



East West Link Project



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Auditor-General

East West Link Project

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The Hon. Bruce Atkinson MLC
President
Legislative Council
Parliament House
Melbourne

The Hon. Telmo Languiller MP
Speaker
Legislative Assembly
Parliament House
Melbourne

Dear Presiding Officers

Under the provisions of section 16AB of the *Audit Act 1994*, I transmit my report on the audit *East West Link Project*.

This audit examined whether the state had effectively managed the East West Link (EWL) project by assessing the total costs of the project, appropriateness of advice supporting key project decisions and the lessons for future major projects.

I concluded that the EWL business case did not provide a sound basis for the government's decision to commit to the investment and that key decisions during the project planning, development and procurement phases were driven by an overriding sense of urgency to sign the contract before the November 2014 state election. Over the life of this costly and complex project, advice to government did not always meet the expected standard of being frank and fearless. This highlights a risk to the integrity of public administration that needs to be addressed.

The audit also found that the EWL project was terminated in June 2015 with more than \$1.1 billion paid, or expected to be paid, by the state. This cost includes expenditure on the planning, development, procurement and termination of the project and will be partially offset by future proceeds from the sale of properties acquired for the project. The Department of Treasury & Finance (DTF) estimates that these properties can be resold for around \$320 million.

The report makes recommendations to DTF to provide guidance for development and delivery of major projects and for the Department of Premier & Cabinet to clarify requirements for frank and fearless advice from the public sector. Disappointingly, these departments have rejected the recommendations.

Yours faithfully



Dr Peter Frost
Acting Auditor-General

9 December 2015

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Auditor-General's comments

This audit assessed the East West Link (EWL) project—its total costs and the appropriateness of advice supporting key project decisions that influenced the project's outcomes and total costs.

The decisions to proceed with the EWL project and enter into a contract with the preferred consortium were based on flawed advice. The likely net benefits of the project were not sufficiently demonstrated and the failure to properly resolve project risks before entering contracts exposed the state to additional financial risk. It was clear the advice provided to the then government was disproportionately aimed at achieving contract execution prior to the 2014 state election rather than being in the best interests of the project or use of taxpayers' money.

There were also shortfalls in terminating the EWL project. Following final settlement of outstanding costs, the state will have incurred in excess of \$1.1 billion in costs on the project with little tangible benefit for taxpayers. This cost will be partially offset by the sale of properties acquired for the project, which the Department of Treasury & Finance (DTF) estimates are worth \$320 million.

The new government was also not provided with updated, comprehensive information on the impacts of completing the project versus the option of cancelling it. This meant it was deprived of comprehensive advice to assure it that termination was the best use of public funds.

Further, there was a failure to adequately ensure some of the settlement payment was not a windfall gain to contractors related to the project consortium. However, weaknesses in the *Audit Act 1994* meant that I could not obtain the information required to confirm this.

While the advice to government examined in this audit was generally comprehensive, in some critical instances it fell short of the required standard of frankness.

The bedrock of our system of public administration is that the public service is apolitical, impartial and has a fundamental obligation to provide frank and fearless advice to the government of the day. Frank and fearless advice should be complete—it is not sufficient for public servants to avoid providing advice or recommendations simply because they believe the government of the day does not want to hear them. Doing so is at odds with the *Public Administration Act 2004* and the *Code of Conduct for Victorian Public Sector Employees*, which require the public service to act impartially and seek to achieve the best use of resources.

This is an important matter and vigilance and leadership is required to protect the best traditions of the Victorian public service.

Audit team

Steven Vlahos and
Tim Maxfield
Engagement Leaders

Tony Brown
Team Leader

Ray Seidel-Davies
Jessica Cross
Daniel Mahoney
Analysts

Engagement Quality Control Reviewer

Dallas Mischkulnig

The EWL project has also highlighted a number of lessons that should be at the forefront of future infrastructure projects. These include the importance of transparency and scrutiny of the business case, and the risks of entering project contracts when other relevant processes, in this case, planning approvals, are unresolved and subject to legal challenge.

Large infrastructure projects take time to properly plan and implement and they should be determined on merit. That's why it is heartening that when announcing the creation of Infrastructure Victoria the government stated that it will take short-term politics out of infrastructure planning and support government decisions by assessing business cases for major projects based on objective, transparent analysis and evidence.

I have made a series of recommendations addressed to the departments of Premier & Cabinet (DPC) and Treasury & Finance which seek to address the underlying issues highlighted by this audit. Disappointingly, they have failed to acknowledge critical deficiencies identified by the audit, and have rejected its recommendations. In their response to this audit, they have also made a number of assertions and drawn inferences which fundamentally misrepresent the content of my report. I respond to these in detail at Appendix C and I would urge anyone interested in public administration to have close regard to the audit report, the responses of DPC and DTF, and to my further audit comments.

From its inception to its termination the EWL project was not managed effectively and it will become an important marker in the history of public administration in this state. This audit points out important and sobering lessons for government, the public officials who advise and serve it, and for taxpayers.



Dr Peter Frost
Acting Auditor-General

December 2015

Audit summary

The East West Link (EWL) was to be an 18 kilometre cross city road connecting the Eastern Freeway at Hoddle Street to CityLink, the Port of Melbourne precinct and on to the Western Ring Road at Sunshine West, with a range of associated works. It would have been one of the largest transport infrastructure projects ever undertaken in Australia, and significant in terms of its impact, complexity and cost.

The genesis for the EWL was the 2008 report *Investing in Transport: East West Link Needs Assessment* by Sir Rodney Eddington, which recommended a new 18 kilometre cross city road corridor to provide an alternative to the West Gate Bridge. During 2009, the then government developed a project proposal for what was known as the WestLink project.

Following the November 2010 state election, the WestLink project was effectively superseded by the development of a business case for the EWL.

The government considered a business case for EWL in April 2013 and decided to go ahead with the project, with the eastern section being commenced as Stage 1 of the project. The government decided to deliver the eastern section as a public private partnership (PPP), and following a competitive tender process finalised a project contract with East West Connect (EWC) to finance, design, construct, operate and maintain the road.

The contract was signed before the caretaker period leading into the November 2014 state election, just after the then Opposition indicated it would not proceed with the project. There was also an unresolved legal challenge to the planning approval for the project at the time. The Opposition had also indicated that if it formed government after the November 2014 election it would not defend the legal challenge to the planning decision.

Following the November 2014 election, the incoming government suspended work on the project and by June 2015 had reached agreement with EWC to terminate the project.

This audit assessed whether the state effectively managed the EWL project and related costs by assessing the:

- total costs of the project, including ongoing financial implications and risks associated with terminating the EWL project
- appropriateness of advice supporting key project decisions that influenced the project's outcomes and total costs
- lessons for future major projects.

Conclusions

If it had proceeded to completion, the entire EWL project would have cost in excess of \$22.8 billion in nominal terms. Limitations in the business case meant there was little assurance that the prioritisation of significant state resources to this project was soundly based.

Key decisions during the project planning, development and procurement phases were driven by an overriding sense of urgency to sign the contract before the November 2014 state election. The significant risks arising from this situation were further compounded by legal challenges to the project and by the absence of comprehensive advice on the potential benefits of deferring the signing of the contract.

Signing the contract in these circumstances was imprudent and exposed the state to significant cost and risk. The risks associated with this decision were increased when the state agreed to amend the contract to provide additional compensation to EWC if the legal challenge to the project planning approval succeeded. The available evidence suggests that the state knew at the time that there was a significant risk that this would happen.

These circumstances demanded comprehensive advice to government on its options and the best course of action for the state. However, advice to government in the lead-up to signing the contract fell short because it did not sufficiently assess the benefits of delaying finalisation of the procurement and contract to mitigate the risks posed by the unresolved judicial review. Instead, achieving the government's desired time line for contract signing was given disproportionate emphasis despite the risks and implications for the state.

The amount payable by the state under the termination settlement negotiated by the new government with EWC was substantially lower than the cost of terminating under the project contract. However, the decision to terminate was made without full consideration of the merits of continuing with the project. Failure to properly assess the benefits of termination against revised costs and benefits of continuing the project means the government was deprived of comprehensive advice to assure it that termination was the best use of public funds.

Further, the validity of project costs reimbursed by the state could not be fully verified because the state accepted EWC's refusal to allow access to the financial records of its related party contractors. This created a risk that EWC's related parties had a windfall gain.

Terminating the EWL project involved the expenditure of hundreds of millions of dollars for little tangible benefit. Following final settlement of outstanding costs, the state will have incurred costs in excess of \$1.1 billion. This includes costs for the acquisition of properties which the Department of Treasury & Finance estimates can be resold for around \$320 million. Pre-construction activities including design and geotechnical work and elements of the complementary projects may provide some value in the future.

Over the life of this costly and complex project, advice to government did not always meet the expected standard of being frank and fearless. This highlights a risk to the integrity of public administration that needs to be addressed. Action and leadership is required from government to reinforce these standards and the related expectations for public servants.

Findings

Project business case

The EWL business case did not provide a sound basis for the government's decision to commit to the investment because it did not:

- clearly establish the need for the investment through robust analysis of the costs, benefits and risks of reasonable options
- provide a sound basis for prioritising the eastern section over other sections of the road
- include sufficient information and evidence to demonstrate the accuracy and plausibility of the assumed wider economic benefits of the project, or the validity of underlying traffic modelling
- adequately address significant issues raised about the traffic modelling by peer reviewers.

The project delivery approach proposed in the business case was sound notwithstanding that undue weight was given to the government's desire to begin work on the project prior to the 2014 state election in the assessment of available options.

Establishing the project contract

The Linking Melbourne Authority (LMA) managed the procurement process well in challenging circumstances, completing it within the tight time lines stipulated by government at the outset of the project. The analysis and advice on the assessment of bids, and selection of the preferred bidder, was generally robust and conducted in accordance with the government's procurement requirements.

The uncertainty created by the unique circumstances in the lead-up to the decision on signing the contract warranted comprehensive advice to government on its options and the best course of action for the state. However, the advice to government did not:

- comprehensively examine the merits of alternative options, including delaying finalisation of the procurement and contract
- directly support or oppose the proposed timing of the transaction and neither identified nor recommended a course of action in the best interests of the state.

Notwithstanding this, the significant implications for the state arising from the unresolved legal challenge to the project planning decision prompted the then Department of Transport, Planning and Local Infrastructure and LMA to provide advice to government in August 2014 emphasising the importance of resolving the judicial review before the contract was signed. This advice indicated that an expedited court timetable was achievable, would deliver early certainty and would provide the best mitigation to the substantial cost and risk exposures to the state that existed at that time. Despite this advice the government decided not to seek an expedited hearing and LMA was instructed to proceed to contract close for the project before the state election in November 2014.

Despite the significance and complexity of the project and the risks and implications for the state, the focus on achieving this time line was given disproportionate emphasis. As a result, subsequent advice to government focused on options to mitigate identified risks if the government determined to proceed to contract close rather than considering and emphasising the merits of delaying signing.

If contract signing had been deferred until after resolution of the judicial review, the state's exposure under the non-standard contract provisions, which were accepted to secure EWC's execution of the contract, could have been avoided.

The contract signed by the state with EWC was standard in most respects and generally consistent with the standard commercial principles established by the National PPP Policy and Guidelines and the Partnerships Victoria requirements, as well as with recent precedent transactions. However, in departures from standard practice for PPP transactions in Victoria, the state agreed to the inclusion of clause 58—Specific Key Approval Event in the contract, and signed a side letter confirming the state's commitment to honour the contract. These variations from standard contractual terms were requested by EWC.

Clause 58 increased the state's exposure in circumstances where the planning approval decision was found to be invalid, as compared to the standard provisions of the contract. The risk and exposure for the state created by clause 58 was linked to the outcome of the judicial review of the planning decision for the project.

Given that the state was aware of the significant risk that the planning approval decision would be quashed, the decision to proceed to contract signing was, in effect, a 'gamble' that the judicial review proceedings would not impact the project significantly.

The only scenario under which the side letter can be argued to have created additional exposures for the state is one in which the state did not have the power to sign the contract. Legal advice obtained by government both before and after the election indicated that this was very unlikely.

Terminating the project

The total cost of the final termination settlement will be around \$642 million. This excludes state expenditure on the planning, development and procurement of the project, and is substantially less than an estimated amount—in excess of \$900 million—that would have been payable under the contract's termination for convenience provisions.

However, to achieve this outcome the state accepted limited verification of the funds spent by EWC and the risk that an EWC-related party contractor had a windfall gain. The government was not able to confirm the reasonableness of the expenditure it reimbursed or the assets it received because EWC refused to allow the state or its advisers access to information at a sufficiently detailed level.

The state's due diligence adviser reported in June 2015 that they were only provided with confirmation that payments had been made from EWC to its design and construction (D&C) and operations and maintenance contractors and that they did not have access to the contractors' supporting documentation. The adviser indicated that this meant it could not verify:

- what these contractors used the money for
- whether or not further undisclosed assets existed, and noted that the list of 'hard assets' was very short and the value immaterial
- whether any expenditure had been refunded
- whether EWC and the contractors took reasonable steps to mitigate expenditure following the issuing of the state's project suspension notice in December 2014.

The due diligence adviser indicated that this created a risk that a related party to EWC, particularly the D&C contractor, was holding either surplus cash, hard assets that were yet to be identified or prepaid assets capable of conversion into cash at a later date. Ultimately, this limited verification was accepted as part of the 'price paid' by the state to secure agreement by EWC to the terms of the settlement.

In an attempt to mitigate the risks identified by the due diligence adviser, the state sought warranties from EWC and its contractors that they had identified all hard assets and intellectual property acquired, and had complied with obligations under the contracts to mitigate project expenditure. However, the warranties provided were subject to limitations that meant they did not fully mitigate or address the risks identified by the state's due diligence adviser, and in particular did not directly address the risk that the D&C contractor was holding surplus cash.

The Auditor-General requested information from EWC and its contractors in July and August 2015 to address the gaps in the due diligence process undertaken by the state. These requests were refused. The Auditor-General does not have explicit power under the *Audit Act 1994* to require provision of such information by private parties.

The final termination agreements involved a different settlement outcome to that initially announced by the government in April 2015. The revised approach to the settlement was based on sound advice to government and delivered a better outcome for the state. The advice comprehensively examined the available approaches, settlement terms and related costs and risks. The strategy adopted was a practical solution to a highly complex situation.

However, only limited analysis was undertaken of the option to complete the project. Although the new government's intention to terminate the EWL project was clearly articulated at the November 2014 election when it was in Opposition, it did not at that time have access to complete and up-to-date information on the project's benefits and cost.

The new government was not provided with updated, comprehensive information on the impacts of completing the project versus the option of cancelling it, to provide a more complete assessment of the merits of terminating the contract. This meant it was deprived of comprehensive advice to assure it that termination was the best use of public funds.

Lessons

The *Public Administration Act 2004* (the Act) imposes an obligation on public officials to provide frank, impartial and timely advice to government. Meeting this obligation means there is sometimes a need to provide advice that a government may not necessarily want to receive.

While the advice to government examined in this audit was generally comprehensive, in some critical instances it fell short of the required standard of frankness. These instances involved advice that did not provide recommendations or that gave too much emphasis to the benefits of approaches that were in line with the government's preferred outcome and little emphasis to alternative options that could be argued were more aligned with the state's best interests.

Presenting options to government without a recommendation in circumstances where public officials know that the option favoured by government will expose the state to significant potential risks and costs is clearly not in the best interests of the state. It is not sufficient for officials in such circumstances to stop at disclosing the potential risks and consequences of the available options, they need to provide a recommended course of action.

The departments of Premier & Cabinet and Treasury & Finance disputed this and advise that the *Code of Conduct for Victorian Public Sector Employees* (the Code) requires the public service to implement government policy decisions once the government of the day has made a clear policy decision. This is a quite narrow reading of the Act and the Code because neither the Act nor the Code explicitly state or imply that the requirement to 'implement government policy' sits at the apex of public sector values.

This suggestion is also inconsistent with the objects set out in section 3 of the Act. The Act does not oblige public servants to implement government policy at any cost. Rather, it seeks a public service which responds to government policy priorities in a manner that is consistent with public sector values. Those values include:

- providing frank, impartial and timely advice to the government
- making decisions and providing advice on merit
- objectively considering all relevant facts and fair criteria
- seeking to achieve best use of resources
- using their views to improve outcomes on an ongoing basis.

The Act and Code empower and oblige public servants to act with integrity and, most importantly, with impartiality.

Some public officials involved in this audit indicated that providing frank and fearless advice when they believe a government does not want to receive it will negatively impact their influence or career opportunities. This belief is regrettable and if it becomes common in the public sector it poses a significant risk to the integrity of government decision-making and public administration, with consequential implications for the effective management of public resources and services.

Recommendations

Number	Recommendation	Page
That the Department of Treasury & Finance:		
1.	provides guidance to support whole-of-project cost tracking and reporting against budget for major projects that involve multiple stages managed by different agencies	17
2.	improves its business case development guidance material, the adherence to this guidance by agencies, and its quality assurance over key inputs by: <ul style="list-style-type: none"> • critically reviewing the analysis of options in business cases against the requirements of existing guidance material and providing feedback to agencies • developing further guidance on methods for transparently determining and quantifying wider economic benefits • strengthening its processes for reviewing and advising government on the adequacy of actions taken to address findings and recommendations arising from peer or other external reviews of key business case inputs such as economic and financial analyses, demand modelling, cost estimates and procurement options analyses 	30
3.	develops minimum standards and enhanced guidance for managing the risks associated with concurrent planning, scoping and procurement processes on major projects	45
4.	mandates the appointment of separate parties to undertake the probity advice and probity compliance review functions on High Value High Risk projects	45
5.	establishes clear guidance for the terms of future negotiations involving the state reimbursing expenditure by private entities, to require full disclosure and transparency of the underlying information and evidence.	56
That the Department of Premier & Cabinet:		
6.	consults with the Victorian Public Sector Commission to support further guidance to clarify the requirements for frank, impartial and timely advice in the public sector by: <ul style="list-style-type: none"> • establishing clear minimum standards for agencies on how to satisfactorily discharge this obligation when providing advice to government • advising government on strategies and options for addressing any cultural issues underpinning the serious deficiencies in the advice provided to government highlighted by this report. 	63

Submissions and comments received

Throughout the course of the audit we have professionally engaged with:

- the Department of Premier & Cabinet
- the Department of Treasury & Finance
- the Department of Economic Development, Jobs, Transport & Resources
- the Department of Environment, Land, Water & Planning
- the Department of Justice & Regulation and the Victorian Government Solicitor's Office
- the Linking Melbourne Authority
- VicRoads
- the Environment Protection Authority
- Planning Panels Victoria
- the Treasury Corporation of Victoria.

In accordance with section 16(3) of the *Audit Act 1994* we provided a copy of this report to those agencies and requested their submissions or comments.

We have considered those views in reaching our audit conclusions and have represented them to the extent relevant and warranted. Their full section 16(3) submissions and comments are included in Appendix C.



1 Background

1.1 Introduction

The East West Link (EWL) project was one of the largest transport infrastructure projects ever proposed in Australia. The full project included an 18 kilometre cross city road connecting the Eastern Freeway at Hoddle Street to CityLink, the Port of Melbourne precinct and the Western Ring Road at Sunshine West. Figure 1A shows the planned EWL.

Figure 1A
Planned East West Link



Source: Commonwealth Budget 2014–15.

In May 2013, the then government announced that funding had been allocated as part of the 2013–14 State Budget for the eastern section of EWL—to become known as Stage 1—at an estimated cost of between \$6 and \$8 billion.

Stage 1 consisted of the following main elements:

- a new tolled motorway linking Hoddle Street and CityLink—mainly via tunnel
- upgrades to both the Eastern Freeway and CityLink
- public transport enhancements north of the central business district.

The tolled motorway between Hoddle Street and CityLink was to be delivered by the end of 2019 in conjunction with the private sector under an availability public private partnership (PPP). This involved the private sector financing, designing, constructing and then operating and maintaining the road for 25 years in return for payments from the state based on the availability of the road. The state was to retain toll revenues and also the associated risk that demand might be lower than expected.

In May 2014, the state announced its commitment to deliver the western section of the EWL (Stage 2) at an estimated cost of between \$8 and \$10 billion with initial works commencing in 2015. Stage 2 involved connecting Stage 1 to the Western Ring Road and improving freight access to the Port of Melbourne precinct. Work on Stage 2 did not proceed substantively beyond the planning stage.

On 29 September 2014, the state appointed the East West Connect (EWC) consortium following a competitive tender, to finance, design, construct, operate and maintain the tolled motorway component of Stage 1. The project agreement (contract) included a new clause 58 in response to concerns about the potential impact of a legal challenge to the validity of the planning approval decision for the project which was pending at the time. In addition, the Treasurer issued a side letter to the consortium, reaffirming the state's commitment to honouring the contract and related payment obligations, in response to EWC's concerns about questions raised in relation to the state's power to enter the contract. Appendix A sets out the key features of the contract.

Consistent with public commitments made prior to the 2014 state election while it was in Opposition, in December 2014 the new government instructed the consortium to suspend works and commenced negotiations to terminate the contract.

On 15 June 2015, the state announced the final termination agreement and acquired the EWC business and associated project assets for \$1. The state paid EWC \$424 million to cover its claim for costs incurred on the project. This included \$81 million spent by EWC to establish a \$3.1 billion loan facility for the project. Under the termination agreements the state acquired the interest rate swap facilities established by EWC as part of the project financing to manage financing risks on the project. The cost of closing out this swap agreement position will depend on interest rate movements but was estimated at \$218 million at 30 June 2015.

As part of the termination the state also negotiated a \$3.1 billion uncommitted note issuance mandate, which gives the state discretionary access to future debt funding, with some members of the EWC banking group. This was a new agreement between the state—through Treasury Corporation of Victoria (TCV)—and the relevant banks and not the loan facility established by EWC for the project.

1.2 Key project events and decisions

Figure 1B outlines key events and decisions in the planning, development and management of the project up to its termination in June 2015.

Figure 1B
Key project events and decisions

Date	Event
April 2008	<i>Investing in Transport: East West Link Needs Assessment</i> report by Sir Rodney Eddington recommended a new 18 kilometre cross city road corridor to provide an alternative to the West Gate Bridge.
2009–2010	Linking Melbourne Authority (LMA) developed a project proposal for the WestLink project.
November 2010	State election.
October 2011	New government provided \$7.5 million to begin work on the EWL business case.
November 2011	EWL included in Victoria's submission to Infrastructure Australia.
December 2012	EWL eastern section declared under the <i>Major Transport Projects Facilitation Act 2009</i> (MTPFA) making it subject to the Act's assessment, approval and delivery requirements.
April 2013	Government approved the business case for the eastern section, allocated \$7.96 billion (nominal) to the project and approved its submission to Infrastructure Australia. Procurement of the project as an availability PPP was also approved.
May 2013	Funding provided for EWL in the Victorian 2013–14 Budget.
July 2013	Expressions of Interest invitation released for the PPP procurement of the eastern section of EWL.
September 2013	The government approved the short-listing of three consortia to participate in the Request for Proposal.
October 2013	Request for Proposal tender documentation released to three short-listed respondents.
November 2013	Comprehensive Impact Statement released for public viewing as part of the statutory planning process for the project.
April 2014	Final proposals submitted by the three short-listed respondents.
June 2014	\$1.5 billion in funding given by the Commonwealth Government for EWL subject to a memorandum of understanding on its use. Minister for Planning issued an approval decision for the project under MTPFA.
July 2014	Moreland and Yarra City Councils filed court proceedings challenging the Minister for Planning's statutory planning approval decision for the eastern section.
September 2014	The Opposition announced that if elected it would scrap the EWL project—pending result of the councils' legal challenge. Project contract signed between the state and EWC. Side letter signed by the Treasurer.
November 2014	State election.
December 2014	Work on EWL project suspended.
April 2015	State signs Heads of Agreement with EWC to facilitate contract termination.
June 2015	EWL termination deal finalised.

Source: Victorian Auditor-General's Office.

1.3 Project governance and management

1.3.1 Decision-making on the East West Link project

Key decisions on the EWL project were made by government through the Cabinet process. The Cabinet made decisions following consideration of advice and/or recommendations from the Minister for Roads and relevant departments and agencies. The Premier and Treasurer also made project decisions.

The government decision-making process was supported by a project steering committee that included senior representatives from the former Department of Transport, Planning and Local Infrastructure—now the Department of Economic Development, Jobs, Transport & Resources (DEDJTR)—LMA, VicRoads, the Department of Treasury & Finance (DTF) and the Department of Premier & Cabinet (DPC).

The EWL project was declared under MTPFA in December 2012 for statutory planning assessment, approvals and project delivery. MTPFA was selected because it is a process specifically designed for projects like EWL. MTPFA combines planning and delivery powers under one Act, and consolidates approvals under 11 separate Acts into a single decision by the Minister for Planning. In addition to consolidating approvals, MTPFA also provides time line certainty.

1.3.2 Agencies involved in planning and development of the project

Department of Economic Development, Jobs, Transport & Resources

DEDJTR was responsible for whole-of-project scope and budget as well as designing the tolling policy for when the road was operational. DEDJTR provided oversight of LMA (which managed and had financial oversight of Stage 1 of the project), and established the EWL steering committee which undertook the core coordination role. DEDJTR was responsible for preparing the final EWL project business case.

Linking Melbourne Authority

LMA was a statutory authority, established in July 2010, as the successor to the Southern and Eastern Integrated Transport Authority. LMA was established to manage complex road projects and was accountable to the Minister for Roads.

The LMA was given responsibility by the government to deliver Stage 1 of the EWL project, including financial oversight, budget monitoring and financial reporting. It was also responsible for the initial development of the business case, statutory planning, developing the Expressions of Interest and Request for Proposal procurement documents, evaluating the bidder's proposals, selecting a preferred bidder and leading negotiations with this bidder to prepare contractual documentation for the project.

In January 2015, the government announced that LMA was to be abolished following the decision to suspend and ultimately discontinue the EWL project.

Department of Treasury & Finance

DTF was responsible for the commercial principles and financial structuring of the project—including structuring revenue and tolling risk transfer. DTF was represented on the project steering committee, which had direct involvement in the governance and management of the project.

DTF also had direct involvement with the contractual and financial arrangements between the state government, Commonwealth Government and EWC. It also provided financial forecasts and assessments, and negotiated with Transurban—the operator of CityLink—on the interface of the proposed EWL with the CityLink toll road.

VicRoads

VicRoads provided technical advice for Stage 1 of the project—road based corridor planning and assessment—and was responsible for the planning and delivery of complementary works on both the eastern and western sections such as the Eastern Freeway upgrade and Doncaster Area Rapid Transit bus upgrade.

Department of Premier & Cabinet

DPC was represented on the project steering committee and provided briefings and advice to government on the progress of the project from planning through to the signing of the contract.

1.3.3 Agencies with a limited role in the planning and development of the project

Department of Environment, Land, Water & Planning

The Department of Environment, Land, Water & Planning—formerly the Department of Transport, Planning and Local Infrastructure—provided advice and support to the Minister for Planning, to inform his approval decision for the project under MTPFA.

Planning Panels Victoria

The Minister for Planning appointed an Assessment Committee under MTPFA to consider the matters associated with the proposed EWL Comprehensive Impact Statement.

The committee conducted public hearings and considered submissions on the Comprehensive Impact Statement from LMA, the Minister for Planning, several councils—Melbourne, Yarra, Moonee Valley, Moreland and Darebin—the Environment Protection Authority (EPA) and a number of community groups. The committee reported to the minister on 30 May 2014 with 43 recommendations.

Environment Protection Authority

Under the *Environment Protection Act 1970* the construction of twin multi-lane road tunnels (with ventilation systems) for Stage 1 of EWL required a works approval from the Minister for Planning. EPA's role was to advise the minister whether a works approval should be issued and what conditions, if any, it should be subject to.

Treasury Corporation of Victoria

TCV was engaged by LMA to provide market interest rate benchmarking services at the signing of the project contract.

Victorian Government Solicitor's Office—Department of Justice & Regulation

The Victorian Government Solicitor's Office (VGSO) and counsel engaged by VGSO provided legal advice to the government on the legal challenges to the validity of the Minister for Planning's EWL project planning approval decision under MTPFA, as well as advice on the power of the state to enter into the contracts with EWC and the side letter.

1.3.4 Agencies involved in the termination of the project

Department of Premier & Cabinet

DPC led implementation of the new government's policy decision that the project would be terminated. DPC was responsible for negotiating a settlement and termination agreement with EWC.

Department of Treasury & Finance

DTF was responsible for seeking to achieve the 'repurposing' of the EWC project loan facility as part of the termination negotiations with EWC and its financiers.

Treasury Corporation of Victoria

TCV provided assistance to DTF on the negotiation and termination of the project finance documents. TCV also assisted DTF in the implementation and management of an interest rate hedge strategy, to limit the interest rate exposure associated with the interest rate swap that transferred from EWC to the state under the termination agreements.

1.4 Audit objective and scope

Audit objective

The objective of the audit was to determine if the state effectively managed the EWL project and related costs by assessing the:

- total costs of the project, including ongoing financial implications and risks associated with terminating the project
- appropriateness of advice supporting key project decisions that influenced the project's outcomes and total costs
- lessons for future major projects.

Audit scope

The audit examined the:

- governance and management arrangements for the project
- key project events and decisions and the soundness of the advice underpinning key government decisions
- costs associated with project planning, procurement and termination, including risks and future obligations of the state arising from the termination
- outcomes of any lessons learned analysis performed by relevant departments and agencies on this project.

The audit included the following departments and agencies:

- the Department of Premier & Cabinet
- the Department of Treasury & Finance
- the Department of Economic Development, Jobs, Transport & Resources
- the Department of Environment, Land, Water & Planning
- the Department of Justice & Regulation and the Victorian Government Solicitor's Office
- the Linking Melbourne Authority
- VicRoads
- the Environment Protection Authority
- Planning Panels Victoria
- the Treasury Corporation of Victoria.

1.5 Audit method and cost

The audit was conducted in accordance with section 15 of the *Audit Act 1994* and the Australian Auditing and Assurance Standards. Pursuant to section 20(3) of the *Audit Act 1994*, unless otherwise indicated any persons named in this report are not the subject of adverse comment or opinion.

The total cost of the audit was \$630 000.

1.6 Structure of the report

The report is structured as follows:

- Part 2 examines the project cost
 - Part 3 examines the project planning and business case
 - Part 4 examines the procurement and contracting of the project
 - Part 5 examines the termination of the project
 - Part 6 sets out lessons for future major projects.
-

2 Project costs

At a glance

Background

The East West Link (EWL) project was one of the largest transport infrastructure projects ever proposed in Australia. It was to be delivered in two stages. Prior to the November 2014 state election, work had commenced on Stage 1, the eastern section, with limited progress on Stage 2, the western section. Following the November 2014 state election, after significant costs had been incurred, the new government terminated the project.

Conclusion

The EWL project was terminated in June 2015 with more than \$1.1 billion paid, or expected to be paid, by the state for little tangible benefit. This cost will be partially offset by future proceeds from the sale of properties acquired for the project. The Department of Treasury & Finance estimates that these properties can be resold for around \$320 million.

Findings

- The arrangements in place to track costs for Stage 1 were mostly comprehensive and robust.
- Monitoring of expenditure against the approved project budget was undertaken and regularly reported for Stage 1 to the EWL steering committee. However, despite only minimal costs being incurred on Stage 2, there was no whole-of-project monitoring and reporting on costs.

Recommendation

That the Department of Treasury & Finance provides guidance to support whole-of-project cost tracking and reporting against budget for major projects that involve multiple stages managed by different agencies.

2.1 Introduction

In May 2013, the state announced its intention to proceed with Stage 1 of the East West Link (EWL) project at an estimated capital cost of \$6 to \$8 billion. Following a competitive tender process the state appointed a consortium—East West Connect (EWC)—to finance, design, construct, operate and maintain Stage 1.

In May 2014, the state announced its commitment to deliver Stage 2 at an estimated capital cost of \$8 to \$10 billion with initial works commencing in 2015.

In June 2014, the Commonwealth Government committed funding of \$3 billion for the EWL project—\$1.5 billion each for Stages 1 and 2. It paid the state \$1.5 billion in June 2014 comprising \$500 million for Stage 1 works and \$1 billion for Stage 2 works.

Following the 2014 state election, the new government instructed EWC to suspend works on Stage 1 and commenced negotiating a termination settlement, which was finalised on 15 June 2015.

This Part of the report examines the financial implications of the project, considering both the termination and the outcome had the project progressed to completion. It also considers the management and reporting of costs by the key entities involved.

2.2 Conclusion

The estimated total project cost of Stages 1 and 2 of EWL, had it proceeded to completion, was in excess of \$22.8 billion in nominal terms over the life of the project. This funding was to be met primarily through imposing tolls on users of the road, with \$3 billion provided by the Commonwealth Government, and the Victorian Government meeting the remaining costs, including taking on the risk that toll revenue might be lower than expected.

The EWL project was terminated in June 2015 with more than \$1.1 billion paid, or expected to be paid, by the state. This cost will be partially offset by future proceeds from the sale of properties acquired for the project. The Department of Treasury & Finance (DTF) estimates that these properties can be resold for around \$320 million.

This significant expenditure will yield little tangible benefit. Pre-construction activities including design and geotechnical work and elements of the complementary projects may provide some value in the future.

2.3 Actual and expected project costs

The EWL project was terminated in June 2015 at an expected total cost to the state in excess of \$1.1 billion. This includes expenditure on the planning, development, procurement and termination of the project.

2.3.1 Costs incurred on the eastern section

Figure 2A shows the total costs for the state associated with Stage 1 including actual costs incurred up to 30 June 2015, and costs expected to be incurred after 30 June 2015 relating to the final settlement of outstanding costs on the project.

Figure 2A
Stage 1 total costs

Item	Costs (\$ '000)
Actual project expenditure at 30 June 2015	
Business case development	26 045.5
Property acquisition costs	276 915.0
Complementary projects	5 668.8
Other state costs	124 784.8
Termination payments made to EWC	424 093.8
Cost of advice on termination	3 176.2
Total costs to 30 June 2015	860 684.1
Expected future costs	
Settlement of interest rate swap on EWC loan facility	217 889.7
Settlement of outstanding property acquisitions and legal cases	75 378.6
Completion of complementary projects	4 003.6
Total estimated future costs	297 271.9
Summary of actual and expected costs by project phase	
Planning, developing and establishing the EWL project ^(a)	503 123.9
Terminating the EWL project ^(b)	645 159.7
Other costs: complementary projects	9 672.4
Total costs	1 157 956.0

(a) The total costs for planning, developing and establishing the project includes costs for business case development, property acquisition, and other state costs including procurement and contract establishment.

(b) The total costs for terminating the project includes termination payments to EWC, the expected future cost of settling the interest rate swap and the costs of advice on termination.

Source: Victorian Auditor-General's Office.

Figure 2A includes around \$350 million in costs relating to property acquisitions. These properties have been offered back to their original owners and a sales strategy is currently being developed for the remaining properties. DTF estimates that these properties can be resold for around \$320 million.

The costs of the project will also be offset by rental revenue on acquired properties and any proceeds from the sale of assets acquired from EWC as part of the termination settlement.

Interest rate swaps

The termination settlement involved the state assuming the interest rate swap established by EWC for its loan facility. The state will realise a loss when it finalises this swap.

An interest rate swap is a financial instrument in which two parties agree to 'exchange' interest rate cash flows or the amount of interest they pay, which effectively results in the parties paying—or receiving—a different interest rate to the rates in their agreements with their financiers. Interest rate swaps assist entities to manage their cash-flow requirements and interest rate risk exposure.

As part of the financing arrangements, EWC entered into an interest rate swap with five of the major financiers providing the loan facility—two major Australian banks and three international banks.

The swap arrangement allowed EWC to effectively pay a fixed instead of a variable interest rate during the construction period. This is a standard component of public private partnership (PPP) financing arrangements as it provides the state with some certainty of the future payments that will be required once the PPP enters the operational period.

The value of the interest rate swap at 30 June 2015 was \$217.9 million. The state will be required to pay the value of the interest rate swap when the arrangement is closed. The amount will depend on interest rates at that time.

2.3.2 Costs incurred on the western section

Stage 2 was still in early planning and development and therefore the procurement method had not been determined by the time the project was terminated. Total costs incurred on the western section to 30 June 2015 were \$15.2 million, comprising:

- costs incurred by the Department of Economic Development, Jobs, Transport & Resources (DEDJTR) in completing the detailed planning work and the interim business case
- costs relating to a package of early works completed by VicRoads, which were passed on to DEDJTR.

2.4 Project costs if it proceeded

The estimated total project cost of EWL had it proceeded to completion was in excess of \$22.8 billion in nominal terms over the life of the project. This estimate is detailed in Figure 2B and is based on approved business cases and budgets and the financial modelling for the PPP.

Figure 2B
Total estimated cost in nominal terms (\$ billion)

Item	Budget (nominal)
Stage 1	
PPP ^(a)	10.697
Other state costs	2.095
Total Stage 1 expenditure	12.792
Stage 2 ^(b)	10.000
Total project expenditure	22.792

(a) The Present Value equivalent for this amount is \$4.3 billion discounted to 30 June 2013.

(b) The total estimated cost for Stage 2 did not include costs for operation and maintenance during its operating phase.

Source: Victorian Auditor-General's Office.

The project was to be funded by the Commonwealth Government, state government and by road users through tolling arrangements.

2.4.1 Eastern section

Project cost and funding

Figure 2C shows the total budget for Stage 1 of the EWL project, based on the outcomes of the tender process that appointed EWC.

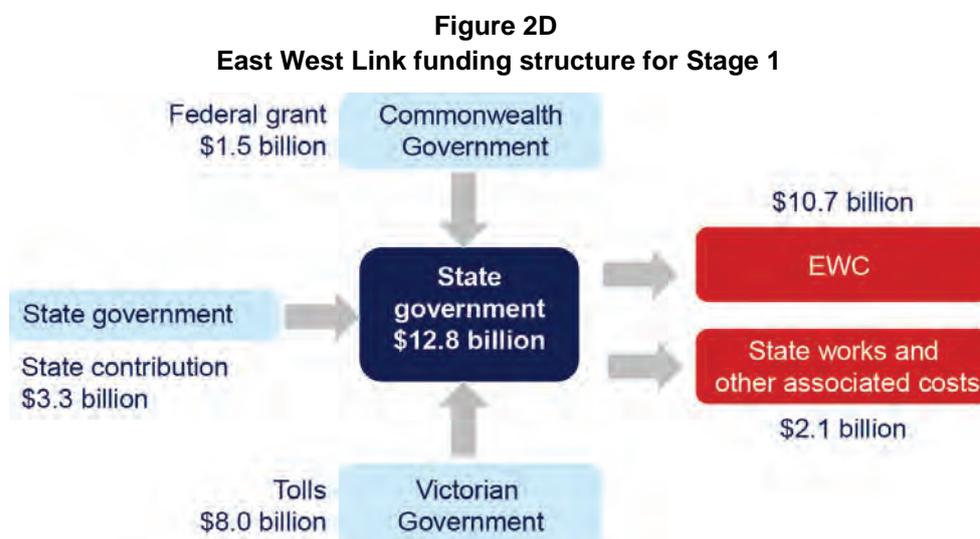
Figure 2C
Total budgeted eastern section costs (\$ billion)

Item	Budget
Costs related to PPP agreement with EWC^(a)	
Design and construction	4.336
Operations and maintenance	3.279
Financing costs	3.082
Total PPP costs	10.697
Other state costs	
Business case development	0.027
Property acquisition	0.515
Complementary projects	0.400
Pre-agreed modifications	0.169
Other design and construction period costs	0.559
Risk and contingency	0.382
Operations and maintenance period costs	0.043
Total other state costs	2.095
Total	12.792

(a) As at financial close, October 2014.

Source: Cabinet submission, financial model for the PPP and Victorian Auditor-General's Office.

Figure 2D shows how the funding for Stage 1 was structured.



Source: Victorian Auditor-General's Office.

Toll revenue

The majority of the costs of Stage 1 of EWL were to be met by tolls on users of the road. Under the PPP terms, the government would collect and retain toll revenue. Actual toll revenue collected would not affect the payments to the road operator. This was different to the models previously used for Victorian tolled road infrastructure—i.e. CityLink and EastLink—where the private road operators charge and collect tolls directly, and therefore bear the risk that revenue will be lower than expected. In the event that EWL traffic volumes were lower than expected, the state would have been required to fund any shortfall, but the state would have benefited from higher than forecast traffic volumes.

Commonwealth Government funding

On 28 June 2014, the government entered into a memorandum of understanding (MoU) with the Commonwealth Government under the *National Partnership Agreement on Land Transport Infrastructure Projects*. Under the MoU, the Commonwealth committed \$1.5 billion funding for Stage 1, of which \$500 million was received by the state in 2013–14. The early receipt of funds allowed for interest to be earned on the contribution, which could then be applied as a further offset against the state costs.

State government funding

As part of the business case, it was identified that for very large projects—those with a capital cost in excess of \$2 billion—a funding contribution from the state may be required to address issues associated with the size of the debt funding required and available funding from debt markets. As a result, in October 2013, the government approved contributions to be made to the selected PPP partner for Stage 1:

- \$2 billion to be made available during construction—\$1.5 billion of which was to be funded from the Commonwealth Government funding contribution plus \$0.5 billion from the state
- \$1 billion to be made available two years after construction was complete, fully funded by the state.

2.4.2 Western section

The 2014–15 State Budget included an initial capital budget for Stage 2 of the project of \$10 billion. This included \$4 million of funding in 2013–14 and \$100 million in 2014–15 to finalise the business case and commence planning work.

The MoU with the Commonwealth Government also included \$1.5 billion in funding for Stage 2, \$1 billion of which was received in 2013–14.

The initial package of works for Stage 2—the upgrade of Paramount Road and Ashley and Dempster Streets—was to commence construction by the end of 2015 to meet the Commonwealth Government's funding conditions.

2.5 Monitoring of project costs

The arrangements in place for agencies to track EWL costs were mostly comprehensive and robust. However, there was no regular monitoring and reporting of costs against budget at the whole-of-project level.

2.5.1 Eastern section

As part of the project governance arrangements, the then Department of Transport, Planning and Local Infrastructure (DTPLI) established the EWL steering committee whose responsibilities included endorsing all recommendations to the Minister for Roads and to Cabinet, including those in regards to whole-of-project scope and budget management.

The steering committee's meeting agendas and minutes indicate that regular reports were provided by the key operational entities for the project—the Linking Melbourne Authority (LMA), DTPLI, the DTF and VicRoads. LMA tracked its own expenditure against the approved project budget together with costs for which other departments and agencies sought reimbursement. LMA reported this information to the EWL steering committee.

The regular reports from departments and agencies were generally noted in the steering committee meetings. However, there was little documentation of discussions that may have occurred and questions that may have been asked. The steering committee only considered Stage 1 and not Stage 2.

2.5.2 Western section

For Stage 2, DEDJTR established a project code in its finance system against which project costs were charged. There was no evidence of regular monitoring and reporting of costs against budget for Stage 2 or at the whole-of-project level.

2.5.3 Departments and agencies

Figure 2E summarises the responsibilities of departments and agencies and to what extent project costs were tracked.

Figure 2E
Agency responsibilities and cost tracking

Agency	Role	Costs tracked
LMA	Lead development of the business case and project manager of Stage 1.	All costs were tracked and recorded.
DEDJTR	Lead department for the project. Stage 2 development was managed by an administrative office within the department.	Staffing costs were not tracked. Other costs were recorded and tracked for Stages 1 and 2.
VicRoads	Contributor to development, as well as project manager for a number of separate components.	All costs were tracked and recorded, however, not all were passed on to LMA.
DTF	Involved in reviewing the business case and the structuring of the PPP arrangement. After suspension of the project, involved in assessing solutions for the financing arrangements.	Staffing costs were not tracked. External costs during the PPP procurement process were the only costs passed on to LMA.
Department of Premier & Cabinet	Represented on the steering committee prior to termination. Responsible for managing termination negotiations with EWC.	Staffing costs were not tracked. External costs during the termination were tracked.
Department of Environment, Land, Water & Planning	Provision of advice and performance of statutory functions in relation to the statutory planning assessment and approvals processes.	Staffing costs were not tracked. Planning functions were transferred from DEDJTR—formerly DTPLI—as a result of machinery-of-government changes. Relevant financial information resided in DEDJTR systems and it provided information on external costs.

Figure 2E
Agency responsibilities and cost tracking – continued

Agency	Role	Costs tracked
Victorian Government Solicitor's Office	Provision of legal advice relating to the project, including in relation to court action.	Operates on a fee-for-service model, with all costs passed on to the relevant agency.
Planning Panels Victoria	Provision of administrative support to the Assessment Committee appointed under the <i>Major Transport Projects Facilitation Act 2009</i> .	Operates on a full cost recovery basis, with all costs passed on to LMA.
Environment Protection Authority	Assessment of the Comprehensive Impact Statement and works approval application, including making a submission to the Assessment Committee.	Costs were not tracked, however, the Environment Protection Authority was able to provide a reasonable estimate of the costs they incurred.
Treasury Corporation of Victoria	Interest rate benchmarking services at financial close of the PPP and involvement in assessing and managing solutions for the financing arrangements.	Work conducted prior to termination was under a fee-for-service arrangement. Costs after project termination were not tracked, however, TCV was able to provide a reasonable estimate.

Source: Victorian Auditor-General's Office.

Some departments did not capture the staff costs attributable to the EWL project. For example DTF, Department of Premier & Cabinet, and DEDJTR staff do not complete timesheets, and therefore internal staff costs were not captured and included as part of the project cost. These departments only passed on costs associated with external consultants to LMA.

Recommendation

1. That the Department of Treasury & Finance provides guidance to support whole-of-project cost tracking and reporting against budget for major projects that involve multiple stages managed by different agencies.

3 Planning the project

At a glance

Background

The East West Link (EWL) project was one of the most significant investments ever proposed for the state in terms of impact, complexity and cost. In October 2011 the government approved funding for the development of a business case for the project. In April 2013, the government approved the eastern section of EWL to proceed as Stage 1 of the project, based on the March 2013 business case.

Conclusion

The business case, which is a critical step in any major project, did not provide a sound basis for the government's decision to commit to the investment because it did not clearly establish the need for the investment through a robust analysis of the costs, benefits and risks of reasonable options.

Findings

- The business case did not provide a sound basis for prioritising the eastern section over other sections of the road.
- There was insufficient information and evidence in the business case to demonstrate the accuracy and plausibility of the assumed wider economic benefits of the project, or the validity of underlying traffic modelling.
- The business case did not address significant issues raised by peer reviewers.

Recommendation

That the Department of Treasury & Finance improves its business case development guidance material, the adherence to this guidance by agencies, and its quality assurance over key inputs to project business cases.

3.1 Introduction

The East West Link (EWL) project was one of the most significant investments ever proposed for the state in terms of impact, complexity and cost. In October 2011 the government approved funding for the development of a business case for the project. The business case was developed between late 2011 and mid-2013.

In April 2013, the government approved the eastern section of EWL to proceed as Stage 1 of the project based on a March 2013 business case. The business case was subsequently updated with the final version noted by government in September 2013.

The former Department of Transport and former Department of Transport, Planning and Local Infrastructure—now the Department of Economic Development, Jobs, Transport & Resources (DEDJTR)—were responsible for developing the business case, and were supported by the Linking Melbourne Authority.

3.2 Conclusion

The EWL business case did not provide a sound basis for the government's decision to commit to the investment. Gaps and weaknesses in the business case—including a failure to adequately address the issues raised by external reviews of key underlying information—meant that it did not clearly establish the need for the investment through a robust analysis of the costs, benefits and risks of reasonable options.

Further, the business case did not provide a sound basis for prioritising the eastern section over other sections of the proposed road.

These issues mean there was little assurance that the prioritisation of significant state resources for this project was soundly based.

The proposed project delivery approach was sound, however, the assessment of options appears to have given undue weight to the government's desire to begin work on the project prior to the 2014 state election.

3.3 Project planning and development timing

While no public commitments were made on the timing of the project in 2011 when the government agreed to fund the business case, it is clear that the government was focused from the outset on accelerating the planning and development of the project.

Figure 3A outlines key events in the project planning phase.

Figure 3A
Key events in the project planning phase

Timing	Events
October 2011	Government committed funding for development of a business case for the EWL project.
June 2012	Government approved a forward program for the project requiring: <ul style="list-style-type: none"> the business case to be completed by the end of 2012 project statutory planning approvals to be finalised by the end of the first quarter in 2014 procurement to be completed by the fourth quarter in 2014 construction to commence in October 2014, before commencement of the caretaker period for the state election.
October 2012	Government was advised that the business case was on track for completion by the end of 2012 and that: <ul style="list-style-type: none"> the eastern section was favoured as Stage 1 of the project toll revenue for Stage 1 was expected to be significantly below the overall project cost market soundings indicated very little private sector appetite for fully taking on the risk that actual demand for the road would not meet forecast demand—i.e. the traditional toll road model adopted for CityLink and EastLink.
March 2013	The business case was completed and this formed the basis for key government decisions on the project.
April 2013	The government considered the March 2013 business case and endorsed the base case and a number of complementary works including an Eastern Freeway upgrade and public transport enhancements to the north of the Melbourne central business district.
June 2013	The March 2013 business case was revised and finalised. The state publicly released an updated 'short-form' summary business case and presented a more detailed version of the short-form business case to Infrastructure Australia that did not include the analysis and assumptions underpinning the updated economic assessment.
September 2013	Government endorsed the final consolidated business case, which was an update to the March 2013 case considered by government in April 2013, and consolidated relevant work completed up until June 2013 for the purposes of preparing the publicly available short-form business case. This last business case included the final economic assessment, and related financing, tolling and procurement strategies.

Source: Victorian Auditor-General's Office.

In April 2012, the government was advised of the risk of legal challenges to the progress of the project. Other advice to government on the project similarly highlighted risks to robust decision-making due to the emphasis on meeting the government's challenging time frame.

The government considered this advice but did not agree to allow additional time for project planning and development. In June 2012 the government approved a target forward program for the project that required construction to commence in October 2014, before the caretaker period for the November 2014 state election. This required concurrent activity on project development and statutory planning processes including approvals, procurement and contracting.

In addition, the government's target time line for the project was given undue weight by the then Department of Transport in arriving at their recommendation in the business case on the procurement and project delivery approach, and associated risk allocation.

3.4 The business case

The Department of Treasury & Finance (DTF) defines a business case as a 'document that forms the basis of advice for executive decision-making for an asset investment. It is a documented proposal that considers alternative solutions and identifies assumptions, benefits, costs and risks'. It is generally accepted that a robust business case is critical to the success of an investment.

The business case initially completed for the project in March 2013 formed the basis for government decisions. This business case was subsequently revised and finalised in June 2013.

The March 2013 business case indicated that the eastern section of the project had weak direct economic benefits arising from the core eastern section project scope and the investment merit relied on wider economic benefits (WEB).

A benefit cost ratio (BCR) of less than 1 indicates the benefits of the investment are less than the costs. Excluding complementary projects and WEBS, the direct BCR was 0.45. Including both WEBS and a range of complementary projects achieved a BCR above 1. This position was not significantly changed when the business case was revised in June 2013.

Figure 3B shows the BCRs disclosed in the March 2013 and June 2013 business cases.

Figure 3B
East West Link project (eastern section) benefit cost ratios

	BCR	
	March 2013 business case	June 2013 business case
Base case^(a)		
Excluding WEBs	0.45	
Including WEBs	0.84	
Base case plus complementary projects^(b)		
Excluding WEBs	0.7	0.8
Including WEBs	1.2	1.4

(a) Comprised the eastern section and a package of integrated land use and public transport initiatives, but not complementary projects such as the Eastern Freeway upgrade. The BCR analysis excluded costs and benefits from urban renewal and public transport initiatives.

(b) Comprised the eastern section and a package of integrated land use and public transport initiatives plus complementary projects including the Eastern Freeway upgrade, public transport improvements and CityLink widening. The BCR analysis excluded costs and benefits from urban renewal and active transport initiatives.

Source: Victorian Auditor-General's Office.

DTF guidelines on economic evaluation for business cases acknowledge that traditional BCR analysis has limitations and is not recommended as the sole quantitative assessment tool for decision-making purposes because it is biased towards small projects and those with early returns.

The March 2013 and later updated business cases:

- set out the strategic rationale for pursuing EWL over other transport investments
- proposed the eastern section as the preferred option for Stage 1 of the project over the other sections—despite the western section likely having a higher BCR
- presented a base case comprising a tolled motorway between Hoddle Street and CityLink, as well as additional options for complementary public transport works with the potential to deliver added benefits over the base case.

However, these business cases did not provide a sound basis for the government's decision to commit to the investment due to weaknesses in the:

- rigour of the economic assessment—specifically the accuracy of the estimates of WEBs and the reliability of the traffic modelling
- basis for prioritising the eastern section over other sections.

As a result the business case did not clearly establish the need for the project by robustly assessing the costs, benefits and risks of reasonable options.

3.4.1 Economic assessment

DTF's Investment Lifecycle guidance emphasises that robust economic evaluation of investment proposals is a vital component of the business case, to support informed investment decision-making by government.

The economic analysis underpinning the EWL business case was developed by a consultant in 2012 and updated during 2013. This analysis was subject to a range of qualifications and caveats due to its preliminary nature given the tight time frames for completing the business case.

Figure 3C summarises the results of the economic assessment in the March 2013 business case as well as the revised assessment in the June 2013 business case.

Figure 3C
Economic assessments in business cases
(\$ million in present value terms)

Costs and benefits	March 2013	June 2013	Difference	Percentage difference
Costs				
Capital costs	3 707	3 739	32	1
Recurrent operating and maintenance costs	293	339	46	15
Total costs	4 000	4 078	78	2
Benefits				
User benefits				
• Travel time savings—car and commercial vehicle	1 083	2 079	996	92
• Travel time savings—public transport users	5	240	235	4 700
• Travel time reliability improvement	88	192	104	118
• Vehicle operating cost savings	420	651	231	55
• Corridor redundancy—interoperability of West Gate Bridge and CityLink tunnels	66	66	0	0
Externalities				
• Air emissions externality cost savings	33	27	-6	-18
• Other externality cost savings	-41	-141	-100	-244
• Crash cost savings	23	39	16	70
Avoided public transport costs	n/a	35	35	100
Residual value of assets	136	153	17	13
WEBs				
• Agglomeration benefits	1 514	2 153	639	42
• Labour supply and competition benefits	31	61	30	97
Total benefits	3 358	5 555	2 197	65
Economic appraisal results				
BCR	0.8	1.4	0.6	75
Net present value	-642	1 476	2 119	330

Note: The June 2013 business case was based on the final approved project scope which included a number of complementary projects.

Source: Victorian Auditor-General's Office.

Figure 3C shows significant increases between the March and June 2013 business cases in the value of estimated benefits in a number of important categories, such as travel time and reliability savings and WEBs. It is important to note that these increases were primarily due to the refinement and resolution of the project scope following the government's consideration of the March 2013 business case. Despite this, the June 2013 business case did not fully explain the basis for these increases in claimed benefits.

Wider economic benefits

The EWL business case relied heavily on the inclusion of estimated WEBs to support the assertion that the project was of net benefit. Without these WEBs, which were unusually high as a proportion of total benefits, the project cost was clearly higher than the expected benefits.

WEBs relate to economic benefits that are not typically captured in traditional cost-benefit analysis. Commonly considered WEBs include:

- 'agglomeration' impact (an increase in productivity due to improved proximity to suppliers and labour markets)
- the impact of transport on increasing competition
- competition related user benefits.

The DTF guidelines indicate that WEBs are most relevant to transport and other large infrastructure projects. However, guidance materials from DTF and Infrastructure Australia indicate caution should be exercised when estimating and considering WEBs as part of the economic assessment of projects.

DTF's guidelines note that the extent to which WEBs exist over and above benefits counted in the standard economic evaluation is not yet clear, and will depend on the nature of the project under consideration.

The June 2013 business case does not provide sufficient information to explain the basis for the significant change in WEBs from the March 2013 business case.

This was important, because an external peer review of the March 2013 business case raised significant issues with the plausibility of the level of WEBs claimed for the project in terms of their ratio to total benefits. Specifically it stated:

- 'initial observations are that the ratio between core travel benefits and WEBs is very atypical with the latter being much higher as a proportion of overall benefits than would normally be expected
- a thorough review of the literature has confirmed our knowledge and experience that WEBs...typically represent around 10–40 per cent of the traditional benefits
- the higher values are for CrossRail in London where WEBs have been estimated 40–50 per cent....mainly [due] to the ability of CrossRail to allow tens of thousands of additional workers to access high value jobs in more productive areas that would otherwise simply not have been possible. This is an extreme situation that is certainly not replicated in Melbourne with the East West Link'.

The peer review concluded that the relationship between the standard user benefits and the WEBs was so highly unusual that they warranted a detailed discussion and explanation if they were not to be discounted as implausible.

The final business case did not satisfactorily address this issue. It only provides a high-level discussion of the approach used to calculate the WEBs and does not specifically address the issues identified by the peer review. As a result, the information included in the business case offered insufficient assurance about the robustness and reliability of the estimated WEBs for EWL.

Limitations of traffic modelling

Around 70 per cent of the estimated \$3.2 billion in direct benefits from the project related to estimated travel time savings derived from traffic modelling undertaken in 2012 and updated in 2013 for the final June 2013 business case.

The then Department of Transport commissioned two peer reviews to examine the traffic modelling. A detailed peer review of the traffic modelling approach, inputs and outputs was undertaken in December 2012 and a broader peer review of the economic analysis underpinning the business case in March 2013 also commented on the traffic modelling.

The December 2012 peer review identified a number of issues impacting on the reliability of the traffic forecasts, including assessments of wider congestion impacts. The peer reviewer concluded that it was more likely that the demand would be lower, rather than higher, than the traffic forecasts relied on in the business case. However, the reviewer indicated that the traffic model used was reasonable for that stage of the business case development process. The peer review made 21 recommendations for improving the model, however, these recommendations were not addressed in the final business case.

The later peer review also identified limitations in the traffic modelling and related business case analysis that were not adequately resolved or addressed in the final business case.

The external peer review in March 2013 noted that the business case did not provide detailed information on estimated traffic flows and that this omission was unusual in a transport project business case. The review stated that the information in a traffic model report appended to the business case was not comprehensive and in some cases was difficult to understand.

The peer review recommended that specific traffic numbers and illustrative diagrams be included in the business case. The review suggested that it would be useful if this section included a description of the effect of the project on public transport patronage and that it should include a detailed discussion of freight traffic. This was not done in the final business case.

Induced demand

There was limited consideration in the business case of induced demand—additional traffic created by improved roads and routes.

Our 2011 audit, *Management of Major Road Projects*, highlighted the significant risks associated with failing to adequately assess induced demand. That audit found that the failure to take induced traffic into account meant that major road projects tended to overestimate benefits and give false confidence to decision-makers about the capacity of the project and the surrounding roads to cope with future traffic flows.

There are six dimensions of induced traffic that need to be considered when assessing major road projects:

- **changing route**—drivers make the same journeys but use the improved route
- **changing destination**—drivers decide to travel to more distant destinations because the improvement makes the journey time acceptable
- **changing mode**—public transport passengers switch to car because the improvement makes road travel more attractive than rail
- **changing time of travel**—drivers decide to travel in the commuting peak period because the improvement reduces journey times to an acceptable level
- **making additional journeys**—people are willing to make additional car journeys because of the improvement
- **relocated trip**—people and businesses relocate to take advantage of the improvement and so make new journeys to the area.

The model used in the EWL business case only addressed the first three of these. The consultant acknowledged that its model did not capture the other elements and acknowledged that further research was required to accurately assess the potential impacts of these elements. There is no evidence that any further action occurred.

The terms of reference for the December 2012 peer review of the traffic modelling included examination of how the traffic model complied with VAGO's prior recommendations relating to induced demand. However, the report did not specifically address this issue other than in a footnote indicating this was considered by the reviewer.

DEDJTR advised that it has recently established a governance framework to oversee transport modelling and economic appraisal of projects and developed guidelines to support a standard approach to traffic modelling.

3.4.2 Prioritisation of stages

A strategic issue when considering potential investment in the EWL project was whether it should be constructed as a single project or in stages, and the order of any staged construction. This was acknowledged in advice to government in April 2012 which indicated that while the business case would examine the case for the entire EWL, it would also take into account the likely need for delivery in stages, given the scale of the project.

A review of subsequent advice to government indicated that a preference to construct the eastern section emerged during 2012, well before completion of the business case in 2013. The advice did not clearly demonstrate the basis for this preferred staging of the project. Relevant departments have advised that the decision to pursue the eastern section first was a policy decision of government.

The business case asserted that while the western section offered significant benefits in its own right, the eastern section would generate 'greater and more widely dispersed benefits' and was the preferred option for Stage 1 of the project. However, the business case did not support this assertion with sufficiently detailed evidence and analysis.

A March 2013 peer review of the business case economic appraisal supported this view. It noted that the absence of an economic analysis of the full road link, and of each of the related stages, was both unusual and an issue that reduced the transparency of the analysis and the decision-making.

The business case analysis included reference to previous cost-benefit assessments undertaken for the former WestLink project—discontinued following the 2010 election—which broadly covered the scope of the western section of the proposed EWL. An appendix in the EWL business case acknowledged that two separate cost-benefit analyses (CBAs) of the WestLink project commissioned by the state in 2009 and 2011 yielded positive and higher BCRs than the proposed eastern section of EWL, both with and without the inclusion of WEBs:

- The 2009 CBA showed a BCR of 1.95 for the full EWL (2.35 with WEBs), and a BCR of 1.33 for WestLink (1.65 with WEBs)
- The 2011 CBA showed a BCR of 1.5 for the western section (1.65 with WEBs).

The BCR disclosed for the eastern section in the 2013 EWL business case varied from 0.4 to 0.8 without the inclusion of WEBs and up to 1.4 with WEBs included.

The BCR should not be considered in isolation when examining the relative merits of competing projects. However, the business case did not present a detailed comparative analysis of the results or any explanation of the differences. It is reasonable to expect that such an analysis should have occurred, given the significant scale of the proposed investment.

The economic analysis presented in the business case was restricted to options associated with the preferred eastern section of the full road only. The absence of such analysis for the other sections reduces assurance that significant state resources were being effectively prioritised to the area of greatest need or benefit.

The decision to prioritise construction of the eastern section was also inconsistent with information in the 2008 East West Link Needs Assessment (EWLNA) study which identified the eastern section as the second highest priority for development. The EWLNA study ranked the sections in order of priority as (1) inner section—i.e. Port to West Melbourne section, (2) eastern section and (3) western section. While the business case acknowledged the 2008 EWLNA study as context for the proposed project, it did not reconcile the difference in priorities.

3.5 Procurement and delivery model

In March 2013, the government was advised that the business case had explored all procurement models, with the view to maximising value for money for the state, and recommended an availability public private partnership (PPP) with the state retaining the toll revenue, and also the risk that demand might be lower than expected.

Analysis and advice on the project delivery model was robust and considered the relevant options including a traditional design and construct procurement approach. The choice of project delivery model was influenced by a reluctance in the market to take on full demand risk (the risk that actual demand for the road will not meet the forecast) and by the desire to sign the contract by November 2014.

The market sounding exercise undertaken for the project identified very little appetite for the traditional toll road model where full demand risk is transferred to the private sector, but some appetite for sharing with, or fully transferring demand risk to the state. This, together with timing considerations, was a key factor in recommending the availability PPP model under which the state fully retained demand risk.

The business case examined two main options, an availability PPP where the state retained full demand risk and a PPP approach where some demand risk was shared with the private sector. One of the reasons for dismissing the second option was the difficulty in implementing it within the government's target time lines.

3.6 Financial implications at planning stage

Development of the business case occurred during 2011–12 and 2012–13. In October 2011, the government approved \$7.5 million to be provided to the then Department of Transport to commence work on a business case for EWL. A further \$19.5 million was approved in December 2012 by the Treasurer for finalisation of the business case and to commence planning and development activities.

In May 2013, the government announced its intention to proceed with the eastern section at an estimated capital cost of \$6 to \$8 billion.

At the time of approving the final business case, the estimated project cost of the eastern section was \$7.96 billion (in nominal terms) comprising:

- \$5.5 billion capital for the EWL road design and construction
- \$920 million for private financing costs
- \$385 million for state costs for property acquisition, project management and procurement
- \$400 million for other related complementary projects
- \$755 million for risk and contingency.

There was no budget allocation in April 2013 for the operation and maintenance of the eastern section, given that this initial budget was developed on the basis of state based, rather than PPP, delivery and for the capital component only. The submission on the project budget noted that the operation and maintenance, toll collection and other life cycle costs were not taken into account as they were expected to be offset by the future toll revenue. Operation and maintenance costs of \$399 million in present value terms over the life of the agreement were noted in later advice to government (after contract signing), but there was no formal budget approval. This is in line with DTF's normal budgeting practices for PPPs and other capital projects.

In May 2014, the state announced its commitment to deliver the western section at an estimated capital cost of \$8 to \$10 billion with initial works commencing in 2015.

The project was to be funded by the Commonwealth Government, state government and by road users through tolling arrangements.

Recommendation

2. That the Department of Treasury & Finance improves its business case development guidance material, the adherence to this guidance by agencies, and its quality assurance over key inputs by:
 - critically reviewing the analysis of options in business cases against the requirements of existing guidance material and providing feedback to agencies
 - developing further guidance on methods for transparently determining and quantifying wider economic benefits
 - strengthening its processes for reviewing and advising government on the adequacy of actions taken to address findings and recommendations arising from peer or other external reviews of key business case inputs such as economic and financial analyses, demand modelling, cost estimates and procurement options analyses.
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4 Establishing the project contract

At a glance

Background

Following a competitive tender process to select a contractor to finance, design, construct, and then operate and maintain the East West Link, the contract for Stage 1 of the project was signed with East West Connect (EWC) on 29 September 2014. The state provided a side letter confirming its commitment to honour the contract on the same day in recognition of the unique circumstances around the government's decision on whether or not to sign the contract. These circumstances included an undetermined legal challenge to the project planning approval decision.

Conclusion

The procurement process was well managed by the Linking Melbourne Authority and met the government's tight time lines and procurement requirements.

Signing the contract when there was significant uncertainty about the status of critical planning approvals was imprudent and exposed the state to greater cost and risk. The risks associated with this decision were increased when the state agreed to amend the contract in favour of EWC to provide it with additional compensation rights if the challenge to the project planning approval was successful. The available evidence suggests that the state knew at the time that there was a significant risk that this would happen.

Findings

- The analysis and advice on the assessment of bids, and selection of the preferred bidder, was robust and in accordance with procurement requirements.
- Advice to government in the lead up to signing the contract did not sufficiently emphasise the benefits of delaying finalisation of the procurement and contract to mitigate the risks posed by the unresolved judicial review of the project planning approval decision.

Recommendation

That the Department of Treasury & Finance develops minimum standards and enhanced guidance for managing the risks associated with concurrent planning, scoping and procurement processes on major projects.

4.1 Introduction

The procurement phase of the East West Link (EWL) project Stage 1, the eastern section, involved engaging a contractor to finance, design, construct, and then operate and maintain the road and tunnel infrastructure through a public private partnership (PPP).

The contract for Stage 1 was signed by the Minister for Roads on behalf of the state with East West Connect (EWC) on 29 September 2014. The Treasurer provided a side letter confirming the state's commitment to honour the contract on the same day to address EWC's concerns with the suggestion that the state did not have the requisite power to execute the contract.

Under the contract the state had obligations to:

- acquire land for the project
- obtain and maintain applicable approvals
- provide state financial contributions and make quarterly service payments during the operations and maintenance phase linked to the availability of the road
- obtain agreement for the interface with CityLink
- deliver the toll collection system and required state works.

In the lead up to the government entering into the contract with EWC:

- there was a legal challenge to the planning approval decision for the project
- the then Opposition indicated that the project should not proceed by providing the government with a copy of legal advice questioning its power to enter into the contract and indicated that, if elected in the November 2014 election, it would not defend the legal challenge to the planning decision
- EWC was refusing to sign the contract unless the state agreed to amendments in its favour.

This Part of the report examines whether the EWL procurement phase was undertaken in accordance with the government's Partnerships Victoria requirements and was supported by robust and comprehensive advice. It also examines how well the risks that emerged as the process evolved were mitigated.

The departments and agencies providing advice were the Department of Premier & Cabinet (DPC), Department of Treasury & Finance (DTF), Department of Transport, Planning and Local Infrastructure (DTPLI) which is now the Department of Economic Development, Jobs, Transport & Resources, and the Linking Melbourne Authority (LMA).

4.2 Conclusion

LMA managed the procurement process well in challenging circumstances, completing it in line with the tight time lines stipulated by the government at the outset of the project, and in compliance with relevant procurement requirements.

Signing the EWL contract when there was significant uncertainty about the status of critical planning approvals was imprudent and exposed the state to greater cost and risk. It is evident that the state knew the risk was significant. The risks associated with this decision were increased when the state agreed to amend the contract in favour of EWC to provide it with additional compensation in circumstances that the state knew were likely to eventuate.

Advice to government did not fully explore or give sufficient emphasis to the potential benefits of delaying finalisation of the procurement and contract to mitigate the risks posed by the unresolved judicial review of the project planning approval decision. This was despite:

- LMA observing that it would be unprecedented for a PPP to proceed to contract signing with the judicial review and other relevant matters undetermined
- the state being aware that the risk the judicial review plaintiffs would be successful was significant, and that the proceedings could be expedited
- the potential for the judicial review to lead to extensive delays and scope changes and to EWC making a claim against the state under the contract.

4.3 Procurement of Stage 1 – eastern section

The procurement process was undertaken in accordance with the government's Partnerships Victoria requirements.

The EWL business case proposed that a competitive tender process be adopted to engage a preferred bidder, but recommended the project team consider ways to streamline and improve the process to achieve better value for money by, for example:

- limiting the number of short-listed bidders to two due to the significant bid cost estimated at \$30 to \$50 million per bidder
- making the tender process as efficient as possible and providing for early selection of a preferred bidder where possible
- only taking the preferred bidder to full documentation as this would further contain bidder costs
- making a contribution to external bid costs.

All of these steps reflected the PPP reforms introduced by the government in May 2013 and were incorporated in the procurement process established by LMA.

4.3.1 Procurement documentation

The procurement process involved two stages—an Expression of Interest (EOI) followed by a Request for Proposal (RFP) for short-listed parties. The EOI and RFP procurement documentation was developed by LMA in close consultation with DTF and the former DTPLI. Figure 4A sets out the key steps and time lines.

Figure 4A
Key EOI and RFP events

Date	Key event
18 July 2013	EOI approved and released to market
31 October 2013	RFP document approved and released to three short-listed respondents
30 January 2014	Interim RFP submissions outlining proposed contract departures lodged by three respondents
7 March 2014	Updated RFP document issued to three respondents following assessment of interim submissions
28 April 2014	RFP submissions lodged by three respondents

Source: Victorian Auditor-General's Office.

The EOI document provided information to potential respondents about the project including design and construction issues and risks, and the proposed PPP payment mechanism. The EOI also set out the evaluation criteria to be used for selecting a short-list of respondents to participate in the RFP phase.

The RFP document covered instructions for responding, project requirements for design, construction, maintenance, operation and hand back, and draft contractual documentation.

The development and release of the procurement documentation was conducted in accordance with the government's Partnership Victoria requirements.

4.3.2 Assessment of submissions

Assessment of EOI submissions was led by LMA. For RFP submissions, assessment was overseen by an executive panel comprising staff from LMA and representatives from DTF and the former DTPLI. This panel was supported by three subordinate panels that assessed three specific aspects of the EWL project—commercial, technical and urban design. These four panels collectively assessed the submissions against 22 criteria including value for money. Figure 4B shows the key assessment steps and time lines.

Figure 4B
Key assessment steps and time lines

Date	Key task
29 August 2013	Four EOI submissions received and assessed
30 September 2013	Government announced three short-listed respondents selected to participate in RFP phase
April 2014	Executive panel and three subordinate panels established to evaluate RFP submissions
28 April 2014	RFP submissions lodged by three respondents
19 May 2014	Three subordinate panels provided the executive panel with their interim assessment reports
18 June 2014	Executive panel issued interim assessment report recommending one respondent be excluded from further evaluation and that evaluation of the remaining two respondents continue through a 'revise and confirm' process
8 August 2014	Revised RFP submissions received
27 August 2014	Final evaluation report issued by executive panel recommending the preferred bidder. Recommendation subsequently endorsed by EWL steering committee
9 September 2014	Government accepted the recommendation and announced the preferred bidder

Source: Victorian Auditor-General's Office.

The advice and documentation supporting the assessments prepared by LMA and DTF was robust, comprehensive, transparent, and met Partnerships Victoria requirements. Assessments were completed in line with the government's time lines.

4.3.3 Appointment of preferred bidder

It was evident that the decision to appoint a preferred bidder was influenced by the then government's desire to sign the contract by 30 September 2014.

Following endorsement of the executive panel's recommendation by the EWL steering committee, a briefing was submitted by the then Minister for Roads to government on 4 September 2014 seeking approval of a proposed strategy to sign the contract on or before 30 September 2014. The briefing emphasised that this involved approving and publicly announcing the preferred bidder by no later than 9 September 2014.

This briefing stated that the evaluation process had concluded which of the two submissions was superior and why, adding that rectifying the deficiencies in the unsuccessful bidders' proposal would take an estimated two further months.

The briefing further stated that a key rationale for selecting a single preferred bidder was that it increased the likelihood of signing the contract by no later than 30 September 2014. This was because:

- full documentation was only required to be progressed and finalised for one bidder, noting that this task can take approximately three weeks from the appointment of a preferred bidder
- finalisation of interface arrangements with Transurban, the operator of CityLink, and the two public transport service providers would be more efficient with only one bidder
- appointing a preferred bidder provides greater impetus for that bidder to finalise the contracts—there is also an incentive for the preferred bidder to finalise arrangements before the caretaker government period.

The government accepted the recommendation and announced the preferred bidder on 9 September 2014.

4.3.4 Probity arrangements

Probity practitioners are engaged for significant procurements to provide independent oversight of compliance with procurement process requirements, and provide assurance on the integrity of the tender process.

LMA engaged a probity practitioner to provide advisory services for the EWL procurement process. The adviser's initial task was to develop a probity plan to provide straightforward guidance to the project team on the practical application of probity throughout the procurement process. This plan was completed in May 2013.

The probity adviser was also required to examine and provide an opinion on compliance with the probity plan. The probity reports subsequently presented to LMA during the procurement process attested that the EOI and RFP phases had been conducted in accordance with the probity plan, evaluation manual and other probity requirements.

Engaging a single party as both the probity advisor and the probity compliance reviewer weakened the independence of the probity practitioner. The scale of the EWL project warranted the appointment of separate parties to undertake these two functions.

4.4 Unresolved issues affecting the project

The procurement phase and contract negotiation were undertaken in parallel with:

- the statutory planning approval process, which was the subject of an unresolved legal challenge
- negotiations with Transurban, the operator of CityLink, regarding the widening of CityLink and its integration with EWL.

Delay in finalising the statutory planning process

The EWL project was to be declared under the *Major Transport Projects Facilitation Act 2009* (MTPFA) in July 2012 with statutory planning to start as soon as possible after that date and be completed by March 2014. However, declaration of the project under the MTPFA did not occur until 20 December 2012.

In March 2013 and again in April 2013, DTF advised the government that it was imperative that the statutory planning process commence as a matter of urgency, because without intervention the process was likely to be finalised around the same time as the procurement process which constituted a significant risk. DTF advised that in normal circumstances there is a gap between the receipt of final statutory planning approvals and the finalisation of the tender process so bidders have certainty when submitting designs as part of their bids.

RFP responses were submitted to LMA as required on 28 April 2014 but the Minister for Planning's approval decision, which was not made until 30 June 2014, imposed conditions and new requirements that affected the project's design and costs.

On 9 July 2014, DTF advised the then Treasurer that the most significant risk resulting from the minister's decision was the uncertainty that some of the conditions and requirements may create for bidders, and therefore the ability of the state to efficiently achieve contractual signing within the scheduled time frames.

On 17 July 2014, LMA applied for a variation to the minister's decision, requesting that he amend or clarify certain conditions he introduced. LMA's application, which requested a response by 1 August 2014, highlighted areas where meeting a condition in the decision would:

- not be physically possible
- be inconsistent with existing standards and requirements
- be highly impracticable (based on bidder feedback).

DTF advice emphasised that if the uncertainties created by the approval decision were not resolved well before contract finalisation there was a risk the preferred bidder may not be prepared to sign the contract. Further, if the preferred bidder was willing to enter into a contract it was likely that the state would be required to bear the cost and time consequences of any alterations required to satisfy the minister's approval decision.

LMA requested the two short-listed bidders to submit revised bids by 8 August 2014 that addressed the changes to the project caused by the minister's approval decision, assuming the variations requested by LMA to the approval decision would be accepted. In making this request LMA recognised there was a risk to the procurement process timing if the changes requested were not accepted by the minister.

Despite this uncertainty the preferred bidder was announced by the government on 9 September 2014 while the variations sought to the approval decision remained unresolved until 19 September 2014 when the minister varied his decision predominantly in line with LMA's requests.

Unresolved legal challenges to planning approval decision

Compounding this uncertainty were unresolved legal challenges to the Minister for Planning's approval decision of 30 June 2014.

On 21 July 2014, two local government councils lodged a claim in the Supreme Court seeking a judicial review of the approval decision asserting that the minister had failed to examine the EWL business case in considering the economic costs and benefits of the project. A second claim was lodged in the Supreme Court on 20 November 2014 by a third council seeking a judicial review based on a claim that a requirement to consult it had not been met when the Minister for Planning determined the variations to the approval decision.

An earlier legal claim against the project had been lodged in April 2014. This claim by a local resident sought a Supreme Court injunction to prevent contract execution on the basis that the project benefits had been misrepresented.

Unresolved arrangements to access CityLink for construction works

As EWL was intended to connect to CityLink it was necessary for an agreement to be reached with Transurban, the CityLink operator, to enable access for construction work.

When the RFP was issued to the short-listed bidders on 31 October 2013, negotiations with the CityLink operator were under way. Updated RFP documentation was subsequently reissued to bidders on 7 March 2014 following assessment of interim submissions requested as part of the tender process. However, as negotiations with the operator of CityLink were still in progress, the updated documentation did not include finalised access arrangements.

Access arrangements were still not finalised when RFP submissions were due, and when the preferred bidder was appointed on 9 September 2014.

In addition to the uncertainty this situation created for bidders, it had the potential to require the state to compromise its position with the CityLink operator in order to finalise the agreement and, conversely, strengthen that operator's negotiating position. It is unclear if this occurred.

4.5 Decision to enter the contract

In addition to the above unresolved issues, in September 2014 the then Opposition stated that it would not proceed with the project if elected in November 2014.

4.5.1 Advice leading up to contract signing

It is not standard for a PPP to proceed to contractual signing when there is significant uncertainty about the status of critical planning approvals. However, this is what occurred on EWL. Such circumstances warranted comprehensive advice to government on its options and the best course of action for the state.

Advice from agencies noted the potential implications of signing the contract despite the litigation and planning risks. This advice included preliminary quantification of:

- potential delay costs estimated at between \$40 million and \$110 million per month, and advice that any scope changes arising from a new planning approval decision may lead to further costs
- compensation payable under termination scenarios which, while difficult to estimate and dependent on the timing of any termination, was advised to be in excess of \$900 million by February 2015 and higher if terminated later.

However, relevant advice to government, associated briefings from DTF and DPC and, to some extent, LMA presentations to the project steering committee, did not fully explore the merits of options to defer selection of a preferred bidder, delay signing the contract, delay finalisation of the project financial arrangements and/or implement some form of 'standstill', 'go slow' or 'short-term' agreement. This was seemingly driven by a view within the departments and agencies that the government would be unreceptive to advice arguing against its objective of signing the contract before November 2014.

LMA advice in August 2014 indicated that, given the significant implications, it was critical that all efforts be made to resolve the judicial review before signing the contract. LMA also advised DTF, the steering committee and DTPLI that it was unprecedented for a PPP contract of this scale to be executed while a judicial review of this nature remained undetermined.

The LMA advice was particularly important given that the government was aware that:

- the risk that the plaintiffs seeking the judicial review of the planning approval decision would be successful was significant
- it was possible to have the proceedings brought to a hearing quickly if the state wished.

In August 2014, DTPLI recommended that the government take action to have the judicial review of the planning approval decision determined as quickly as possible. This recommendation was supported by an awareness that there was a significant risk that the challenge to the planning approval decision would be successful. Therefore its timing was critical because the longer the judicial decision took, the higher the potential contracting risks and the greater the potential financial exposure of the state under the contract, should a contract be signed before the judgement. DTPLI advice indicated that an expedited court timetable was achievable, would deliver early certainty, and would provide the best mitigation to the substantial cost and risk exposures to the state that existed at that time.

Despite this advice the government decided not to seek an expedited hearing. LMA advised that following this decision DTPLI provided it with verbal:

- advice that the state intended to seek a hearing date in December 2014 for the judicial review proceeding
- instructions that the government wished to proceed to contract signing for the project in accordance with its previously determined time line and LMA should seek to finalise the contract documentation with the preferred bidder.

The focus on achieving this time line was given disproportionate emphasis given the significance and complexity of the project and the risks and implications for the state. Consistent with the overriding desire to achieve the established time frames, subsequent advice to government focused on options to mitigate identified risks if the government determined to proceed to signing the contract rather than emphasising the potential benefits of delaying signing and fully exploring the merits of alternative options.

Specific gaps in the advice to government included the failure to:

- comprehensively examine the merits of alternative options—while noting that options to delay contract signing and/or finalisation of the project financial arrangements existed, the advice contained only limited discussion and analysis of these options and gave undue weight to the need to reach agreement with EWC on possible options
- directly support or oppose the proposed timing of the transaction—i.e. advice did not directly recommend any course of action in the best interests of the state.

The reasonable prospect that the planning approval decision would be overturned by the judicial review warranted more comprehensive advice to government examining options other than signing the contract in terms of potential costs, benefits and risks. These options should have included extending the tender process to defer the selection of a preferred bidder and contract signing while, at the same time, seeking to expedite the application for judicial review. If the approval decision was overturned, such options could have offered a better outcome for the state than a scenario of a claim under the contract. The state had discretion to extend the procurement process if it wished to do so.

The 24-day period from announcement of the preferred bidder on 9 September 2014 to contract signing on 29 September 2014 and finalisation of the project financial arrangements on 3 October 2014 was relatively short. Benchmarks published by Infrastructure Australia and otherwise established by recent PPP transactions in Victoria suggest that around six weeks would have been considered efficient.

While there were no missed steps in the typical finalisation process for a PPP transaction, the government's overriding desire to achieve its time line, compromised the state's ability to:

- adequately explore options to extend the tender process—i.e. defer selection of a preferred bidder, delay signing the contract, delay financial close and/or implement some form of 'standstill', 'go slow' or 'short-term' agreement; and/or
- negotiate optimal contractual terms with EWC in relation to the litigation and planning risks.

Options to minimise construction expenditure, and avoid or reduce the significant up-front costs until the planning risks could be resolved were flagged in advice to government, but were not pursued.

If contract signing had been deferred until after resolution of the judicial review, the state's exposure under the non-standard contract provisions accepted to secure EWC's execution of the contract, could have been avoided.

4.6 Executing the project contract

The state signed a contract appointing EWC to finance, design, construct, operate and maintain Stage 1 of EWL in September 2014. The Treasurer also issued a side letter to EWC affirming the state's commitment to honouring the contract and related compensation payment obligations.

4.6.1 'Non-standard' contract provisions

The contract was standard in most respects while also including a number of project-specific provisions relating to land acquisition, key approvals, the interface with CityLink, the toll collection system and state works.

The termination and compensation provisions in the contract were also generally consistent with the standard commercial principles established by the National PPP Policy and Guidelines, the Partnerships Victoria requirements and with recent precedent transactions. However, in departures from standard practice for PPP transactions in Victoria, the state agreed to the inclusion of clause 58—Specific Key Approval Event in the contract and signed a side letter to the contract.

These variations from standard contractual terms were introduced at the request of the preferred bidder. EWC's requests were prompted by the legal challenge to the Minister for Planning's approval decision for the project and the Opposition's announcement that it had legal advice questioning the state's power to enter into the contract and that it would not defend the application for judicial review of the planning decision if elected in November 2014.

Clause 58

Under the contract, the state bore the risk of any litigation or changes relating to key project approvals such as statutory planning approvals. This is part of the standard risk allocation in PPP contracts.

EWC requested that a new clause (clause 58) be inserted in the contract and the state agreed. Clause 58 increased the state's exposure in circumstances where the planning approval decision was found to be invalid, as compared to the 'standard' provisions of the contract.

Specifically, clause 58 exposed the state to the following primary consequences if the approval decision was held to be invalid within two years of finalisation of the project financial arrangements:

- higher delay cost caps than those applicable to other delays—up to \$2.5 million in Prolongation Costs per day
- an obligation to terminate 'for convenience' where any decision that the planning approval decision was invalid had a material impact on EWC for a continuous period of 12 months—under this scenario, the standard compensation payout formula was modified to include a fixed payout to equity of around \$30 million, as opposed to fair market value, plus the termination costs payable by EWC to its management services provider during the contract.

In addition, if the judicial review of the planning decision resulted in changes to the approval decision this could trigger a claim from EWC for costs under another clause of the contract.

The side letter

The Treasurer executed the side letter in favour of EWC on the same day the contract was signed. The obligations in the side letter would have been triggered if a court declared within three years of finalisation of the project financial arrangements that the state did not have the executive power to execute the project contract, and that the contract was void or unenforceable.

In this scenario, the side letter committed the state to pay EWC compensation calculated in accordance with the contract as if the contract had been terminated by the state three months after the date on which the contract was declared or decided to be void or otherwise unenforceable.

The payment obligation created by the side letter was subject to a number of conditions, including that the state was entitled to a three-month period to remedy the fact that the contract was void or unenforceable.

The only scenario under which the side letter can be argued to have created additional exposures for the state is one in which the state did not have the authority to sign the contract. Legal advice obtained by government both before and after the election indicated that this was very unlikely.

4.6.2 Advice on contract provisions

The state's external legal and commercial advisers signed off on the general alignment of the contract with the National PPP Policy and Guidelines but qualified this with specific reference to clause 58.

Advice to government clearly explained the basis for, and implications of, the new clause 58 and the side letter. However, the advice did not clearly explain the rationale for aspects of the higher compensation payable under clause 58 and did not adequately highlight the qualifications included in the 'sign-off' letters from the state's legal and commercial advisers for the project.

DTF advice to government in September 2014 stated that the side letter was a proportionate and appropriate way of calming investor and funder nerves over the executive power issues. This was consistent with the legal advice that the state did have the power to enter into the contract and therefore the side letter would never be triggered.

The risk and exposure for the state created by clause 58

The risk and exposure for the state created by clause 58 was linked to the outcome of the judicial review of the planning decision for the project.

The grounds for the application for review of the planning approval decision included that the Comprehensive Impact Statement assessment committee and Minister for Planning failed to have regard to mandatory relevant considerations. These principally related to the economic effects of the planning scheme amendments and in particular that the assessment committee unreasonably refused to require production of the state's business case and other documents relevant to economic costs and benefits of EWL.

The available evidence suggests that the state knew on 19 August 2014 that the risk and exposure relating to the potential for the judicial review to quash the approval decision, later the subject of clause 58, was significant. This position was presented to government in advice from DTPLI on 20 August 2014.

A file note prepared for the EWL project steering committee at the end of September 2014 indicated that the state's prospects of success in the judicial review may have been more positive. The basis for this view was not documented but the view was conveyed to government on 23 September 2014.

Basis of the potential \$30 million payout to equity

Clause 58 modified the 'termination for convenience' compensation formula to include a fixed payout of return of capital plus \$30 million, and the termination costs payable by EWC to its management services provider.

Advice to government on the basis for the \$30 million was not clear or consistent. Despite this, LMA advice to government on 23 September 2014 suggested that under the standard termination provisions of the contract the payment for return of equity would be 'immaterial' but under the proposed clause 58, it would be \$30 million. Based on this advice, the fixed payout to equity component of clause 58 did create 'additional' exposure for the state as compared to the standard provisions.

The likelihood of this payment being triggered was linked to the likelihood that the planning approval decision would be quashed, and the length of time that might have been required to 'remake' the decision, assuming the then government sought to do so.

Rationale for higher delay cost caps

Clause 58 exposed the state to higher delay cost caps than those applicable under the 'standard' provisions of the contract, noting that EWC was only entitled to actual, additional, net costs properly and reasonably incurred and directly attributable to the relevant delay event.

The cap on prolongation costs if clause 58 was triggered was set at \$2.5 million per day plus CityLink Traffic Impact Fees plus Financing Delay Costs.

This \$2.5 million figure compared to the standard range of caps applicable to prolongation costs, as in Schedule 4 of the contract, as follows:

- \$555 000 per day for months one to three after financial close
- \$1.75 million per day for months four to 18
- \$2.05 million per day for months 18 to 40
- \$1.75 million per day beyond that point.

The likely time frame for when clause 58 could have been triggered was early 2015, so the most relevant comparator is the \$1.75 million per day for months four to 18 after financial close. There was no clear commercial rationale for an increase of around 43 per cent in the relevant daily cap under clause 58. This is because there was little logical basis for one specific type of delay event warranting a higher cap than other types of delay events.

Advice to government did not explain why one specific type of delay event warranted a higher cap than other types of delay events. From the state's point of view, the request for higher delay cost caps should have highlighted the need for further consideration of options to mitigate the exposure of the state, pending resolution of the judicial review.

With more time it may have been possible to negotiate a more favourable position for the state in relation to clause 58 and related provisions. For example:

- the commercial rationale behind the increase in the delay cost cap was not clearly explained, nor was the basis for calculation of the potential \$30 million payout to equity in a termination scenario
- advice to government noted the possibility of negotiating some form of 'standstill' or 'go slow' arrangement to help mitigate the costs incurred by EWC until the judicial review was determined—it appears that LMA discussed this option with DTF but it was not raised with the preferred bidder due to a reluctance to introduce further risks to meeting the time line for finalising the contract.

Alternatively, the potential exposure under clause 58 could have been avoided by deferring contract signing until the judicial review was resolved. This would have required an extension to the time lines previously disclosed to bidders.

In taking the decision to proceed to contract signing the state was, in effect, 'gambling' that the judicial review proceedings would not impact the project significantly.

Recommendations

That the Department of Treasury & Finance:

3. develops minimum standards and enhanced guidance for managing the risks associated with concurrent planning, scoping and procurement processes on major projects
 4. mandates the appointment of separate parties to undertake the probity advice and probity compliance review functions on High Value High Risk projects.
-

5

Terminating the project

At a glance

Background

The government announced final agreements to bring the East West Link (EWL) project to an end in June 2015. The termination settlement involved the state reimbursing East West Connect (EWC) for claimed expenditure on the project and acquiring the project assets and interest rate swaps established for the project. The state also negotiated an uncommitted bond financing mandate for up to \$3.1 billion with some members of the EWC banking group.

Conclusion

The cost of the final termination settlement was substantially less than estimates of what would have been payable under the contract's 'termination for convenience' provisions. However, to achieve this outcome the state accepted limited verification over the funds expended by EWC and the risk that a related party had a windfall gain. Failure to properly assess the option of continuing the project means that there is limited assurance that the termination was the best use of public funds.

Findings

- The advice to government on the merits of terminating the project did not adequately examine the costs, risks or benefits of completing it.
- The final termination agreements involved a different settlement outcome to that initially announced by the government. These changes were based on sound advice to government and delivered a better outcome for the state.
- The total cost of the final termination settlement will be around \$642 million.
- The state accepted limitations in the due diligence investigation caused by EWC's refusal to provide detailed expenditure information. VAGO could not address these weaknesses due to gaps in the *Audit Act 1994*.

Recommendation

That the Department of Treasury & Finance establishes clear guidance for the terms of future negotiations involving the state reimbursing expenditure by private entities, to require full disclosure and transparency of the underlying information and evidence.

5.1 Introduction

Consistent with public commitments made in the lead up to the 2014 state election, in December 2014 the new government instructed East West Connect (EWC) to suspend works on Stage 1 of the East West Link (EWL) project and began negotiations to terminate the contract. At this time, around \$425 million had been spent by the state on EWL, including property acquisition costs.

In June 2015, the government reached an agreement with EWC to terminate the project.

The Department of Premier & Cabinet (DPC) had primary responsibility for managing the termination process. The Department of Treasury & Finance (DTF) managed negotiations on the termination of EWC's loan facility for the project.

5.2 Conclusion

Advice to government on negotiation of the termination of EWL comprehensively examined the available approaches, settlement terms and related costs and risks. The strategy adopted was a practical solution to a highly complex situation. However, only limited analysis of the option to complete the project was undertaken, meaning the government was deprived of comprehensive advice to assure it that termination was the best use of public funds.

The total cost of the final termination settlement will be around \$642 million depending on the final cost of the interest rate swap arrangements. The cost to the state, negotiated without reference to the termination provisions in the contract, was substantially less than estimates of what would have been payable under the 'termination for convenience' provisions of the contract.

However, to achieve this outcome the state accepted limited visibility over the funds expended by EWC and accepted the risk that a related party had a windfall gain. The government was not able to fully confirm the reasonableness of the expenditure it reimbursed or the assets it received because EWC refused to allow the state or its advisers access to information at a sufficiently detailed level.

5.3 Decision to terminate the project

The advice to government on the merits of terminating the project did not comprehensively examine the costs, risks or benefits of completing the project. This appears to have been due to election commitments to discontinue the project and because the project was considered to have a low benefit-cost ratio (BCR).

5.3.1 Incoming government advice

Advice and recommendations from DPC and DTF as part of the incoming government briefings contained a useful summary of the key issues associated with terminating the EWL contract and were appropriate, assuming that the decision to cancel the project was final and that the government would seek to terminate for convenience under the contract. Under the termination for convenience provisions of the contract, compensation was estimated to start at around \$900 million and depended on the timing of the termination. The advice correctly noted that a decision to terminate sooner rather than later would minimise the amount paid by the state. However, it did not fully assess the benefits of completing the project.

While there was no direct discussion of the merits of continuing the project in this early advice, this was understandable given that advice to the incoming government is intended to focus on the implementation of announced policy positions.

5.3.2 Analysis of project completion option

Although the intention to terminate the EWL project was clearly articulated at the November 2014 election, the then Opposition did not at that time have access to comprehensive information on the costs, benefits and funding arrangements for the project.

On its election, the new government should have been provided with updated, comprehensive information on the impacts of completing the project versus the option of cancelling it, to provide a more complete assessment of the costs and benefits of terminating the contract.

The limited advice that was provided to the new government on the completion option was superficial. It simply compared the costs of a termination settlement to the 'much greater costs to the state if the project proceeded'. There was little mention of the costs previously incurred on the project.

The advice presented the project costs in nominal dollar terms and stated that the project would involve a significant economic cost to the state, because the:

- tolling revenues may be insufficient to cover the quarterly service payments due to EWC over the term of the operations phase
- business case suggested a direct economic benefit of only 45 cents for each dollar invested in the project
- project funding obligations may limit the state's capacity to fund other election commitments and major infrastructure projects.

The expected project benefits were not discussed beyond the reference to the direct BCR from the initial business case. This BCR of 0.45 excluded wider economic benefits and the positive BCR of complementary projects, and was based on information from 2012–13.

Updated analysis should have been provided to government on the benefits of the core project scope and the complementary projects. These updated project benefits could then have been compared to the expected costs of the project, which were known with greater certainty.

Other relevant factors that were not fully explored in advice to government included the:

- forecast \$8.0 billion (nominal dollar value) of toll revenue from the completed project
- \$1.5 billion Commonwealth funding contribution to Stage 1 of EWL that was at risk of being lost if the project was cancelled
- significant funds already expended by the state on the project.

The state had spent significant amounts on planning, developing, procuring and contracting EWL. Although these were 'sunk costs' they may have impacted the extent of 'future costs' required if the option of completing EWL was compared directly to other priority projects. This is because other projects would have required expenditure on pre-construction and procurement activities that had already been completed for EWL.

The absence of detailed analysis of the completion option means the government had limited assurance that the termination of the project represented the best use of public funds.

5.3.3 Government consideration of termination options

Subsequent advice focused on the available approaches to termination. This advice contained little analysis of the merits of completing the project, but it was otherwise generally comprehensive and accounted for expected future costs and risks from termination, including sovereign risk issues.

The consideration of termination options was supported by detailed analysis and advice from the departments and commercial and legal advisers. The advice adequately articulated, assessed and costed the alternative approaches of:

- terminating under the 'termination for convenience' provisions of the contract
- terminating the contract using legislation
- achieving an effective termination through an agreed settlement with EWC and its financiers—the approach ultimately adopted.

The settlement strategy adopted by the state involved an 'aggressive' approach of effectively repudiating the contract and treating it as unenforceable, in conjunction with the exploration of options to legislate to extinguish any liability to EWC.

The state sought to mitigate its exposure through a negotiation strategy that included:

- a direction to EWC to suspend work on the project and mitigate costs
- a refusal to terminate using the defined 'for convenience' provisions of the contract, given the expected payment required
- consideration of the option to extinguish liability to EWC using legislation
- 'without prejudice' negotiations to achieve an agreed settlement with EWC and its financiers, including consideration of options to 'repurpose' the loan facility.

EWC largely refused to negotiate on this basis between December 2014 and February 2015 and instead demanded that the state terminate for convenience under the contract. This position meant that the state found it necessary to consider a range of unilateral options, such as:

- legislation to extinguish liability under the contract
- a public inquiry into the project
- limits on the right of EWC members to participate in future projects
- offering opportunities for other state work.

5.4 Achieving project termination

On 15 April 2015 the government signed a non-binding heads of agreement (HoA) with EWC to facilitate termination of the project. The HoA set out key commercial terms, a process and a timetable for termination of the contract.

The commercial terms included in the HoA involved:

- the state acquiring the companies in the EWC consortium for \$1
- EWC being reimbursed for net funds of \$339 million already drawn down from the project loan facility to cover already incurred project-related costs, subject to a cost certification process
- the state reimbursing EWC for the \$81 million in fees paid when establishing the loan facility with the intention of taking over this \$3.1 billion facility, to contribute to funding for the Melbourne Metro Rail Project, to obtain value for those fees.

A cost sharing arrangement was agreed with EWC on 2 June 2015 which required the state to meet 75 per cent of EWC's financing costs for the period 15 May to 15 June 2015 and to reimburse EWC for any legal costs, above a threshold of \$50 000, incurred by the financiers' external legal advisers in reviewing, negotiating and finalising replacement refinancing documents.

Final agreements terminating the project were completed on 15 June 2015. The agreements involved:

- the state acquiring, for \$1, the hard assets and intellectual property (IP) owned by EWC and the design and construction (D&C) contractor, and the rights to the business name, domain name and logo of EWC
- relevant contracts being terminated and releases from future legal liability being granted
- the state paying EWC \$424 million as reimbursement for project costs, including the \$81 million in fees paid to establish the credit facility and \$4 million under the cost sharing regime
- the state taking over the interest rate swap established by EWC on the project loan facility in September 2014, which was valued at \$217.9 million, at 30 June 2015—the state will be required to pay the value of the interest rate swap when the arrangement is closed
- the state separately establishing an 'uncommitted note issuance mandate' of up to \$3.1 billion with a number of the banks involved in the project credit facility—this was a different facility to that established by EWC for the project.

The total cost of the final termination settlement will be around \$642 million depending on the final cost of the interest rate swap arrangements. The final agreements involved a different settlement approach to that announced by the government on 15 April 2015 because the state did not acquire the EWC companies and did not take over the loan facility established for the project.

Adequate advice was obtained and provided to government in relation to the settlement approach and the final terms agreed with EWC and its financiers, including the:

- terms announced on 15 April 2015 following the signing of the HoA with EWC
- final terms of the termination and related agreements announced on 15 June 2015.

Following the signing of the HoA there was appropriate advice to government on the merits of adjusting the settlement approach in response to developments in the negotiations, and to information and risks emerging from the due diligence processes undertaken by the state under the terms of the HoA.

5.4.1 Repurposing of EWL loan facility

Advice on options for repurposing the EWC loan facility enabled a better value-for-money outcome for the state than the approach initially announced by government.

The government initially announced that it intended to take over that facility to contribute to funding for the Melbourne Metro Rail Project and that by doing this it would receive value for the facility establishment fees of \$81 million that were reimbursed to EWC by the state.

The government ultimately determined not to take over the \$3.1 billion credit facility established by EWC. This was based on robust analysis and advice from DTF on the complexities and value-for-money issues associated with this approach. Instead the state negotiated an 'uncommitted note issuance mandate' with selected members of the EWC banking group.

The advice to government recommending this approach noted that it involved lower fees as there was no commitment to underwrite the notes. However, this outcome meant that the state did not receive value from the \$81 million paid to EWC as reimbursement for the costs of establishing its credit facility. On balance, these changes are likely to have delivered a better outcome for the state.

5.4.2 Cost of termination process

As at 30 June 2015, the government had incurred other costs of over \$3 million relating to the termination. These are detailed in Figure 5A.

Figure 5A
State costs relating to the termination

Entity	External costs (\$'000)
Department of Premier & Cabinet	2 656.1
Department of Treasury & Finance	46.9
Treasury Corporation of Victoria	473.2
Total	3 176.2

Source: Victorian Auditor-General's Office based on entity provided information.

These costs primarily related to legal and other professional fees incurred as part of the settlement negotiations with EWC and Treasury Corporation of Victoria costs for hedging the state's interest rate exposure arising out of the termination.

Costs are expected into the future to finalise arrangements not completed at 30 June 2015, including negotiations with the independent reviewer, the sale of physical assets acquired and the termination of the interest rate swap arrangement.

5.4.3 Value of acquired properties

As at 30 June 2015, \$276.9 million had been spent on property acquisition, with a further \$73.8 million to be paid for outstanding settlements. Acquired properties have been offered back to their original owners and a sales strategy is being developed for the remaining properties.

Property sales are not expected to commence until 2016–17 and may take several years in order to avoid an oversupply of property in the market. DTF estimates that the properties can be resold for around \$320 million.

5.5 Cost certification process

The termination agreements included the state paying EWC \$424 million as reimbursement for costs incurred on the project and \$1 to acquire hard assets valued at less than \$1 million and project IP owned by the EWC partnership, the D&C contractor and operations and maintenance (O&M) contractor.

Gaining access to detailed expenditure information was crucial given the:

- state's proposed settlement involved reimbursing EWC for reasonably incurred project-related expenditure
- inherent incentive in the settlement approach for EWC to overstate its costs and understate the assets to be transferred to the state.

However, the government was not able to confirm the reasonableness of the expenditure it reimbursed or the assets it received because EWC refused to allow the state or its advisers access to information at a sufficiently detailed level.

The Auditor-General's lack of 'follow the dollar' powers meant that we were similarly unable to access this information despite our direct requests to EWC and its contractors.

5.5.1 Due diligence process

In the lead up to the signing of the HoA, EWC was unwilling to provide any documentation to prove its claimed project expenditure. In early negotiations the state sought 'open book' access to EWC's financial records.

The due diligence process was to be a key feature of the HoA, to resolve the 'information asymmetry' between the state and EWC and ensure that the final settlement:

- only involved reimbursing EWC for legitimately incurred project-related expenditure
- ensured that EWC transferred all hard assets obtained with the project expenditure
- did not leave the state with inappropriate risks or liabilities.

The due diligence process was also intended to enable the state to confirm that EWC had adequately mitigated its expenditure following the project suspension notice of 12 December 2014.

EWC resisted a robust due diligence process and refused to have it extended to its D&C and O&M contractors. This was significant because these entities were related parties of EWC members, and had been paid significant sums for which EWC was seeking reimbursement from the state. EWC had paid around \$164 million to the D&C contractor and \$2.5 million to the O&M contractor.

The HoA required only limited cost certification and verification and was reliant on an existing process established under the project contract. The HoA outlined a 'certification and verification process and methodology' which stated the process would be successfully completed by EWC providing evidence that payments to the D&C contractor were certified by the firm appointed by the project financiers to certify project-related expenditure claimed by EWC.

This process provided limited visibility on what the payments were actually used for, and provided little capacity for the state to gain insight into the arrangements at the contractor level and below.

The state's due diligence adviser reported that it was only provided with confirmation that payments had been made from EWC to the D&C and O&M contractors and that it did not have access to supporting documentation from the contractors. The adviser indicated that this meant it could not verify:

- what these contractors used the money for
- whether or not further undisclosed assets existed, and noted that the list of 'hard assets' was very short and the value immaterial
- whether any expenditure had been refunded
- whether EWC and the contractors took reasonable steps to mitigate expenditure following the issuing of the state's project suspension notice.

The due diligence adviser indicated that this created a risk that a party related to EWC, particularly the D&C contractor, was holding either surplus cash, hard assets that were yet to be identified, or prepaid assets capable of being converted into cash at a later date. The adviser indicated that should any of these scenarios eventuate, the state would not receive the benefit of these assets and EWC members would receive a windfall gain. The adviser noted that the level of assets purchased by the D&C contractor was extremely low given the payments it had received from EWC.

This process was substantially different to the 'open book' process sought by the state during early negotiations with EWC. Ultimately, this limited verification was accepted as part of the 'price paid' by the state to secure EWC's agreement to the terms of the settlement.

5.5.2 Adequacy of warranties obtained by the state

In an attempt to mitigate the risks identified by the due diligence adviser, the state sought, as part of the final termination agreements, warranties from EWC and its related parties—including the D&C and O&M contractors—that they had identified all hard assets and IP acquired with the project debt.

These warranties were particularly important for the state given the limited expenditure verification process and associated risks identified by the due diligence process.

The warranties provided by EWC and the contractors included that:

- the lists of tangible assets were complete and accurate
- the project IP was accurately represented
- they had complied with obligations under the contracts with respect to mitigation.

However, these warranties did not directly address all the risks, given that they were:

- limited to hard assets and IP and specifically excluded cash or other liquid assets
- quite specific in relation to the extent to which costs were avoided or mitigated, because the D&C and O&M contractors provided no warranty in relation to the mitigation of costs prior to 15 April 2015.

The warranties were also subject to, or qualified by, disclosures made in a letter included as one of the termination agreement documents. For example, the disclosure against the warranty that the list of assets was complete and accurate clarified that the list only covered items 'to be incorporated into the works' and for which the D&C contractor had claimed payment and been paid. This raised the possibility that other assets had been acquired, with expenditure ultimately reimbursed by the state, and were not disclosed or transferred to the state on the basis that they were not to be incorporated into the project works.

Given these limitations, the risk that EWC's contractors had a windfall gain from the project through holding 'surplus' cash or assets procured from project funds was not fully mitigated or addressed by the warranties included in the final agreements.

5.5.3 VAGO request for information

In July and August 2015, VAGO wrote to EWC and its contractors seeking access to the information the state had been seeking from the contractors. Specifically, we sought information and evidence on payments made and received by the D&C and O&M contractors to and from third parties to inform a view on:

- the completeness of assets made available to the state under the termination agreements
- whether payments were made for goods and/or services that were not ultimately received or rendered
- the reasonableness of cost mitigation actions subsequent to the state's project suspension notice of 12 December 2014.

This information was needed to inform our assessment of the adequacy of the state's due diligence process. EWC and its contractors refused our requests. The Auditor-General does not currently have explicit 'follow-the-dollar' powers under the *Audit Act 1994* to require the provision of such information by private parties.

Recommendation

5. That the Department of Treasury & Finance establishes clear guidance for the terms of future negotiations involving the state reimbursing expenditure by private entities, to require full disclosure and transparency of the underlying information and evidence.
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6 Lessons for future projects

At a glance

Background

The *Public Administration Act 2004* (the Act) seeks to ensure the maintenance of an apolitical public sector that responds to government priorities in a manner that is consistent with public sector values. The Act imposes an obligation on public officials to provide frank, impartial and timely advice to government.

The planning, development, procurement, contracting and termination of the East West Link (EWL) project spanned two governments with directly opposing policy positions on the merits of pursuing the project. These circumstances created significant challenges for the public officials tasked with providing comprehensive advice in the best interests of the Victorian community.

Conclusion

Advice to government over the life of the EWL project did not always meet the required standard of being frank and fearless. This highlights a risk to the integrity of public administration that needs to be addressed.

Findings

- The audit identified instances where advice did not provide clear recommendations or gave too much emphasis to the benefits of approaches that were in line with a government's known preferred outcome and little emphasis to the analysis and benefits of alternative approaches.
- The 'compartmentalisation' of knowledge and/or roles at key points in the project may have constrained the ability of key agencies and advisers to obtain the 'full picture' relevant to their role, and compromised their ability to provide comprehensive advice.

Recommendation

That the Department of Premier & Cabinet consults with the Victorian Public Sector Commission to support further guidance to clarify the requirements for frank, impartial and timely advice in the public sector.

6.1 Introduction

The *Public Administration Act 2004* (the Act) seeks to ensure the maintenance of an apolitical public sector that responds to government priorities in a manner that is consistent with public sector values. Figure 6A shows key public sector values specified in the Act. Values of particular relevance to our assessment of the quality of advice provided to government on the East West Link (EWL) project are shown in **bold** text.

Figure 6A
Public sector values specified in the Act

<p>Responsiveness</p> <p>Public officials should demonstrate responsiveness by:</p> <ul style="list-style-type: none">• providing frank, impartial and timely advice to the government• providing high quality services to the Victorian community• identifying and promoting best practice <p>Impartiality</p> <p>Public officials should demonstrate impartiality by:</p> <ul style="list-style-type: none">• making decisions and providing advice on merit and without bias, caprice, favouritism or self interest• acting fairly by objectively considering all relevant facts and fair criteria• implementing government policies and programs equitably <p>Accountability</p> <p>Public officials should demonstrate accountability by:</p> <ul style="list-style-type: none">• working to clear objectives in a transparent manner• accepting responsibility for their decisions and actions• seeking to achieve best use of resources• submitting themselves to appropriate scrutiny <p>Respect</p> <p>Public officials should demonstrate respect for colleagues, other public officials and members of the Victorian community by:</p> <ul style="list-style-type: none">• treating them fairly and objectively• ensuring freedom from discrimination, harassment and bullying• using their views to improve outcomes on an ongoing basis.

Source: Victorian Auditor-General's Office based on section 7(1) of the Act.

The audit included examination of advice provided to government by the:

- Department of Premier & Cabinet (DPC)
- Department of Treasury & Finance (DTF)
- former Department of Transport, Planning and Local Infrastructure now the Department of Economic Development, Jobs, Transport & Resources (DEDJTR)
- Department of Environment, Land, Water & Planning (DELWP)
- Linking Melbourne Authority (LMA).

The planning, development, procurement, contracting and termination of EWL spanned two governments with directly opposing policy positions on the merits of pursuing the EWL project. In addition, key decisions on the project were taken shortly before and after a state election. These circumstances created significant challenges for the public officials tasked with providing comprehensive advice in the best interests of the Victorian community.

6.2 Conclusion

Meeting the obligation to provide frank and fearless advice means there is sometimes a need to provide advice that a government may not necessarily want to receive. While the advice to government examined in this audit was generally comprehensive and clear, it did not always meet the required standard of being frank.

This highlights a risk to the integrity of public administration that needs to be addressed. Action and leadership is required from government to reinforce these standards and the related expectations for public servants.

6.3 Frank and fearless advice

The instances where the advice provided was not sufficiently frank involved advice that did not provide recommendations or that gave too much emphasis to the merits of approaches that were in line with the government's preferred outcome and little emphasis to alternative options that were more aligned with the best interests of the state.

The clearest example of this was advice provided to government in September 2014 in the lead-up to its decision to sign the contract with East West Connect (EWC) for Stage 1 of the project. While the submission to government about the decision on whether or not to sign the contract was from the Minister for Transport, DPC and DTF did not provide a recommendation to government on the best option for the state.

Outlining options to government without a recommendation in circumstances where public officials know that the option clearly favoured by government will expose the state to significant potential risk and costs is not in the best interests of the state. It is not sufficient for officials in such circumstances to stop at disclosing the potential consequences of the available options, they need to provide a recommended course of action. This advice is examined in detail in Part 4 of this report.

Similarly, the audit identified that advice to the new government following the November 2014 state election failed to properly assess the option of terminating the project against the revised costs and benefits of continuing the project. While this was consistent with the new government's announced policy position it meant there is limited assurance that the termination represented the best use of public funds. This is considered in Part 5 of this report.

DPC and DTF disputed this and advised that the Code of Conduct for Victorian public sector employees (the Code) requires the public service to implement government policy decisions once the government of the day has made a clear policy decision. This is a quite narrow reading of the Act and the Code because neither explicitly state or imply that the requirement to 'implement government policy' sits at the apex of public sector values.

This suggestion is also inconsistent with the objects set out in section 3 of the Act. The Act does not oblige public servants to implement government policy at any costs. Rather, it seeks a public service which responds to government policy priorities in a manner that is consistent with public sector values. Those values include:

- providing frank, impartial and timely advice to the government
- making decisions and providing advice on merit
- objectively considering all relevant facts and fair criteria
- seeking to achieve best use of resources
- using their views to improve outcomes on an ongoing basis.

The Act and Code empower and oblige public servants to act with integrity and, most importantly, with impartiality. This high standard of conduct cannot be achieved by the public service if this narrow reading of the Act and the Code holds sway.

This interpretation has contributed to the serious deficiencies in the advice provided to government on the EWL project.

Some public officials consulted in the course of this audit indicated that providing frank and fearless advice when they believe a government does not necessarily want to receive it is naïve and creates a risk that they will lose influence or career opportunities. If this attitude becomes pervasive in the public sector there is a significant risk to the integrity of government decision-making and public administration, with consequential implications for the effective management of public resources and services.

Further guidance and support is needed to clarify and emphasise the existing requirements for frank and fearless advice in the public sector.

6.4 Transparency of advice and decision-making

The EWL project should now be used to identify lessons to prevent similar wastage of significant public and private resources on future projects in the state.

6.4.1 Broader lessons

At a high level, some of the drivers behind the significant wasted expenditure on the EWL project included:

- lack of transparency around the business case for the overall project and around the decision to prioritise the eastern section
- signing the project contract in circumstances where the merits of the project and the validity of the planning approvals were contested

- the nature of long-term public private partnerships (PPP), which typically involve high bid costs and high up-front payments to financiers, advisers and subcontractors.

In terms of the broader lessons from the project, areas for consideration by government include:

- encouraging greater transparency around business cases
- strengthening the role of non-partisan institutional bodies in investigating and prioritising investments
- ensuring that transaction time lines allow for the effective contribution of planning authorities and public consultation processes.

On the transparency of business cases, an inquiry into the circumstances surrounding the side letter to EWC commissioned by DPC in early 2015 recommended legislation requiring the release of business cases for major infrastructure projects to enable public scrutiny and increase transparency. The new government publicly released the March 2013 EWL business case and the final business case at the end of 2014.

On strengthening the role of non-partisan institutional bodies in investigating and prioritising investments, the Victorian Parliament passed legislation creating Infrastructure Victoria in early September 2015. When announcing this, the government indicated that Infrastructure Victoria will:

- take short-term politics out of infrastructure planning
- be tasked with ensuring Victoria's immediate and long-term infrastructure needs are identified and prioritised based on objective, transparent analysis and evidence
- consult widely, consider the needs of the whole state and prioritise the projects that deliver the best results
- support government decisions by assessing business cases for major projects.

6.4.2 Advice to government – potential lessons learned

'Compartmentalisation' of advice

LMA and its advisers did not have any direct involvement in the judicial review proceedings associated with the legal challenge to the Minister for Planning's approval decision. Advice to government in relation to the judicial review was presented to a different committee of Cabinet than that to which LMA typically presented. At a critical time in the project, this meant that:

- in one 'compartment', government was being advised on the likelihood that the plaintiffs would be successful in the judicial review proceedings, and on the importance of expediting the hearing
- in another 'compartment', LMA were being asked to consider the legal and commercial implications of proceeding to contractual and financial close while the judicial review remained undetermined, and to advise on the inclusion of a new clause in the project contract relating to the judicial review (clause 58).

This 'compartmentalisation' of knowledge and/or roles created silos and may well have constrained the ability of key agencies and advisers to obtain the 'full picture' relevant to their role, and may have compromised their ability to provide comprehensive advice that adequately assessed the risks and benefits of alternative options.

To illustrate, advice to government clearly stated that an assessment of the state's exposure under clause 58 depended on the outcome of the judicial review. At the same time, the sign-off letters provided by the state's commercial and legal advisers prior to awarding the contract stated that 'We understand that LMA is not involved in the judicial review and, as our scope of work does not include providing advice in relation to the judicial review, we make no comment in this respect'.

Sign-off letters in relation to PPPs

In accordance with standard practice for PPPs, LMA obtained 'sign-off' letters from its legal and commercial advisers in relation to the alignment of the project contract with the National PPP Policy and Guidelines.

In relation to the sign-off letters customarily provided in connection with PPP projects prior to contractual close, it would be beneficial if:

- relevant advisers were given formal access to any separate advice to government that is relevant to the opinions expressed
- any 'non-standard' qualifications or exclusions from adviser sign-off letters were specifically noted in relevant advice to government
- sign-off letters were more specific as to:
 - the aspects of the National Commercial Principles and jurisdiction-specific guidance that have been used to inform development of the PPP contract—for example which aspects of the principles for 'social' and 'economic' infrastructure projects have been applied
 - the areas of the PPP contract that represent project-specific departures or are otherwise not consistent with relevant aspects of the National Commercial Principles and/or jurisdiction-specific guidance
 - relevant client instructions.

Although these issues are unlikely to have affected the final outcomes of the EWL project, the value of the sign-off letters will be increased if these suggestions are implemented.

Entering contracts with other critical issues unresolved

At the time the project tender submissions were due, 28 April 2014, the access arrangements for the connection of the eastern section to CityLink were still being negotiated, creating uncertainty for bidders. This remained unchanged when the preferred bidder was appointed on 9 September 2014. In addition to the uncertainty this situation created for bidders, this potentially compromised the states negotiating position.

Also, delays in completing, and challenges to, the statutory planning process meant there was a lack of certainty regarding the final design and scope of EWL when the preferred bidder was announced.

DTF should develop enhanced guidance for identifying and managing risks associated with concurrent planning, scoping and procurement processes.

Nominal dollars, net present value and discount rates

The differences between cost and benefit forecasts in nominal dollar terms—the amount it cost when it was announced—versus net present value—what that amount of money is worth today—often leads to confusion in public debate, and has the potential to undermine the clarity of advice to government.

For example, advice to the current government in relation to the proposed cancellation of the project and the settlement with EWC:

- noted the state's commitment in nominal dollar terms over the 25 to 30-year contract term, which totalled \$10.7 billion
- commented that this commitment 'created significant economic and opportunity costs' with reference to the initial EWL business case which suggested a direct economic benefit of 45 cents in the dollar.

This advice was presented without specifying the nominal dollar value of forecast toll revenue, or highlighting the state's commitment in present value terms. The way this advice was presented tended to overstate the net costs of completing the project.

Advice to government, and any associated public statements, should wherever practicable present costs and benefits in both nominal and present value terms, with the discount rate and other key assumptions explicitly stated.

Recommendation

6. That the Department of Premier & Cabinet consults with the Victorian Public Sector Commission to support further guidance to clarify the requirements for frank, impartial and timely advice in the public sector by:
 - establishing clear minimum standards for agencies on how to satisfactorily discharge this obligation when providing advice to government
 - advising government on strategies and options for addressing any cultural issues underpinning the serious deficiencies in the advice provided to government highlighted by this report.
-

Appendix A.

Key features of the project contract

This Appendix is drawn from the East West Link (EWL) project summary prepared on behalf of the Linking Melbourne Authority (LMA) in October 2014. In a departure from usual practice for public private partnership (PPP) arrangements in Victoria, the project summary for EWL was not publicly released. The government released a partly redacted copy of the project contract documents in April 2015.

Parties to the project agreement and other project documents

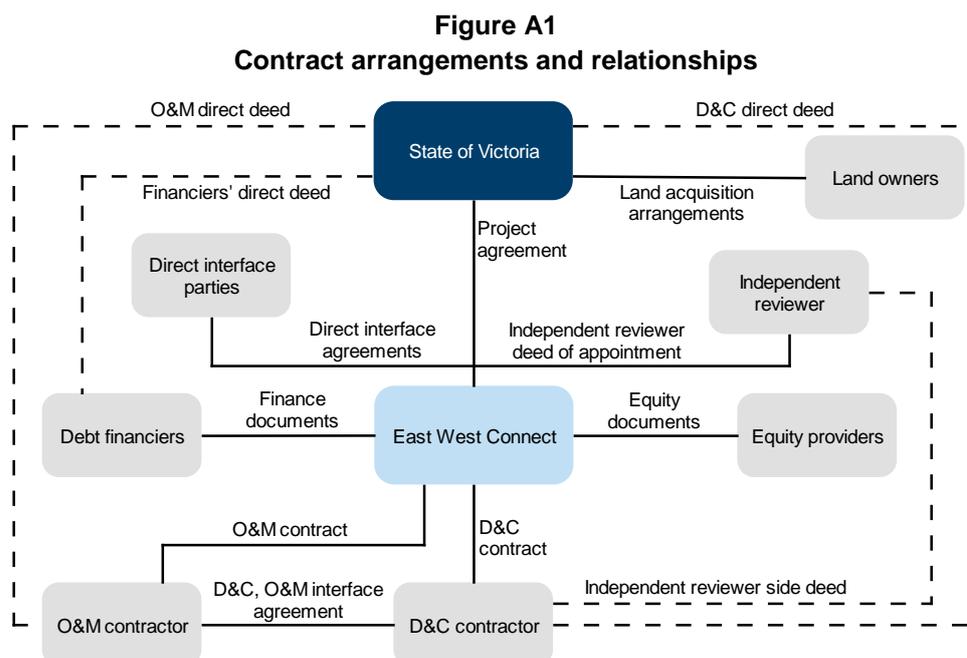
On 29 September 2014, the state executed the project agreement with East West Connect (EWC) to design, construct and finance the project and to operate and maintain it over approximately 30 years—including approximately a five-year design and construction (D&C) phase and 25-year operations and maintenance (O&M) phase. Financial close was subsequently achieved on 3 October 2014, whereby remaining contractual and financing arrangements were finalised between the state, EWC, its key contractors and debt and equity providers.

The key entities involved in the project included:

- **The state**—as a signatory to the project agreement and other ancillary project documents. The Minister for Roads executed the project documents on behalf of the state.
- **LMA**—the state government authority with responsibility for managing the project on behalf of the state.
- **EWC**—the EWC consortium was selected to deliver the project, and was the counterparty to the project agreement. EWC, in turn, contracted with its consortium partners to perform elements of the project. Notwithstanding this, EWC was to be the entity ultimately responsible to the state for the project.
- **Equity providers**—equity for EWC was to be provided by five entities.
- **Debt financiers**—equity for EWC was to be provided by seven entities.
- **D&C contractor**—EWC contracted an unincorporated joint venture comprising three related parties to design and construct the project.
- **O&M contractor**—EWC contracted a related party to operate and maintain the road for the 25-year term.
- **Independent reviewer**—the state and EWC jointly engaged an independent reviewer for the project.

Contractual relationships

The relationship between the state, EWC and other related parties was detailed in the project agreement and associated contracts. Figure A1 outlines the structure and principal agreements.



Source: Victorian Auditor-General's Office.

Contractual terms and risk transfer

The contractual terms and risk allocation in the project agreement were generally consistent with the Partnerships Victoria framework. Through the Partnerships Victoria framework, the state seeks to achieve best value for money by allocating risks to the party best able to manage them. This process results in various risks being retained by the state, transferred to the private sector or shared between the parties.

The project agreement and associated project documents established the obligations of each party in managing the project risks.

Figure A2 outlines at a high level the risk allocation for the project. Where a risk is allocated to both parties, the parties may not necessarily share that risk equally. The project agreement and associated project documents explicitly set out express contract terms for the risks. It should be noted that EWC bore the majority of project risks associated with the PPP project.

Figure A2
Risk summary

Risk category	Description	State	EWC
Approval risk			
Obtaining and maintaining key planning approvals	Risk of delays and/or costs of obtaining and maintaining the key approvals for the project under the <i>Major Transport Projects Facilitation Act 2009</i> (Vic)	✓	
Obtaining additional/ amendments to approvals	Risk of delay and/or costs caused by amendments to the key planning approvals or the need for additional approvals, attributable to any changes to EWC's design solution post contract close		✓
Compliance with approvals	Compliance with all approvals, including those obtained under the <i>Major Transport Projects Facilitation Act 2009</i> (Vic)—subject to limited exceptions where the state has the responsibility for compliance		✓
Site risk			
Contamination caused, contributed to, disturbed or interfered with during the project term	Risk of delay and cost associated with contamination that is caused, contributed to, disturbed or interfered with during the project term	✓	✓
Land acquisition	Risk of cost and delay associated with acquiring land identified as required at contract close	✓	
D&C risk			
Completion of the works	The risk that construction activities cannot be completed on time and/or to budget		✓
Defects risk	The cost of rectifying defects identified during, or following completion of construction		✓
Fit for purpose risk	The risk that the road is not constructed to be fit for purpose or does not comply with contractual obligations under the project agreement		✓
Construction delays caused by inclement weather	The risk of cost and delay caused by inclement weather		✓
Construction delays caused by force majeure events	The risk of cost and delay caused by force majeure events (natural and unavoidable catastrophes that interrupt the expected course of events and restrict participants from fulfilling obligations)	✓	✓
Construction costs and delays caused by certain defined extension events	Risk of cost and delay if caused by defined extension events including breaches by the state of the project agreement (not caused or contributed to by EWC)	✓	
State-initiated modifications to the D&C activities or an occurrence of a specific event requiring modification	Risk of cost and delay associated with the implementation of a state-initiated modification to the D&C of the project or an occurrence of a specific event requiring a modification	✓	
Modifications to the D&C activities initiated by EWC	Risk of cost and delay associated with the implementation of a modification initiated by EWC		✓
Interface risk	The risk associated with the interface between project activities and impacted third parties	✓	✓

Figure A2
Risk summary – continued

Risk category	Description	State	EWC
Operation and maintenance risk			
Carrying out O&M activities	The risk that O&M activities cannot be completed in a timely manner, to the required standards and/or to budget		✓
Handover risk	The risk that the asset will not be in the required condition at the end of the O&M phase		✓
Force majeure risk	The risk that force majeure events affect the operations of the project or its availability	✓	✓
O&M costs caused by defined intervening events	The risk of noncompliance with performance requirements or cost, if caused by defined intervening events (not caused or contributed by EWC)	✓	
Traffic demand risk	The risk that traffic flow, vehicle mix and volume is greater, less or otherwise different than that anticipated at contract close	✓	
Industrial relations risk			
Delays caused by any industrial action except where it is a direct result of an act or omission of the state	The risk of cost and delay caused by such industrial action		✓
Industrial action which is a direct result of an act or omission of the state	The risk of industrial action affecting the construction or the operation of the project which is a direct result of an act or omission of the state which occurs only at the project site or only in respect of the project	✓	
Finance risk			
Financing risk	The risk of providing finance to meet D&C costs—other than the payment of the state's contribution during and following construction—including future refinancing risk		✓
Base interest rate risk after financial close to the first scheduled refinancing	The risk of movement in base interest rates after financial close to the first scheduled refinancing—seven years post financial close		✓
Base interest rate risk after the first scheduled refinancing	The risk of movements in base interest rates from the first scheduled refinancing—seven years post financial close—to the end of the 25-year O&M phase	✓	

Source: Project Summary prepared on behalf of LMA in October 2014.

General obligations of EWC

The state contracted EWC to finance, design and build the project and then operate and maintain it over the 25 year O&M phase—starting from the date for construction completion. The project agreement and associated project documents contained the full range of EWC's obligations.

Figure A3 summarises the key obligations of EWC.

Figure A3
Summary of key EWC obligations

Project element	Description
All risks	Responsible for all risks relating to the project unless expressly specified otherwise.
Time	Responsible to complete all D&C activities and achieve completion of the road by the contracted date for construction completion.
Design, construction, financing and commissioning	Responsible for all aspects of design, construction, finance and commissioning of the project, including: <ul style="list-style-type: none"> • coordination and management of the design development process • liaising with all relevant government agencies and utilities providers and installation and maintenance works to ensure the provision of utility and external infrastructure to the site as required for the project • compliance with <i>Victorian Industry Participation Policy</i> requirements, the Victorian Code of Practice for the Building and Construction Industry and the Victorian Government's <i>Implementation Guidelines to the Victorian Code of Practice for the Building and Construction Industry</i> • implementing an appropriate communications strategy, in conjunction with LMA, to engage with the community and various stakeholder groups.
O&M	Provision of the following services for the project throughout the 25-year O&M phase, in accordance with the performance standards specified in the project scope and requirements and the project agreement more generally: <ul style="list-style-type: none"> • O&M of EWL to a pre-agreed standard, including liaison and interface with other road network operators and performance levels relating to road and traffic management and traffic incident management • provision of traffic management services, including proactive measures to manage traffic flows and performance, and the provision and use of intelligent traffic information systems to maximise road network efficiency, safety and user information • safety and environmental management, including adherence to applicable approvals, laws, guidelines and standards.
Insurances	EWC is required to take out a range of insurances during both the D&C phase and O&M phase of the project.
Finance	Procurement of necessary debt and equity to finance delivery of the project.
Handover	Undertake all necessary tasks to ensure that the project assets and site are handed back to the state on expiry of the O&M phase in the required conditions and in accordance with the end-of-term requirements set out in the Project Agreement.

Source: Project Summary prepared on behalf of LMA in October 2014.

General obligations of the state

The state retained certain obligations under the project agreement. The following summarises some of its key obligations:

- acquire the necessary land to enable EWC to deliver the project
- obtain the relevant key planning approvals under the *Major Transport Projects Facilitation Act 2009 (Vic)*
- establish and facilitate a community advisory group to seek to ensure stakeholder and community involvement in the project
- consider material submitted by EWC in accordance with the project agreement

- undertake defined activities in relation to the project's interfaces with other parts of the transport network
- make state financing contributions:
 - during the D&C phase to assist with payment of construction costs
 - during the O&M phase to facilitate a reduction in private sector debt consistent with an efficient capital structure for this phase of the project
- make an early completion incentive payment if completion of the project and completion of the tolling system are achieved at least one week before the contracted date for construction completion
- make quarterly service payments to EWC during the O&M phase of the project—subject to any abatement that may apply if services are not delivered to the required standard.

Payment mechanism and abatement regime

The state was not required to pay any quarterly service payments to EWC until the project had been certified as having been fully constructed in accordance with the requirements of the project documents.

It is noted that the state intended to separately contract a tolling services contractor to provide relevant works and services, including the commissioning of road-side tolling equipment. In the event that the tolling services contractor did not complete its works until after EWC had met its construction completion requirements, quarterly service payments to EWC may have been paid prior to the road being open.

During the O&M phase, the state was to pay quarterly service payments to EWC according to the payment mechanism in the project agreement. The payment mechanism included an abatement regime to provide an incentive to EWC to operate and maintain the road in accordance with the standards in the project agreement. In other words, the quarterly service payments would be reduced if the road was unavailable or EWC did not meet the necessary performance standards, including:

- availability abatements—which are sized by reference to the number of vehicles affected by the unavailability having regard to historical traffic figures for time periods that correspond to the period of unavailability
- failure to meet required key performance indicators—which cover a range of operation and maintenance activities including those relating to:
 - emergency contact points
 - incident response
 - compliance with certain operational plans
 - maintenance inspections and works
 - reporting and environmental management.

EWC had to monitor its performance against the requirements of the payment mechanism, with a duty to record all performance failures. This obligation was supported by audit rights for the state.

State financial contributions

Traditionally a PPP project is financed by the private sector. Given the size and risk profile of the EWL project and in accordance with the updated Partnerships Victoria guidance with respect to alternative financing options, the state considered a number of financing options to deliver value for money. Reflecting this assessment, the state elected to provide financial contributions to EWC during both the D&C phase and the O&M phase (state contributions) to reduce the amount of private financing that EWC would otherwise have to raise for the project.

The key features of the state contributions were:

- During the D&C phase, a state contribution of \$2 billion (nominal) was to be made available to EWC once a total amount equivalent to 80 per cent of the debt and 100 per cent of equity for the D&C of the project was drawn down by EWC. The state contributions were payable in instalments at the same time as, and in proportion to, remaining drawdowns of debt.
- A final state contribution of \$1 billion (nominal) was to be paid to EWC approximately seven years after financial close, provided certain conditions were satisfied. This contribution was to be used to repay part of EWC's debt obligations, achieving an efficient capital structure for the post construction phase of the project.

The independent reviewer had the ability to undertake 'look forward' tests at any time during the construction phase of the project to determine whether EWC would achieve construction completion on time. If the independent reviewer formed an opinion that construction completion would be late, EWC was required to develop and implement a cure plan to rectify the situation and achieve completion as soon as practicable.

Federal funding for the project

The Commonwealth Government committed a total of \$3 billion to the EWL.

The Commonwealth Government funding was received as grant revenue by the state government under a memorandum of understanding between the Commonwealth and the state. However, the state had sole contractual liability for capital funding contributions to EWC as and when they fell due under the project agreement. The state received \$1.5 billion of this grant for both the EWL – Eastern Section and EWL – Western Section in the 2013–14 financial year.

Finance arrangements

Initial financing

EWC's financing comprised senior debt and equity as follows:

- senior debt comprised a construction facility which converted to a term loan on the scheduled commencement of the O&M phase, with a combined loan term of seven years from financial close when it was expected to be refinanced
- equity was provided by five entities.

The state and EWC's financiers held a range of security over the project's assets in order to secure their interests. The financiers' Direct Deed detailed the rights and priorities between these security interests.

Future refinancings

EWC's debt was to be refinanced at various intervals during the project term. The project agreement entitled the state to a specified share of future refinancing gains. EWC fully bore future refinancing losses.

CityLink interface

The project had a significant physical interface with CityLink, therefore, the project documents incorporated a regime for managing this interface between the state, EWC and, the CityLink manager during the D&C phase and O&M phase.

Tolling interface obligations

The project documents anticipated that the state would separately engage:

- a tolling services contractor to provide works and services including the commissioning of road-side equipment
- a tolling collection contractor to provide toll collection, maintenance and related services or works.

The project agreement set out the obligations of EWC to provide access to these contractors during the term of the project.

Proximate state work

Under the project agreement, the state could, at any time during the project term, construct, operate, maintain or repair any road or other means of vehicle, public transport, pedestrian or bicycle access, or utility infrastructure under, on, above or adjacent to the project land. Where the state exercised these rights, it had to compensate EWC for its increased costs arising from the proximate state works in accordance with the requirements of the project agreement.

Modifications

The state could propose a modification to the project activities at any time during the project term. This included an ability to remove works or O&M services from the project scope. Certain events may have also triggered a requirement for the state to issue a modification, including certain changes in law or policy. Under the modifications regime, EWC was required to provide an estimate of the cost impact of any modification proposed by the state, in a manner which complied with the requirements of the project agreement.

The state was to pay for the modification(s) either by a lump sum payment, milestone payments, or an adjustment to the quarterly service payment—if the modification is financed by EWC. To provide greater transparency and certainty regarding the cost of modifications, the project agreement specified a range of pre-agreed margins.

In addition to the ability to request modifications, a number of pre-agreed modifications had been costed by EWC and included in the project agreement, which the state could nominate to include into the project scope at any time before a specified deadline.

The state had already elected to include two pre-agreed modifications at financial close. These were:

- an additional northbound lane on CityLink between Racecourse Road and Moreland Road—this modification was nominated in connection with the CityLink Tulla Widening project—in relation to which the parties reached agreement on 6 October 2014
- a new shared user overpass on the Eastern Freeway—this was included as a pre-agreed modification after a number of procurement options were considered for this element before determining what the best value-for-money outcome was.

Default, step-in and termination regime

Default

For a major default, EWC was generally required to provide a cure plan and diligently pursue a remedy within the time frames specified in the project agreement. If EWC failed to diligently pursue a remedy, or failed to remedy the event of default within the required time frame, it would generally—subject to financier cure rights—give rise to a state right to terminate the project agreement.

Certain defaults were so severe or not capable of remedy that EWC was not provided with the opportunity to cure the default. These would have given rise to a state termination right immediately—subject to the financiers' cure regime. These events were called default termination events.

Step-in

In addition to triggering termination rights, in the event of (i) a default termination event, (ii) an incident which represents a serious risk to safety, (iii) the project being suspended as a result of a force majeure event or (iv) in certain circumstances in the event of a major default, the state could assume temporary total or partial control of the project and take any steps that were necessary in the reasonable opinion of the state to perform the project activities.

Where the state exercised its right to step in and the event giving rise to that step-in was attributable to a breach by EWC:

- during the D&C phase, EWC had to compensate the state for any costs it incurred during the step-in
- during the O&M phase, the state had its costs reimbursed via the abatement of the quarterly service payment.

Termination

Where the project agreement was terminated before the expiry of the 25-year O&M phase, EWC may have been entitled to a termination payment. Figure A4 summarises the four types of termination payments in the project agreement.

Figure A4
Termination payments

Event	Trigger (summary)	Termination payment (summary)
Termination for convenience	The state may terminate the project agreement at any time by giving 90 days' notice to EWC.	EWC's outstanding debt as at the termination date plus the fair value of the equity, together with any other reasonable costs incurred by EWC as a result of the termination (including amounts payable to subcontractors for loss of profit).
Termination for convenience following a specific key approval event	The state may terminate the project agreement for convenience following a specific key approval event, or the state is required to terminate the project agreement following an extended period of a material impact on the project as a result of a specific key approval event.	EWC's outstanding debt as at the termination date plus an equity component which has been sized to reflect the early termination of the project, together with any other reasonable costs incurred by EWC as a result of the termination (including amounts payable to subcontractors for loss of profit).
Termination for force majeure	The occurrence of a force majeure event which prevents the state and/or EWC from carrying out all or a material part of the project.	EWC's outstanding debt as at the termination date less any insurance proceeds.
Termination for default termination event	The occurrence of a default termination event.	The project's fair market value determined by tendering or an independent valuer. An independent valuer must be used in certain circumstances including where there is no liquid market.

Source: Victorian Auditor-General's Office based on the project summary prepared on behalf of LMA in October 2014.

Specific key approval events

As noted above the state was responsible for obtaining and maintaining key planning approvals, which were the subject of an application for judicial review. Specific provisions were set out in the project agreement to address the circumstances that the key planning approval for the project was found to be invalid or set aside anytime during the first two years after financial close (specific key approval event). In these circumstances, EWC was entitled to an extension of time and costs relating to the delay. The costs claimable by EWC relating to the delay were subject to a daily cap.

The state was required to terminate the project agreement if the specific key approval event subsisted for a specific period of time and had a material impact on EWC's ability to carry out the project activities. In these circumstances, or if the state terminated the project agreement for convenience following the occurrence of a specific key approval event, EWC was entitled to a termination for convenience payment with an equity component sized to reflect the early termination of the project.

To the extent that any new, revised or varied key planning approval procured by the state to address the specific key approval event differed from the original key planning approval, the difference was to be deemed to constitute a modification.

State rights at expiry of contract

Starting from three years prior to the expiry of the O&M phase, EWC and the state were to carry out periodic joint inspections of the road to determine the maintenance and repair work required to achieve the asset condition required under the project agreement at handover.

The estimated costs of carrying out those works were to be progressively set aside in a handover account—or subject to a handover bond of that amount—and reimbursed by the state to EWC as the work was incurred.

At the end of the O&M phase, the road was to revert to the state at no cost. Any money remaining in the handover account was to be paid by the state to EWC.

Reimbursement of bid costs for unsuccessful tenderers

The project was identified as a trial project under new Partnerships Victoria guidelines for reimbursing proposal costs. As such, the state was to contribute to proposal costs of the unsuccessful short-listed respondents equal to 50 per cent of the respondent's verifiable external proposal costs—subject to a maximum payment to any unsuccessful short-listed respondent of \$12 million.

The payment to each short-listed respondent was subject to the unsuccessful short-listed respondents licensing the intellectual property rights in its proposal to the state and otherwise complying with the new Partnerships Victoria requirements and various terms and conditions set out during the tender process.

Audit and inspection rights of the state

The project agreement had contractual rights for the state to be given access to information and data, including to:

- inspect, observe or test any part of the works, infrastructure or project activities
- examine and make copies of the accounts and other records, reports and all documents reasonably requested of EWC or any of its key contractors in connection with the project.

The state had the ability to disclose information in connection with the project to satisfy the disclosure requirements of the Victorian Auditor-General or to satisfy the requirements of Parliamentary accountability.

Appendix B.

Termination agreements and costs

Termination agreements

The state entered into the following termination agreements with the East West Connect (EWC) consortium on 15 June 2015.

Business Purchase Deed (BPD): The state paid \$1.00 for the hard assets and intellectual property (IP) acquired/developed by EWC and the design and construction contractor (D&C) in connection with the Project (sale assets). The IP transferred to the state included the domain name, business name and logo of EWC. It also removed liabilities to the state from the purchase and provided it with representations and warranties for the assets purchased and the mitigation measures undertaken by EWC and the D&C contractor.

Completion Side Deed (CSD)—this document regulated and coordinated the process by which:

- EWC repaid the debt owed to the banks so that the money owed was equal to the state funds
- the state paid the agreed net debt amount of \$420 million plus its contribution to costs incurred since 15 May 2015
- certain finance documents were terminated on a no liability/full release basis
- security granted in favour of the banks and the state was released or returned to the sponsors, and completion occurred under the BPD
- the termination of certain project contracts (and associated releases) took effect.

Other agreements

- **Disclosure Letter**—an agreed form letter under which EWC, the D&C contractor and the Operation and Maintenance (O&M) contractor made disclosures against the warranties given under the BPD.
- **BPD Completion Notice**—notice given by the state under the CSD confirming that the completion obligations under the BPD had been satisfied or waived.
- **Deed of Termination and Release (D&C Access Co-ordination Deed)**—deed under which the state, EWC, CityLink and Transurban agreed to terminate and discharge the 'EWL D&C Access Co-ordination Deed' between the parties.
- **Deed of Termination and Release (Financiers' Certifier Deed and Financiers' Certifier Direct Deed)**—deed under which the state, EWC, Security Trustee and the financiers' certifier agreed to terminate and discharge the 'Financiers' Certifier Deed' and the 'Financiers' Certifier Direct Deed'.

Project costs reimbursed by the state as part of termination

The total contribution to the project costs by the state was \$424 million, including the \$81 million in fees paid to establish the credit facility and \$4 million under the cost sharing regime. EWC had made payments for the following items, as confirmed by the state's due diligence expert.

Figure B1
Payments made by EWC

Item	Description	Costs (\$)
Debt related payments		109 578 998
Equity related payments		
Bid development fees—paid to the D&C contractor	Fee paid to the D&C contractor for services provided prior to financial close	60 000 000
Financial advisory services fee—paid to the financial adviser	Consideration for financial advisory services provided in relation to the bid and financial close achievement.	45 000 000
Equity development fee	Consideration for the services to develop, lead, formulate, revise and implement a development plan for the bid, those services having been provided between commencement of the expression of interest process and financial close.	11 543 066
Bid cost reimbursement	Reimbursement of bid and closing costs incurred.	13 544 626
Letters of credit fees	The letters of credit were letters guaranteeing that the equity contributions would be received on time and for the correct amount. In the event the partners were unable to make payment on the purchase, the bank would have been required to cover the full or remaining amount of the purchase. There are fees payable for these which it was agreed would be paid out of the partnership.	3 879 315
Total equity related payments		133 967 007
Design and construction related payments		
Development success fee	Payment to the engineering arm of the D&C contractor for services to reach financial close.	8 750 000
EWC contractor payments	Construction payment claims as verified by the financier's certifier.	164 051 806
Total design and construction related payments		172 801 806

Figure B1
Payments made by EWC – *continued*

Item	Description	Costs (\$)
Other payments		
O&M contractor payments	Pre-operations service payments made to fund the elements of O&M activities that must be completed prior to entering the O&M phase to be able to commence operations.	2 289 606
Management fees	Payment for services by the management services provider including accounting and finance, human resources and secretarial.	3 613 950
Independent reviewer costs	The independent reviewer provided oversight of the project, including confirming design and construction in line with requirements and reviewing, for EWC, extension of time claims, variations and corresponding cost claims by contractors.	391 045
Financiers' certifier fees	Costs to certify the progress claims from the D&C contractor on behalf of the financiers.	120 832
Engineering services	Payments for proof engineering services.	415 157
Employment services	Payments for training and employment services.	128 159
Long lead items	Payment to the Linking Melbourne Authority relating to contracts for long lead items (i.e. power supply) which were entered into by the Linking Melbourne Authority but novated to EWC under the D&C contractual arrangements.	338 584
Legal and other advisory services	Payments for legal and other advisory services.	473 767
Total other payments		7 771 100
Total payments made by EWC		424 118 911

Source: Victorian Auditor-General's Office based on information from the Department of Premier & Cabinet.

Appendix C.

Audit Act 1994 section 16— submissions and comments

Introduction

In accordance with section 16(3) of the *Audit Act 1994*, a copy of this report, or part of this report, was provided to the Department of Premier & Cabinet, the Department of Treasury & Finance, the Department of Economic Development, Jobs, Transport & Resources, the Department of Environment, Land, Water & Planning, the Department of Justice & Regulation, the Victorian Government Solicitor's Office, Linking Melbourne Authority, VicRoads, Environment Protection Authority, Planning Panels Victoria and the Treasury Corporation of Victoria.

The submissions and comments provided are not subject to audit nor the evidentiary standards required to reach an audit conclusion. Responsibility for the accuracy, fairness and balance of those comments rests solely with the agency head.

Responses were received as follows:

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RESPONSE provided by the Secretary, Department of Premier & Cabinet



Department of
Premier & Cabinet

1 Treasury Place
Melbourne Victoria 3002
Telephone: 03 9651 5111
dpc.vic.gov.au

D15/154158

Dr Peter Frost
Acting Auditor-General
Victorian Auditor-General's Office
Level 24, 35 Collins Street
MELBOURNE VIC 3000



Dear Acting Auditor-General

Performance audit – East West Link project

Thank you for the opportunity to comment on the draft report on the performance audit of the East West Link project.

As explained below, DPC has two key concerns with the draft report:

- As the report notes, there is a fundamental difference between DPC and your Office about the public service's purported failure to meet the "frank" standard in its advice to Government on the project.
- DPC disagrees with the proposed treatment and presentation of the costs of the project.

1. "Frank" advice standard

As the Secretary of the Department of Premier and Cabinet, I have an institutional stewardship role in maintaining the integrity of the Victorian Public Service as a trusted, apolitical public institution. I take this role very seriously.

It is with this role at the forefront of my mind that I would like to reiterate that DPC maintains its position that the advice provided to Government on the project was consistent with the standards, practices and conventions associated with the public service's role in our Westminster system of representative democracy. Further, the advice met all relevant standards under the *Public Administration Act 2004* and the Code of Conduct for Victorian Public Sector Employees.

The draft report presents a view that DPC is arbitrarily adopting a narrow reading of the *Public Administration Act 2004* in so far as the report claims that DPC is asserting that a requirement to 'implement government policy' sits at the apex of public sector values.

DPC rejects these views.

Since the earliest articulation of a professional, apolitical public service in the 1850s, the role of the public service has been to serve, and act as an instrument of, the government of the day, subordinate to the Ministers that it serves. Ministers are responsible to Parliament, and through



**RESPONSE provided by the Secretary, Department of Premier & Cabinet –
continued**

Parliament to the people, for their decisions and actions, as well as those of their departments. Implementing government policies goes beyond a public sector value; it is the principal reason why the public service exists.

The obligation to provide frank and impartial advice is a corollary of the core role of the public service to serve the government of the day. The public service must remain apolitical so that it is able to serve successive governments of different political persuasions. Providing frank, professional and candid advice is a key aspect of remaining apolitical.

The draft report also implies that the Victorian Public Service implements Government policy uncritically and “at any cost”, compromising the public service’s integrity and impartiality.

DPC also rejects this view.

The Victorian Public Service has, and will continue to provide, frank and impartial advice to Government, consistent with the role of a professional public service to advise, assist and, importantly, influence the government of the day.

Being a public servant is more than just a job; we have an essential public function to influence Government decision-making through professional, frank and apolitical advice. This is what distinguishes public servants from fee-for-service consultants and political advisers.

After a Government or Minister has made a decision, the public service must understand how to exercise its role appropriately. We continue to provide objective and impartial advice that is of practical assistance in implementing those decisions and Ministers are advised of risks, particularly if circumstances surrounding a matter change. However, the role and duties of the public service do not extend to prosecuting its own agenda by repeatedly advising of other options that it may prefer, but that run counter to the Government’s settled and stated decision.

In an environment where advice is contestable, and can be sought from parties that have no obligations to neutrality, DPC remains of the view that the public service’s credibility and influence with Government would likely diminish if the public service repeatedly and explicitly recommended a course of action that is contrary to the Government’s settled policy.

If the draft report’s implications were followed to their logical conclusion, it would appear to permit public servants to refuse to enact lawful government decisions on the premise that the public service is the best judge of what is in the public interest. For a public servant to hinder progress to implement a lawful decision, constantly recontest that decision, or refrain from actions that follow from a lawful decision of a Minister, would be to fundamentally undermining the Victorian Public Service as a trusted and apolitical institution, undermine the integrity of our democracy, and erode longstanding conventions that are at the heart of the Westminster system of government.

It is not a uniquely Victorian approach to view the role of the public service as serving the government of the day by diligently implementing lawful government decisions, and through providing impartial advice both in the forming of those decisions and on potential risks flowing from those decisions. Public service guidance from other Australian jurisdictions, including Auditor-General reports, consistently articulate this role for the public service. For example, in instances where Government has already made a lawful decision, New South Wales guidance material advises that it is the responsibility of public servants to implement that decision diligently and to the best of their ability, and to advise the Minister if they see potential risks resulting from that decision.

Finally, the draft report claims that there were serious deficiencies in the advice provided to



**RESPONSE provided by the Secretary, Department of Premier & Cabinet –
continued**

government on the EWL project.

DPC reiterates that the quality of advice provided by the public service about any project can only be assessed fairly and effectively by considering the advice cumulatively and in totality over a project's life cycle.

An auditing process that focuses on individual briefs rather than on a continuous program of advice in its totality would set an unreasonable standard for the public sector, and Ministers, to manage.

2. Treatment and presentation of costs

Emphasis on sunk costs

DPC is also concerned that report places too much emphasis on sunk costs as a relevant and appropriate factor in decision-making and, consequently, as a measure of assessing the value of projects.

In particular, the report notes that the Government was provided with comprehensive advice about the termination of the project, but that advice did not fully consider the benefits of completing the project or include detailed information about the amount of sunk costs.

While the amount of sunk costs incurred on the project was significant, the only costs relevant to a rational investment decision are prospective costs. In the context of the incoming Government's decision about whether to continue the project, as the report notes, the prospective costs of:

- discontinuing the project were estimated at \$900 million (though DPC notes that this cost would vary over time depending on the time of termination); and
- proceeding with the project were \$22 billion.

Presentation of costs

The approach used to calculate the costs of the project also potentially materially overstates its costs, and does not fairly represent the offsets or other benefits that the State will realise.

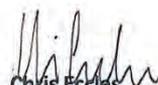
In particular, the headline figure of \$1.1 billion in costs is misleading, because it does not offset the revenue that the State expects to realise from renting and selling properties that were acquired for the project.

DPC also notes that the headline figure includes costs of "complementary" projects (approximately \$9.7 million) that are proceeding and deliver standalone benefits to the state, and pre-construction activities such as design and geotechnical work that may be of value in future.

DPC considers that these issues are fundamental to an informed discussion of the project.

Please contact me if you would like to discuss any of these matters further.

Yours sincerely


Chris Eccles
Secretary

02 DEC 2015



Further audit comment in response to the submission from the Secretary, Department of Premier & Cabinet

The department has raised several significant issues and concerns in their responses that warrant my further comment.

Department of Premier & Cabinet comment	Acting Auditor-General Comment
1. 'Frank' advice standard	
<p>As the Secretary of the Department of Premier and Cabinet, I have an institutional stewardship role in maintaining the integrity of the Victorian Public Service as a trusted, apolitical public institution. I take this role very seriously.</p>	<p>It is important that the secretary, as head of the Victorian Public Service has taken a particular interest in the findings of my report concerning the quality of advice to government. I welcome this and strongly support the fundamental principles set out in the secretary's response that:</p> <ul style="list-style-type: none"> • the public service must remain apolitical so that it is able to serve successive governments of different political persuasions and providing frank, professional and candid advice is a key aspect of remaining apolitical • public servants have an essential public function to advise, assist and, importantly, influence government decision-making through professional, frank and apolitical advice • the role and duties of the public service do not extend to prosecuting its own agenda by repeatedly advising of other options that it may prefer, but that run counter to the government's settled and stated decision • for a public servant to hinder progress to implement a lawful decision, constantly recontest that decision, or refrain from actions that follow from a lawful decision of a minister, would be to fundamentally undermine the Victorian Public Service as a trusted and apolitical institution, undermine the integrity of our democracy, and erode longstanding conventions that are at the heart of the Westminster system of government. <p>However, the secretary has drawn a number of inferences in his response suggesting this report is at odds with these fundamental principles. This is incorrect and these and other elements of the secretary's response are addressed below.</p>

Department of Premier & Cabinet comment	Acting Auditor-General Comment
1. 'Frank' advice standard	
<p>DPC maintains its position that the advice provided to government on the project was consistent with the standards, practices and conventions associated with the public service's role in our Westminster system of representative democracy. Further, the advice met all relevant standards under the <i>Public Administration Act 2004</i> and the Code of Conduct for Victorian Public Sector Employees.</p>	<p>It should be noted that my report also includes praise for the robust advice to government on elements of the project.</p> <p>My report clearly describes instances where advice to government in the lead up to key decisions on the project fell short of the required standard of frankness. Specifically, in the lead up to the government decision to sign the contract with East West Connect (EWC) the advice to government did not:</p> <ul style="list-style-type: none"> • comprehensively examine the merits of alternative options, including delaying finalisation of the contract to mitigate the risks posed by the unresolved judicial review of the project planning approval decision • directly support or oppose the proposed timing of the transaction • recommend any course of action. <p>Instead, achieving the then government's desired time line for contract signing was given disproportionate emphasis despite the emerging risks and implications for the state.</p> <p>The report also identifies that the newly elected government was not provided with updated, comprehensive information, previously unavailable to it in opposition, on the impacts of completing the project versus the option of cancelling it, to provide a more complete assessment of the merits of terminating the contract. This meant it was deprived of comprehensive advice to assure it that termination was the best use of public funds.</p>
<p>The draft report presents a view that DPC is arbitrarily adopting a narrow reading of the <i>Public Administration Act 2004</i> in so far as the report claims that DPC is asserting that a requirement to 'implement government policy' sits at the apex of public sector values. DPC rejects these views. Since the earliest articulation of a professional, apolitical public service in the 1850s, the role of the public service has been to serve, and act as an instrument of, the government of the day, subordinate to the Ministers that it serves. Ministers are responsible to Parliament, and through Parliament to the people, for their decisions and actions, as well as those of their departments. Implementing government policies goes beyond a public sector value; it is the principal reason why the public service exists.</p>	<p>This statement is factually incorrect. The report does not claim that DPC 'is asserting' that the requirement to implement government policy sits at the apex of public sector values.</p> <p>The report's criticisms extend only to DPC's interpretation of the <i>Public Administration Act 2004</i> (the Act) and the <i>Code of Conduct for Victorian Public Sector Employees</i> (the Code) as being 'narrow' because it is analogous to suggesting that that the requirement to implement government policy sits at the apex of public sector values. This is a critically important distinction, as the comment in question reflects VAGO's analysis of the logical conclusion of DPC's narrow reading of the Act and the Code in this instance. The statement in question, therefore, does not purport to reflect an explicit assertion of DPC.</p>

Department of Premier & Cabinet comment	Acting Auditor-General Comment
1. 'Frank' advice standard	
<p>The draft report also implies that the Victorian Public Service implements Government policy uncritically and 'at any cost', compromising the public service's integrity and impartiality. DPC also rejects this view.</p>	<p>This statement is factually incorrect. The report correctly states that the Act does not oblige public servants to implement government policy at any costs, but rather seeks a public service which responds to government policy priorities in a manner that is consistent with public sector values.</p> <p>The report does not imply that the Victorian Public Service implements government policy uncritically and 'at any cost'. It states that the Act and the Code empower and oblige public servants to act with integrity and, most importantly, with impartiality.</p>
<p>The Victorian Public Service has, and will continue to provide, frank and impartial advice to Government, consistent with the role of a professional public service to advise, assist and, importantly, influence the government of the day. Being a public servant is more than just a job; we have an essential public function to influence Government decision-making through professional, frank and apolitical advice. This is what distinguishes public servants from fee-for-service consultants and political advisers.</p>	<p>These principles are not in dispute and are strongly supported. The purpose of my recommendation to the department is consistent with these principles as it encourages the department to support further guidance to clarify the requirements for frank, impartial and timely advice to government in the public sector.</p>
<p>After a Government or Minister has made a decision, the public service must understand how to exercise its role appropriately. We continue to provide objective and impartial advice that is of practical assistance in implementing those decisions and Ministers are advised of risks, particularly if circumstances surrounding a matter change. However, the role and duties of the public service do not extend to prosecuting its own agenda by repeatedly advising of other options that it may prefer, but that run counter to the Government's settled and stated decision.</p> <p>In an environment where advice is contestable, and can be sought from parties that have no obligations to neutrality, DPC remains of the view that the public service's credibility and influence with Government would likely diminish if the public service repeatedly and explicitly recommended a course of action that is contrary to the Government's settled policy.</p> <p>If the draft report's implications were followed to their logical conclusion, it would appear to permit public servants to refuse to enact lawful government decisions on the premise that the public service is the best judge of what is in the public interest. For a public servant to hinder progress to implement a lawful decision, constantly recontest that decision, or refrain from actions that follow from a lawful decision of a Minister, would be to fundamentally undermine the Victorian Public Service as a trusted and apolitical institution, undermine the integrity of our democracy, and erode longstanding conventions that are at the heart of the Westminster system of government.</p>	<p>These statements misrepresent my report. There is no suggestion in the report that public servants should refuse to enact lawful government decisions in pursuit of their own agendas. Rather, the report indicates that when advising government on key decisions, or on significantly changed circumstances that impact on previous decisions, the public service has an obligation to go beyond apprising government of risks, to also making an impartial recommendation that is in the best interests of the state. At critical points in this project, this did not occur.</p> <p>The report neither asserts nor implies that the public service should 'repeatedly and explicitly recommend a course of action that is contrary to the government's settled policy'. It is important to note that the report's major criticism of the quality of advice primarily relates to circumstances in which <i>government had yet to make a final decision</i> on whether or not to sign the contract with EWC prior to the November 2014 election.</p> <p>The report notes that it was clear that the government's policy intent was to have a contract in place for stage 1 of the project before the caretaker period for the November 2014 state election. However, it sought and considered advice on the timing and precise content of that contract and its other options before making a final decision on contract signing.</p>

Department of Premier & Cabinet comment	Acting Auditor-General Comment
<p>1. 'Frank' advice standard</p>	<p>This advice was provided to government on 23 September 2014. The advice made it abundantly clear that <i>government had not made a decision to sign</i> the contract before that day because the submission to Cabinet and the covering briefs from DPC and DTF all clearly indicated that the government faced a choice between:</p> <ul style="list-style-type: none"> • signing the contract in line with the previously set timeframe of having it in place before the election, noting that to achieve this would require accepting the contract amendments and providing the side letter sought by EWC • delaying contract signing until after the judicial review of the project planning decision was resolved. <p>My report is critical of the advice to government on 23 September 2014 because it did not comprehensively examine the merits of options alternative to signing the contract, including delaying contract finalisation, or directly support or oppose the proposed timing of the transaction.</p> <p>The public service had an opportunity in its advice to government on that day to recommended a course of action in the best interests of the state based on its understanding of the risks posed by the unresolved judicial review and the potential additional costs if the state signed a contract with the amendments sought by EWC and the judicial review went against it.</p> <p>This opportunity was not taken despite advice from the Linking Melbourne Authority that it would be unprecedented to sign a PPP contract in the circumstances that prevailed at that time. Instead, the advice to government included no recommendation on whether or not signing the contract at that time was in the best interests of the state and it did not sufficiently assess the benefits of delaying finalisation of the contract to mitigate the risks posed by the unresolved judicial review.</p> <p>That is why the report concludes that the advice to government fell short of the expected standard of being frank and fearless.</p> <p>It should be noted that the government decided to sign the contract with EWC on 23 September 2014. Yet the department's response suggests that a decision to sign the contract had already been made before 23 September 2014. If this were true, there would have been no purpose or reason for outlining the options available to the government in the advice presented to it on that day. On this basis, the criticism in the department's response that my report is suggesting that the public service should have prosecuted its 'own agenda' by 'repeatedly advising on options that were against the government's settled and stated decision', or to 'hinder progress to implement a lawful decision', or 'constantly recontest that decision' cannot stand.</p>

Department of Premier & Cabinet comment	Acting Auditor-General Comment
1. 'Frank' advice standard	
	<p>There is no suggestion in the report that the public service should have frustrated or resisted the government policy decision to sign the contract, once that decision was made.</p> <p>The department has had no regard to another pertinent example which is appropriately acknowledged in my report. This relates to advice to government from DTF on options for repurposing the EWC loan facility. The government initially announced its intention to take over that facility. DTF advised on the significant complexities and value-for-money issues associated with this approach and the government ultimately determined not to take over the loan facility. This was an instance where <i>'government had signalled a preferred outcome but had not yet taken a final decision to implement that outcome'</i>. The public service provided frank and fearless advice and the government was influenced to adopt an approach which was different to its initial preference.</p>
<p>It is not a uniquely Victorian approach to view the role of the public service as serving the government of the day by diligently implementing lawful government decisions, and through providing impartial advice both in the forming of those decisions and on potential risks flowing from those decisions. Public service guidance from other Australian jurisdictions, including Auditor-General reports, consistently articulate this role for the public service. For example, in instances where Government has already made a lawful decision, New South Wales guidance material advises that it is the responsibility of public servants to implement that decision diligently and to the best of their ability, and to advise the Minister if they see potential risks resulting from that decision.</p>	<p>These principles are not in dispute. They are strongly supported. The purpose of my recommendation to the department is consistent with these principles as it encourages the department to support further guidance in the public sector to clarify the requirements for frank, impartial and timely advice to government.</p>
<p>The draft report claims that there were serious deficiencies in the advice provided to government on the EWL project. DPC reiterates that the quality of advice provided by the public service about any project can only be assessed fairly and effectively by considering the advice cumulatively and in totality over a project's life cycle.</p> <p>An auditing process that focuses on individual briefs rather than on a continuous program of advice in its totality would set an unreasonable standard for the public sector, and Ministers, to manage.</p>	<p>The deficiencies in the advice are discussed above and are clearly set out in my report. The suggestion that my audit and report have somehow selectively focused on individual briefs is emphatically rejected as it fails to acknowledge that my audit has examined this project from its inception to termination.</p> <p>My office has been monitoring the progress of this project since mid-2013. When planning and conducting this audit we took particular pains to gain assurance that departments and agencies had disclosed all relevant information and my officers obtained and reviewed thousands of pages of advice and other project related documentation.</p> <p>While the audit did examine all relevant advice and other evidence, it would be a disservice to the Parliament if my report did not seek to distil the key issues. The report is appropriately focused on the adequacy of advice to government on key project decisions on matters such as the business case, procurement outcome, contract signing and project termination.</p>

Department of Premier & Cabinet comment	Acting Auditor-General Comment
2. Treatment and presentation of costs	
<p><i>Emphasis on sunk costs</i></p> <p>DPC is also concerned that report places too much emphasis on sunk costs as a relevant and appropriate factor in decision-making and, consequently, as a measure of assessing the value of projects.</p> <p>In particular, the report notes that the Government was provided with comprehensive advice about the termination of the project, but that advice did not fully consider the benefits of completing the project or include detailed information about the amount of sunk costs.</p> <p>While the amount of sunk costs incurred on the project was significant, the only costs relevant to a rational investment decision are prospective costs. In the context of the incoming Government's decision about whether to continue the project, as the report notes, the prospective costs of:</p> <ul style="list-style-type: none"> • discontinuing the project were estimated at \$900 million (though DPC notes that this cost would vary over time depending on the time of termination); and • proceeding with the project were \$22 billion. 	<p>DPC assert that the 'sunk costs' incurred on the project were totally irrelevant to decision-making on the future of the project by the new government and that only prospective costs should have been considered. My office previously responded to DTF and DPC on this issue, noting that the argument is not soundly based because the report clearly indicates that the state had spent significant amounts on planning, developing, procuring and contracting EWL and that although these were 'sunk costs' they may have impacted the extent of 'future costs' required if the option of completing EWL was compared directly to other priority projects. This is because other projects would have required expenditure on pre-construction and procurement activities that had already been completed for EWL.</p> <p>The other main deficiency in the departments' argument is that it is totally cost-centric, and ignores the fact that sunk costs are relevant for determining both realised and future benefits. The report fairly observes that advice to government on termination options did not adequately analyse the comparative benefits of proceeding with the project against terminating it to fully inform the government's decision on whether or not to terminate.</p>
<p><i>Presentation of costs</i></p> <p>The approach used to calculate the costs of the project also potentially materially overstates its costs, and does not fairly represent the offsets or other benefits that the State will realise.</p> <p>In particular, the headline figure of \$1.1 billion in costs is misleading, because it does not offset the revenue that the State expects to realise from renting and selling properties that were acquired for the project.</p> <p>DPC also notes that the headline figure includes costs of 'complementary' projects (approximately \$9.7 million) that are proceeding and deliver standalone benefits to the state, and pre-construction activities such as design and geotechnical work that may be of value in future.</p>	<p>These assertions are incorrect and misrepresent the content of my report because:</p> <ul style="list-style-type: none"> • references in the report to the state having expected costs of in excess of \$1.1 billion on the project are appropriately and transparently qualified with reference to the fact that the properties acquired for the project can be resold and includes the Department of Treasury & Finance's estimate of future sale proceeds • the report fairly notes in both the Audit summary and Part 2 that pre-construction activities including design and geotechnical work and elements of the complementary projects may provide some value in the future.

RESPONSE provided by the Secretary, Department of Treasury & Finance



Department of
Treasury & Finance



1 Treasury Place
East Melbourne Victoria 3002
Telephone: +613 9651 5111
DX210759

- 2 DEC 2015

Dr Peter Frost
Acting Auditor General
Office of the Victorian Auditor General
Level 24, 35 Collins Street
Melbourne VIC 3000

Dear Dr Frost

PERFORMANCE AUDIT REPORT – EAST WEST LINK

Thank you for the opportunity to comment on the revised report on the East West Link (EWL) performance audit which the Department of Treasury and Finance (DTF) received on 30 November 2015.

As you are aware, DTF has consistently raised concerns about successive drafts of the audit report regarding a lack of substantiation of some of the findings and selective quotation of advice with inadequate context. DTF remains disappointed that despite extensive feedback, my Department and your office continue to disagree on many matters of substance.

As such, DTF considers that the report does not offer an appropriate basis to reasonably support the audit recommendations, and therefore we are unable to, and do not, accept any of the recommendations.

Of particular importance, the report makes a number of findings about providing advice to successive governments, and specifically that in some instances it fell short of the required standard to be "frank and fearless". I fundamentally disagree. I believe that the Department acted with integrity and impartiality in providing advice to both the current and former governments in line with our responsibilities, duties and the best traditions of the Victorian Public Service. I am firmly of the view that at all times the Department met all the relevant standards of the *Public Administration Act 2004*, the *Code of Conduct for Victorian Public Sector Employees* and further relevant implied and express conventions.

Throughout the development and implementation of the EWL project and serving the government of the day, DTF provided appropriate and frank, impartial and apolitical advice. The report makes unattributed allegations that some staff felt "that providing frank and fearless advice when they believe a government does not want to receive it will negatively impact their influence or career opportunities". All signatories to the DTF briefings on the project and other key DTF staff advising both the current and former governments have confirmed this was never a consideration in their advice.



**RESPONSE provided by the Secretary, Department of Treasury & Finance –
continued**

The report develops a theme that the project was rushed and implies this led to poor outcomes. DTF's view is that within the policy setting clearly established by the former government from the outset and in implementing subsequent ministerial decisions, the planning, development and procurement of the project was undertaken by the bureaucracy in a highly robust, appropriate, considered and efficient manner.

The report highlights a "total expected" or "total incurred" cost to the State of around \$1.1 billion for the eastern section. As previously advised, DTF considers this presentation to be selective and misleading by including incurred and expected future costs associated with land purchases but excluding the corresponding estimates of land sale proceeds. DTF considers a net figure split into the separate time periods of project development and termination is a more appropriate presentation throughout the document.

DTF also notes that the total expected costs quoted include sunk costs at the time the decision was made to terminate the project. DTF remains of the view that sunk costs are not a relevant determinant in making decisions on future actions.

I am available to discuss any elements of this response further with you at your convenience.

Yours sincerely



David Martine
Secretary

Further Audit comment in response to the submission from the Secretary, Department of Treasury & Finance

The department has raised several significant issues and concerns in their responses that warrant my further comment.

Department of Treasury & Finance comment	Acting Auditor-General Comment
<p>DTF has consistently raised concerns about successive drafts of the audit report regarding a lack of substantiation of some of the findings and selective quotation of advice with inadequate context. DTF remains disappointed that despite extensive feedback, my Department and your office continue to disagree on many matters of substance.</p> <p>As such, DTF considers that the report does not offer an appropriate basis to reasonably support the audit recommendations, and therefore we are unable to, and do not, accept any of the recommendations.</p>	<p>The department's assertion lacks foundation as it is made without supporting evidence, and misrepresents both the content of my report and the veracity of issues it claims it has consistently raised. This latter inference is particularly misleading as it incorrectly implies my office has repeatedly ignored DTF's concerns, and that DTF has consistently made plausible and accurate representations to my office concerning these matters.</p> <p>It should also be noted that DTF's submission is not subject to audit, nor the Australian Auditing and Assurance Standards applying to my office when making findings and forming an audit conclusion.</p> <p>DTF's refusal to accept any recommendation is at odds with its earlier response to a draft of my report in which it indicated at least partial support for elements of the recommendations.</p> <p>Consistent with standard practice, my office carefully considered and promptly responded to issues and concerns raised by DTF during this audit. This involved considering the basis for all matters raised and the veracity, sufficiency and appropriateness of any supporting evidence.</p> <p>While my office made a number of changes to the draft report in response to some of these issues, most of DTF's claims did not warrant the adjustments it was seeking as they would have compromised the accuracy and integrity of this audit. This is because they were not supported by sufficient and appropriate evidence, and in particular would have:</p> <ul style="list-style-type: none"> • obscured the scale of the state's expenditure on the EWL project • diverted attention from the inadequate advice to the government at critical junctures of the project. <p>Our assessment of, and responses to, DTF's concerns were clearly documented in the form of acquittals and promptly communicated to DTF during this audit. While DTF maintains it is 'disappointed' by the outcome, I am satisfied that these assessments were objective, balanced, appropriate and made in the public interest.</p>

Department of Treasury & Finance comment	Acting Auditor-General Comment
<p>Of particular importance, the report makes a number of findings about providing advice to successive governments, and specifically that in some instances it fell short of the required standard to be 'frank and fearless'. I fundamentally disagree. I believe that the Department acted with integrity and impartiality in providing advice to both the current and former governments in line with our responsibilities, duties and the best traditions of the Victorian Public Service. I am firmly of the view that at all times the Department met all the relevant standards of the <i>Public Administration Act 2004</i>, the Code of Conduct for Victorian Public Sector Employees and further relevant Implied and express conventions.</p> <p>Throughout the development and implementation of the EWL project and serving the government of the day, DTF provided appropriate and frank, impartial and apolitical advice.</p>	<p>These statements echo those from the Department of Premier & Cabinet (DPC) and have been extensively dealt with above in my response to the comments from DPC. In short, they misrepresent the content of my report as it clearly demonstrates instances where, over the life of this project, the advice to government in the lead up to key decisions fell short of the standard and values espoused in the <i>Public Administration Act</i> and the Code.</p>
<p>The report makes unattributed allegations that some staff felt 'that providing frank and fearless advice when a government does not want to receive it will negatively impact their influence or career opportunities'. All signatories to the DTF briefings on the project and other key DTF staff advising both the current and former governments have confirmed this was never a consideration in their advice.</p>	<p>The views cited in the report were expressed verbally, in confidence, to my officers by more than one official in more than one agency. Given this, the commentary in the report is supported by sufficient evidence. It is important that these views, as expressed to us, are disclosed in the report because as stated in the report, if this view becomes common in the public sector it poses a significant risk to the integrity of government decision-making and public administration.</p>
<p>The proposed report develops a theme that the project was rushed and implies this led to poor outcomes. DTF's view is that within the policy setting clearly established by the former government from the outset and in implementing subsequent ministerial decisions, the planning, development and procurement of the project was undertaken by the bureaucracy in a highly robust, appropriate, considered and efficient manner.</p>	<p>The report fairly assesses the management of the project and advice to government and includes praise for the completion of the procurement process in line with the government's desired time lines.</p> <p>The report also highlights issues that arose due to the concurrent activity on project development, statutory planning, procurement and contract negotiation. Our review of advice to government shows ample evidence of DPC and DTF raising issues about the challenging time lines for the project and the risks relating to parallel processes.</p>
<p>The report highlights a 'total expected' or 'total incurred' cost to the state of around \$1.1 billion for the eastern section. As previously advised, DTF considers this presentation to be selective and misleading by including incurred and expected future costs associated with land purchases but excluding the corresponding estimates of land sale proceeds.</p>	<p>This assertion is incorrect and misrepresents the content of my report because references in the report to the state having expected costs of in excess of \$1.1 billion on the project are appropriately and transparently qualified with explicit references to the fact that the properties acquired for the project can be resold and DTF's estimated value of the proceeds from these potential future sales of \$320 million.</p> <p>However, we do not consider it appropriate to deduct this figure from the actual cost of the project as the properties in question have yet to be sold and thus actual proceeds from any sale may materially differ from DTF's current estimate as they will depend heavily on the timing of any future sale and the prevailing conditions of the property market at that time.</p>

Department of Treasury & Finance comment	Acting Auditor-General Comment
<p>DTF considers a net figure split into the separate time periods of project development and termination is a more appropriate presentation throughout the document.</p>	<p>We have clearly acquitted the objective for this audit which included assessing the total costs of the project. These costs are set out in Figure 2A of the report which also includes adequate discussion on the components of the total expected cost. As noted above, this total cost is appropriately qualified with reference to the fact that the state will obtain future revenue from the sale of properties acquired for the project.</p> <p>Figure 2A of my report also includes an appropriate breakdown of the total project costs by phase, including the periods of project development and termination.</p>
<p>DTF also notes that the total expected costs quoted include sunk costs at the time the decision was made to terminate the project. DTF remains of the view that sunk costs are not relevant in making decisions on future actions.</p>	<p>My office has previously responded to DTF and DPC on this issue, noting that the argument is not soundly based because the report clearly indicates that the state had spent significant amounts on planning, developing, procuring and contracting EWL and that although these were 'sunk costs' they may have impacted the extent of 'future costs' required if the option of completing EWL was compared directly to other priority projects. This is because other projects would have required expenditure on pre-construction and procurement activities that had already been completed for EWL.</p> <p>The other main deficiency in the departments' argument is that it is totally cost-centric, and ignores the fact that sunk costs are relevant for determining both realised and future benefits. The report fairly observes that advice to government on termination options did not adequately analyse the comparative benefits of proceeding with the project against terminating it to fully inform the government's decision on whether or not to terminate.</p>

RESPONSE provided by the Secretary, Department of Environment, Land, Water & Planning



Department of Environment
Land, Water & Planning

8 Nicholson Street
East Melbourne, Victoria 3002
PO Box 500
East Melbourne, Victoria 8002
www.delwp.vic.gov.au

Dr Peter Frost
Acting Auditor-General
Level 24, 35 Collins Street
MELBOURNE VIC 3000



Ref: SEC011692

Dear Dr Frost

EAST WEST LINK PERFORMANCE AUDIT

Thank you for your letter dated 4 November 2015 inviting submissions for inclusion in the final report for the performance audit *East West Link*.

The Department of Environment, Land, Water and Planning notes the findings and the recommendations from the audit and will work with the Department of Premier and Cabinet and the Department of Treasury and Finance to address the recommendations for High Value High Risk projects.

Thank you for raising this matter with me.

Yours sincerely

Adam Fennessy
Secretary

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**RESPONSE provided by the Secretary, Department of Justice & Regulation –
continued**



Department of
Justice and Regulation

Secretary



121 Exhibition Street
Melbourne Victoria 3000
GPO Box 4356
Melbourne Victoria 3001
Telephone: (03) 8684 0500
Facsimile: (03) 8684 0525
greg.a.wilson@justice.vic.gov.au
justice.vic.gov.au
DX210220

Our ref: CD/15/516061

Dr Peter Frost
Acting Auditor-General
Victorian Auditor-General's Office
Level 24, 35 Collins Street
MELBOURNE VIC 3000

Dear Dr Frost

Proposed Audit Report: East West Link Project

Thank you for your letter dated 4 November 2015 enclosing the audit report *East West Link Project* and the invitation to provide a response.

The Department of Justice & Regulation notes the findings articulated in the report.

Yours sincerely

Greg Wilson
Secretary



RESPONSE provided by the Acting Chief Executive Officer, Linking Melbourne Authority



16 November 2015

Dr Peter Frost
Acting Auditor-General
Victorian Auditor-General's Office
Level 24, 35 Collins Street
Melbourne Vic 3000



Dear Dr Frost

Performance Audit Report: East West Link Project

Thank you for your letter dated 4 November 2015 regarding the performance audit report *East West Link Project* (the report).

The Linking Melbourne Authority appreciates the opportunity to consider the report and its recommendations.

The Linking Melbourne Authority's operations are in the final stages of being concluded. For this reason, we make no further comment in relation to the report.

Yours sincerely

A handwritten signature in blue ink, appearing to read "Duncan Langdon".

Duncan Langdon
Acting Chief Executive Officer

www.linkingmelbourne.vic.gov.au



Level 20, 180 Lonsdale Street, Melbourne 3000 | PO Box 21710 Little Lonsdale St VIC 8011 | T: 03 8681 4500 | E: contact@lma.vic.gov.au

RESPONSE provided by the Chief Panel Member, Planning Panels Victoria



Planning Panels Victoria
Department of Environment, Land, Water and Planning

1 Spring Street
Melbourne Victoria 3000
GPO Box 2392
Melbourne, Victoria 3001
Telephone (03) 8392 6397
Facsimile (03) 8392 6381

13 November 2015

Mr Tony Brown
Senior Audit Manager, Performance Audit
Victorian Auditor-Generals Office
By email: tony.brown@audit.vic.gov.au



Dear Mr Brown

Re: East West Link Report

I refer to your email of 4 November 2015 regarding the East West Link Audit report (November 2015).

Thank you for the opportunity to review this report, which I have done so confidentially.

Planning Panels Victoria has no further comment to make about your findings and recommendations, and I thank you for the opportunity to be involved in this audit review process.

If you require any further information from Planning Panels Victoria, please contact me on 83926389 or Kathy.mitchell@delwp.vic.gov.au

Yours sincerely

Kathy Mitchell
Chief Panel Member

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RESPONSE provided by the Chief Executive Officer, Environment Protection Authority Victoria

Our Ref: MA006770

Dr Peter Frost
Acting Auditor-General
Level 24, 35 Collins St
MELBOURNE VIC 3000



Dear Dr Frost

Proposed Audit Performance Report: East West Link Project

Thank you for your letter of 04 November 2015 regarding the final draft audit report for the East-West Link Project and the opportunity to participate in the process.

EPA has reviewed the draft report and has no comments to be included.

Yours sincerely

NIAL FINEGAN
CHIEF EXECUTIVE OFFICER
ENVIRONMENT PROTECTION AUTHORITY VICTORIA

19 / 11 / 2015



Environment
Protection
Authority Victoria

200 Victoria Street
Carlton VIC 3053

GPO Box 4395
Melbourne VIC 3001

DX 210082

T 1300 372 842
1300 EPA VIC

W epa.vic.gov.au



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Follow up of Managing Major Project (2015–16:2)	August 2015
Follow up of Management of Staff Occupational Health and Safety in Public Schools (2015–16:3)	August 2015
Biosecurity: Livestock (2015–16:4)	August 2015
Applying the High Value High Risk Process to Unsolicited Proposals (2015–16:5)	August 2015
Unconventional Gas: Managing Risks and Impacts (2015–16:6)	August 2015
Regional Growth Fund: Outcomes and Learnings (2015–16:7)	September 2015
Realising the Benefits of Smart Meters (2015–16:8)	September 2015
Delivering Services to Citizens and Consumers via Devices of Personal Choice: Phase 2 (2015–16:9)	October 2015
Financial Systems Controls Report: Information Technology 2014–15 (2015–16:10)	October 2015
Department of Education and Training: Strategic Planning (2015–16:11)	October 2015
Public Hospitals: 2014–15 Audit Snapshot (2015–16:12)	November 2015
Auditor General's Report on the Annual Financial Report of the State of Victoria, 2014–15 (2015–16:13)	November 2015
Local Government: 2014–15 Audit Snapshot (2015–16:14)	November 2015
Responses to Performance Audit Recommendations 2012–13 and 2013–14 (2015–16:15)	December 2015

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Victorian Auditor-General's Office
Level 24, 35 Collins Street
Melbourne Vic. 3000
AUSTRALIA

Phone: +61 3 8601 7000
Fax: +61 3 8601 7010
Email: comments@audit.vic.gov.au
