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VICTORIA SETS THE STANDARD FOR PPPS

Owen Hayford*

The Victorian government has been the front-runner of Public Private Partnership infrastructure procurement in Australia in recent years. The 2005 release by the Department of Treasury and Finance (DTF) of its Standard Commercial Principles - the latest addition to the Partnerships Victoria suite of Guidance Materials - is further evidence of the leading role the Partnerships Victoria program will play in improving public procurement internationally as well as in Australia.

RATIONALE AND APPLICATION

According to Victorian Treasurer John Brumby, Standard Commercial Principles aim to reduce the costs of bidding for PPP projects, by providing a standard approach to the allocation of risk between the parties. Developed in consultation with industry and other Australian governments, particularly NSW, the Standard Commercial Principles represent the Victorian Government's considered and preferred position on risk allocation. As such, DTF has stated that any deviation from the standards will require strong justification by the private sector party and a clear demonstration of value for money.

The principles are intended to be broadly applicable to all Partnerships Victoria delivered infrastructure, including economic infrastructure. More specifically, however, they are designed for core services/accommodation style Partnerships Victoria projects, where the government has already chosen the site and payment is based on availability. The principles assume that the facility will revert to government at no cost at the end of the concession period and that the private sector party is a special purpose vehicle, whose obligations will be performed by sub-contractors.

THE PRINCIPLES IN CONTEXT

Non-standard contracts are a major contributor to the lengthy tender processes and high bid costs which have traditionally characterised PPP procurement in Australia. In contrast, as evidenced by the more streamlined process employed in several recent Sydney toll road projects, a more standardised approach to PPP documentation can lead to shorter bidding periods and lower transaction costs. A more standardised approach to PPP documentation will also lead to increased contractual certainty, and lower contract administration costs for both government and the private sector.

Of course, absolute uniformity is undesirable. There will always be the need to maintain a certain degree of flexibility in order to account for the unique characteristics of individual projects. Opportunities for project-specific deviations from the standard risk allocation which allow government to obtain better value for money should also be explored. Further, strict rigidity would inhibit the improvement and evolution of documentation over time. However, there are opportunities for greater consistency of boilerplate and generic clauses and ancillary documents, which have remained largely unexploited until now, due to insufficient national acceptance of and involvement in the development of standards.

Although designed specifically for use in Partnerships Victoria projects, the Standard Commercial Principles arose in the context of the National PPP Council forum - a Victorian initiative "designed to deliver better coordination, information sharing and support among Australian governments." As such, they are likely to enjoy greater national participation and acceptance than other inter-government standards. Further, Treasurer Brumby aims to encourage the adoption of the principles by other Australian

governments through the forum. The NSW government has already expressed the intention to trial them along with Victoria for upcoming PPP projects.

SOME KEY POINTS

As well as feedback from industry and other Australian governments, the principles reflect the results of a review of previous Partnerships Victoria contracts. Accordingly, many of the principles represent relatively uncontroversial positions already adopted successfully in PPP projects. Nonetheless, several aspects of the principles are worthy of comment.

- Liquidated damages - Where Commercial acceptance is not achieved by the date specified, erosion of the operating period as an incentive for time delivery will be preferred to payment of liquidated damages. Where the project agreement does not provide for such erosion, liquidated damages may be payable, but only where they represent value for money.

Although liquidated damages will not usually be payable for late delivery, a failure to make the services available by a "drop dead" date will enable government to terminate. Accordingly, the project agreement will still need to incorporate an extension of time (EOT) mechanism to adjust the "drop dead" date for specified EOT events, such as government-initiated modifications.

- Security bonds - As a general rule, government will not require the private party to provide government with a security bond for the construction phase. Rather, it will require the private party to obtain a security bond from the construction subcontractor. This will avoid the common practice whereby the construction subcontractor is required to provide two sets of bonds - one for the private party (over which the private party's financiers will take security) and another for government. Whilst government will have a right to claim under the bond provided to the private party to rectify a default by the construction subcontractor, government's ability to claim will be subject to the financier's right to access the bond.
- Change in law - The principles provide for compensation to be paid to the private sector party for changes in law exclusively affecting the project or category of project. Where this is not the case, the government may still be obliged to fund additional capital expenditure where the change in law necessitates significant expenditure or has significant operating cost effects which are not captured through benchmarking or indexation. The latter scenario will apply only in the case of a core services model project.



- Industrial action - Time relief and compensation will be provided for industrial action to the extent that it directly affects the project and the relevant project related industries and where the action results directly from the actions or inactions of the government contracting party or any of its employees at the facility. However, no relief or compensation will be provided for industrial action motivated by opposition to PPPs.
- Force majeure - Relief is to be limited to specific events (i.e. there is no catch-all encompassing any other event beyond the reasonable control of the private party), and should be extended to any other event unless the nature of the project renders it unnecessary. Relief will take the form of suspension of obligations for up to a pre-agreed period of time (usually between 6 and 12 months) after which either party will be entitled to terminate.

The private sector party is entitled to compensation for force majeure termination, although this will be limited to the lower of actual and forecast senior debt (including break costs), less any insurance proceeds, sums due from the financiers, set-off amounts and credit balances on the private party's bank accounts. However, where this amount is lower than the fair market value of the project (adjusted for selling costs, set-offs, etc), government will pay the adjusted fair market value instead.

- Insurance - The principles reflect a broad approach to insurance, requiring the private sector party to obtain and maintain such insurances as a prudent owner or services provider would obtain and maintain for the type of facility in question. These must include, and be on no less favourable terms



than, the minimum insurance requirements set out in the project agreement. The private party will generally be liable for unexpected increases in insurance costs during the term. However, retrospective reviews will be conducted on a pre-agreed, periodic basis, pursuant to which any cost increases for certain categories of operational insurance will be shared by government (within agreed thresholds).

- Uninsurable risk - The private party will be relieved of its obligation to procure insurance for a risk which becomes uninsurable during the concession period, and the service fee will be adjusted to reflect the fact that the anticipated premium is not being paid. If the risk materialises, government must either pay an amount equal to the insurance proceeds which would have been payable if the relevant insurance was available or, if the facility is substantially damaged, terminate the agreement and pay compensation on a force majeure termination basis.
- Voluntary right to terminate - Government will have the right to terminate without cause subject to paying compensation equal to the aggregate of: the lower of actual and forecast senior debt (including break costs), the greater of the fair market value of the equity and the equity return forecast in the original base case financial model, and redundancy payments; less any insurance proceeds, sums due from the financiers, set-off amounts and credit balances on the private party's bank accounts.

Conversely, the private party has no express right to terminate the project agreement.

- Refinancing gains - Government is to share in gains resulting from refinancing (other than refinancing contemplated at financial close) on a 50:50 basis, provided the projected equity return at the time of refinancing exceeds that forecast in the original base case financial model.

THE NEXT STEP

From a theoretical perspective, the Standard Commercial Principles are a significant and important step in the contract standardisation process, and thus, in the move to reduce bid costs and streamline the tender process for PPP-delivered infrastructure. Further, their implementation has reinforced Victoria's leading role in the development of PPP policy Australia-wide.

It should be noted, however, that the principles represent only the first stage in the Victorian contract standardisation initiative. Following their application to the \$367 million Melbourne Convention Centre project, a set of draft standard contractual clauses is to be issued for consultation with industry and other Australian governments. Accordingly, it is their practical implementation that will determine the true worth of the principles to the Australian PPP market, and provide the springboard for the next stage in the standardisation process, which is expected to commence in 2006.

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Joint Communiqué: First Ministerial Partnerships Forum. Available at www.treasury.nsw.gov.au/www/pdf/communique.pdf