions.** The contract is usually drafted to allocate all taxation risks to the private party. The bid evaluation process should focus on the assumptions made about taxable income (i.e. including timing of the recognition of income and timing and availability of tax deductions). If the project structure assumes incorrect tax assumptions, the private party could face a much larger tax liability than is reflected in its bid, with potential consequences for its viability.

**Risks of shared use.** Where a bid proposes that the infrastructure be used to service the requirements of both government and third parties, the associated risks need to be considered. Improved usage of the asset is positive as it should lead to lower service charges to government. However, the third party activities need to be appropriately partitioned. For

example, in a hospital development where part of the facility is to be used to operate a private hospital, government must assess how a possible failure of private operations could adversely affect services to government. This should include consideration of the financing arrangements and the specific rights of financiers if the private hospital fails.

### 13.2.3 Design evaluation issues

Some of the issues that may arise as part of the design evaluation include the following.

**Functionality of design.** The ability of the design to enable government to deliver its core services is a key evaluation criterion. The design requirements of the RFP should be used as the basis of the evaluation. The proposed solution should be measured to determine the extent to which it meets these requirements. Some of the specific issues to be considered may include the impact of government staff numbers and how the design maximises government's opportunity to provide the core services in the best possible manner.

**Performance specifications.** The RFP is likely to contain a range of technical performance criteria. The evaluation of these should focus on how the proposed solution addresses the required outputs.

**Flexibility.** The flexibility of the proposed solution and therefore the opportunity to enable change should be evaluated. Given the long-term nature of these contracts, the ability to incorporate change is critical to the success of the project. For example, it is very likely that the specific manner in which the core services are delivered will change on a number of occasions over 25 years. Therefore, the ability of the design to enable this change without material amendment to the physical infrastructure is a key consideration.

### 13.2.4 Service delivery evaluation

Some of the issues that may arise as part of the services evaluation include the following.

**Management structure.** The proposed structure for management of the delivery of the services over the operational period is integral to the project's success. An appropriate management structure can substantially mitigate any potential issues in relation to the delivery of individual services.

**Impact on core services.** The manner in which the services are proposed to be implemented and how this will impact on the delivery of the core services, should be assessed, for example the proposed maintenance regime in terms of the timing and frequency of asset replacement activities and how this is scheduled to avoid detrimental impacts on the delivery of the core services.

## 13.3 Evaluation reports

The evaluation of final bids should be presented in an evaluation report. The report should specifically consider the evaluation criteria contained within the EOI/RFP and the proposed evaluation methodology. It should provide an objective analysis of the bids and a recommendation to government.

The evaluation report should arrive at a joint view from the separate evaluation teams (e.g. finance/commercial, design, service delivery) on the overall ranking of bids and a recommendation of which bidder should be the preferred party. The report should discuss the rankings within each area of evaluation and the basis for the procurement team's agreement on the preferred bidder. For example, bidder A may be preferred by the commercial team, bidder B by the design and bidder C by the service delivery team. These separate views need to be brought together to reflect the proposal which is considered overall to deliver the best value for money.

# 14 Probity and integrity

Governments are committed to efficiency, fairness, impartiality and integrity in all dealings. Probity is an important issue for government as a custodian of the community's assets.

A comprehensive probity plan is essential in all PPP projects and a Probity Practitioner (either an auditor or advisor) will be appointed for large, complex and unusually sensitive projects.

By adopting a clear probity process, all parties are assured of the integrity of the awarding process.

To ensure that the participation of related companies in a tender does not impact on the probity, competitiveness or cost of a project, the companies may be required to sign a probity process deed.

Each individual jurisdiction will have probity and process requirements relevant to commercial and PPP transactions including:

- public service codes of conduct or similar;
- probity policies or similar;
- procurement and probity process guidelines or similar; and
- legislative requirements and/or statutory directions.

The codes of practice and guidelines establish ethical principles and standards of behaviour for all parties involved and will apply to all procurement actions from calling for EOIs through to contractual execution and contract management actions.

## 14.1 Management of probity

Good process and probity are consistent with achieving value for money in commercial engagements. Probity management is an integral part of the process, not a separate obligation.

A commercial engagement which conforms to the expected standards of probity has clear procedures, consistent with government policies and legislation. It also takes into account the impact on bidders of participating in the transaction. The procedures are established, understood and observed from the outset and throughout the process. Decisions should be made in a transparent way so they can be understood. The justification for any decision should be clear.

The essential tool of probity management is a wellcrafted probity plan that helps foster a probity culture, spells out proper process, results in records demonstrating the equity of the process and assists with the efficient achievement of project objectives.

Probity must be an integral part of a process and not a last-minute consideration. Departments and agencies should have systems, policies and procedures in place that can withstand public scrutiny and are consistent with existing government policy.

## 14.2 Use of Probity Practitioners

Probity Practitioners can assist the PPP project by undertaking one or more of the following roles:

- independent assessment and/or advice throughout the procurement process as to whether processes have been properly managed and completed in accordance with requirements;
- ongoing independent advice on probity issues; and
- an independent and appropriate sign-off, at designated milestones in the process, on probity requirements.

The Probity Practitioner is commonly an observer in dealings between bidders and the procurement team, such as at presentations and interviews. The Probity Practitioner should also be available generally to answer questions and provide advice to the procurement team, Project Steering Committee or senior staff of a department or agency.

## 14.3 Probity plan

Key elements in drafting a probity plan, procurement conduct plan or similar are to:

- plan the engagement and role of a probity auditor — one element of the role is to endorse the probity plan;
- ensure that related parties have developed and implemented reasonable safeguards to ensure the probity of the bidding process;
- formally specify levels of authority for making decisions and commitments and for the conduct of dealings with particular persons or bodies, including bidders;
- formally specify principles and practices for access, dissemination, use and storage in relation to project information and records;
- allocate responsibility and authority for management of probity, including responding to problems and queries;
- set out principles and procedures that will promote probity with efficiency. Ensure in particular that the principles and procedures will not inhibit achievement of project objectives. A principle or procedure must be redesigned if, for example, it could result in incomplete questioning of material presented by a bidder; and
- develop a strategy to promote a probity culture.

Individual jurisdictions will have probity templates available for use in PPP projects.

## 14.4 Ensure security and confidentiality

While government is committed to a policy of openness and transparency, a strong measure of confidentiality may be required during the procurement process. This protects both the competitive position of individual bids and the commercial interests of departments. The requirements for confidentiality and disclosure must be considered with the provisions of individual jurisdictions, Freedom of Information and other relevant legislation.

While confidentiality primarily limits inappropriate transmission of information, one relevant issue for PPP projects is ensuring that people have all the information they need to fulfil their roles. Processes that ensure confidentiality must not be allowed unduly to delay the necessary dissemination of information.

All public officials have a general obligation of confidentiality to their employer. Non-public officials involved in a tender process may not be under an obligation of confidentiality to the department. They should be asked to give an undertaking to protect the confidentiality of all the information they obtain during a tendering process.

Similarly, processes must serve the government commitment to openness. In particular, members of procurement teams must be aware of government policy on the public disclosure of bidding and contract-related information.

Departments must establish clear security procedures for handling tender-related documents (produced by both bidders and the department). The highest level of confidentiality is to be accorded to bids and bid evaluation documents. Particular consideration should be given to storage and access restrictions. Only authorised procurement team members with a direct need to know should be party to tender-related commercially sensitive information. The security arrangements should be reviewed and approved by the relevant departmental officer and/or Probity Practitioner.

Confidentiality is also important in electronic communications and on-line storage or submission of relevant tender material, and may warrant further attention.

## 14.5 Intellectual Property

Intellectual property is a key issue for both bidders and government in the formal bid processes and discussions around projects. The legal characteristics and limitations of intellectual property need to be recognised. The key issues needing to be dealt with include:

- identification of intellectual property;
- treatment of intellectual property contained in formal bid documents; and
- the manner of dealing with intellectual property in contractual arrangements.

### 14.5.1 Identification of intellectual property

The term 'intellectual property' refers not only to legally protectable intellectual property (such as copyright, patents, registered designs etc.) but also to ideas and information protected only as confidential information at common law or under contract.

Departments and agencies should consider the manner in which genuine intellectual property presented by private parties may be protected. However, ideas or concepts presented to government, while they may be considered by the companies to reflect intellectual property, are often high-level in nature and do not constitute true intellectual property.

Intellectual property commonly encountered in PPPs includes:

- designs, drawings etc. relating to the construction of infrastructure and assets;
- technology associated with delivery of services (e.g. technical solutions for more efficient treatment of waste water). Such technology is usually governed by some form of licence in any event; and
- operational processes for delivery of outputs.

While government should be alert to the issues, the owner is responsible for identifying specific intellectual property which it wishes to protect.

### **14.5.2 Tender process**

Intellectual property in proposals or bids submitted as part of a bidding process should be protected and not made available to any other bidder. An objective of PPPs is to encourage the private sector to develop innovative approaches to service delivery. Any perceived risk that bid information would be made available to other parties would seriously impede the objectives of the policy.

### **14.5.3 Treatment of intellectual property in contractual arrangements**

The treatment of intellectual property relating to a PPP project needs to be reviewed in the context of each project and in consultation with the procurement team's legal advisors. As a general rule, government should seek to acquire a royalty-free transferable licence to the intellectual property for the life of the service requirement. In some cases, however, it is appropriate for government to seek ownership of the project intellectual property. The value of the intellectual property is typically reflected in the payments which government agrees to make. Government must ensure that it can access all the tools required to deliver the service over the life of the contract. If the private party is replaced under the contract, the new provider must be able to access any necessary intellectual property to continue delivering the required outputs.

### **14.5.4 Protection of intellectual property from premature disclosure**

Members of the public may seek access to documents provided during the bidding process through the relevant jurisdictions' Freedom of Information framework. There may be relevant exemption criteria that would cover the premature disclosure of government or bidders' intellectual property in this context. It may also be the case that if a freedom of information request is received then the government representative would need to consult the private party, and that private party may have rights to appeal the decision.

This is a complex area and legal advice should be sought before entering into arrangements to protect intellectual property.

## **14.6 Conflicts of interest**

Conflict of interest is a key issue that may arise as part of a PPP project. Specific guidance on conflict of interest issues has been provided in Appendix C.

## **14.7 Related-party probity principles**

Specific processes should be in place to address situations where related parties are included in two or more separate consortia involved in bidding on the same transaction. Related-party probity principles are established to ensure that related parties have implemented internal safeguards to ensure probity requirements are met. This may include the establishment of processes and protocols to ensure that related parties involved with separate bidding consortia do not collude or in any way compromise the integrity of the bidding process.

Additional guidance on related-party probity principles is provided in Appendix D.

# 15 Interactive tender process guidelines

An interactive tender process is recommended for PPP procurements. The aim is to assist agencies and their advisors to consider this matter more rigorously and consistently when designing the tender process and timetable. The interactive tender process is continually being refined and the guidance below and in Appendix E reflects the current practice.

## 15.1 What is an interactive tender process?

The interactive tender process (ITP) provides an opportunity for an appropriate amount of direct interaction between the project team and short-listed bidders prior to bid submission. It is an opportunity for the project team to explain and clarify their expectations and for short-listed bidders to seek relevant feedback for their bid development.

This two-way communication takes the form of presentations, meetings and/or workshops involving individual bidders and the government project team.

## 15.2 Objectives of the interactive tender process

One of the main differences between PPP projects and a traditional procurement approach such as 'design and construct' is that government aims to transfer whole-of-life asset condition risk and fit-for-purpose risk to the private sector. The private sector party has outputs to be met for the term of the project, but retains responsibility for determining the most suitable method to deliver the facility and services.

A key objective of the ITP is to improve the quality of proposals, and ultimately deliver better outcomes for government. The quality of proposals is improved where they:

- meet the requirements of the RFP;
- are developed with a full understanding and appreciation of the government's expectations; and
- are affordable for government.

The ITP provides an opportunity for an appropriate amount of direct interaction between government and the private sector during the RFP phase of the project. Individual bidders have an opportunity to discuss the development of their proposals, including the commercial and technical aspects, and to seek clarification and feedback in the context of the RFP and government's expectations and requirements.

Although the RFP will contain detailed information regarding government's requirements and expectations, experience on previous PPP projects suggests that it is difficult in words alone to explain fully the commercial and functional requirements of a project. Furthermore, bidders can misinterpret government's requirements. Where this occurs, government is placed in a difficult position of either having to go through a further bidding phase to address the shortcomings or having protracted negotiations with the preferred bidder in circumstances where much of the competitive tension has been lost. These are not attractive options as they undermine government's objectives of minimising cost and time and securing value for money through maintaining competitive tension.



## 15.3 Interactive tender process in social infrastructure projects

An interactive tender process can be particularly useful for social infrastructure projects (e.g. a hospital), where there is a high level of interface risk between public sector operators and private sector infrastructure and service providers. Interface risk is commonly a feature of PPP projects in the social infrastructure sector because the infrastructure is designed and constructed by one party (private sector) and operated and managed by another party (public sector). This is in contrast to other PPP models where the operator is part of the private sector consortium and is intimately involved in the design of the infrastructure from both an operational and whole-of-life perspective (e.g. a toll road).

Social infrastructure facilities such as prisons and hospitals are highly dependent on the functionality of the infrastructure for operational outcomes and efficiencies. For example, the lines of sight between various officer posts in a prison affect staffing levels and recurrent costs. It is therefore essential that the bidders' facility concepts and designs take into account operational philosophies and practices at an early stage.

While the interactive process is especially useful for projects involving a public sector operator, it should be emphasised that the process could offer value to both parties for other types of PPP projects.

## 15.4 Interactive tender process protocols

A set of interactive tender process protocols is in Appendix E. The protocols are followed by specific guidance on the issues associated with implementing an interactive tender process.

# 16 Communication

## 16.1 Communication during the bidding process

Communication with bidders occurs at a number of stages throughout the project and needs to be appropriately planned and managed. Commonly the key points of communication are:

- market soundings with the broader marketplace held during project development;
- market briefing held to inform the market when the EOI is released;
- tender communication during the EOI and bid phase that comprise written Q&A procedures;
- tender communication during the bid phase that involves an interactive tender process; and
- debriefing of unsuccessful parties once contract execution or financial close is achieved.

PPP projects may require a greater opportunity for bidders to seek clarification and advice than is necessary on some other projects. In these circumstances, three considerations arise:

- ensuring that information provided by a bidder does not become available to any other bidder, whether directly or by inference;
- ensuring that no bidder receives an unfair advantage as a result of elaboration given in response to a question; and
- ensuring that related probity practices are sufficiently well designed so they do not unnecessarily restrict achievement of value for money.

## 16.2 Communication strategy

A communication strategy is an integral part of project development and delivery. Internal or external resources may be used to develop the communication strategy. Endorsement or sign-off in accordance with jurisdictional procedures would be necessary and would usually encompass approval or endorsement at a departmental and Ministerial level.

The initial public statements are critical in framing the general public and market perception of the project. Particular attention should be given to public statements regarding the monetary value, delivery timetable and objectives of the project.

It is critical to communicate clearly the scope and definition of the PPP project to ensure there is no mistaken understanding about the role of the private sector in the provision of public infrastructure. It may also be necessary to distinguish between the government's desired outcomes (e.g. improved health services in a region) and the project's outputs (e.g. new hospital facilities). The success of the procurement team should not be related to the *outcomes* sought by government nor the validity of the process which defined the required outputs. Clarity about this distinction can be particularly important, and the procurement team's work should relate only to its specific commission.

Project communication has a variety of distinct purposes. The interests and needs of various stakeholders (bidders, users, investors, trade unions, politicians at local and state levels and various special interest groups) vary widely, as do their perceptions of a particular project. A communication strategy should take account of the differing recipients.

Consistency and clarity in communication are important. A communication strategy must identify the individuals authorised to speak for particular purposes and the means by which their communication can be relayed quickly to others connected with the project.

### **16.2.1 Public consultation**

Public consultation varies from project to project. In selecting the appropriate public consultation strategy, the procurement team should consider the size, complexity and sensitivity of the project. For small and non-controversial projects, consultation may need as little as ensuring notices appear in the local press. Other projects require a more elaborate process including regular press releases on project topics, public forums and calling for and considering public submissions.

### **16.2.2 Market communication**

The communication strategy should include specific processes to ensure bidders are properly briefed as the project progresses. Information outside the tender documentation needs to be communicated to bidders in a timely manner. The more controversial or high-profile the project, the more important these processes become.

Communication occurs either directly or indirectly with the broader infrastructure market. The market is particularly interested in the efficiency of processes, their predictability, probity and the like. It is important that communication about a project is consistent with the actions of the procurement team. For example, if the project is to include broad consultation with interested parties, interaction should be visible and any outcomes must be properly considered in developing the project.

### **16.2.3 Ongoing communications and disclosure**

Communication does not cease once the tender process is completed. Shortly following financial close there is likely to be communication around the disclosure requirement (for example the publication of the project summary or public release of the contract). There may also be communication around any reviews or audits of the project.

There will be ongoing communication requirements during the construction phase and long-term service delivery phase. It is becoming increasingly common for the successful private parties to establish project websites during construction phase in consultation with the stakeholder department.

Communication between the state and the private party and with the general public is a key element of contract management and is considered further in Appendix H.

# 17 Post-tender debriefing principles

It is common practice for Procuring Agencies to debrief bidders following a tender decision. A debrief that provides considered and objective feedback has the benefit of enabling both bidders and Procuring Agencies to incorporate lessons for improvement in future procurements. It also recognises the considerable investment of time and resources by all parties in preparing a PPP project for market and bidding. The feedback provided should be objective and consistent with the evaluation criteria and Evaluation Report and be focussed on the performance of the bidder.

The objective of the principles is to provide some consistent guidance as to the overall tone and structure of a debrief. Specific details and content will be determined by individual Procuring Agencies and take into account project specifics.

A structured debrief process will facilitate equitable treatment of all bidders. Balanced feedback on strengths and weaknesses is appropriate. While the focus is on the bidder's performance it is appropriate to provide some comparative feedback on how they performed in an overall sense relative to other bidders.

## 17.1 Two phases of debriefs

Debriefs may be required at two points in the tender process.

1. Debrief sessions can occur following the short-listing of bidders at the EOI stage. This would occur following announcement of a shortlist and prior to the release of the RFP document. Procuring Agencies may offer a debrief opportunity to the unsuccessful bidder(s) as well as the successful short-listed bidders. The debrief would be a high level face to face discussion. It would follow the principles below but is likely to be shorter and less detailed than the post-tender debrief. A debrief at the EOI stage with the short-listed bidders also provides an opportunity to raise any issues prior to the release of the RFP.
2. Debrief sessions are expected to occur following financial close. The Procuring Agency would offer a debrief opportunity to the unsuccessful bidder(s) as well as the successful party. This would occur as soon as practicable following financial close to ensure relevant personnel are available and information is still fresh. The debrief would involve a face to face discussion with key project team personnel participating. The debrief would cover detailed feedback against the evaluation criteria.

## 17.2 Principles

The following are the key principles for Procuring Agencies to consider when conducting debrief sessions.

### 17.2.1 Probity

- The debrief sessions must be conducted in accordance with the relevant probity protocols. The debrief is a confidential verbal face-to-face discussion and no written feedback would be provided.
- Feedback will be restricted to comments that pertain specifically to the performance of the bidder. It is possible to provide comparative comments subject to confidentiality obligations. The Evaluation Report will be used as the basis for debriefing the unsuccessful bidder.

### 17.2.2 Timing

- The debrief sessions should be held in a timely manner following financial close. While the unsuccessful bidders may request debriefings earlier in the tender process (e.g. if a preferred bidder announcement is made prior to contract award) it is not appropriate to hold debrief meetings until the contract has been finalised. Taking this into account, it is preferable to promptly hold debriefs while key members from the project team and bid team remain available.
- A debrief session would not generally exceed two hours.

### 17.2.3 Attendees

- Senior representatives of the project team should conduct the debrief, with the same project team members present for each debrief session. The session should be chaired by the Project Director. The number of participants should be limited to the few project team members involved in the evaluation as these participants will have sufficient understanding of the commercial, design and technical aspects of the bids to provide targeted and knowledgeable feedback. It is important for participants to adequately prepare debriefing notes.
- Other attendees may include an advisor or consultant where appropriate (e.g. commercial advisor or Probity Practitioner). It is desirable to have a Treasury or PPP policy representative present at the meeting to capture any lessons to share with future PPP transactions, and to actively contribute to any discussion on both generic PPP policy and project finance issues.
- It is at the discretion of the bidder who attends the debrief with the likely participants being the core bidding members.

### 17.2.4 Agenda

- As far as practicable an agenda should be agreed in advance, with the unsuccessful bidder asked to identify ahead of the session any particular issues they wish to discuss, to allow for adequate preparation.
- In the debrief session, the Procuring Agency should cover the key aspects of the commercial, legal, design, services and technical elements of the bids. The bidders should have the opportunity to provide feedback on key aspects of the process and tender documents. Refer table 16-1.

Table 16-1 Example Agenda

1	Project Director	Overview of the process and evaluation with commentary at a high level on strengths and weaknesses.
2	Project team members	Feedback on specific elements/evaluation criteria including (but not limited to): <ul style="list-style-type: none"> <li>- Design</li> <li>- Technical/Services</li> <li>- Commercial and legal</li> </ul>
3	Bidder/consortium members	Feedback on the tender process and relevant aspects of the tender that could include documentation, timing, scope and departures, risk and the commercial framework.
4	Other business	Opportunity for other relevant issues to be raised

- The debrief session is to cover strengths and weaknesses, to enable learnings to be incorporated into future projects. The Procuring Agency should provide feedback that is an assessment against the evaluation criteria, and as far as possible all comments should be objective and consistent with the evaluation panel's position. It is appropriate to provide some comparative feedback to give a sense of performance relative to other bidders. However comparisons should not include details of other bids or relative evaluation scores.
- While it is recognised that the financial criteria are of key interest to the unsuccessful bidders, value for money is made up of numerous components. The Procuring Agency should not volunteer to disclose details of price. However, there may be occasions where the Procuring Agency can indicate, in generalised terms, the unsuccessful bidder's relative cost competitiveness - for example, the unsuccessful bidder's risk adjusted cost was "comparable to" or "significantly higher than" the winning bidder's offer, before considering relative design, technical and service merits, as part of the overall value for money solution.
- After the Procuring Agency provides its feedback, the session should take the form of a questions and answers forum – that is, it must be a two-way interaction with opportunities for an unsuccessful bidder to seek clarification on any aspect of the process or its bid. The Procuring Agency may choose not to respond to every question, and should indicate in this case why it considers answering a question is inappropriate.
- The debrief session with the winning bidder is likely to take place amongst many other workshops and meetings. However, the debrief should follow an agenda, and aim to build the future working relationship. It is an opportunity to provide an early indication of the key areas the Procuring Agency intends to monitor during design and construction and operations.

## Appendix A Glossary of terms

Term	Meaning
BAFO	Best and final offer; as part of the RFP phase, this is a further short-listing process to determine a preferred bidder.
BOOT	Build, own, operate and transfer.
Business Case	The document that articulates the rationale for undertaking a project.
Competitive Neutrality	The competitive advantages that accrue to a government business by virtue of its public sector ownership.
Conflict of Interest (COI)	Arises where a member of a project team, or an advisor to a project team, has an affiliation or interest which might be seen to prejudice their impartiality.
Consortium	Those private sector persons who together intend to deliver a PPP.
Consortium Members	Those persons who make up a consortium.
Contract Summary	The document that is released to the public following financial close that sets out the key aspects of the project, including contract terms.
Core Services	For social infrastructure, those services for which governments have particular responsibilities to people using the service and the community (e.g. hospitals, schools, etc.).  For economic infrastructure, services included in this definition will be determined on a case-by-case basis.
D&C	Design and construct.
DBFM	Design, build, finance and maintain.
DBFO	Design, build, finance and operate.
DBOM	Design, build, operate and maintain.
DCM	Design, construct and maintain.
Debrief	The session usually held post financial close to discuss a bidder's performance.
Discount Rate	The rate used to calculate the present value of future cash flows.  See the Discount Rate Guidance for public private partnerships.
EOI	Expressions of interest for a project.
EOI Phase	The phase used to shortlist parties to proceed to the RFP phase who are capable of delivering the project.
EOI Respondents	The parties submitting a response to an Invitation for EOI issued by government for a project.

Term	Meaning
EOI Responses	The responses from the market to the invitation for EOI issued by government for a project.
ESD	Ecologically sustainable development.
Guidelines	These National PPP Guidelines.
Intellectual Property (IP)	Inventions, original designs and practical applications of good ideas protected by statute law through copyright, patents, registered designs, circuit layout rights and trademarks; also trade secrets, proprietary know-how and other confidential information protected against unlawful disclosure by common law and through additional contractual obligations, such as confidentiality agreements.
Interactive Tender Process	The process of interaction between short-listed bidders and key stakeholders during the RFP phase as outlined in the <i>Practitioners' Guide</i> .
Invitation for EOI	An invitation to the market to seek expressions of interest for a project.
Jurisdictional Requirements Document	The set of specific guidance applicable to individual jurisdictions that are to be read in conjunction with the Guidelines.
National Commercial Principles for Social Infrastructure and Economic Infrastructure	Those principles of the Guidelines that set out the considered position of government across jurisdictions in relation to risk allocations under a PPP. This is set out in <i>National Commercial Principles for Social Infrastructure</i> and the <i>National Commercial Principles for Economic Infrastructure</i> .
National Commercial Principles for Social Infrastructure	Those principles of the Guidelines that set out the considered position of government across jurisdictions in relation to risk allocations under a PPP. This is set out in <i>National Commercial Principles for Social Infrastructure</i> .
National PPP Guidelines	The suite of guidance material that will form the national guidance on PPPs.
National PPP Policy Framework	The document that will detail the scope and application of the National PPP Guidelines across governments in all jurisdictions.
Negotiation and Completion Phase	The phase involving negotiations with the preferred bidder and finalisation and completion of contractual agreements.
NPC	Net present cost.
Output Specification	The document that defines the outputs and performance levels in relation to construction and services for the project, and incorporates those aspects as identified in the <i>Practitioners' Guide</i> .
PPP	A public private partnership.
Preferred Bidder	A short-listed bidder who has been selected following the RFP Evaluation phase as preferred and to proceed to the negotiation and competition phase.
Probity Practitioner	An independent expert retained to monitor the bidding process at critical stages, assessing and reporting whether the process has been conducted to the required standards of probity.



Term	Meaning
Procurement Options Analysis or Strategy	The document that outlines the rationale for adopting various procurement methods for a particular project.
Procuring Agency	The government body (department, agency, statutory body or GBE) that is responsible for delivering the project on behalf of government.
Project Director	The person with overall responsibility for delivery of the project and management of all members of the project team.
Project Steering Committee	The committee of departmental/agency representatives established by the Procuring Agency to direct the development of the PPP project and deal with key issues.
Project Team	The group of specialists and departmental/agency representatives, established by the Procuring Agency, that is responsible for assisting the Project Director to deliver the project (including developing project documentation and undertaking evaluation processes).
PSC	The Public Sector Comparator for a project, which is defined in the Guidelines as the hypothetical, risk-adjusted whole-of-life cost of a public sector project if delivered by government.
Raw PSC	The base cost to government of producing and delivering the reference project.
Reference Project	The basis for calculating the PSC, reflecting government delivery of the project by traditional means.
Relevant PPP Authority	The government department or agency responsible for the application of PPP policy within a jurisdiction (often treasuries).
Retained Risk	The value of those risks or parts of a risk that government bears under a PPP project.
RFP	A request for proposal issued by government for a project.
RFP 'Bid' Phase	The part of the RFP phase where short-listed bidders are preparing RFP responses.
RFP 'Development' Phase	The part of the RFP phase where government is preparing RFP documentation for release to short-listed bidders.
RFP 'Evaluation' Phase	The part of the RFP phase where government is evaluating RFP responses.
RFP Phase	The phase involving the release of the RFP to short-listed bidders for detailed, fully-costed and binding RFP responses, followed by evaluation and selection of the preferred bidder.
RFP Response	A proposal from a short-listed bidder in response to the RFP issued by government for a project.

Term	Meaning
Risk Allocation	The allocation of responsibility for dealing with the consequences of each risk to one of the parties to the contract; or alternatively, agreeing to deal with a particular risk through a specified mechanism which may involve sharing that risk.
Short-listed Bidder	Those parties who are invited to submit a proposal in response to an RFP issued by government for a project.
Special Purpose Vehicle (SPV)	In establishing a project consortium, the sponsor or sponsors typically establish the private party in the form of a special purpose vehicle (SPV) which contracts with government. The SPV is an entity created to act as the legal manifestation of a project consortium.
Tender Process	Includes each of the following phases: <ul style="list-style-type: none"> <li>• EOI phase;</li> <li>• RFP phase; and</li> <li>• Negotiation and completion phase.</li> </ul>
Traditional Procurement	The delivery of the infrastructure and associated services by government using its normal procurement processes.
Transferred Risk	The value of those risks (from government's perspective) that are likely to be allocated to the private party under a PPP project.
Whole-of-life	The integration of up-front design and construction with ongoing maintenance and refurbishment elements over the life of the asset under the PPP arrangement.

## Appendix B Example risk table

The following table identifies some of the key risks that are applicable to PPP projects:

Risk category	Description	Consequence	Mitigation	Preferred allocation
<b>Site risks</b>				
Existing structure (refurbishment/ extensions)	The risk that existing structures are inadequate to support new improvements.	Additional construction time and cost.	The private party will be able to manage this risk by commissioning expert engineering reports which can be used to assess and cost the management of this risk in its bid.	Private party.
Site conditions	The risk that unanticipated adverse ground conditions are discovered which cause construction costs to increase and/or cause construction delays.	Additional construction time and cost.	The private party can mitigate and manage this risk through site inspections, testing and due diligence.	Generally this risk will be allocated to the private party. However in certain circumstances it may be appropriate for government to accept some site risk.
Approvals	The risk that necessary approvals may not be obtained or may be obtained only subject to unanticipated conditions which have adverse cost consequences or cause prolonged delay.	Delay in works commencement or completion and cost increases.	Mitigation will be contingent on planning approval processes and legislation planning approval risk.	The private party, unless government assumes this risk.
Environmental (1)	The risk that the project site is contaminated requiring significant expense to remediate.	Clean-up costs and delay (recognising that the ultimate responsibility for clean-up remains with the polluter, if available).	The private party can mitigate this risk by commissioning expert reports and possibly through insurance.	Generally this risk will be allocated to the private party. However, in certain circumstances it may be appropriate for government to accept some contamination risk; for example, if there is significant risk of unidentified contamination or uncertainty as to the overall extent of the possible problem.

<b>Risk category</b>	<b>Description</b>	<b>Consequence</b>	<b>Mitigation</b>	<b>Preferred allocation</b>
Environmental (2)	The risk that prior to financial close offsite pollution has been caused from a government preferred site to adjacent land.	Clean-up liability (recognising that the ultimate responsibility for clean-up remains with the polluter, if available).	Government can mitigate this risk by commissioning contamination reports, given that government should also have greatest knowledge of the past uses of its site.	Government may assume responsibility by way of indemnity or obligation to compensate for unidentified off-site pollution pre-financial close where the site is a government site.
Environmental (3)	The risk that prior to financial close (in the case of a non-government site) or after financial close (for either a non-government or government site) off-site pollution is caused to adjacent land.	Clean up liability (recognising that the ultimate responsibility for clean-up remains with the polluter, if available).	The private party can manage this risk by controlling activities on the site after financial close.	The private party.
Clean-up and rehabilitation	The risk that the use of the project site over the contract term has resulted in a significant clean-up or rehabilitation obligation to make the site fit for future anticipated use.	Financial liability on residual owner (recognising that the ultimate responsibility for clean-up remains with the polluter, if available).	The private party can mitigate and manage this risk by managing the use of the asset. Government may require sinking funds if it is to resume the site and its use is liable to result in significant clean-up / rehabilitation cost.	Generally this risk will be allocated to the private party (whether government is to resume possession of the site or not), except to the extent that government has accepted contamination risk.
Native title	The risk of costs, delays and compensation or risk of injunction and/or invalidity of approvals.	Delay, cost and compensation.	Government can mitigate and manage this risk by searching relevant registers, making enquiries if appropriate and where required, obtaining expert advice.  There are also a number of mechanisms available under the <i>Native Title Act 1993</i> (Commonwealth).	Government will usually accept this risk on government-preferred sites.

<b>Risk category</b>	<b>Description</b>	<b>Consequence</b>	<b>Mitigation</b>	<b>Preferred allocation</b>
Cultural heritage	The risk of costs and delays associated with archaeological and cultural heritage discoveries.	Delay and cost.	This risk can be managed and mitigated by searching relevant registers, making enquiries if appropriate and, where required, obtaining expert advice.	Government will usually accept this risk on government-preferred site. Where the private party chooses the site, this risk will be allocated to the private party.
Availability of site	The risk that tenure/access to a selected site that is not presently owned by government or the private party cannot be negotiated.	Delay and cost.	This can be mitigated by requiring bidders to secure access to the site prior to contract signing.	The private party, as it makes the decision to bid on a non-preferred site.
<b>Design, construction and commissioning risk</b>				
Design	The risk that the design of the facility is incapable of delivering the services at anticipated cost.	Long-term increase in recurrent costs – possible long-term inadequacy of service.	The private party can manage this risk by trying to pass the risk to its builder/architects and other subcontractors, although it will continue to remain primarily liable under the contract with government.	The private party will be responsible except where an express government mandated change has caused the design defect.
Construction	The risk that events occur during construction which prevent the facility being delivered on time and on cost.	Delay and cost.	The private party will generally manage this risk by entering into a fixed-term, fixed-price building contract to pass the risk to a builder with the experience and resources necessary to satisfy the private party's construction obligations under the contract.	The private party will be liable unless the event is one for which relief as to time or cost or both is specifically granted under the contract.

Risk category	Description	Consequence	Mitigation	Preferred allocation
Commissioning	The risk that either the physical or operational commissioning tests which must be completed for the provision of services to commence, cannot be successfully completed.	For the private party and its financiers - delayed/ lost revenue; for government - delayed service commencement.	The private party will manage this risk by using an expert design, construction, operations and project management team.	The private party, although government will assume an obligation to cooperate and facilitate prompt public sector attendance on commissioning tests. The private party will not be able to earn revenues until the facility is commissioned.
<b>Sponsor</b>				
Sponsor risk	The risk that the private party is unable to provide the required services, or becomes insolvent, or is later found to be an improper person for involvement in the provision of these services, or financial demands on the private party, or its sponsors exceed its or their financial capacity causing corporate failure.	Cessation of service to government and possible loss of investment for equity providers.	Ensure project is financially remote from external financial liabilities, ensure adequacy of finances under loan facilities or sponsor commitments supported by performance guarantees; also through the use of non-financial evaluation criteria and due diligence on private parties (and their sponsors).	Government bears the provision.
Probity	The risk that after execution of contracts the private party is found to be an improper person for involvement in the provision of the contracted services.	Possible cessation of service to government, management crisis-and/or forced change in ownership.	Government can mitigate this risk by assessing the probity of the private parties and their sponsors when evaluating the bids.  Further, the contract will generally have provisions allowing government to ensure continuity of physical delivery of essential services.	Government

<b>Risk category</b>	<b>Description</b>	<b>Consequence</b>	<b>Mitigation</b>	<b>Preferred allocation</b>
Financial	The risk that after execution of contracts the private party becomes insolvent or financial demands on the private party or its sponsors exceed its or their financial capacity, causing corporate failure.	Possible cessation of service to government, forced change in ownership and/or possible corporate failure causing financial loss to private party.	Government may mitigate this by ensuring the project is financially remote from external financial liabilities, ensuring adequacy of finances under loan facilities or sponsor commitments supported by performance guarantees; and by due diligence on private parties (and their sponsors). Contractual provisions will allow the government to ensure continuity of physical delivery of essential services.	Government ultimately bears this risk because it can affect the provision of adequate public services. However, the government would have the right to terminate the private party in such circumstances and the private party would bear any financial losses associated with termination.
Technical	The risk that the private party is unable to deliver the required infrastructure and/or operational systems in the required timeframes.	Non-delivery or cessation of service to government.	Government will mitigate this risk by assessing the experience and technical competence of the private party to deliver the required infrastructure and operational systems. Contractual provisions will allow the government to ensure continuity of physical delivery of essential services and to abate service payments for non-performance.	Government ultimately bears this risk because it can affect the provision of adequate public services. However, the government would have the right to terminate the private party in such circumstances and the private party would bear any financial losses associated with termination.

<b>Risk category</b>	<b>Description</b>	<b>Consequence</b>	<b>Mitigation</b>	<b>Preferred allocation</b>
Operational	The risk that the private party is unable to effectively manage the service delivery operations.	Cessation or reduced quality of service to government.	Government can mitigate this risk by assessing the experience and competence of the private party to manage and deliver the required services. Private party may be required to provide performance guarantees during the operation phase. Contractual provisions will allow the government to ensure continuity of physical delivery of essential services and to abate service payments for non-performance.	Government ultimately bears this risk because it can affect the provision of adequate public services. However, the financial impact of poor performance would be borne by the private party.
Interest rates pre-completion	The risk that prior to completion, interest rates may move adversely and undermine bid pricing.	Increased project cost.	Both government and the private party would manage this risk by hedging interest rates.	Government usually takes interest rate risk up until financial close and during the operations period but not during the construction period(s). The private party takes this risk during the construction period(s).
Financing unavailable	The risk that when debt and/or equity is required by the private party for the project it is not available and in the amounts and on the conditions anticipated.	No finance to progress or complete construction.	Government will try to mitigate this risk by requiring all bids to have fully-documented financial commitments with minimal and easily achievable conditions.	Government ultimately bears this risk because it can affect the provision of adequate public services. This is despite the fact that government would have the right to terminate the private party in such circumstances.



<b>Risk category</b>	<b>Description</b>	<b>Consequence</b>	<b>Mitigation</b>	<b>Preferred allocation</b>
Further finance	The risk that where government is required under the contract to pay for a variation, the private party cannot obtain finance. In this case, the government must pay for the variation up-front instead of through an adjustment of the service charge.	No financing available to complete further works required by government.	Government can mitigate this risk by: - contractually requiring the private party to exercise commercial and prudent endeavours to obtain financing acceptable to government; or - where it believes such variations are inevitable (particularly during the construction phase) requiring the private party to put in place a variation facility.	Government takes the risk that private finance is unavailable.
Change in ownership	The risk that a change in ownership or control of the private party results in a weakening in its financial standing or support or other detriment to the project.	Government assurance of the financial robustness of the private party may be diminished and, depending on the type of project, probity and other non-financial risks may arise from a change in ownership or control which may be unacceptable to government.	Government can mitigate this risk by requiring its consent prior to any change in control.	This is generally a shared risk in the sense that the government will bear the risk that the change in ownership has an adverse effect on the project and the private party bears the risk that the revised structure inhibits its ability to perform the project leading to termination.
Refinancing benefit	The risk (upside) that at completion or other stage in project development the project finances can be restructured materially to reduce the project's finance costs.	A beneficial change in the financing cost structure of the project.	Government will contractually require the private party to share half of any gains made during a refinancing (subject to the project meeting its projected equity return).	The benefit of this risk will be shared equally by government and the private party.

Risk category	Description	Consequence	Mitigation	Preferred allocation
Tax changes	The risk that before or after completion the tax impost on the private party, its assets or on the project will change.	A negative effect on the private party's financial returns and in extreme cases, it may undermine the financial structure of the project so that it cannot proceed in that form.	NSW: With respect to specific infrastructure tax, particularly relating to transactions with government, the private party will be required to obtain a private tax ruling from the ATO. Victoria: The private party can mitigate against this by ensuring that its financial returns can withstand such change.	Private party.
<b>Operating</b>				
Inputs	The risk that required inputs cost more than anticipated, are of inadequate quality or are unavailable in required quantities.	Cost increases and in some cases adverse effect on quality of service output.	The private party can manage this risk through long-term supply contracts where quality/quantity can be assured.	This risk is generally allocated to the private party, although in limited circumstances government may take back some of this risk through benchmarking or where it controls inputs, e.g. water catchment.
Maintenance and refurbishment	The risk that design and/or construction quality is inadequate, resulting in higher-than-anticipated maintenance and refurbishment costs.	Cost increases where private party has assured whole-of-life obligation and adverse effect on delivery of contracted services and, in core services model, a corresponding adverse effect on government's ability to deliver core services.	The private party can manage this risk through long-term sub-contracts with suitably qualified and resourced sub-contractors and through formal or informal consultation processes with government.	Private party.

<b>Risk category</b>	<b>Description</b>	<b>Consequence</b>	<b>Mitigation</b>	<b>Preferred allocation</b>
Changes in output Specification outside agreed specification range	The risk that government's output requirements are changed after contract signing whether pre- or post-commissioning.	A change in output requirements prior to commissioning may necessitate a design change with capital cost consequences depending on the significance of the change and its proximity to completion. A change after completion may have a capital cost consequence or a change in recurrent costs only; for example, where an increase in output requirements can be accommodated within the existing facility capacity.	Government can mitigate this risk to an extent by minimising the chance of its specifications changing and, to the extent they must change, ensuring the design is likely to accommodate it at least expense. This will involve considerable time and effort in specifying the outputs up-front and planning likely output requirements over the term.	Government.
Operator failure	The risk that a sub-contract operator may fail financially or may fail to provide contracted services to specification.	The failure may result in service unavailability, an inability for government to deliver core services and, in each case, a need to make alternate arrangements for service delivery with corresponding cost consequences.	The private party can manage this risk by carrying out necessary due diligence on all subcontractors. Government may carry out due diligence on principal subcontractors for probity and financial capacity and commission a legal review of the major subcontracts including the guarantees or other assurances taken by the private party. If failure does occur, the private party may replace the operator or government may require operator replacement.	The private party.

Risk category	Description	Consequence	Mitigation	Preferred allocation
Technical obsolescence or innovation	The risk of the contracted service and its method of delivery not keeping pace, from a technological perspective, with competition and/or public requirements.	The private party's revenue may fall below projections either via loss of demand (user pays model) payment abatement (availability model) and/or operating costs increase. For government, consequence may be failure to receive contracted service at appropriate quantity/quality including adverse effect on core service delivery in core service model.	The private party can manage this risk by arranging a contingency/reserve fund to meet upgrade costs subject to government agreement as to funding the reserve and control of reserve funds upon default.  This risk can also be mitigated through its monitoring obligations in the contract and the development of detailed, well-researched output specifications (government) and design solution (private party).	The private party except where contingency is anticipated and government agrees to share risk possibly by funding a reserve.
<b>Market</b>				
General economic downturn	In a user pays model, the risk of a reduction in economic activity affecting demand for the contracted service.	Revenue below projections.	Where government is the primary off-taker the private party will seek an availability payment element; otherwise the private party will ensure robust financial structure and sponsor/financier support/competition.	The private party, except to the extent that Government has committed to an availability payment element or agreed to provide redress for impact of government subsidised competition.
Competition	In a user pays model, the risk of alternate suppliers of the contracted service competing for customers.	Revenue below projections arising from a need to reduce the price and/or from a reduction in overall demand, because of increased competition.	The private party can manage this risk by reviewing likely competition for service and barriers to entry.	The private party, except to the extent that government has committed to an availability payment element or agreed to provide redress for impact of government subsidised competition.
Demographic change	The risk of a demographic/socio-economic change affecting demand for contracted service.	Revenue below projections.	The private party can manage this risk by reviewing likely competition for service and barriers to entry.	The private party, except to the extent that government has committed to an availability payment element.

Risk category	Description	Consequence	Mitigation	Preferred allocation
Inflation risk	That value of payments received during the term is eroded by inflation.	The diminution in real returns of the private party.	The private party can mitigate this risk by seeking an appropriate mechanism to maintain real value, e.g. via linkage to CPI.  Government should undertake its own due diligence on the indexation procedure to ensure that its payments do not overcompensate for inflation and to avoid any double payment for cost adjustments, e.g. on changes in law.	The private party takes risk on the methodology adopted to maintain value. Government shares to the extent of agreed indexation.
<b>Network and interface</b>				
Withdrawal of support network	The risk that, where the facility relies on a complementary government network, that support is withdrawn or varied, adversely affecting the project.	Negative patronage and revenue consequence.	The private party will seek financial redress against change which unfairly discriminates against the project, particularly on a user pays project where revenue is directly affected. Under an availability model, the private party will seek to avoid abatement where the cause of unavailability is due to government withdrawal of a support network.	Government, where the change discriminates against the project.
Changes in competitive network	The risk that an existing network is extended/changed /re-priced to increase competition for the facility.	Negative patronage and revenue impacts.	The private party will seek financial redress against change which unfairly discriminates against the project by government subsidising competition (existing or new).	The private party, except to the extent that government provides redress for appropriate, discriminatory changes.

Risk category	Description	Consequence	Mitigation	Preferred allocation
Interface (1)	The risk that the delivery of core services in a way not specified/anticipated in the contract adversely affects the delivery of contracted services.	Adverse effect on delivery of contracted service, potential for default by private party and possible need for government to make other arrangements for service provision.	Government manages core service activities, allowing it to influence the materialisation of interface risk and its consequences. Mitigation also includes an up-front assessment (by both government and the private party) of the likely interface issues, continual review and monitoring and development of a communication strategy in respect of delivery of the two related services. Government will also specify in the contract the extent of core services and the way in which they will be delivered so that only manifest and adverse changes and deficiencies can trigger this risk.	The private party except to the extent that government provides redress.
Interface (2)	The risk that the delivery of contracted services adversely affects the delivery of core services in a manner not specified/anticipated in the contract.	Adverse effect on delivery of core services, default by private party and possible need for government to make other arrangements for core service provision.	The private party can mitigate this risk by managing the way in which it delivers the contracted service activities.	Private party.
<b>Industrial relations</b>				
Industrial relations and civil commotion	The risk of strikes, industrial action or civil commotion causing delay and cost to the project.	Cost and time delay.	The private party or its subcontractors can manage this risk through the way it manages project delivery and operations.	Private party, except to the extent that government grants relief or extensions of time.
<b>Legislative and Government</b>				
Approvals	The risk that additional approvals required during the course of the project cannot be obtained.	Further project development or change in business operation may be prevented.	The private party should manage this risk by using expert advice and by consulting with relevant planning authorities.	The private party unless government has initiated the change requiring approval.

<b>Risk category</b>	<b>Description</b>	<b>Consequence</b>	<b>Mitigation</b>	<b>Preferred allocation</b>
Changes in law (1)	The risk of a change in law of the state government only, which could not be anticipated at contract signing and which is directed specifically and exclusively at the project or the services and which has adverse capital expenditure or operating cost consequences for the private party.	A material increase in the private party's operating costs and/or a requirement to carry out capital works to comply with the change.	Government may mitigate its liability for such change by monitoring and limiting (where appropriate) changes which may have these effects or consequences on the project and via mechanisms in the contract allowing the sharing of some of the financial consequences of a change in law or, where appropriate, in a user pays model based on a regulatory regime which allows pass-through to end users.	Government, although the parties may share the financial consequences of capital cost increases in an agreed way, for example by the private party meeting a percentage of the cost up to a specific limit and government meeting any excess.
Changes in law (2)	In some cases, the risk of a change in law (at whatever level of government it occurs) which could not be anticipated at contract signing which is general (i.e. not project-specific) in its application and which causes a marked increase in capital costs during the operations phase and/or has substantial operating cost consequences for the private party.	The requirement on the private party to fund and carry out capital works or meet a marked increase in operating costs to comply with the change.	Government mitigates its exposure to this risk by excluding compensation for changes in tax law or changes for which the private party is compensated under a CPI adjustment. Government usually specifies a regime for sharing financial consequences of changes in law up to a specified threshold after which government meets any excess and, where appropriate, in a user pays model having in place a regulatory regime which allows pass-through to end users.	Government, although the parties may share the financial consequences of capital cost increases in an agreed way, for example, by the private party meeting a percentage of the cost up to a specific limit and government meeting any excess.
Regulation	Where there is a statutory regulator involved there are pricing or other changes imposed on the private party which do not reflect its investment expectations.	Cost or revenue impacts.	Private party to assess regulatory system and may make appropriate representations.	Private party.

Risk category	Description	Consequence	Mitigation	Preferred allocation
<b>Force majeure</b>				
Force majeure	The risk that inability to meet contracted service delivery (pre- or post- completion) is caused by reason of force majeure events.	Loss or damage to the asset, service discontinuity for government (may include inability to deliver core service) and loss of revenue or delay in revenue commencement for private party.	The private party is given relief from consequences of service discontinuity. If uninsurable, private party may establish reserve funding. Government to establish contingency for alternate service delivery. If insurable, private party must ensure availability of insurance proceeds towards repair of asset and service resumption and government is to be given the benefit of insurance for service disruption costs.	The private party takes the risk of loss or damage to the asset and loss of revenue. Government takes some risk of discontinuity of contracted service and core service, subject to insurance availability, and will need to arrange alternative service provision, the cost of which will be met from redirected service payments and (if insurable) any shortfall made up from insurance proceeds.
<b>Asset ownership</b>				
Technical obsolescence	The risk that design life of the facility proves to be shorter than anticipated, accelerating refurbishment expense.	Cost of upgrade.	The private party may have recourse to designer, builder or their insurers.	The private party, but in certain high-technology projects, costs may be anticipated and shared.



Risk category	Description	Consequence	Mitigation	Preferred allocation
Default and termination	The risk of 'loss' of the facility or other assets upon the premature termination of lease or other project contracts upon breach and without adequate payment.	Loss of investment of private party; possible service disruption for government.	The private party (and its debt financiers) will be given cure rights (time and opportunity) to remedy defaults which may lead to termination including under a tripartite deed with financiers. If termination occurs pre-completion government may (but need not) make payment for value in the project on a cost-to-complete basis. If it occurs post-completion, government may negotiate a payment, generally based on fair market value less all amounts due to government. Government will require step-in rights to ensure access and service continuity until ownership/control issues are resolved.	The private party will take the risk of loss of value on termination.
Residual value on transfer to government	The risk that on expiry or earlier termination of the services contract, the asset does not have the value originally estimated by government at which the private party agreed to transfer it to government.	Capital costs incurred to upgrade the asset to the agreed value and useful life or asset demolished or removed.	Government will impose on the private party maintenance and refurbishment obligations, ensure an acceptable maintenance contractor is responsible for the work and commission regular surveys and inspections. It may also direct funds from the project into dedicated controlled sinking fund accounts to accumulate funds sufficient to bring the asset to agreed condition and/or (if required) obtain performance bonds to ensure the liability is satisfied.	Government (to the extent that the private party is unable to fund any required rectification of the asset).

# Appendix C Conflict of interest

A conflict of interest arises where a member of or advisor to a procurement team has an affiliation or interest which might be seen to prejudice their impartiality. Conflicts of interest are commonplace and, provided they are identified early and dealt with effectively, are manageable without detriment to the project. This section deals separately with conflict of interest issues for public officials and for advisors engaged by government.

## C.1 Identify and resolve conflicts of interest for public officials

Conflict of interest (COI) provisions apply to public officials as part of their conditions of employment. The key point is to ensure that all participants in the procurement team declare their interests before the tendering process begins and at critical stages throughout it, and to ensure that any issues arising are resolved.

A COI arises when a team member has an affiliation or interest that will or may compromise, or have the appearance of compromising, their impartiality, incentive and/or ability to fulfil their duties to government in their engagement on a PPP project (obligation to government). This definition is distinct from the legal interpretation of a conflict of interest.

COI can be defined in three categories:

- *Actual COI* means a set of established circumstances (interests) that detract from the public official fulfilling their obligation to government;
- *Potential COI* means a set of established circumstances where actual conflict may result if one or more future known events occur; and
- *Perceived COI* means a set of circumstances which may or be seen to compromise the interests of government by diminishing the fairness and competitiveness of the PPP procurement process.

Responses to a COI, or potential COI, will vary depending on the circumstances. Disclosures should be directed initially to the Project Director. It is expected that the Project Director can effectively manage most disclosure and COI events within their delegated level of authority. It is anticipated that the Project Director will rely on advice from the Probity Practitioner, the Treasury project officer and the senior responsible officer.

Public officials involved in procurement projects have a responsibility to inform themselves of their department's guidelines for dealing with conflicts of interest and dealing with offers of gifts and other benefits. This is in addition to being informed generally on standards of conduct set out in various state-based legislation for public officials.

In planning for a procurement process, market research involving contact and meetings with prospective bidders commonly occurs. This may be to inform department of requirements for a bid, or of the potential for the market to meet the department's requirements. Such contacts do not of themselves constitute a conflict of interest. However, they may constitute a potential conflict of interest and, if not managed correctly, could lead to an unacceptable conflict of interest being created.

## C.2 Disclosure and management of conflicts of interest for advisors

Government departments engage a range of advisors from finance, commerce, the law, the environment and other professional services to assist in conducting PPP projects.

Close collaboration between small groups of specialist advisors is a key feature of these projects. This collaboration is necessary to deliver value-for-money results. However, the potential for conflicts of interest (COIs) in engaging advisors is heightened by the relatively small size of the Australian advisor market, the rationalisation of advisory firms and the scale and duration of PPP projects.

The information below provides an assessment framework and advice on managing COIs, not a rigid set of rules.

This guidance is intended to encourage greater advisor disclosure by outlining higher levels of certainty, consistency and accountability in the way disclosures are dealt with across government. There is an increased onus on advisors to identify and disclose all events and activities which will or could give rise to a Conflict of Interest. It is not expected that every disclosure will automatically constitute an actual Conflict of Interest.

Project Directors will coordinate the management of conflicts of interest, along with their existing project development activities, using this guidance, and existing probity tools and processes.

This COI framework should be read in conjunction with individual jurisdictions' specific requirements.

### C.2.1 Disclosure requirement

Advisors are required to disclose all interests, affiliations and relationships that could be categorised as perceived, potential or actual conflicts of interest.

### C.2.2 Disclosure of a perceived COI

In deciding whether a *perceived COI* exists, the following questions should be also considered.

- Does the advisor have other interests or is that advisor engaged in a capacity that might raise questions of bias, inappropriate use of PPP confidential information or other impropriety?
- How would the reasonable person test apply, e.g. if the circumstances were made fully public, how would the public judge the situation?

### C.2.3 Scope of information to disclose

In determining what information to disclose in the PPP project context, the advisor must examine, at a minimum:

- all engagements and interests for the bidding parties (including subcontractors and related parties) on the PPP project on which they are engaged;
- all engagements and interests for the bidding parties (including subcontractors) on other concurrent PPP projects;

- all engagements for bidding parties to advise on other concurrent PPP projects in other jurisdictions; and
- all other affiliations and interests, such as financial interests, board and other positions or offices held, business relationships and engagements and close personal affiliations with bidding parties.

Examples of situations requiring disclosure for PPP projects include:

- an advisor specifically engaged by government to carry out value-for-money calculations as part of evaluating a PPP project is also providing advisory services to some of the bidders on the project;
- the spouse of an advisor to government on a PPP project is a senior executive of a bidding entity;
- an advisor to government has offices in both Melbourne and Sydney. A Melbourne partner is advising government on a PPP project and a Sydney partner is providing tax advice to the preferred tenderer on the project;
- an advisor to government on a PPP project has shares in the company bidding for the project;
- an advisor to government on one PPP project is also advising a bidder on another PPP project; and
- an advisor to government on a PPP project also provides audit services to one or more bidders.

Advisors who do not fully comply with these guidelines may be subject to sanctions, including suspension or termination of the engagement on the PPP procurement project.

### ***Guiding principles on scope of disclosure***

#### **Disclosure of business relationships and close personal affiliations**

In examining business relationships and engagements, the advisor must examine external contractual relationships, partnerships, private companies or any other commercial trading activity.

In examining close personal affiliations, the advisor must (*for each project team member and supporting managers*) examine direct relationships with parents, children and siblings, other financial dependants, spouses, de-facto partners, and any other known close relatives, in-laws or people with whom a current or recent close relationship could potentially compromise the interests of the project. *Normal acquaintances with work colleagues can be excluded.* Where other affiliations, outside the project team and supporting managers, are known within the firm, these should also be disclosed.

#### **Uncertainty on what to disclose**

Where there is any doubt, advisors should declare all disclosure events to the PPP Project Director rather than seek to deal with it internally. In many instances, this process is not expected to result in any further management action beyond that proposed by advisors.

#### **Audit services and confidential business agreements**

While disclosure is required, the provision of audit services by itself does not automatically preclude an advisor from participating in a PPP project.

Where an advisor is constrained from declaring a disclosure event that is subject to a confidentiality agreement (e.g. a merger or acquisition situation), it is sufficient to declare the broad nature of the matter without disclosing the actual counterparties and how any COI arising from it will be managed. However, once the activity is generally known, the advisor is obliged to disclose all known details to the Project Director.

### General exceptions

Exceptions to the general rule include activities that are adequately covered by signed confidentiality, engagement and other contract agreements, and which comply with them.

These activities should ordinarily be considered permissible, for example:

- earnings from seminars, lectures, or conference engagements sponsored by public or not-for-profit entities;
- income from service on advisory committees or review panels for public or not-for-profit entities;
- service on boards and committees of organisations, public or private, that do not distract unduly from PPP project obligations;
- membership of other organisations where there is no possible benefit or perception of benefit;
- normal working associations with colleagues;
- casual acquaintanceship with members of other organisations; and
- casual meetings with members of other organisations through
  - ordinary networking and business conduct;
  - informal social functions and events; and
  - common memberships of clubs, associations and sporting facilities.

## C.3 Stages of disclosure

Advisors have an ongoing obligation to disclose potential, perceived and actual conflicts of interest during the term of the engagement as they become aware of them.

- **Pre-engagement phase.** Advisors to PPP projects are usually required to sign a COI declaration and confidentiality deed and disclose any actual, potential or perceived COI relating to their proposal before any engagement.

- **During the term of the advisor's engagement.** During the advisor's engagement on the project, periodic reviews at critical milestones should be undertaken to ensure that all COI events have been declared and managed. If there is any change to the advisor's situation that may give rise to a conflict of interest, then once they become aware of it, the advisor is required to bring it to the attention of the Project Director. There are four stages at which the Project Director should formally seek disclosures:
  - before issuing EOI (in relation to known project consortia which have declared intent to bid);
  - before evaluating EOIs for short-listing (in relation to known project consortia);
  - before issuing the RFP (in relation to know project consortia and subcontractors); and
  - before announcing a preferred tenderer and beginning contract negotiations (affirmation of previous disclosures).
- **Post-engagement.** The contract with the advisor may impose responsibilities that continue after the engagement has ended. These may include, for example, not 'switching sides' to subsequently act on behalf of another party in the project. The Project Director will offer advice to advisors, should it be required, to ensure they meet these requirements on completing their engagement.

As a general rule, most disclosures proceed to a further assessment, although general exceptions are permitted.

## C.4 Responsibilities

Disclosures should be directed initially to the Project Director who then reviews the disclosed situations in consultation with probity advisors, legal advisors, the Project Steering Committee, the Treasury project officer and/or the senior responsible officer as needed.

It is expected that the Project Director can effectively manage most disclosure and COI events within their delegated level of authority. It is anticipated that the Project Director will rely on advice from the probity advisor, the relevant PPP authority and the senior responsible officer in deliberations on applying this guidance.

### C.4.1 Project Directors

Project Directors have direct responsibility for overseeing the COI guidelines and implementing them in individual projects.

To the extent permitted by law, all information about a COI event is confidential and should be disclosed only to project team members with delegated authority for dealing with and recording such matters.

Written records should be kept of COI considerations and COI assessments should be made promptly and notified to the advisor in a timely manner.

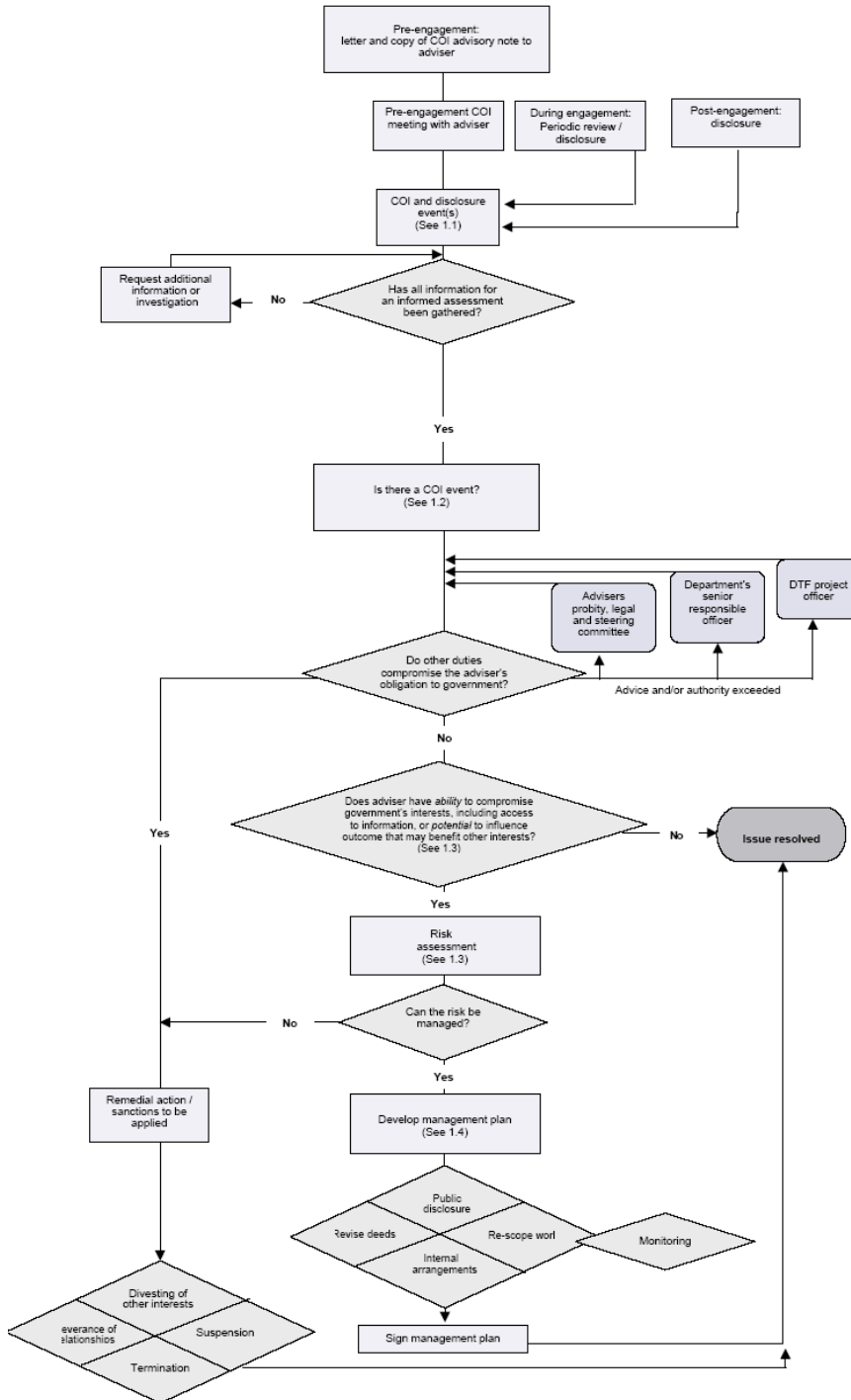
### C.4.2 Advisors

Advisors are required to disclose information relevant to COI events for consideration, follow the guidelines and implement appropriate management strategies.

### C.4.3 Senior responsible officer

The senior responsible officer (SRO) is deemed the 'project owner' and is the single agency representative responsible for adjudicating on all COI events for all projects in an agency which are outside the Project Director's authority. The SRO may be, in some instances, the chair of the Project Steering Committee or chair of the board of a joint venture or other special purpose vehicle responsible for delivering the project.

Conflict of interest management flowchart - Disclosing, assessing and resolving COI



## C.5 The COI test

This three-question test determines whether a COI exists and whether further risk assessment or immediate remedial action is required. The test aims to establish whether the interests of government and the competitive process could be compromised by this event.

- Might the advisor's other duties result in the advisor compromising their obligation to government (i.e. conflict of duty)?

When an advisor to a project is also a director or holds another position in a company that stands to gain from that project, the advisor is not able to fulfil their obligation to government on the project without compromising their duty as a director to the company and vice versa.

For example, an advisor who earns a substantial fee advising a department in developing the procurement strategy for a major project is discovered to be on the board of a private company which actively campaigns for more private sector involvement in that particular project.

- Does the advisor have the ability to compromise their obligation to government by accessing information that may benefit the advisor or other parties?

The Project Director considers whether the advisor has access to commercially sensitive information or other information that, if transferred, could benefit the advisor or other parties, e.g. pricing and costing details, evaluation methodology and preferred negotiation positions, commercial principles or preferred risk allocations.

For example, an advisor engaged by a department to develop the Public Sector Comparator for a procurement project could be considered to have more access to commercially sensitive information that would benefit the advisor or other parties than an advisor engaged to develop the environmental impact study to be made available to all bidders for a procurement project.

- Does the advisor have the ability to compromise the interests of government and their obligation to it by potentially influencing or altering the outcome to government in a material way that will benefit the advisor or other parties?

The Project Director considers the role of the advisor and their scope materially to influence the outcome in a way that would directly benefit the advisor or other interests. This includes whether the advisor holds any position or provides advice that will lead to the selection of the successful bidder or other project outcomes that could have a material impact.

For example, an advisor who has another interest with a bidding party is engaged by a department to perform the value-for-money evaluation for a procurement project. That advisor could be considered to have a greater ability to potentially influence the final outcome than another advisor engaged to complete a limited modelling assignment on the same project.

### ***Guiding principles on COI assessment***

#### **Conflict of interest test**

An advisor with a specific and limited brief is ordinarily permitted to accept a new engagement to act for bidders or potential bidders on the same or a similar project where they:



- do not have access to commercial or other information of interest that could benefit other parties;
- cannot materially influence the outcome; and
- can meet obligations to government without compromising their duty to other parties.

In this case, no conflict of interest exists.

### **Commercially sensitive information and potential benefits to another party**

A COI exists and requires further risk assessment where an advisor has access to commercially sensitive information or can materially influence the outcome to the potential benefit of another party. For example, two different PPP projects, A and B, are managed by the same government entity. Advisors for each project are brought together to develop tender evaluation criteria common to both projects. Subsequently, it is discovered that the commercial advisor for project A is also engaged as the advisor to provide commercial advice to a bidder on project B.

Where there is a conflict of interest, an advisor cannot act on both sides of a PPP project. Exceptions are permitted only in the rare circumstances where the advisor can satisfy the Project Director that the risk is acceptable and can be managed.

## **C.6 Is the conflict of interest risk manageable?**

If a COI exists (whether actual, potential or perceived) the Project Director must undertake a risk assessment and determine whether the risk is manageable. As noted, the advisor must also submit a proposed management strategy when identifying the COI to the Project Director.

To complete the risk assessment, the Project Director must examine the following questions.

- What is the degree of incentive for the advisor to compromise the interests of government?

The Project Director considers the following:

- To what extent would the advisor and/or their interests benefit if the advisor compromised the interests of government?
- What are the nature and significance of the other relationships or interests?
- In what way will an individual or organisation benefit or be disadvantaged?
- Is the advisor working on a success fee basis or a fee-for-service basis?
- If an individual or organisation benefits or is disadvantaged by bias, how will that impact on the project?
- Will other stakeholders consider the impact material?

Take the example of the two different PPP projects, A and B, (mentioned above) where the commercial advisor for project A also provides advice to a bidder on project B. This could be considered a very difficult risk to manage using the considerations of incentives listed above. However, the Project Director could be expected to consider the risk more manageable if the advisor was engaged only to provide limited advice on a specific matter for project B, and that matter was not central to the overall bid evaluation.

- What level of ability does the advisor have to compromise or harm government's interests?

The Project Director considers the following:

- How seriously does the matter impact on the fairness of the competitive process?
- Would a bidder, or other person with access to the information obtained or the report prepared by the advisor, gain an unfair advantage?
- Will any relevant information obtained by the advisor be disclosed to all bidders?
- What protection is provided by the evaluation framework and the advisor's role in this framework?
- Could the advisor's access to information compromise the government's interests in other ways?

For example, for projects A and B, the 'level of ability to compromise or harm government interests' could be considered a very difficult risk to manage under the measures above. However, the Project Director could well consider the risk more manageable if the advisor was working on an environmental impact study common to both projects, to be made publicly available to all bidders.

- Are current internal management arrangements sufficient to manage the COI event or could new arrangements be put in place?

The Project Director considers the following:

- Does the advisor have mechanisms in place – such as internal management arrangements acceptable to the Project Director – to prevent bias and unnecessary information exchange being introduced into the project? These arrangements could include, among other things:
  - different personnel working on the project;
  - separation of internal management streams;
  - different locations for engagements; and
  - restrictions on sharing information between teams.

For example, in the illustration of an advisor working on different sides of two different but related PPP projects, internal management arrangements could also be considered a very difficult risk to manage according to the internal management considerations above. However, the Project Director could be expected to consider the risk more manageable if a different team of individuals from a different office under the direction of a different partner is providing the advice to the bidder, and the advisor's internal management arrangements are acceptable and fully disclosed.

In assessing the potential risk of the COI, the Project Director should also consider the extent to which existing contractual agreements – including signed confidentiality deeds and the terms and conditions of the advisor's engagement agreement – will mitigate the risk.

As stated previously, where a COI exists, an advisor is able to act on both sides of a PPP project only in rare circumstances. For the Project Director to consider the risk of the COI event acceptable, the proposed management strategy must include, at a minimum, a central committee within the firm, with partners outside the affected management streams signing off on internal management arrangements and willing to monitor compliance over the life of the contract.

**Table C-1: Potential outcomes, criteria and actions in managing conflict of interest risk**

COI event	Criteria	Actions
<b>The risk is considered manageable</b>	A COI event risk is considered manageable when the Project Director is satisfied that: <ul style="list-style-type: none"> <li>• an advisor has limited ability to compromise or harm the state's interests and the advisor has limited incentive to do so; or</li> <li>• management plans can be put into place to monitor the COI event risk.</li> </ul>	Where a COI event risk can be mitigated through a management plan, the plan is developed by the advisor in consultation with the Project Director.
<b>The COI event requires remedial action</b>	A COI event requires remedial action when: <ul style="list-style-type: none"> <li>• the advisor has incentive and is able to compromise or harm the competitive process for the PPP project; and</li> <li>• a management plan is not sufficient to mitigate the COI event risk.</li> </ul>	Remedial action could include, for example, a requirement to remedy the situation within a nominated period of time by: <ul style="list-style-type: none"> <li>• divestiture of relevant personal interests; and</li> <li>• severing outside relationships that pose conflicts.</li> </ul>
<b>If the situation is not remedied...</b>		The Project Director may decide to: <ul style="list-style-type: none"> <li>• suspend the advisor from the PPP project; or</li> <li>• terminate the advisor's relationship with the PPP project.</li> </ul>

### C.6.1 Dealing with perceived conflicts of interest

Some perceived COIs represent no real risk to the project according to the table above. For these, the Project Director must determine to what extent government, while acting prudently, should deal with the perceived COI. This could vary from project to project since Project Directors may perceive risks differently for different projects. There may be a harder line on projects that are considered more sensitive.

The test is: what undertakings should government prudently accept from the advisor to be satisfied that the project's integrity is defensible if a COI issue is raised? In considering particular undertakings, the Project Director should take into account whether the perceived conflict will be adequately addressed if all project stakeholders are informed of the nature of the conflict, the proposed undertakings and other management arrangements. All perceived COIs will require ongoing monitoring by the Project Director.

## C.6.2 COI management plan

Where a COI event risk can be mitigated, the advisor, in consultation with the Project Director, must develop a management plan. The management plan may include some or all of the following actions, depending on the nature and extent of the COI event risk.

**Table C-2: COI management plan actions**

Action	Details
1. Disclosure of all relevant information by the advisor	As is the case with the perceived COI, to some extent, disclosure of the COI event and verification that it is being managed may be sufficient to manage the risk. A communication plan may be required.
2. More defined confidentiality and probity deeds completed by the advisor	These may be required to reaffirm, clarify and, in some instances, extend the obligations of the advisor, with ramifications agreed if these obligations are not met. This solution would be suited to high-risk COI events.
3. Reformulation of the advisor's scope of work	This will involve reformulating the advisor's scope of work to remove or limit the impact of the COI event.
4. Verification and strengthening of internal management arrangements	The Project Director will require the advisor to provide detailed written internal procedures and processes governing how they will structure their internal management arrangements to manage the COI event, e.g. physical separation of individuals, file management systems, confidentiality of information, separation of support services and protocols for contact.
5. Close monitoring of the advisor's activities	This will involve the Project Director obtaining periodic updates on the status of the advisor's relevant circumstances, either directly or through an independent medium.

# Appendix D Related-party probity principles

## D.1 Overview

Related-party probity principles apply in instances where related parties are included in two or more separate consortia bidding on the same transaction. Related-party probity principles are established to ensure that related parties have implemented internal safeguards to ensure the integrity of the bidding process.

This appendix provides an example of some of the probity principles that may be included as part of the bidding process in addressing related-party probity considerations. Consideration of related-party probity issues may vary between projects depending on a number of factors, including scale of the project.

## D.2 Related-party consortium members

- Respondents are to identify in their proposal any consortium member that is a related party of any consortium member of any other respondent.
- All members of each consortium who may be a related party are also to be identified in the proposal.
- No person can be a member of more than one consortium.
- All consortium members, executive managers and board members of the related party consortium member may be required to sign process and confidentiality agreements before the RFP is issued.
- No confidential information about a proposal is to be disclosed to a person unless the person is a consortium member or a member of the relevant holding company board sub-committee (see below for requirements for the board sub committees) and has complied with these principles.
- Each related party must have all required measures in place to prevent access to confidential information by any person who is not a consortium member or a member of the relevant holding company board subcommittee.
- Each related party will be required to enter into a process agreement satisfactory to government. The agreement will include detailed commitments from the respondent to ensure compliance with these principles.
- Participation in the tender process is conditional on receiving signed process and confidentiality agreements before the RFP phase begins. These agreements will be provided to respondents when short-listed.
- Government has the right to disqualify respondents if a breach of the process or agreements occurs at any time during the process and may result in the calling in of some or all of any bid bond (or other security). No compensation will be payable.

## D.3 Holding company of related consortium members

- If the related party's group policy requires approval of the proposal at a holding company level (or other board level, e.g. ultimate parent level), the holding company (or parent company) must establish a board subcommittee for each respondent, with authority to make final decisions.
- Where a board subcommittee is required to be established, the full board cannot be shown any information of any individual proposals.
- No person can be a member of more than one board subcommittee.
- All holding company board members (whether members of a board subcommittee or not) and executive managers may be required to sign process and confidentiality agreements.
- Immediately prior to, and as a condition precedent to, contract execution, all holding company board members and executive managers must sign statutory declarations confirming compliance with obligations under any relevant process and confidentiality agreements.
- The holding company is to have all required measures in place to prevent access to confidential information relating to one proposal by any person who is not a Consortium member or a member of the board subcommittee for the relevant respondent.
- The holding company is also subject to oversight by an additional independent Probity Practitioner appointed by government. These Probity Practitioner costs will be met by the holding company.
- The holding company will be required to enter into a process agreement satisfactory to government. The process agreement will include detailed commitments from the holding company to ensure compliance with these principles.
- Participation in the tender process is conditional on receiving signed process agreements and confidentiality agreements from the holding company before commencement of the RFP phase.
- Government has the right to disqualify a respondent if a breach of the process or the agreements by the holding company occurs at any time during the process and may result in the calling in of some or all of any bid bond (or other security). No compensation will be payable.
- If the highest ranked respondents include related parties, the Procuring Agency reserves the right to shortlist the highest ranked independent respondent ahead of higher ranked related party respondents.

# Appendix E The interactive tender process

The purpose of this appendix is to provide detailed guidance on protocols for implementing an interactive tender process (ITP) and the principles on which these are based. It should be noted that this area is continually evolving and the approaches in this appendix will need to be considered in light of ongoing contemporary practice.

## E.1 Protocols for interactive tender workshops

### E.1.1 General principles

- ITP workshops are intended to raise the level of understanding of the government's requirements for the project and in turn, improve the quality of proposals.
- ITP workshops are not negotiation sessions.
- Responses provided and concepts presented at the workshops will not form part of evaluation.
- There should be equitable and respectful dialogue between parties.
- Open two way communication is critical to a successful ITP process. All representatives should interact positively with the other team.
- An ITP should be conducted within a framework that ensures the principles of probity are adhered to, and in accordance with a project's Probity Plan (see also section E 4 in relation to Probity).

#### **Principle 1: Workshops are to follow meeting agendas agreed in advance**

- The government project team will meet separately with each bidder in order to conduct the workshops.
- Each bidder will have equal opportunity to engage with the government project team via the workshops, although it will be at the discretion of each bidder as to the extent it wishes to utilise those opportunities.
- The government project team will provide bidders with adequate notice of each meeting to allow bidders sufficient time to prepare for each workshop.
- The government project team will advise bidders of the broad categories of available workshops in advance – e.g. technical or commercial. An agreed agenda (including attendees) should be issued by bidders in advance of each meeting advising the government project team of the matters they wish to discuss within each category.

**Principle 2: Workshop attendees are to be aligned according to workshop topics**

- The Project Director (or a replacement person nominated by the Project Director) should attend all workshops and endeavour to ensure continuity and that the appropriate members of the government project team attend workshops.
- If the attendees for the government project team include a legal representative, the bidder shall be given the opportunity to bring its own legal representative to the meeting.

**Principle 3: Workshop interaction is to be structured around RFP clarification questions**

- The meetings will be structured in a manner which will allow both the government project team and the bidders to provide information, with the other party able to ask questions as relevant.

Bidders may:

- request feedback during the workshops on issues relating to the preparation of their proposal;
- ask questions to clarify specifics of the RFP;
- seek the government project team's feedback as to whether it considers a particular approach addresses the requirements of the RFP;
- present concept designs or drawings or ask specific questions relating to the information set out in the RFP;
- direct questions to any of the Government project team's representatives. However, the Project Director may (at their discretion) determine who answers the question.

**Principle 4: Workshop feedback is to be clear, equitable and relate to the RFP**

- Overall, the purpose of feedback is to provide clarity to bidders on the government's requirements and expectations.
- The government project team will not indicate or suggest how a bidder should comply with the RFP, but rather whether it considers the bidder does or does not comply. Comments should be framed in the context of the government's requirements as set out in the RFP, noting that at times it may be appropriate to clarify and expand on the requirements of the RFP, and the reasons behind the government's requirements rather than simply referring bidders back to the RFP.
- Feedback should not prescribe the content of bids or lead bidders to a particular solution. The bidder will need to form its own view of how to incorporate government project team feedback into its proposal.
- Bidders should not seek, and the government project team will not provide, outright endorsement, approval or evaluation of design concepts or other issues.
- In addition to responding to specific questions asked by a bidder, the government project team may unilaterally indicate where it has concerns regarding designs or other information presented to it. These concerns must be expressed however in terms of the specific requirements of the RFP e.g. a bidder may be asked how they believe the proposal addresses the requirements of particular section of the RFP.



- While the government project team will endeavour to draw the bidder's attention to an element of the proposal that it considers may be inconsistent with the RFP or fails to adequately meet the government's requirements, the government project team cannot and will not represent that every inconsistency or issue will be detected and/or commented upon.
- Government representatives should express a collective view and avoid personal opinions. In responding to questions the government project team shall ensure consistency of response.
- The government project team may decline to answer specific questions from a bidder at a workshop. In this case, the government project team should indicate why it considers answering the question is inappropriate.
- As a guiding principle, wherever possible, bidders should not be allowed to leave a workshop in a state of confusion with questions unanswered. A summary session should be held at the end of each meeting to ensure this does not occur and that bidders leave the session with a good understanding of the aspects of the RFP discussed.
- Where appropriate, significant issues that are raised by all bidders could be clarified by way of a "joint amplification session" involving all consortia.

**Principle 5: Workshops are to be minuted and allow questions on notice**

- The questions and answers of both the government project team and the bidder will be minuted and dealt with in accordance with the RFP procedures (i.e. the government project team may provide a copy of those minutes to the bidder).
- The government project team may elect to take any question on notice and provide a subsequent written response. The government project team shall then provide all bidders with a formal written response in accordance with the timeframes set out in the ITP process (unless the question is proprietary).

**Principle 6: Workshops are to adhere to confidentiality and intellectual property requirements**

- Commercial-in-confidence and intellectual property material will be treated appropriately by the government project team to ensure that a bidder's "competitive advantage" is protected. Although the design concepts to be presented by each bidder will be different, the approach taken by the government project team will be to focus discussion on whether the design will achieve the government's requirements in relation to the RFP. Under no circumstances will any discussion of other bidder's concepts, designs or proposals be permitted and the government project team's participants in each workshop will be specifically briefed to ensure they do not inadvertently disclose information from another bid.
- At the end of every workshop, the government project team will review the responses provided to the bidder. Where the Project Director (or where required on advice from the Probity Practitioner), considers that information has been provided to a bidder that was not included in the RFP, the relevant information will be circulated to all bidders unless by doing so, the Project Director (or where required on advice from the Probity Practitioner) considers it may breach confidentiality relating to a bidder's proposal.

**Principle 7: Workshops are to allow tabling of drawings, plans or other documents by Bidders at workshops**

- Bidders may be permitted to leave drawings, plans or other documents with the government project team following a workshop, or to submit such documents for consideration prior to a scheduled workshop along with the associated agenda. This may be appropriate when considering particularly complex design concepts where further analysis or input from experts not in attendance at the workshop may be considered beneficial. If documents are left with the government project team, particular care must be taken by them to ensure that the principles of document security and confidentiality are strictly adhered to. Processes will be implemented to ensure that documents left with the government project team are held securely, that access is strictly controlled and that all documents are returned to the bidder or destroyed once they have been reviewed in sufficient detail.
- The bidder is responsible for retrieving and removing all drawings and materials provided or created during the workshop at the conclusion of each workshop. The government project team will not be asked to retain or take away any documentation relating to a bidder's proposal or the workshops, subject to bidders being permitted to leave drawings etc with the government project team in the circumstances outlined in the point above.

**Principle 8: Workshops are to allow for separate break out rooms/spaces and limit discussion during break times**

- A break out room should be made available so that representatives of either the bidder or government project team can have confidential discussions between themselves.
- No discussion should be held with any representative of the bidders during coffee or lunch breaks as those discussions will not be minuted. As a general rule, members of the government project team and bidder should retire to separate rooms during breaks.

## E.2 The principles underlying the protocols

### E.2.1 Planning and documenting the process

The project team should start to consider the level of interaction, and its preferred approach, during the pre-tendering phase of the project, and well before the release of the RFP documentation.

The design of an interactive process is ultimately a matter for the project team. Once a process has been determined, it should be clearly documented, internally as part of the broader approach to ensuring the integrity of the procurement process, and externally to bidders, who must also plan their participation in the process.

### E.2.2 Preparing the terms & conditions

The terms and conditions for an interactive process, including the procedures and 'ground rules' should be included in the broader set of conditions, rights and obligations to which bidders consent. This is necessary to mitigate the manageable legal risks associated with undertaking an interactive process. Conditions can be stipulated by including appropriate references to an interactive process in the conditions of tendering published in the RFP, and/or through the use of a probity and process deed. The method used is a matter for the project team to determine.

By discussing its objectives for an interactive process, government can be equally clear that it is prepared to engage in the process using its best endeavours to facilitate the most efficient possible process, but within clear parameters. This would contribute to building the required degree of trust for the process. In particular, government should reiterate that it retains discretion at the bid evaluation stage to form a view of the best proposal regardless of comments made earlier in the process.

The conditions of participation in interactive processes typically require an acknowledgment by bidders of the specified terms and conditions (including the fact that the interaction does not form part of the evaluation process) and the rights of government.

The terms and conditions of tendering require bidders to acknowledge that they will not rely on the representations made by government during the procurement process, nor will they attribute any loss to comments provided. However, a residual risk to government remains, which needs to be managed by:

- providing the project team with a clear understanding of the ITP and its boundaries at the outset of the RFP period (including a training session if required); and
- providing a clear set of objectives and ground rules for bidders at the start of the process. This will include an explanation that the state's feedback must necessarily be qualified by its inability to form a full interpretation of a bidder's proposal prior to bid submission. The public sector can address particular parts of a proposal separately, but may not be in a position to provide feedback on the 'sum of the parts'. Ultimately, the bidders must take the risk that their proposal as a whole responds adequately to the RFP.

### E.2.3 Workshops

An interactive process typically involves a series of workshops or meetings held separately with each bidder. As a general rule, a number of workshops are held with each bidder. The workshops cover:

- **technical workshop(s) dealing primarily with design issues** which can also be broken up into stages (i.e. master-plan, concept design and detailed design);
- **service specification workshop(s)**; and
- **commercial clarification session(s)**, which are intended to discuss key commercial issues and the government's intention behind the commercial positions.

The structure of an ITP will depend on the complexity of the project. The agenda and format of the workshops will be a balance between the requirements of government and the bidders. The general principle is that the onus is on the bidders to identify the issues they wish to discuss. However, there will be instances where government will wish to obtain information from bidders to ensure they are appropriately addressing a key project issue. In this instance, the government project team should inform the bidders of the issue and the proposed timing of the discussion.

The use of meeting agendas is strongly recommended. The government team should require bid teams to pre-circulate agendas. This enables teams to be aware of the issues in advance and ensure the appropriate representatives will be available.

### ***Timing of the workshops***

The workshops will commence after the RFP is released and are spread over the bid preparation period. The mix and timing of these sessions are for the project team to determine. However, technical workshops are typically scheduled early in the bid preparation period, so that the clarity and understanding gained by bidders can influence their bids.

The timing of the workshops is critical and should generally match tender development to maximise benefit. For example, bidders generally do a lot of work on the design early in the tender period so design and service specification workshops should begin early in the tender period. The designs are then costed and commercial issues addressed so commercial workshops will generally commence later in the process. As the tender period progresses, any workshops held towards the submission date, are more likely to be of a clarification nature rather than addressing substantive issues.

The timing or stages of workshops is a factor in determining the total tender period. A short period may adversely affect bidders' capacity to adequately assess various concept options and design solutions.

## **E.2.4 Protecting intellectual property**

Particular care must be taken by the state project team to protect each bidder's commercial-in-confidence material and intellectual property as these elements can provide a competitive advantage and often have a commercial value. Ideas from one bidder cannot be communicated to other bidders.

To the extent that bidders choose to provide information on their proposals to government to seek feedback, the project team should be careful about the circulation of this material among team members. Circulation should be on an 'as needs' basis only. The use of an online data room, with restricted access, may be a better option in this regard. Provisions should also be made for securely isolating and storing this material once it has been reviewed.

## **E.2.5 Attendees**

In respect of workshops or other meetings, government should consider which project team members should attend. That is, government should provide access to individuals with the

ability to provide the feedback sought by bidders or considered necessary, but should otherwise be seeking to reduce the number of its representatives.

For social infrastructure it is very important to get users' feedback (e.g. head clinicians in a hospital). These personnel are generally extremely busy and therefore effort needs to go into scheduling, setting the agenda in advance and holding the workshops either on site or close to the site.

The project team should also consult the project Probity Practitioner about the extent of their attendance at the workshops/sessions. In general the attendance of the Probity Practitioner has not been required following agreement on the protocols to be used for the interactive process. However, this should be considered on a case-by-case basis.

Personnel requirements can include:

- The same project team members attend a category of workshops with each bidder to ensure consistency. For example, the same personnel would attend all technical workshops. The same personnel do not necessarily attend all the workshops due to time and resource constraints, though senior project team members may choose to attend all workshops.
- Team members are provided with protocols to ensure independence and impartiality.
- Engage operator or user groups directly in discussions as required, as their perspective is likely to be valuable, particularly where design issues are being discussed. It is important for the public sector to ensure messages delivered continue to be consistent with the RFP and the evaluation criteria.
- Limit the size of the groups attending each workshop. Meaningful discussion is more likely to occur in smaller, focused groups. Consideration should be given to staggering the workshop so that particular personnel can enter or exit the session as required to address agenda specific issues.

Before releasing the RFP documentation, which is likely to contain information on the interactive process, the public sector should also consider the following resource issues:

- the availability of the core team that will participate in the interactive process, including any advisors. The estimate of the availability required from team members should be flexible as the intensity of the process, such as the number of meetings, may change as the process progresses. It should be noted that the availability required will impact on the budget required for the procurement, though it should be noted that funds invested in an effective interactive process are likely to be more than offset by avoiding subsequent re-bidding processes;
- the availability of the team (and other potential participants such as representatives of operator or user groups) for a training workshop; and
- the amount of time built into the procurement timetable for workshops and meetings. Depending on the complexity of the project, more workshops and a longer tender submission period may be required.

## **E.3 Providing feedback**

The core of an interactive process is providing direct and specific feedback to bidders on the aspects of their bid development presented to government. It is emphasised that the purpose of feedback is to provide clarity to bidders on the state's requirements and expectations. The purpose is not to prescribe the content of bids or lead them to a particular solution.

In principle, all feedback provided should be as specific as possible, and be accompanied by a clear rationale. Feedback to tenderers (both positive and negative) should ideally go beyond simply pointing out references to the RFP documentation (though these references are important for establishing a consistent logic and context for the state's feedback).

The principle of open communication is integral to the success of the workshops and therefore the limitation of communication to a central spokesperson should be avoided. In general all attendees at the workshops should be encouraged to participate in the discussion to ensure that the issues are appropriately discussed. However, from a practical point of view, a single spokesperson providing feedback following government 'break out' sessions has been used effectively in the past.

### E.3.1 Selecting the type of feedback

There are generally three types of feedback which bidders will require. These are set out below together with guidance on how the state might respond.

- **Confirming:** This feedback provides confirmation of a bidder's clarification in respect of the RFP. Normally oral feedback is appropriate for this type of clarification.
- **Interpretation:** This information is required so a bidder can properly interpret the state's requirement as set out in the RFP. Oral feedback in conjunction with additional information in writing would be appropriate in this case. Any written feedback would be provided to all bidders. For example, if the brief has stated that noise should not exceed a particular threshold during normal working hours and the project team then clarifies with a bidder what those working hours are, e.g., 8:00am to 6:30 pm, then this should be communicated to all bidders.
- **Additional Information:** This is information not contained in the RFP and may come to light as a result of the interactive workshops.

Written feedback should be provided and all bidders informed by way of an addendum to the RFP or specific questions and answers. For example, if during the interactive tender process a bidder has requested additional information from the project team in relation to site condition that information should be made available to all bidders.

### *Positive and negative feedback*

A clear distinction also needs to be drawn between positive and negative feedback. This is because positive and negative feedback send different but equally important messages. Negative feedback will be a catalyst for a bidder to re-consider their approach, while positive feedback is a signal that a bidder is 'on the right track' and can further develop its proposal.

- Negative feedback is an expression of dissatisfaction or disapproval for reasons such as:
  - inconsistency with the project objectives and RFP
 

For example, does the team consider that a proposal would fail to deliver some of the services sought, or has not appreciated the level of performance expected? Alternatively, is the state comfortable with the proposed design? These considerations will be particularly important for design and technical issues;
  - inconsistency with the public sector's operational philosophy
 

For example, does the team consider that a proposal would sufficiently support a public sector operator's approach to services delivery, now and in the future? The functionality of the approach proposed by bidders is likely to be important here;

- inconsistency with the preferred risk allocation

For example, is a bidder proposing an allocation that is materially different from the government's position?

- inconsistency with the stated expectations of key stakeholders

For example, does the team consider a proposal adequately addressed, or is sufficiently sensitive to the concerns of stakeholders? In government's view, is the proposal likely to be acceptable to stakeholders? Aesthetic design, visual impact, and community access to facilities are common issues in this regard for social infrastructure projects.

- inconsistency with the public sector's affordability constraint

For example, is the proposal clearly beyond the constraint, given the team's awareness of underlying project costs for different degrees of functional amenity? While the team will not have any bid price information before the submission of bids, a bidder may be proposing an expensive solution because of a misinterpretation of, or over-reaction to, requirements.

Negative feedback can be provided for:

- an aspect of design – indicate that the design does not meet certain parts of the brief or other requirements, including a discussion of the rationale for this view;
- an aspect of the functionality proposed – indicate that the level or type of functionality proposed is not considered sufficient to deliver the services to the required standards or would compromise or limit the achievement of other aspects of the brief or objectives; and
- a proposed departure – indicate that the departure is not acceptable and the bidder is discouraged from submitting it as part of the proposal.

Positive feedback is an expression of satisfaction or affirmation for similar reasons:

- consistency with the project objectives and RFP;
- consistency with the preferred risk allocation or operational philosophy;
- consistency with the stated expectations of key stakeholders; and
- consistency with the affordability constraint.

Positive feedback does not mean that one bidder's proposal is preferable to others. Rather, it is a message that a particular approach appears, from the information provided, to be capable of delivering the services and achieving the outcomes of the project. The subsequent evaluation process will determine which bid is ultimately the best.

Positive feedback can be provided for:

- an aspect of the proposed design – indicate that the Proposal conforms to the project team's interpretation of the RFP and would be considered compliant if submitted, including discussion of the rationale for this view. Further, it has strengths and (any identified weaknesses aside) is in line with expectations and desired outcomes;
- an aspect of design or functionality where the bidder is unsure of its compliance with the RFP or unsure of its likely acceptance by government – indicate that such an aspect is

considered compliant and consistent with expectations, including discussion of the rationale for this view; and

- a proposed departure – indication that, while government considers it a departure, it does not reject it and can see merit in it, and would be prepared to consider this as part of the evaluation, including discussion of the rationale for this view.

In each case, the feedback provided must be qualified by the level of knowledge about the bid that has been made available.

### ***Managing positive feedback or non-response***

Positive feedback is particularly important for bidders, as it provides the confidence and encouragement to pursue the innovative elements of their proposals. Experience suggests that the public sector is more comfortable providing negative feedback than positive feedback. However, an absence of positive feedback requires a bidder to 'guess' whether their bid meets the public sector's requirements or expectations in particular areas where a range of plausible interpretations exist.

There is often a perception that positive feedback carries a higher level of probity risk. In principle, this is not the case. The key issue for the public sector is to preface and represent the feedback it provides to bidders. That is, to the extent that the public sector sets clear boundaries and observes them, positive feedback can be provided without creating additional risk exposure. The preface for positive (and negative) feedback is essentially the re-iteration of the context for, and ground rules of, the interactive process, in particular re-stating the agreement between the parties on the issues of reliance and prejudice of the evaluation process (which are discussed below).

There are likely to be instances during the interactive workshops where the state team cannot respond. This may be due to the requirement for additional information to be provided by the bidder and/or the requirement for the project team to consider the issue in more detail. In these instances, bid teams are advised to defer a response to the issue in hand until such time as appropriate information is provided and/or the issue has been fully considered. The approach adopted will depend upon particular circumstances but include:

- requesting additional information from the bidder to assess the issue;
- taking the question on notice and providing a response at a later time or outside of the workshop session; and
- using a 'break out' session where the project team can consider the issue and provide a response following the 'break out' but during the same workshop session.

### **E.3.2 Preparation by the project team**

The project team should dedicate sufficient time and resources to preparing for the interactive process. As discussed earlier, the team should ensure that all members have an adequate understanding of the process, its objectives and their roles. This is important for establishing a level of confidence and for planning and scheduling resources.

- To the extent that the bidder would like to discuss the RFP and its requirements, rather than a bidder's proposed solution, the project team should consider its position on the agenda items and prepare a consolidated position that takes account of the views of all team members.
- To the extent that the bidder would like to discuss aspects of its proposal, the team should be clear that, following the presentation of material by a bidder, additional time



may be required to consider a response. As discussed below, this time may be taken on the same day (e.g. using a 'break-out' session) or through a scheduled follow-up meeting. The project team will need to form a view on the positive and negative feedback, with the supporting rationale, to be provided to the bidder.

From an administrative perspective, the public sector team should ensure that sufficient time is set aside for workshops so there is adequate time for discussion and feedback (rather than providing time for presentations only).

### **E.3.3 Preparation by the bid teams**

Bidders should consider how they could extract maximum benefit from an interactive process. They need to consider the way they choose to present their designs and the time they allocate to testing their interpretation of the output specifications.

Bidders should consider providing adequate material in advance of workshops or meetings including:

- the functionality of their proposed solution;
- the indicative design of their proposed solution; and
- the approach to service delivery and the levels of performance.

In each case, the bidder should outline their interpretation of the service delivery and other key requirements, and explain how they propose to achieve them. For commercial workshops, any departures proposed should be provided with the bidder's alternative position and supporting arguments.

To the extent that bidders require specific feedback on the RFP and its requirements, such as a discussion of the interpretation of aspects of the services specification or risk allocation, they should aim to provide the government team with a full and clear agenda of issues, to direct the team to their concerns. In particular, bidders should:

- identify issues that require clarification;
- submit full and comprehensive agendas in advance of meetings; and
- prepare and submit material as appropriate.

### ***Bidder feedback***

Where bidders provide feedback that identifies issues such as omissions or errors in relation to the RFP, the team should be prepared to receive and act upon such feedback. An example of this type of issue is inconsistency between various documents within the suite of the RFP. In this instance, following review and resolution of the issue, the government should issue a clarification to all bidders.

## **E.4 Probity**

Probity needs to be considered as part of the implementation of the interactive process. However, it is important to note that if an appropriate framework is put in place, open communication can be achieved without exposing government to unacceptable probity risk.

The key elements that need to be considered from a probity perspective and suggested strategy for managing these issues are as below:

### **Personnel**

Principle: Probity requires the independence and impartiality of all persons involved in shaping the transaction and influencing the final outcomes.

Strategy: To the extent practicable, consistent attendance by project team members will be ensured and attendees will be provided with protocols (refer below) to be observed during the meetings. In addition, the Probity Practitioner may elect to attend any or all of the sessions if considered appropriate.

### **Communication**

Principle: Probity requires that effective communication protocols can establish equitable and respectful dialogue between parties.

Strategy: Protocols should be developed to ensure communication with bidders is undertaken in accordance with the key principles outlined above i.e. positive v. negative feedback, confirmation v. additional information etc. In addition, a full briefing of all project team members that will participate in the workshops should be undertaken prior to attendance. This briefing will address both probity issues and the proposed conduct of the workshops.

### **Information**

Principle: Probity requires that all project documents and information, whether government's or bidder's, be managed in an equitable and respectful way.

Strategy: Meetings should be conducted in a manner that will allow both government and the bidders to provide information, with the other party able to ask questions as relevant. Where the Project Director forms the view that the project team has disclosed information during a workshop that has not previously been disclosed to all bidders, the project team will issue a release to all bidders containing the relevant information.

### **Confidentiality**

Principle: Appropriate treatment of commercial-in-confidence and intellectual property material to ensure that a bidder's intellectual property is protected and not communicated to another bidder.

Strategy: Discussions on any aspect of a competitor's proposal or submission should be prohibited and the project team in each workshop should be specifically briefed to ensure they do not inadvertently disclose information from another bidder.

## **E.4.1 Risk of procedural challenge**

Following on from the probity issues discussed above, there remains a risk that a bidder could initiate a procedural challenge on the basis of:

- a process contract having arisen between the government and a bidder; or
- misleading or deceptive conduct on the part of the government.

In the case of a procedural challenge, a bidder would need to demonstrate their reliance on the information received during the interactive process, to their detriment. These risks are

discussed below. The legal devices used by the government to regulate the procurement process should be capable of appropriately mitigating these risks.

### **Reliance**

To demonstrate reliance, a bidder would need to show that there was a representation made or communicated during the interactive sessions, and that they relied on that representation or communication to their detriment. There is a risk that an inappropriate comment regarding, for example, a particular design aspect could lead a bidder to conclude erroneously that only that approach was acceptable to the state. While the public sector should be considered in its approach to providing feedback, the conditions of the process should explicitly address this matter.

### **Contract**

It is an established legal principle that a 'process' contract can be created in certain circumstances between a procurer and a bidder. In these circumstances, the essential terms of the contract are held to include a promise by government to treat bidders equally and abide by stated procedures. This is in consideration for the bidder providing the necessary resources to submit a bid.

### **Misleading or deceptive conduct**

Government could be exposed to a misleading and deceptive conduct claim if it has made any representations during the interactive process that could be construed as having misled or deceived a bidder.

## **E.5 Conclusion**

The interactive tender process has become common practice for PPP projects. It has been well received by the project teams (who feel the verbal interaction adds an extra dimension to the RFP) and well received by the bidders (who appreciate the opportunity for direct feedback, particularly on technical and design matters). The aim is to improve the quality of tender submissions with a particular focus on the design aspects of tenders. Whilst not solving all design or technical matters there is evidence that the interactive tender process certainly helps improve outcomes in accordance with the RFP.

An interactive tender process is essential in social infrastructure projects and other projects where there is a high level of interface risk. The interactive process appears to add most value when addressing technical and design issues; less value is apparent when clarifying commercial matters. The level of interaction (e.g. number of workshops and number of issues covered) depends on the complexity of the project.

The project team will always seek to observe high ethical standards and conduct in commercial projects. When implementing an interactive tender process, probity considerations should provide a guiding framework rather than constrain the interaction.

In the end, the success or otherwise of an interactive tender process depends largely on the degree to which certain basic principles are observed by the parties.

For private sector bidders this involves:

- acknowledging the need for transparent and equitable treatment for all bidders involved in public procurement processes;
- taking up the workshop opportunities offered;

- timely submission of questions on notice and meeting agendas in what can be a very tight timetable; and
- observing communication and procedural protocols by all team members.

For the government project team, the basic principles are:

- a commitment to transparent and equitable treatment of all bidders;
- an understanding of the sensitivity surrounding commercial-in-confidence and intellectual property issues;
- a capacity to articulate clearly the government's requirements relating to the output requirements; and
- ensuring that bidders have agreed to the proposed process before it starts, that they have signed disclaimer and indemnity deeds and conditions of tendering have been developed specifically for the workshops.

If these principles are followed, there is no impediment to developing an interactive process that allows greater freedom in articulating the government's requirements.

Although there are inherent risks in this approach, the benefits – such as potential design improvements and avoiding or limiting any potential re-design tender stage – can materially outweigh the risks and provides significant value to projects.

# Appendix F Tax issues

## F.1 Division 250

### F.1.1 Division 250 capture

Subject to the Division 250 (Div 250) thresholds (exemptions for small business taxpayers, carve-outs for smaller transactions e.g. nominal sum of contract payments <\$5m etc.) and discretionary relief provided by the Commissioner, Div 250 applies where (if all five tests are met):

- 1 There is tax-preferred asset use. Div 250 adopts a "lease, use or control of use" of the asset test:
  - a) Tax-exempt end user is the lessee of the asset; or
  - b) Someone other than the taxpayer uses, or effectively controls the use of, the asset:
    - I. and the asset is not committed to the production of tax assessable income;
    - II. control can be direct or indirect; and
    - III. control can be physical or financial.
- 2 Arrangement period > 12 months.
- 3 Financial benefits provided to the taxpayer in respect of the asset use by a tax-exempt. The tax-exempt party provides financial benefits to the taxpayer for the tax-preferred use of the asset. The term "financial benefits" is defined in the debt / equity tax legislation and includes up-front contributions and payments at the back end of the deal.
- 4 If not for Div 250, the taxpayer would be entitled to claim capital allowances on the asset:
  - a) plant and equipment;
  - b) Div 40 depreciation allowances;
  - c) structures; and
  - d) Div 43 amortisations.
- 5 The taxpayer does not have the predominant economic interest (PEI) in the asset. For most projects, PEI will be the decider for Div 250 capture.

There are a handful of subtests – if any one of these PEI subtests is failed then the fifth test is failed:

**PEI One - limited recourse debt limit.** The Div 250 threshold generally allows up to 80 per cent of the cost of the asset to be so funded;

**PEI Two - right to acquire.** Div 250 only allows the tax-exempt to acquire at market value. Simple reversion to tax-exempt at the end of the contract is also permitted;

**PEI Three - Effectively non-cancellable long-term arrangements.** Captures deals where:

- the arrangement period > 30 years or 75 per cent of the remaining effective life; and
- the deal is cancellable only with the permission of the taxpayer or the deal is cancellable without taxpayer permission but a replacement deal is required or the penalty for cancellation is such as to discourage cancellation.

**PEI Four - Level of expected financial benefits test.** The taxpayer:

- lacks a PEI if the asset has a guaranteed residual value under the contract; or
- the sum of the financial benefits (now in PV terms) provided in relation to the asset use by the tax-exempt party exceeds 70 per cent of the market value of the asset.

### **F.1.2 Division 250 tax payable upon project capture - Taxation of Financial Arrangements (TOFA) mathematics**

If a project is caught by Division 250, the tax consequences are based on the Division 16 D model. Accordingly, the arrangement is deemed to constitute a loan from the taxpayer to the tax-exempt, and the financial benefits provided to the taxpayer for the tax-preferred use of the asset(s) are re-characterised, bifurcating the loan servicing into interest (taxable) and principal (capital account). However, whilst the administration of the new law is still in the developmental phase, the assessable interest component of the deemed loan under Div 250 (other things equal) may be greater in a PPP arrangement when compared to Div 16 D due to:

- not restricting the relevant income stream (for bifurcation into interest & principal) to the actual cash payments. The compounding accruals method allows taxation in advance of cash, and this implies a bring forward e.g. a higher tax liability in present value terms; or
- the deeming/imputing of sums where no transaction has occurred e.g. end values may be counted where the taxpayer continues to hold the asset i.e. taxation of unrealised gains.

### **F.1.3 Transitional rules**

The general principle is that Division 250 will regulate arrangements going forward e.g. where a contract is signed after 01 July 2007 and first asset use (tax-preferred asset use) starts after 01 July 2007. A number of transitional rules have been legislated and they are complex. Possibly the most relevant situations are likely to be:

**Election.** Deal signed before 01 July 2007 but first asset use (tax-preferred asset use) starts after 01 July 2007, then a once off, all embracing, irrevocable taxpayer election can be made to have Div 250 apply where either S 51 AD or Div 16 D would have applied;

**Material Alteration.** Existing deal – The arrangement was entered into pre-01 July 2007. Neither S 51 AD or Div 16 D applied pre 01 July 2007. If there was a material alteration to the arrangement after 01 July 2007, and but for Div 250, S 51 AD or Div 16 D would now apply, then Div 250 applies post the alteration; or

**S 51 AD switched off from 01 July 2003.** For income years commencing on or after 01 July 2007, Section 51 AD will not apply to arrangements entered into before 01 July 2007 where the tax-preferred use started between 01 July 2003 and 01 July 2007. In these circumstances Div 16 D will normally apply (unless there is a material alteration on or after 01 July 2007).

# Appendix G Accounting issues

The following Appendix provides additional details supporting the relevant accounting issues previously addressed in Section 10.2.

## G.1 HoTARAC PPP accounting guidance

In 2004, the Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) developed and issued specific guidance for government bodies, based on a predominant economic ownership model, using seven risk and reward categories.

The HoTARAC guidance was adapted from the UK FRS 5 Application Note F – *Private Finance Initiative and Similar Contracts*. Prior to the establishment of an Australian Standard, agencies should generally refer to the AASB Framework and the risks and rewards test under AASB 117 Leases as described in Section 10.2.2. As the HoTARAC guidance does not have the same authority as the AASB Framework or AASB Standards, this should be referred to for guidance only.

The HoTARAC guidance states that where a PPP contract can be separated into elements that operate independently of each other, and where some of those elements relate only to services separate from the property asset, any such service elements are excluded from the analysis as they are not relevant to determining which party has the asset.

Once any separable service elements have been excluded, PPPs can be classed into those where the only remaining elements are payments for the property and those where the remaining elements include some services. Where the only remaining elements are payments by the grantor for the property asset, the PPP should be accounted for as a lease in accordance with AASB 117 *Leases*. Where the remaining elements include some payments for services, the PPP should be accounted for in accordance with this guidance.

The guidance states that the question of which party should recognise the property as its asset should be determined by considering which party has most of the risks and benefits in relation to the property. The guidance identifies the principal factors that might be relevant to an arrangement such as demand risk, third-party revenues, who determines the nature of the property, penalties for under-performance and non-availability, potential changes in relevant costs, obsolescence and residual value risk.

Where the grantor has an asset and a liability to pay for it, these should be recognised in its balance sheet.

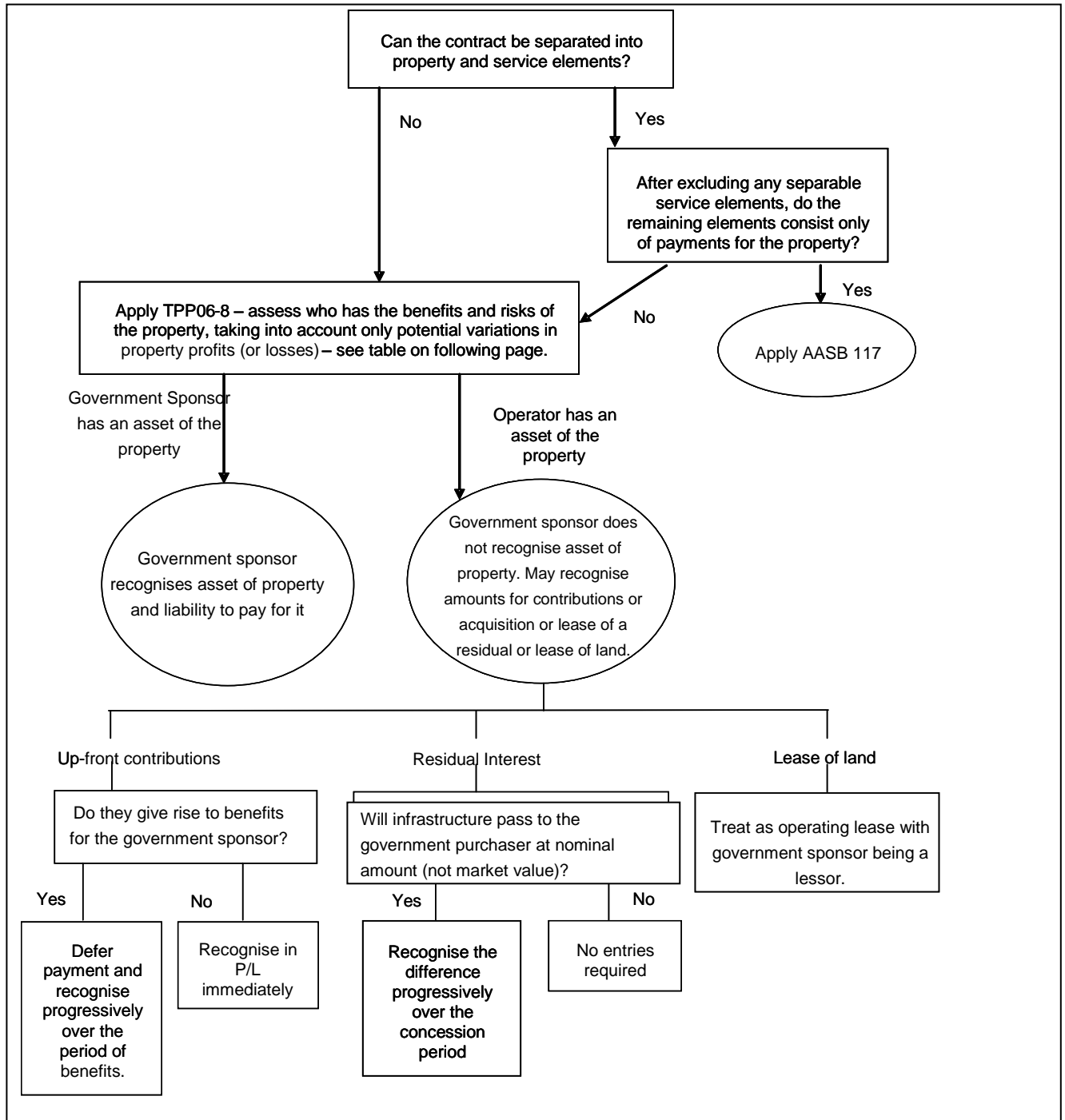
Where the grantor does not have an asset of the property, other assets or liabilities may require recognition. These can relate to up-front contributions, the residual interest in the property, and associated leases of land.

In relation to up-front contributions, the policy states that the accounting treatment depends on whether the contributions give rise to future benefits for the grantor. If they do, they should be deferred and recognised in the income statement progressively over the period of the benefits. If they do not, they should be recognised immediately.

In relation to the residual interest in the property, the guidance states that the accounting treatment depends on the amount at which the property will transfer to the grantor at the end of the PPP. Where the contract specifies the amount (including zero) at which the property will be transferred to the grantor at the end of the contract, any difference between that amount and the expected fair value of the residual, estimated at the start of the contract, should be recognised progressively over the term of the contract.

Conversely, where all or part of the property will pass to the grantor at the end of the contract on payment of its then market value, no accounting is required until the date of transfer as this represents future capital expenditure for the grantor.

The following chart summarizes the decision route for the application of HoTARAC guidance:





## G.2 Australian Interpretation 12

The Australian Accounting Standards Board (AASB) issued Interpretation 12 in February 2007 applicable for financial reporting periods commencing from 1 January 2008. It applies specifically to private operators (not Government grantors). Since AASB Interpretation 12 does not address accounting issues from the Government grantor's perspective, nor accommodate public sector specific issues, the AASB also established a specialist Interpretations Advisory Panel to make recommendations on unresolved concerns. The Panel's work has been somewhat merged into the work conducted under the banner of the IPSASB.

## G.3 ITC 16 Request for comment on the IPSASB consultation paper on Accounting and Financial Reporting for Service Concession Arrangements

The AASB has released an invitation to comment on the IPSASB consultation paper on ITC 16. The International Public Sector Accounting Standards Board (the IPSASB) proposes a grantor that controls the property underlying a PPP arrangement should recognise that property as an asset in its financial statements.

HoTARAC endorsed the involvement of IPSASB in PPP accounting and supported the use of the control test to determine which party owns the underlying assets, but not the proposed tests on the grounds that they were not principles-based (rather rule-based), and appear to be too limited.

The resulting IPSASB's consultation paper is the first step of a project undertaken to address internationally the accounting for PPPs by public sector grantors.

Within the scope of the IPSASB consultation paper, PPPs are described as transactions in which the government (the grantor) conveys to a private sector entity (the operator) the right to provide services directly or indirectly to the public through the use of infrastructure or a public facility. The operator in turn assumes an obligation to provide the services in accordance with performance requirements set by the grantor.

The IPSASB proposes that a grantor that controls the property underlying a PPP should recognise that property as an asset in its financial statements. The criteria for assessing control are:

- the grantor controls or regulates what services the operator must provide, to whom they are provided and the price ranges or rates that can be charged; and
- the grantor controls the residual interest in the property at the end of the arrangement.

The reference to "regulates" in the first limb of the control criteria is restricted to arrangements agreed upon by the grantor and the operator and excludes generally legislated regulation that does not establish control for the purposes of financial reporting.

If both criteria are satisfied, the asset is recognised along with a liability reflecting the obligation to provide cash or other compensation to the operator. The ITC includes proposals on the timing for recognition and measurement of the asset and liability, how it would be recognised and how it would be measured.

The following table illustrates a scenario when one criterion is satisfied.

Arrangement	Grantor controls use	Grantor controls residual	Proposed accounting
New asset  Existing asset	✓	X	Grantor might: <ul style="list-style-type: none"> <li>account for the property as a lessee if the definition of a lease is met; or</li> <li>if the definition of a lease is not met; <ul style="list-style-type: none"> <li>recognise the property (and potentially a liability if the arrangement involves newly constructed property) until the property is transferred to the operator; or</li> <li>expense outlays as they are incurred.</li> </ul> </li> </ul>
New asset	X	✓	<ul style="list-style-type: none"> <li>Progressively recognise an asset over the period of the arrangement for the excess of the expected fair value of the property at the end of the arrangement over the grantor payments for the property to be made on its reversion to the grantor.</li> </ul>
Existing asset	X	✓	Grantor might: <ul style="list-style-type: none"> <li>apply the guidance for lessors in relation to existing property if the definition of a lease is met; or</li> <li>if the definition of a lease is not met, derecognise existing property under the arrangement and recognise an asset for the operator's obligation to return the property at the end of the arrangement. This asset should be recognised at the expected fair value of the property at the end of the SCA. The net derecognition amount should be reported as a gain or loss in the period in which the SCA was entered into.</li> </ul>

If neither criterion is satisfied, the grantor should not recognise the property underlying the SCA and grantor payments should be expensed as the services are rendered by the operator.

Any existing property should be derecognised and accounted for as a disposal.

The consultation paper also includes proposals for areas commonly encountered in PPPs including:

- Guarantees and commitments by a grantor should be accounted for under either IAS 39 Financial Instruments: Recognition and Measurement if the definition of a financial guarantee contract is met or otherwise under IPSAS 19 Provisions, Contingent Liabilities and Contingent Asset.
- Revenue from revenue-sharing arrangements would be recognised as it is earned, once any contingent event is deemed to have occurred.

- Revenue from contractually-determined inflows would be recognised from the beginning of the concession term on a straight-line basis or another basis that better reflects the consumption of access to the property or the time value of money.
- Issues regarding whether an operator is controlled by a grantor.

This paper does not yet have the same authority as the AASB Framework or AASB Standards and is for guidance only. The Procuring Agency should consult the relevant Finance and/or Treasury Department to ensure that the accounting treatment for PPP transactions is being correctly applied in accordance with jurisdictional requirements.

# Appendix H Contract management guidance

This section outlines the nature and function of contract management and critical elements for a successful result. The purpose of this section is to provide:

- general guidance for the government party's management of a PPP contract through the lifecycle of a project – to help achieve project objectives incorporating balanced long-term value for money outcomes; and
- direction for the procurement team involved in developing a PPP project – to enable them to address and support the principles of effective contract management in the executed contract for the project.

The underlying principles in this section should be considered 'best practice' at the time of publication. They may also be useful in the management of non-PPP long-term service contracts by government departments and agencies.

## H.1 Contract management through the project lifecycle

A typical PPP project has several distinct stages:

- **procurement stage:** the process leading up to contract execution, during which the government party should establish sound foundations for its contract management over the life of the contract;
- **construction stage:** from the time construction (or implementation) starts through the commissioning process to the start of payments when delivery of the services required by the output specification begins;
- **service delivery stage:** covering the provision and use of the contracted services during the remaining life of the contract; and
- **contract expiry or termination stage:** the period leading up to and after contract expiry or termination.

For each lifecycle stage, there is a range of contract management activities that should be conducted within the government party if the contract is to be managed effectively.

# The relationship between risk and contract management

## H.1.1 What is risk?

In the context of infrastructure projects, risk has been defined as 'the chance of an event occurring which would cause actual project circumstances to differ from those assumed when forecasting project benefit and costs.'<sup>1</sup> Risk is at the core of project profitability (for the private party) and efficiency (in delivering public sector objectives). Management of risks holds the key to project success or failure because 'projects are about risks...their evaluation and their subsequent acceptance or avoidance'.<sup>2</sup>

**Risk** is the chance of an event occurring that would cause actual project circumstances to differ from those assumed when forecasting project benefits and costs.

## H.1.2 Effective contract management manages risk

To be effective in the context of a PPP project, contract management must identify, monitor and manage all risks over the life of the project contract to achieve project objectives and value for money outcomes. This includes:

- quantifying actual and potential risks and their associated losses (or benefits) to identify those risks that must be managed over the contract lifecycle; and
- developing management strategies to assume, control, mitigate or eliminate these risks or losses.

Contract management builds on the allocation of project risk in the contract. The framework for this risk allocation in PPP projects is set out in the risk allocation guidance material.

From time to time, the private party in a PPP project will approach the government party with proposals for changes to the contract or new opportunities that they believe will lead to mutual benefits. Effective contract management also helps the government party to assess and realise the benefits of these proposals.

Effective contract management incorporates identifying, monitoring and managing all risks and opportunities over the life of the project contract to achieve project objectives and value for money outcomes.

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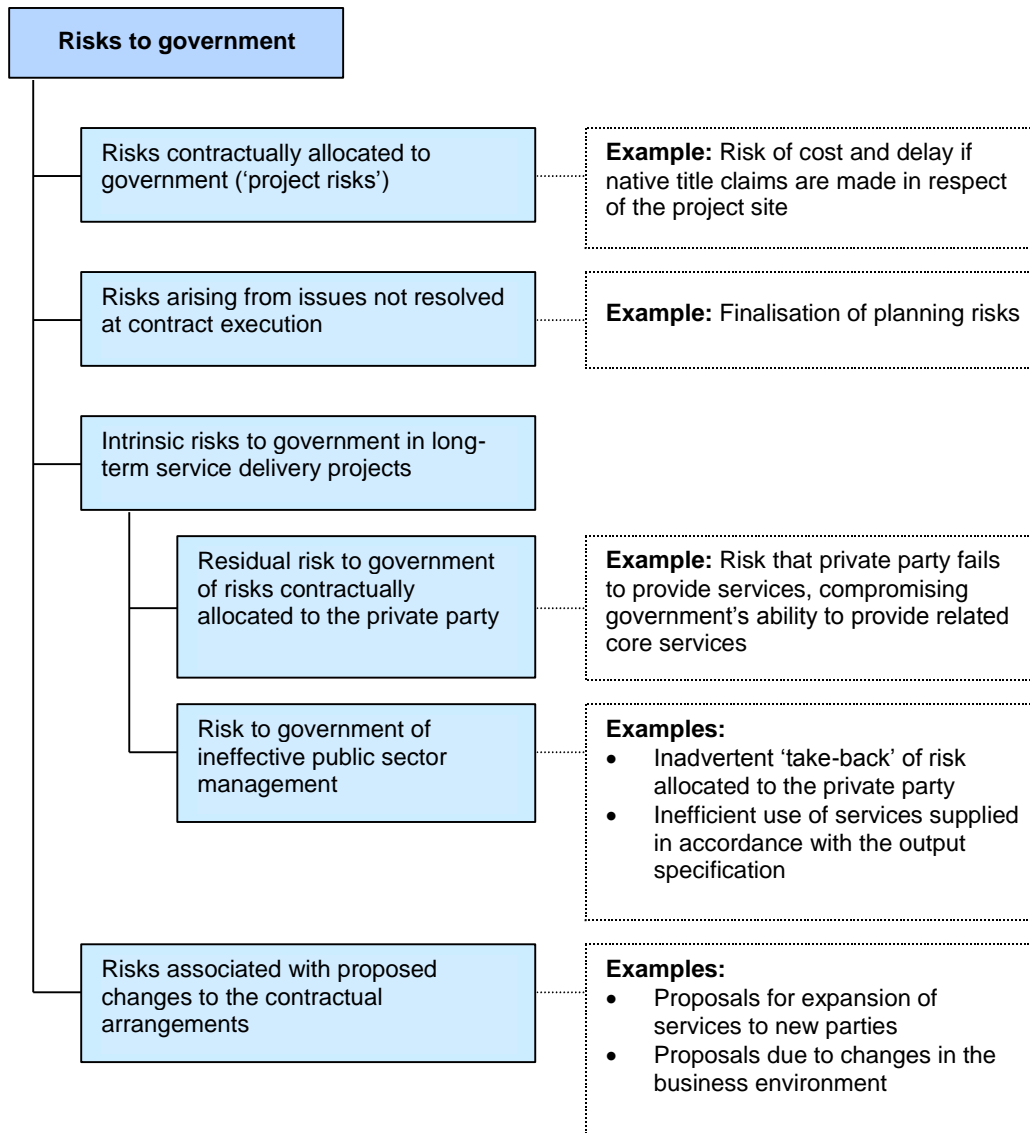
<sup>1</sup> Chris Furnell, 'Risk identification and risk allocation in project finance transactions', paper presented at the Faculty of Law, The University of Melbourne, May 2000, p. 1.

<sup>2</sup> Allen & Overy, from Furnell, *ibid.*, p. 3.

## H.2 What risks must be identified and managed?

There are a number of sources of contract risk to government that may compromise or otherwise impact on the value for money outcomes of a PPP project.

**Figure H-1: Categories of contract risk in a PPP project**



The range of risks that must be considered for contract management purposes (contract risks) is broader than the range of risks considered by the procurement team for contractual risk allocation purposes (project risks).

To identify and manage this range of contract risks, a contract management strategy should incorporate thorough information collection, analysis and management practices, and an ongoing review process. New and emerging risks through the project lifecycle must be identified and control action taken. Failure to develop and implement an effective contract management strategy for the project is, in itself, a risk that must be managed.

Risks that must be identified and managed ('contract risks') in a PPP project are all risks that may compromise project objectives and value for money, including risks allocated to government, residual risk to government of risks allocated to the private party (for example, the residual risk to government of ineffective private party performance) and risks arising through ineffective public sector performance.

Risks not identified cannot be proactively managed and can be very damaging. Risks cannot be correctly identified unless there are clear project objectives that provide an unambiguous description of success for the project.

## H.2.1 Key categories of contract risks

The following paragraphs describe in more detail the key categories of risk identified in Figure H-1. However, these categories do not encompass all possible risks to government in a PPP. Contract management teams must carefully consider the full range of risks in their specific project.

### ***Project risks contractually allocated to government***

Selected project risks that directly affect PPP project outcomes or deliverables are contractually allocated to government. Aside from express allocation of risks, commercial contracts may contain contractual obligations implied by law. There may also be consequences arising from statute<sup>3</sup> or from the general law.<sup>4</sup> Government must appropriately manage those risks allocated to it by the contract and those that arise from implied duties under the contract<sup>5</sup> or from general law.

### ***Risks arising from issues not resolved at contract execution***

As a practical matter, not all issues that may arise in a PPP project will have been identified and expressly allocated in the project contracts. Some may not have been identified at all. For example, before 11 September 2001, unavailability of terrorism insurance in Australia was not generally identified as a project risk.

Other risks may have been identified, but were intentionally or unintentionally left unresolved. The fact that these issues are unresolved creates a risk that they may, in future, compromise the ability of the parties to achieve the project objectives. Government must appropriately manage the unresolved issues consistently with the risk allocation for the project generally, to minimise the impact of this risk on the project objectives.

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<sup>3</sup> For example, *Trade Practices Act 1974* (or its jurisdictional equivalent) issues of misleading conduct and unconscionable conduct

<sup>4</sup> For example, a failure to warn

<sup>5</sup> For example, where applicable, the duties to act in good faith and to act fairly

## ***Intrinsic risks borne by government***

A variety of risks are intrinsic in a long-term service delivery project and must be managed by government. These include:

- the residual risk to government of a failure by the private party (or its subcontractors) to adequately to control and mitigate risks contractually allocated to the private party; and
- risks arising from ineffective public sector management (including poor contract management).

### **Residual risk to government of risks contractually allocated to the private party**

The nature of a PPP project results in all project risks that are not assumed by government implicitly falling to the private party (whether expressly allocated in the contract or not).

Government may face significant residual risk where the services delivered by the project impact upon core services of the government party. In these circumstances, if the private party fails to deliver the contracted services, this may interfere with government's ability to provide the core services. Government's preferred position is that this interface risk be allocated to the private party.

Where interface risk is allocated to the private party, government may be entitled to financial compensation under the contract should a failure by the private party to deliver the contracted services interfere with government's ability to provide the core services. However, money alone may be insufficient to compensate government for failing to fulfil its obligations to third parties and deliver key outcomes. Thus, while the financial risk of non-performance is contractually allocated to the private party, government retains a residual risk should the private party fail to perform or pay compensation.

Government may also retain a significant residual risk if it has a continuing, non-delegable duty of care to people receiving services provided by the private party.

There can be similar residual risks to government, in the absence of core service interface risk or a non-delegable duty, where a project risk allocated to the private party materialises and there is a political or public interest imperative for government to deliver the services.

### **Risks arising from ineffective public sector management**

Consequential risks can arise if the public sector does not meet its general (non-contractual) responsibilities and mismanages the contract. These risks do not necessarily involve a failure by either party to perform its contractual obligations or impact upon the delivery of services in accordance with the output specification. They can, however, compromise the value for money outcomes of the project. They can also result in adverse political consequences for government, or damage to personal, organisational or broader government reputation.



Examples of such risks include:

- take-back risk, which can result in government ultimately bearing the financial responsibility for project risks originally allocated to the private party. (This may occur, for example, where government fails to respond to a private party request within a contractual timeframe or where the government party engages in a pattern of behaviour at odds with the contractual arrangements); and
- the inefficient use by the public sector of the contract outputs supplied by the private party in accordance with the output specifications.

### ***Risks associated with proposed changes to the contractual arrangements***

Proposed changes to contractual arrangements involve two forms of risk:

- the risk that the change process is not managed effectively; and
- risks to the ongoing success of the project that result from the proposed change.

As part of the process for managing risks in the change process, the risks to the ongoing success of the project that result from the proposed change should be identified, assessed and allocated, and appropriate mitigation strategies should be put in place.

## **H.3 Contract management, the contract and the procurement process**

The contract negotiation process must be conducted with the understanding that the contract will form part of a broader risk management framework for the project. It is vital to build a contract that identifies clearly the obligations of the private party and government, and enables a productive relationship built on long-term perspectives and commitments.

The development of such relationships in the contract is an essential component of effective contract management. The contract should not be so rigid that it precludes flexible, constructive management or the natural maturing of the relationship between government and the private party.

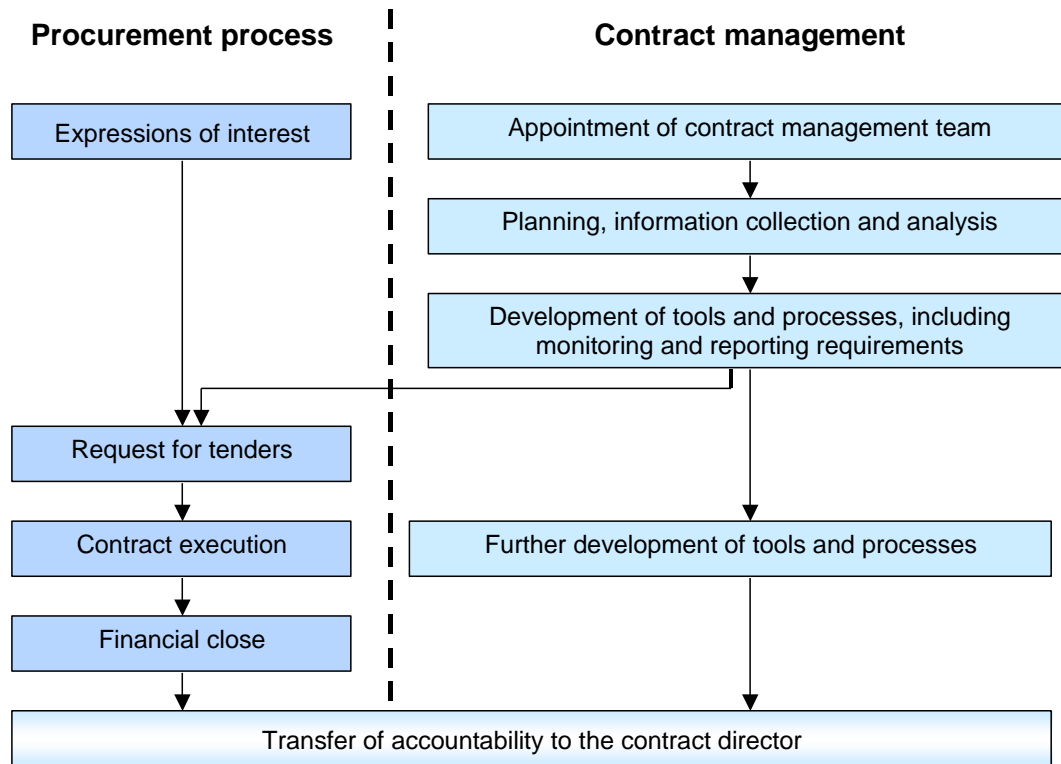
As risk is a dynamic concept, contract management must evolve with the delivery of the contracted services throughout the project lifecycle. While contract management evolves, the contract itself should not evolve inadvertently. Through effective contract management, the government party should ensure that the contract is modified only by written agreement of the parties. For risk to be managed effectively the foundations for contract management must be incorporated into the RFP and the draft contract provided to bidders, and maintained through the further development and finalisation of the contract. Doing so ensures that:

- a sound contractual basis for effective contract management is incorporated in the contract;
- there is adequate knowledge transfer from the procurement team to the contract management team; and
- the contract management strategy for the project is in place as soon as practical after the contract is executed.

To help this process, it is essential to include the proposed contract director in the procurement team at an early stage, or at least allow that person to observe the procurement

process and have access to procurement team members to enable an informed preparation of the contract management strategy. The procurement team should provide practical help in understanding the project and the risks inherent in it. The Project Director has overall responsibility to ensure that the contract director works with the procurement team to develop an effective contract management strategy.

**Figure H-2: The relationship between contract management and the procurement process**



Effective contract management must be initiated early in the procurement stage of the project and requires a strong understanding of the contract itself.

The Project Director succeeds by achieving a contractual arrangement that will deliver the project objectives. As the identification and management of risks is necessary to achieve the project objectives, the Project Director must support risk identification and management, and the development of an effective contract management strategy. The contract director succeeds by ensuring that the project objectives are delivered.

## H.4 Contract management through the project lifecycle

Given the long-term duration of PPP projects, it is inevitable that the physical, business and technological environment in which a project operates will change over the life of the project. In addition, the project itself will pass through a number of stages and significant events. Each lifecycle stage and significant event involves particular risks and provides opportunities for the government party to implement particular control and mitigation strategies. The government party must ensure that its contract management strategy evolves through these lifecycle stages and change processes and is adapted to particular circumstances.

Effective contract management must take account of and adapt to changing circumstances and significant events through the project lifecycle.

## H.5 Contract risk management resources

To ensure that the value-for-money outcome obtained in the initial contractual allocation of project risks is not compromised and risk is managed over the life of the contract, the government party must devote adequate resources to contract management activities. Inadequate resourcing can lead to inappropriate contract management strategies and skill levels to control and mitigate risks borne by government. In addition, a lack of adequate contract management capabilities can lead to the unintentional 'take-back' of risks that have been allocated to a private party through the earlier procurement process.

The resources required for good contract management include:

- an adequate budget;
- personnel with the knowledge and experience to manage relationships with the private party and other stakeholders; and
- a standing arrangement providing access to senior advisors experienced in the project.

As good contract risk management starts during the procurement phase with the development of appropriate risk management strategies, contract risk management resources should be available for use during the procurement stage, not simply after contract execution.

Where feasible, the Project Director (who has overall responsibility for delivery of the project through the procurement process) should either be the inaugural contract director, or should be engaged until commissioning, working with the inaugural contract director during this period.

Effective contract risk management requires the dedication of appropriate financial resources and experienced personnel to the establishment of a contract risk management strategy during the procurement phase of the project and the maintenance of that strategy throughout the project lifecycle.

## H.6 Key elements of effective contract management

### H.6.1 Planning, information collection and analysis

Planning, information collection and analysis are the key first steps towards effective contract management for PPP projects. These activities go hand in hand. Planning the contract management strategies that will be used for the project helps determine the information that will be required to implement those strategies, while the information collected and analysed helps refine the contract management plan and helps the government party to identify, understand and manage project risks.

In a well-managed PPP project, robust contract management planning and information collection and analysis processes have the following outcomes:

- Contract management personnel understand the legislative, regulatory and commercial context of the project;
- All the key project risks are identified and updated as necessary. The likelihood of each risk materialising, and its potential consequences and impact on project objectives, have been assessed;
- Possible controls and mitigants for each risk have been identified, assessed and implemented;
- Interdependencies between risks are understood;
- The private party's ability to manage the risks allocated to it has been assessed; and
- Potential changes in the project's risk profile over its lifecycle have been considered, planned for and responded to. Good contract management is not reactive, but aims to anticipate and respond to business needs of the future.

Planning, information collection and analysis commence during procurement and are iterative processes. Regular review of plans will help determine what new information should be collected and analysed and where it can be sourced. Regular analysis of the information gathered then helps to refine the overall contract management strategy.

Planning, information collection and analysis are key first steps towards effective contract management for PPP projects and must continue throughout the project.

### H.6.2 Contract administration

Contract administration is generally the most significant task (in terms of time and resources required) in managing a PPP project after contract execution. Contract administration requires an understanding of the legal documentation for the project and:

- the commercial intent of the parties;
- the operating, industry and community issues associated with service provision; and
- the legislative and regulatory context in which the project operates.

In a well-managed PPP project, the contract director, with assistance from the procurement team, prepares a comprehensive contract administration manual (or similar) that enables the Contract Director to understand the key contract provisions and the environment in which the contract must be administered. The contract administration manual answers the following key questions relating to the project:

- **What needs to be done, by whom and when?** The manual assigns accountabilities, identifies government's obligations, mitigation and control of risks and how it will monitor the private party's performance of its obligations.
- **How will government's role be performed?** The manual identifies the resources, delegations and authorisations required for government to perform its obligations.
- **What are the ramifications of any non-performance or default by the private party or government, and how should these be addressed?** The manual identifies contingency plans, and issue and dispute resolution mechanisms.

By answering these questions, the contract administration manual assists the contract director to anticipate and mitigate risk, maximising the project outcomes. Ongoing review and periodic updating of the manual ensures it remains of value throughout the project lifecycle.

Effective **contract administration** in a PPP project enables the government party to anticipate and mitigate risk throughout the project lifecycle, ensuring that the project objectives are delivered.

### H.6.3 Performance reporting and monitoring

PPP projects, by their nature, experience high levels of change. In a well-managed PPP project, the government party can sensibly control this dynamic situation because it has access to adequate information on which to base control actions. This information is received through effective monitoring of the state of health of the project as an integral part of the government party's overall contract management strategy.

In the absence of an effective performance monitoring and reporting strategy, the government party is unlikely to have an adequate understanding of the private party's business and will not receive early warnings of risks to the project outcomes. An effective performance monitoring and reporting strategy is built upon the following elements:

- The government party understands the business environment and the objectives of government in entering into the contract in the first place. Performance measures lie at the heart of performance management and it is important that performance measures are linked to strategic objectives or to desired outcomes.
- The government party understands the private party's internal operating environment, such as its cash flows. It is through this understanding that the government party can derive an awareness of the private party's strengths and weaknesses, including financial performance.
- The government party monitors soft indicators of the management quality of the private party, looking for weaknesses or trends that may provide an early indication of trouble.
- The government party regularly measures the quality of service against the KPIs and output specifications.

- Having assessed the data collected through these monitoring activities, the government party takes appropriate action to mitigate or control any risks that are materialising, and to maximise value for money from the project.

Effective **performance monitoring** in a PPP project provides access to relevant information on which to base control actions intended to mitigate any risks that are materialising.

#### H.6.4 Relationship management, dispute resolution and issue management

Given the long-term duration of PPP projects, it is imperative to maintain a strong relationship between the government party and the private party. Good relationship management enables the parties to anticipate risk events more effectively and deal with risks that do materialise.

Good relationship management in a PPP project creates a long-term relationship of mutual benefit between the parties. Common features of good PPP relationships include the following:

- The parties appreciate one another's objectives, strategy and point of view;
- The parties are prepared to work collaboratively when required in order to resolve issues and disputes that may arise during the lifecycle of the project;
- There is open and clear communication between the parties at a number of levels;
- A degree of commercial trust has been established between the parties; and
- The relationship is championed at senior levels in each organisation.

Good communication and a strong relationship are essential, especially if issues arise which go to the heart of the contract's operation. It is also important to recognise that disputes and service delivery issues most likely will arise and will need to be appropriately managed. If the parties have strong dispute and issue management principles and procedures in place, these will help minimise damage to the relationship and help the parties achieve success in the project.

Effective **relationship management** in a PPP project creates a long-term relationship of mutual benefit between the parties, enabling them to more effectively anticipate risk events before they occur and deal with any risks, issues and disputes that do materialise.

#### H.6.5 Governance, probity and compliance

Proper management of a PPP project by the government party involves not only managing the contract and relationship with the private party, but also ensuring appropriate governance, probity and compliance practices are established within the government party and in its interactions with the private sector party and any other government stakeholders.

In a well-managed PPP project, the risks associated with government's ultimate accountability for the delivery of infrastructure and services is effectively managed through a project governance, probity and compliance framework. This framework helps the government party manage the contract in the context of:

- Ministerial accountability to Parliament and the people (including accountability for government's contracting activities);
- the relevant Acts and related Regulations and Directions, designed to safeguard public money and to ensure that it is spent efficiently;
- scrutiny of the Auditor-General;
- government's obligation to act as a 'moral exemplar' in commercial dealings with the private sector;
- the availability of administrative law remedies including any Freedom of Information legislation;
- privacy obligations in relation to personal information in the hands of the government; and
- political or commercial constraints in exercising legal rights for non-performing or defaulting contractors.

Effective **public sector governance and compliance practices** in a PPP project ensure that appropriate governance, probity and compliance practices are established within the government party and in its interactions with the private sector party and any other government stakeholders. This helps the government party to comply with relevant laws, regulations, and government policy.

## H.6.6 Knowledge and information management

A government party's ability to manage a contract successfully can depend on the contract director having an effective knowledge and information management strategy tailored to the project's needs. In a well-managed PPP project, the contract director ensures the information collected in relation to a project is maintained, periodically reviewed and organised for easy retrieval and access. These practices assist the government party to comply with:

- record-keeping obligations;
- disclosure obligations, such as those under Freedom of Information legislation; and
- intellectual property laws and confidentiality obligations.

An effective **knowledge and information management strategy** in a PPP project ensures that information relating to the project can be easily retrieved and accessed, enabling the government party to comply with obligations relating to information retention, disclosure and protection.

## H.6.7 Change management

During the lifecycle of a PPP project, it is likely that a number of changes will occur, requiring proper management. Changes may be contemplated at the time of procurement and provided for in the contract, or not contemplated during procurement but seen as desirable or necessary alterations to services or the contract. In either case, change events are both a source of risk and a potential opportunity to extract additional benefits from the project.

Good change management processes incorporate the following features:

- appropriate protocols are in place to manage change;
- appropriate staff have the authority to request and authorise changes;
- potential changes are assessed thoroughly by suitably experienced personnel, having consulted with all relevant stakeholders;
- changes are appropriately prioritised and their implementation is properly resourced;
- the implementation of changes is controlled and tested;
- changes are appropriately documented; and
- changes do not compromise value-for-money outcomes.

In a well-managed PPP project, particular care is taken during change processes to ensure that there is no unintentional take-back of risk allocated to the private party. Take-back can occur where the contract allocates risk associated with an aspect of a project (for example, design of the project facilities) to the private party, but the government party approves that aspect as part of the change process (for example, it approves designs for alterations to project facilities). Such an approval can result in the private party subsequently arguing that government has accepted the risk that that aspect of the project will be inadequate to enable the project to deliver the desired outputs.

Effective **change management** in a PPP project ensures that change events are managed smoothly without creating unnecessary risk or the unintended acceptance of risk by government.

## H.6.8 Contingency planning

Contingency planning is vital to a PPP project because it may not be possible to fully transfer responsibility for the risk of service delivery failure to the private party. If the private party fails to deliver services according to the requirements of the contract, the government party, and possibly government as a whole, may retain accountability and potentially face adverse reaction from end users and third parties. In addition, the private party's obligation to provide services may be suspended through the operation of force majeure provisions. If so, the government party may be compelled or subjected to strong pressure to ensure that the public or other third parties are not inconvenienced by a disruption to the supply of those services.



In a well-managed PPP project:

- potential contingency events have been identified and their financial consequences have been assessed;
- information explaining the operation of the relevant contractual provisions is available for easy access and use by contract management personnel; and
- appropriate contingency plans have been developed. These may include disaster recovery and business continuity plans, step-in plans and default plans.

Effective **contingency planning** in a PPP project ensures government can react to unplanned events and control the impact of these events on service delivery and value-for-money outcomes.

### H.6.9 Ongoing review

Contract management processes must change and adapt throughout the lifecycle of a PPP contract, and therefore should be reviewed on an ongoing basis to ensure that management is sufficiently informed of current and emerging risks and issues. In addition to regular reviews, the impact of the following events should be considered as and when they occur:

- divergence between each party's expectations and actual project outcomes;
- changes in the project itself through change events, contingency events, or as a result of the project moving from one stage to another in its lifecycle; and
- changes in the external environment in which the project operates.

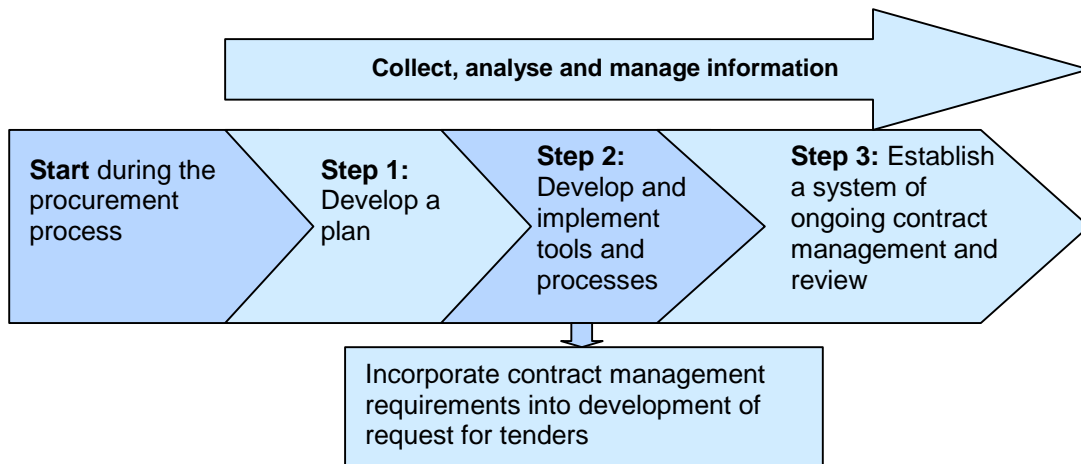
Ongoing review of contract management practices and outcomes not only benefits individual projects, but can also provide knowledge to be shared across a range of PPP projects.

**Ongoing review** of contract management processes ensures that those processes change and adapt throughout the lifecycle of a PPP project and knowledge gained through those processes is retained and spread.

### H.6.10 The three steps to developing a contract management strategy

Developing and implementing a contract management strategy should start at an early stage during the procurement process so that contract management requirements are included in the draft contract developed by the government party. In particular, an effective performance monitoring regime requires reporting obligations to be included in the contract. The strategy should be developed and implemented through three steps.

**Figure H-3: Three steps for developing and implementing the contract management strategy**



Each of these steps relies on the essential processes of information collection, analysis and management.

Having identified the appropriate tools and processes, resources and time constraints, the contract director should collect and analyse information in a structured form so that the contract management tools and processes can be developed. The central task in this process is to identify and analyse the key risks to the project's success.

### H.6.11 Step 1: Develop a plan

The development of an effective contract management strategy must be carefully planned. The contract director can begin the planning process by asking the following questions.

- **What contract management tools and processes may be required for the project?** Identify those tools and processes relevant to a particular project.
- **What human, financial and technology resources are available?** The available resources may dictate the form taken by contract management tools and processes.
- **What time constraints should be set for the development of the contract management tools and processes?** The time constraints should be matched to both the available resources and the expected project delivery dates and milestones.

### H.6.12 Step 2: Develop and implement contract management tools and processes

After obtaining appropriate resources, and collecting and analysing relevant information, contract directors should proceed to develop and implement the necessary contract management tools and processes and inform the development of the request for project tender documentation.

The processes and tools developed and implemented for contract management purposes should be collated in a contract administration manual (or similar). The manual and the performance reports produced over the life of the contract are key documents.

### **H.6.13 Step 3: Establish a system of ongoing contract management and review**

In establishing a system of ongoing contract management and review, the contract director relies on the review tools and processes.

Step Three also requires the contract director to establish a culture of ongoing contract management which includes the systematic review of the contract management strategy and tools and processes during the lifecycle of the project. Senior management should support the culture of effective contract management in the relevant government entity, including via any available contract management training.

## **H.7 Further guidance**

Further guidance material may be available within each jurisdiction on contract management process and practices.