At a glance

Background

In July 2002, the then Spencer Street (now Southern Cross) Station Authority (SCSA) entered into a services and development agreement (SDA) with a private consortium (Civic Nexus Pty Ltd) under a public-private partnership (PPP) for the redevelopment of the station. Under the SDA, Civic Nexus Pty Ltd (the concessionaire) was assigned responsibility to redevelop the station and, upon completion, manage the operations of the station for 30 years.

Construction of the station was contracted to be complete on 27 April 2005. The concessionaire subcontracted the design and construction of the station to a developer (Leightons Contractors). Delays were encountered by the developer and the agreed construction milestones were not met. This resulted in a global settlement agreement worth $32.25 million between the State, the concessionaire and the developer.

Key findings

Design and construction phase

- The construction phase risks of the redevelopment project were appropriately allocated between the State and the private sector parties in accordance with Partnership Victoria policy and guidance, and the approved project business case.
- The final global settlement agreement between the State and private sector parties was negotiated to minimise any adverse impact and effectively conclude all remaining disputes and claims arising from the construction phase.

Operations and service delivery phase

- Expected service standards are clearly defined, however, there is a lack of clarity in key performance indicator (KPI) measurement.
- Operational risks have been transferred to the concessionaire, however, the SCSA retains some residual operational risks resulting from the potential for the concessionaire to under-perform.
- The reward and sanction regime is adequately aligned to the service delivery requirements and the penalty weightings are an appropriate mechanism to direct attention to critical service areas.
Key findings - continued

- The SCSA has enforced an abatement on one occasion under the SDA, but is also trying to establish improved performance and a good working relationship with the concessionaire and other key stakeholders, so has refrained from applying other possible abatements in exchange for a commitment to performance monitoring system improvements. For the previous quarter (April to June 2007) these abatements are able to be applied retrospectively if the concessionaire fails to achieve the agreed improvements.
- The SCSA has put in place a rigorous risk identification and management process, and has been able to work effectively with the concessionaire on a number of potential and emerging issues with precinct stakeholders.

Recommendation

3.1 To enforce the SDA performance specifications, the SCSA should make demonstrable progress in addressing the recognised inadequacies of the current KPI measurement and assessment regime.
3.1 About the Southern Cross Station PPP

3.1.1 Key elements of the redevelopment project

In February 2000, the Government released the *Linking Victoria*\(^1\) program to deliver new transport infrastructure projects and upgrade Victoria’s ports, roads and rail network. The redevelopment of Melbourne’s Southern Cross Station (formerly known as Spencer Street Station) was integral to the program. A master plan for the redevelopment was released in June 2001, comprising:

- a major refurbishment of the rail terminal
- the provision of significant new transport infrastructure
- the integration of the station precinct with the City of Melbourne and the Docklands area.

To facilitate the development, the Government sought a public and private sector partnership delivered under the aegis of *Partnerships Victoria*\(^2\). The Southern Cross Station redevelopment project is one of the largest public-private partnership (PPP) projects undertaken in Victoria.

The objectives of the project, as set by the Department of Treasury and Finance (DTF) and outlined in the approved project business case, were to:

- provide a world-class inter-modal transport facility at the station
- minimise the long-term costs to the taxpayer associated with the construction, maintenance and operation of the station
- transfer risk to the private sector where it constitutes good value-for-money
- make cost-effective allowance for future patronage growth, and for new transport services and infrastructure at the station over time
- secure the delivery of the development in a timely fashion, in accordance with target dates and deadlines set by Government
- ensure that the development is managed in a transparent and accountable way, in consultation with stakeholders and in accordance with the highest standards of probity.

3.1.2 Delays in delivery of the infrastructure

On 2 July 2002, the Southern Cross Station Authority\(^3\) (SCSA) entered into a services and development agreement (SDA) with Civic Nexus Pty Ltd (the concessionaire). Under the SDA, the concessionaire was assigned responsibility to design and construct the station and, upon its completion, to manage the operations of the station for a 30-year period.

---

\(^1\) The *Linking Victoria* policy can be found at [www.linkingvictoria.vic.gov.au](http://www.linkingvictoria.vic.gov.au).

\(^2\) The *Partnerships Victoria* policy can be found at [www.partnerships.vic.gov.au](http://www.partnerships.vic.gov.au).

\(^3\) Formerly known as the Spencer Street Station Authority.
On 27 August 2002, Leighton Contractors (the developer) was engaged by the concessionaire to complete the construction of the station. Construction commenced in October 2002.

The redevelopment was to be completed on 27 April 2005 at which time the SCSA would hand over management of the operations to the concessionaire. However, construction progress was slow and it became apparent that the construction milestones would not be met by the developer due to significant time delays and cost overruns.

By late 2004, the developer had publicly announced a forecast loss on the project of $122.6 million, and was beginning to make some significant compensation claims, primarily against the State and to a lesser extent against the concessionaire.

The SCSA undertook a lengthy negotiation process with the concessionaire and the developer to settle the claims. On 31 July 2006, a global settlement agreement was finalised and the principal construction works were completed.

On 1 August 2006, the concessionaire took over management of the station precinct operations.

March 2004 saw the closure and demolition of the old station building.

3.1.3 Costs related to the project

Under the original SDA signed in 2002, the state was not required to make any payment to the concessionaire until completion of construction and hand over of operations. At this point, the 30-year concession period would begin, and the SCSA would commence quarterly core service payments (CSPs) to the concessionaire. Figure 3A provides an outline of the CSPs.
Due to the delays in completing construction, the SCSA withheld payment of the CSP from 27 April 2005 (the original date for completion). As a result of the global settlement agreement, the SCSA agreed to pay the capital component of the CSP from 27 April 2005.

This means effectively that the concession period for the capital and operating components has been split. Figure 3B shows the revised dates for commencement of the concession periods.

### 3.2 Audit objective

The overall objective of the audit was to assess whether the SCSA is effectively managing the SDA with the concessionaire for the Southern Cross Station precinct.

To achieve this objective, we focused our examinations on 2 distinct phases of the PPP development, and posed the following questions:

- Design and construction phase
  - Were the project construction phase risks allocated appropriately between the State and the private sector parties?
  - Was the global settlement agreement consistent with the desired allocation of risks?
- Operations and service delivery phase

---

**Management of the Southern Cross Station PPP**

**Audits of 2 Major Partnerships Victoria Projects**

---

**Figure 3A**

<table>
<thead>
<tr>
<th>Cost component</th>
<th>Cost per quarter ($ million)</th>
<th>Total cost ($ million)</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital</td>
<td>(a) 5.8</td>
<td>(b) 1 120</td>
<td>Reimburses the concessionaire for the cost of redevelopment of the station.</td>
</tr>
<tr>
<td>Operating</td>
<td>(a) 2</td>
<td>(b) 433</td>
<td>Compensates the concessionaire for managing the operations of the station for the 30-year concession period.</td>
</tr>
<tr>
<td>Insurance</td>
<td>One quarter of the annual insurance premium.</td>
<td></td>
<td>Compensates the concessionaire for insuring the operations of the station for the 30-year concession period.</td>
</tr>
</tbody>
</table>

(a) Base amount to be indexed according to a formula in the SDA.
(b) Nominal value.

*Source:* Victorian Auditor-General’s Office analysis of SCSA documents.

### Figure 3B

**Southern Cross Station’s 30-year concession period**

<table>
<thead>
<tr>
<th>Core service payment</th>
<th>Effective date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital</td>
<td>27 April 2005</td>
</tr>
<tr>
<td>Operating and insurance</td>
<td>1 August 2006 (a)</td>
</tr>
</tbody>
</table>

(a) The commencement of the operating phase.

*Source:* Victorian Auditor-General’s Office analysis of SCSA documents.

---
3.3 Overall conclusions

3.3.1 Construction phase risk allocations

After analysis of the project risk allocations in the business case, commercial framework summary and the SDA, we found that the actual construction phase risk allocations in the SDA were consistent with, and in some cases achieved a better outcome, compared with the preferred allocations in the Partnerships Victoria Risk Allocation and Contractual Issues guide.

Due to refinement of the project risks, after more information was gathered and more analysis was conducted by the SCSA, there were justifiable differences between the specific actual construction phase risk allocations under the SDA and to the government-preferred allocations stated in the business case.

The key high-level risks that the State intended for the concessionaire to bear (as outlined in the original business case) were actually allocated to, and borne by, the concessionaire under the terms of the SDA, being:

- the majority of the design, construction, finance and operational risks associated with the transport interchange
- virtually all of the design, construction, finance and operational risks associated with the commercial development
- the risks associated with the construction of the rail and signalling infrastructure.
3.3.2 Global settlement of claims

Most of the project objectives as detailed in the business case were achieved, with the exception that the project was not completed within the original time frame.

The final global settlement agreement between the State and the private parties dealt with the 15-month delay in the project, and while there were some costs incurred by the State in the settlement, the benefits outweighed the potential costs.

The global settlement agreement was negotiated to minimise adverse impacts on the State’s original cost expectations for the redevelopment. This was achieved by:

- a rigorous and structured negotiation process overseen by an interdepartmental committee
- use of independent experts to assist in legal, commercial and financial risk assessments to determine the State’s actual liability and potential risk exposure
- persuading the concessionaire to contribute a fair and significant cash payment to the settlement
- avoiding lengthy litigation and legal costs estimated by the SCSA’s legal advisers to potentially exceed $200 million.

The agreement resulted in some risks being allocated to the State that were not consistent with the desired risk allocation, namely:

- payment of $8.5 million for settlement of non-contractual claims by the developer for which it did not admit liability
- relieving the concessionaire from paying damages for not meeting construction milestones
- provision of a $20 million non-cash benefit to the concessionaire resulting from the SCSA agreeing to pay the capital core service payment component backdated from the original scheduled completion date, rather than from the date works were actually completed.

However, these measures were considered necessary to settle the developer’s claims and ensure that the additional costs to the State were minimised. In addition, at least some of the delays encountered by the developer were, in part, a result of site contamination (for which the SCSA was liable) and some State-initiated modifications.

The final settlement between the State, the concessionaire and the developer thus effectively concluded all remaining disputes and claims arising from the construction phase of the project.

3.3.3 Adequacy of service delivery standards and management of operational risks

Based on our analysis, we concluded that operational risks are allocated appropriately, with commercial operational risks allocated to the concessionaire, and contract management risks remaining with the SCSA.
The allocation of contract management risks to the SCSA is reasonable because, under government policy, it is not possible for overall responsibility for the management of the station to be transferred away from the State, which is the ultimate owner of the station.

The reward and sanction regime is adequately aligned to the service delivery requirements and the penalty weightings are an appropriate mechanism to direct attention to critical service areas.

Nevertheless, the application of the key performance indicator (KPI) regime is dependent upon effective performance measurement and assessment. We consider that the ongoing issues associated with KPI monitoring and assessment compromises the effectiveness of such a regime.

The SCSA needs to continue to address the issue of monitoring and measuring KPIs including improving performance management system data integrity, to enable effective management of performance to expected service standards through the KPI reward and sanction regime.

3.3.4 Management of the precinct to specified standards

Generally, our analysis showed that the SCSA is fulfilling its contract management role, however, improvements must be made to address certain identified issues. In its most recent corporate plan, the SCSA has acknowledged that these issues affect its ability to efficiently and effectively perform its contract management and oversight role and sets a timetable to rectify the problems.

We consider that the SCSA is effectively monitoring and assessing concessionaire performance against the standards by conducting a regular review of KPI achievement. Although the SCSA has been in a position to apply abatements against the concessionaire – in accordance with the sanctions available in the SDA – it has instead reasonably used these potential sanctions to assist negotiations with the concessionaire to improve the long-term KPI monitoring, measurement and assessment regime.

Notwithstanding the above, we consider that due to the recognised inadequacies within the KPI regime, the SCSA may not be able to adequately enforce the performance based penalty system until KPIs are enhanced and made more transparent and measurable.

3.3.5 Ongoing management of the station precinct

On the ongoing management of the station precinct, we conclude that the SCSA has put in place a rigorous risk identification and management process, and has been able to work effectively with the concessionaire on a number of potential and emerging issues with precinct stakeholders.
Recommendation

3.1 To enforce the SDA performance specifications, the SCSA should make demonstrable progress in addressing the recognised inadequacies of the current KPI measurement and assessment regime.

RESPONSE by Chief Executive Officer, Southern Cross Station Authority

The SCSA would like to thank the audit team for the professional and comprehensive manner in which this performance audit has been conducted.

The audit has been of benefit to the SCSA in providing an independent review and endorsement of the strategies and directions identified by the SCSA within the current Corporate Plan.

With regard to the review of the Global Settlement Agreement, the SCSA agrees with the conclusion reached by the audit team.

For clarity, it should be noted that the costs of the delays encountered by the Developer as a result of contamination, were a shared risk between the SCSA and the Concessionaire, with each responsible for 50 per cent of the costs of removing non identified pre existing contamination. This was the risk allocation under the original SDA and was unchanged by the Global Settlement.

With regard to the review of the Operations and Service Delivery phase the SCSA agrees with the Recommendation in the Report. However, it should be appreciated that the Operating Phase of the PPP commenced just over one year ago and for a significant portion of this period was in a transition phase, designed to enable a smooth hand-over.

During this period, the SCSA has identified areas where performance could be improved and both parties are working together towards achieving the agreed service levels and continued improvements in performance. This settling-in period has been invaluable in establishing the groundwork for the future and enabling the development of an effective working relationship between the SCSA and the Concessionaire.

The SCSA has identified that the measurement of some of the Service Standards and related Key Performance Indicators (KPIs) needs to be clarified to ensure that performance monitoring is transparent and measurable and that there is integrity and auditability of the data generated by the Performance Management System. The SCSA will continue to work with the Concessionaire to achieve these objectives.

Whilst it is expected that commercial tensions will exist where there is a reward and sanction regime, which is normal practice for the operation of a PPP project, the SCSA considers that gaining a greater clarity of the required service standards is essential to deriving the full benefits of this PPP arrangement.
3.4 Were the project construction phase risks allocated appropriately between the State and the private sector?

3.4.1 Introduction

In July 2002, the then Spencer Street (now Southern Cross) Station Authority entered into an SDA with a private consortium (the concessionaire) for the redevelopment of the station in accordance with Partnerships Victoria policy and guidance. Under the SDA, the concessionaire was assigned responsibility to redevelop the station and, upon completion, manage the operations of the station for a 30-year period.

Construction of the station was to be completed on 27 April 2005. The concessionaire subcontracted the design and construction of the station to the developer. Delays were encountered by the developer and the agreed construction milestones were not met.

These delays led to the negotiation of a global settlement agreement between the State of Victoria, the concessionaire and the developer. This settlement agreement was supplementary to the SDA, and amended some of the risk allocations and responsibilities that had already been agreed by the State and the private party.

The Partnerships Victoria policy suite provides a framework and guidance for the establishment of partnerships with private sector entities for the provision of public infrastructure and related services.

One of the principles of Partnerships Victoria is the allocation of key project risks to the party which can best manage those risks in order to achieve value-for-money and the best outcomes for the State of Victoria. Further guidance, including government preferred risk allocations, is provided in the Partnerships Victoria Risk Allocation and Contractual Issues Guide.

3.4.2 Criteria we used

To assess whether the construction phase risks were allocated appropriately between the State and the private party, we used the Partnerships Victoria framework, particularly its risk management and contract management guidance to determine whether:

- risk allocations between parties were consistent with the approved business case
- risks were allocated in accordance with the Partnerships Victoria policy (i.e. to the party best able to effectively manage the risk at the least cost)

---

Were risk allocations consistent with the business case?

The Department of Infrastructure (DOI) established a project team to develop a business case for the Spencer Street Station redevelopment. The business case development relied on the expertise of the DOI project team, as well as external consultants experienced in Australian and UK PPP projects.

On 28 June 2001, the final business case was submitted to the Government, so that it could make an informed decision as to whether to proceed with the redevelopment project.

Figure 3C provides an outline of the contents of the business case.

### Figure 3C
Spencer Street Station redevelopment business case

<table>
<thead>
<tr>
<th>Business case outline</th>
</tr>
</thead>
<tbody>
<tr>
<td>Project scope and objectives</td>
</tr>
<tr>
<td>Alternative redevelopment options and their costs</td>
</tr>
<tr>
<td>Commercial delivery options</td>
</tr>
<tr>
<td>Risk allocation</td>
</tr>
<tr>
<td>Contractual issues</td>
</tr>
<tr>
<td>Financial evaluation</td>
</tr>
<tr>
<td>Cost-benefit analysis</td>
</tr>
</tbody>
</table>

Source: Victorian Auditor-General’s Office analysis of SCSA documents.

The key project risks were identified and an analysis of the optimal risk allocation for each of the key risks was covered by the business case. The government-preferred risk allocations were further assessed in the commercial framework summary. The summary was included with the project brief and was provided to tenderers in the request for proposal documentation.

We observed that the risks were identified with reference to the key project risks outlined in the Partnerships Victoria risk allocation guidance material. External consultants and the project team conducted workshops to identify the risks and assess the likelihood of occurrence and the possible impact on the station redevelopment. The project team worked with legal and commercial advisors and DTF to further refine and specify the key project risks. This was reflected in the commercial framework summary document that was provided to tenderers as part of the request for proposal documentation.
Were risks allocated in accordance with the *Partnerships Victoria* policy?

The *Partnerships Victoria* Public Sector Comparator (PSC)⁶ was used as the basis for allocating risks.

The following parties were consulted on the risk allocations:
- Spencer Street Station redevelopment project team
- DOI
- DTF.

Risks to be transferred as a result of assessment from the PSC were reviewed by the project team to ensure the best value-for-money. If the proponent’s price for the risks was significantly higher than the State’s costs, it either allocated the risk to the proponent or retained the risk with the State.

An example of a State-retained risk we observed was the cost of operating insurance up to the commencement of the operating phase, which was related to the decision to maintain services at the station during the construction phase.

Tenderers were required to indicate which risks they were willing or unwilling to accept in their bids. Consistency of a bid with the Government’s preferred allocations was one of the main considerations in choosing the successful bidder.

The final risk allocations agreed by the State and the proponent are detailed in the SDA. A summary of the risk allocations is in Appendix C of this report. Some of the risk allocations achieved a better outcome for the state compared with the preferred allocations described in *Partnerships Victoria*.

---

⁶ The PSC estimates the hypothetical risk-adjusted cost if a project were to be financed, owned and implemented by government, so that this hypothetical cost can be used as a benchmark against private sector bids. Further information on the PSC can be found at <http://www.partnerships.vic.gov.au>.
3.4.3 Conclusion on construction phase risk allocation

Analysis of the project risk allocations in the business case, commercial framework summary, SDA and the *Partnerships Victoria Risk Allocation and Contractual Issues* guide, found that the actual construction phase risk allocations in the SDA were consistent with, and in some cases achieved a better outcome, compared with the preferred allocations in the *Partnerships Victoria Risk Allocation and Contractual Issues* guide.

As further analysis by SCSA was conducted and the project risks refined, there were justifiable differences between the specific actual construction phase risk allocations under the SDA and the government-preferred allocations stated in the business case.

The key high-level risks that the State intended for the proponent to bear (as outlined in the original business case) were actually allocated to, and borne by, the proponent under the terms of the SDA, being:

- the majority of the design, construction, finance and operational risks associated with the transport interchange
- virtually all of the design, construction, finance and operational risks associated with the commercial development
- the risks associated with the construction of the rail and signalling infrastructure.

A summary of the key risks identified at each stage of the project is included in Appendix C of this report.
3.5 Was the global settlement agreement consistent with the desired allocation of risks?

3.5.1 Introduction

On 27 August 2002, the concessionaire contracted the developer to design and construct the station. Construction progressed slowly and it became apparent to the SCSA that the milestones in the SDA would not be met by the developer\(^7\). Figure 3D outlines the factors that contributed to the delays.

![Image of Southern Cross Station](image)

In March 2006, the station was ready for the Commonwealth Games.

**Figure 3D**

**Factors contributing to the delays in construction**

<table>
<thead>
<tr>
<th>Contributing factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>The unique and complex design of the station roof.</td>
</tr>
<tr>
<td>Logistical and stakeholder interface issues arising due to construction activity occurring while the station remained fully operational.</td>
</tr>
<tr>
<td>Interpretation issues related to the project scope.</td>
</tr>
</tbody>
</table>

*Source: Victorian Auditor-General’s Office analysis.*

By late 2004, the developer had publicly announced its forecast loss on the project of $122.6 million, and was beginning to make significant compensation claims, primarily against the State and to a lesser extent against the concessionaire.

\(^7\) We reported on this delay in *Report of the Auditor-General on the Finances of the State of Victoria, 2003-04.*
The SCSA undertook a lengthy negotiation process with the concessionaire and the developer to settle the claims. On 31 July 2006, the global settlement agreement was finalised and the principal construction works were completed.

3.5.2 Criteria we used

In order to assess whether the global settlement agreement was consistent with the desired allocation of risks, we examined whether:

- the final settlement between the State and the private parties was negotiated to minimise adverse impacts on the original cost expectations for the project
- the final settlement between the State and the private parties effectively concluded all remaining disputes and claims arising from the construction phase of the project.

Did settlement negotiations minimise adverse cost impacts?

In response to the claims received from the developer, several steps were taken to determine the potential exposure to risk and minimise the cost of settlement, including:

- engaging independent experts to assess the potential legal, commercial and financial risk exposures associated with the claims
- establishing an interdepartmental committee to oversee negotiations with the developer and concessionaire. The committee comprised representatives of the SCSA and the DTF, Department of Premier and Cabinet (DPC) and DOI
- setting up a senior strategy committee to investigate the veracity of the claims and make recommendations to the interdepartmental committee. The senior strategy committee comprised representatives from the SCSA, DOI and independent expert advisors
- appointing a high-level negotiating team to conduct negotiations.

Government required certain settlement terms and set maximum contributions to be made by the State. Government was kept informed on the progress of negotiations and ensured that negotiations were conducted within the set parameters.

Prior to finalising the agreement, the SCSA appointed an independent commercial mediator to assess the proposed settlement and certify whether:

- the process to negotiate a settlement was properly informed and rigorous
- the analysis of the proposed settlement and the amount to be contributed by the State was consistent with the SCSA's assessment of the State's potential commercial and legal risk, and adequately addressed that risk.

The SCSA engaged a Queen's Counsel (QC) experienced in the construction industry and dispute resolution to provide certification on the settlement. The QC concluded that: "The settlement agreement was the best possible commercial settlement that was able to be negotiated following a lengthy and vigorous process of commercial negotiations."
Did settlement effectively conclude all remaining disputes?

On 31 July 2006, the SCSA executed the final global settlement agreement after lengthy negotiations with the concessionaire and the developer. The agreement was reached on the same day as the principal construction works of the main interchange facility were completed.

The terms of the agreement provided for the State to be indemnified and released from any future claims relating to works completed at that date. The timing of the settlement, to conclude on the same day that principal works were completed, enabled the State to minimise its exposure to any future claims by the developer.

The SDA was amended to reflect the terms of the final settlement.
Figure 3E
Main outcomes from the final global settlement

<table>
<thead>
<tr>
<th>SCSA cash payment</th>
</tr>
</thead>
<tbody>
<tr>
<td>A cash contribution of $32.25 million paid by the SCSA to the developer comprising:</td>
</tr>
<tr>
<td>• $21 million for modifications and additional works to which the SCSA agreed that the developer was entitled under the original contractual terms</td>
</tr>
<tr>
<td>• $8.5 million to settle claims to which the SCSA does not admit liability, but considered it had a financial risk</td>
</tr>
<tr>
<td>• $2.75 million to settle a site access claim after the 2006 Commonwealth Games.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Time extension</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agreement to extend the practical completion date for principal works by 15 months from April 2005 to the end of July 2006 and relieve the concessionaire and the developer of their obligation to pay liquidated damages for not meeting the original scheduled completion dates.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Change to concession period</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under the original SDA signed in 2002, practical completion of construction was scheduled for completion on 27 April 2005. At this time, operations were to be handed over to the concessionaire, and the SCSA would commence quarterly payments of the core service payments, comprising capital, operating and insurance cost components. The capital and operating components were to be indexed.</td>
</tr>
<tr>
<td>As the completion milestone was not met, the SCSA withheld all payments.</td>
</tr>
<tr>
<td>Under the terms of the global settlement, the concession period (originally scheduled to be the 30-year period commencing 27 April 2005) was effectively split into 2 concession periods:</td>
</tr>
<tr>
<td>• The 30-year operating concession period commenced upon handover of operations to the concessionaire on 1 August 2006 was 15 months later than agreed in the original SDA</td>
</tr>
<tr>
<td>• The 30-year capital concession period remained the original 30-year planned period commencing 27 April 2005.</td>
</tr>
</tbody>
</table>

As a result of this decision, the SCSA then owed (and paid) the concessionaire the capital payments owing from 27 April 2005 in a $30 million lump sum upon settlement. This amount would have to have been paid regardless of the change in concession period.

However, the SCSA calculated that it was providing the concessionaire with a $20 million non-cash benefit by sticking to the original concession period for the capital component, i.e. had it delayed the concession period by 15 months, the NPV of total capital payments would have been $20 million less than the NPV of the payments commencing from 27 April 2005.

<table>
<thead>
<tr>
<th>De-scoped works</th>
</tr>
</thead>
<tbody>
<tr>
<td>As part of the settlement, some rail modification and signalling upgrade works were removed from the project scope, as the works agreed in the original SDA were not adequate to meet the long-term needs of the State as well as rail operators. This led to DOI taking over responsibility for completion. The State received a credit (calculated by an independent reviewer) from the concessionaire for the de-scoped works.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Concessionaire cash payment</th>
</tr>
</thead>
<tbody>
<tr>
<td>The concessionaire was required to make a cash payment of $30 million to the developer, and to implement an air quality management system, monitor the air quality levels daily and be accountable for any non-compliance with air quality standards.</td>
</tr>
</tbody>
</table>

Source: Victorian Auditor-General’s Office analysis.
30 June 2007, the SCSA had incurred $135 million in costs relating to the redevelopment project, comprising:

- $32 million – project costs
- $32.25 million – legal settlement (cash)
- $30 million – legal settlement early payment of core service payments (capital component)
- $40.69 million – finance lease expenses.

The SCSA also recognised a $360 million finance lease liability, representing the present value of the capital component of the core service payments, and $505 million (indexed nominal value) of operating lease commitments (being the operating and insurance cost components of core service payments payable to the concessionaire over the 30-year contract).

The liability and commitment balances reflect the agreed core service payment amounts agreed between the SCSA and concessionaire in the original SDA.

At the time of preparation of this report, no further costs had been incurred by the SCSA in relation to the construction phase of the project, and the only construction work by the developer was to rectify defects as required under the terms of the SDA.

### 3.5.3 Conclusion on the global settlement agreement

The project objectives as detailed in the business case have been achieved with the exception that the project was not completed within the original time frames.

The final global settlement agreement between the State and the private parties dealt with the 15-month delay in the project, and while there were some costs incurred in the settlement, the benefits outweighed the potential costs.

The settlement agreement was negotiated to minimise adverse impacts on the original cost expectations for the redevelopment. This was achieved by:

- a rigorous and structured negotiation process overseen by the interdepartmental committee
- use of independent experts to assist in legal, commercial and financial risk assessments to determine the State’s actual liability and potential risk exposure
- the concessionaire agreeing to contribute a fair and significant cash payment to the settlement
- avoiding lengthy litigation and legal costs estimated by the authority’s legal advisers to potentially exceed $200 million.

The agreement resulted in some risks being allocated to the State that were not consistent with the desired risk allocation, namely:

- payment of $8.5 million for settlement of non-contractual claims by the developer for which it did not admit liability
- relieving the concessionaire from paying damages for not meeting construction milestones
• provision of a $20 million non-cash benefit to the concessionaire resulting from the SCSA agreeing to pay the capital core service payment component backdated from the original scheduled completion date rather than from the date works were actually completed.

However, these measures were considered necessary to settle the developer’s claims and ensure that the additional costs to the State were minimised. In addition, at least part of the delays encountered by the developer were, in part, a result of site contamination (for which the SCSA was liable) and some State-initiated modifications. The final settlement between the State, the concessionaire and the developer has effectively concluded all remaining disputes and claims arising from the construction phase of the project.

3.6 Does the SDA adequately specify expected service delivery and manage operational risks?

3.6.1 Introduction

After the concessionaire assumed the operational management of the station following the completion of the station’s construction phase, the SCSA’s key roles became:
• monitoring and assessing the concessionaire’s management and operation of the station based on a KPI regime
• managing a number of capital projects within the precinct
• owner obligations over SCSA land within the broader station precinct.

The concessionaire is contracted to deliver 15 key services as defined in the SDA. The SCSA is responsible for the oversight of the SDA over the concession period of 30 years.

3.6.2 Criteria we used

To assess whether the SDA adequately specifies expected service delivery and manages operational risks, we examined whether:
• operational risks are allocated in an optimal manner between the State and Civic Nexus (i.e. to the party best able to effectively manage the risk at the least cost)
• services to be provided have well defined-standards which can be measured and assessed for compliance
• reward and sanction regimes are in place and are aligned with the critical service requirements for the precinct.

Allocation of operational risks

Under the terms of the SDA, responsibility for the management and operation of the Southern Cross Station was effectively transferred from the SCSA to the concessionaire over a phased transition period from August 2006 to December 2006.
The operational risk burden for the delivery of services rests with the concessionaire. The SCSA, as the owner of the station, is ultimately responsible for management of key public infrastructure and the provision of residual services and, therefore, has retained some residual operational risk associated with its contract management and oversight role with regards to the performance of the concessionaire.

This aligns with Partnerships Victoria guidance on the allocation of risk for PPP contracts, requiring that operational risk of delivery remains with the private party and is not inadvertently taken back by government.

This operational risk allocation is common in PPPs, as the overall responsibility for service delivery invariably reverts to the State as any serious underperformance would inevitably be raised by the public with government.

In our view, operational risks are allocated appropriately; commercial operational risks are allocated to the concessionaire, while contract management risks remain with the SCSA.

**Specification and measurement of service standards**

The SDA requires the concessionaire to meet 15 service standards and 60 associated KPIs for the management and operation of the station.

They are also required to provide the SCSA with a range of documentation demonstrating performance obligations against the KPIs. Figure 3F lists the required documentation.

| Figure 3F  |
| Concessionaire documentation |
| **Required documentation** |
| - Quarterly performance reports (QPRs) |
| - Operating manuals |
| - Quality assurance manuals |
| - Asset management plans |
| - Annual reports |

Source: Victorian Auditor-General’s Office.

The concessionaire has subcontracted many of the key services, including the development of documents, to a number of key service providers (KSPs), however, the concessionaire retains overall operational responsibility for the service delivery.

The expected service standards and the provision of key documentation is clearly defined in the SDA, however, some of the KPIs have been difficult to measure. This presents a challenge for the SCSA in terms of its ability to monitor performance and assess the concessionaire’s service delivery.
The SCSA has acknowledged these problems and has demonstrated its intent to rectify them in its most recent corporate plan.

The SCSA has commissioned a review of the Performance Management System (PMS) adopted by the concessionaire (as the primary management system for recording instances of KPI non-performance). In June 2007, the final PMS review report was provided to the SCSA. Figure 3G highlights the issues from the report.

### Figure 3G
Issues arising from PMS review

<table>
<thead>
<tr>
<th>Issue</th>
<th>Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset Management Plan is incomplete</td>
<td>Only 800 of the approximately 3,000 assets are registered. This impacts the ability of the KSP responsible for maintenance to effectively schedule maintenance and ensure compliance.</td>
</tr>
<tr>
<td>Integrity of data reported by the KSPs is unverified</td>
<td>Documentation showed some instances of inaccurate data entered into the system by KSPs. Potential for undetected or unreported incidents, as well as intentional fraud.</td>
</tr>
<tr>
<td>KPI measurement is difficult</td>
<td>Many of the KPIs require physical attendance at the location and a manual survey.</td>
</tr>
<tr>
<td>Current reporting requirements do not allow for trend analysis</td>
<td>Hinders the SCSA’s ability to assess overall performance and value-for-money.</td>
</tr>
</tbody>
</table>

Source: Victorian Auditor-Generals Office.

The SCSA has accepted these findings and plans to implement strategies to address them in 2007-08.

In relation to enhancing the measurement and assessment of KPIs, the SCSA has established clear and specific objectives to effectively manage contractual obligations, including:

- establishment of a monitoring and audit regime to ensure that the concessionaire meets its operational and asset management responsibilities
- proactive management of the KPI regime by measuring and assessing performance against KPIs, seeking evidence of compliance, and ensuring asset management plans are being developed and applying abatements for non-performance.

Although the concessionaire’s KPIs are clearly defined in the SDA, some have been difficult to measure. Inadequate measurement (and, therefore, assessment), presents a serious risk to the SCSA’s ability to manage the concessionaire’s performance.

The SCSA has acknowledged the KPI measurement issue and has committed to a number of actions and timelines in its corporate plan. We reviewed these plans and consider them to be reasonable and achievable. We also noted some evidence of early progress.
Reward and sanction regimes align with critical services

A reward and sanction regime is defined in the SDA. The reward system involves the SCSA making quarterly payments (via an escrow account) to the concessionaire for the delivery of key services outlined in the SDA. Sanctions or abatements are applied when the concessionaire fails to meet the specified KPIs.

Each KPI failure attracts penalty points and the accumulation of penalty points each quarter is used to calculate an abatement amount.

Penalty units are weighted in regard to the most critical services. The penalties are commensurate with the level of risk associated with the particular KPIs.

3.6.3 Conclusion on adequacy of service specifications and management of operational risks

Our analysis found that operational risks are allocated appropriately, with commercial operational risks allocated to the concessionaire, and contract management risks remaining with the SCSA.

The allocation of contract management risks to the SCSA is reasonable because, under government policy, it is not possible for overall responsibility for the management of the station to be transferred away from the State, which is the ultimate owner of the station.

The reward and sanction regime is adequately aligned to the service delivery requirements and the penalty weightings are an appropriate mechanism to direct attention to critical service areas.

Nevertheless, the application of the KPI regime is dependent upon effective performance measurement and assessment. The ongoing challenges associated with KPI monitoring and assessment compromises the effectiveness of such a regime.

The SCSA needs to continue to address the challenges of monitoring and measuring KPIs, including improving PMS data integrity, to enable the effective management of performance to expected service standards through the KPI reward and sanction regime.
3.7 Do the PPP arrangements enable the effective management of the public infrastructure within the station precinct to the specified standards?

3.7.1 Introduction

Now that the construction phase of the Southern Cross Station PPP is complete, the current operations and service delivery phase requires effective oversight and management of the delivery of these services to ensure that:

- the PPP contract (SDA) is being followed
- the fees paid to the concessionaire are for services being adequately delivered.

3.7.2 Criteria we used

To assess if the arrangements enable the effective management of the public infrastructure within the station precinct to the specified standards, we examined whether:

- the Authority performs its statutory management and oversight role in an efficient and effective manner
- key performance criteria and standards for service delivery by Civic Nexus are monitored and enforced by the Authority.

SCSA’s oversight role

Upon completion of the station’s construction phase, the concessionaire assumed the operational management of the station.

In contrast to the SCSA’s earlier role of directly managing the precinct and the redevelopment, the SCSA’s key roles are now to:

- monitor and assess the concessionaire’s management and operation of the station based on a KPI regime on behalf of the State
- manage a number of capital projects within the precinct
- exercise owner obligations over SCSA land in the broader station precinct.

The SCSA monitors the concessionaire’s service delivery and performance against KPIs by reviewing the Quarterly Performance Reports (QPRs) provided by the concessionaire. Based on the review, the SCSA assesses any underperformance and determines whether an abatement amount should be applied.

The SCSA relies on the accuracy and quality of the QPRs which are populated from PMS data. As already mentioned, a recent independent review (commissioned by the SCSA) found a number of issues related to the PMS. These issues affect the rigour and accuracy of any assessment of the concessionaire’s performance.
As an interim response to the difficulty in measuring some of the current KPIs, the SCSA conducts ad hoc spot checks of the concessionaire’s service performance as an additional method of performance monitoring. However, these checks are not conducted with a frequency or schedule which would allow rigorous performance inferences.

The SCSA’s change in operational objectives and responsibilities has also highlighted staffing issues in terms of the number of skilled people available and the skills required to perform its present management and oversight role. For example, there is only one contract manager who is responsible for monitoring and assessing all of the concessionaire’s performance standards.

In its corporate plan, the SCSA has recognised the need to review its staffing requirements as it continues to monitor and assess the performance of the precinct, as well as manage a range of capital projects within the precinct.

Generally, our analysis showed that the SCSA is fulfilling its contract management role, however, improvements must be made to address issues in terms of:

- incomplete asset management plans
- KPI measurement difficulties
- PMS data integrity
- QPR format inconsistency (and its impact on trend analysis)
- staffing requirements.

The SCSA has acknowledged that these issues affect its ability to efficiently and effectively perform its contract management and oversight role. The SCSA has recognised these issues in its most recent corporate plan which sets a timetable to rectify the problems.

It should be noted that identification of these issues in itself is evidence that the SCSA’s governance structure has worked appropriately to address gaps in effectiveness of the existing monitoring regime.
Key performance criteria are monitored and enforced

Due to the identified limitations of the KPI regime contained in the SDA, and the consequential impact on SCSA’s ability to effectively monitor and assess the concessionaire’s performance, there have been some disagreements between the SCSA and the concessionaire as to whether underperformance has occurred and whether an abatement is warranted.

In the first year of operation by the concessionaire, the SCSA has assessed underperformance on 3 out of 4 quarterly reports; however, an abatement was only applied once (in the first quarter).

Correspondence between the SCSA and the concessionaire highlighted robust discussion between the parties at the time of the QPR assessments, particularly where underperformance has been found.

The SCSA has been able to use these commercial tensions to negotiate a range of specific commitments and formal plans from the concessionaire to address performance lapses in exchange for the withholding of abatements.

The SCSA views the resolving of any transitional and other operational issues, and the maintenance of a positive ongoing working relationship with the concessionaire and resolving any transitional and other operational issues as preferable to applying abatements which potentially harm the relationship, and prevent long-term solutions.

In SCSA’s view, at this stage of the operations period the financial implications of not applying abatement are small compared with the benefit of maintaining a good relationship with the concessionaire in order to resolve issues as they arise.
Although the SCSA has enforced an abatement on one occasion under the SDA, it is also trying to establish good working relationships with the concessionaire and other key stakeholders.

During the period April to June 2007, the SCSA has refrained from applying other possible abatements in exchange for a commitment to performance monitoring system improvements. These abatements are able to be applied retrospectively if the concessionaire fails to achieve the agreed improvements.

Agreement was reached in August 2007 on a protocol to manage the relationship and achieve desired results for both parties. The agreement states that withheld abatements can be retrospectively applied if expected service standards are not met in future operation periods.

A breakdown in the relationship with the concessionaire is rated as the third highest strategic risk for the SCSA. Therefore, deferring the application of an abatement in exchange for a commitment to improve aspects of the KPI monitoring and reporting framework is considered an appropriate response.

### 3.7.3 Conclusion on whether the PPP arrangements enable the effective management of the station precinct to the specified standards

Our analysis showed that the SCSA is fulfilling its contract management role, however, improvements must be made to address QPR and PMS issues. In its most recent corporate plan, the SCSA has acknowledged that these issues affect its ability to efficiently and effectively perform its contract management and oversight role, and sets a timetable to rectify the problems.

We conclude, therefore, that the SCSA is monitoring and assessing concessionaire performance against the standards via a regular review of KPI achievement. Although the SCSA has been in a position to apply abatements against the concessionaire – in accordance with the sanctions available in the SDA – it has instead reasonably used these potential sanctions to assist negotiations with the concessionaire to improve the long-term KPI monitoring, measurement and assessment regime.

Notwithstanding the above, due to the recognised inadequacies within the KPI regime, the SCSA may not be able to adequately enforce the performance-based penalty system until KPIs are enhanced and made more transparent and measurable.

### Recommendation

3.2 To enforce the SDA performance specifications, the SCSA should make demonstrable progress in addressing the recognised inadequacies of the current KPI measurement and assessment regime.
3.8 How effectively has the SCSA managed operational service issues and risks that have emerged since hand over of management?

3.8.1 Introduction

Although there are a number of contractual and performance monitoring mechanisms in place to monitor the station precinct from day-to-day, there is also a need for the SCSA to actively monitor unforeseen risks and issues that arise from time-to-time.

3.8.2 Criteria we used

To assess whether the SCSA has effectively managed operational service issues and risks that have emerged since hand over of management, we examined whether:

- any unforeseen issues/risks arising since practical completion of the redevelopment have been effectively identified and managed by the SCSA
- the SCSA works proactively with the concessionaire and other precinct stakeholders to address any emerging operational risks and issues.

Ongoing risk management by SCSA

The SCSA has formal policies and procedures in place to manage and monitor risk, including a risk register with all identified risks. The risk register is comprehensive, and includes an assessment and rating for each risk, along with mitigation actions and timing, and allocation of responsibility for the identified risk.

The SCSA has rigorous risk identification and management processes in place. In particular, this system includes:

- formal annual risk workshops (facilitated by the internal auditor) where risks are identified and treated
- follow-up reviews of identified risks
- risk management methodology reviews conducted by the Victorian Managed Insurance Authority
- adoption and application of the ANZS:4360 risk management standard
- status reports on key risks provided regularly to the SCSA board.

Issues or risks arising since completion

The SCSA has identified corporate governance and public safety as its key strategic risks. The SCSA is segmenting its risk workshops so that senior management can focus on strategic risks and other staff can focus on operational and capital project type risks.

The SCSA has also recognised the risks that arise from weaknesses in the KPI monitoring and measurement, as well as risks related to interface and coordination arrangements for the whole precinct.
A further strategic risk that the SCSA has recognised is its long-term ability to manage the SDA and assess service standards in the precinct if there is a change to its organisational structure or resource allocation. This risk was identified due to the potential that the SCSA could be absorbed into DOI at some point in the future⁸.

Stakeholder engagement on emerging risks and issues

Even though there have been some commercial tensions between the SCSA and the concessionaire due to the KPI reward and sanction regime, the SCSA has been able to work effectively with them on a number of issues, such as:

- counter-terrorism and community safety enhancements to the station
- State-initiated modifications to the precinct
- the impact of public transport re-franchising in 2009

Audit observed that other emerging issues such as diesel fumes from locomotives idling within the precinct, and community demands for better stormwater harvesting have been actively managed by both parties.

Specific actions have been taken as required to address these issues, resulting in implementation of a rigorous air quality monitoring regime and a decision to install stormwater capture facilities for re-use of water within the station.

SCSA management informed us that in the case of these 2 risks, the risk allocation patterns agreed for the PPP have been an effective framework for negotiation as it identifies the concessionaire as responsible for environmental compliance (including air quality).

On the issue of engagement with precinct stakeholders, we observed that the SCSA is now trying to establish forums and frameworks for precinct stakeholders to address operational interface and project issues, as well as develop more formalised and consistent stakeholder management and communication. This approach is designed to identify and deflate issues before they become escalated or unmanageable.

3.8.3 Conclusion on emerging service issues and risks

On management of the station precinct going forward, the SCSA has put in place appropriately rigorous risk identification and management processes, and has been able to work effectively with the concessionaire on a number of potential and emerging issues with precinct stakeholders.

⁸ A recent example is the case of the CityLink Authority which had its role and resources absorbed into VicRoads after the private sector operator of the CityLink toll-road had settled into the operations phase of the concession.