Contract management guide

January 2018

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ISBN 978-1-922222-91-6

Published January 2018

If you would like to receive this publication in an accessible format please email: [information@dtf.vic.gov.au](mailto:information@dtf.vic.gov.au)

This document is also available in PDF format at: [www.dtf.vic.gov.au](http://www.dtf.vic.gov.au)

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| --- | --- | --- | --- |
| Version control | Last updated | Updated sections | Rationale |
| 1 | June 2003 |  | Original publication |
| 2 | January 2018 | Material update and revisions throughout document  Addition of:   * Part 3: Contract performance * Part 4: Specific contract management events | Updates made to reflect *Partnerships Victoria* policy development and best practice contract management to improve project outcomes. |

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# 

Glossary

The glossary contains explanations of terms used in this guide.[[1]](#footnote-1)

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| **Abatement** | Commonly seen in payment mechanisms, where abatement refers to a reduction in a service payment due to underperformance relative to a specified key performance indicator (KPI). |
| **Asset management plan (AMP)** | A plan developed for the management of one or more infrastructure assets that combines multi-disciplinary management techniques, over the life cycle of the asset in the most cost effective manner to provide a specific level of service. |
| **Business case** | A document that sets out the rationale for a proposed project. It details what services the project will deliver, and provides analysis of the expected costs and benefits. A business case enables government to decide whether to support the project, before significant resources are spent on its development. |
| **Cabinet** | Cabinet includes a Cabinet committee, or other body or person exercising authority delegated by Cabinet. |
| **Commercial acceptance** | A stage in the carrying out of works under a project deed when all of the commercial acceptance criteria have been met to the satisfaction of the independent reviewer (or sometimes the government party on social infrastructure projects). Commercial acceptance generally occurs when the works are deemed substantially complete (save for minor defects or omissions) and reasonably capable of being used for their intended purpose and after which the private party can begin performing the contracted services and the service payment begins to be paid. On linear infrastructure projects, this is usually the first stage of completion, and on social infrastructure projects this is usually the second stage of completion (after technical acceptance) – however this may differ between projects. |
| **Commissioning** | Commissioning refers to the proving processes involving the start‑up of operations and delivery of the contracted services as specified in the project deed. |
| **Construction phase (also called, among other things, development phase)** | Project stage including design and construction (or implementation) from financial close through the commissioning process to commercial acceptance. |
| **Contract administration manual (CAM)** | A document or set of documents developed by the government party, based on the contract management plan, to identify, understand and manage project risks over the life of the project. It provides detailed information for the contract management team on how to administer the contract over the life of the project. It needs to be regularly reviewed and updated. |
| **Contract director** | The contract director has overall responsibility for managing the project, usually after commercial acceptance once steady-state operations has been achieved, and acts as the government party’s agent in managing contractual arrangements between the government party and the private party during the service delivery phase. |
| **Contract management** | Contract management incorporates all the activities required to identify, monitor and mitigate all risks over the life of the project deed to assist the government to achieve its project objectives and maximise value for money. |
| **Contract management plan** | An initial high-level document that seeks to identify, understand and manage project risks and service improvement opportunities during the term of the project. The *Partnerships Victoria* *Requirements* (2016) mandates it to be developed by the government party (or the procuring agency if applicable) and signed off by both the responsible Minister and Treasurer within 60 days of financial close. |
| **Contract management team** | A contract management team, reporting to the contract director, will carry out many day‑to‑day contract management activities. |
| **Contracted services** | The services the private party is required to perform during the service delivery phase under a project deed. Contracted services may include building maintenance, cleaning, catering, pest control, logistics and portering. On a road project, it may often include operation of the relevant road. Unless a *Partnerships Victoria* project is fully outsourced to the private party (for example, both operations and maintenance of the relevant project assets), the contracted services are to be distinguished from the services, operations or functions provided by the government (or a separate entity) in relation to the project assets. |
| **Cure period** | A specified period of time for a party to rectify/cure a default (that can be rectified or cured) before the government party has the right to enforce any remedies for default specified in the project deed. |
| **Default** | The failure of a party to perform a contractual requirement or obligation, including failures to meet deadlines, to perform to a specified standard, to meet a loan repayment or to meet its obligations in relation to a materialised risk. |
| **DTF** | Department of Treasury and Finance, Victoria. |
| **Estoppel** | The legal principles known as estoppel arise in contracts where a party has:   * + - 1. made a representation (oral or by conduct) which is not included in the actual agreement; or       2. where after the agreement is signed, a party agrees not to exercise a discretion in a certain way. In such circumstances, the relevant party may be bound by that representation or action.   For example, in the context of a *Partnerships Victoria* project, if the government party leads the private party to expect that the government party will not require the private party to achieve a particular contractual KPI, and the private party acts in reliance on this expectation, the government party may be unable to later abate payments for failure to meet the KPI. |
| **Financial close** | The time where all documentation for a project has been executed by the relevant parties, and all conditions precedent have been satisfied or waived. At financial close, the borrower (generally the private party or a specifically purposed special purpose vehicle) may obtain the finance for the project as negotiated with its financier. |
| **FOI Act** | The *Freedom of Information Act 1982*. |
| ***Force majeure*** | Acts of God and other specified risks (for example, terrorism) that are beyond the control of the parties to a contract, and as a result of which a party is prevented from performing all or a material part of its obligations under a contract. |
| **Government party** | The department, agency or any other public sector entity sponsoring a *Partnerships Victoria* project. |
| **Key performance indicator (KPI)** | A specified performance standard or benchmark that the government party is seeking for the private party to achieve or maintain during the service delivery phase. The private party’s service payment is usually calculated by reference to the KPIs. |
| **Material adverse effect regime** | The designation of particular categories of risks (usually only on economic infrastructure PPP projects) which, if they materialise, will have a material adverse effect on the project and are to undergo a special process of assessment and allocation between the parties. |
| ***National PPP guidelines: commercial principles*** | The *National PPP policy and guidelines – Volume 3: Commercial principles for social infrastructure* and *Volume 7: Commercial principles for economic infrastructure*. |
| ***National PPP guidelines: practitioners’ guide*** | The *National PPP policy and guidelines – Volume 2: Practitioners’ guide*. |
| **Output specification** | The output specification sets out the range of outcomes the government is seeking to achieve, including the contracted services that government is seeking to procure. In project deeds entered into after 2017, the output specification will be included in the project scope and delivery requirements (PSDR). |
| **Payment mechanism** | The payment mechanism puts into financial effect the allocation of risk and responsibility between the government party and the private party. The payment mechanism sets out how the service payment is calculated, including various components (e.g. availability component, services component, lifecycle component etc.) as well as abatement arrangements for poor performance against KPIs. |
| ***Partnerships Victoria* framework** | The Victorian government PPP policy framework that consists of the *Partnerships Victoria* *Requirements* *2016* and annexures (which include the *Partnerships Victoria* *contract management guide*) and the [*National PPP policy and guidelines*](https://infrastructure.gov.au/infrastructure/ngpd) <https://infrastructure.gov.au/infrastructure/ngpd>. |
| ***Partnerships Victoria* project** | A public private partnership procured under the *Partnerships Victoria* framework. |
| ***Partnerships Victoria* standard project deed guidance notes** | *Partnerships Victoria* guidance materials provided for standard form project deeds introduced in 2017 to deliver either social infrastructure availability PPP projects or linear infrastructure availability PPP projects, available on the [DTF website](http://www.dtf.vic.gov.au/Infrastructure-Delivery/Public-private-partnerships/Policy-guidelines-and-templates) <http://www.dtf.vic.gov.au/Infrastructure-Delivery/Public-private-partnerships/Policy-guidelines-and-templates>. |
| ***Partnerships Victoria* *Requirements*** | The Victorian government requirements for *Partnerships Victoria* projects, contained in the [*Partnerships Victoria* *Requirements 2016* document](http://www.dtf.vic.gov.au/Publications/Infrastructure-Delivery-publications/Partnerships-Victoria/Partnerships-Victoria-Requirements) <http://www.dtf.vic.gov.au/Publications/Infrastructure-Delivery-publications/Partnerships-Victoria/Partnerships-Victoria-Requirements>. |
| **PPP** | Public private partnership. |
| **Private party** | The private sector entity with which the government party directly contracts. Traditionally, the private party has been a special purpose vehicle created specifically for the purposes of the project. The private party is not limited to this form, and it can be set up under a number of structures, including a joint venture or a trust. Behind the contracting party, however, there may be a number of private sector interests, seeking to be represented through the contracting party. (See also special purpose vehicle.) |
| **Procurement team** | Under the guidance of a steering committee, the procurement team is responsible for the day-to-day management of the project until commercial acceptance. |
| **Procurement phase** | The phase in which a *Partnerships Victoria* project is procured, usually through a number of stages, including: an invitation for expression of interest, a request for proposal, contract negotiation, contract execution and financial close. |
| **Procuring agency** | In some *Partnerships Victoria* projects, a separate entity may act on behalf of the government party, during the procurement phase to procure the project and possibly for part or all of the construction phase. |
| **Project assets** | Generally, the assets that the project company must design, manufacture, supply, construct, install, commission, complete and, in respect of which the contracted services are provided.  Each project deed may refer to the project assets in a different way, for example, the facility or the relevant infrastructure. |
| **Project deed or project agreement** | The main project contract setting out the terms on which the private party carries out the project for the government party. |
| **Project director** | The project director has overall responsibility for delivery of the project through the procurement phase, and management of all members of the procurement team, including external advisers and consultants.  The project director usually stays on the project during the construction phase.  The project director role usually transitions to the contract director role once commercial acceptance has been achieved and the project is in steady-state operations. However, the transition between project director and contract director (where different people) occurs during construction phase to ensure a smooth transition. |
| **Project risks** | Those risks which may cause actual project circumstances to differ from those assumed when forecasting project benefit and costs. |
| **Project scope and delivery requirements (PSDR)** | In project deeds entered into after 2017, the PSDR contains all project requirements for the construction phase and service delivery phase, including the output specification and the services specification. |
| **Public sector comparator (PSC)** | The public sector comparator (PSC) represents the most efficient public procurement cost (including all capital and operating costs and share of overheads) after adjustments for competitive neutrality, retained risk and transferable risk (for definitions of these terms please refer to the [public sector comparator technical note](https://infrastructure.gov.au/infrastructure/ngpd/files/Volume-4-PSC-Guidance-Dec-2008-FA.pdf) <https://infrastructure.gov.au/infrastructure/ngpd/files/Volume-4-PSC-Guidance-Dec-2008-FA.pdf> to achieve the required service delivery outcomes. This is used as the benchmark for assessing the potential value for money of private party bids in *Partnerships Victoria* projects. |
| **Refinancing** | A change in the type, amount, pricing, tenor, terms for payment or repayment or hedging of financial accommodation. |
| **Reviewable services** | Those elements of the contracted services which will be subject to a periodic benchmarking or market testing process. |
| **Risk** | Potential events, consequences, or a combination of these, and how they can affect the successful delivery of the benefits expected of the investment. Risk is often expressed in terms of a combination of the consequences of an event or a change in circumstances, and the associated likelihood of occurrence. |
| **Risk allocation** | The allocation of responsibility for dealing with the consequences of a project risk to one of the parties to a contract, or agreeing to deal with the risk through a specified mechanism which may involve sharing the risk. |
| **Risk assessment** | The determination of the likelihood of identified risks materialising and the magnitude of their consequences if they do materialise. |
| **Risk identification** | The process of identifying all the relevant risks. |
| **Risk management** | The identification, assessment, allocation, mitigation and monitoring of risks. The aim is to reduce their variability and impact. |
| **Risk matrix** | A method of presenting all possible significant risks likely to be encountered, the magnitude and likelihood of the risks occurring, their areas of impact, and the risk mitigation techniques to be employed. |
| **Senior responsible owner** | The person in the government party responsible for the project, usually the Chief Executive Officer or a Deputy Secretary. The project director and then the contract director usually report to the senior responsible owner. |
| **Service delivery phase (also called, among other things, the operational phase, operating phase or services phase)** | Project phase in which the contracted services are delivered by the private party, usually commencing on commercial acceptance and ending on expiry or termination of the project deed. |
| **Service payment** | The periodic payment made by the government party to the private party for performance of the contracted services and calculated in accordance with the payment mechanism. The service payment is usually only payable after commercial acceptance. Service payments are made periodically (usually quarterly or monthly) and the frequency of the service payment will be set out in the project deed. |
| **Services specification** | The contractualised outcome of the output specification. It sets out the contracted services and the performance levels required for each of those contracted services, usually within the project deed schedules.  In project deeds entered into after 2017, the services specification will typically be included in the PSDR. |
| **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 the government party. The SPV is an entity created to act as the legal manifestation of a project consortium and only acts for the purposes of the project it was created for. The SPV itself has no historical financial or operating record which government can assess. |
| **State-initiated modification** | A change to the project assets and/or contracted services that are initiated by the government party. |
| **State representative** | The person formally nominated in the project deed to act on behalf of the State, to administer the project deed on behalf of the State, by exercising all rights, powers, authority and functions of the State. |
| **Step-in** | The government party’s election to assume all or some of the service delivery obligations of the private party under the project deed for a period of time. The circumstances where the government party may have the right under the project deed to exercise rights to step in may include a need to prevent or mitigate a serious risk (to the environment; public health; the safety of persons or property), guarantee continuity of an essential service, discharge a statutory duty or deal with a default by the private party under the project deed. |
| **Technical completion (also called, among other things, technical acceptance, practical completion and provisional acceptance)** | That stage in the carrying out of work under a project deed when all of the technical completion criteria have been met to the satisfaction of the State. The first stage of completion for projects (usually social infrastructure projects) where the government party requires a significant period of time to work with the private company to commission the asset after technical completion. |
| **Value for Money** | A balanced whole of life benefit measure that considers quality levels, performance standards, risk exposure, other policy or special interest measures, as well as price. |

Part 1: Introducing *Partnerships Victoria* contract management

The diversity and long-term nature of *Partnerships Victoria* projects requires a range of contract management strategies to assist government achieve project objectives and value for money outcomes.

The *Partnerships Vic*toria Contract management guide (the guide) includes:

* Contract management guide
* [Contract management guide – Templates](http://www.dtf.vic.gov.au/sites/default/files/2018-02/contract-management-guide-templates_0.docx)
* [Contract management guide – Appendices](http://www.dtf.vic.gov.au/sites/default/files/2018-02/contract-management-guide-appendices_0.docx)

This guide is intended to help contract managers develop and implement suitable contract management strategies. It sets out principles for managing a *Partnerships Victoria* project. It is not a substitute for the terms of the project contracts. Neither this guide, nor any action taken or not taken in reliance on it, are to be taken as a variation of contract, waiver or estoppel by the government party, unless the government party, by a person duly authorised to do so, expressly confirms in writing that it is varying the contract or waiving a specific right under the contract.

The guide is an update of the version published in June 2003.

Part 1 outlines the nature and function of contract management, critical elements for success and key contract management issues.

Chapter 1 Overview of managing contracts and performance

Chapter 2 The relationship between risk, service delivery and contract management

http://nginx-php-dtf-production.lagoon.vicsdp.amazee.io/sites/default/files/2018-02/contract-management-guide-appendices.docx

* + 1. Overview of managing contracts and performance

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| Part 1: Introducing *Partnerships Victoria* contract management |  |
| **Overview of managing contracts and performance** | **Chapter 1** |
| The relationship between risk, service delivery and contract management | Chapter 2 |

The *Partnerships Victoria* framework requires compliance with:

* + - the [*Partnerships Victoria* *Requirements* and supporting guidance](http://www.dtf.vic.gov.au/Publications/Infrastructure-Delivery-publications/Partnerships-Victoria/Partnerships-Victoria-Requirements) <http://www.dtf.vic.gov.au/Publications/Infrastructure-Delivery-publications/Partnerships-Victoria/Partnerships-Victoria-Requirements>, which includes the *Partnerships Victoria* *contract management guide*; and
* the [*National public–private partnerships policy and guidelines*](https://infrastructure.gov.au/infrastructure/ngpd) <https://infrastructure.gov.au/infrastructure/ngpd>, published by the Commonwealth.
  + - 1. The purpose of the guide

Contract management is a key activity for the government party to a *Partnerships Victoria* contract after the project contracts are executed. This contract management guide largely focuses on the contract management activities required for the service delivery phase.

Implementing effective contract management practices will assist the government to achieve project objectives and value for money outcomes on behalf of the community.

The guide is for government departments, agencies and entities proposing, procuring and/or managing *Partnerships Victoria* projects. It provides:

* guidance for the government contract management team in managing *Partnerships Victoria* projects over the project lifecycle to help achieve project objectives and value for money outcomes;
* guidance for the procurement team developing a *Partnerships Victoria* project to ensure the executed project contracts can be effectively managed; and
* best practice principles relevant to managing a *Partnerships Victoria* project.

The underlying principles in this guide should be considered best practice at the time of publication. They may also be useful in the managing long‑term service contracts that are not public private partnerships.

* + - 1. The *Partnerships Victoria* contract management framework

The *Partnerships Victoria* contract management framework is set out in the *Partnerships Victoria* *Requirements* 2016, which details both the government party and DTF accountabilities, as set out below.

The government party is responsible for establishing a robust contract management framework, maintaining effective contract management practices during the project term and achieving project objectives. The government party will implement:

* appropriate governance structures and effective communication and reporting lines;
* appropriate training for contract management team members within 12 months of their appointment, unless they have existing contract management experience or credentials;
* systems to ensure the continuity and retention of project knowledge and information;
* risk and dispute mitigation and reporting; and
* ongoing review of contract management practices to manage issues.

*Partnerships Victoria* in DTF is accountable for:

* supporting and reviewing contract management and assist in risk mitigation and dispute resolution;
* managing all re-financing consent requests;
* facilitating the sharing of contract management knowledge, including conducting forums for contract managers to share lessons learned;
* implementing appropriate training for public sector contract managers; and
* monitoring and advising the Treasurer and Government on significant contract management issues.
  + - 1. Contract management through the project lifecycle

A typical *Partnerships Victoria* project has the following phases:

* **project preparation phase** – the phase in which the business case is developed to enable project and funding approval. Following these approvals, it also includes the preparation of the project to start the formal procurement phase;
* **procurement phase** – the phase in which a project is procured, usually through a number of stages, including: an invitation for expression of interest, a request for proposal, contract negotiation, contract execution and financial close;
* **construction phase** – the phase in which the design and construction (or implementation) occurs, commencing after financial close and concluding through the commissioning process, once commercial acceptance has been achieved;
* **service delivery phase** – the phase after commercial acceptance, when the private party utilises project assets to deliver contracted services required under the services specification during the remaining life of the project deed which concludes upon project deed expiry or termination; and
* **contract expiry or termination phase** – the conclusion of the contract, including any handover or transition period leading up to and after project deed expiry or early termination.

The guide contains material relevant to each lifecycle phase and significant contract management activity that may occur within the stages. The key activities in each lifecycle phase are summarised in Table 1.1.

*Partnerships Victoria* projects are long term, and the operating environment will change over the project lifecycle. In addition, the project itself will pass through a number of phases and significant events. Each lifecycle phase and significant event involves risks and opportunities for the government party to implement control and mitigation strategies. The government party’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.

Table 1.1: Contract management issues and the project lifecycle

| Project preparation phase | Procurement phase | Construction phase | Service delivery  phase | Project deed expiry or termination phase |
| --- | --- | --- | --- | --- |
| **Resourcing** | **Resourcing** | **Manage performance** | **Manage performance** | **Manage performance** |
| * Identify and obtain approval for contract management resourcing | * Plan for contract director arrangements throughout project lifecycle * Confirm budget for contract management resources | * Monitor construction progress and management quality * Consider detailed designs * Manage commissioning and prepare for operations/service delivery | * Manage performance by government including service delivery payments * Monitor private party’s performance against KPIs * Manage any legacy issues * Seek user feedback (e.g. via survey) | * Manage performance by government including the end of service strategy * Monitor private party’s compliance with obligations on expiry/termination and provision of adequate handover information |
| **Planning and development** | **Planning and development** | **Manage relationships** | **Manage relationships** | **Planning and development/ Manage relationships** |
| * Develop service needs and broad KPIs * Incorporate lessons learnt from any current or previous contracts for similar services | * Develop contract management plan * Collect and analyse relevant information | * Continue and strengthen communications with private party * Establish contract management committees * Interact with 3rd party stakeholders | * Maintain and strengthen communications with private party * Ensure the right participants from government and private party are involved in contract management committees * Interact with 3rd party stakeholders | * Confirm service delivery arrangements post contract expiry * Maintain strategic relationship with private party |
|  | **Develop tools** | **Manage change** | **Manage change** | **Manage change** |
|  | * Develop performance monitoring * Develop contract administration manual template * Develop other tools and processes | * Manage transition from procurement through construction to contract management (including transition from project director to contract director) * Manage any disputes or subcontractor claims * Manage commissioning issues | * Manage evolution of services specifications * Manage automatic contractual changes, such as indexation of payments * Assess changes in service requirements and technology that impact project service delivery * Manage any disputes or subcontractor claims | * Implement end of service strategy and prepare for transition of services * Manage asset transfer (including transfer of necessary information and records) if assets are transferred to government * Manage any disputes or subcontractor claims |
|  | **Integrate contract management in the project deed** | **Manage contingency events** | **Manage contingency events** | **Manage contingency events** |
|  | * Integrate reporting and KPIs * Integrate dispute and issue management mechanisms | * Maintain contingency plans and review prior to commencement of service delivery * Respond to breaches, defaults and disasters | * Maintain and review contingency framework * Scan environment for potential impacts * Respond to any breaches, defaults and disasters | * Maintain and review contingency framework * Scan environment for potential impacts * Respond to breaches, defaults and disasters |
|  | **Governance** | **Governance** | **Governance** | **Governance** |
|  | * Project director ensures that:   + the contract director has access to resources and information required to prepare the contract management plan   + the contract management plan is prepared   + governance, reporting arrangements are in place for commencement | * Project director usually continues in role during the construction phase. * Contract director engaged at appropriate time during the construction phase to ensure smooth transition to the service delivery phase. * Project and/or contract director ensures that   + contract management plan is approved and implement the contract management plan   + reports to senior management and DTF * represents the government party on project control group and Senior Representatives Group (if applicable) | * Contract director assumes responsibility at the commencement of, or early in, the service delivery phase * Contract director, applies and regularly reviews contract management tools and processes * Contract director reports to senior management and DTF * Contract director represents the government party on project control group and Senior Representatives Group (if applicable) * Government entity plans succession | * Contract director or similar asset and service manager role continues * If required, accountable government entity provides or procures replacement services or assists in transfer of facilities and knowledge to government * Contract director reports to senior management and DTF * Contract director represents the government party on project control group and senior representatives group (if applicable) |
|  | **Administration** | **Administration** | **Administration** | **Administration** |
|  | * Is the contract director credentialed? * Do reality checks. Can the KPIs be measured etc.? | * Populate contract administration manual * Manage knowledge and project records * Review contract management practices | * Update contract administration manual * Manage knowledge and project records * Review contract management practices | * Manage knowledge and project records * Review contract management practices |

* + - 1. Where do I start?

Developing and implementing a contract management strategy for a *Partnerships Victoria* project can be a complex task requiring significant resources. However, completing this task early has significant benefits, as effective contract management assists the government party to achieve the value for money and project outcomes agreed upfront in the project deed.

The diverse nature of *Partnerships Victoria* projects requires a range of contract management strategies to manage a wide variety of risks that differ in likelihood and severity from one project to another. For instance, the scope of services and number of KPIs is different across projects. Consequently, this guide is a starting point to assist contract managers ask the right questions as they develop and implement effective contract management strategies in *Partnerships Victoria* projects.

Existing *Partnerships Victoria* contract managers are very useful sources of information to assist develop both procurement documentation and contract management strategies.

The contract management strategy should be developed and implemented through steps, as outlined in Figure 1.1.

Figure 1.1: Steps for developing and implementing the contract management strategy



Procurement phase activity – contract management plan

Developing and implementing a contract management strategy should start at an early stage during the procurement phase so that contract management requirements are included in the request for proposal and draft contract developed by the government party (or procuring agency if applicable).

Once the project deed has been executed, the contract management strategy should capture all of the obligations relevant to the construction phase and service delivery phase based on plans developed by the successful private party during the procurement phase.

The contract management plan is the key output at the end of the procurement phase based on the executed project contracts. The plan should be developed during procurement and approved by the Treasurer and the relevant Minister within 60 days of financial close. The central task in this process is to list and understand each party’s obligations and identify and analyse the key risks to the project’s success. 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?**

Appendix G lists the tools and processes discussed in this guide, and may assist the contract director to identify the tools and processes relevant to their project.

* + - **What human, financial and technology resources are available?** The available resources may dictate the form of contract management tools and processes. In instances where the government party has existing *Partnerships Victoria* projects on foot, it will be a case of identifying additional resource needs and obtaining related budgetary and staffing approval.
    - **What time constraints should be set for developing 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. The contract management plan should also outline arrangements for a transfer of responsibilities to the contract director and the contract management team.

Construction phase activity – contract administration manual

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.

These processes and tools should be collated in a contract administration manual. It may be appropriate to document some of the tools and processes separately from the contract administration manual. For example, certain contract management processes may be contained in documents that apply across the government party, rather than applying specifically to the individual project deed. If this is the case, an up-to-date copy of the separately document should be available to the contract management team.

The contract administration manual and the performance reports produced by both the private party and the government party over the life of the project are key documents for the project.

Service delivery phase activity

It is important for the contract director to establish a system of ongoing contract management and review. The contract director, supported by senior management should 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.

As part of establishing an effective contract management culture, contract directors and their teams should undertake training that provides skills and competencies in managing *Partnerships Victoria* projects and engage in ongoing knowledge exchange with peers by participating in whole-of-government contract management networks.

* + - 1. Success factors for effective contract management

Developing the contract management strategy early

Effective contract management requires developing a contract management strategy early in the project lifecycle. The strategy should be in place before contract execution. It should also be reviewed and updated over the life of the project.

Dedicated resourcing, governance and probity

The government party must dedicate adequate resources to contract management activities. This will ensure that the value for money outcome and contracted performance standards are not compromised and risk is managed over the life of the project. Adequate budget and experienced personnel are required for good contract management as well as ensuring that appropriate governance, probity and compliance practices are established.

Active relationship management, dispute resolution and issue management

Given the long-term nature of *Partnerships Victoria* projects, it is important to maintain a strong relationship between contracting parties. Effective relationship management enables the parties to anticipate and deal with risks and benefit from opportunities that arise.

Upfront planning, information collection and analysis

Planning, information collection and analysis are key ongoing steps in effective contract management. Determining the information required from the private party will assist structure and implement the contract management strategy. The information collected and analysed helps the government party to identify, understand and manage project risks and service improvement opportunities.

Formal contract administration plan and manual

Contract administration is a significant task in managing a *Partnerships Victoria* project. An approved contract management plan is required post contract execution. The plan is then developed into more detailed contract management strategies or a manual. The contract administration manual will evolve over time as the project moves through different phases. This will cover the key aspects of managing performance and reporting.

Active knowledge and information management for performance monitoring

The contract director will implement a knowledge and information management strategy tailored to the project ensuring the information collected is relevant to performance management, maintained, periodically reviewed and organised for easy retrieval. This enables the government party to comply with obligations relating to information retention, disclosure and protection. It also enables the government party to efficiently undertake a range of activities including its payment arrangements, administering change notices and effective asset lifecycle replacement using transparent asset registers.

Effective contingency planning

Effective contingency planning in a *Partnerships Victoria* project ensures the government party can respond to unplanned events and control the impact of these events on service delivery and value for money outcomes.

Ongoing review

Contract management processes will need to adapt over the lifecycle of a *Partnerships Victoria* 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.
      1. Contract performance

Construction phase

During the construction phase, relationships with the private party that are embedded in the governance and reporting arrangements formally commence. Specific contract management issues can arise during the construction phase that can impact future service delivery or value for money.

The period of design development requires due diligence by the contract management team to ensure the government party receives the required standard of asset and that the asset will have the capability to provide the contracted services. The technical completion tests for the asset are a key milestone during the construction phase (in projects where technical completion is contemplated) as is the operational readiness period leading up to commercial acceptance and its related commissioning tests.

The role of the independent reviewer is also critical during the construction phase. Both the government party and the private party must cooperate and provide the information to the independent reviewer to ensure commissioning tests are able to be completed in a timely manner.

Service delivery phase

Contract performance during the service delivery phase focuses on monitoring service provision, maintaining asset condition and managing payments. An effective performance monitoring and reporting strategy is based on:

* + - understanding the business environment and the objectives of government in entering into the project deed. It is important that performance measures are linked to strategic objectives and desired outcomes;
    - understanding the private party’s internal operating environment, including its cash flows and the range of subcontracted or associated service providers can lead to an awareness of the private party’s strengths and weaknesses, including financial performance;
    - actively monitoring the management quality of the private party, checking for weaknesses or trends that may provide an early indication of risks to the project; and
    - regularly reviewing the quality of the service against the key performance indicators and services specifications. 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 *Partnerships Victoria* project has a robust strategy for monitoring service delivery and accessing relevant information to mitigate any risks and take advantage of any service improvement opportunities that are materialising.

* + - 1. Overview of common contract management events

Change management

Changes during the lifecycle of a *Partnerships Victoria* project require active management. Changes may be contemplated during procurement and provided for in the project deed. In some cases, unanticipated alterations to the project assets, contracted services or the project deed (or other project contract) become necessary. In either case, change events are both a source of risk and a potential opportunity to gain additional benefits from the project. The government party should ensure there is no unintentional take-back of risk allocated to the private party during a change event.

State-initiated modifications and augmentations

State-initiated modifications are likely to occur during the life of most *Partnerships Victoria* projects to change the project assets or the contracted services performed by the private party. Typically, a State-initiated modification will involve the government party preparing a change request to issue to the private party in order for the private party to provide a proposal to the government party for design (if required), pricing and any other relevant information in relation to the State-initiated modification.

A material modification to the project may be treated as an augmentation (significant increase in the size of the asset or service requirements). Typically, the project deed will specify a process to agree and implement a State-initiated modification and augmentation.

Reviewable services

A range of ‘soft services’ – such as cleaning, security and grounds maintenance services – are typically subject to a price review at regular intervals during the service delivery phase. It is likely to provide better value for money to review these labour-based services regularly, rather than locking in price and other arrangements for the full term of a *Partnerships Victoria* project.

Refinancing

Refinancing refers to any change to a project’s debt financing arrangements. There can be scheduled and unscheduled refinancing events. *Partnerships Victoria* *Requirements* statethat all refinancing consent requests must be managed by DTF in conjunction with the contract director. The financial and risk impact of a refinancing event must be reviewed by the government party when assessing the refinancing proposal and determining State consent.

Change of 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. Typically, the State requires the private party to seek prior approval of changes in control (other than in respect of on-market acquisitions, where consent may be sought immediately after the change in control) in order to ensure that the private party entity continues to be a suitable body to be entrusted with the contracted service delivery responsibilities. More recent project deeds may also allow for ‘permitted share capital dealings’, which are changes of control that the government party and the private party agree as part of negotiating the project deed. These do not require State approval.

End-of-term arrangements

A *Partnerships Victoria* project can conclude at expiry of the term of the project deed or earlier through mutual agreement or early termination due to force majeure, private party default or the government party termination for convenience.

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

* + 1. The relationship between risk, service delivery and contract management

|  |  |
| --- | --- |
| Part 1: Introducing *Partnerships Victoria* contract management |  |
| Overview of managing contracts and performance | Chapter 1 |
| **The relationship between risk, service delivery and contract management** | **Chapter 2** |

* + - 1. Risk and service delivery

Project risk is the effect of uncertainty on project objectives. It refers to the risks associated with potential events occurring and the consequences that may impact on project objectives. As such, project risk is often expressed in terms of a combination of the consequences of an event or a change in circumstances, and the associated likelihood of occurrence.

The [*Victorian Government risk management framework*](http://www.dtf.vic.gov.au/Publications/Victoria-Economy-publications/Victorian-risk-management-framework-and-insurance-management-policy) <http://www.dtf.vic.gov.au/Publications/Victoria-Economy-publications/Victorian-risk-management-framework-and-insurance-management-policy> describes the minimum risk management requirements for government entities covered by the *Financial Management Act 1994* and adopts the Australian Standard ISO 31000.

Service delivery is central to *Partnerships Victoria* projects. Government contracts with the private party to deliver contracted services to prescribed standards and the government party pays according to delivery of the services.

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.

Service delivery risk is the foremost concern to contract managers.

* + - 1. Government accountability

Ultimate accountability for the delivery of government services rests with government in a *Partnerships Victoria* project, even though the contractual responsibility for certain deliverables is transferred to the private party. The reporting and procedural obligations of the government party include:

* + - Ministerial accountability to Parliament and the people (including accountability for government’s contracting activities);
    - complying with the *Financial Management Act 1994* and the Financial Management Regulations and Directions, designed to achieve a high standard of public financial management and accountability;
    - complying with the *Audit Act 1994*, if required, by assisting the Victorian Auditor-General’s Office to undertake a performance audit to assess the efficiency and effectiveness of the management of public resources by the procuring agencies, or service delivery through contracts with private providers (under its ‘follow-the-dollar’ powers);
    - meeting the *Partnerships Victoria* *Requirements*, including:
      * ensuring that all contract directors and relevant members of their teams undertake appropriate training within 12 months of their appointment, unless they have existing contract management experience or credentials;
      * regularly reporting to DTF and consulting with DTF on matters including changes in control, refinancing, material modifications and augmentations, and any dispute resolution;
      * publishing both the contract and project summary within 60 days of financial close;
      * complying with whole-of-government probity standards and practices. Government must meet a high standard of probity in its commercial contracts, and act as a ‘moral exemplar’ in contracting by behaving fairly and ethically;
    - adhering to administrative law remedies, including the Ombudsman’s jurisdiction and the *Freedom of Information Act 1982*; and
    - complying with privacy obligations in relation to personal information in the hands of the government under the *Privacy and Data Protection Act 2014.* 
      1. Contract management, the project deed and the procurement process

The project deed should clearly identify the obligations of the private party and the government party and enable the parties to build a productive relationship. The project deed (and other project contracts) drafting and negotiation process is conducted with the understanding that the project contracts will form part of a broader risk management framework for the project.

The relationship between the parties is an essential component of effective contract management. The project contracts should not be so rigid that it precludes flexible, constructive management or the natural maturing of the relationship between the parties.

The foundation for good contract management will be established during the procurement phase by including a contract management perspective in the procurement team. The project director and procurement team must work with the contract director and contract management team (who will be responsible for managing the project during the service delivery phase) to develop an effective contract management strategy and ensure a smooth transition.

Effective contract management must be initiated early in the procurement phase of the project and requires a strong understanding of the project deed (and other project contracts).

* + - 1. Effective contract management manages risk

Effective contract management manages material risks over the project lifecycle to achieve project objectives and value for money outcomes. This includes:

* + - understanding the project objectives and the intent of the project deed;
    - understanding the principles behind allocating specific risks;
    - identifying risks and assessing their materiality; and
    - developing management strategies to assume, control, mitigate or eliminate risks and associated impacts.

Contract management is based on the risk allocation in a project deed. The commercial principles in the *National PPP policy guidelines* and the *Partnerships Victoria* standard project deed guidance notes form the foundation of the PPP risk allocation for all *Partnerships Victoria* projects, which is further developed and refined for each specific *Partnerships Victoria* project during the procurement phase. The private party bears the risks that the built asset meets the output specification and is suitable for service delivery over the project lifecycle. Usually, this risk allocation is enforced through the fitness for purpose warranty provided by the private party in the project deed.

All risks associated with service delivery are allocated to the private party except where the project deed specifies a risk the government party has retained, on the basis it is better value for money for the risk to be managed by the government party. The payment mechanism, and the associated performance regime, is the key tool for enforcing this risk allocation to the private party in a project deed.

* + - 1. Ensuring accountability and protecting the public interest

Appropriate standards of accountability in *Partnerships Victoria* projects must be maintained over the project lifecycle. *Partnerships Victoria* projects must satisfy a public interest test as an integral part of the procurement process.

The procurement team must ensure the public interest is protected in the executed project deed and other project contracts. Public interest can cover issues such as accessibility, accountability, security and equity. The government party must ensure that the private party complies with its obligations related to the public interest, and must implement a strong governance, probity and compliance framework throughout the life of the project.

The risks to government can be effectively managed by developing a project governance, probity and compliance framework and integrating it into the contract management process so that appropriate standards of project accountability and performance are established, measured and maintained.

The governance framework is linked to the contract administration manual and the project performance, monitoring and reporting measures.

* + - 1. What retained risks must be identified and managed?

Contract management includes thorough information collection, analysis and review. New and emerging risks through the project lifecycle must be identified and control actions taken. Figure 2.1 outlines some key government retained risks that require contract management strategies.

Figure 2.1: Categories of contract risk in a *Partnerships Victoria* project



Risks contractually allocated to government

Selected project risks are contractually allocated to the government party in the project deed developed during the procurement phase, based on the commercial principles outlined in the *National PPP guidelines:* commercial principles and the *Partnerships Victoria* standard project deed guidance notes. The contract director must appropriately manage those risks retained by the government party in the project deed.

Risks arising from issues not resolved at contract execution

Not all issues that may arise in a *Partnerships Victoria* project will be identified and allocated in a project deed. Some risks may have been identified, but were intentionally or unintentionally left unresolved.

The contract director must manage the unresolved issues in accordance with the risk allocation for the project generally to minimise negative impacts on the project objectives and maintain value for money outcomes.

Risks arising from issues not resolved at commercial acceptance

The aim of commercial acceptance is to have a fully functioning and service offering ready for service delivery. However, there may be some outstanding issues which are not resolved. The project director or contract director (as applicable) should ensure that where completing a matter is required to achieve technical completion, commercial acceptance or final acceptance, that the matter is in fact completed prior to certification of acceptance.

Intrinsic risks borne by government

A variety of risks are intrinsic to a long-term contract and must be managed by the contract director. These risks include:

* + - the residual risk to government of a failure by the private party to adequately control and mitigate risks contractually allocated to the private party;
    - risks arising from ineffective public sector management; and
    - risks arising from the government party’s implied obligations.

Residual risks

The nature of *Partnerships Victoria* project deeds is that all project risks not allocated to the government party implicitly fall to the private party.

Government’s preferred position is that this interface risk is allocated to the private party. Allocation of interface risk to the private party may entitle the government party to financial compensation if the private party’s failure to deliver the contracted services interferes with government’s ability to provide services.

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 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.

Government also bears risk if the private party is unable to continue to provide the contracted services due to circumstances such as financial failure of a major sponsor or the triggering of a major probity event (i.e. relating to whether the private party is a fit-and-proper legal entity to undertake the contracted services). While the government may be entitled to financial compensation under the project deed for such events, government ultimately retains responsibility to continue service delivery.

Risks arising from ineffective public sector management

Risks can arise if the government party does not meet its administrative responsibilities and mismanages the project deed. The consequence may not directly affect service delivery, but it may compromise value for money.

Government’s implied obligations

*Partnerships Victoria* contracts expressly impose obligations on the government party (such as service payment obligations) and there are also likely to be implied obligations on the government party. In particular, the contract director should be aware of implied obligations for the government party to:

* + - refrain from engaging in any activity which would hinder the ability of the private party to fulfil its contractual obligations or deprive the private party of the benefit of the contract; or
    - act reasonably and in good faith when performing obligations or exercising discretions under the project deed.

Risks associated with proposed changes to the contract

Proposed changes to contractual arrangements involve risks that the change process is not managed effectively and that the change may jeopardise the ongoing success of the project. These risks should be identified, assessed and allocated as part of an appropriate mitigation strategy. Tools and processes for managing risks in the change process are discussed in detail in Part 4 of this guide.

The project director succeeds by achieving a contractual arrangement that will deliver the project objectives and enable effective contract management. The contract director succeeds by ensuring that the project objectives are delivered, State obligations are met and risks are actively managed.

* + - 1. The private sector perspective

Effective contract management requires an understanding of the dynamics of the private party, the allocation of risks between consortium members and the impact of project financing on the private party’s approach to due diligence and risk management.

Who is the private party?

The private party is the party that enters into the project deed with the government.

Typically, the private party will comprise a consortium of debt financiers, equity investors, a builder, a facility management subcontractor and potentially an operator (in projects where the operations have been outsourced to the private sector). Figure 2.2 shows a typical consortium and its relationship with the government party. In most projects, the consortium forms a special purpose vehicle specifically for the purposes of the PPP project. This special purpose vehicle enters into the project deed with the government party and is referred to as the private party.

The contract director’s primary point of contact for the project will be the nominated representative of the private party. In some cases, the private party will engage a specialist asset manager under an asset management agreement. The role of the asset manager is to provide whole-of-life asset management services on behalf of the consortium members, and they will be a primary contact for the contract director. The contract director may also on occasion interact with a representative of the facility management subcontractor during the service delivery phase.

Figure 2.2: Typical private sector consortium



Occasionally, the private party is a company that already has other significant business activities, or has subsequently undertaken other business activities. Where the private party is not a special purpose vehicle, there are both risks and benefits for government.

Risks include:

* + - the private party, and hence the project, may be affected by its other interests – poor performance of its other activities may even result in the private party becoming insolvent; or
    - there may be a loss of transparency, as management of the project by the private party (and the consequent costs) may be intermingled with management (and costs) of its other business activities – this can add complexity to the operation of various contractual mechanisms such as the sharing of additional revenues and refinancing gains, and the pricing of modifications.

Benefits include:

* + - the private party’s other business interests mean that it is not dependent upon the individual project, and therefore may have greater ability to effectively manage challenging project circumstances; or
    - there may be efficiencies for the private party in operating a number of similar businesses, which may result in financial benefits for government. For example, the private party may be able to refinance on better terms than if it was a special purpose vehicle, and government may share in this benefit.

If the private party requests the government party’s approval to undertake activities other than the project activities under the project deed, the contract director should seek advice on the potential implications and take action to ensure that the government party is, on balance, no worse off.

The private party's approach to risk

The project deed allocates project risks. While the private party special purpose vehicle is responsible to the government party for the project and services, the risk allocation is typically passed down to relevant consortium members through the subcontracts and other project contracts. The risk allocation between the consortium members is determined during the procurement phase and will be priced by the builder, facility management subcontractor, operator (if applicable), debt financiers, equity participants. There are often interface agreements between consortium members that specify risk allocation and the financial consequences of the risk. This is particularly relevant in relation to the payment mechanism that underpins the contractual performance regime.

The contract director should understand how risks are shared between consortium members at different stages of the lifecycle of the project. At times, there may be competing or differing views between consortium members. The contract director needs to ensure that the private party as a whole remains accountable.

In some projects, the private party or related companies of the private party will undertake commercial development activities in conjunction with the project. These activities can affect the commercial positions taken by the private party and its consortium members in dealings with government. The commercial development may also offer synergistic benefits for the *Partnerships Victoria* project (for example, if the commercial development is a hotel associated with a convention centre project) and there may be interface risks between the project and the commercial development. It is therefore important that the contract director understands the risks, benefits and commercial arrangements associated with the commercial development, and how these may affect the project and the private party’s behaviour.

The impact of project financing on risk assumptions

The equity and debt financiers in a *Partnerships Victoria* project will conduct ongoing due diligence of project performance against modelled project returns, both during the construction phase and the service delivery phase. Therefore, risk events and change events are assessed against their impact on project returns. Different members of the consortium may have different appetite for risk or willingness to adopt contractual changes. The contract director should understand this as part of managing the project.

Equity participants may accept a greater level of risk than debt financiers, as their potential returns are higher. While the majority of risks are transferred to subcontractors, some risks remain with equity providers, such as the risk of subcontractor insolvency or non‑performance.

Debt financiers will be concerned not to take on risks that may jeopardise the project cash flows. This is particularly so if the project is funded on a limited-recourse basis (most common in PPPs), which means that the debt financier is dependent on the cash flow from the project, and has no call on any other assets of the equity participants or related parties/activities, other than any bonds or guarantees provided to the private party by members of the consortium (usually the builder and the facility management subcontractor).

Part 2: Key elements of effective contract management

Part 2 (Chapters 3–9) outlines the key elements to be considered in designing an effective contract management framework. It also provides guidance on a range of contract management processes and tools that can be used to manage *Partnerships Victoria* projects.

[Contract management guide – Templates](http://www.dtf.vic.gov.au/files/17403977-f304-4264-902e-a86900c58806/Contract-management-Guide-Templates.docx) have been developed for a number of these contract management processes and tools are available on the DTF website.

Chapter 3 Resourcing, governance and probity

Chapter 4 Relationship management, dispute resolution and issue management

Chapter 5 Contract management planning

Chapter 6 Contract administration

Chapter 7 Knowledge and information management

Chapter 8 Contingency planning

Chapter 9 Ongoing review

* + 1. Resourcing, governance and probity

|  |  |
| --- | --- |
| Part 2: Key elements of effective contract management |  |
| **Resourcing, governance and probity** | **Chapter 3** |
| Relationship management, dispute resolution and issue management | Chapter 4 |
| Contract management planning | Chapter 5 |
| Contract administration | Chapter 6 |
| Knowledge and information management | Chapter 7 |
| Contingency planning | Chapter 8 |
| Ongoing review | Chapter 9 |

* + - 1. Introduction

This chapter addresses the contract management team and its resourcing, governance issues and reporting, probity issues and related principles to guide the conduct of the contract management team. It also outlines issues relating to compliance.

* + - 1. Contract management team and resourcing

Contract administration resources

The government party must ensure that adequate resources are applied to contract administration which should ideally be planned upfront during the business case stage.

The procurement phase and construction phase of a *Partnerships Victoria* project are considered to be high value and high risk. Consequently, these phases require sufficient procurement team members, advisory resources and budget to be allocated. During the construction phase, the project needs to retain sufficient resources and budget, typically managed by the project director and the carryover procurement team. The service delivery phase is considered lower risk once steady-state operations have been achieved.

During the procurement phase, the government party (or procuring agency if applicable) should take steps to confirm or recruit the resources needed to manage the contract during both the construction phase and the service delivery phase. Usually, the project director and the members of the procurement team remain engaged with the project during the construction phase to manage the design and construction process.

It is common for the project director and members of the procurement team to leave the project once commercial acceptance is achieved. In this case, the procurement team and the new contract management team must work closely together to transition the project from the construction phase into the service delivery phase. This close working relationship will also ensure that the contract management team is ‘up to speed’ on the project from the beginning of the service delivery phase.

The contract management team is responsible for a complex high-value project and for delivery of important services during the service delivery phase. This means that prior to the service delivery phase commencing, the government party must allocate sufficient and appropriate staffing, consultancy and other budget resources to enable efficient and effective contract administration during service delivery.

Determining the appropriate resources will require the government party to:

* + - identify contract management team obligations – both contractually and more broadly – and their resource intensity;
    - consider the volume of the private party’s reporting requirements, including service performance KPIs that require monitoring;
    - consider the extent to which the contract management team will delegate direct monitoring of service performance KPIs to another government entity (e.g. Department of Health and Human Services will delegate direct monitoring of service performance KPIs to a local health service hospital);
    - assess the range of project risks and issues and identify the expertise required to monitor and respond to those risks;
    - determine the extent to which that expertise should be sourced internally or from external consultants – this will influence the relative staffing and consultancy resource requirements;
    - consider whether the contract management team has appropriate resources for the acquisition and operation of technical support systems (e.g. there can be sizeable costs in establishing and operating electronic knowledge and information technology platforms); and
    - consider whether the allocated budget for the range of contract management activities is sufficient.

Another important factor in determining resource requirements will be whether the relevant government party has an existing *Partnerships Victoria* contract management team in place. If such a team is in place, additional resources required may be less than if a contract management team needs to be established from scratch.

It is also important to be aware that the contract management resources needed to manage a *Partnerships Victoria* project will vary significantly from project to project and over the lifecycle of individual projects. For instance, there is likely to be a need for greater resources during major change events, such as a State-initiated modification or augmentation to expand the asset.

Contract management team members

The government party must ensure that team members involved in contract administration have appropriate levels of authority to administer the contract effectively.

The key roles within the government party during contract management stages of a *Partnerships Victoria* project include:

* + - the senior responsible owner (the person with overall responsibility for the project and related services, and to whom the project director and contract director report. This term is used for consistency with gateway review terminology);
    - the project director and the procurement team (during the procurement phase and construction phase);
    - the contract director (during the service delivery phase); and
    - the contract management team (during the service delivery phase).

Contract management team members need to have sufficient authority, in the form of delegations or otherwise, to fulfil their roles in managing contracts (delegations and authority are discussed in detail in Section 3.4 of this guide).

The government party responsible for the project must:

* + - nominate a State representative under the project deed as the primary interface with the private party;
    - identify the role of staff involved in administering the contract, particularly the actions contract management team members are required to undertake on behalf of the government party;
    - identify the source of authority of the contract management team members (for example, legislation or regulation, Ministerial delegation);
    - identify the scope of the authority of all staff involved in administering the contract;
    - determine whether existing forms of authority are sufficient for staff to carry out the tasks required to manage the contract; and
    - identify the capacity and flexibility with which the authority of contract management team members can be increased as the need arises or circumstances change.

The senior responsible owner

The senior responsible owner is usually the Chief Executive Officer or a Deputy Secretary of the government party. The senior responsible owner has overall responsibility for the successful delivery of government services relevant to the *Partnerships Victoria* project.

The senior responsible owner must ensure that:

* + - the project’s significance is appropriately recognised;
    - the government party’s board or Minister is periodically briefed;
    - the government party’s senior management group takes an active interest in the ongoing delivery of the contracted services during the life of the project; and
    - adequate financial resources, an appropriate contract director and contract management team are in place to satisfactorily deal with the private party and the project’s complexity and challenges.

The project director and contract director

It is essential to the success of a *Partnerships Victoria* project that a suitably qualified individual has overall responsibility for managing the project from the date of contract execution to achieve project objectives and value for money over the project term. This person is the State representative under the project deed.

Figure 3.1 below shows how the transition of responsibility for management of the contract generally occurs on projects from the procurement phase to the service delivery phase.

Figure 3.1: Transition from project management to contract management



Generally, the project director during the procurement phase will remain engaged on the project during the construction phase to manage the design and construction process. The timing of transition to a contract director can vary.

The appointment of a contract director should be identified early in the construction phase and will usually be either the:

* + - appointment of the project director as the inaugural contract director following commercial acceptance. If the project director during the construction phase becomes the inaugural contract director, the project director should appoint a contract management team with responsibility to develop the contract management tools and processes during the procurement process; or
    - appointment of a new contract director. If the project director does not intend to remain engaged on the project after commercial acceptance, a new contract director should be appointed as early as practical during the construction phase.

Regardless of when the transfer of responsibility from the project director to the contract director occurs, the contract director must be familiar with the project, and be ready with the necessary tools and processes before the start of the service delivery phase.

The project director, the procurement team and their advisers should assist the contract director to establish these contract management tools and processes. The project director must ensure the procurement team’s knowledge is transferred to the contract management team. Where feasible, the project director should provide support as necessary until the project has reached stable operations, working with the inaugural contract director during the transition.

The contract management team

A contract management team, reporting to the contract director, will carry out many day‑to‑day contract management activities. The size of this team may vary depending on the nature of the project and may vary over the life of the project.

Where the government party has an existing *Partnerships Victoria* contract management team, this team will likely provide input in the procurement phase, so that practical contract management provisions can be included in the project contracts.

Training

Personnel involved in contract management must be adequately trained to effectively and competently carry out their roles and responsibilities. Inexperienced personnel represent a significant risk to effective contract management, public sector accountability and successful project outcomes.

DTF has established a formal training program to provide contract directors and contract management team members with relevant skills. It is expected that the government party will supplement this training with ongoing training for skill development, including:

* + - project and time management;
    - negotiation and communication skills;
    - probity and compliance;
    - dispute and issue management; and
    - relevant computer software.

Succession

Given the long-term nature of *Partnerships Victoria* projects, the personnel involved in management of a project are likely to change several times through the project lifecycle. New personnel will need time to become familiar with a project before they can effectively manage it.

The government party should establish a succession plan for key personnel to manage personnel changes efficiently by:

* + - limiting concurrent departures;
    - ensuring that the team has a good mix of experience levels; and
    - integrating its contract administration manual (Chapter 6) and knowledge and information management systems (Chapter 7) into succession planning.

The importance of having a detailed, up-to-date and easy to use knowledge management system with good record keeping to ensure smooth succession planning cannot be over-emphasised.

The succession plan must be sufficiently flexible to provide quality ongoing management and accommodate change, including:

* + - the possibility of personnel choosing to leave their positions prematurely or being absent on extended leave;
    - the need for incoming personnel to complete appropriate training (preferably with the involvement of the incumbent contract director); and
    - the likelihood that roles and workloads will change over the lifecycle of a *Partnerships Victoria* project.

The need for a comprehensive succession plan is related to broader government objectives of supporting contract management as a recognised career path and the career advancement of contract management personnel.

Consultancy resources

Effective contract management will also require use of expert external resources from time to time. The original private sector legal, commercial and technical advisers will have a level of familiarity with the project circumstances to provide specific advice.

A sufficient budget will need to be available for regular ongoing contract management activities. This budget may need to be supplemented during major change events.

In addition, expert resources may be sourced from the public sector, such as:

* + - DTF;
    - Treasury Corporation of Victoria (TCV) – financial modelling and invoice payments;
    - Victorian Managed Insurance Authority (VMIA) – insurance advice; and
    - Valuer-General Victoria (VGV) – valuations advice.
      1. Developing a governance, probity and compliance framework

Appropriate project governance, probity and compliance arrangements are fundamental to good contract management. Good governance is important for dealings with the private party and internally within government. The contract management team must conduct itself and its dealings in a way that is consistent with acceptable probity principles, as well as ensuring the private party complies with relevant laws, regulation and government policies.

The task of developing a governance, probity and compliance framework relies on an analysis of four questions:

What assurance is necessary to ensure appropriate standards of governance, probity or compliance (as applicable) are met?

What needs to be done, by whom and when, to ensure adherence to the applicable standards, and that the risk to government is managed effectively?

What are the consequences to government and project outcomes if the applicable standards are not met?

How should the consequences of a failure to meet the applicable standards be effectively managed?

Figure 3.2 shows the elements of the governance, probity and compliance framework.

Figure 3.2: Governance, probity and compliance framework



After analysing the collected information, the government party should consider the division of public/private responsibility. This enables the government party to identify each task relating to the *Partnerships Victoria* project as either:

* + - the government party’s sole responsibility;
    - the private party’s responsibility;
    - a shared responsibility between the government party and private party; or
    - a residual government party responsibility that is not the subject of any project deed obligations.

The government party can then develop specific governance, probity and compliance tools and processes.

* + - 1. Governance

Governance is concerned with processes for project decision making and reporting. It defines the behavioural controls within the government party that ensure accountable project outcomes and processes. Governance is concerned with accountability and responsibilities. It encompasses authority, stewardship, leadership and control.

Roles and responsibilities

For good governance of a *Partnerships Victoria* project within the government party, the contract management team must have:

* + - clearly defined roles and responsibilities;
    - an appropriate mix of skills, experience and training; and
    - enough time, resources and support from their government entity to fulfil their responsibilities.

Clearly designated accountability, based on a comprehensive understanding and an appropriate allocation of responsibilities minimise the risk of contract management tasks ‘falling through the cracks’. Roles and responsibilities relating to the administration and fulfilment of the contract should be identified in the contract administration manual (discussed in Chapter 6). Any other roles and responsibilities should also be clearly identified and should be recorded.

Delegated authority and reporting lines

The nature and function of delegations

Good governance requires that powers to enter into and administer government contracts are only exercised by people with the authority to do so. Under this principle, a project deed is executed following compliance with a series of government approval requirements, set out in section 6 of the *Partnerships Victoria Requirements.* The project deed requires the government party to exercise various functions, rights and powers.

However, as a practical necessity, contract management personnel exercise many of these functions, rights and powers. These personnel, principally the senior responsible owner and the contract director, are generally authorised to act on behalf of the government party, and to make the financial commitments, within certain parameters, necessary to manage the project.

It is vital that the contract director has the necessary authority to take action which is required to comply with the government party’s obligations under the project deed (and other project contracts). In some cases, the level of monthly/quarterly service payments may be such that they require approval of the senior responsible owner. In some projects, action by other stakeholders may be required for the government party to comply with its obligations under the project deed. In these circumstances, a mechanism must be established so that an appropriate person – for example the contract director, senior responsible owner or a Minister – can direct those stakeholders to take action that is necessary to ensure that the government party complies with its obligations.

Delegations in the context of a *Partnerships Victoria* project

Appendix D to this guide provides background information on delegations. In the context of a *Partnerships Victoria* project, the government party should give an appropriate member of its staff responsibility for managing delegations relating to the project. The following discussion assumes that person is the contract director.

The contract director should have thorough knowledge of the regulatory and policy frameworks that apply to delegation of legal power and financial capacity in the government party, and obtain legal advice where required.

Delegation of legal power

It is common for a project deed to include delegations by the Minister who executes the project deed, or by the government party if it is a separate legal entity. These delegations allocate particular functions, rights and powers under the project deed (and other project contracts) to the holders of specified positions or specified individuals. For example, some powers may be delegated to the Secretary of the relevant department, and others to a person nominated as the project director or contract director. There may be a clause or schedule in the project deed that identifies all the delegated functions, rights and powers. A typical clause delegating functions, rights and powers in this way is:

*‘The State may from time to time appoint a person to be contract director. The contract director will have the functions, rights and powers set out in Schedule xx.’*

Alternatively, specific clauses in the project deed may confer specific functions, rights or powers on the holders of specified positions or an identified individual.

In some instances, legislation applying to a project will also delegate functions.

In addition to delegation in the project deed or legislation, particular functions, rights or powers may be delegated in separate instruments of delegation. For example, the Minister of the relevant department may give a separate delegation of a particular power conferred on the Minister by the project deed.

The contract director should maintain a delegations register identifying the functions, rights and powers delegated under or in relation to the project. A delegations register template is set out in Template D.

The contract director should also keep a record of authorisations in which one person authorises another to exercise any function, right and power relating to the project on behalf of the first person. The authorisation should be in writing. If there are numerous authorisations relating to the project, these should be summarised, either by identifying in the delegations register who is authorised to exercise each delegated function, or by establishing a separate authorisations register and storing this with the delegations register.

If a member of the contract management team is exercising a function that involves making a financial commitment on behalf of government, they must have capacity to make that financial commitment, as well as legal authority to exercise that function.

Financial conferrals or authorisations

If the government party is subject to the *Financial Management Act 1994* (the FM Act), the entity’s personnel should only make financial commitments according to any financial conferrals or authorisations under the Minister for Finance’s Standing Directions made under s. 8 of the FM Act. If the government party is not subject to the FM Act, the entity’s personnel should only make financial commitments within their authority according to the entity’s policies concerning the authorisation of expenditures. The financial conferrals or authorisations established for contract management personnel should ensure that appropriate personnel will be able to:

* + - authorise payment of service charges under the project deed; and
    - up to appropriate limits, meet other expenses incurred in the management of the project.

The financial conferrals or authorisations relevant to a *Partnerships Victoria* project are usually relatively simple compared with the delegations of legal authority. Nevertheless, the contract director should ensure that the relevant financial conferrals or authorisations are recorded in a single accessible document, such as an up-to-date financial delegations register.

Payments and other expenses should be recorded and reported according to the FM Act or other requirements that may apply.

Delegations to other government agencies

In a *Partnerships Victoria* project where the government entity that operates the relevant project asset is separate from the government party that is responsible for contract management of the project deed, performance monitoring responsibilities are generally delegated to the entity that operates the project asset. This structure will generally be applicable to availability-type PPPs and examples of such entities include regional hospital networks.

In such instances, the asset operator will usually report to the government party contract management team on the findings of its performance monitoring at regular intervals, typically in line with regular contractual service payment invoices submitted by the private sector party.

Under this structure the contract director will need to take an oversight role to ensure delegations are being managed appropriately to ensure that the asset operator is making consistent decisions so that the government party can deliver on its obligations.

Review of delegations and authorisations

It is likely that, at various times during the project lifecycle, the contract director will need to arrange for the execution of new delegations and authorisations relating to the project, and update the delegations register accordingly. The contract director should review delegations and identify any necessary changes in the following circumstances:

* + - **regular review** – when the contract director reviews contract management issues, the contract director should consider whether existing delegations and authorisations are sufficient for effective contract management at the time of the review and in the medium term. If the existing delegations and authorisations are insufficient, the contract director should consider what changes are necessary, obtain legal advice if required and arrange for any necessary changes to be implemented. Changes in delegations and authorisations should be communicated to relevant people to ensure that their authority to act is current and valid and has not lapsed or been revoked. Ongoing review of contract management issues is discussed in detail in Chapter 9 of this guide;
    - **personnel changes** – when there is a change in contract management personnel, or in their position titles, the contract director should consider the impact this will have on existing delegations and authorisations, and obtain legal advice if required. The contract director should be alert to any changes in personnel within or outside the contract management team, and should identify and respond to any changes that result in the lapsing of any relevant authorisations; and
    - **contract variations** – when there is a contract variation, the contract director should consider the impact this will have on existing delegations and authorisations, whether any new delegations or authorisations are required, and obtain legal advice if required. Change management, including contract variations, is discussed in detail in Chapter 12 of this guide.

Governance arrangements with the private party

Establishing efficient governance arrangements with the private sector party is essential to effective contract management, and promotes a good business relationship with the private party. Relationship management is addressed in further detail in section 4.2 of this guide.

The more recent project deeds set out in some detail the governance arrangements to apply between the parties. These arrangements include:

* + - nominating the State representative and private party representatives and their respective responsibilities. The State representative will generally be the project director during the construction phase and the contract director during the service delivery phase;
    - nominating other key government and private party personnel who have responsibilities set out in the project deed (and other project contracts) (e.g. the prison governor, in a *Partnerships Victoria* correctional services contract); and
    - inter-party committees, their membership, functions and frequency of meeting, such as the senior representative group and the project control group (refer to section 4.2).
      1. Internal reporting arrangements

Depending on the nature of the project, the contract director may receive a number of reports from the private party, and produce considerable additional information through other monitoring mechanisms. The contract director therefore needs to carefully consider how information should be communicated to senior management of the government party. Best practice entails that internal reports are produced in an ‘exceptions’ format, identifying any issues of significance. They should be signed-off by the contract director regardless of whether a reportable event has taken place or is emerging. Internal reporting is important to maintain ongoing accountability and focus on scanning the contract management environment.

The suggested structure and contents of these reports is detailed in Templates G and H.

These reports can be:

* **regular reports** – ideally these reports are aligned with the project’s performance reporting and monthly/quarterly payment cycle, and focus on the short-term performance of the private sector service provider (including elements such as key performance indicators (KPIs), recent performance trends and payments); and
* **annual reports** – these reports should focus on the broader contractual matters, including strategic performance and benefit realisation of the project, the health of the private sector party and the status of its ongoing relationship with the State.

Additional guidance on reporting is provided in the contract management templates and appendixes on the [DTF website](http://www.dtf.vic.gov.au/) <http://www.dtf.vic.gov.au/Infrastructure-Delivery/Public-private-partnerships/Policy-guidelines-and-templates>. A range of issues to consider in developing a reporting regime is provided in (Annexure C), and templates are provided for reporting during the construction phase (Template G) and the service delivery phase (Template H).

Department of Treasury and Finance reporting requirements

Under the *Partnerships Victoria* *Requirements*, DTF is required to monitor and advise the Treasurer and the government on significant contract management issues. The *Partnerships Victoria* *Requirements* also provide guidance on a number of issues that government parties must consult with DTF about in relation to a *Partnerships Victoria* project. These are listed in Table 3.1.

To assist DTF monitor *Partnerships Victoria* projects, members of the contract management team are required to regularly update DTF on contract performance. It is recommended that these reports cover a range of issues which are listed below in Table 3.1. To assist, the suggested structure and content of this report is detailed in Template I.

While the government party is responsible for identifying and managing issues that arise under the project deed, the *Partnerships Victoria* group within DTF is available to assist the government party respond to issues raised by the contract management team.

Table 3.1: Level of DTF consultation required for contract management issues

|  |  |
| --- | --- |
| Issues that must be consulted with DTF | Issues recommended to be consulted |
| * Change in control | * Service delivery issues resulting in significant or frequent abatements and/or KPI changes |
| * Refinancing | * Financial health |
| * Material modifications and augmentations | * Management quality |
| * Dispute resolution | * Relationship quality |
| * Default, termination and step-in events | * Risk outlook |
| * Any other change that requires an update to the financial model | * Benchmarking and/or reviewable services |
| * Any material amendment to the project deed (or other project contracts) impacting the State’s risk allocation | * End of term planning |
| * Extensions or delays (including delay to commercial acceptance) (construction phase) | * Intervening events (service delivery phase) |

* + - 1. Coordinating with other public sector entities

Contract administration involves coordinating the actions of other public sector entities where necessary.

Managing the contractual obligations of the government party can be complex because of the range of government stakeholders involved in many *Partnerships Victoria* projects. The government party acting on its own may not be able to fully meet the government’s obligations under the project deed (and other project contracts), or to ensure that the benefits of the project are realised.

The contract director may need to coordinate the actions of other public sector entities in order to ensure the government party:

* + - can deliver on its obligations under the project deed; and
    - does not inadvertently act so as to hinder or prevent the private party from meeting its obligations under the project deed.

In some projects, performance monitoring obligations may be delegated to another government entity (e.g. from the Department of Health and Human Services as the contract management entity to a local health network operating a hospital). Template J provides an example of a structure for the delegated entity to report to the contract management entity.

It is important to distinguish between government stakeholders that are, or need to be, part of the governance framework and those that are not. Within government, common good practice involves regular meetings of a steering committee with representatives from multiple relevant government agencies. The steering committee has senior government representation, and is chaired by the senior responsible owner. Its role is to provide strategic guidance to the government party, and to make decisions on the more material project-related matters – referring matters to Ministers as necessary. The project director and contract director report to the steering committee. The steering committee will be established to oversee the procurement phase and the construction phase, and in some cases this will extend into the initial phase of service delivery. It is important to continue the committee, perhaps with revised membership and meeting frequency, during the life of the project.

In some *Partnerships Victoria* projects, a government party contracts to receive services ultimately used by multiple public service entities. For instance, the Emergency Services Telecommunications Authority is the government contracting party in the Metropolitan Mobile Radio and Mobile Data Network projects, but the end-users are individual emergency services agencies. In such projects, the contract director should enter into a memorandum of understanding or a service level agreement with the other public service entities. This document should set out the roles and responsibilities of each public service entity, the payment obligations and processes, and the communication and consultation processes between the contract director and these public service entities.

In some cases, establishing a reference group to enable effective communication and consultation with other government entities that have a strong interest in the project but are not part of the decision-making process may be warranted.

Stakeholder consultation and communications

Appropriate consultation and communication with stakeholders is an important component of good governance. It also assists the government party to ensure the private party conforms with public interest considerations. Some projects may be of such significant interest to the community and other third parties (such as other governments), that the contract management team needs to provide public information. Developing and maintaining a project website detailing project progress and status can be an efficient way to communicate and meet some of the community demand for information on the project. Examples include the Royal Children’s Hospital or the Victorian Comprehensive Cancer Centre project websites.

Stakeholder consultation and communications plans should be documented or referred to in the contract administration manual (Chapter 6), and in contingency plans (Chapter 8). Some project deeds may require the private party to prepare its own stakeholder consultation and communications plan, which the contract director may refer to in developing its own plan.

In determining what level and forms of consultation and communication are appropriate, the government party should consider the following questions:

* + - Who are the stakeholders for the project?
    - What are the objectives of each stakeholder?
    - Which stakeholders need to be part of the governance framework for the project, and how are they best accommodated within this framework?
    - Who are the appropriate contacts within the stakeholder group?
    - What matters should each stakeholder be consulted about?
    - What is the likely involvement and role of each of the stakeholders?
    - What information should be provided to each stakeholder?
    - Have the stakeholder arrangements been discussed and agreed with the stakeholders?
    - How should the stakeholder arrangements be documented?
    - Who within government should be asked for input into the stakeholder communication and consultation plans?
    - Is there a need for a public communication process?
      1. Probity requirements

Integrity and the right culture are part of the bedrock of the Victorian public sector. Probity signifies integrity, fairness and honesty. Probity means good process demonstrated by transparent actions, equity, confidentiality and managing conflicts of interest, whether actual or perceived. Probity is integral to achieving value for money outcomes. The government party will operate with integrity, impartiality and accountability. No person should improperly achieve personal advantage or disadvantage through involvement in the process.

In March 2016, the Victorian Secretaries Board prioritised reforms to strengthen existing integrity frameworks. Following recent Independent Broad-based Anti-corruption Commission (IBAC) hearings, the Victorian Secretaries Board has reaffirmed its commitment to a robust integrity culture across the Victorian public sector.

The existing Victorian government policy information concerning probity is detailed in the Victorian Government Purchasing Board (VGPB) governance policy, in particular the [*Guide to probity*](http://www.procurement.vic.gov.au/Buyers/Policies-Guides-and-Tools/Governance-Policy) <http://www.procurement.vic.gov.au/Buyers/Policies-Guides-and-Tools/Governance-Policy>.

Good probity practice is important for:

* + - business and community confidence in the integrity of government procurement processes;
    - encouraging and enabling purchasers and businesses to deal with each other on the basis of mutual trust and respect; and
    - improving the defensibility of market engagement processes and procurement outcomes.

Probity should underpin every aspect of every procurement activity, including contract management. In practice, probity requires:

* + - acting with integrity and impartiality;
    - ensuring market equality by applying an appropriate level of competition and contestability relevant to the procurement activity;
    - consistent and transparent processes;
    - secure and confidential market engagement information;
    - identifying and managing conflicts of interest;
    - allocating appropriate capability to elements of the procurement process; and
    - engaging a probity practitioner where the complexity of the procurement warrants independent process oversight.

The government party should apply each of these principles throughout the project lifecycle.

Ensuring appropriate probity processes are in place for contract management

The government party will have a range of existing probity requirements and processes in place. These should be included in the contract administration manual.

The probity requirements and processes should address:

* + - internal organisation and decision-making processes;
    - confidentiality and disclosure;
    - dealing with proprietary information;
    - dealing with conflicts of interest for contract management team members and their advisers (see also Section 13.6 and Appendix C of the *National PPP guidelines: practitioners’ guide*);
    - consultation with the government;
    - establishing a probity culture;
    - queries on probity (including scrutiny by the Auditor-General, Parliament, and the Ombudsman);
    - the requirements of the *Public Administration Act 2004*; and
    - the standards of conduct (including the duty of confidentiality and in relation to accepting, declaring and recording the receipt of gifts or benefits) for all public servants under the Code of Conduct for Victorian Public Sector Employees.

Probity issues also apply to private sector parties and their conduct. For guidance on this matter refer to Chapter 38 of the *National PPP guidelines:* *commercial principles for social infrastructure* and Chapter 37 of the *National PPP guidelines: commercial principles for economic infrastructure* (as applicable) and the *Partnerships Victoria* standard project deed guidance notes*.*

* + - 1. Compliance

Compliance ensures the project meets the requirements of laws, regulations, and government policy beyond those specifically addressed in the contract.

The government party may also develop a contract compliance program to manage and monitor compliance with legislative or government policy requirements. This may be as part of a broader service delivery framework, particularly if there are multiple projects under active management.

A compliance program helps the government party to identify, document and manage compliance risk throughout the project lifecycle. It may be appropriate to prepare a document outlining the compliance program and compliance procedures. This will form part of the contract administration manual.

Developing a contract compliance management system

The International Standard on Compliance Management Systems, ISO 19600-2014, is the benchmark for compliance management systems.

According to ISO 19600-2014, a compliance management system is an essential element in the good governance of an organisation (or project). It should:

* + - promote a culture of compliance within the organisation;
    - aim to prevent, and where necessary, identify and respond to breaches of laws, regulations, codes or organisational standards in the organisation; and
    - assist the organisation in remaining or becoming a good corporate citizen.

An effective compliance management system requires dynamic and strategic management of the project’s regulatory environment. Accordingly, the person responsible for the compliance program should either have a high level of status and authority within the government party, or be supported by a suitably senior executive.

Developing compliance procedures

The government party should develop and document compliance procedures in accordance with ISO 19600-2014. These should address:

* + - the roles and responsibilities of management and staff;
    - areas where compliance failures are likely to arise, and procedures to anticipate and prevent such failures;
    - action plans to deal with problems and faults that may arise;
    - ongoing monitoring, assessment and reporting to ensure staff compliance;
    - knowledge and information management systems (refer to Chapter 7 for further discussion);
    - incorporating compliance standards into:
      * computer systems;
      * forms;
      * contracts; and
      * administrative procedures;
    - specific arrangements for reporting instances of compliance failure;
    - broader government reporting requirements; and
    - educational and training requirements.

The government party should ensure that the compliance procedures contain:

* + - a practical summary of relevant laws, regulations and organisational standards;
    - operational procedures to ensure that the government party’s own compliance and governance standards have been met, both internally and when managing the project interface with the private sector party; and
    - practical examples of compliance applicable to the government party’s management of the contract.

The compliance procedures should be readily available to all personnel involved in managing the project.

* + 1. Relationship management, dispute resolution and issue management

|  |  |
| --- | --- |
| Part 2: Key elements of effective contract management |  |
| Resourcing, governance and probity | Chapter 3 |
| **Relationship management, dispute resolution and issue management** | **Chapter 4** |
| Contract management planning | Chapter 5 |
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* + - 1. Introduction

The long-term nature of *Partnerships Victoria* projects means it is imperative to maintain a strong relationship between the government party and the private party throughout the entire project lifecycle. Cooperation and open and clear communication are fundamental to effective contract management and delivering successful project outcomes in *Partnerships Victoria* projects. Establishing and maintaining strong relationships will enable the parties to constructively manage the service delivery issues, changes or disputes that will arise.

* + - 1. Relationship management

Key factors in establishing good relationships

There are a number of key factors in establishing a good relationship between the government party and the private party and other project stakeholders:

* + - **mutual benefit** –the parties must approach the project as a mutually beneficial arrangement between the government and the private party;
    - **understanding of objectives** – the government stakeholders, the private party and other consortium members must understand each other’s objectives and those they have in common;
    - **trust** –trust can only be built up over time. It is fostered by both parties seeking to achieve mutual benefit, through open and transparent communication and timely completion of obligations. It involves a consistent approach to doing business with a ‘no surprises’ approach; and
    - **open communication** – open communication is a key to maintaining a good relationship. It fosters a spirit of cooperation and the alignment of common interests between the parties. Open communication does not mean the parties must share all information relating to the project. However, because open communication will enhance the relationship, the default approach should be to share information, except where commercial or legal reasons constrain sharing.

Establishing relationship management structures

Factors to be considered in establishing structures to manage the relationship include:

* + - **senior management support** – the relationship should be championed at senior levels in both organisations. Senior management attitudes and actions will signal to other personnel how they should treat the relationship;
    - **peer-to-peer communication** – working relationships between the parties should be conducted between peers. Typically, a government party contract manager should communicate with their contract manager counterpart in the private party;
    - **separation of roles** –while introducing multiple formal management levels may be unnecessary, day-to-day contract management and service delivery should be separate from management of the overall strategic relationship and long-term strategic issues. In major projects, it is desirable to separate the detailed contract management functions carried out by the contract management team, from the strategic relationship management functions by having a senior executive officer (the contract director) responsible for strategic relationship management. This will prevent day‑to‑day issues swamping the contract director. In some projects, it is also appropriate for the senior responsible owner to also have regular contact with equivalently senior private partner or consortium representatives;
    - **appropriate and clear roles and responsibilities** – roles and responsibilities of contract team members (and also for private party representatives) should be clear and personnel involved in managing the relationship need an appropriate level of authority to carry out their jobs effectively; and
    - **escalation paths –** issue and decision escalation paths should be established, understood and used appropriately so that problems are resolved early. If a timely decision or resolution cannot be made at one level, it should be referred promptly to a more senior level. The project deed should set out in some detail the joint management forums as well as escalation paths to resolve issues that arise.

The ‘partnership’ aspect of a *Partnerships Victoria* project

The intention of the parties to a *Partnerships Victoria* project should be to enter into a project deed (and associated project contracts) that creates a long-term relationship, recognising that each party starts the project expecting that it will receive certain benefits from the project. This is not a ‘partnership’ in the strict legal sense, but rather it is a relationship in which the parties understand the importance to each other of project performance, but do not compromise their respective contractual rights and obligations.

The government party should recognise the importance of the commonality of interest involved in a *Partnerships Victoria* project. The contractual risk transfer, output specification, services specifications and payment mechanism are important contributors to the common interest, as they align the private party’s commercial interests with government’s project objectives. Therefore, for the partnership to be successful, the government party must be careful to:

* + - enforce contractual compliance and penalty mechanisms for poor performance (or non-performance) to ensure the services specifications are maintained and contractual rights are not undermined or inadvertently waived; and
    - avoid action that could result in project risk being assumed or transferred back to the government party. For example, during the construction phase, the government party should not normally approve any detailed drawings or designs. Rather, it should focus on providing comments on design packages submitted by the private party. Comments should focus on where it believes the designs are not consistent with those accepted by the government party at contract execution or they believe the design will impact adversely the delivery of contracted services or the government’s ability to deliver services from the project assets. For guidance on monitoring construction performance and unintentional take-back of design risk during the construction phase see Chapter 10 of this guide, and the *National PPP guidelines: commercial principles for social infrastructure,* Chapter 10 and *National PPP guidelines: commercial principles for economic infrastructure*, Chapters 9 and 10 (as applicable) and the *Partnerships Victoria* standard project deed guidance notes.

Joint management forums

A joint management forum for project review and improvement or a project control group is a key tool to assist parties in developing and maintaining a mutually beneficial relationship over the life of the project. While not involved in the day-to-day management of the project, interparty project review forums provide significant benefits during the construction and service delivery phases of projects. These forums provide a valuable reporting mechanism to the government party on the progress of a project. For larger and more complex projects, it is usually practical to have separate strategic and working level forums.

Interparty project review forums should have a clearly defined role. The parties should ensure that the forum remains focused on its role, and does not become an environment for the discussion of issues best dealt with through other channels or mechanisms. In recent *Partnerships Victoria* projects, the framework for the interparty project review forum is set out in the project deed. The framework generally includes the forum’s charter and objectives, membership and chair (which may alternate), meeting frequency and powers to create subcommittees. It may be possible to develop the forum’s procedure and specific areas of responsibility as the project itself develops. The appointment of an independent chair for the meetings, and to help resolve interparty issues, may also be of value in some instances.

If not specified in the project deed, the forum should meet regularly to ensure that any problems are addressed quickly and that solutions are recommended by the parties jointly. A clear escalation path for resolving problems ensures that responsibility is directed to the appropriate level of management. The seniority, technical skill levels, decision-making capacity and project familiarity of forum participants are all important when determining the make-up of the forum or any subcommittees.

Recent *Partnerships Victoria* projects have also included a senior representatives group. The role of this group is to ensure all key stakeholders are informed of the status of the project and have the opportunity to address significant issues early that may impact the project.

Understanding each other

An appreciation of each other’s objectives, strategy and point of view, coupled with good communication, is important to the success of *Partnerships Victoria* projects. The government party benefits from understanding the private party’s strengths and weaknesses, as it can then focus contract management efforts where the return on effort is maximised.

It is important that the contract management team understands the interests and composition of the private party, as this will influence the contract management team’s actions (refer to section 2.7 of this guide for additional detail).

A strong relationship can be developed by engendering a culture of sharing appropriate information. The types of information that can be of benefit if shared include:

* + - **objectives and expectations of each party** – these are set and shared early in the procurement phase, and remain central to service delivery. They should be revisited regularly. It is important that the parties also understand each other’s higher-level expectations, strategic objectives and potential for changes to service needs. By managing each other’s expectations, the parties can minimise surprises, and better manage the project and potential change events for their mutual benefit;
    - **plans and information about potential future directions** – these can help ensure the parties develop the relationship in line with changes to business needs. At the start of the relationship, senior management must ensure that both parties have similar aspirations in relation to their approach to business (for example, the relative importance of commercial approaches to resolving contractual issues), common goals and strategic ambitions. This needs to be developed throughout the project lifecycle, and it should be a two-way process. An understanding of where the private party sees its business heading is as important as the government party’s own expectations when it comes to maximising opportunities for consistent objectives and better managing divergent positions;
    - **an issues log** – this outlines the outstanding issuesbetween the parties, allocates responsibilities, sets timelines and current status can help monitor and resolve issues. A common issues log should be shared by both parties, ideally through an electronic knowledge management platform. The State contract management team may also retain a separate State issues log for the project, for issues that do not need to be shared with the private party. It can be beneficial to set up the issues log so that the issues can be sorted and filtered in different ways (for example, by the date the issue was raised, by the target date for resolution, and by the status of the issue);
    - **concerns about the wider relationship** – theseshould be discussed frankly, whether they relate to contract performance, progress, or people. If this is not done, there is a risk that problems will increase in seriousness; and
    - **information about how the private party views the government party** – the focus should be on providing and seeking information with a view to improving the relationship over time, rather than unnecessarily apportioning blame. The government party should seek such information if not freely provided by the private party. A candid approach should be encouraged, although there is a need to avoid being defensive about criticism.

The government party should not just passively receive information about the private party. Information should also be analysed and synthesised into the contract management tools and processes. A useful tool to assist in understanding the private party’s business is a SWOT (strengths, weaknesses, opportunities, threats) analysis.

The information collected also forms part of the broader information matrix of factual background for other contract management processes and tools. Information collection for overall contract management purposes is discussed in detail in Section 5.4.

Establishing and using communication channels

Figure 4.1: Common communication channels in PPP projects



Formal and informal contact points

The project deed normally identifies one or more formal points of contact between the government party and the private party. However, to ensure a good relationship is maintained, a number of other contact points at various levels should be established. For example, as suggested above, forums that meet regularly are important vehicles to manage ongoing business issues and to coordinate the change processes that occur through the project lifecycle. These contact points themselves may change through the project lifecycle. Further guidance on managing risks inherent in change processes is outlined in Chapter 12.

It is important that communication channels are properly managed so as not to confuse the responsibilities of the parties in relation to the project deed or compromise contract management.

The degrees of formality used in dealing with issues between the parties should vary depending on the degree of control required, the nature of the issue, and the stage of the project lifecycle in which the issue arises. For example, an issue related to the day-to-day delivery of contracted services should be handled very differently from a strategically significant issue. This is where the operation of a two-tier inter-party committee arrangement can work well.

In addition, there can be benefit in the contract director having semi-regular informal meetings with their private party counterpart. However, any material matters discussed in informal meetings will need to be progressed through formal forums. The government party should also be aware that if the private party, its parent company or another entity involved in the project is publicly listed, it will have continuous disclosure obligations that may impact upon communications.

If appropriate, other government departments or agencies that are stakeholders in the project should be represented on committees, or reference groups, dealing with communications issues. Refer to section 4.5 for further detail.

The contract director should consider establishing a communications plan to include in the contract administration manual (see Chapter 6). This plan should differentiate between regular business-as-usual communications and specific emergency or contingency planning communications protocols (see Chapter 8).

Peer-to-peer communication between the parties

Communication channels operate at different organisational levels. Peer-to-peer discussions may differ depending on the issue. Operational matters will require frequent communication, and more strategic or health-check discussions will occur regularly but less frequently.

Direct communication is important. The private party’s management will prefer to hear criticism and discuss issues directly with their public sector counterparts, rather than through indirect channels.

Agreed protocols are necessary for peer-to-peer communication to function effectively. Where necessary, these protocols should also provide for consultation between the parties in relation to communications between them and third parties. For example, it is appropriate for the parties to consult each other on the content of any public communication in relation to the project, and protocols around this are typically set out in the project deed. In the case of larger projects with significant public profiles, the parties should have regular formal meetings to discuss public relations.

Vertical communication within each party

To ensure consistent communication through the various communication channels, particularly at middle and senior management levels, it is essential that there are consistent ‘vertical’ internal communications. For example, the government party’s contract management personnel must communicate with the contract director to ensure they have a common understanding of the status of the relationship, and are delivering consistent messages to their private party counterparts. If this is not done, differences in perspective may create or mask problems in the relationship. For example, the contract director may regard the relationship as successful, and be unaware of significant friction between junior contract management personnel and their private party equivalents.

Documenting verbal communications

While good communication should avoid excessive formality, it may be necessary to document an agreed record of what was said. For example, if it is verbally agreed that each party will consider a proposed variation to a service delivery KPI, a written record of the discussion is critically important to clarify that no party has yet committed to the variation.

Appropriate practices for documenting verbal communications include the following:

* For informal discussions, record the key outcomes and action points, and provide this to the other party as confirmation of the discussion.
* For formal meetings, prepare minutes of the meeting, circulate these to all attendees, and obtain confirmation that the minutes are accurate.
* Add agreed decisions to the electronic copy of contract documentation, where this is used by the parties, as notes.
* Add pending matters to the parties’ joint issues log where appropriate.

The written record or minutes should be prepared or reviewed by a person with a strong understanding of the context of the discussions before being circulated to the other party. This is important to avoid a record that is incomplete or inaccurate. The record of verbal discussions, or email correspondence, contribute to the information underlying the broader contract management strategy for the project.

It is important to note that informal communication has the potential to change the contractual agreement, where the government party makes a representation or behaves in a way that is inconsistent with the contractual agreement and the private party relies on that representation or behaviour, for example regular waiver of abatements. As such, all communication, including verbal or other informal communication, should be recorded. In addition, the contract director and contract management team should perform all contract management activities with this in mind.

See also Chapter 3 in relation to governance and compliance requirements for project records.

Adequacy and matching of skills

For peer-to-peer communication channels between the parties to function effectively, the individuals responsible at each level must have adequate and appropriate skills. If skills are not properly matched at a particular level, it may compromise effective communication. A contract director who believes there is a skills mismatch at a particular level should change the communication channels between the contract management team and private party to correct this problem.

Communication with the parent company or sponsors

In many *Partnerships Victoria* projects, the private party will be a special purpose vehicle or a subsidiary of a larger company. While the project deed may provide for formal communication channels between the government party and the private party, the government party should also consider regular communication with the private party’s sponsors or parent company where this is not already set out in the project deed. For example, it may be appropriate to invite representatives of the parent company to attend performance review meetings or government process seminars to foster better private sector understanding of government objectives and processes.

Project deeds usually provide for a senior representative group that conducts regular formal meetings between the contract director with senior representatives of the private party, its parent company, its key subcontractors and its financiers. This is regarded as best practice, and on projects where the project deed does not expressly require such meetings, the government party should still consider holding them.

When communicating with the parent company or sponsor, the contract director should ensure that confidentiality and privacy obligations set out in the project deed are observed. Particular care should be taken where the parent or sponsor is not the sole owner of the private party.

Relationship management and succession planning

Relationships can be put under significant strain when key contract management team members move on. Trust has to be rebuilt. Ideally, there should be a period where the successor works closely with the incumbent and the private party counterparty to enable as smooth a transition as possible.

The lengthy contract terms of *Partnerships Victoria* projects mean that contract management team members are likely to change throughout the project lifecycle. Consequently, forward-thinking succession planning by both parties is important to ensure appropriate relationships and understandings of the project are maintained. Effective succession planning requires well-managed project-role handovers between incoming and outgoing personnel with appropriate induction and exit procedures. Good knowledge management systems and processes can assist to overcome the loss of individual knowledge on each side of the relationship. It is important that advice from outgoing personnel on managing the relationship is documented to assist in this succession process.

Monitoring the relationship

As well as measuring performance against service, financial and other measures, the government party should monitor and assess the quality of the working relationship. For example, attendance by the private party’s representatives at formal meetings can easily be monitored, as attendance should be recorded in the minutes of meetings. If attendance by the private party’s representatives falls away, the contract director should consider whether this indicates that the relationship between the parties is losing strength, attention is being diverted to other priorities, or that the relevant committee is not an effective communication and management forum.

Monitoring the parties’ working relationship and management processes is valuable in highlighting aspects of the relationship that are perceived to be working well and those that require greater attention.

* + - 1. Issue management and dispute resolution

In a *Partnerships Victoria* project, there is a clear distinction between service delivery issues and disputes. This is summarised in the following table.

Table 4.1: *Partnerships Victoria* projects: differences between service delivery issues and disputes

|  |  |
| --- | --- |
| Service delivery issues | Disputes |
| Is measurable and need not involve any difference of opinion or position between the parties | Involves a difference of opinion or position between the parties (by definition) |
| Outcome is an interruption, change or other disturbance to service delivery | Need not involve any interruption or other disturbance to service delivery |
| May trigger an abatement of service fees or other remedies | The existence of a dispute will not in itself trigger an abatement of service fees |

The consequences and strategies for managing service delivery issues and resolving disputes in *Partnerships Victoria* projects still have much in common. Most obviously, if left unresolved, a major service delivery issue or dispute may cause an irreparable breakdown in the parties' relationship and failure of the project. Similarly, not properly managing minor service delivery issues or disputes may damage the relationship and limit the benefits of the project to the parties.

Issue management

However sound the relationship between the government party and the private party, service delivery problems will arise. The primary objective is to ensure that problems are recognised and then resolved quickly and effectively. Clear procedures for raising these issues and handling problems should be established. This will ensure that issues are dealt with at the earliest possible stage and at the appropriate level in each organisation.

The contract director and the private party should work together to establish and agree on issue management procedures acceptable to both parties (consistent with contractual requirements) and these procedures should form part of the contract administration manual. A joint issues log (as discussed in section 4.2) may also be an effective avenue for issues management.

Issues management procedures should incorporate the following:

* Service delivery issues are recorded as they occur, in order to highlight any trends and to help in assessing overall contract performance and value for money. It is recommended that each party add matters to the joint issues log, and that all new and outstanding issues be jointly reviewed regularly by the parties. A sample of headings to use in an issues log (either joint or for internal State issues) is set out in Template F. This can be modified to suit a particular *Partnerships Victoria* project.
* Effective communication means promptly advising the counterparty directly of major issues before adding to the issues log.
* Approaches and efforts taken to resolve problems should be documented clearly and precisely.
* Escalation procedures should be followed where escalation is appropriate to resolve the issue.

The contract director should collate information on the number and severity of issues, as well as the way they are resolved, during the life of the project. This information should be used to cross-check the accuracy of service delivery performance reports. In addition, trends in the frequency with which service delivery issues arise and the speed and effectiveness of resolving them are a useful indicator of private party performance. Performance reporting and soft indicators of performance are discussed in detail in Chapter 11.

Serious or persistent service delivery issues may trigger a right for the government party to initiate default processes and, ultimately, terminate the project deed. Responses to private party defaults are discussed in detail in Chapter 8.

Dispute resolution

In a well-planned and well-managed *Partnerships Victoria* project, disputes between the parties should be infrequent, but may occur because of unforeseen outcomes or circumstances. Like service delivery issues, disputes should be dealt with as early as possible and at the appropriate level in each organisation, so that they can be resolved quickly and effectively. The solution should be critically considered by someone who has an understanding not only of the immediate context of the dispute, but also of the broader possible consequences of the solution adopted.

A crucial role for the contract director is to try to ensure, through early intervention and management, that formal protracted disputes are avoided. These early intervention and management strategies should encourage negotiation between the parties and provide incentives for the parties to discover a solution themselves rather than pursuing formal dispute resolution mechanisms. In seeking to resolve disputes through informal means, the contract director should consider the commercial context of the dispute as well as the contractual context, as both are important in the early stages of a dispute. The contract director should also consider seeking appropriate advice (if required). If a party escalates a dispute unnecessarily, or resorts to an inappropriate dispute resolution process, this can further damage the relationship.

If a dispute cannot be resolved in the short term, it is important that it is promptly dealt with through a formal dispute resolution process set out in the project deed. Commercial principles in relation to dispute resolution are outlined in the *National PPP guidelines: commercial principles* and the *Partnerships Victoria* standard project deed guidance notes.

The parties should be required to undertake various informal dispute resolution processes prior to accessing more formal dispute resolution processes, as formal dispute resolution processes are costly, do not lend themselves to an early or negotiated outcome and are damaging to the relationship.

The parties should review the formal dispute resolution procedure and consider whether it is appropriate to agree on a process for dealing with disputes before the formal procedure is invoked. Alternatively, it may be desirable for the parties to agree on a process for invoking the contractual dispute resolution procedure if this process is not detailed in the project deed. More recent project deeds require negotiation between senior management before any more formal resolution procedure can be commenced. The dispute resolution procedure should be set out in the contract administration manual.

Department of Treasury and Finance’s role in issue management and dispute resolution

The *Partnerships Victoria* group in DTF is available to assist government parties to manage issues and resolve disputes. Where there is an emerging potential difficulty with State budgetary implications, or the sustainability of the project’s contractual and commercial arrangements are at risk, DTF must be informed.

* + 1. Contract management planning

|  |  |
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* + - 1. Introduction

Planning, information collection and analysis are key foundation elements of effective contract management for *Partnerships Victoria* projects. Proper planning of the project’s contract management strategy will, in itself, reduce the risk of the project being poorly managed. Comprehensive information collection and analysis will assist the contract management team to understand the risks involved in the project and to develop effective contract management strategies. Through proper planning, the contract management team establishes what information should be collected and its source. The information collected then helps them refine the overall contract management strategy.

The contract management plan is developed following contract execution, and outlines the key steps that need to be taken, including preparing a contract administration manual.

* + - 1. Developing a contract management plan

To be effective, contract management planning must start early in the procurement phase of a *Partnerships Victoria* project. Contract management builds on the risk allocation framework outlined in the relevant *National PPP guidelines: commercial principles* and the *Partnerships Victoria* standard project deed guidance notes*.* While the procurement phase places a strong focus on risks, especially those being transferred to the private sector, contract management planning must place a strong focus on the project risks retained by the government party and on the risks associated with managing the contract.

The contract management plan should outline the key steps and responsibility for developing a contract administration manual. Precedent documents developed for other projects may be helpful to guide a contract director unfamiliar with these processes.

The contract management plan is a relatively high-level document outlining the key steps that are proposed to develop an effective contract management regime for a *Partnerships Victoria* project.

Template A provides a recommended structure and included content for the contract management plan.

Developing a contract management plan is a key activity for the government party during the procurement phase and early construction phase of the project. Aspects of the plan will be relevant to the construction phase.

The contract management plan should include:

* + - internal governance arrangements, identifying the key persons responsible for management of the project and related contractual arrangements and associated committee and reporting arrangements. These apply to the construction phase and the service delivery phase, and how to transfer responsibilities between these stages;
    - budgetary and staff position allocations for contract management, and whether supplementary funding and/or additional positions are sought. This covers staffing and funding for consultancy, administrative and systems support;
    - proposed contents of the contract administration manual and timing and process for its preparation and implementation; and
    - proposed knowledge management arrangements.

Identify significant risks

Identify (in broad terms) the significant risk issues raised by contract management (for example, Inadequate monitoring of private party performance). As discussed in Chapter 2 of this guide, the significant risks may include:

* + - risks allocated to the government party in the project deed (and associated project contracts);
    - risks arising from issues not resolved at contract execution;
    - the process for managing risks arising from issues not resolved at commercial acceptance;
    - residual risk to the government party of risks contractually allocated to the private party;
    - risks arising from ineffective public sector management; and
    - risks associated with proposed changes to the contractual arrangements.

Analyse the risks

Ask the following questions:

* + - What strategy will be used to control that risk? For example, ‘Develop and implement a performance monitoring framework for the project’.
    - What is the date by which the government party needs to deliver and implement the strategy for control of that risk?
    - What contract management tools or processes will be used as part of the strategy and incorporated in the contract administration manual?
    - Who will be responsible for implementing the contract management plan? If appointed during the procurement process, the contract director will typically lead the development and implementation of the contract management plan. However, the project director, the procurement team’s legal adviser and the procurement team’s commercial adviser will have the strongest knowledge of many of the issues to be addressed and should therefore provide input into the contract management tools and processes and prepare the relevant sections of the contract management plan and contract administration manual.
    - What process of review should be applied throughout the project lifecycle?

Refine the plan

Refine the contract management plan as further information is gathered, the contract administration manual is developed, and the project moves through different lifecycle phases.

Obtain senior management sign-off

Obtain sign-off from senior management of the government party in relation to:

* + - the completed contract management plan, as soon as practical after financial close so that the plan can be submitted for approval; and
    - an updated contract management plan, and the contract administration manual, prior to commencing the service delivery phase.

These tasks should be started as early as possible in the procurement phase, and should be completed during the transition from the procurement phase to the construction phase.

* + - 1. Approval of the contract management plan

The contract management plan must be approved by the portfolio Minister, in consultation with the Treasurer within 60 days of financial close to inform government of the proposed contract management strategies.[[2]](#footnote-2)

Assistance with the contract management planning process is available, on request, from the *Partnerships Victoria* group within DTF. Before submitting the government party’s contract management plan to the portfolio Minister and the Treasurer, the government party should provide a copy to DTF so that it can review its consistency with this guide and best practices identified by DTF.

The *Partnerships Victoria* *Requirements*, state that the contract management plan must be updated and the contract administration manual (or equivalent tool) must be completed before the transition from the construction phase to the service delivery phase.

* + - 1. Information collection and analysis

Planning, information collection and analysis are also ongoing processes. Throughout the lifecycle of a *Partnerships Victoria* project, the risk profile of the project will change. Sources of change in the risk profile include:

* + - the natural progression of the project through its lifecycle stages, such as construction, commissioning, service delivery and contract termination or expiry;
    - internal factors such as changes in the relationship between the parties, State-initiated modifications or a change in law specific to the project; and
    - external factors, such as technological change, a fundamental change in financial markets or a change in law of general application.

As changes occur, the government party will need to:

* + - gather and analyse further information on the impact of the changes on the project’s risk profile and contract management strategies; and
    - if appropriate, revise or develop new contract management strategies.

Collecting and analysing information plays a central role in developing and maintaining contract management tools and processes, as illustrated in Figure 5.1.

Figure 5.1: The role of information collection and analysis in contract management



Sources of information

When initially collecting information during the procurement phase, major sources of information for contract management purposes will include:

* + - the business case for the project;
    - the project risk analysis conducted by the procurement team for the purpose of developing the contractual allocation of project risk between the parties. Note that this will not necessarily identify all risks to government during subsequent stages of the project, and it will not necessarily reflect the risk allocation agreed in the final project deed;
    - the project contract documents (typical contracts in a *Partnerships Victoria* project are listed in Appendix A), including the output specification, the services specification, returnable schedules and draft contract;
    - interviews with the procurement team and their advisers; and
    - existing risk management tools within the government party.

During the construction phase, additional sources include:

* + - final project deed (and associated project contracts);
    - the published project summary (to be released by government within 60 days of financial close);
    - associated financial, structural and organisational details of the private party;
    - notes and minutes from regular meetings with the private party under the contractual governance arrangements; and
    - materials prepared by the procurementteam during the construction phase.

Throughout the project lifecycle, the government party will collect further information relevant to the contract management strategy.

It is important to treat the information gathered in relation to the project as a whole. Information collected to establish a performance reporting regime for the project during the service delivery phase, for instance, may also influence contract administration generally and affect other specific contract management issues such as contingency planning.

Analysing the information

The government party will need to establish and maintain systems for recording and analysing the information collected.

A recommended tool for collating risk information is a risk matrix or risk register. Each material risk is described in the risk matrix, together with an assessment of its likelihood and severity, and a summary of the relevant controls and mitigants.

By collating risk information in one place, a picture of government’s overall risk exposure resulting from the project can be developed. The risk matrix should be a dynamic document, reviewed and updated regularly throughout the project lifecycle, to ensure it accurately reflects the risks faced. The example in Template E shows a basic risk matrix, which can be tailored as required.

In addition, the contract management team may create issues logs to keep a record of risks, obligations and other issues that it must manage. The example in Template F shows a basic issues log, which can be tailored as required. As discussed in section 4.3, it is common for the contract management team to keep two issues logs: a joint issues issue log for sharing with the private party, and a State issues log.

Managing the information

Information collected to develop contract management tools and processes must itself be managed, along with the substantial volume of other information relating to the project. Information management issues are discussed in Chapter 7.

* + 1. Contract administration

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* + - 1. Introduction

Building on Chapter 5, this chapter outlines a framework and relevant matters to be considered for developing a contract administration manual.

The contract administration manual is a living document used throughout the life of the project and should reflect the specific contract to be managed and meet the needs of the individual contract director and the contract management team.

Contract administration is about the contract director and the contract management team working with the private party and relevant government parties to achieve the government’s project objectives. Effective and efficient public sector contract administration is essential to the delivery of project and government objectives (including the value for money outcomes agreed at contract execution).

The *National PPP guidelines: practitioners’ guide*[[3]](#footnote-3)sets out five key tasks for contract administration throughout the project lifecycle. For completeness, six further tasks have been added for the purposes of this guide to produce the following list of key tasks:

Formalise management responsibilities for transition between the project stages.

Monitor project delivery.

Manage variations.

Monitor the service outputs.

Maintain the integrity of the contract.

Monitor contract performance.

Maintain strong working relationships with the project parties and service providers.

Resolve project issues and disputes fairly and efficiently.

Work with government colleagues to identify potential service delivery and other change events that may impact the project.

Ensure that standards of probity, governance and compliance are adhered to.

Conduct regular contract and project reviews to ensure continuous improvement.

The processes and tools described in Parts 2 and 3 of this guide will aid the contract director and the contract management team in monitoring contractual and financial issues with a view to identifying emerging risks to the project and government.

The key output is a contract administration manual or similar set of documents. The contract administration manual should, on a rolling basis, list government’s project objectives, summarise the project to date and related key decisions, highlight immediate and critical actions to be taken in administering the contract and align the available resources with the most time‑critical and materially significant risks at the various stages during the project lifecycle.

* + - 1. Purpose of the contract administration manual

The contract administration manual identifies:

* project overview and strategic context – lists the government’s project objectives, summary of project to date and related key decisions, details of the private party, and any outstanding issues that will require management by the contract management team;
* service delivery KPIs and payment mechanism – references the contracted service delivery, and other deliverables, and details of the payment mechanism and abatement arrangements. Records any key matters including abatements made;
* what needs to be done, by whom and when – assigns accountabilities, identifies the government party’s obligations, and mitigation and control of risks. It lists the private party’s reporting arrangements and how the government party will monitor these (performance monitoring during the service delivery phase is discussed in detail in Chapter 11 of this guide).
* how government's role will be performed – outlines the government party’s proposed approach to managing the project. Identifies the resources, delegations and authorisations required for government to perform its obligations, and available budgetary and staffing position allocations. If required, it may also outline the approach to servicing government sector customers, detailing the roles and responsibilities of each party which may be detailed in a separate agreement such as service level agreement (SLA);
* interface arrangements with the private party – identifies key private party counterparts and communication arrangements, including formal meetings and shared knowledge management arrangements;
* stakeholders and communications – outlines key stakeholders directly impacted by the project, or with a strong interest in the project, and arrangements for communication with these stakeholders; and
* contract rights – the ramifications of any non-performance or default by the private party or the government party, and how these should be addressed. Identifies the contingency framework and issue and dispute resolution mechanisms.

The contract administration manual collects the document references for all of the tools and processes used in managing the project.

The contract administration manual is not a substitute for the terms of the project deed. It reflects the project deed and, when using the contract administration manual, the contract director should refer back to the project deed whenever this is appropriate to give a full understanding of the content of the contract administration manual.

The foundation of contract administration manual is a strong understanding of the contractual arrangements. Contract directors need to be familiar with the government party’s obligations, both express and implied, to minimise the risk of default by the government party, hindering of the project by actions of government party, and inadvertent take-back of risk. After identifying these obligations, contract directors must ensure that these obligations can be fulfilled and the project deed can be managed efficiently and effectively. A contract director needs to:

* + - understand how government’s obligations will be met, the consequences if they are not met and their time sensitivity; and
    - ensure that there are resources available to undertake these obligations, and that relevant staff have appropriate authority.

The contract administration manual is a key tool to enable contract directors and the contract management team to carry out these tasks. It is part of a dynamic system to ensure the outputs sought by the government party through the *Partnerships Victoria* process are delivered by the private party. The contract administration manual should assist the contract director and the contract management team to understand the project deed and the environment in which the project deed must be administered.

Where other public sector entities are the end users of the contracted services or other services provided in relation to the project assets, the contract administration manual also informs those entities of the government party’s rights and obligations.

The contract administration manual should provide answers to the key questions:

* + - What needs to be done, by whom and when?
    - What are the ramifications of any failure to deliver contracted services, or default by the private party or government party, and how should these be addressed?
    - What are the service delivery requirements and payment arrangements?
    - Who are the key stakeholders and what are the communication arrangements?

It should also provide the historical context and address strategic issues, such as:

* + - How will the government party's role be performed?
    - What is the strategy for managing the project and for dealing with the private party?
    - What was the rationale for key decisions made in the project to date, and what lessons have been learnt?
      1. Assumptions underlying contract administration manual development framework

The framework for developing a contract administration manual is assumes:

* + - the project director and the procurement team will manage the project during the construction phase and are therefore responsible for developing the contract administration plan;
    - there will be a contract director appointed who will be ultimately responsible for managing the project during the service delivery phase and, therefore, for developing the contract administration manual;
    - the contract administration manual is designed to be used during the service delivery phase and the contract expiry or termination phase;
    - there will be a succession of staff during the life of the project;
    - the life of the project contract period may be up to 25 years or more; and
    - public officers are likely to require the support of external advisers to manage the project and issues that arise.

Where these assumptions are not valid for a specific project, the contract director should develop the contract administration manual with the alternative environment in mind.

Provided the content of the contract administration manual is arranged in an accessible and useful format, it is not necessary for the contract administration manual to be a single consolidated document. It may consist of a number of discrete documents that together serve the objectives set out above.

* + - 1. Content of the contract administration manual

The content of the contract administration manual should be arranged in an accessible and useful format. A recommended template and a methodology for developing the content of the contract administration manual using this template is outlined in Template B. The contract administration manual needs to build on the contract management plan, and be practical and relevant to both the day-to-day and the longer term management of the project deed. Therefore, it should:

* + - **provide a strategic context –** the contract administration manual should provide a brief historical summary of the project to date, including the service delivery context, the rationale for key decisions and discussion of key issues with the private party, and outline key elements of the private party. It should also outline the strategy for achieving the government party’s project objectives. The contract administration manual should include a summary of ‘the deal’ that illustrates the intent behind the project deed and its key provisions, rather than simply repeating or describing the meaning of contractual clauses. In this sense, it should capture what the project deed is trying to achieve and whether it is in fact being achieved;
    - **highlight actions** – the contract administration manual must highlight, on a rolling basis, the most immediate and critical actions that must be taken by the contract director to administer the project deed. These actions need to be set in the context of a clear understanding of the commercial intent of the parties, and the relevant commercial, legislative, regulatory and policy background. These actions should be included in an obligations register (see below for further details). Actions will extend beyond those listed in the project deed, and should include matters such as the need to undertake gateway reviews during the service delivery phase and prior to contract expiry;
    - **align resources** – the contract administration manual must enable the contract director to identify the resources required to perform necessary tasks and manage the most time-critical and materially significant risks at various stages during the project lifecycle;
    - **support governance** – the contract administration manual must support public sector governance practices, including communications, accountability and decision-making processes. It should outline internal reporting processes, including to the senior responsible owner and DTF;
    - **collate contract management tools and processes** – the contract administration manual must provide a cohesive set of contract management tools and processes. Some of these tools and processes may be developed separately from the contract administration manual. For example, the government party’s communications strategy for the project may be integrated with the government party’s agency-wide communications strategy. The contract administration manual needs to outline processes for:
      * identifying, monitoring and reviewing a risk analysis for contractual and other risks;
      * understanding service obligations, obtain reports, monitor performance and have clear payment arrangements; and
    - **ongoing review and development** – the contract administration manual must be a dynamic document, updated regularly so that it remains relevant throughout the project lifecycle. The contract director should implement procedures for reviewing and updating the contract administration manual at regular intervals.

The contract administration manual should include an obligations register which clearly outlines the key actions of the contract management team, and includes:

* + - the specific action;
    - the individual responsible for the action; and
    - the time or date by which the actions will be done (including whether the action is required once only, recurrently, or in response to specific events).

The contract director may find it convenient to set out this information in tabular form. Template C shows a sample obligations register.

* + - 1. Collecting information for the contract administration manual

The information to be gathered for preparing the contract administration manual should answer the question ‘What does government need to know in order to administer the contract effectively?’

What information needs to be gathered?

In collecting relevant information, the contract director should understand the distinction between the project deed obligations, but also the many requirements that sit alongside the project deed (e.g. relationships and stakeholders).

The project deed will set out a range of processes that may be followed by the parties, but it will not detail the internal steps within government that must be undertaken. To properly administer the project deed, the contract director must understand these internal steps.

What are the best sources of this information?

The best sources of information are commonly:

* + - people, such as:
      * the project director;
      * members of the procurement team;
      * the procurement team’s advisers (including legal, commercial, technical and, where applicable, operational);
      * the government operator (in ‘availability’ *Partnerships Victoria* projects);
      * the senior responsible owner;
      * end users;
      * independent assessors/reviewers;
      * *Partnerships Victoria*; and
      * fellow contract manager practitioners.
    - documentation, such as:
      * the project deed (and associated project contracts)

(Appendix A lists typical project contracts in a *Partnerships Victoria* project), including:

service KPIs and payment mechanism;

plans required to be submitted by the private party under the project deed (some at financial close and others by commercial acceptance); and

annotated comments by the procurementteam and contract management team;

* + - * internal reports;
      * minutes/actions from government steering committee and working groups and from meetings with the private party;
      * documents relating to approvals obtained during earlier stages of the project;
      * the risk matrix developed to allocate project risk under the project deed (and associated project contracts);
      * the public sector comparator for the project (for the allocation of risk and quantification of retained risk);
      * the public interest test (as documented in accordance with the *Partnerships Victoria Requirements*); and
      * input from the project control group, management committee or similar forum relevant to the project.

While much of this documentation will be available at financial close, the further the project deed extends into the service delivery phase, the more important information generated during the contract period becomes to effectively manage the project.

* + - 1. Risk analysis for contract administration

Risk analysis plays an integral role in contract administration.

In order to administer the project deed, the contract director needs to identify the potential risks, and to assess the likelihood of each material risk eventuating and the magnitude of possible consequences. The relationship between service delivery, risk and contract management generally, and the categories of risks relevant in the *Partnerships Victoria* contract management context, are discussed in Chapter 2 of this guide.

During the procurement phase, a risk analysis is carried out to determine how project risks should be allocated under the project deed and other project contracts. In preparing the contract administration manual, the government party, contract director and contract management team will need to further develop this risk analysis to:

* + - identify the project risk allocation under the project deed and other project documentation;
    - identify pre-existing or new risks that may not have been considered or dealt with in the contractual risk allocation process and incorporate in the existing risk analysis;
    - assess the likelihood of the risk occurring and the magnitude of the consequences, to the extent that these issues have not been addressed previously;
    - develop risk and contingency management processes and tools as listed in Appendix G for the most critical risks (see Chapter 8 of this guide for details on developing a contingency framework); and
    - determine whether the fact that a risk event occurs should trigger a review of the contract administration manual.

Contract risk analysis should be undertaken regularly, at least annually during both the construction phase and service delivery phase, and risk registers and/or issues logs should be updated accordingly.

* + - 1. The relationship between contract administration and performance monitoring

Contract administration includes the steps necessary to monitor the performance by the private party of its service delivery obligations.

Contract administration involves monitoring the performance by the private party of its service delivery obligations. The contract administration manual should include actions required to implement the performance monitoring and reporting strategy developed according to Chapter 11.

To ensure appropriate monitoring of the project and the private party’s performance, the government party should:

* + - review the project deed and other relevant project contracts in order to:
      * confirm the reporting obligations on the private party; and
      * identify the timeframes in which these obligations must be undertaken;
    - identify obligations of the private party under the project deed and other relevant project contracts that are not subject to specific reporting obligations but need to be monitored by the Government and identify how the government party will monitor these obligations; and
    - identify any obligation which should be implied into the project contracts by law or through the private party’s conduct.

The above should be captured in the contract administration manual.

The contract director will have responsibility for signing off on payment of the service payment invoices submitted by the private party, after satisfying themselves that the private party has fully met their service delivery and other KPI requirements.

Service delivery under the project deed will also support the government party meeting its output performance targets under the Victorian Government’s output funding model, and the contract director will need to also sign off on whether or not performance targets have been achieved in this respect.

In some projects, other members of the private party’s consortium will have obligations to the government party through a direct contract with the government party (for example, a tripartite agreement or a guarantee). The government party must review the relevant party’s obligations to the government party under these documents in the same way it reviews the private party’s obligations under the project deed. These obligations should also be included in the contract administration manual.

* + - 1. Managing unresolved issues

In administering a contract, the government party must manage any issues left unresolved at contract execution or commercial acceptance.

When the contract is executed there will remain matters to be agreed between the parties and the contract will outline the processes and timing (e.g. equipment selection). The contract management team will need to devote sufficient resources to resolve issues during the construction phase as robustly and expeditiously as possible. For instance, planning matters can be very complex and time consuming on some projects (further construction issues discussed in Chapter 10).

Similarly, there may be some outstanding issues to resolve as at commercial acceptance. For example, at commercial acceptance if an independent reviewer confirms that the works under a project deed criteria have been substantially completed, apart from minor defects and the facility is capable of being used for its intended purpose, the Government party may enter into an agreement to allow the private party to begin performing the contracted services and receive partial service payments, until the outstanding defect item is rectified.

The project director and/or the contract director (as applicable) should:

* + - identify and record any compromises made by the parties as the deal was negotiated in the procurement phase;
    - identify and record aspects of the deal that have been left intentionally for future development;
    - identify and record aspects of the deal which will be subject to other processes (for example, subject to the conditions of a planning approval or permit);
    - consider whether there are any matters that have been unintentionally forgotten; and
    - determine the likely ramifications of these unresolved matters.

Typically, such unresolved issues will be added to the issues log that is maintained jointly by both parties.

* + - 1. Reviewing and updating the contract administration manual

A contract administration manual must be regularly reviewed and updated to ensure its ongoing relevance to the project.

A *Partnerships Victoria* project generally involves the delivery of contracted services to or on behalf of government under a long-term contract. Each party’s obligations and the risks if these obligations are not fulfilled vary at different points in the project lifecycle.

An effective contract administration strategy must recognise and reflect the current stage in the project lifecycle but also include forward looking processes (e.g. planning for reviewable services periods.) The contract administration manual needs to be regularly reviewed and updated. There should be a formal review:

* + - at pre-determined milestones; and
    - in response to significant events affecting the project.

A review of the contract administration manual should assess any variations to the project deed and the environment in which the project deed has been managed. Any review should critically assess the contract administration manual and determine whether it is adequate to manage the project risks and any changes in the contract environment.

The need to maintain an up-to-date contract administration manual was an express recommendation made by the Victorian Auditor-General’s Office in its 2013 report, *Operating water infrastructure using private public partnerships.*

If a contract management tool or process is developed separately from the contract administration manual, the contract director should ensure they are also kept up-to-date as the tool or process develops over time.

In reviewing the contract administration manual, the contract director may need to consider complex issues that arise under the project deed. It is likely that the contract director will need access to ongoing legal advice to assist. The contract director should ensure there is an adequate budget for this ongoing legal advice and representation.

* + 1. Knowledge and information management

|  |  |
| --- | --- |
| Part 2: Key elements of effective contract management |  |
| Resourcing, governance and probity | Chapter 3 |
| Relationship management, dispute resolution and issue management | Chapter 4 |
| Contract management planning | Chapter 5 |
| Contract administration | Chapter 6 |
| **Knowledge and information management** | **Chapter 7** |
| Contingency planning | Chapter 8 |
| Ongoing review | Chapter 9 |

* + - 1. Why manage knowledge and information?

Effectively managing knowledge and information is essential to:

* + - ensure the continuity and availability of project knowledge and information assets throughout the project lifecycle; and
    - meet legislative, policy and contractual requirements**.**

In order to meet a government party’s governance and compliance obligations (see Chapter 3), it is essential to have effective knowledge and information management processes. This chapter is about developing an integrated project knowledge and information management strategy.

* Information is data in context that can be used for decision making.
* Knowledge is a body of facts, information or skills acquired through experience or education. It provides theoretical or practical understanding of a subject.
* Information management is the means and processes by which an organisation manages the creation, collection, storage, retrieval and distribution of information resources. It is technically part of a larger continuum of managing knowledge in an organisation or project.
* Knowledge management is a multidiscipline approach to achieving organisational objectives by making the best use of knowledge.
* Records management is a component of information management and is concerned with corporate records that document and verify business activities.[[4]](#footnote-4)

Figure 7.1: The relationship between knowledge management and information management



Initially, the contract management team should identify the government party’s knowledge assets and, where possible, use an electronic recordkeeping system to monitor and record key project performance and activities. It is most useful when the information management system records ‘tacit’ knowledge[[5]](#footnote-5) in addition to explicit knowledge and key project decisions.

Knowledge management is an important part of succession planning to ensure a seamless transition when contract management personnel change.

* + - 1. What are knowledge assets and knowledge activities?

Knowledge assets can be classified into two basic types:

* + - **explicit knowledge,** whichhas been physically embodied or recorded in a document, image or some other medium; and
    - **tacit knowledge**, which resides in a person’s mind and may include aspects of culture or ‘ways of doing things’.

Knowledge assets include:

* + - electronic documents such as word documents, spreadsheets, correspondence, presentations;
    - emails;
    - hard copy records such as signed project contracts, submissions, briefings and correspondence;
    - web-based information;
    - corporate memory (the sum of individual memory and expertise relevant to the project); and
    - records of conversations, meetings etc.

Knowledge activities involve:

* + - discovering, creating and receiving knowledge;
    - capturing and storing knowledge;
    - presenting, distributing and sharing knowledge; and
    - reviewing, maintaining and disposing of knowledge.
      1. How do I manage knowledge and information effectively?

Managing knowledge and information effectively requires:

* + - **a system** – use an electronic document and records management system to organise project information. The government party should seek to use existing technological systems or products, and avoid bespoke or customised products that have high upfront or ongoing costs. The system needs to be adaptable for the project lifecycle phase and project specific circumstances. The system should comply with the government party’s departmental/agency records management framework and obligations under the *Public Records Act 1973*, and enable access to the information as required over and beyond the life of the project;
    - **appropriate tools and processes** – develop and use knowledge and information tools and processes such as protocols, guidelines, policies and procedures that reflect the project lifecycle phase. Many public sector agencies have policies on managing information, records and documents. These should be used as a starting point in developing consistent contract management information processes; and
    - **an appropriate culture** – the contract management team needs to have a culture that values the processes and tools to manage knowledge and information. Fostering an appropriate culture is also useful to ensure that tacit knowledge and expertise is transferred to and retained by the government party. This will facilitate effective change management and maximise the continuity of contract management information when there are changes in contract management personnel.
      1. Developing a knowledge and information management strategy

When developing a strategy to manage knowledge and information effectively and identifying appropriate systems, processes and cultural levers, the government party should consider the following issues:

**Discovering, creating and receiving knowledge and information**

* + - Who creates the information?
    - What information will be collected?
    - What types of documents and information are there, and what are their attributes and relationship with other information?
    - Who owns and controls the information?
    - What specific provisions must be included in the project deed to ensure that the knowledge and information requirements are legally enforceable between the parties?
    - How will information that may be difficult to collect – such as emails, outcomes of conversations or meetings – be captured?

**Capturing and storing knowledge and information**

* + - How will knowledge and information be stored and maintained (both electronically and physically)?
    - What metadata[[6]](#footnote-6) will be attached to the information to assist with its retrieval?
    - What are the security requirements for the information?
    - How should the information be classified when it is stored? Does the project justify the cost of a barcoding or other sophisticated identification system?
    - Will different types of documents and information have specific storage requirements? For example, copies of disaster recovery and business continuity plans, and copies of difficult to replace documents (such as land titles, technical plans and certificates of insurance) should be stored onsite and in other locations offsite. There may be different requirements for formal or commercially/legally sensitive documents compared to informal emails.

**Presenting, distributing and sharing knowledge and information**

* + - What are the purposes for which the information is likely to be used by the contract management team or by others during the different project phases?
    - Are there common tasks (such as document, communication and version control) for all phases of the project?
    - How will the information be accessed and by whom? Will it be shared with the private party?
    - Are there types of information maintained by the private party (for example, operating and maintenance manuals, design, engineering and survey plans) that the government party will need to access? If so, in what stages during the project? In what form?
    - How will the information be transmitted between team members, stakeholders and contractors, and in what form?
    - What internal records, document and information management policies, procedures and guidelines should be adhered to?
    - What information or documents will the government party need to share regularly with stakeholders (for example, contact lists and organisational charts)? In what format? How will the information or documents be transmitted?
    - Are stakeholders clear on their information provision responsibilities?
    - What information does the government party need to satisfy stakeholders’ performance reporting requirements?
    - In what electronic and/or hard-copy format is this information required? How will the information be transmitted?
    - What agreed information formats should be established between parties to reduce double handling of information and resource duplication?

**Reviewing, maintaining and disposing of knowledge and information**

* + - How will the quality of the information be monitored over the life of the project (for accuracy, consistency and currency) and during the various phases of the project and transitions between phases?
    - Who will be responsible for the various processes of information management? How will they know the scope of their responsibilities?
    - How can the relationship between electronic and physical records be maintained effectively?
    - How will the information be disposed of? Under whose authority?
    - What knowledge, information, tools and processes need to be delivered to the government party on termination, step-in or expiry of the project?
    - What access restrictions (internally and between the parties) are appropriate?
    - How can the government party best meet its governance, compliance and legislative responsibilities (for example, obligations under Freedom of Information legislation)?
      1. Measuring the success of a knowledge and information management plan

The government party should regularly review whether its knowledge and information strategy is effective. The government party can measure the success of its information and knowledge management strategy by evaluating whether:

* + - relevant personnel have ready access to information and documents are easy to identify and retrieve;
    - the quality of information is accurate and current and relevant;
    - the information satisfies legislative and policy requirements;
    - double handling of information is effectively minimised;
    - the tools and processes for managing knowledge and information have been designed to fit a particular project phase, while also catering for common tasks within all project lifecycle phases;
    - information and documents are submitted and transferred between stakeholders in the appropriate form and at the appropriate time;
    - the project deed enshrines into legally enforceable rights those components of the knowledge and information management strategy that require the cooperation of the private party throughout each project lifecycle phase; and
    - it makes change of contract management personnel and succession planning easier.
      1. Regulatory and compliance requirements

The government party should:

* + - have useable records of the knowledge and information created, received, retrieved and used in conducting contract management activities; and
    - protect the integrity of those records for as long as they are required.

This support will enable the government party to comply with regulatory requirements for retaining records, outlined below and in section 7.7. The government party should integrate the records management requirements into its contract management knowledge and information management strategy. The contract director should ensure that these processes, however they are documented, are included in the contract administration manual.

Record-keeping obligations

The contract director should be familiar with the record keeping obligations set out in the Victorian Auditor-General, *Managing public sector records* (March 2017) and *Records management in the public sector* (March 2008). Adequate and accurate contract records are required for scrutiny of the contracting process. They support effective contract management, including appropriate performance monitoring. Relevant records include:

* + - records of contract negotiations;
    - changes to the agreements;
    - agreed performance measures;
    - ongoing performance data and management reports; and
    - complaints or dispute documents.

Project records are divided between contract records and contractors’ records:

* + - **Contract records** document the process of establishing and managing a project deed and other relevant project contracts.
    - **Contractors’ records** are generated by the private party while performing the contract.

The government party’s ability to efficiently and effectively manage the project deed depends upon accurate, up-to-date and easily accessible records. Government agencies are required to manage records in a manner that is consistent with open and accountable government, while protecting the integrity of records and maintaining appropriate security and confidentiality. Full and accurate records and recordkeeping are a prerequisite to government agencies being able to meet their statutory and legal obligations.

Poor recordkeeping practices contribute to organisational inefficiencies, affect the ability of staff to make reliable business decisions and weaken government’s accountability. A records management strategy is key to the knowledge management and information strategy.

Protocols for creating documents

As part of its information management strategy, the government party should establish internal protocols for creating documents. Protocols should include guidance on:

* + - ensuring the documents accurately reflect discussions etc. and, where the document is not a final document, its stage in the process (for example, drafts);
    - ensuring documents that record confidential discussions or information obtained in confidence are appropriately identified;
    - ensuring that documents subject to Cabinet in Confidence or legal professional privilege are appropriately identified, and that separate protocols for dealing with such documents are adhered to;
    - noting that documents may be subject to a court discovery process or a Freedom of Information request; and
    - document naming conventions.

* + - 1. Access to information and the *Freedom of Information Act 1982*

A contract director for a *Partnerships Victoria* project should have an understanding of the obligations in the Freedom of Information (FoI) Act. Appendix E of this guide discusses some of the issues relevant to this area of public sector compliance. The contract director should seek advice from the FoI or legal units within the government party when developing its knowledge and information management strategy. The contract management team should also receive specific training on FoI, with advice from the FoI or legal units, to ensure that the contract management team complies with FoI requirements. The contract director will need to:

* + - manage FoI issues when they arise;
    - achieve an approach to records management that complies with the project knowledge and information management system;
    - record information in a way that supports operation of the FoI Act; and
    - ensure that the project deed (and associated project contracts) reflects government policies to maximising public access to project information.
      1. Intellectual property and confidential information

**Intellectual property** includes various classes of rights protected by legislation (such as copyright, patents and registered designs), together with confidential information and trade secrets protected at common law or under contract. In any *Partnerships Victoria* project, there is a possibility of intellectual property passing between the government party and the private party. Section 13.5 of the *National PPP guidelines: practitioners' guide* discusses the intellectual property issues that arise during the procurement process. Appropriate provisions should be included in the project deed to govern intellectual property rights after contract execution. Intellectual property can be a source of complex issues, as such contract directors should refer to the [whole-of-Victorian Government IP policy](http://www.dtf.vic.gov.au/Victorias-Economy/Victorian-Government-intellectual-property-and-data-policies/Intellectual-Property-Policy) <http://www.dtf.vic.gov.au/Victorias-Economy/Victorian-Government-intellectual-property-and-data-policies/Intellectual-Property-Policy> and seek further legal advice, if required.

Managing intellectual property

As part of its knowledge and information management strategy, the government party should identify and manage the intellectual property relating to the project.

The contract director should have an understanding of the nature of the intellectual property that the government party may hold or receive in relation to the project, and should also understand the legal principles applying to the protection of that intellectual property. The project deed may require the private party to provide a register of intellectual property for the project.

Section 13.5 of the *National PPP guidelines: practitioners’ guide* presents an overview of the identification and treatment of intellectual property in *Partnerships Victoria* projects and outlines the interaction of the FoI Act and the protection of trade secrets.

The appropriate intellectual property management strategy will depend on the nature of the intellectual property and the contractual provisions applying to it. Both the *National PPP guidelines: commercial principles*[[7]](#footnote-7) and the *Partnerships Victoria* standard project deed guidance notes set out the government’s preferred contractual position in respect of intellectual property. The contract director should ensure that the contract administration manual specifies the actions necessary to fulfil the government party’s intellectual property obligations under the project deed. Actions and processes that may be relevant include:

* + - ensuring confidential information in any intellectual property is kept in secure storage and personnel are aware of its confidential nature;
    - restricting access to particularly sensitive information held by the government party so that only a select group of personnel can access it;
    - identifying confidential information in any intellectual property in the government party's information management systems;
    - maintaining a register of all intellectual property used in relation to the project; and
    - ensuring any licences and sub-licences of intellectual property are reviewed and renewed when necessary.

The private party’s intellectual property management

In monitoring the service performance, the government party should monitor the private party's compliance with any obligations that relate to its possession and handling of the government party's intellectual property.

Private sector confidential information held by the government party

The protection the law provides to confidential information depends on whether the information is private or public sector information. Confidential information in the private sector will generally be protected if disclosure would be detrimental to the owner of the information. In contrast, confidential information in the public sector generally will not be protected unless the relevant government party can establish that disclosure is likely to injure the public interest. However, if the government party in a *Partnerships Victoria* project receives information from the private party, and the government party has a contractual obligation to keep that information confidential (for example, the information is ‘commercial in confidence’), the government party must comply with that obligation unless it is subject to an overriding disclosure obligation.

Confidential information and overriding disclosure obligations

The different levels of protection for confidential information in the public and private sectors do not detract from the private sector’s concern that doing business with the government will result in public disclosure of information that the private party would otherwise keep confidential. This is partly because of government policy and partly because a contractual obligation to keep information held by government confidential can be overridden through various statutory means.

Contract disclosure policy and project summary requirements are set out in Section 17 of the *Partnerships Victoria Requirements.* Current government policy is to publish the executed project deed on the Victorian Government tenders website within 60 days of financial close. The private party should be given the opportunity to mark-up parts of the project deed it believes should not be disclosed on the grounds of ‘commercial-in-confidence’. The contract management team will need to review these mark-ups to ensure that only material that is genuinely ‘commercial-in-confidence’ is redacted. More recent project deeds may contain a schedule of commercially sensitive information which sets out the ‘commercial-in-confidence’ information in the project deed or other project contracts that must be redacted prior to any public disclosure.

The government's policy in relation to contract disclosure (discussed in Appendix E of this guide and in Section 17 of the *Partnerships Victoria Requirements*) allows ‘commercial-in-confidence’ information to be withheld from the versions of the project contracts that are disclosed. However, such information may be made public as a result of an application under the FoI Act (see Appendix E of this guide for a detailed discussion of the mechanism for disclosure). The Auditor-General, the Ombudsman, the Independent Broad-based Anti-corruption Commission and parliamentary committees, under their statutory powers and functions, can also access and publish what would otherwise be ‘commercial-in-confidence’ information.

For contract managers, the status of commercial-in-confidence information may change over the lifecycle of the project. Requests for information may prompt a review of the original redactions to ensure they can be substantiated.

Auditor-General access

Where private sector entities take on expenditure of public funds, it is reasonable that they be subject to public sector transparency expectations which may be greater than in the private sector. In May 2016, the *Integrity and Accountability Legislation Amendment Act 2016* was passed to amend the *Audit Act 1994*. These reforms now provide the Victorian Auditor-General’s Office with follow-the-dollar powers for performance audits (i.e. the capacity to consider the effectiveness, efficiency and economy of public sector services or functions that are delivered through contracts with the private or not-for-profit sectors). This enables the Auditor-General to obtain information about private parties’ activities in respect of their expenditure of public funds.

As confidential information may be made public through the FoI Act, or by the Auditor-General, the Ombudsman or parliamentary committees, a contract director should avoid giving the private party absolute assurances about the confidentiality that will be accorded to information the private party provides to the government party.

Further information

Further information on creating a knowledge and information management strategy, incorporating a records management strategy, is available from:

* + - Chapter 10 of *A guide to the project management body of knowledge,* 2000 edition, ProjectManagement Institute*,* Newtown Square, USA;
    - the [UK Office of Government Commerce website](http://www.ogc.gov.uk/sdtoolkit/reference/deliverylifecycle/delivery.html) <www.ogc.gov.uk/sdtoolkit/reference/deliverylifecycle/delivery.html>;
    - AS ISO 9001 Quality Management Systems;
    - Interim Australian Standard AS 5037 (int)-2003, from Standards Australia;
    - AS ISO 15489.1 Australian Standard Records Management Part 1: General; and
    - AS ISO 15489.2 Australian Standard Records Management Part 2: Guidelines.

The government party can find further information on the use of electronic document management systems on the [Victorian Electronic Records Strategy website](https://www.prov.vic.gov.au/recordkeeping-government/a-z-topics/vers) <https://www.prov.vic.gov.au/recordkeeping-government/a-z-topics/vers>.

The [Public Records Office of Victoria records management standards](https://www.prov.vic.gov.au/recordkeeping-government/about-standards-framework-policies) <https://www.prov.vic.gov.au/recordkeeping-government/about-standards-framework-policies> set out general requirements for records management standards.

* + 1. Contingency planning

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* + - 1. Introduction

Contingency planning is vital to a *Partnerships Victoria* project to ensure the government party is prepared in the event of service failure by the private party. While the private party is financially accountable and the first point of redress, the government party retains ultimate accountability to the community and may need to act to manage the consequences of a service failure.

The contract management team needs to regularly assess current risks and issues, and scan for potential new risks and issues.

Specific planning for some potential contingency events can be warranted, such as a private party default leading to a partial or full loss of services. However, given the range of possible major events that could cause a loss of services or other material concern, it is likely to be more effective (and efficient) to develop a contingency management framework that can be applied to any event.

If unexpected events do occur, there may be a need to add resources to the contract management team at short notice, including bringing in external advisers. It is critical that budget funding for such resources can be readily accessed, as necessary.

* + - 1. Contingency framework

The elements of a contingency framework may include:

* + - a list of key stakeholders dependent on the contracted services, or which may be affected by a service failure, and up-to-date contact details including out-of-hours details;
    - a list of other government stakeholders that should be advised of contingency events (on a ‘need to know’ basis) and up-to-date contact details including out-of-hours details;
    - the basis of a communication strategy;
    - a plan for accessing alternative sources of service;
    - a plan for accessing additional budget funding; and
    - a plan for engaging expert advisers, as needed, at short-notice.

This contingency framework should link to the government party’s wider business continuity and disaster recovery plans, if these exist. This contingency framework should be appended to the contract administration manual, be regularly updated and should address the following types of events:

* + - **events that interrupt service delivery but do not involve default by the private party** – for example, force majeure events;
    - **events that interrupt service delivery and involve a default by the private party** –for example, the private party fails to maintain the project assets as required by the project deed, and consequently fails to meet the services specification; and
    - **private party defaults that do not result in an interruption to service delivery** –such defaults could include failure by the private party to maintain professional indemnity insurance as required by the project deed, and subsequent insolvency of the private party because of a negligence claim.

There may be merit in the government party identifying the range of significant potential contingency events in a *Partnerships Victoria* project. This will inform the contingency management framework that can be applied readily should any specific event occur.

* + - 1. Planning for contingency events

There are three primary (and overlapping) contingency processes relevant to *Partnerships Victoria* projects:

* + - **service interruption response planning** – to prepare for any interruption to service delivery during the service delivery phase;
    - **step-in planning** – to prepare for the exercise of any step-in rights in the *Partnerships Victoria* contract, whether as a result of an interruption to service delivery, a default by the private party, or another event negotiated as a step-in trigger; and
    - **default planning** – to prepare for any default by the private party in either the construction phase or the service delivery phase.

Service interruption response planning

Service interruption response planning in a *Partnerships Victoria* project is a tool to mitigate the impact of an interruption on the public, government party and other key stakeholders.

The private party will generally bear the financial consequences of an interruption in the contracted services that it provides. The government retains ultimate accountability to customers and the community, and must therefore have appropriate plans in place to appropriately respond to such interruptions. For example, a government health services authority overseeing multiple hospitals will operate and maintain hospitals directly as well as via a PPP. Therefore the project specific service interruption response plan can build on the common elements in existing facility business continuity and disaster recovery plans.

Developing a service interruption response plan

A service interruption response plan should be short, clear, easily understandable and easily available, given it could be activated at short notice in circumstances in which the personnel responsible for the plan’s implementation may be under significant pressure.

The key issues to consider in developing and maintaining a service interruption response plan in the context of a *Partnerships Victoria* project include the following:

* + - What are the potential events that may trigger activation of the service interruption response plan?
    - What immediate actions should be taken to respond to an interruption to service delivery, before taking steps to stabilise or restore critical services?
    - How should various components of the services be prioritised under the service interruption response plan?
    - What are the roles and responsibilities of the government party personnel responsible for activating and implementing the service interruption response plan? Do these personnel understand their roles and responsibilities? Do they have appropriate delegated authority for their roles and responsibilities?
    - Who is authorised to activate the plan?
    - What communications are required to activate and implement the service interruption response plan?
    - What communications to stakeholders, the public and the private party are required when the service interruption response plan is implemented? A proactive communication strategy can prevent the government party becoming inundated with incoming queries from concerned end users, the public and the media, and can prevent a loss of public confidence in the government agency.
    - Is the service interruption response plan available to the people who need to invoke it?
    - Is the service interruption response plan integrated with business continuity plans for core or similar services provided by the government party?
    - How and when will the service interruption response plan be tested? Testing is essential to ensure the plan can be implemented as planned and personnel are familiar with its operation.
    - What are the private party’s contingency plans and are the private party’s contingency plans consistent with the government party’s contingency plans?

When a service interruption occurs, the initial priority should be to mitigate any immediate safety risks. To this end, it may be necessary for the contract management team to take action, make decisions, or approve action by the private party without having the opportunity to fully consider the contractual implications. Where possible this should be done in consultation with the senior responsible owner and, once the immediate danger has been averted, the contract management team should promptly revert to operating within the contractual framework. Within this framework, the specific tasks required to further respond to the service interruption will significantly depend upon the nature and circumstances of the service interruption. In this context, the following issues should be considered:

* + - What are the time periods or targets for stabilising or restoring critical components of the services?
    - During the period of service interruption will replacement services be provided by the government party, will the private party provide the services to the extent that it is able, or will a combination of these solutions be used?
    - What resources are required to restore delivery of each critical component of the services? How will these resources be mobilised?
    - What service specifications and service level targets should be set for each critical component of the services during the response period? Have relevant stakeholders been informed that these service specifications and targets will apply during the response period? In some cases during such temporary operating conditions, acceptable service specifications and service levels may be less stringent than those imposed on the private party in the relevant project deed.
    - What information is required when implementing the service interruption response plan? These information requirements should be considered when developing the government party’s knowledge and information management strategy, discussed in Chapter 7.
    - How will the government party exit from the service interruption response plan? This may be by the private party restoring services, consistent with the services specification, or by establishing an ongoing source of alternative services.

The private party’s contingency plans

A project deed should oblige the private party to maintain its own contingency plans. The allocation of risk to the private party also provides commercial incentives for the private party to develop its own contingency framework. It is important that both parties have a basic understanding of one another’s plans for these events. This way, should services be interrupted, they are not working at cross-purposes in seeking to restore the services or mitigate the effects of an adverse event. Where a degree of coordination appears necessary, the parties should also cooperate in testing their contingency plans.

Step-in planning

Most project deeds give the government party a right to ‘step in’ in certain circumstances and temporarily enter or take control of the project assets used to provide contracted services. Careful planning is required to put the government party in a position to effectively exercise step-in rights should the need arise, and then step out.

Step-in rights are clearly documented in a project deed, however exercising those rights is complex and requires careful planning. Contractual issues in relation to step-in are discussed in detail in the *National PPP guidelines*: *commercial principles for social infrastructure* (Chapter 27) and *National PPP guidelines:* *commercial principles for economic infrastructure* (Chapter 26) (as applicable) and the *Partnerships Victoria* standard project deed guidance notes.

It is unlikely that a detailed step-in plan covering all circumstances can be developed prior to a step-in event occurring. Where step-in rights exist in a project deed and a situation arises in which step-in may be an appropriate response, a step-in plan should be finalised in conjunction with (and possibly as part of) the service interruption response and default plans for the project. The final details of the plan will significantly depend upon the nature and circumstances of the event triggering the step-in.

For example, step-in rights may be available if a *force majeure* regime relieves the private party from its obligation to deliver the contracted services, and the government party is in a position to restore or maintain the contracted services but the private party is not able to do so.

If step-in rights are available where there has been a default by the private party, step-in planning overlaps with default planning.

A critical part of step-in planning is planning how and when to step out without creating legal problems. Contract directors should seek legal advice in this instance.

Developing a step-in plan

Issues to consider in developing a step-in plan include:

* + - What events have occurred that can trigger the government party’s step-in rights?
    - What contractual conditions must be satisfied before the step-in rights can be exercised?
    - What are the roles and responsibilities of the government party personnel responsible for activating and exercising step-in rights? Do these personnel understand their roles and responsibilities? Do they have appropriate delegated authority for their roles and responsibilities? What are the limits within which step-in rights are exercisable?
    - What internal authorisations are required before exercising step-in rights?
    - What third-party acknowledgements or consents might be needed to enable the government party to effectively exercise its step-in rights? Should those consents be obtained in advance of any step-in situation arising?

This should be discussed with the government party’s legal advisers at the time the step-in rights are negotiated. Should a step-in situation arise, the government party must act quickly. Consequently, the government party may wish to seek an acknowledgment of the existence of the step-in rights from those landlords and suppliers, together with any necessary consent, before any step-in situation arises.

* + - What obligations and liabilities may be incurred in exercising step-in rights? Is adequate insurance in place? Has the risk of public sector employees being deemed to be directors of the private party for *Corporations Act 2001* (Cth) (Corporations Act) purposes been considered? The CorporationsAct provides that certain people involved in the management of companies may be deemed to be directors of the company. The risk to individual should have been addressed during the procurement phase and may need to be confirmed at the time of step-in.
    - What are the taxation consequences of exercising step-in rights? Step-in may have significant taxation consequences for the private party. These consequences may affect the future of the project or result in taxation costs being passed back to government. Advice should be sought from government’s tax advisers at the time the step-in rights are negotiated.
    - What resources are required to implement the step-in plan? Does the government party have access to sufficient skilled personnel to enable it to effectively exercise its step-in rights? How will resources and personnel be mobilised? For example, if the private party abandons the project site and the government party steps-in, the government party may need to hire a security company to secure the site.
    - What information is required when implementing the step-in plan? The information requirements should be considered when developing the government party’s knowledge and information management strategy, discussed in Chapter 7.
    - What communications are required to activate and implement the step-in plan?
    - What communications to stakeholders and the public are required when step-in rights are exercised? A proactive communication strategy can reduce the incoming queries from concerned end users, the public and the media.
    - How will the government party ‘step out’? Is step-out possible or feasible in this project?
    - Can the government party step in and not step out? If so, can it (from both legal and practical perspectives) re-tender the project? Should the government party step in and not step out?
    - Is the step-in plan available to the people who need to invoke it?

If a significant unexpected event triggers a need to step-in, it may be necessary for the contract management team to take action without having the opportunity to fully consider the issues above. Where possible this should be done in consultation with the senior responsible owner and, once the immediate need for action has been met, the contract management team should promptly review any outstanding issues associated with the step-in.

Generally, it is not possible to fully test a step-in plan. However, consideration should be given to ‘walking through’ a range of step-in scenarios as a means of testing the plan’s validity.

Default planning

A *Partnerships Victoria* project deed generally gives the government party the right to invoke a default provision if the private party fails to meet its contractual obligations in a material way.

While it is fundamental that a *Partnerships Victoria* project be treated as a mutually beneficial relationship between the parties, the government party must adequately prepare for any default by the private party.

Default processes are clearly documented in project deeds, however exercising those rights is complex and requires careful planning. Contractual issues in relation to default are discussed in detail in the *National PPP guidelines*: *commercial principles for social infrastructure* (Chapter 24) and *National PPP guidelines: commercial principles for economic infrastructur*e (Chapter 23) (as applicable) and the *Partnerships Victoria* standard project deed guidance notes.

If a situation arises in which activating the default process may be an appropriate response, a default plan should be developed, if appropriate in conjunction with (and possibly as part of) the service interruption response and step-in plans for the project. The details of the default plan will significantly depend upon the nature and circumstances of the default event.

Developing a default plan

In developing a default plan the plan should be short, clear, easily understandable and available.

The key issues to consider in developing and maintaining a default plan for a *Partnerships Victoria* project include:

* + - What are the potential default events?
    - To what extent does each default event affect the provision of the services, both immediately and in the longer term?
    - What time periods must expire before the government party can act in response to the default? What is the timeframe for the cure periods available to the private party (or its financiers)?
    - What remedies are available under the project deed? What are the potential consequences of each remedy?
    - What are the roles and responsibilities of the government party personnel responsible for activating and implementing the default plan? Do they understand their roles and responsibilities?
    - What resources are required to implement the default plan? How will these be mobilised?
    - What information is required when implementing the default plan? The information requirements should be considered when developing the government party’s knowledge and information management strategy, discussed in Chapter 7.
    - What communications are required to activate and implement the default plan?
    - What communications to stakeholders, the public and the private party are required when the private party is in default? A proactive communication strategy can reduce the incoming queries from concerned end users, the public and the media.
    - How will the government party exit from the default process? This may be through a return to ‘business as usual’ service provision by the private party, a negotiated outcome, termination of the project deed (and associated project contracts), or another outcome specified in the project deed.
    - Is the default plan available to the people who need to invoke it?
    - What notices have to be given to clear away any estoppels or waivers which have arisen in contract management?
    - Are there any duties of good faith applicable? If so, what notices do these duties require the government party to give before it can take further action?

Responding to default events

A contractual default may not always affect performance of the project activities therefore the action taken under the default plan needs to be determined in light of the overall relationship with the private party.

In some instances, it may be appropriate to take no direct action in response to a particular default, such as a private party not getting consent for a change of control. However, in doing so, the government party should be careful not to give up its right to act freely in respect of future defaults of the same kind or of any other kind, or in respect of other existing defaults. It should avoid informal waivers. The government party should seek legal assistance in preparing a written waiver letter. If the government party wants to be able to act freely in respect of future defaults, the waiver letter should clearly communicate to the private party that:

* + - the private party was in default under the project deed;
    - in this particular instance, the government party has chosen not to take action;
    - the private party will be expected to fully comply with the project deed (and associated project contracts) in future; and
    - future defaults may result in the government party taking any action available to it under the project deed.

If the government party is willing to give up the right to take any action relating to similar future defaults, this should be documented as a variation to the contract or waiver of the right to act in that instance.

* + 1. Ongoing review

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* + - 1. Introduction

Contract management processes must change and adapt throughout the lifecycle of a *Partnerships Victoria* project, as the project will be subject to:

* + - divergence between original expectations and actual project outcomes;
    - changes in the project itself – through change events reflecting different demand, or as a result of contingency events, or as a result of the project moving from one phase in its lifecycle to another; and
    - changes in the external environment in which the project operates (including financial markets, technology and the labour market).

As part of its overall contract management strategy for the project, the government party should establish a process for ongoing review of its contract management tools and processes.

The government party should be looking at ways to continually improve its contract management tools and processes. Some project deeds have an explicit objective, and related mechanisms, to identify opportunities that can provide win-win outcomes for both parties. However even where a project deed does not contain such provisions, contract managers should be open to continuous improvement opportunities.

* + - 1. Keeping knowledge and information up to date

Knowledge and information gathered through the project lifecycle should be used in conducting regular reviews of the project’s risk profile. Keeping information up to date and continually analysing information is a necessary foundation for ongoing review of the project’s contract management framework.

A regular review of the government party’s knowledge and information management strategy should consider:

* + - whether new risks have emerged – this requires a consideration of the entire project context, including the business and policy context;
    - whether the likelihood or severity of existing risks has changed significantly;
    - whether new standards or best practice approaches have emerged, for instance updated KPI regimes;
    - whether there has been any intended or unintended shift in the allocation of a risk;
    - whether existing risk controls and mitigants remain effective; and
    - whether any new risk controls and mitigants should be implemented.

It is important that contract managers keep abreast of changes in the external environment and the latest industry or sector developments that may impact their *Partnerships Victoria* project. To keep up to date, contract managers may take a number of actions, including attending relevant industry conferences and events, regularly interacting with fellow practitioners and participating in communities of practice, such as the *Partnerships Victoria* Contract Management Forum or National Contract Management Forum.

* + - 1. Review and testing of existing plans, processes and tools

Using up-to-date knowledge of the project’s risk profile, the government party should regularly review and test (where appropriate) its individual contract management processes and tools.

Issues to consider in reviewing contract management processes and tools include testing the original principles together with the following:

* + - **Do assumptions remain correct?** Have there been any changes in the underlying assumptions on which the process or tool was based? For example, while it may be correct to assume that the private party has a strong incentive to fulfil its maintenance obligations early in the contract term, this assumption may not hold toward the end of the contract term, and closer monitoring of maintenance performance may be appropriate at that time.
    - **Are resources adequate?** What resources are required to effectively implement the contract management process or tool should a risk materialise in the future? Does the government party have these resources?
    - **Have contract management tools and processes been effective?** If risks have materialised and were managed using the process or tool, how effective was it? See the discussion below in relation to ‘lessons learned’.

A useful part of the ongoing review process is a regular stocktake of issues to identify trends, reassess risks, and review the effectiveness of processes for dealing with those issues.

* + - 1. Identifying and recording ‘lessons learned’

Identifying and recording ‘lessons learned’ is both an information collection process and a contract management review process. By identifying risks that have materialised and their consequences, the government party deepens its understanding of the likelihood and severity of the risk. By examining the contract management strategies used to control and mitigate that risk, it can assess the effectiveness of that strategy and identify potential improvements.

It is recommended that procurementteams, and contract management teams, formally undertake a lessons learnt review at various stages throughout the project lifecycle.

For contract managers, this review should be informed, in part, by a review of contract management documentation – including notes annotated on the government party’s electronic copy of the project deed, where such technology is used. This review can identify matters for improvement in the current project, provide specific matters for consideration in future *Partnerships Victoria* projects in that sector or identify matters that may benefit *Partnerships Victoria* practitioners more generally. DTF will assist in communicating lessons learned across government, through the Contract Managers Forum.

Figure 9.1: The ongoing review process



* + - 1. Formal review of the project performance

A formal review of the project performance, including the appropriateness of the KPIs, should be completed in the first year after commercial acceptance. The review should start as early as possible, to take advantage of the availability of the procurement team.

The formal review may establish that the actual project circumstances differ from the circumstances jointly expected by the parties at the time of project deed execution. If so, the government party should consider:

* + - whether the consequences of the unexpected circumstances should be borne according to the contractual allocation of project risk; or
    - whether an amendment to the project deed (or other project contracts) should be negotiated to better ensure the achievement of the project objectives.

For example, it may be appropriate to recalibrate the KPIs documented in the project deed to ensure they are meaningful and relevant to the project. In recent projects, the project deed provides that a function of the project control group (see section 4.2) during the service delivery phase is to discuss the application of the payment mechanism and agree to any changes to the regime if required.

Further formal reviews should be undertaken at various stages throughout the project lifecycle to assess whether the project is delivering value for money. Determining value for money can be informed by comparing outcomes against the target benefits articulated in the full business case, and as expanded into more detail in the contractual KPIs, and against the estimated costs.

The gateway review benefits evaluation review (gate 6) provides a high-level qualitative framework. Where a review happens later in the project lifecycle, it will need to consider the changes made to the project deed (and associated project contracts) over time to reflect evolution of government requirements. Gateway reviews are arranged by the gateway review Team in DTF and are applicable to all high-value high-risk projects.

Government parties may also wish to commission their own more specific reviews on project matters through their own internal audit group or engagement of a specialist independent third party.

To obtain the most value from such reviews, it is recommended that they be undertaken by independent parties and report to the senior responsible owner.

Part 3: Contract performance

Part 3 (Chapters 10–11) outlines the key elements of effective contract performance for *Partnerships Victoria* projects, expanding on the information provided in the National PPP Guidelines[[8]](#footnote-8). In particular, it addresses the range of issues applicable to each of the construction and service delivery phases of the project lifecycle and provides both principles to underlie actions and practical guidance.

Chapter 10 Construction phase

Chapter 11 Service delivery phase

* + 1. Construction phase

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* + - 1. Introduction

In *Partnerships Victoria* projects, sound contract management is essential to ensure that project objectives are met, contracted services are delivered to an appropriate standard and that value for money is achieved over the life of the project.

This chapter addresses the unique contract management challenges that arise during the construction phase of a project. It covers the key phases of design development, construction management and commissioning. All of these processes are guided by the project’s contract management plan. This chapter provides a contract management perspective on the construction issues covered. It does not provide guidance on *project* management during the construction phase.

Figure 10.1 shows the timing of the key processes in the construction phase of a typical *Partnerships Victoria* project.

Figure 10.1: Timing of processes in a typical project



* + - 1. Governance and relationship management

Governance

From the date that a project deed is executed, effective contract management will ensure that the project objectives are delivered. As section 3.2 outlines, the project director during the procurement phase will generally remain engaged on the project during the construction phase to manage the design and construction process. Usually the project director role transitions to the contract director role, once commercial acceptance has been achieved and the project is in steady-state operations.

A reference to the project director in this chapter should be taken as a reference to the person responsible for managing the project on behalf of the government party during the construction phase, whether that means the project director or a separate person in the role of contract director.

The project’s advisers and the commercial manager from the procurement phase should be available to the procurementteam in the construction phase to clarify contractual matters. Additionally, the project director should be aware of the delegations relating to the project and that relevant parties are adhering to these delegations.

Governance structures, such as the steering committee, are likely to remain in place throughout the project, including during the construction phase. The contract administration plan must be prepared and approved by the portfolio Minister in consultation with the Treasurer within 60 days of financial close.

Establishing relationships

At the core of a successful contract management framework is a strong working relationship between the project director (and contract management team) and the consortium (including both the private party and its subcontractors).

The construction phase of any project can involve a fast-moving, high-pressure work environment. Deadlines, unforeseen design issues, accountability requirements, and pressure from stakeholders are common issues faced by project directors.

It is important for people with contract management responsibilities to ensure that the relationships between the government party and the private party teams begin and remain professional and productive at all times. This will not happen by chance, and requires active effort and monitoring to build and maintain a solid relationship.

Project directors need to balance short-term imperatives during the construction phase with long-term service objectives. In particular, it may be important to remind procurementteam members that during the construction phase, which has a limited duration, hard tactics and destructive personal styles that may produce short-term benefits in negotiations are likely to be counterproductive in the longer term.

The project deed outlines the contract management protocols and expectations for regular meetings between the parties, the private party’s reporting requirements and dispute resolution mechanisms. In addition to these contractual processes the professional conduct of the government party during the construction phase, particularly in working through disagreements constructively, may assist to develop a successful working relationship with the private party throughout the life of the project.

The role of the private party

The private party is the contracting party responsible for the delivery of the project and is the primary interface with the project director. Throughout the construction phase, the private party will interact frequently with the builder, and as commissioning approaches, typically the facility management subcontractor and other operators will become more involved.

In a *Partnerships Victoria* project, the builder is subcontracted by the private party, not by the government party. As the builder’s contract is with the private party, contractual and commercial issues should not be resolved directly between the government party and the builder. The government party relies on private party employees and representatives of the equity providers (who are independent of the builder) to manage contractual and commercial issues with the builder directly. It is not acceptable for the private party to delegate its management role to its subcontractors, as a subcontractor’s decision making and behaviours reflect their shorter time horizons and higher risk profile in projects.

*Partnerships Victoria* projects are usually financed by the private party through a mix of debt (in the form of bank loans or bond finance) provided by lenders, and equity (also known as risk capital) often provided by project sponsors or other investors. Typically, as in most businesses, equity investors are likely to take a more active role than debt financiers as variations in business performance are felt directly by equity investors, while debt providers are indirectly affected (usually only if the variation is relatively large and results in an inability for the private party to service its debt).

Equity providers may take either an active role in managing the project, or they may take a more passive approach by engaging a specialist management company to manage the project on their behalf. The differing degrees of involvement of active and passive equity providers can influence their behaviour and decision making in a project. Therefore, it is important for the project director to be aware of the approach being taken by a project’s equity providers, in order to understand these parties’ value drivers.

Equity finance serves an important purpose in providing the private party with adequate capital to absorb any negative financial consequences arising from construction risks or from abatements arising from poor performance in delivering the services specified. In addition, this ‘skin in the game’ also reduces the debt providers’ risk profile, which may reduce the cost of the debt.

As such, the project director should set an expectation that equity providers (or their appointed specialist managers) will need to be involved in project decision making and coordination during construction.

* + - 1. Risk management

Understanding and maintaining risk allocation

*Partnerships Victoria* projects are structured to achieve optimal risk allocation between the government party and the private party. Achieving project objectives, service delivery and the agreed value for money depends on the management of risks allocated to each party. As such, the project director must ensure all key stakeholders understand and maintain the project’s contractual risk allocation. Primarily, the project director will actively manage the government party’s retained risks. However, they will also need to understand and monitor how the private party is managing its contractual risks.

As decisions made on issues that arise during the construction phase can impact on later stages of the project, it is important for the project director to inform and educate government party stakeholders about the risk allocation for the project, and to ensure that project delivery decision makers understand and respect the contractual risk allocation.

The project deed and the contract administration manual, as well as the various plans and reports submitted by the private party, will be the primary references on risk management and allocation. The procurementteam should hand over sufficient material to the contract management team to ensure a full understanding of the risk allocation and intensions of the project deed.

The importance of these documents reinforces the need for the project director to ensure there is effective knowledge transfer during the transition between the procurementteam and the contract management team.

Contingency planning

Risk events during the construction phase can cause a delay in the date for commercial acceptance, the beginning of the service delivery phase. It is important that contingency planning is in place should such delays occur to enable the government party to manage the impact on service delivery. The project deed will usually contain extensive provisions about managing delay and the consequences of delay.

Lessons learned from the procurement phase

There is often a period after financial close and before significant project activity occurs which provides an opportunity for updating the commercial principles matrix approved prior to the release of the request for proposal. This work will reflect the commercial principles set out in the final project deed (and associated project contracts), capturing lessons learned and outstanding issues from the procurement phase. This review can help inform contract management in the construction phase as well as for future projects.

* + - 1. Design development

The *National PPP guidelines: commercial principles for social infrastructure*[[9]](#footnote-9) states that ‘the private party must develop the basic design proposed in its bid (and set out in the project agreement) in accordance with an agreed consultative process and submit all final design documentation (and any amendments) to the government party for comment.’

The project director must be familiar with the design development process set out in the project deed, and ensure that the procurementteam and stakeholders are providing timely, useful and constructive comments about the design in accordance with the contractual process. The other challenge for the project director is to avoid having the procurementteam and stakeholders stepping into or intervening in the private party’s design role and thereby taking back risk. The general rule is that the procurementteam and stakeholders can comment, identify and highlight any concerns or potential issues with the proposed design, but should not propose solutions, as this is the private party’s responsibility.

As there is significant workload for the project director and government party in the design renew and user group process, the procurementteam will often use proprietary workflow management software to manage this activity in a timely way.

It is important for the government party to adequately plan for and resource the design renew process, because this process is often the final opportunity to refine requirements regarding the functional design of the facilities and how they will be built.

In conjunction with the coordination role played by the procurementteam, the project director plays an important role in the design process, in ensuring that the design documentation reflects what was bid by the private party and what is set out in the project deed. The project director should guard against pressure from the private party to depart from the project deed when it comes to design requirements. Significant departures from those documents can have probity and value for money implications for the State. Material departures are effectively contract variations, and should only be accepted with adequate value for money justification, proper documentation and authorised approval of the variation (additional information is provided in section 14.4).

* + - 1. The independent reviewer

Typically, the independent reviewer during the construction phase is jointly appointed by both the Government and the private party under an independent reviewer deed of appointment. The procurement process for the independent reviewer may differ between projects. If the independent reviewer has not been appointed prior to financial close, which only typically occurs on ‘social infrastructure’ projects, the project director and procurement team will be responsible for engaging the independent reviewer based on the process set out in the project deed.

The independent reviewer’s role varies from project to project. On ‘linear infrastructure’ projects, typically the role of the independent reviewer includes a role for general overview and reasonable checking in relation to project activities, reviewing design documentation, reviewing certifications and reviewing claims (e.g. extensions of time). On ‘social infrastructure’ projects, typically the role is limited to reviewing the construction program progress, reviewing and determining claims for extensions of time and other 'time-related' issues and reviewing commissioning tests to certify completion.

Responsibility for payment of the independent reviewer is typically shared equally between the government party and the private party. Exceptions to this general rule are where a party requests the independent reviewer to prepare a report not otherwise required by the project deed or the independent reviewer deed of appointment, in which case the party requesting the report is responsible for the relevant costs.

The project director has an important part to play in ensuring that the government party’s representatives (including the procurement team) respect the independent reviewer’s role. In particular it is important to ensure that the project director does not attempt to step into the role of independent reviewer, which may cause the transfer of some level of performance risk to revert back to the government party.

* + - 1. Contract variations or amendments

The project director is responsible for ensuring that the private party meets its contractual obligations during the construction phase. Variations to the contract or waivers of rights have the potential to undermine the contractually agreed project risk allocation.

During the construction phase, variations to the contract or waivers of rights may be required. However, these must be documented, and approved at the appropriate level (such as a steering committee or Ministerial level for material variations).

The *Partnerships Victoria* team within DTF must be consulted when considering any material modifications proposed to vary or depart from the project deed. Contract variations impacting the project’s budget, liabilities, or overall affordability will need to be referred to the responsible Minister, Treasurer and/or the relevant Cabinet subcommittee for approval. For non-financial contract variations which may have a service delivery or public interest impact, e.g. changes to KPI regimes, it is the project director’s responsibility to brief the Minister.

The project deed can never be detailed enough to anticipate every circumstance that may arise during the construction phase of a project. Nevertheless, it should contain processes to enable contract amendments to be made (if required). Some items may need to be resolved during the construction phase using these processes. As such, the project director should ensure that any amendments are clearly documented so that the intention and reasoning behind them are understood during later stages of the project. This is important to ensure that the government party follows the correct procedures to avoid later disputes and ensure that their conduct has followed due process.

If an issue has the potential to affect the project’s risk allocation, cost, scope, or timelines, appropriate approval should be sought before committing to any resolution reached with the private party. In these circumstances, the *Partnerships Victoria* team within the DTF should be kept informed of potential and emerging risks to the project.

* + - 1. Modifications and design departures

Developing and refining design documents in accordance with the design review process set out in the project deed will not themselves constitute a modification or design departure. However, as design and construction progresses, stakeholders may raise ideas for additional project assets to be constructed, or for changes to be made to the design brief included in the project deed. In general terms, modifications refer to changes to the project’s requirements. For example, a hospital PPP project design which included a requirement to install a magnetic resonance imaging machine were adjusted to align the operators desk with the equipment, after feedback from hospital staff indicated a more efficient way to operate the equipment in accordance with their standard operating procedures. This design departure did not involve a change to the project’s requirements, but rather a change in the means by which requirements are met.

In Victoria, typically the government party will compensate the private party for modifications or design departures initiated by the government party, where there is a resultant cost increase. If such a modification or design departure results in a cost reduction or saving, the government party will reduce its payment to the private party. Conversely, modifications or design departures initiated by the private party that increase costs will not usually be covered by the government party. However, if the private party initiates a modification or design departure that offers cost savings for the project, while still meeting the project requirements, the two parties will generally share the cost saving resulting from a modification or design departure in the percentages set out in the project deed.

Introducing modifications and design departures during the construction phase can introduce new risks to the project, for example:

* + - Making changes to the project assets detailed in the project deed may have consequences for other elements of the project deed (or other project contracts), such as the relevance and usefulness of key performance indicators and service standards.
    - Giving direction on how the design should be changed can mean that the government party may take back part of the performance risk for the project assets.
    - The private party may attempt to take advantage of the lack of competitive tension during the construction phase to recoup costs for risks it had previously accepted. To counter this possibility, the government party should strictly adhere to the value for money safeguards in the project deed. These safeguards include prior agreements on the magnitude and type of costs and margins related to modifications that the private party can claim.
    - Delays to commercial acceptance have consequences for project cash flows, private party cash flows, commencement of service payments and the delivery of services to end users. Therefore, the project director must be aware of a modification's impact on the project's critical path.

Throughout the construction phase, either the government party or the private party may request modifications. These will usually be considered by the project steering committee in the context of their expected effect on the project’s lifecycle costs. It may be that due to design integration and construction cost savings, the proposed modifications should be undertaken. Alternatively, the modifications may be delayed until construction is completed. Importantly, the project director should ensure that there is no unapproved ‘scope creep’ that may undermine the project’s value for money.

* + - 1. Funding of modifications

The risk allocation negotiated for each project will result in a set of risks being retained by the government party. The project’s funding allocation will recognise the price of these retained risks by setting aside a budget for ‘retained risks funding’ which can be called upon at any time during the project’s life in the event that these risks materialise. In practice, for most *Partnerships Victoria* projects, some level of funding is set aside for construction phase retained risks only.

The project director must recognise the purpose of the retained risk funding, and guard against the idea that it should be treated as a construction phase contingency fund. The project’s governance structure should monitor the use of retained risk funding for risks which eventuate. Access to retained risk funding should require prior endorsement by the steering committee.

Pressure can arise for the retained risks funding to be used to fund scope changes, including modifications initiated by the government party. However, this funding should not be used for that purpose. Scope changes and design departures need to be funded by offsets or additional funding should be sought through the existing budgeting processes.

* + - 1. Claims for relief events and compensation events

During the construction phase, the private party may claim to be entitled to an extension of time due to a relief event (often referred to as an ‘extension event’), or to an extension of time and compensation due to a compensation event (often referred to as a ‘compensable extension event’). A claim by the private party is usually a result of the builder making a similar claim to the private party, however the fact that the builder may have a claim against the private party does not necessarily mean that the private party has a claim against the government party. If the builder makes a claim against the private party, the private party is usually required to take reasonable steps to ensure that the claim made by the builder is bona fide, prior to making any related claim against the government party.

The project director should ensure that any claims are appropriately analysed. Construction of a project is complex, and consequently it can be difficult to separate the impact of a relief event or compensation event from other factors affecting the project. The Independent Reviewer is responsible for determining extension of time claims during the construction phase. However the project director should consider whether any additional expert advice is needed to consider the private party’s entitlement in respect of the claim.

If a claim is valid, the project director should ensure that the relevant contractual processes are followed to confirm the private party’s entitlement. Usually there are a number of conditions precedent to the private party’s entitlement to an extension of time, including that the private party has submitted the claim within a specified period and that the delay caused by the relief event or compensation event has or will actually cause a delay to activities on the critical path.

In addition, usually the government party’s liability to the private party for a valid claim will be reduced to the extent that the relief or compensation event was caused or contributed to by the private party or the private party fails to mitigate the effects of the relevant relief or compensation event. The project director should always consider whether the private party’s entitlement should be reduced. If the claim is wholly or partly invalid or the private party’s entitlement should be reduced, the project director should seek legal advice on the appropriate form of response to the private party, and should develop an appropriate management strategy if it is expected that the private party will persist with the claim.

Claims for extensions of time or compensation should be reported via the steering committee to the government party’s senior management and to DTF through the project governance arrangements.

* + - 1. Transition to operations

The original business case used to initiate the project should have identified requirements and strategies for the transitioning the project assets into operational readiness. There will be different strategies based on whether the project is for a replacement asset or a new additional asset. Irrespective there is likely to be significant change management planning required. These plans should include the hiring of staff and purchasing of equipment, and also outline the change management effort (including training and potentially restructuring) needed to capture the efficiency gains the new project assets are designed to achieve. The transition planning will need to commence early in the construction phase.

This is not generally a task led by the procurement team. Instead, the ‘transition for operations’ activity is usually the responsibility of the contract management team, working in conjunction with operational subject matter experts and the private party.

The project director should ensure that the government party and the steering committee is aware of its respective responsibilities for planning and carrying out this activity, and that this activity begins early enough. The steering committee should request a transition plan from senior operational staff. The plan should forecast the resources needed, and should factor in the need for coordination between the government party and private party teams. The project director is responsible for ensuring there is alignment between the private party’s transition plan and the provisions under the project deed and that the interface is effectively managed.

In a fully outsourced PPP, the private party is responsible for operating the project asset, and typically will have appointed an operations subcontractor for this purpose. During the construction phase, the project director should ensure that the private party and its operations subcontractor are planning for the transition to operations, and that this activity begins early enough.

* + - 1. Common issues at completion and commissioning

Template G lists some of the main aspects to be covered during commissioning and handover. Two areas in particular need attention during completion and commissioning: the asset maintenance plan, and commercial wrap-up.

The asset maintenance plan

The asset maintenance plan is one of many plans that must be submitted, and accepted, by the government party prior to commercial acceptance. The private party is required to provide an asset maintenance plan that sets out the planned frequency of routine preventative maintenance and refurbishment activities over the life of the project.

The asset maintenance plan is usually prepared by the builder, with responsibility for subsequent updates resting with the facilities management subcontractor and it should be a detailed and highly project-specific document.

As such, it is important for the project director to carefully review the draft asset maintenance plan before accepting it, to ensure that the scheduled activities address the full range of assets for which the private sector party has maintenance and lifecycle responsibility, and to ensure that any assumptions and exclusions mentioned in the plan are consistent with the project deed. Generally, the asset maintenance plan should also provide detail on the facilities management system to be used, the detailed reporting templates to be used and the frequency that these will be provided to enable the contract director and contract management team to monitor project assets over the project term.

There is a tendency for builders to leave preparation of the asset maintenance plan until too late, and not have it ready at commercial acceptance. This is not acceptable. Given the importance of the asset maintenance plan to ongoing fitness for purpose of the project assets, the project director should set a clear expectation early in the construction phase that the asset maintenance plan must be delivered in a timeframe that allows sufficient time for review by the procurement team – and specialist advisers, if required – and resubmission as necessary prior to the expected date for commercial acceptance.

Commercial wrap-up

The commercial issues to be dealt with at commercial acceptance commonly include variation claims from the builder and adjustments to be made to the financial model at commercial acceptance. Resolving these issues may require analysis, negotiation, and assistance from external legal, technical and commercial advisers.

Achieving commercial acceptance at the conclusion of the construction phase is a significant milestone in a *Partnerships Victoria* project. At this stage of the project, there will be intense focus from both the builder and procurement team on completing last-minute construction-related tasks and planning for transition to the service delivery phase and demobilisation from site.

The project director has a key role to play in ensuring that the commercial wrap-up of issues are given proper attention at this time, and that the outcome of any negotiations maintains the project’s value for money standing. The project director is responsible for developing and implementing budgetary and service payment arrangements in time for commercial acceptance.

At commercial acceptance there are budgetary, commercial and reporting arrangements within the government party and between the agency and the *Partnerships Victoria* team within DTF that need to be agreed. The project director is responsible for ensuring that these arrangements are developed and in place in time for the start of the service delivery phase and commencing service payments to the private party.

* + - 1. Handover to operations contract management team

The project director is responsible for ensuring that the private party is held to its contractual obligations and risk allocation. Failure to do so may jeopardise the value for money of the project.

The transition between the construction phase and the service delivery phase of the project is one point where lack of continuity between procurementteam and the contract management team can put value for money at risk. Therefore, a thorough handover between these teams is vital and should include:

* + - the transfer of all project contracts detailing:
      * any unresolved issues with financial estimates of their impact (if available);
      * any contract variations to date; and
      * any extra contract items agreed during the construction phase;
    - provision of full details of expenditure to date; and
    - detailed discussions to convey the intention of various elements of the project contracts.

The transition period places many demands on the departing procurementteam, at a time when team members may be tired and ready to move on to the next project. For this reason, the government party’s senior management help should be enlisted to ensure that the handover task is prioritised and thoroughly completed before the procurementteam moves on. A key factor in successfully managing the private party during the service delivery phase is an effective transition and handover.

* + 1. Service delivery phase

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| Part 3: Contract performance |  |
| Construction phase | Chapter 10 |
| **Service delivery phase** | **Chapter 11** |

* + - 1. Introduction

This chapter focuses specifically on the contract management activities relating to the service delivery phase in order to ensure the State achieves its broader project objectives, contracted services are delivered to the contracted standards to ensure that value for money outcomes are achieved over the life of the project.

As outlined in section 3.2, responsibility for a *Partnerships Victoria* project typically transfers to the contract director after commercial acceptance has been achieved and the project enters steady-state operations. At this time, the contract director becomes the person responsible for managing the project on behalf of the government party during the service delivery phase.

*Partnerships Victoria* projects are pay-for-service contracts. Typically, no payments are made to the private party until service delivery commences. Full service payment in each payment period depends on full service provision in accordance with the project deed.

*Partnerships Victoria* projects, like all long-term contracts for service delivery, can be affected by changes to the broader economic and business environment. If the government party’s contract management team is to effectively manage this dynamic situation sensibly, it is important it has access to adequate information on which to base its ‘control’ actions. The government party must therefore effectively monitor the health of the project as an integral part of its overall contract management strategy.

Contract performance during the service delivery phase must focus on both:

* + - regular provision of contracted services (daily, weekly, monthly, quarterly basis), monitoring performance, authorisation of related payment invoices, as appropriate, and addressing related performance risks and issues; and
    - broader performance management issues by monitoring the financial health of the private party and its sponsors, looking ahead to identify risks and emerging issues and how they might be mitigated, and identifying and progressing ways to maintain or improve value for money outcomes for the government party.

In the context of *Partnerships Victoria* project, the role of performance monitoring and reporting is to:

* confirm that the performance requirements in the services specification are being met by the private party; and
* ensure long-term service continuity by enabling the government party to understand the sustainability of the project.

Performance monitoring and reporting provide the government party with information on which to authorise service payments and to base ‘control’ actions.

* + - 1. General framework for performance monitoring and reporting

The government party’s ability to monitor the performance of the private party largely depends on the private party being required to report appropriately under the project deed. Consequently, it is essential that reporting requirements are considered early in the procurement phase, are written into the request for proposal and the draft project deed provided to bidders, and are retained in the executed project deed.

In developing an appropriate performance monitoring and reporting strategy, the government party needs to consider the following issues in the context of the particular project:

* + - **the timescale for monitoring and reporting** – the government party must consider how its monitoring and reporting activities should change over time. In a *Partnerships Victoria* project, the level and type of monitoring and reporting that was appropriate during the construction phase is likely to be quite different from that required during the subsequent service delivery phase, where the reporting requirements may even differ between initial service delivery and mature steady-state service delivery;
    - **the nature of the monitoring and reporting** – the type of project and any external regulatory controls influence monitoring and reporting requirements. A reliance (partially or fully) on self-reporting by the private party, combined with random review or auditing by the government party may be appropriate in some PPPs (e.g. waste water treatment facilities) whilst in others (e.g. hospital) self-reporting by the private party may be combined with more regular hands-on monitoring and reporting by the government party. Monitoring may be undertaken fully by the contract management team or delegated in part to the government party customers (e.g. Melbourne Convention and Exhibition Trust);
    - **the range of reporting information** – the information to be reported and monitored will vary for different projects and sectors. Requirements for a hospital project are different from the requirements for a waste water treatment project. Monitoring requirements also depend on the project delivery structure and project documentation. For example, appropriate financial reporting for a special purpose vehicle may be different from financial reporting where the private party is a substantial publicly listed company undertaking the project based on the strength of its own balance sheet; and
    - **level or type of action envisaged based on monitoring and reporting** – the government party’s monitoring and reporting should enable it to effectively focus control on key areas. The authorisation of regular service payments is one such key area. Therefore, the monitoring system needs to supply relevant information in relation to the payment mechanism (including the service standards that underpin the payment mechanism).

Contract management team members who perform these tasks should understand the private party’s business and have experience in performance monitoring of service delivery projects. The government party should set expectations for reporting from day one, consistent with the level and form of reporting that needs to be provided in line with contractual requirements. This reinforces the importance of appropriate reporting.

The purpose of performance monitoring and reporting

Monitoring, reporting and subsequent control actions can only be really effective if the government party can relate them to project objectives. The government party can then implement control actions to ensure the private party delivers the required project outcomes in the future.

Monitoring and reporting should be ongoing activities that feed information into an assessment process and provide a coherent basis for exercising control actions. In the context of *Partnerships Victoria* projects, these control actions are, broadly:

* + - assurance that services are available and being provided as anticipated;
    - decrease the quantum of service payments (abatements for under-performance);
    - change management (discussed in detail in Chapter 12);
    - increase monitoring and/or reporting requirements;
    - trigger default scenarios and consequent government party actions under the project deed (including remedies, such as the replacement of a specific service provider) (discussed in detail in Chapter 8); and
    - contingency planning for ensuring continuity of services and potential government party step‑in under the project deed (discussed in detail in Chapter 8).

In some instances, circumstances may change over the life of the project so that a specified baseline for performance monitoring (e.g. a required level of service) becomes difficult or impossible to achieve, resulting in a persistent failure of the private party’s performance to meet the baseline. Depending on the underlying reason for persistent failure, the government party may consider whether the baseline remains an appropriate measure of performance, or whether it should be modified to reflect a different level of performance in the changed circumstances. A modification will only be appropriate if the private party’s failure to meet the existing baseline is not detrimental to the end users of the services.

As the service delivery requirements have been extensively considered and agreed to by the private party and the government party during the procurement phase, the contract director should only consider modifying the service delivery requirements set out in the project deed where the State receives an offsetting benefit, such as a reduction in the quantum of service payment, to maintain or improve the government party’s value for money outcome for agreeing such modification.

Figure 11.1 is a flowchart illustrating the role of performance monitoring.

Figure 11.1: The performance monitoring process



Contract management actions taken in the early days of the service delivery phase set the basis and expectations for later behaviour. The contract director therefore needs to appropriately implement the service performance monitoring arrangements from the beginning of the service delivery phase.

The contract director is responsible for ensuring that services are delivered in accordance with the project deed. This responsibility requires the contract director to use the steps available within the project deed to incentivise the private party to improve their performance, if the agreed standards are not being met. The abatement arrangements are a central part of these incentive arrangements.

### Information required

The government party should ensure that it collects adequate information to confirm that the output specifications and services specification in the project deed are being met by the private party; and to ensure long term service continuity by enabling the government party to understand the sustainability of the project.

Performance monitoring in a *Partnerships Victoria* project should focus on what the private party is required to achieve, rather than how it achieves it. However, from the government party’s perspective, monitoring outcomes is unlikely to be sufficient to provide all the information needed to assess the full range of control actions that may be appropriate. If the government party only monitors the private party’s short-term performance against the output specification and services specification, it may not alert the government party to longer term issues that may eventually result in project failure, such as the private party experiencing financial distress.

As discussed in section 2.2, the government party carries the ultimate risk of non-delivery of services under a *Partnerships Victoria* project. It is therefore essential that the government party has access to information that goes beyond short-term monitoring of service performance standards, and attempts to understand the long-term sustainability of the project (e.g. gathering information about the financial health of the private party may provide signs that the party is in financial distress, potentially placing ongoing contract performance at risk).

The information required may include information related to subcontractors and/or investors in the private party. In identifying and gathering such information, there may be efficiencies for the contract director in taking a collaborative approach with contract directors for other *Partnerships Victoria* projects that involve the same project sponsors, subcontractors and/or investors.

Hard and soft data

The information the government party needs to effectively monitor a project is likely to contain both ‘hard’ and ‘soft’ data:

* + - **Hard** data is quantifiable and measurable data available that can be compared against past performance or benchmarks.
    - **Soft** data is qualitative data that is not easily quantified. Monitoring soft data relies on the skills, training and experience of the contract director.

More recent project deeds require the private party to provide regular performance reports. These reports should be in a form that enables easy analysis by the contract director and/or contract management team. The ‘hard’ information that the private party is required to provide is generally quite comprehensive. However, a sole focus on process (that is, contract reporting of hard data) does not and cannot replace good contract management skills and experience. Good contract management does require reporting, but it also requires experienced contract directors and contract managers who are capable of identifying soft information, interpreting it and implementing effective control actions.

Information obtained outside the contract

In addition to the information collected through reporting processes specified in the project deed, the contract director should look outside the project deed for information relevant to performance monitoring.

The private party is obliged by the project deed to provide information on performance against the services specification and output specifications.[[10]](#footnote-10) However the contract director also needs to separately obtain and analyse additional information on project. This additional information will often be ad hoc, may not be neatly presented and absolute, and will usually be highly dependent on the contract director’s experience. The process of identifying the information to be collected must start with three fundamental questions:

What is known or measurable and can be used?

What is unknown and potentially immeasurable, and needs to be clarified and obtained?

What are the best sources of information (outside the contractual reporting requirements) to validate project objectives?

As the answers to these questions are likely to be project-specific, a number of different approaches have been adopted on different *Partnerships Victoria* projects to obtain information outside the project contracts.

* + - 1. Service standards and the payment mechanism

As outlined in Chapter 2, both risk allocation and service delivery are the core of a *Partnerships Victoria* project.

Project deed appendices or schedules will usually set out the services to be delivered by the private party, the standards (or KPIs) for each service (including the quality, quantity, timing and location) and related abatement criteria. These standards should be as simple as possible, relevant to the government party’s underlying service requirement, and readily measurable.

The services provided by the private party may be of a full service nature (e.g. a road project) or an availability nature (e.g. school facilities ready for use by the government party to provide teaching services to students), or may combine full service and availability type outputs (e.g. the Victorian Desalination Plant project).

The project deed will also set out the payment mechanism, outlining the payment levels for delivery of specific services and related arrangements for determining abatement calculations. Some payment mechanisms can be quite complex and it is critical that they are fully understood by the contract director. The contract director should consider the need for expert advice on the operation of the payment mechanism, and should institute quality assurance processes to ensure that payments are correctly calculated. In many projects, the calculation process can be made significantly more rigorous and efficient by using a spreadsheet model of the payment mechanism prepared by expert advisers.

At the conclusion of each specified payment period (usually monthly or quarterly), the private party will submit a claim for payment for the services delivered. The contract director will need to consider the self-reporting provided by the private party in accordance with the project deed (reinforced by government party audits) and direct monitoring by the contract management team and/or the government party end users to assess whether the private party has provided the services in accordance with the requirements of the project deed for which it has claimed payment.

Abatements

Abatements are a reduction in a service payment due to underperformance relative to a specific key performance indicator (KPI). If an abatement issue arises, the contract director should advise the senior responsible owner of any proposal to abate, or not to abate, and the rationale for the decision before processing the payment.

If an abatement has been triggered and is applied to the service payment, the abatement process usually requires the contract director to document and advise the private party in writing. It is good practice to discuss the abatement issue with the private party to understand the issue, and how the private party plans to meet the required service standards in future.

If an abatement has been triggered and is not applied to the service payment, the contract director will need to have a good rationale, consistent with the overarching contract management strategy. This should be documented and communicated to the private party. Before a decision not to abate is reached, consultation should occur with any government party end users or third-party stakeholders directly affected by the service delivery failure.

In economic or user-pays PPP projects, such as toll road projects, the private party will have an in-built incentive to improve its revenue performance. In these projects where the private party receives revenue solely from private users, without a government party service payment, the project deed will usually include contractual service standards that need to be met. If there is no abatement regime for a project, the project deed will usually contain other incentive regimes such as penalties or bonuses to incentivise the private party to meet its service requirements.

KPI recalibration

Key performance indicators (KPIs) contained in the project deed are carefully calibrated and informed by experience in the relevant service delivery area.

During the service delivery phase, where the service standard KPIs have been set at a level that is not readily achievable by the private party and are above the level required by the government party, it may be mutually beneficial to recalibrate these KPIs. In return for changes to any KPI requirements, the government party should seek to achieve an offsetting benefit, via a reduction in its regular service payment, to maintain or improve the government party’s value for money outcome.

During the service delivery phase due to changes in practice or new requirements, additional KPI’s may be identified and negotiated with the private party.

* + - 1. Broader contract performance monitoring and reporting

As outlined above, in addition to the regular monitoring of service delivery outputs, the contract director also needs to review the project from a broader perspective, by looking ahead to identify risks and emerging issues that may impact service delivery, understanding how these risks and issues might be mitigated, and identifying and progressing ways to maintain or improve value for money outcomes for the State.

The Victorian Auditor-General’s Office emphasised the importance of paying sufficient attention to the broader aspect of contract performance monitoring in the 2013 review of *Operating water infrastructure using public private partnerships*.[[11]](#footnote-11) The review found that there was scope for all water corporations with operational *Partnerships Victoria* projects to ‘improve monitoring of service providers’ financial health and broader project risks’.

The government party’s monitoring of the project must also provide the information necessary to enable appropriate reporting to senior management and to DTF. Appendix C contains guidance on issues to consider in developing a service delivery phase regime for such reporting. Templates H and I contain templates for these reports, and Template J contains templates for supporting reports from any government operator of the facility.

Framework for broader performance monitoring

A framework for broader performance monitoring and reporting for *Partnerships Victoria* projects can be built around three essential steps:

**Step 1**: Understand the private party’s business (that is, understand the factors that will influence the private party’s strategic and project-level performance).

**Step 2**: Analyse the underlying quality of the project measured in terms of:

* + - financial health of the project ‘business’;
    - management quality;
    - government party’s relationship with the private party;
    - service performance trends; and
    - asset maintenance.

**Step 3**: Determine the reporting requirements for the project, including both hard data and soft data. The sources of this data should be identified.

These steps should be taken early in the procurement phase to enable the private party’s reporting requirements to be included in the draft project deed provided to bidders in the request for proposal. As discussed above, not all the data of interest to the contract director will be provided by the private party under the project deed. The contract director will also need to collect some data (particularly soft data) from other sources.

Step 1: Understanding the business

Contract directors need to understand the business environment and the government party’s objectives in entering into the project deed. Performance measures lie at the heart of performance management. It is important that performance measures are linked to strategic objectives, or to desired outcomes. Understanding the business requires the contract director to have a good appreciation of the government party’s service, its place in the broader service network (if applicable), the customers and other key stakeholders, the project deed (and other project contracts), the contract administration manual, the request for proposal, and the private party, including its contractual structure.

The contract director needs to identify those processes most critical to delivering business success. Doing so will create a clearer picture of what needs to be measured (which should be embedded in the project deed).

Strategic and project-level performance

To fully understand the business, the contract director needs to consider performance at both a strategic and a project level. Strategic performance is primarily concerned with outcomes. In contrast, project-level performance is primarily concerned with outputs.

Each project will have different strategic outcomes and project outputs (in particular, cash flows and the impact of risks are highly project specific).

Cash flows

Cash flow is central to the private party’s success in a *Partnerships Victoria* project. The project must have clear and defined revenues to cover its cost structure and debt service obligations, which are likely to comprise:

* + - project costs –
      * management and operating costs (including materials and labour);
      * maintenance and replacement capital expenditure (lifecycle costs);
      * insurance premiums;
      * tax costs;
    - debt service obligations –
      * interest expense;
      * principal repayments; and
      * fees and charges.

In addition, investors will expect to receive a return on equity commensurate with the development and long-term project risk they have taken.

In order to monitor the underlying business health of a *Partnerships Victoria* project, the contract director must have a deep understanding of cash flows and, in particular, the drivers for revenue streams. A user-pays revenue stream (used in a toll road project) is significantly different from an availability payment mechanism (used in government party availability project). The user-pays system transfers demand risk to the private party (so the private party will only receive payment if the project assets are used), whereas the availability mechanism transfers performance risk and not demand risk (so the private party will receive payment provided the project assets are available for use, and the private party has performed in accordance with the performance requirements). In projects where the private party takes the demand risks (and benefits), it has some ‘blue-sky’ revenue potential, whereas in an availability PPP, upside revenues are very constrained. As a result, the private party’s drivers are likely to be different for each of these two types of project.

Cash is the key driver of business health and vitality. By monitoring the cash flow impacts on the project, the contract director will be in a better position to identify the early warning signs of a project potentially in financial stress.

To fully understand the cash flows, the contract director needs to consider both past performance and projected future performance of each of the elements in the cash flow.

The financial model

The financial model forms a critical component of a *Partnerships Victoria* project throughout its lifecycle. The private party develops its financial model during the procurement phase. This model sets out in detail the specific cash flows required by the private party to deliver its proposal. It is usual in *Partnerships Victoria* projects for the model to be updated at financial close, becoming the ‘base-case financial model’ for the purposes of the project deed.

The financial model continues to be used throughout the life of the project, particularly as a key input to the calculation of the financial consequences of change events and compensation events. The project deed will include specific processes for updating the model to reflect changes. In user-pays projects such as toll roads, the financial model is also an important input to various demand risk-sharing mechanisms, such as the government party sharing in additional revenue generated by the private party, and adjustment mechanisms to deal with the impact on demand of changes in the surrounding road network.

Given the complexity of the financial model, the contract director should consider obtaining expert advice from external financial advisers and/or Treasury Corporation of Victoria on its use and interpretation. The contract manager should also institute quality assurance processes (such as version controls) to ensure that any updates to the model are correctly recorded.

Risks

The nature of the contract management risks to be managed through the lifecycle of a *Partnerships Victoria* project is discussed in detail in Chapter 2. Effective contract management requires an understanding of all the material risks, analysis of their changing impact on the project and the formulation of dynamic contract management strategies. From a performance monitoring perspective, it is most useful to distinguish between risks that are borne by the government party and risks that have been transferred to the private party. As discussed in Section 2.2, the risks borne by the government party include:

* + - risks contractually allocated to the government party;
    - the residual risk to government of risks transferred to the private party;
    - risks arising from issues not resolved at commercial acceptance;
    - the risk of private party failure; and
    - the risk of ineffective public sector management.

Effective contract management requires an understanding of the project risks that have been transferred to the private party. Understanding these risks is essential to understanding the private party’s business.

Understanding the business throughout the project lifecycle

The factors affecting project-level performance, including cash flows and risks – and how they influence the private party (and its management, sponsors or parent company) – will change over the project lifecycle. For example:

* + - the release of performance bonds or guarantees at particular stages in the project lifecycle can significantly alter the risk profile of the project from the private party or its parent’s perspective; and
    - towards the end of the project term, the private party may have reduced incentive to fulfil maintenance and replacement capital expenditure requirements. As a result, if the government party takes ownership of the asset at the end of the contract term, the contract manager must understand, monitor and enforce any handback requirements outlined in the project deed to ensure that the State receives a properly maintained asset.

The contract director should maintain an up-to-date understanding of the factors that may influence project-level performance. When these factors change, the contract director should consider how the change affects the performance reporting and monitoring regime for the project, and make any necessary changes to this regime.

Step 2: Analyse the underlying quality of the project

Financial health

A review of the private party’s internal operating environment is a crucial step towards understanding the underlying credit-worthiness (or solvency) of the business. By reviewing this environment, the government party can derive an awareness of the private party’s financial strengths and weaknesses. A financial health review should be undertaken annually.

The availability of information can also change through the project lifecycle. For example, if a special-purpose vehicle (SPV) (or its parent company) is listed on a stock exchange, it will have public disclosure obligations as a result of that listing, and its stock exchange announcements can be a valuable source of information. If it ceases to be listed on the stock exchange, this source of information will no longer be available. As detailed in Chapter 16, the contract director should monitor such changes, and respond as necessary to ensure the performance reporting and monitoring regime continues to provide adequate information.

Indicators of financial health will vary from project to project. To identify appropriate indicators for a project, the government party should review the private party’s organisational structure and financial position, including gearing. It is important to monitor the financial health of not only the private party but also its parent companies. For instance, the voluntary administration in 2012 of the Wodonga Wastewater Treatment Plant PPP private party’s parent company led to the early termination of this PPP contract.

The contract director should consider whether to also monitor the business health of key subcontractors. The need to monitor subcontractors will depend on:

* + - the extent and nature of the obligations subcontracted;
    - the ease with which the subcontractor could be replaced by the private party if required; and
    - the size, financial standing and experience of the subcontractor.

The government party’s personnel responsible for analysing the private party’s financial position need a strong understanding of the private party’s cash flows. Expert advice may be required from external financial advisers and/or Treasury Corporation of Victoria.

Management quality

In a *Partnerships Victoria* project, the government party’s primary contractual relationship is with the private party which is usually an SPV. The project deed will generally stipulate that the private party must nominate a person to be its representative with this appointment (and any subsequent replacement) requiring the approval of the government party. It is important also that the private party representative is adequately supported by an internal SPV team. In the early days of *Partnerships Victoria* projects, there was a tendency by some SPVs to under-resource their SPV teams and attempt to have the government party deal directly with subcontractors. However, in more recent times, the private parties have understood the need to appropriately resource their SPV team and have it perform the key interface role with the government party.

As most of the SPV’s obligations under the project deed are subcontracted, in more recent *Partnerships Victoria* projects it is common for the project deed to identify key people within key subcontractors to the private party, who cannot be replaced without the government party’s written approval. During the service delivery phase, these key people may include senior operator personnel (in a full-service PPP) and senior facilities management personnel.

While the government party may wish to monitor a subcontractor as part of its monitoring of the overall health of the project, the contract director must remember that it is the private party that is obliged to provide the services, and has the direct contractual relationship with the government party. As a general rule, the government party should not involve itself in the private party’s management of its relationship with its subcontractors.

Beyond its direct role in appointing key people, monitoring management quality is difficult and largely falls into the ‘soft’ indicator category. Nevertheless, an experienced contract director should regularly monitor the quality of the private party’s management and operating personnel, looking for weaknesses or trends that may provide an early warning signs for future issues.

Monitoring the government party’s relationship with the private party

Monitoring of the government party’s relationship with the private party is discussed in Chapter 4.

Service performance trends

In addition to regular monitoring of service performance for the purposes of calculating the service payment and any abatements, the contract director should regularly review trends in the quality of the service as measured against the KPIs and the services specifications. A review of trends may indicate areas of potential service performance risk.

Asset maintenance

In *Partnerships Victoria* projects, there is an inherent incentive for the private party to adequately maintain the project assets so that it can continue to meet its KPIs and the services specifications. The private party will also appreciate that a backlog of maintenance can result in a need to undertake costly repairs later. However, the contract director cannot rely on these incentives alone to ensure an adequate level of asset maintenance.

A failure by the private party to allocate necessary expenditure to asset maintenance can be an indicator either of financial ill-health or a propensity to run down the asset, and perhaps have it fail the condition test on contract expiry (if applicable).

More recent project deeds generally require sufficient reporting (including on private party expenditures on asset condition and on service performance) by the private party to allow effective monitoring of asset maintenance, and may include KPIs related to the performance of planned maintenance activities. They may also include government party rights to audit asset quality, at its expense. In older project deeds, where such reporting and audit rights may not exist, it may be necessary for the government party to negotiate provision of this information from the private party to enable it to obtain sufficient comfort on this matter.

Step 3: Reporting requirements

The government party’s reporting requirements need to be articulated in the request for proposal and draft project deed provided to bidders during the procurement phase and set in the executed project deed. The reporting requirements necessary to enable ‘broader’ performance monitoring (beyond that necessary to approve service payments) should have regard to the matters that are to be monitored, as set out in step 2. These reporting requirements should be captured in the contract management plan and detailed in the contract administration manual.

While additional reporting may be negotiated during the service delivery phase, this can take significant time and effort.

* + - 1. Broader project management

In addition to monitoring service delivery performance for each period, and risks to delivery over the longer-term, contract directors also need to assist in achieving broader project objectives. These may include:

* + - identifying opportunities to improve value for money outcomes under the project deed; and
    - developing proposals for major change events, such as a change to the service requirements under the project deed arising from an increase in demand or a policy or legislative change, and their implementation if approved.

The pursuit of endeavours to achieve these broader project objectives may not require constant application of resources but may need to be prioritised at times. Such activities can be resource intensive for significant periods, and are likely to involve working with other parts of government. The contract management team will need flexibility in resourcing levels and skills to enable allocation of sufficient attention and resources to these broader objectives as well as undertaking day-to-day contract management activities. Contract management activities related to specific change events are addressed in Part 4 of this guide.

Part 4: Specific contract management events

Part 4 (Chapters 12–17) addresses a number of specific contract management events for *Partnerships Victoria* projects, expanding on the information provided in the National PPP Guidelines[[12]](#footnote-12). It focuses on how to manage these events if they occur during the service delivery phase, in order to minimise any adverse impact on project objectives and value for money outcomes. As contract management events may occur at any time during the contract term, the general principles outlined are applicable during both the construction phase and service delivery phase. In particular, Part 4 addresses a range of issues applicable to each of these significant contract management events and provides both principles to underlie actions and practical guidance.

Chapter 12 Change management and innovation

Chapter 13 State-initiated modifications

Chapter 14 Reviewable services

Chapter 15 Refinancing

Chapter 16 Change of ownerships/control

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* + 1. Change management and innovation

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* + - 1. Introduction

During the lifecycle of a *Partnerships Victoria* project, there are likely to be a number of change events to be carefully managed. These change events may have been contemplated during the procurement phase and provided for in the project deed, or may relate to new matters such as an operational innovation which may benefit service delivery.

Chapters 12–16 address specific contract management events for *Partnerships Victoria* projects that may occur during the service delivery phase. These specific change events have been selected because of their potential to impact project objectives and value for money outcomes, their relatively common occurrence and specific lessons learned on other projects.

This Chapter addresses a number of common issues and processes across change events. In the context of a long term *Partnerships Victoria* project, change management involves planned or unplanned change events impacting the ongoing service provision. This includes innovations that have the potential to offer the State additional benefits or better value for money service provision.

* + - 1. Change events

A key feature of *Partnerships Victoria* projects is the focus on the delivery of services according to an output specification or services specification. The project deed defines the type and level of services upfront. However over the lifecycle of the project there is likely to be a need to manage changes to service delivery.

Events provided for in the contract

A project deed may provide for a variety of change events, including:

* + - transition from one project phase to the next:
      * construction phase to service delivery phase, with associated changes to payment and performance reporting;
      * end of contract term, which may involve ceasing services, extending service delivery under similar or different arrangements, or other outcomes;
    - changes defined in the project deed, such as reviewable services; and
    - changes contemplated under the project deed, the timing of whose occurrence may not be predictable, e.g. change in ownership.

Events not provided for in the contract

Given the long-term nature of *Partnerships Victoria* projects, it is to be expected that, from time to time, either of the parties will seek an amendment to the project deed.

By negotiating and agreeing to appropriate amendments, both parties can increase the likelihood that the partnership will adapt to changing circumstances and continue to provide mutual benefits. In some instances, the private party may propose amendments to the contractual arrangements to introduce innovative service delivery processes or facility enhancements. Any proposed changes may fall within the change management mechanisms in the project deed or an alternate change mechanism via:

* + - modifications;
    - augmentations; or
    - market-led proposals (initiated by the private party solely or with other parties)

The modification process contained in the project deed of early *Partnerships Victoria* projects may not provide the flexibility required to accommodate significant changes to the project or project assets. If this is the case, the proposed change may fall within the *Market-led proposals guideline*[[13]](#footnote-13), and the contract director should seek further advice from DTF as to whether this is the case and how to proceed. In the *Partnerships Victoria* standard project deed, a regime for significant changes (referred to as augmentations) has been included to allow for such changes to occur under the project deed and not under the *Market-led proposals guideline*.

* + - 1. Change control procedures

Changes in a *Partnerships Victoria* project, whether initiated by the private party or the government party, will be easier to deal with if appropriate procedures are in place. In the case of changes provided for in the project deed, appropriate change control processes should be included in the contract administration manual (as discussed in Chapter 7). In the case of other changes, similar contract management issues arise and similar processes are required and should also be incorporated in the contract administration manual.

The issues that need to be considered in preparing any change management process for a *Partnerships Victoria* project include:

* + - Who can request a change?
    - Who should be involved in assessing the impact of the change?
    - Who can authorise the change?
    - How is the change prioritised?
    - How is implementation of the change controlled and tested?
    - How is the change documented?

The change management process should establish a central point through which all changes are coordinated.

Who can request a change?

This question has two parts:

* + - **Does the party wishing to initiate the change have power to do so under the contract?** If the answer is ‘yes’, then the change control procedure in the project deed should be followed. If the answer is ‘no’, the party wishing to initiate the change can still raise the proposed change with the counterparty, but the change will only proceed if the counterparty is willing and able to initiate the change through an acceptable change control procedure, or is willing to agree to the change as a variation of the project deed.
    - **Does the individual requesting the change have the authority to do so on behalf of the relevant party?** The government party should ensure that changes are only requested by authorised personnel under the project’s governance arrangements (as detailed in Chapter 3), and that change requests received from the private party comply with any contractual requirements specifying which of the private party’s personnel can request a change.

The flowchart below (Figure 13.1) illustrates the steps in determining whether a change can be made through a contractual change control process, and who can request the change.

Figure 12.1: The process for initiating a change



In managing changes, the government party should be aware of the level of work involved by the private party in responding to change requests. Most change requests should only be submitted by the contract director. However, it may be appropriate in some instances for other personnel (for example, managers of the end users of the services) to have limited authority to submit and manage change requests within specified budgetary and technical constraints, as agreed by the contract director.

Who should be involved in assessing the impact of the change?

There is likely to be may be a range of individuals within the government party or other stakeholders who should be consulted to fully assess the impact of a proposed change. In addition, it may be appropriate to work jointly with the private party to assess the potential impact of the change.

In assessing any change request, careful consideration should be given to the impact of the change. For example, some performance measures may become irrelevant if one performance requirement is changed. In these circumstances, the government party should consider whether an amendment to the project deed to introduce a new performance measure would be appropriate. The contract administration manual should also be updated to take account of each change. Furthermore, variations in performance requirements which increase costs can lead to price variations and compromise the original value for money outcomes.

Who can authorise the change?

Contractual changes may have to be authorised or approved by a person other than the person who requested the change. Responsibility for authorising different types of change may rest with different people. In the case of project deed amendments, the amendment should be authorised by each party in accordance with relevant legislative and governance requirements (as detailed in Chapter 3). However, where a project deed has been given the effect of force of law through legislation (for example, the *Melbourne City Link Act* *1995*), changes to the project deed may only be made by Parliamentary amendments of the relevant legislation unless the legislation provides some other change mechanisms. Managing change processes under such contracts requires special consideration. Wherever possible, the legislation should incorporate contractual change mechanisms (for example, provisions for regulatory change) to give effect to what can be classified as essentially ‘housekeeping’ or non-substantive events (for example, increasing prices in line with indexation provisions).

Material project deed changes that create budgetary or risk allocation issues need to be approved by the Treasurer (through DTF) before being implemented.

How is the change prioritised?

Some changes may require significant work and outlay to implement. For example, a change may mean the private party has to alter the project assets used to provide services. There must be some means of determining how the change is prioritised with other work carried out by the private party. A variety of methods can be used to prioritise appropriately, depending on the nature of the change. Possible methods include:

* + - setting a time limit for implementing the change;
    - specifying that it be given priority over certain other responsibilities of the private party; and
    - providing financial incentives for implementing the change.

How is implementation of the change controlled and tested?

What was intended to be a minor change to services may, if not properly implemented, compromise the delivery of the services as a whole. For example, if a private party provides communications services, a poorly implemented upgrade to the communications hardware used to provide those services may cause the hardware to cease functioning. The implementation of changes should be carefully controlled and, where appropriate, changes should go through a rigorous testing process before being fully implemented. Any control and testing process specified in the project deed (or associated project contracts) should be highlighted in the contract administration manual.

For major change processes, including transfer of the project assets back to the government party at the end of the contract term (as detailed in Chapter 17), the parties should jointly develop and agree on a detailed implementation plan for the change (in some circumstances referred to as a transition plan). Developing the plan should commence well in advance of implementation.

Suitable testing processes will depend on the nature of the services concerned. Any acceptance testing procedure used for commissioning the project may be a useful guide. For change control processes within the project deed (or associated project contracts), the process should specify the appropriate testing process.

How is the change documented?

Both the specifications of the change itself, and correspondence and discussions with the private party in relation to the change, should be fully documented and kept in order to avoid subsequent disputes as to what was agreed. This is an aspect of appropriate communication planning and management (as detailed in Chapter 4).

It is vital that changes modifying a project deed are documented as formal amendments using an appropriate version control process. Any change negotiated between the parties should not be effective unless and until it is formally agreed. The parties should not rely on informal agreements for noncompliance with the terms of the project deed. However, occasionally a proposed amendment will impose no new or additional obligations on the government party, and will not relieve the private party of its existing obligations. In these circumstances, it may be appropriate for the parties to agree to treat the amendment as being effective before the formal documentation is executed.

As noted above, major change processes require a detailed implementation plan, which should be documented in advance of implementation.

* + - 1. Change and contractual risk allocation

It is important that contractual changes do not inadvertently undermine the original risk allocation established during the procurement phase. Changes over time to the project and its external environment may result in attempts by the private party to shift the overall risk allocation or transfer particular risks. For example, if changed circumstances necessitate a change in performance requirements for services, the private party may ask the government party to approve its proposed method of meeting those changed circumstances. If the government party gives such an approval, it may inadvertently take back the risk that the private party’s service delivery methods are unable to meet the performance requirements. Approvals of such changes should not be given.

An adjustment in risk allocation is an acceptable outcome of a change process in some circumstances. For example, the private party may be able to offer the government party a better value for money proposition if a risk borne by the private party is reallocated to the government party. However, this reallocation should entail a corresponding reduction in the service payment or some other offsetting benefit. Any proposal of this type should be carefully analysed by the government party in conjunction with representatives from DTF. A cost–benefit analysis can assist in analysing such a proposal.

Material changes that create budgetary or risk allocation issues need to be approved by the Treasurer (through DTF).

* + - 1. Change and resource planning

Continuity of key personnel is particularly important during the major change processes of a *Partnerships Victoria* project lifecycle. These processes can significantly increase demands on the government party’s contract management team, as well as temporarily increasing the level of risk inherent in the project. Consequently, future change management activities for a project should be factored into the resourcing and succession plan for key government party personnel.

* + - 1. Service delivery innovations

Using the change management principles discussed in this chapter, a *Partnerships Victoria* project is able to accommodate a range of change events that occur during the construction phase or the service delivery phase.

New service delivery innovations may provide potentially important change events that could provide both the private party and government party with benefits, including improved value for money outcomes for the project.

Under the outputs-based service model used by *Partnerships Victoria*, there is some flexibility for the private party to introduce service delivery innovations to more efficiently achieve the contractually agreed output requirements. As a result, the private party is able to realise the total benefit of these innovations.

However, if a new service delivery innovation presents a material change or requires a contract modification to meet the contractual output specification or services specification, the private party will be required to work with the government party to propose, evaluate and potentially implement a service delivery innovation. As a result, the benefits of such an innovation may be shared between both the private party and the government party.

As it is complex for the private party to work with the government party to implement innovative service delivery proposals, it is important that a contract director provides an environment that does not inhibit private sector innovation. A number of good contract management practices and principles outlined in this guide may be useful to assist to develop the right environment, including:

* + - developing a solid and transparent working relationship between the government party and the private party (which includes regular meetings) to promote a well-developed understanding of each parties needs and drivers;
    - a cultural willingness to embrace innovation, where it is expected that a contract director will ask for new service delivery innovations, and the private party will actively look for and consider their service delivery innovations options;
    - a contractual structure that supports (or at least does not inhibit) the private party from introducing new service delivery innovation proposals; and
    - the contract director to consider providing incentives (such as cost reimbursements or a gain sharing mechanisms) to encourage the private party to invest in innovations.

The importance of encouraging innovation in *Partnerships Victoria* projects is demonstrated by including innovation clauses in a number of recent *Partnerships Victoria* projects and in the *Partnerships Victoria* standard project deed. These provisions are designed to encourage the private party to introduce new service delivery approaches that may potentially benefit both the private party and the government party. The private party may potentially improve its internal rate of return on the project, while the government party may potentially improve the value for money outcomes of a specific project (or across a wider portfolio of projects). This approach is being used on the Ravenhall Prison project to encourage best practice service delivery innovations. In this project, the private party is required to report to the State annually on potential innovations. Introducing innovations or changes is subject to developing a business case, which will allow the government party to analyse the project specific or wider service delivery benefits offered. This may result in the government party choosing to invest in a proposed innovation on the Ravenhall Prison project or across the wider portfolio of prisons operated by the Department of Justice and Regulation.

Barriers to innovation

There are a number of barriers to innovation that may stifle introducing service delivery innovations, these include:

* + - the lack of positive obligations in existing project deeds incentivising the private party to introduce service delivery innovations – this barrier has been addressed in recent projects and the *Partnerships Victoria* standard project deed; and
    - risk averse approaches that may be adopted by both the private party and the government party that can make it difficult to introduce new service delivery innovations, where –
      * the contract director is focused on ensuring that the government party receives the contractual outputs, agreed upfront over the project term. As such introducing a new service delivery innovation may be seen as something that is unusual, may be difficult to understand, assess and implement;
      * the private party is focused on providing the project outputs as contractually agreed. The private party may not look at any innovative service delivery options given that risk adverse equity investors may want to maintain their known project risk allocation.

Due to the inherent barriers to innovation, it is important for the contract director to encourage (or at least not inhibit) innovation. The contract director may consider using incentives such as cost reimbursements or a benefit sharing mechanism to encourage the private party (via equity, facilities managers or operators) to invest in innovations that can demonstrate value for money benefits for the project.

When considering any proposed service delivery innovations, the contract director will need to evaluate the benefits of the proposed changes along with any incentives offered. If the proposal is still able to demonstrate a value for money outcome, then the government party may use a State-initiated modification (as detailed in Chapter 13) to implement the required changes in conjunction with the private party.

Opportunities for innovation

During the service delivery phase, there are a number of change events that may provide opportunities for the government party to encourage private party innovation in service delivery, including:

* + - reviewable services processes (as detailed in Chapter 14), which present an opportunity for the contract director not just to seek an updated price for these services, but to seek innovations from the private party. Service providers should be encouraged not only to provide a price using the current methods of delivering these services, but to look at innovative ways to provide the service for the State, potentially providing a less expensive or superior quality service for the State. An example of this is provided by a security service review undertaken by an operational Partnerships Victoria project. The government party used the reviewable services mechanism to request different service provision options. In response, the private party proposed a new approach to staff rostering that provided better service to facility users during the peak periods, while using the same number of staff hours. This simple innovation provided the government party with better service delivery during the peak period and provided better value for money for the project; and
    - refinancing and change of ownership/control processes (as detailed in Chapters 15 and 16). As both of these events usually require State consent, they can also present opportunities for the government party to benefit from private party innovation associated with how the service delivery is financed. If the private party introduces an innovative method to finance the project debt and/or equity, the State is typically obliged to consider and assess any new structure – which may provide benefits such as less expensive service delivery, or potentially reducing risk for the State. Typically, *Partnerships Victoria* projects will have a refinancing gain-sharing mechanism to ensure that any gains from the refinancing be shared between the State and the private party. An example of this was provided by a private party project sponsor that approached the State seeking to restructure ownership of a number of projects with an injection of funds from overseas institutional investors. While this was a new approach to funding the projects, as the projects were in a mature steady-operating state, there was no additional risk or costs to the government party. On this basis, the government party provided its consent. This approach however had other benefits, including providing opportunities for new investors to participate in the Australian PPP market, and enabling the project sponsor to sell down its holdings in mature projects to less risk-averse investors, potentially enabling the sponsor to invest in future projects.
    1. State-initiated modifications

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* + - 1. Introduction

This chapter aims to assist contract directors to plan for and implement an effective process when considering modifying the project assets or the services of an existing project in the service delivery phase. Any such change initiated by the government party is referred to as a State-initiated modification.

As *Partnerships Victoria* projects are long-term service-focused projects, it is not uncommon for a changing service requirements to trigger a State-initiated modification. For example, continued growth and changing health service requirements led to expansions (via modification) of the Casey Community Hospital, with the addition of a special care nursery (2010), a 30-bed subacute redevelopment (2014) and 128 multi-day beds in 2017.

The focus of any proposed modification must be on its ability to meet changing service requirements. This chapter details a range of issues a contract director should consider if they are considering a modification to the project assets or services. It also provides a set of principles and tools to support the modification process.

Key contract management tasks during a modification process include the:

* + - the government party clearly specifying the change in service requirements sought and clearly articulating any other requirements that may impact how the private party responds to the request;
    - the private party responding and developing a proposal for the modification;
    - confirming design requirements (if applicable), including that the proposed design can meet the government party’s service requirements;
    - undertaking independent review;
    - confirming value for money (following the contractual processes, if required);
    - confirming funding arrangements;
    - assessing the impact on existing services (interface issues); and
    - documenting the modification.

Most State-initiated modifications will be managed under the change management framework in the project deed. However, depending on the nature and extent of a significant modification (or augmentation), these may need to be managed under the under the *Market-led proposals guidelines* or, in *Partnerships Victoria* projects procured after 2017, under the augmentation schedule in the project deed.

* + - 1. Specifying a State-initiated modification

*Partnerships Victoria* projects with significant capital assets usually operate over 25–30 year terms. These long-term projects provide the government party with transparent, predictable, long-term pricing for public sector infrastructure-related services, and a consistent standard of maintenance of the project assets over this period.

As discussed in Chapter 12, it is inevitable that change events will occur during the contract term. As such, the value for money rationale underpinning each project may be undermined if these long-term contracts cannot incorporate changing public sector needs or innovations resulting from changes in technology. For example, if the demand for a facility changes or current equipment cannot meet higher level service needs, it is possible that the government party will not achieve value for money over the longer term without changing the project assets or services.

It is not only unplanned changes in service needs that lead to State-initiated modifications. In some cases, the State-initiated modification is considered as part of the original design, but is not built at the time due to affordability constraints. In others, scope for specific modifications are set out in the request for proposal, and built into the design, allowing for future modifications to occur. For example, both original project deeds for the Victorian County Court project and the Melbourne Convention and Exhibition Centre project included requirements for future facility expansion.

Usually the framework for managing a State-initiated modification will be outlined in the project deed. As with construction works in the original request for proposal, State-initiated modifications should, to the extent possible, be framed in terms of changes to the output specifications or services specification, which will in turn affect the project’s performance regime, key performance indicators and the payment and abatement provisions.

Typically, the project deed will also provide for minor asset and technology upgrades at certain points during the contract term, and also provide mechanisms to either benchmark or market test certain services. Unless these changes require a material modification to the project assets or services, they are not within the scope of this chapter.

*Partnerships Victoria* projects are structured to achieve optimal risk allocation between the government party and the private party. One of a contract director’s main roles is to ensure that the risk allocation negotiated for the project is maintained. This is particularly important when State-initiated modifications are being implemented. Without good contract management processes, the private party may use the change process to attempt to recoup the cost of risks that it had previously accepted, or to transfer risks back to the government party.

Successful State-initiated modifications begin with a carefully developed scope and clear output specifications. The output specifications should be developed in conjunction with users and other stakeholders to ensure a thorough understanding of what changes are required, and what will be delivered.

In addition to clarity of what needs to be delivered, the contract director needs to ensure that users, stakeholders and decision makers have realistic plans for delivery timeframes, a realistic expectation of the cost of construction, and an understanding of the likely impacts on the cost of service delivery. In particular, plans for delivery timeframes (if changes to the project assets are contemplated) should allow for statutory processes that are outside both the government party’s and private party’s control, such as the process for gaining planning approval. Modifications to project assets during the service delivery phase may experience more lengthier development processes due to contractual and resource constraints.

Making changes to the project assets or services may have flow-on consequences for other elements of the project deed, such as the relevance and usefulness of key performance indicators and service standards. As well as agreeing on the price and timeline of any State-initiated modification, the contract director should agree with the private party upfront (i.e. before approving the private party’s proposal) on the new contractual arrangements, including, new output specifications, services specifications, performance standards, and key performance indicators that will apply to the new services and project assets. The contract administration manual should also be updated to take account of any changes.

Prior to issuing a formal request for modification, the government party should consult the private party with respect to the potential State-initiated modification. This interaction will clarify possible issues arising from a modification, while fostering greater understanding of both the government party’s and the private party’s needs and concerns.

* + - 1. Developing a proposal

A modification request triggers significant activity within the private party consortium, because many parties must be consulted. Even before issuing a formal request for modification, the government party should consult with the private party, who will in turn consult with members of their consortium, with respect to the potential State-initiated modification.

After the government party lodges a request for a State-initiated modification with the private party:

* + - the private party’s representative will refer it to either an established or a new project team responsible for design and construction. The size of the project team will depend upon the scale and complexity of the proposed modification;
    - typically, within a defined period after the government party’s request, the private party must provide to the government party a quote for the cost of preparing a proposal for the State-initiated modification. If the government party accepts the quote, the private party must prepare the proposal and the private party will only be entitled to recover from the government party the amount quoted for preparing the proposal. If the government party rejects the quote, it may require the private party to submit a further quote, or advise the private party that it will not proceed with the modification;
    - after assessing the modification, the private party’s project team will refer the request to private sector contractors for conceptual design development and pricing (if applicable);
    - the project team will also seek the views of the facilities management subcontractor as a modification is likely to impact maintenance and asset management activities (in a full-service PPP, the operator will also be consulted);
    - the project team will deliver a proposal (including conceptual design, assumptions, pricing and impact on service requirements) to the private party, which will pass this work on to the project’s financiers and facilities management subcontractor and operator (if required) to review. The facilities management subcontractor and operator (if required) will estimate the change in lifecycle costs and operating costs (if required), as a result of the modification; and
    - finally, the financiers, facilities management subcontractor and operator (if required) will respond to the private party, which will pass the consolidated information in the form of a proposal to the government party. Where the government party decides not to proceed with a modification after receipt of a proposal, but has accepted a quote for the preparation of the proposal, the government party must pay the private party the amount accepted for preparation of the proposal even if the modification will not be implemented.
      1. Design development

As is the case in the project’s construction phase, it is important for the government party to adequately resource the design development activity of a State-initiated modification process (if applicable), because this process is often the final opportunity to fine tune requirements relating to the modification. It is particularly important that the contract director is confident the private party’s proposed design solution will meet the State’s changed service delivery requirements.

Depending on the scale of the State-initiated modification, the contract management team should be assisted by technical specialists (such as architects, engineers and quantity surveyors) along with user groups and stakeholders, to review the detailed designs. The contract director has an important role to play by ensuring that experts, users, and stakeholders are providing useful and constructive comments about the design, without intervening in the private party’s innovation and design role. Such interference may result in the government party assuming performance risk and potentially some occupational health and safety risk. This re-allocation of risk may undermine the project’s value for money.

* + - 1. The need for an independent reviewer

During the construction phase of a project, it is usual for an independent reviewer to be engaged jointly by the government party and the private party. As discussed in section 10.5, the independent reviewer’s role varies between projects – it can be limited to confirming that all commissioning tests have been done and passed, or could be as broad as reviewing all detailed designs for compliance with standards and specifications. If the State-initiated modification occurs during the construction phase, the independent reviewer will still be engaged and the modification should be included in the commissioning tests.

During the service delivery phase, in the event of a State-initiated modification or larger augmentation requiring capital works the need for an independent reviewer should be considered on a case-by-case basis. The value of the capital works, the materiality of the works to the service delivery, and how the works are funded/financed are relevant considerations.

* + - 1. Confirming value for money

A 2008 UK study[[14]](#footnote-14) found that State-initiated modifications in some UK projects have historically provided poor value for money. Contributing factors include the lack of a competitive tendering process, the impact of overheads and mark-ups on small changes, insufficient resources, and a lack of contract management skills.

Modifications initiated during the construction phase and service delivery phase may not benefit from the competitive tension that existed before the project deed and associated contracts were signed, and there is a risk that the pricing of a State-initiated modification may reflect a non-competitive margin.

Competitive tendering for State-initiated modifications is one method to alleviate this risk. Contracts developed in accordance with the *National Public Private Partnership guidelines* (2008) typically give the government party tools to achieve competitive pricing. The contract director should understand the tendering requirements in the relevant project deed. In some projects, the project deed requires the private party to provide the government party with a price for the works together with ‘evidence that it has used reasonable endeavours’ to obtain competitive funding for the cost of the works or services. If the government party is not satisfied with the proposed cost, it has the right to request a competitive tender for the works, which will be conducted by the private party, and it has the right to have the works delivered by the tenderer that offered best value for money. In other projects, the project deed requires that the private party carries out a tender process where the cost of the works or services is likely to exceed an agreed threshold, unless otherwise agreed by the State.

Contract directors may be reluctant to require competitive quotes or to run a competitive tender process, either due to time constraints, the cost of the tender process, or concerns about the risk of integrating assets built by a third party with existing project assets. However, any decision not to evaluate the proposal’s costs using competitive processes should have sound justification, and should be based on a robust consideration of how value for money can best be tested and achieved.

Even if the private party uses some form of competitive quoting in developing its proposals, the contract director should be aware that the private party’s incentives might not be aligned with the government party’s in seeking best value for money. The private party may be concerned to ensure that the State-initiated modification will not put at risk its ability to meet its contractual obligations and service standards, and so might be inclined to favour quotes that offer higher standards than the government party might consider ‘fit for purpose.’ Furthermore, because the private party may be charging a margin (refer below) for managing delivery of a State-initiated modification, it may not have any incentive to minimise government party costs.

Some elements of pricing for State-initiated modifications are inherently unsuited to competitive tendering – for example, changes to the remuneration of existing staff for changed duties, or changes to existing software systems. In these circumstances, the contract director should seek to use benchmarking and negotiation to achieve value.

Compensation payable for a State-initiated modification

The price paid to the private party for State-initiated modifications includes:

* + - the base cost of the materials and labour of the subcontracted builder to construct the changed project assets (if any);
    - a margin element to cover overheads and provide profit to the subcontracted builder undertaking the change;
    - the lifecycle cost – the facility management subcontractor’s additional cost of replacing any part of the changed project assets during the remainder of the service delivery phase;
    - the maintenance cost – the facility management subcontractor’s additional base costs to maintain the changed project assets or provide the changed services during the remainder of the service delivery phase;
    - a margin element to cover overheads and provide profit to the subcontracted facility management subcontractor undertaking the change;
    - in a full-service *Partnerships Victoria* project, the price may also include the operator’s additional base costs and profit margin for providing the additional services; and
    - possibly a management margin charged by the private party for large State-initiated modifications – it is expected that the private party’s business-as-usual functions include managing unexpected events and changes in respect of the project, and therefore should be appropriately resourced to manage most modifications. Therefore any management margin should only be payable on large State-initiated modifications.

In more recent *Partnerships Victoria* projects, the margin that may be charged by the builder and facility management subcontractors and the private party (if any) for undertaking a State-initiated modification have been specified in the project deed, usually on a sliding scale depending on the cost of the State-initiated modification. The margin is usually levied in the form of a percentage on top of the base costs.

The private party has overall responsibility to the government party and will usually be the party coordinating the process, however the facility management subcontractor or another subcontractor will implement most of the changes involved in a State-initiated modification.

It is recommended that in projects where there is likely to be a steady pipeline of State-initiated modifications, and the project deed does not already specify the amount of any margin, that the contract director negotiates a schedule of fees in advance, to avoid delays and disputes at the time that the State-initiated modifications are eventually requested. Prior to any such negotiation, the contract director should contact DTF to get an indication of the levels of margin that have been negotiated for recent projects.

The lifecycle cost of a modification can also be a subjective measure. Determining a lifecycle cost requires a judgment of how often equipment or facilities will be replaced during the service delivery phase, as well as an estimate of how much it will cost at the time. There can be debate about which items will need to be replaced at all, particularly if routine preventative maintenance is carried out. As such, expert knowledge and experience is recommended to make these judgements. Smaller items such as knobs, hinges, taps and data points may, in practice, be treated as consumables by the facility management subcontractor and therefore be absorbed in its maintenance budget, not needing lifecycle funding.

Contract managers need to fully understand both the scope and costs of any proposed State-initiated modification. The contract managers should also be willing to question the private party about all cost items included in a proposal, and not allow the threat of possible delays due to disagreement with the private party lead to unreasonably high pricing.

* + - 1. Funding the State-initiated modifications

The *National PPP guidelines: commercial principles* and the *Partnerships Victoria* standard project deed guidance notes outline several options for the government party in paying for the State-initiated modifications, including:

* + - where the State-initiated modification involves capital works, making a lump sum payment (on completion of the works) through a one-off capital expenditure payment;
    - requiring the private party to initially fund the works, with the government party then paying the cost through an upwards adjustment of the service payment over the remainder of the project; or
    - with the private party’s agreement, extending the service delivery phase of the project.

Other options for payment include paying periodically in arrears, paying milestone payments (where capital works are involved), or as an adjustment to the service payment.

The project deed may or may not include a list of payment options. It is always possible to negotiate a form and timing of payment for State-initiated modification that is not included in the project deed, however care must be taken to ensure that value for money can be demonstrated.

In assessing various payment options, it is important to consider the broader budgetary context, the impact on the specific project deed and the ability to negotiate with the private party.

The option to extend the term of the project deed should be carefully considered. There can be justification for the government party agreeing to the extension of the project, particularly where extending the term will enable the State to secure future services at currently contracted prices that may be cheaper than those available in the future. Contract extension may offer best value for money for relatively large modifications undertaken well into the contract term. However, changing community expectations and emerging technology can create uncertainty around the need for existing services in future, and difficulty forecasting future costs can make it challenging to evaluate whether such an extension offers value for money. Therefore, the government party should carefully assess both the benefits and risks relating to any suggestion that the project deed term should be extended in order to pay for current State-initiated modifications. Any decision to extend should be taken on operational and value for money factors. The government party should not extend the original contract term unless doing so would have been justified on a separate stand-alone basis. Extending the project deed term to ease a possible affordability constraint cannot be justified as an end in itself.

Deciding between paying upfront or through an adjustment to the service payment should be done on a case-by-case basis, as the relative cost of these options can be influenced by any difference between the State’s discount rate and the private party’s cost of funds. When making this decision, the government party should consider the service payment adjustment principles particular to each project, which may determine which funding option will provide better value for money. The impact of each option on any subsequent abatement calculation should also be reviewed and understood before deciding on a funding method.

Finally, contract managers should be wary of pressure to use a project’s ‘retained risk funding’ to fund State-initiated modifications. As outlined in section 0, the risk allocation negotiated for each project will have resulted in a set of risks being retained by the government party. The project’s funding allocation will recognise the price of some of these retained risks by setting aside a budget of ‘retained risk funding’ which can be called upon at any time during the project, in the event that these risks materialise. It is important for contract managers to recognise that the retained risk funding should only be used if the risk for which such funding is allocated eventuates, and that it should not be treated as a State-initiated modifications fund.

* + - 1. Impact on existing services

State-initiated modifications are generally prompted by a need to expand or improve services to users. However, contract managers need to be aware that there can be short-term impacts on existing operations as a result of the State-initiated modification process.

As part of its proposal to carry out the State-initiated modification, the private party should indicate whether implementing the modification (e.g. the construction of new project assets) will negatively impact on its ability to maintain service standards and availability of existing project assets. The contract director should consider whether these claims are reasonable and valid, and should document the government party’s performance expectations for existing project assets and services during the period in which the modification is being implemented.

If the State-initiated modification will result in a material ongoing change in the private party’s service delivery responsibilities, it may be appropriate to require private party to meet a set of operational commissioning tests in respect of the revised services, as well as the commissioning tests for the physical assets.

* + - 1. Documentation

It is vital that changes modifying a *Partnerships Victoria* project, including State-initiated modifications, are documented formally.

In the first instance, contract managers should be aware of the provisions in the project deed relating to State-initiated modifications. Contract managers should use the provisions that are contained in the project deed to manage the State-initiated modifications process, rather than just ‘running with it’. Following the processes set out in the project deed helps to maintain the project’s risk allocation, ensures that the government party has access to robust information for decision making, and ensures decisions are adequately documented to reduce the likelihood of later disputes.

Internal project documentation

The contract director should ensure that appropriately updated insurance, warranties, manuals and plans are in place to reflect the scale and scope of the State-initiated modification or augmentation. Updated documents should be a condition before finalising the State-initiated modification.

The contract director must also ensure that details of the modification or augmentation are captured and clearly documented within internal contract management documents, processes and tools by the contract management team. The modification or augmentation needs to be reflected in updates to at least the;

* contract administration manuals;
* updated asset management plans;
* updated payment models;
* updated key performance indicators;
* updated abatement regimes;
* updated risk matrices; and
* updated obligations registers.

External documentation requirements

If a modification or augmentation is considered to be a material change there may also be a number of external documents the contract director may be required to update to comply with contract disclosure and the *Partnerships Victoria* project summary requirements. DTF is able to available to assist the contract director meet these requirements.

* + 1. Reviewable services

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This chapter provides assistance to contract directors to plan for and implement an effective process when undertaking a re-pricing of reviewable services.

* + - 1. What are reviewable services?

Reviewable services are services that are subject to repricing at pre-agreed points during the life of a *Partnerships Victoria* project.

For most *Partnerships Victoria* projects, only ‘soft’ facility management services are subject to repricing. These services are predominately labour-based services like cleaning, gardening or waste management. As the costs of ‘soft’ services change over time in a manner that cannot easily be predicted over the life of a *Partnerships Victoria* project, it is not value for money to lock in the pricing of the service for the entire project term. A formal review of the pricing of these services is typically undertaken at regular pre-determined points throughout the life of the project.

In contrast, ‘hard’ facility management services relate to physical asset services like building mechanical and electrical services. These hard services are usually linked to the design and construction methodology adopted by the private party, and are typically included in asset lifecycle, maintenance and refurbishment costing for an asset over the life of the project. Consequently, these services are not suited to price reviews.

Reviewable services included in current *Partnerships Victoria* projects, include:

* + - cleaning services;
    - security services;
    - information technology support services;
    - grounds and garden maintenance;
    - pest control services;
    - waste management services; and
    - carpark and traffic management.
      1. Why are service reviews undertaken?

Reviewing and re-contracting the cost of reviewable services is undertaken to ensure that service costs paid by the government party over the life of the project are competitive, and continue to provide value for money during the project term. The review enables the private party’s subcontractors to adjust their service costs based on a range of cost factors, such as movements in the wage price index. It also allows the government party to ensure the agreed rates reflect the actual costs of service provision. For example, if there have been technological innovations during the previous reviewable services term, the service review provides the private party with an opportunity to introduce innovations that may improve the service and/or lower the cost of services for the benefit of both the private party and government party.

The contract director also has the opportunity to review the service specifications and performance regime with a view to identifying any changes that could improve value for money for the government party. For example, services specifications and/or KPIs can be clarified, and abatement levels could be more closely aligned with service impacts to potentially enable a reduced service cost. For the contract director, a key consideration in applying the reviewable services regime, is how it can be used to incentivise the private party to provide future innovations and/or efficiencies for the government party. While the reviewable services regime provides an opportunity to clarify or align services specifications and/or KPIs, the review process should not be regarded as a mechanism for general changes to the scope of services under the project deed. The appropriate mechanism for making changes to the scope of services is via the State-initiated modification regime (see Chapter 13).

* + - 1. Planning for reviewable services

The project deed outlines the intervals and processes for reviewing and recontacting of reviewable services. Typically, this will occur every five, seven or 10 years. Contract directors should ensure the review and re-pricing commences early enough for a full and proper process to occur. It may take up to 12 months to complete the services review process which can be impacted by a number of factors, including:

* + - the number and type of services that are being reviewed;
    - the processes used in the review; and
    - the current relationship between the government party and the private party.

In the first instance, contract directors should refer to the processes outlined in the project deed and the contract administration manual, and consider the level of complexity involved. The private party may also be reluctant to provide information to the government party as the review process approaches, and a contingency should also allow for unexpected delays in the process. Good communication with the private party will minimise the risk of drawn-out negotiations. Appropriate planning can also prevent delays in government party approvals which might result in the current reviewable services term being extended for a short transition period.

**Understanding the reviewable services process contained in the contract**

The approach to reviewable services must be undertaken in accordance with the project deed. The project deed will outline which services will be reviewed (if any), and at what time intervals this must occur. It will also detail the processes to be used in the services review, which may involve:

* + - a submission to the government party by the private party;
    - benchmarking against other comparable services; or
    - market testing by way of a competitive tender.

If there are insufficient details in the project deed, the process should be agreed upfront by the government party and the private party. However, before engaging with the private party, the contract director should have established an agreed State position on the desired process, and considered any desired changes to the services specifications or payment regime to ensure the government party’s position is achievable and represents value for money.

As the review may be a complex process, contract directors should seek legal, commercial and technical advice to assist with understanding key issues, such as how subcontractor margins are provided for in the current service payment. Previous experience indicates that the use of a specialist facilities management adviser firm is highly recommended, as they understand the current facility management services markets, have access to current market rates, and will be able to assist with the benchmarking and market testing (which can be difficult in non-comparable markets), if required. In a full-service PPP project, it may also be necessary to engage other advisers to advise on service delivery and cost implications of operational aspects of the project.

The contract director should also undertake early discussions within the government party, in terms of the funding implications of the services review. As the cost of services in the next reviewable services term may increase rather than decrease, the contract director should start engaging with the finance area and/or DTF to provide early notification of potential changes to the project’s funding requirements, and to agree on funding strategies.

**Reviewing the services specification and performance regime**

In order to understand the level of performance that the government party will request as part of the services review, the contract director should engage with the key project stakeholders and user groups to understand their future service requirements, and to ensure these are aligned with the level of performance requested. The government party should form a working group of key stakeholders and user groups to review the current performance requirements, and to find out if they are appropriate to meet the future service requirements. If not, the government party may need to make changes to the performance requirements, which may include:

* + - changes to performance targets for existing KPIs;
    - changes to the abatement amounts applicable to existing performance targets;
    - introducing new KPIs where these are necessary to ensure a satisfactory level of service; or
    - removing existing KPIs where these are unnecessary to ensure a satisfactory level of service.

The review should also consider whether any aspects of the existing service requirements are unclear or ambiguous, and identify any clarifications or changes required to the services specification.

The review may identify changes in the scope of services to be provided by the private party. Changes to the scope of services that require a material change to the project assets or the services should be implemented through the State-initiated modification regime. However, it may be appropriate to plan the timing of such modifications to coordinate them with the repricing of reviewable services.

**State’s position on the reviewable services**

Based on the agreed service requirements, the facilities management adviser will develop a revised service specification, payment regime and service costs that should be benchmarked with industry standards. This will form the basis of the government party’s evaluation and negotiations with the private party.

**Engaging with the private party**

Once the government party’s initial position has been established, the contract director should engage with the private party as early as possible. This is important as the private party may interpret the requirements of the reviewable services processes outlined in the project deed differently to the government party, and it may take some time to come to an agreement on the actual processes to be followed.

Ultimately, for the services being provided, the government party and the private party will need to agree on:

* + - the actual processes to be followed in the services review;
    - the service level requirements (and any associated KPIs);
    - an appropriately calibrated abatement regime; and
    - the cost of the services for the next reviewable services term (and how the change in cost will be paid).

The private party may seek other variances based on their practical service delivery experience which the government party will need to carefully consider including:

* + - clarification of the services requirements or changes to the performance regime;
    - any recommendations for innovations, service improvements or efficiencies;
    - provision of additional services, which raises a range of issues for the government party (e.g. Are the additional services required? Can they be funded? Will they affect the delivery of other services such as ‘hard’ maintenance?). If these changes are acceptable to the government party, they should be implemented through the State-initiated modification regime; and
    - provision of services by a new subcontractor(s), in which case the contract director should have regard to the provisions in the project deed concerning the engagement and replacement of subcontractors.

The contract director should seek to ensure that the private party does not change the risk allocation or introduce new margins as part of the review. This will require assistance and advice from the legal and technical advisers.

Approval of the new reviewable service contracts will be required from a number of different entities on both the private party and the government party sides. Therefore, in planning the timing of the process, the contract director should ensure that there is adequate time allowed for all approval processes to be undertaken.

* + - 1. Benchmarking – key issues

Where the review is to take the form of a benchmarking process, the key issue for the government party is to obtain comprehensive comparable information on the cost of delivering the relevant services. The private party and its subcontractor are likely to have extensive industry information, but the contract director needs to be in a position to validate and, where appropriate, challenge this information. The key sources of data to inform the contract director include specialist facilities management advisers and any other recent contracts entered into by the government party for similar services (including other *Partnerships Victoria* projects).

Where an integrated service provision model is in operation on a project, it may be necessary to disaggregate overhead costs and allocate these across individual services, for example by splitting out helpdesk costs for hard services. In light of this, the contract director needs to be particularly careful about how overheads are treated by the private party, and that the right level of overhead is applied to the right cost. This may involve a detailed analysis of the financial model, possibly with the help of modelling specialists and the specialist facilities management adviser.

* + - 1. Market testing – key issues

Market testing involves the private party conducting a competitive tender for the performance of the reviewable services for the next reviewable services term. The successful tenderer will provide the services as a subcontractor to the private party for the next reviewable services term.

The project deed will typically provide for the government party and the private party to agree the procedures for market testing, but it will be the private party that undertakes (at its cost and risk) the market testing. The government party has the right to observe the process. The contract director must ensure that the process is run in a manner consistent with good procurement practices to ensure transparency and a value for money outcome.

The incumbent subcontractor has a significant advantage in the tender process, having delivered the existing services and possessing a strong understanding of the project. Other service providers competing in the market testing process may have strong service delivery capability and efficient businesses, but will not have such a strong understanding of the specific project and may price in a risk premium to account for their lack of detailed knowledge of the project. To ensure a strong competitive outcome, the process should be structured to address this information asymmetry by making as much relevant and useful information available as possible.

In some projects, the private party may be required to obtain approval from its financiers to replace a subcontractor. In these cases, it is advisable for the both parties to engage with the financiers prior to conducting the competitive tender to ensure that the financiers’ requirements are addressed through the process.

* + - 1. Ongoing knowledge management

The contract director should make sure to fully document the outcome of the services review, and capture it as required within the project deed.

It is also recommended that the contract director update the contact administration manual to capture the key details and lessons learned from undertaking the reviewable services process in order to prepare for the next review.

* + 1. Refinancing

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* + - 1. Introduction

*Partnerships Victoria* projects are financed by the private party through a mix of debt (in the form of bank loans or bond finance) provided by lenders and equity (also known as risk capital).

The term ‘refinancing’ refers to any changes in a projects debt finance arrangements, related to the; type, amount, pricing, tenor, terms for payment, or repayment, or hedging of financial accommodation.

The private party is responsible for refinancing, however ultimately if the private party is unable to secure replacement financing or is unable to service its debt, under the provisions of the project deed this may trigger a default event that will usually give rights to the government party to act to ensure the project’s viability.

As refinancing has the potential to change a *Partnerships Victoria* project’s agreed risk allocation, it requires advance government party consent (although the consent rights may differ according to the materiality of the refinancing). Contractual provisions relating to refinancing have evolved over time, in response to changing financial market conditions. The original financial structure of a *Partnerships Victoria* project (which reflects the market conditions during the procurement phase) will significantly influence the likelihood of refinancing occurring, and the potential issues that may arise. For example, where long-term debt financing is procured for the full project term, refinancing will not be required. As such, contract directors must carefully examine the refinancing provisions in each project deed, understand the project’s financial structure, and consult with DTF in relation to any proposed refinancing.

The project’s financial structure

The specific mix of financing arranged for each project is determined by:

* + - the size and complexity of the project;
    - the financial market conditions at the time of financing;
    - whether or not government makes up-front funding contributions (via State capital contributions or some other alternative financing structure);
    - the credit reputation and rating of the borrower;
    - the skills and knowledge of the project sponsor; and
    - the project’s risk profile.

Debt finance

The debt finance for a *Partnerships Victoria* project is generally comprised of either bank loans or bonds (or a combination) for a specific term.

Debt finance is usually provided on a limited recourse basis under a finance agreement between the project company and the lender(s). This means that the lender is dependent on the cash flow from the project and typically has security or encumbrances over the project specific assets and cash flow. The lender has no right to call on any other assets of the sponsors or related parties activities, other than any project specific bonds or guarantees provided by the private party.

The debt provided for a *Partnerships Victoria* project is generally known as ‘senior debt’. It is distinguished from any loans that equity providers may have made to the private party, which are a form of ‘subordinated debt.’ If the private party becomes insolvent, senior debt has a higher ranking, and must be repaid before other lending parties receive any payment. There is typically an inter-creditor document (as part of the finance documents) that governs the repayment hierarchy.

Through the restrictions and conditions associated with the loan, debt providers impose financial and management discipline on borrowers, which helps to encourage both initial due diligence in capital structure decisions, and ongoing incentives for good performance.

The costs associated with debt finance, whether in the form of bank debt or bonds, generally comprise the base interest rate, the credit or interest rate margin (margin), and fees.

Equity finance

Equity finance is usually provided for the full project term, through a combination of ordinary shares in the private party, and subordinated debt provided by sponsors and sometimes external investors.

The involvement of equity finance in a project’s financing mix creates significant incentive for the private party to deliver high performance, particularly where a material proportion of the equity is comprised of ‘active equity’ (equity contributed by one or more of the key private party entities that is in a position to influence the private party’s performance).

Equity investors receive a return on their investment over the life of the PPP project. In many PPP projects, much of the equity investors’ return is only received in the later years of the project. This provides a strong performance incentive – equity investors will be motivated to ensure that the project performs so that they receive these strong returns in the later years.

Equity finance serves an important purpose in providing the private party with adequate capital to absorb negative financial consequences arising from risks materialising. Many risks will have been transferred to subcontractors, however if that risk transfer is ineffective (for example, because a subcontractor becomes insolvent or because the risk transfer is poorly documented) the financial consequences will flow through to the equity investors. Some other risks are generally retained by equity, and are not transferred to subcontractors.

In addition, equity’s involvement reduces the risk shouldered by the debt providers, as the equity providers in the consortium are in a first loss position. As a result, the providers of equity finance risk losing some or all of their investment if the project does not go well. However, they also expect to earn a higher return on their investment than the providers of senior debt finance, if the project is successful.

In some projects, finance may also be provided in the form of mezzanine debt (ranking in priority between senior debt and equity) or through a hybrid financial instrument (which can have some characteristics of equity and some characteristics of debt, depending on the specific terms agreed with the financiers). As such, the government party should ensure that it understands the nature of such instruments and how they are treated in the project deed and related contractual documentation (whether it is treated as debt or equity).

What is refinancing?

As stated above, refinancing refers to any change to a project’s debt financing arrangements. Such changes might include one or more of the following:

* + - increasing the term of the bank loan;
    - changing the lender (although the original financing documents may allow some changes in the lenders that will not constitute refinancing);
    - changing the ‘margin’ used to determine the amount of interest payable on the loan;
    - changing the hedging arrangements used to fix interest rates;
    - increasing the size of the loan (sometimes done to enable the equity providers to be repaid some of their equity or to enable early repayment of subordinated debt);
    - removing or easing constraints on dividend payments to shareholders;
    - removing or easing conditions on the loan such as the requirement to hold money in reserve accounts; or
    - replacing bank debt with bond finance, or vice versa.

Scheduled and unscheduled refinancing events

Refinancing events may be undertaken as either a scheduled or unscheduled event.

A scheduled refinancing event is detailed in the project deed and is scheduled to occur at a specific point in time (expiry of initial finance term).

An unscheduled refinancing event is undertaken on an ad hoc basis for a specific purpose. An unscheduled refinance usually occurs when the private party can take advantage of favourable market conditions. Another common trigger for an unscheduled refinancing is as a result of a ‘change in control’ of the legal or beneficial ownership of the private party (from the original parties at contract execution) which requires a change to a project’s original debt financing arrangements. Changes in control are discussed in Chapter 16 of this guide. *Partnerships Victoria* projects typically require the private party to seek the government party’s prior approval for any change in control. If a refinancing occurs in conjunction with a change in control, the private party must satisfy the contractual approval requirements in relation to both the change in control and the refinancing.

Base interest rate risk allocation

In most cases since the Global Financial Crisis(GFC), the government party accepts the risk associated with fluctuations in the base interest rate (as this is not within the private party’s control), from the first refinancing. *Partnerships Victoria* policy requires the private party to fix the base interest rate until the first refinancing. Thereafter, the government party may choose to either leave the exposure unhedged, or manage the interest rate risk (either by entering into interest rate swaps itself, or requiring the private party to do so on the its behalf).

The floating rate component in the payment schedule is a mechanism which provides for movements in actual interest rates compared to the base interest rate for each interest period from the first refinancing. For each interest period, the calculation will produce a floating rate component amount that is a positive or a negative number, depending on which way interest rates have moved relative to the base interest rate agreed in the model output schedule in the financial model.

Should the government party require the private party to hedge the interest rate exposure beyond the first refinancing, the floating rate component will be a fixed payment each interest period comprising the difference between the hedged rate and the base interest rate. Alternatively, where the government party hedges the interest rate exposure via the Treasury Corporation of Victoria (TCV), the government party manages the floating rate component payments to the private party by entering into a back to back interest rate swap with TCV (outside of the project deed). Cash flow management with respect to the interest rate swap between TCV and the government party will need to be agreed upfront with DTF.

The floating rate component is paid in addition to the service payment. It is not subject to abatement, but may be subject to set‑off by the government party where it is an amount payable by the private party.

Refinancing risk allocation

At a refinancing, changes to the debt financing (other than base interest rate changes) could result in changes to the project equity distributions compared to the base case financial model. These are mainly due to changes in credit margins and fees but could also result from other factors such as a release of reserves. To the extent that equity distributions are higher or lower than those forecast in the base case financial model, there will be a refinancing gain or loss, respectively, as determined by the relevant project deed. Typically, the government party does not take any risk on refinancing losses (e.g. losses accruing as a result of higher fees and margins or changes in the debt profile compared to that originally forecast), rather this risk is entirely borne by equity.

The evolution of market conditions and contractual provisions

Conditions and contractual provisions prior to the GFC

Prior to the GFC, Australia experienced favourable financial conditions for the financing of PPP projects, with readily available long-term debt for the term of the project, at a relatively low cost. Furthermore, the base interest rate for PPP projects prior to the GFC was generally fixed for the life of the project. Refinancing for these projects is therefore not necessary, but can be undertaken opportunistically if market conditions allow the private party to replace its initial financing with lower-cost financing. It should be noted that there may be financial break costs associated with amending an existing fixed hedging profile.

Many pre-*Partnerships Victoria* PPP projects did not contain detailed provisions concerning refinancing. Since the original *Partnerships Victoria* guidance material in 2001, the government party adopted a consistent policy position to ensure all refinancing required government party consent, and ensure that the government party would share in any gains that could be generated by certain types of refinancing.

Early toll road projects were generally financed with shorter-term debt, and this debt would be refinanced as required as the project is de-risked following construction and traffic ramp-up. A practice developed whereby some refinancing was ‘assumed’ or ‘scheduled’ in the initial bid for the project. As the benefit of these refinancing activities was reflected in the bid price, the government party would not share in the gains generated by these refinancing activities. However, these project deeds provided that the government party would share in ‘windfall’ gains generated by non-scheduled refinancing.

Conditions and contractual provisions during the GFC

During the GFC, the availability of finance reduced dramatically. The cost of debt increased and tenors (the time over which the debt is to be repaid) reduced. This significantly affected refinancing opportunities for existing *Partnerships Victoria* projects, and changed the nature of the debt finance arrangements for new projects.

The kind of opportunistic refinancing undertaken prior to the GFC disappeared, as it was no longer possible to obtain new finance on more favourable terms than the existing finance for these projects.

*Partnerships Victoria* projects continued to need to refinance their short-term debt, but had to do so in a less favourable market.

New projects could only secure short-term debt, which would have to be refinanced during the life of the project. Hence the financing structures for these projects assumes there will be a number of refinancing events over the project’s life. The difficulty in raising debt was exacerbated by heightened perceptions of refinancing risk. In some projects, the government party provided carefully targeted support to mitigate elements of the refinancing risk for the private party. During this period, the contractual provisions concerning refinancing were customised to the needs of the particular project.

Current market conditions and contractual provisions

By 2014, market conditions had stabilised, however long term debt remained uncompetitive. Post GFC some private parties have taken advantage of improved market conditions to undertake unscheduled refinancing to achieve improved pricing (lower base interest rates and credit margins).

Debt tenors remain shorter than the full contract term, and therefore more recent projects continue to be bid on the basis that there will be a number of scheduled refinancing instances over the project’s life.

Recent refinancing in 2016-17 have shown increasing interest by financiers in providing long term debt which fully amortises over the project term. This has been noticeable in both committed bid proposals and refinancing of operating projects. These long term structures remove future refinancing risk.

Under more recent PPP project deeds, all refinancing requires the government party’s consent and the consent rights differ according to the materiality of the refinancing. Typically, the government party is entitled to share in refinancing gains except in specific defined circumstances.

* + - 1. Risks associated with refinancing

There are risks to both the private party and the government party in refinancing situations. The following sections explain those risks and offer guidance to contract directors on how to manage them on behalf of the government party.

Risks to the State

The general principle behind consenting to a refinancing is that the State should be ‘no worse off’ as a result of the refinancing (other than changes in the base interest rate which is a State retained risk). To ensure that the State is no worse off, the government party should carefully examine any changes in the State’s risk position as a result of the refinancing. Any new or increased risks allocated to the government party, will need to be accompanied by adequate compensation provided by the private party.

Typically, the government party does not take any risk on refinancing losses (e.g. losses accruing as a result of higher fees and margins or changes in the debt profile compared to that originally forecast), rather this risk is entirely borne by equity. However, in some *Partnerships Victoria* projects procured during the GFC, the government party did agree to share in refinancing losses. In this context, being no worse off means the government party should be no worse off than the agreed contractual position – that is, the government party will bear its share of the refinancing losses, but should not be required to also take on additional risks unless it is adequately compensated.

Increased termination liabilities

An increase in the project’s debt could result in an increase in termination liabilities for the government party. This is one of the main reasons that the private party requires consent from the government party in advance of refinancing.

Termination liabilities are the amount of compensation payable by the government party to the private party if the project deed is terminated early. The actual amount payable depends on the circumstances giving rise to termination. However, apart from termination following private party default, the size of the termination liabilities is usually linked to the amount of the senior debt outstanding at the time of termination. Even if at the date of the refinancing the nominal termination liabilities are unchanged, changes in amounts of debt or debt profiling may result in higher termination liabilities over time (due to reduced or delayed repayments of debt).

A change in the size of the senior debt is not the only factor that may lead to an increase in termination liabilities. For example, refinancing that allows the private party to release cash reserves may also increase termination liabilities. Changing hedging arrangements as part of the refinancing can increase termination liabilities if higher hedge break-costs apply under the new arrangements.

Of primary concern is termination due to *force majeure*. In such an event, the government party is likely to be required to pay off the outstanding senior debt and other costs resulting from early termination. The government party will not be required to compensate equity holders (or subordinated debt in the nature of equity). While termination of a project for *force majeure* is extremely rare, the termination payment is a contingent liability of the State, and as such, the State should be compensated for any increase in this liability as a result of a refinancing so that it is no worse off.

Increased payments during a *force majeure* event

In most project deeds, if the private party’s obligations have been suspended due to a *force majeure* event, and the event is not covered by insurance, the government party will service the private party’s senior debt commitments while the obligations are suspended (usually only the lower of the forecast and actual commitments). Like the *force majeure* termination payment, the servicing of senior debt is a contingent liability of the State, and so the State should receive compensation from the private party for any increase in this liability so that it is no worse off.

Risks to both parties

Less favourable financing covenants

In negotiating with new debt providers, the private party may propose, or be asked to agree to, financing covenants that are less favourable than those that applied to the initial debt finance. For example, the new lender may impose greater restrictions on modifications, or different triggers for finance defaults that may increase the likelihood of such defaults occurring. Contract directors should seek advice on whether these financing covenants are current market standard, as this could mean the covenants are acceptable where the risk remains with the private party under the financing documents (as opposed to the State being directly exposed to this risk under the project deed). To the extent that such changes restrict the future rights of the government party, it should be compensated so that it is no worse off.

Relationship quality

A strong relationship can assist the parties in managing a refinancing event. If both parties are proactive in anticipating refinancing events and plan for them appropriately, and if the private party ensures that it gives enough notice to facilitate consent and potential information requirements, the refinancing has a greater chance of proceeding smoothly than if the parties do not work well together. Nevertheless, the long-term working relationship between the parties can be put at risk if the government party accepts a refinancing that depletes the private party’s contingency reserves to an unsustainable level, or one which reduces the amount of equity investment in the project to the extent the private party’s interest in providing high performance is diluted.

Increased risk of poor performance

The involvement of equity capital in the project’s financing mix delivers a significant incentive for the private party to deliver high performance. Equity reserves also provide the private party with the ability to absorb the financial consequences of the risk allocation in the project deed.

A refinancing has the potential to reduce the proportion of equity in the project which may reduce the private party’s incentive to perform and may also threaten the private party’s ability to deal with project risks as they materialise.

Similarly, refinancing which reduces gearing beyond sustainable levels could create perverse incentives that might motivate the private party to ‘cut and run’ if the project faces adverse circumstances in future. This situation could come about in a circumstance in which the private party shareholders have taken most of the benefits of refinancing (withdrawn equity or taken higher dividends), and the private party is facing additional costs (due to the adverse circumstances). At such a time, the private party might be less concerned about project performance – leading to the government party considering termination for poor performance.

However, this risk should be partly offset by the due diligence that the lender can be expected to undertake during the refinancing. The lender will be concerned that the repayment of its debt is not put at risk as a result of the refinancing. The debt provider will assess the future profitability of the project and the likelihood of termination before agreeing to the replacement finance. The debt provider will also consider how incentivised the private party will be to continue performing following the refinancing.

Asymmetrical information in determination of refinancing benefits

When a refinancing is proposed, there is likely to be an asymmetrical distribution of information between the parties.

* + - The private party is likely to be better informed as to current financial market conditions and the terms on which the project can attract replacement finance. The private party is likely to prioritise its own interests in any refinancing proposal ahead of any benefit to the government party. As such, the government party risks agreeing to a sub-optimal proposal.
    - The government party has a stronger understanding than the private party of risks to the State of a refinancing. As such, the private party could underestimate the issues that a refinancing proposal may raise for the State.

Key actions to mitigate these risks include the following:

* + - There should be early discussions between both the private party and the government party (including DTF) and their respective advisers to openly share information related to any refinancing proposal. Typically discussions on potential refinancing options should commence 12 months prior to the maturity date of existing debt facilities. The appropriate processes are discussed further in section 15.5 below.
    - The government party must have robust and ongoing processes for monitoring the financial position of the private party, so that it is able to appropriately scrutinise the information that it receives in relation to the refinancing.

Risks specific to scheduled refinancing events

While some refinancing events are opportunistic, and are typically intended to take advantage of favourable market conditions, other refinancing events are necessary because the private party has an obligation to repay its existing finance, and must raise new debt to do so. These refinancings are assumed in the Base Case Financial Model and there are specific risks for both the private party and the State associated with this type of refinancing.

Deterioration in lending markets or project risk profile

It is possible that either general debt market conditions or the risk profile of the particular project will have deteriorated by the time the private party seeks to implement a scheduled refinancing. If this is the case, the terms and conditions of the new debt may be more stringent than the original terms, and in some cases a refinancing loss may eventuate.

The private party should bear the risk of any refinancing losses unless the project deed specifically provides otherwise (which was the case in a limited number of projects negotiated during the GFC).

Risks involved in ‘bullet’ repayments

Refinancing that introduces a ‘bullet’ repayment element to the debt will require the private party to repay creditors a lump sum on a specified future date. It is conceivable that the funds to be repaid via the bullet repayment may exceed the available cash held by the private party at the time, providing an incentive to attempt to refinance prior to the bullet payment due date.

If the private party cannot refinance prior to the bullet payment date, it risks insolvency and default, giving the government party a right to step in and assume responsibility for the project (and associated risks). The lenders may also decide to step in to resolve issues or refinance the debt and assume responsibility in order to avoid risking a debt default. If the private party is able to refinance in time, the risk exists that the refinanced debt terms may be worse, constituting a refinancing loss.

Risks specific to ‘rescue refinancing’ events

If a private party is experiencing significant financial distress, refinancing might be attempted in order to gain temporary relief through renegotiated debt terms.

While this type of ‘rescue refinancing’ might reduce the likelihood of the private party becoming insolvent, the new debt terms could result in the imposition of longer-term penalties on the private party such as higher debt payments in future periods or tighter restrictions on dividend payments to equity holders. Not only can these factors reduce the return to equity from the project, they can also give rise to many of the risks to the State described above. Again, the refinancing should not leave the State any worse off. However, in the context of rescue refinancing, the appropriate comparison may be whether the State is worse off in comparison to the alternative of a default occurring and the various consequences under the project deed and the financing documents that may flow from that.

* + - 1. Factors influencing the timing and nature of refinancing

Financial market conditions and contractual provisions related to refinancing have evolved over time. Contract directors need to be aware of changing financial market conditions and the potential impacts that market conditions may have on the stability of the PPP financing in place, including the potential for unscheduled refinancing.

This section explains the market-wide and project-specific circumstances that can lead to potential refinancing gains.

Improvement in market conditions

Financial market conditions evolve over time. Both base interest rates and the interest margin required by lenders for a given level of risk will fluctuate, as will a range of other factors such as coverage ratios and the acceptable level of gearing. If market conditions improve relative to the conditions that prevailed at the time the existing debt financing was negotiated, lenders may be prepared to offer new financing on improved terms, resulting in a refinancing gain.

Improvement in the project’s risk profile

For individual projects, improved financing terms may be available once construction is complete and the service delivery phase has commenced satisfactorily. This is because the terms of finance offered by lenders are related to the level of the project’s risks. Once the service is operational and the initial design, construction and implementation risks have been dealt with, lenders may be prepared to improve the terms of the original debt financing, resulting in a refinancing gain.

However, this is not a possibility in every PPP project. Many projects have been financed so as to incorporate a lower risk margin in the service delivery phase. In this case the initial debt arrangements for a project may already distinguish between the construction phase and service delivery phase, with associated differences in pricing.

Lack of initial optimisation

If the original debt financing for a project was not optimised, a refinancing gain may be possible. In this situation, the opportunity should exist for improved financing terms to be achieved at any time that the project is proceeding successfully.

* + - 1. Potential benefits to Government from refinancing

A share in refinancing gains

The National PPP guidelines provide that ‘Government will be entitled to a 50 per cent share of any Refinancing Gain where the projected equity return at the time of the Refinancing (taking into account any Refinancing) is above that reflected in the original Base Case Financial Model’[[15]](#footnote-15). Typically the projected equity return is improved where a refinancing involves lower margins and fees than originally forecast. And the government party also benefits from refinancing by sharing in the financial gain that is generated.

Where the State elects to take refinancing gain over the project term, rather than as a lump sum, the resultant reduction in service payments to the private party will need to be agreed following financial close of the refinancing. Project deeds generally allow the private party to recover prior refinancing losses before sharing in refinancing gains.

Savings to the State from reduced base interest rates at the time of refinancing

The full amount of the difference (whether positive or negative) between the base interest rate forecast in the base case financial model and that applying to the refinancing will accrue to the State.

Most PPP projects since the GFC have a floating rate component in the payment mechanism, effective from the first refinancing, which facilitates the State retaining the risk of movements in base interest rates from the first refinancing. If unhedged, for each interest period during the new financing term, the floating rate component will be a positive number (payable to the private party) or a negative number (payable to the State), depending on which way actual interest rates have moved relative to the interest rate forecast in the base case financial model.

Changes resulting from a refinancing

In some projects, the payment schedule also provides a mechanism for the State and private party to negotiate in circumstances (usually a refinancing) where a change to the private party’s debt profile is proposed. The floating rate component section of the payment schedule recognises that whilst the State takes the risk on movements in the base case interest rate, it should not accept the additional base interest rate risk which results from the private party proposing to increase the quantum of debt as part of a refinancing. Should the State agree to an increase in the private party’s debt profile, it will need to be proportionately compensated for the incremental risk. This mechanism benefits both parties in circumstances where some of the gains from a refinancing proposal (which will typically be shared between the State and the private party) result from the private party increasing the amount of debt in the structure. The compensation can be made either:

* + - with an upfront payment where the base interest rate remains unchanged in the base case financial model, and the compensation is based on (a) the difference in the original base case interest rate and the interest rates as determined by the swap curve of the additional debt, plus (b) costs associated with entering into a hedge (either by the State or the private party); or
    - by a change in the base case interest rate in the base case financial model where there is no upfront payment (compensation is effectively received over time), and the base case interest rate is amended to reflect a 'weighted' average interest rate, that includes (a) the interest rates determined by the swap curve with respect to the additional debt, plus (b) costs associated with entering into a hedge (either by the State or the private party).

This ensures the State has no liability for the additional debt to pay where interest rates are higher than the original base case interest rate.

Compensation can also be made through a combination of both an upfront payment and a change in base interest rate, but generally one of the two above approaches would be chosen.

In the event the base case interest rate is to remain constant in the base case financial model, the upfront payment provided for in the floating rate component section of the payment schedule is calculated as the difference in net present cost of the floating rate component before and after the refinancing (in order to keep the State whole with respect to base interest rate risk associated with an increased debt profile). If the refinanced facility is to be hedged by the private party, the net present cost of the floating rate component is calculated using standard swap market conventions (including a 'market' swap margin), whereas for State-implemented hedging, a TCV/State determined swap margin will be applicable. It is important to note that the methodology will also be based on standard swap market conventions including a TCV/State determined swap margin where the decision is made not to hedge the refinanced facility. This is because the only practical way to estimate the magnitude of additional base interest rate risk to be borne by the State is to adopt a revised swap curve at the time of the refinancing, as if the State was intending to hedge the additional debt. Note where ongoing floating rate component payments are made between the parties, these will be with respect to the total debt (original plus additional).

Making funds available for other projects

Refinancing events involving either a change in lender or which enable an equity provider to withdraw funds from the project can be of benefit to the overall PPP market. The funds freed up by the refinancing become available to fund other projects and help progress the flow of new deals seeking finance. A refinancing enabling an equity provider to withdraw funds from an existing project may be particularly beneficial where the equity provider is seeking to free up funds for another project but either does not want to dispose of its stake in the existing project, or is constrained from doing so by the change in control provisions in the project deed.

Greater flexibility for the project

In some cases, depending on the specific agreements between the government party and the private party, refinancing may provide greater flexibility. This flexibility may be a result of less stringent loan covenants, which in turn may allow modifications to be approved more easily. The funding source after a refinancing may also grant greater flexibility; for example, replacing bonds with a drawdown facility.

Contract extension

The decision by the private party to refinance may be accompanied by a request for an extension to the project deed. By extending the project deed, the private party may be able to extend the term of its debt finance and therefore borrow more for modifications, resulting in a refinancing gain.

There can be justification for the government party agreeing to extending the project, specifically when extending the term will enable the government party to secure future services at currently contracted prices, which may be cheaper than those available in the future.

Government parties need to carefully assess both the benefits and risks relating to any proposed extension of the project deed term, with the decision being taken on operational and value for money factors. Government parties should not extend the original project deed term unless doing so would have been justified on a separate stand-alone basis, regardless of the refinancing event.

Requests for contract extensions should be considered in consultation with the *Partnerships Victoria* team at DTF, to ensure the implications for the government party, including any need for additional budget cover and change in risk are understood.

* + - 1. Dealing with refinancing requests and notices

General principles

The government party’s role and obligations in respect of refinancing will be set out in the project deed. The government party is required to provide or withhold its consent to the refinancing proposal and/or variation to the finance documents within a specified period. The definition of refinancing and the scope of the associated consent rights will determine the contract director’s actions and necessary resources. DTF will manage all PPP refinancing events in consultation with contract directors to ensure a timely and consistent approach to assessing and consenting to refinancing requests.

Each project deed will specify the particular consent requirements and process to be followed. Unless the project deed expressly provides otherwise, the following principles should apply when assessing or reviewing refinancing requests from the private party, and should be agreed between the government party and the private party as a condition of approval for changes to the finance documents:

* + - any refinancing gain must be shared between the government party and the private party on a 50:50 basis, provided that the projected equity return at the time of the refinancing is above that reflected in the original base case financial model;
    - the outcome of the refinancing should not threaten the perceived value for money of the project;
    - a refinancing should not jeopardise the stability and success of the long-term contractual relationship between the private party and the government party;
    - the reasonableness of any fees payable by the private party in relation to the refinancing should be carefully assessed, as the fees may be an indirect means of extracting funds from the transaction without needing to share gains with the government party;
    - any gains which are to be received must be carefully weighed up against the extra risk which may arise as a result of the refinancing;
    - appropriate benefits such as compensation should go to those bearing risks;
    - it is reasonable for the government party to seek compensation for any increased exposure to termination liabilities arising from a refinancing; and
    - the government party’s reasonable third-party costs for assessing the refinancing request must be met by the private party.

Which party initiates refinancing?

The private party is responsible for initiating a refinancing.

It is possible, although uncommon, for the government party to request a refinancing. However, there are risks to the government party in pressing for a refinancing, since the private party might seek to gain a negotiating advantage from the government party’s eagerness for a refinancing.

Contract directors should be mindful of the differing incentives of those involved in refinancing. Financial intermediaries, such as investment banks, earn fees for arranging new forms of finance and from underwriting a refinancing for an existing project. They therefore have an incentive to seek and stimulate refinancing opportunities.

Being prepared and resourcing

While it should be left to the private party to initiate refinancing, there are benefits from the contract director being aware of the refinancing intentions of their private party counterparts.

In order to be ready to deal with refinancing proposals, the contract director should have a basic understanding of the following aspects of the project:

* + - the current financing arrangements and the financial agreements that govern them;
    - the current financial model;
    - how to calculate debt cover ratios for their projects, and the existing value of those ratios; and
    - the circumstances in which refinancing needs approval (usually all); and
    - the provisions for calculating and sharing refinancing gains or losses under the project deed and related project contracts.

Refinancing of a *Partnerships Victoria* project is one way in which both the government party and the private party can share in the benefits of a successful project. Government parties should therefore be receptive to refinancing proposals from the private party. There are significant technical financial issues to be dealt with in a refinancing, so preparing in advance is an advantage. Importantly, and consistent with recent project deeds, the *Partnerships Victoria* standard project deed requires that the private party must notify the State regarding its proposed refinancing strategy, at least 60 business days prior to formally requesting the State’s consent to a refinancing.

The *Partnerships Victoria* team at DTF must be consulted when considering any proposal for a refinancing event, and will lead assessing and negotiating the refinancing, in close consultation with the contract director.

Assessing and negotiating a refinancing is a resource-intensive activity requiring suitably qualified senior resources and decision makers, as well as increased interaction with professional advisers. The government party (including DTF), should ensure that such resources are in place when a refinancing proposal is received, to achieve the optimal outcome for the State.

The government party should engage experienced legal and commercial advisers (and where feasible, should also consider using TCV) to assist them to understand the full implications of any refinancing proposal, to advise them in any associated negotiations, and to check that the refinancing gain or loss has been calculated correctly.

Refinancing strategy

In the event of a scheduled refinancing, the private party will usually be contractually required to prepare a refinancing strategy to guide the refinancing event, and will be required to provide a copy of the strategy to the government party.

The project deed may also require the private party to prepare a refinancing strategy for any unscheduled refinancing. Even if the project deed does not require this, it is recommended that contract directors request a refinancing strategy document from the private party.

The refinancing strategy document should describe the private party’s plans for managing both volume risk (underwriting) and pricing risk (refinancing gains and losses).

At a minimum, the refinancing strategy should include:

* + - an audited financial model relating to the refinance;
    - details of assumptions used in the financial model;
    - the key aspects of the proposed refinancing, including establishment fees, debt margins, principal amortisation profile, debt service reserve requirements and any associated interest rate or foreign currency hedging;
    - a comparison with any refinancing assumed within the original financial model;
    - a certificate from the auditors of the financial model;
    - the amount of the proposed refinancing gain or loss;
    - details of any changes in amounts payable by the State under the project deed as a consequence of the refinancing;
    - fees payable to financial advisers/lenders;
    - a description of proposed changes to the private party’s obligations to its equity investors;
    - copies of proposed changes to the existing financial agreements;
    - drafts of any new financial agreements; and
    - a program detailing the timing of all key milestones in the refinancing request and consent process, including (but not limited to):
      * submission of all draft documentation to the State;
      * clarification meetings between the private and government parties, as required;
      * provision of in-principle agreement by the State to the draft proposal and documentation;
      * formal submission of the private party’s refinancing consent request;
      * provision of any updated documentation, as may be required;
      * date by which the State’s consent is due under the relevant project deed;
      * contract execution; and
      * financial close.

The refinancing strategy should be provided to the government party sufficiently in advance of the private party’s formal consent request submission to enable the State to consider the impact of the refinancing. If the project deed does not specify a time for providing the refinancing strategy, the contract director should request that such a strategy be provided by the private party at least 60 business days prior to any proposed refinancing.

Providing or withholding consent

The government party will need to be prepared to respond in a timely way to refinancing events. The scope of consent rights will be specified in the project deed. The State is not able to unreasonably withhold consent. In older project deeds, the State usually has the right to withhold consent for an unscheduled refinancing in certain circumstances. In newer project deeds, all refinancings (scheduled and unscheduled) require the State’s consent.

There are limited circumstances detailed in the project deed in which the State is able to withhold consent. These circumstances include:

* + - where the refinancing increases or adversely changes the profile of the risks or liabilities of the State under any project document to which the State is a party without adequate compensation to the State;
    - where the terms and conditions of the proposed finance are not on arm’s length commercial terms, or are not in accordance with current market practice;
    - where the new financing will not be used solely for the project;
    - where, in connection with the refinancing, there will be a change in the equity financing of the project; and
    - when the new financial arrangements would be disadvantageous to the private party compared with the existing arrangements and the government party considers that the new arrangements will adversely impact the private party’s financial health or ability to perform its obligation under the project deed.

In withholding consent to a refinancing, the government party should have a strategy in place for managing the broader market perceptions of this action, to ensure that the refusal to provide consent is not seen by the market as a disincentive to invest in other *Partnerships Victoria* projects. The government party should be aware that, if a refinancing is necessary (for example, because the initial debt raised for the project was short-term debt and the bid assumed the debt would be refinanced), rather than purely opportunistic (motivated by a desire to take advantage of favourable market conditions), a refusal to provide consent may lead to a default under the private party’s financing arrangements unless the grounds on which the State refused consent can be resolved or mitigated.

In the context of rescue refinancing negotiations, the government party should consider what other options are available to the private party to ensure sufficient funds for the project are available if consent is withheld.

How should any gains be taken?

The private party may take refinancing gains as an immediate lump sum payment. However, the government party can elect to take its share of any refinancing gains as:

* + - a lump sum;
    - a reduction in services payments over the remainder of the term of the project deed; or
    - a combination of these two.

There are benefits and risks associated with each option.

If the government party elects to receive its share of the gains as a lump sum, the private party may need to take on additional debt to fund the lump sum, especially if the refinancing would otherwise only have involved repaying the original borrowings over a longer period. Increased borrowings to fund the lump sum could in turn increase the government party’s termination liabilities.

On the other hand, taking the gains as a reduction in service payments might reduce the refinancing gain itself because a reduction in service payments will reduce the project’s debt cover ratios, which will in turn reduce the amount of new debt that can be raised.

The decision may also involve considering the equity internal rate of return, and the impact this may have in eroding the potential gains to the State over the contract term. That is, if the equity internal rate of return is quite high (which would be a function of financial market conditions prevailing when the contract was executed), there may be reduced value to the State in receiving an upfront payment (measured in net present value terms).

Use of the gains

A refinancing gain should not be considered a windfall for the project or government party itself. Refinancing gains will be accounted for as consolidated revenue in the first instance. Therefore, the decision on how to take the gains is one in which DTF should be consulted.

Any proposal by the government party to apply gains to the project itself, such as to address affordability concerns or to invest in facility improvements, will be assessed on a case by case basis through existing DTF budgeting processes.

*Partnerships Victoria* projects are of finite length, with the debt remaining within the project generally reducing over time. This reduction in debt over time means that the potential gains or losses to be made from refinancing the debt will diminish (other things being equal) the later in a project a refinancing is undertaken.

* + 1. Change of ownership/control

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* + - 1. Introduction

A project deed will typically require the private party to obtain prior consent from the government party for transactions affecting the control and ownership of the private party and any key subcontractors. In this context, it is important to understand the difference between control and ownership:

* + - Control generally refers to the ability to make or determine the outcome of decisions concerning an entity’s financial and operating policies. The precise meaning of ‘control’ is usually defined in the project deed, typically by adopting the definition in the Corporations Act. Applying this definition to the circumstances of a particular project can be complex. Contract directors should seek legal advice where necessary.
    - Ownership generally refers to having a direct or indirect legal or beneficial interest in the private party (or a key subcontractor). A change in ownership may not necessarily constitute a change in control, for example, a sale of 40 per cent of the shares in the private party may be a change in ownership, but may not be a change in control if the new shareholder is not able to make or determine the outcome of decisions concerning the private party’s financial and operating policies.

Why are changes in control and ownership regulated in *Partnerships Victoria* contracts?

As *Partnerships Victoria* project deeds are typically for long-term asset-based service provision, it is important that the State understands the financial health and sustainability of the contracted counterparties. During the procurement phase, the State will have carried out detailed due diligence on the private party and its consortium members. This is to understand:

* + - the capabilities of each consortium member;
    - the role each consortium member will undertake within the consortium;
    - how the consortium plans to effectively work together to provide service outcomes;
    - the reputation of each consortium member for service provision;
    - the financial stability and capability of each consortium member and the consortium’s ability to meet its financial obligations under the project deed (including parent company guarantees; and
    - any historical legal disputes, or if any are currently outstanding.

Prior to contractual close of a *Partnerships Victoria* project, the private party is required to confirm the structure of its consortium and provide a warranty or assurance to the State of the legal and beneficial ownership of each member. Maintaining this structure minimised counterparty risk. However over the life of the contract, changes are likely to occur and the State consent provisions in the project deed enable the government party to conduct adequate due diligence on the proposed changes in control or ownership.

* + - 1. State consent prior to any change in ownership/control

While each project deedis different, typically the private party must not permit any change to the legal or beneficial ownership of any shares or units or any other interests (providing a change in control) of it or any member of the consortium, without the State's prior consent. The project deed will outline the circumstances in which it would be reasonable for the government party to withhold its consent. If none of the reasons are satisfied, the government party must provide its consent to the change in ownership/control.

Additionally, recent project deeds mandate that designated equity investors (which are considered sufficiently critical to the private party’s ownership structure and ability to meet its obligations through the construction and initial operating period) must maintain their initial ownership level for a specified period (usually two years from commercial acceptance) to ensure the designated equity investors remain incentivised to manage the asset to steady-state operations. This means that the State has an absolute discretion to withhold consent to a change in ownership/control during the minimum hold period.

Typical ownership structures are complex

The ownership structure of the private party in a *Partnerships Victoria* project is initially developed by the bidding consortium to meet both the government party’s requirements and the needs of investors. The ownership structure of the private party can be complex. In most cases, the investors do not invest directly in the private party, instead investing through one or more intermediate entities that may be companies, trusts or partnerships. A change in the ownership or control of any one of these entities may result in a change in ownership or control of the private party. In addition, any of these entities may appoint an investment manager to manage the investment on their behalf, and that manager may be in a position to exercise control over the private party, even if it does not have an ownership stake.

Key subcontractors may also have complex ownership structures. The contract director must consider the specific ownership structure of the project, and understand how the relevant contractual provisions apply to each entity with a role in the ownership or control of the private party or key subcontractor. When any change is proposed, it may be necessary for the contract director to undertake due diligence to ascertain its appropriateness by seeking legal advice on the rights of each entity. This may require a legal review of all of the relevant company constitutions, shareholders agreements, trust deeds and partnership agreements.

Permitted changes in ownership/control

In some *Partnerships Victoria* projects, ‘permitted’ changes in ownership or control (also known as permitted share dealings) are proposed by a bidder and included in the project deed. The private party or the relevant subcontractor can implement a permitted change in ownership or control without the State’s prior consent, but usually is required to give prior notice the State.

The contract director should be diligent in reviewing any proposed or actual permitted change in ownership or control to evaluate whether in fact it meets the requirements of the project deed. If the private party or a key subcontractor proposes or implements a transaction that is similar to, but different from, the permitted change in ownership or control documented in the project deed, the standard process requiring the State’s consent should be followed.

Change in ownership/control process

As discussed in Chapter 4, it is important to maintain a good working relationship through regular interactions with the private party (including informal discussions and formal meetings). This will provide the private party with the opportunity to advise the State early of an impending change in ownership/control, providing the contract director with additional time to prepare for the request (which may be important if the project deed provides the State with a short response period).

When a contract director receives a change in ownership/control request or notification, the contract director will need to:

* + - review the relevant project deed clauses to understand the requirements of the contract;
    - review the processes outlined in the contract administration manual; and
    - determine if any legal or commercial advice is required.

Should professional advice be required, the contract director should consult their *Partnerships Victoria* contact as DTF has visibility over other *Partnerships Victoria* projects that could be receiving the same request. In this case, DTF can facilitate procuring a common set of advice which will be more efficient and ensure a consistent State response across projects.

At a minimum, legal and commercial advice should be sought to carry out the necessary due diligence assessment on the proposed transaction, to ensure the reputation, experience and financial viability of the new entity and to ascertain if there are any reasons why the State should consider withholding its consent to the change in ownership/control request.

Project deeds typically provide for the State to be reimbursed for adviser costs incurred in considering the request for change in ownership/control because it is a private party initiated event.

The contract director also needs to consider the drivers for each of the parties involved in the proposed transaction, as exiting parties’ interests are not necessarily aligned with those of the proposed investor or the State. Therefore the contract director should be aware that each party’s own position and interests may impact their representations and conduct throughout the change in control process.

Reasons to withhold consent

The State should try to ensure that it is no worse off by agreeing to the change in control. It should therefore try to maintain the agreed financial security package and risk positions that were agreed upfront when the initial project deedwas signed.

The grounds on which the State may be able to reasonably withhold consent are usually set out in the project deed, and typically include the following:

The private party has not provided the State with full details of the proposed change in control and any further information requested by the State.

The change in control is to take effect prior to the second anniversary of commercial acceptance (where it relates to the private party only).

The proposed investor/entity:

is not solvent and reputable;

has an interest which conflicts in a material way with the interests of the government party and is involved in a business or activity which is incompatible, or inappropriate, in relation to the construction or operation of the facility; or

does not have a sufficient level of financial and technical capacity.

The proposed change in control is against the public interest.

The proposed change in control would increase the level of risk or liabilities to the government party.

The proposed change in control would impact adversely on the ability or capacity of the private party to perform its obligations under the project deed or any other project contracts, and if applicable, of the key subcontractor to perform its obligations under the key subcontract.

Potential consequences for the private party if the State withholds consent

The State’s right to withhold consent is an important protection for the State against the risks that may arise as a result of a change in control or ownership. However, the contract director should be aware of the potential consequences for the private party if the State withholds consent. The consequences may include the following:

* + - The proposed change in control or ownership may reflect the fact that the existing investor has a risk appetite and capabilities appropriate for the higher risk early stages of a project, but less appropriate for the current status of the project (particularly if the project is now in its service delivery phase and performing well). In these circumstances, the existing investor may wish to sell out to an incoming investor with a preference for the long-term, lower-risk investment opportunity presented by the operating project. If the change cannot proceed because the State does not give consent, this may create difficulties in the relationship between the State and the private party, as there may not be a strong alignment of interest in the long-term project outcomes.
    - The proposed change in control or ownership may be intended to allow an existing investor to recycle their capital, raising funds for investment in new projects. If the change cannot proceed because the State does not give consent, this may prevent the investor investing in new State projects.

Internal restructures and transfers to related parties

The State's prior consent is usually not required for a change in control or ownership where the new owner is a related body corporate of the outgoing owner. This enables the private party and key subcontractors to undertake internal corporate restructures, provided the ultimate ownership remains the same.

However, the private party is still required to notify the State prior to any such changes.

Publicly listed entities

If the ultimate holding company of the private party or a key subcontractor is listed on a stock exchange, a change in control may occur as a result of trading on that stock exchange. Practically, it could be difficult for the listed entity (or the private party) to provide prior notice to the State ahead of such a change in control. In these circumstances, the private party must seek the State’s consent immediately after the change in control occurring (providing full details), and the State must notify the private party within a specified period whether it consents to the change in control. If the State does not consent to the change in control, the project deed usually requires the private party to procure that the relevant entity cease to retain control within a specified time, or that an alternative subcontractor be procured.

Any off-market transaction (i.e. a transaction not occurring on the stock exchange) that may result in a change of control or ownership of a listed company is subject to the general consent requirements set out above.

Ability and capacity of the private party and subcontractors to perform their roles

Changes in ownership can result in the departure of an investor with strong knowledge and capability related to the project, and their replacement by an investor with less knowledge and capability. For example, a common change in ownership is the sale by an initial project sponsor of its interest in the project to a long-term ‘passive’ investor once the project has reached a state of steady operations. The contract director should carefully consider whether the private party will continue to have access to the necessary resources and expertise to satisfactorily perform its obligations.

Where an initial active investor is replaced by a long-term passive investor, particular attention should be paid to the proposed arrangements for operating and managing the private party. In a *Partnerships Victoria* project, the subcontractors are engaged by the private party, not by the government party. The government party relies on private party employees and representatives of the investors (behind the private party) to manage the private party’s subcontracts. When a change in ownership or control is proposed, the State must assure itself that appropriate arrangements will be in place to give the private party access to the strategic, technical, commercial and legal capacity required to perform its obligations under the project deed and manage the subcontracts appropriately. It may be appropriate to seek formal commitments from the private party or its investors in relation to the ongoing availability of this capacity.

Ability and capacity concerns can also arise in relation to changes of ownership of key subcontractors. Within the framework of the change in control or ownership consent requirements, the contract director should carefully consider whether the subcontractor will continue to have access to the necessary resources and expertise to satisfactorily perform its role on an ongoing basis, taking into account the range of risks and circumstances that may arise.

Probity investigations

In assessing a proposed change in control or ownership, the State must consider whether any probity concerns arise. In most projects, these issues will be assessed as part of the due diligence conducted by the State in considering whether to consent to the change. In some projects more sensitive to probity concerns, the project deed will regulate probity issues separately from the change in control or ownership process. The contract director should ensure that such mechanisms in the project deed are appropriately applied to any proposed change.

Implications for parent guarantees

The private party’s security arrangements, including any parent company guarantee from the builder’s parent company, are particularly important during the construction phase.

A consent to the change in ownership or control of a key subcontractor does not necessarily translate to a consent to the change in entity providing the parent guarantee in respect of the key subcontractor. The State needs to be satisfied that it is not left in a worse position with the change in parent guarantor. For example, the new entity being domiciled in another country potentially reduces the enforceability of the parent guarantee.

Until the State is satisfied with the replacement parent guarantee, and provides consent to the change in entity providing the parent guarantee, the parent guarantee from the existing parent entity must remain on foot.

Financiers’ approval of changes in control and ownership

The private party’s financing documents are likely to require it to also obtain the consent of its financiers to changes in control and ownership. There is a degree of alignment between the government party and the financiers, in that the financiers will be concerned about any impact the change may have on the risk profile of the project. However, the financiers’ focus will be on financial risks (that is, the risk that the private party may be unable to meet its payment obligations), whereas the government party is concerned about a broader range of issues, including public interest considerations and ongoing sustainability of service delivery. The fact that the financiers have approved a change in control or ownership should therefore not be regarded as an indication that the change should also be acceptable to the government party.

* + 1. End of term arrangements

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* + - 1. Introduction

This guide covers two primary ways that a *Partnerships Victoria* project may end, either by contract expiry or termination. This chapter focuses on contract expiry. This an important stage in a *Partnerships Victoria* project. A range of activities must be undertaken by both the government party and the private party in the period before, during and after contract expiry – referred to as the end of term arrangements.

For some *Partnerships Victoria* projects, the expiry of the contract may complete the project lifecycle, while for others the ongoing service need leads to a new contractual arrangement or asset investment (undertaken according to the Investment lifecycle guidelines[[16]](#footnote-16)).

This chapter deals with the likely issues and commercial principles for contract directors to consider before, during and after contract expiry in order to:

* plan and implement the end of a public private partnership project; and/or
* plan a smooth transition to a future asset or service arrangement.

There are a range of different *Partnerships Victoria* contracts, with different contractual expiry or termination arrangements which may present materially different or complex situations. This guide provides an initial source of information on the processes and provides practical assistance in assessing the next steps for the project. If required, contract directors may also seek assistance from DTF, or may wish to obtain appropriate professional advice.

Steps in end of term planning and implementation

The government party will need to prepare for the end of term at least four years from contract expiry by undertaking the following steps:

due diligence – understanding contract expiry conditions/options, asset condition, performance of the private party, lessons learnt from the current contract (including any reviews undertaken);

determining future service delivery needs for the relevant sector, and how they are best delivered, including the assets required to support service delivery. Due diligence work from step 1 will help to inform this assessment. This analysis should determine the specific future role of the project assets in meeting these future service needs, including the extent of any necessary modifications or augmentations to the project assets. Options include:

* continuing to use or upgrading / modifying project assets for further use;
* decommissioning or disposing of project assets; or
* developing other short-term contingency service provision options, if there is a risk that the new arrangements are unlikely to be ready in time.

gaining the government party’s approval and funding for the strategy determined in step 2, and for any additional resourcing required to manage that transition;

developing an end of term / service plan to execute the agreed strategy. The plan should include the establishing a governance structure and resourcing to implement the agreed strategy; and

implementing the transition to the new arrangements.

Each of these steps is outlined in further detail below.

* + - 1. Step 1: Due diligence

The first step in the end of term process is taking stock of the contract expiry arrangements and all key information known about the *Partnerships Victoria* project. This will inform the assessment process in following steps.

Reviewing the project deed

As each *Partnerships Victoria* project is unique, the contract director must comprehensively review the existing contractual arrangements to ensure they have a thorough understanding of the range of specific expiry provisions and how they apply to each party to the contract. These specific contract expiry conditions may include:

**ownership and control of assets at contract expiry** – the project assets and site usually remain with or vest in the State on contract expiry, but this is not always the case (e.g. Victorian County Court project). The Government’s options are more limited if the private party retains ownership or control of the project assets at contract expiry. In some project deeds, the government party may have the option to ask the private party to decommission the project assets and remediate the site;

**contract extension provisions** – some project deeds include specific provisions for one or more extensions of the term for a pre-specified period on similar terms and conditions at the request of the government party and agreement by the private party. Of course, the project deed can be renegotiated by mutual agreement between the parties, but this is a larger and more complex exercise than the exercise of a contract extension provision under the project deed;

**condition of assets at the end of term** – unless the private party will own the project assets after contract expiry, the private party must ensure that the project assets meet the government party's return conditions at contract expiry. For the purposes of informing end of service considerations, the contract director must understand the condition of the project assets. The *National PPP guidelines: commercial principles* call for an independent, jointly funded, inspection four years prior to the end of the contract term. Contract managers should be aware of their project asset inspection rights under the project deed;

**payment adjustments** – the project deed may permit the government party to withhold service payments or seek a performance bond (usually up to a specific value) if, following the asset condition inspection, the government party is concerned that the Project Assets may not meet its condition targets on contract expiry; and

**obligations on the private party if the government party elects to re-tender the services** – if the government party elects to re-tender the contract services at the end of the contract term, the incumbent service provider must take all reasonable steps to ensure that the contract services continue with minimum disruption and risk to both government party employees and public users. Typically, these obligations will include providing project documentation such as asset registers or asset condition reports.

The contract director must review the end of term provisions in the project deed applying to the specific *Partnerships Victoria* project. Contract directors are encouraged to obtain appropriate professional legal advice to ensure they gain a thorough understanding of the State’s rights and obligations under the project deed (and associated project contracts), and understand the implications of these rights and obligations for the end of term arrangements.

Harnessing lessons learnt from the project

The contract management team will have a view on the performance of the project, any positives, any issues, and any lessons learnt that can inform the decision-making process for post end of service arrangements. These views are usually recorded and documented progressively over the life of the project. As part of the due diligence process it is beneficial to conduct an independently-facilitated lessons learnt session.

Lessons learnt should be supported by a range of objective data including:

* + - extent to which performance measures have been met;
    - abatements;
    - areas of dispute and resolutions;
    - major problems and solutions;
    - change events; and
    - staffing levels and turnover.

In addition to harnessing the lessons learnt from an in-house perspective, information should also be available from independent reviews of the project undertaken during its life. Such reviews may include:

* + - post-implementation reviews undertaken as part of the Investment lifecycle guidance;
    - gateway reviews[[17]](#footnote-17) (specifically related to gate 6: benefits evaluation);
    - any reviews jointly-commissioned with the private party; and
    - Auditor-General reviews.

Under the Investment lifecycle guidance[[18]](#footnote-18), the stage 5 ‘realise’ guideline can assist the government party evaluate the extent to which the planned benefits have been delivered. It also provides an opportunity to assess how well a project has been planned, procured and implemented. When conducting a post-implementation review, sometimes called the ‘investment evaluation’, it is important to reflect, document and communicate the lessons learned so that future planning and design of similar investments can be informed

A gate 6 gateway review, can be the mechanism for a review and contribute to future service need analysis. The gate 6 gateway review covers a number of issues, including:

* + - whether the benefits in the business case are being delivered;
    - assessing the effectiveness of the ongoing contract and/or service delivery management processes; and
    - confirming a business need exists for the investment and assess ongoing requirements.

It is common for the Auditor-General’s Office to review most *Partnerships Victoria* projects, at least once during their contract term given that they generally fall into the high-value high-risk project category.

Collectively, these in-house and independent reviews will contain a significant amount of relevant material that should be used, distilled and harnessed to inform the next steps in the end of term process. They will assist the contract director to develop an accurate understanding of the issues encountered in the project and to determine whether difficulties encountered over the contract term were caused by relationship/management disharmony, the contractual arrangements/structure, external factors, or a mixture of these factors.

More broadly, by effectively capturing and applying lessons learned from existing projects, both *Partnerships Victoria* and other government departments and agencies are able to improve:

* + - project planning and selection;
    - contractual arrangements and structures;
    - project management and outcomes; and
    - government department/agency and *Partnerships Victoria* policies.

* + - 1. Step 2: Determining future asset and service requirements

Determining future asset and service requirements should occur within the Investment lifecycle and high value – high risk guidance framework, as well as any other applicable departmental guidelines. This framework has five phases:

conceptualise (prepare a strategic assessment or preliminary business case to confirm the business need);

prove (prepare a business case and recommend an investment);

procure (undertake a procurement process and award a contract);

implement (deliver the solution); and

realise (deliver the benefits and measure the success of the investment).

The first two phases – conceptualise and prove – need to be undertaken and submitted to government for approval and funding before formal action can begin to procure an agreed solution based on ongoing service provision.,

In the event that the government party decides to discontinue the service there is no requirement for any government approval or additional funding for the end of term arrangements. However the government party will remain responsible for either disposal or decommissioning of the existing project assets and ensuring an orderly exit from the service contract.

Conceptualise phase – confirming the future service need

The conceptualise phase begins with a review of the relevant government party long-term service plan, and the need for a continuing service provision. The asset planning should align with the government party’s asset management strategy and consider the requirements of the Victorian Government’s Asset Management Accountability Framework.[[19]](#footnote-19)

An investment logic map can be a useful tool in the conceptualise phase to:

* + - identify the key problem(s) that need to be addressed;
    - identify the major benefits that will accrue if they are addressed;
    - explore the range of potential strategic interventions and identifies the preferred strategic response to address the problems and achieve the benefits; and
    - identify the likely solution, at a strategic level.

It is likely that the service requirements will differ materially from that in the current project given the passage of time. For instance, models of care have changed significantly in the health care and corrections sectors over the past 20 years.

The contract director, working with policy and or service areas of the government party, should prepare a preliminary business case (if the project is high-value, high-risk) or a strategic assessment (if the project is below the high-value, high-risk threshold). Either document can be prepared in-house if sufficient expert resources are available, otherwise expert adviser support may need to be engaged. Once completed, a gate 1 (strategic assessment) review should then be undertaken, arranged through the Gateway Unit in DTF.

The preliminary business case / strategic assessment will be submitted to the portfolio Minister, and to Cabinet as necessary, to determine whether the service need is high priority and whether the project should proceed to phase 2, ‘prove’.

If the proposed project does not receive Ministerial/Cabinet approval to proceed to phase 2, it may mean the service is no longer valued highly, and the provision of the service is to be discontinued upon contract expiry. If the service is discontinued, it is likely the government party would either:

* + - arrange to dispose of or sell the underlying project asset(s); or
    - decommission the project asset(s) that have been used to provide the service.

Either of these options will provide the government with an orderly exit from the existing *Partnerships Victoria* project. Under this route, the contract director will still need to ensure the services continue until contract expiry, and an orderly exit the contract consistent with contractual obligations. A plan and resourcing will be required (this is addressed below in section 17.5).

Prove phase – assessing viable options and developing a business case

Once a future service need that aligns with both departmental and government policy has been confirmed by Cabinet, the end of term arrangements for the existing project need to be managed within the context of phase 2 of the Investment lifecycle and high-value, high-risk, guidelines. This requires preparing a full business case which assesses project options (based on the preferred strategic option of phase 1), and recommends a preferred project solution and procurement method, and identifying likely costs, risks, stakeholder plans and resourcing for implementation.

In assessing the options, all viable options must be examined and analysed to identify the recommended solution.

The business case will assess a range of asset management strategies to provide the recommend service solution over the new project term. This will consider options including;

* + - continuing to operate the existing assets;
    - upgrading, refreshing or modifying the existing project assets; or
    - replacing the existing project assets with new assets.

The business case will also assess a range of service delivery options to provide the recommended solution. This will include considering a range of service provision options, including:

* + - the State to assume public service provision;
    - re-negotiating with the existing private sector service provider; or
    - re-tendering to engage an alternative private sector service provider.

The business case should include details of proposed implementation arrangements to deliver the recommended solution, including governance and resourcing arrangements and budget to manage the transition/procurement process.

A gate 2 (business case) review must be undertaken before the investment proposal is submitted to Cabinet for consideration.

Figure 17.1: End of term decision tree



* + - 1. Step 3: Government approval and funding

The business case submitted to Cabinet should seek funding to implement the recommended option and to deliver the services for a defined period. Specific funding should be sought for:

* + - any capital works to be undertaken by the government party;
    - service payments to a private provider or recurrent budget funding for the government party to deliver the services (to the extent that such funding does not already exist);
    - procurement and/or transition process resourcing and adviser support;
    - if the project deed is to continue or a new contract is to be negotiated;
    - any changes to contract management resourcing; or
    - as necessary, any funding to decommission the facility.

The relevant project governance committee must endorse the recommended option, which the appropriate Minister(s) should also ratify.

The formal enactment of the end of service plan should not begin prior to the Cabinet decision and approval of funds (if applicable).

* + - 1. Step 4: Developing an end of service plan and project team

As soon as government approval and funding is obtained, an end of service plan should be fully developed. This plan may need to cover arrangements for new service delivery arrangements and/or completion of the existing project deed (if applicable). Separate teams may need to undertake these tasks.

The end of service plan will need to:

* + - establish governance and resourcing arrangements, including whether activities will be undertaken by one or two teams;
    - identify all of the key drivers, risks and issues that may affect the end of term processes;
    - identify all of the key stakeholders and develop a stakeholder management plan;
    - clarify the contractual rights and obligations of the parties to the existing contract; and
    - map out managing the transition to new arrangements.

Once the initial end of term plan has been developed, the plan will need to be updated and maintained until the transition to a new arrangement has been completed.

Establishing an end of term team

End of term planning is a key work stream for the contract management team. The extent of change involved can influence the resources required. Some transition activities may be completed as part of business-as-usual activities. More material changes may require additional resources and expert adviser support.

Typically, the end of service team will be established and operated as either an internal team within the business as usual team or as a specific purpose end of term team. Separating the end of term work stream from the business as usual work stream will allow the contract director to concentrate on managing the existing project and business as usual team. This separation reduces probity risk (where the existing service providers are active participants in the bidding to provide any future service arrangements).

Figure 17.2: Difference between internal and specific purpose end of term teams



Internal end of service team

Typically, an internal end of term team is used where:

* + - end of term arrangements are considered to be less complex, and may be treated as a business as usual activity;
    - minimal changes are being made to the existing contractual arrangements or the contractual arrangement is being extended or rolled over; and
    - there are no probity considerations that prohibit the business as usual team undertaking this role.

Specific purpose end of term team

An external end of service team is typically used where:

* + - end of term arrangements are considered to be highly complex or unusual;
    - significant changes are being made to the existing contractual arrangements;
    - active negotiations with the private party are required; and
    - material probity issues are likely to arise.

The contract director has an important role managing the existing project, developing the initial end of term plan and establishing the end of term team. It is recommended that a separate project manager/lead negotiator be appointed to manage an external end of term project team.

Ideally, the end of term project team will include the incumbent contract director (or senior member of the contract management team) in an advisory capacity, to provide their corporate knowledge of the existing contractual arrangements. In addition, it is also recommended that the team draw on the knowledge and expertise of the existing contract management team and project advisers for input and support, as required.

The size and the composition of the end of term team will reflect the size and complexity of the *Partnerships Victoria* project. It is suggested that the team include the following members:

* + - end of term project manager/lead negotiator;
    - senior officer from department service area (i.e. customer representative);
    - contract director (from business as usual team);
    - legal adviser(s);
    - commercial adviser(s);
    - technical adviser(s);
    - *Partnerships Victoria* (DTF) representative; and
    - other members (as required)
      1. Step 5: Implementing the transition to a new or ongoing arrangement

Managing the transition to a new or ongoing arrangement is a critical stage in the end of term process. The arrangements will be based on the business case and government approvals outlined in the previous steps. Critically, the contract director must ensure that there is continuity of services for the users, either by:

* + - a contract continuation or extension for the existing services provider;
    - a modified contract with a new contract provider offering a new service; or
    - a new arrangement to replace the existing service offering with a new/different service arrangement.

Guidance on the tendering for new arrangements is provided in other documentation and will not be addressed further in this chapter. Detailed guidance materials relating to management of this transition are set out in both the procure and implement solution stages of the Investment lifecycle and high-value, high-risk guidelines, and under the gateway review process, gate 3: readiness for market, gate 4: tender decision and gate 5: readiness for service.

Current *Partnerships Victoria* contract expiry arrangements, including any term extensions

The project deed will typically include transition provisions that set out the rights and responsibilities of the parties. Therefore, the contract director must understand these provisions and plan for the impact of transition to future arrangements. Some items to consider include general matters such as:

* + - important dates;
    - assets (including asset registers and maintenance logs);
    - personnel;
    - intellectual property;
    - training obligations;
    - site access arrangements;
    - data (including performance reports, documents and records);
    - leases, licences, rights; and
    - provision of a transition plan.

Condition of project assets at the end of term

Unless the project assets remain with the private party, the incumbent service provider must ensure the project assets meet the government party's handover conditions at contract expiry. The contract director must understand the contractual rights with regard to the condition of the project assets and site at the end of the contract term, and any provisions governing hand-back arrangements.

To ensure these contractual obligations are met, an independent assessor is usually appointed to inspect the project assets. Depending on the condition of the project assets, the assessor may notify the government party and the incumbent private party service subcontractor of any works required to be carried out to meet the handover conditions and a program and the expected cost of carrying out the works.

Understanding these contractual provisions enables the contract director to plan for assessment of assets and completion of any required works program to ensure that the project assets’ condition at the end of term meets contractual requirements.

Where there the contract is extended, some of the assets may be close to the end of their service life at the end of the contract term, and accordingly the contract director or end of service project manager must consider:

* + - additional costs and risks that may be incurred by the private party over the extension period (and the overall increase in service payments);
    - the cost of any other additions, upgrades or modifications;
    - indexation of the existing service payment model over the extension period; and
    - any modifications required for the performance regime.

Final service payment

Prior to making the final service payment under the project deed, the contract director should consider a number of issues that may impact the end of term payment. In general, these issues may comprise, but are not limited to:

* + - withholding part of the final payment or requiring a performance bond, if it is likely that the private party will not perform any of its specified ongoing obligations after expiry of the project deed;
    - making payment of any monies withheld during the contract term for any outstanding obligations that have been satisfied by the private party, as it is likely that the end of term date will correspond with the end of the remediation period; and
    - calling on the performance bond to the extent that the private party has failed to perform its obligations (the performance bond will usually expire 12 months after the end of the project deed).

If the government party seeks to withhold funds or requires a performance bond, the amount will depend on a number of considerations:

* + - what contractual rights to withhold money or require security the government party has under the project deed;
    - whether the government party will continue using the project assets at the end of the contract term;
    - whether the government party will be re-tendering the services;
    - the risk and effect on the government party of the private party not complying with its end of term obligations; and
    - whether the private party is a special purpose vehicle or a company of substance financing the project on balance sheet.

Obligations on the private party if the government party elects to re-tender the services

If the government party elects to re-tender the contract services at the end of the contract term, the incumbent service provider is obliged to ensure that the services continue with minimum disruption and risk to both government employees and public users.

In the event of a re-tender the private party’s obligations will include providing:

* + - performance reports;
    - operations manuals;
    - asset registers;
    - maintenance records; and
    - details of current legal documents (including variations, subcontracts, leases).

The project manager or contract director must understand the contractual rights with regard to the re-tendering obligations of the incumbent service provider. Understanding these provisions enables the project manager/ contract director to plan and allocate adequate time and resources to ensure the State is able to access the required data, without disrupting the activities undertaken by the incumbent service provider.

The government party also requires adequate resources and time to analyse the data and develop a better understanding of the operational capability of the infrastructure, operating practices and performance of the incumbent service provider. This understanding will enable the government party to develop better future service requirements or to run a more efficient tender process. Understanding this information will enable the contract director or project manager to:

* + - develop a thorough understanding of the existing or base service provision;
    - develop a better appreciation of the impact of any proposed changes or modifications to the current service arrangements that might be considered;
    - provide potential bidders basic information required to bid; and
    - develop a benchmark to assess bids against the current or base service provision.

Again, the contract director or project manager must allocate adequate time and resources to collect and effectively use this data as part of the end of service arrangements plan.

Continuing obligations

Typically, expiry of a project deed does not affect any accrued rights and obligations under the project deed as at the expiry or termination date (including any rights and obligations accrued as a result of a default). In addition, the project deed will typically include specific provisions that survive expiry of the project deed. These provisions usually relate to:

* + - indemnities and warranties;
    - defects liability period;
    - end of term maintenance and refurbishment obligations;
    - payment and termination provisions;
    - intellectual property;
    - confidentiality obligations;
    - dispute resolution;
    - public relations and publicity;
    - records; and
    - end of term rights and obligations.

The contract director or project manager will need to review a range of different contractual provisions, which may be affected by any proposed contract extension. These provisions include:

* + - any existing contractual provisions that are expressed in absolute terms rather than as a percentage of a particular value or amount (e.g. liability caps);
    - any contract provisions expressed using actual dates that would not remain valid in an extension period (e.g. a requirement that a parent company guarantee must remain in place until a specific date);
    - whether specified usage volumes or other utility arrangements are appropriate for the extension period;
    - any access issues that may be affected by leasing arrangements under the existing contract;
    - the impact on the service payment model that may have been structured over the existing term; and
    - the impact on any KPIs, which may need to be adjusted to meet the required level of service.

Short-term contract extension options

Early in the planning for the end of term arrangements, the contract director will need to consider the degree of flexibility to extend the existing project deed (i.e. does that State have a short-term option that it is able to exercise in the existing project deed?). This flexibility may determine whether or not the State pursues a short-term contract extension. Additionally, planning for a short-term extension may be a prudent contingency exercise should implementing new arrangements be delayed.

Importantly, a short-term contract extension should not be regarded as a means of providing additional time to undertake end of term arrangements or to compensate for poor planning, as an extension may:

* + - not be acceptable to the incumbent service provider or subcontractors;
    - not provide adequate flexibility to assist with managing timelines for procurement;
    - require difficult negotiations with the incumbent service provider; or
    - require additional project funding and/or not provide value for money.

As part of reviewing the existing project deed, the contract director must gain an understanding of the existing project deed provisions (and provisions in associated project contracts) that may affect a short-term contract extension. Such provisions may include

* + - whether the contract is able to be extended;
    - the potential length of contract term extension;
    - the number of times the contract may be extended;
    - the process to provide notice to the private party;
    - whether the private party has the right to refuse or re-negotiate an extension;
    - how the services to be provided by the private party will be determined; and
    - how payment for these services will be determined.

All these factors will influence whether a short-term contract extension is a valid option. In addition to the project deedthere may be other project contracts that impact options for the future, such as lease arrangements that detail site tenure arrangements, which could also constrain the State’s options.

If a short-term contract extension is a valid option, it is important to recognise that contractual may need to be amended (i.e. service payment model and performance regime requirements). If a contract does not specify how either the service payment model or performance regime requirements will change in the event of an extension of the contract term, negotiations with the private party should be commenced as soon as is practicable.

1. These explanations are not necessarily the same as definitions adopted in authoritative documents, such as accounting standards, or in other *Partnerships Victoria* guidance material, as the context in which the terms are used may differ in this document. [↑](#footnote-ref-1)
2. *Partnerships Victoria* *Requirements* (November 2016), p. 20. [↑](#footnote-ref-2)
3. *National PPP guidelines, Volume 2: Practitioners’ guide.* [↑](#footnote-ref-3)
4. Definitions adopted or adapted from those contained in Standards Australia International Ltd, *Australian Standard AS 5037* 2005, Sydney. [↑](#footnote-ref-4)
5. Tacit knowledge is that which resides in a person’s mind, and may include aspects of culture or ‘ways of doing things’: Standards Australia, Interim Australian Standard AS 5037 (int)-2003, op. cit. [↑](#footnote-ref-5)
6. Metadata or metatags are keywords or information about the information. For example, using a tag or label like ‘lifecycle’ or ‘risk’ that enables other information about lifecycle or risk to be retrieved. [↑](#footnote-ref-6)
7. *National PPP guidelines*, refer to: *Volume 3: Commercial principles for social infrastructure*, Chapter 37 and *Volume 7: Commercial principles for economic infrastructure*, Chapter 36. [↑](#footnote-ref-7)
8. Infrastructure Australia 2015, *National PPP guidelines: Practitioners’ guide*, section 7.3. [↑](#footnote-ref-8)
9. *National PPP guidelines*, refer to: *Volume 3: Commercial principles for social infrastructure*, Chapter 37 (page 23). [↑](#footnote-ref-9)
10. The private party’s willingness to provide information may be conditional on appropriate protection of confidentiality in the project deed. The extent of the confidentiality protection for the private party will have been considered during the procurement phase as part of the public interest test. The public interest test is discussed in detail in Section 14 of the *Partnerships Victoria Requirements* (2016). The confidentiality provisions in the project deed will reflect the balance between transparency and confidentiality inherent in the public interest test. [↑](#footnote-ref-10)
11. Victorian Office of the Auditor-General, *Operating water infrastructure using public private partnerships*, 2013, p vii. [↑](#footnote-ref-11)
12. Infrastructure Australia 2015, *National PPP guidelines: Practitioners’ guide*, section 7.4 [↑](#footnote-ref-12)
13. *Market-led proposal guideline* (2015) available at http://www.dtf.vic.gov.au/Publications/Infrastructure-Delivery-publications/Market-led-Proposals-Guideline/Market-led-Proposals-Guideline. [↑](#footnote-ref-13)
14. *Making changes in operational PFI projects*, report by the Comptroller and Auditor-General, National Audit Office, 17 January 2008. [↑](#footnote-ref-14)
15. Infrastructure Australia 2008, *National PPP guidelines: commercial principles for social infrastructure*, section 32.4. [↑](#footnote-ref-15)
16. [DTF website](http://www.dtf.vic.gov.au/Investment-Planning-and-Evaluation/Investment-professionals-toolkit/Investment-lifecycle-and-High-Value-High-Risk-products) <http://www.dtf.vic.gov.au/Investment-Planning-and-Evaluation/Investment-professionals-toolkit/Investment-lifecycle-and-High-Value-High-Risk-products> [↑](#footnote-ref-16)
17. [DTF website](http://www.dtf.vic.gov.au/Investment-Planning-and-Evaluation/Investment-professionals-toolkit/Investment-lifecycle-and-High-Value-High-Risk-products) <http://www.dtf.vic.gov.au/Investment-Planning-and-Evaluation/Investment-professionals-toolkit/Gateway-products> [↑](#footnote-ref-17)
18. [DTF website](http://www.dtf.vic.gov.au/Investment-Planning-and-Evaluation/Investment-professionals-toolkit/Investment-lifecycle-and-High-Value-High-Risk-products) <http://www.dtf.vic.gov.au/Investment-Planning-and-Evaluation/Investment-professionals-toolkit/Investment-lifecycle-and-High-Value-High-Risk-products> [↑](#footnote-ref-18)
19. [DTF website](http://www.dtf.vic.gov.au/Investment-Planning-and-Evaluation/Investment-professionals-toolkit/Investment-lifecycle-and-High-Value-High-Risk-products) <http://www.dtf.vic.gov.au/Investment-Planning-and-Evaluation/Understanding-investment-planning-and-review/What-is-asset-management> [↑](#footnote-ref-19)