



P. Poon

Performance Audit Report

Roads and Traffic Authority

- **The M2 Motorway**



BOX 12 GPO
SYDNEY NSW 2001

Mr R D Grove
The Clerk of the Legislative Assembly
Parliament House
SYDNEY NSW 2000

Dear Mr Grove

In compliance with Section 38E(2) of the *Public Finance and Audit Act 1983*, I present to you a performance audit report titled **The M2 Motorway**.

The Report is issued pursuant to Section 38C of the *Public Finance and Audit Act 1983*, and is to be dealt with in accordance with Section 63C of that Act.

The Report is very similar to the Draft Report I forwarded to the Minister for Roads on 1 December 1994 and which the Minister himself tabled in Parliament that same day. Alterations which have been made in finalising this Report are:

- the inclusion of a new section, incorporating comments by the Roads and Traffic Authority and subsequent views of Audit;
- an updated cost for the audit, including final costs of publication; and
- minor typographical corrections.

The changes do not alter the findings, conclusion or recommendations of the Report.

Yours faithfully

A C HARRIS

Sydney
31 January 1995

Performance Audit Report

Roads and Traffic Authority

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State Library of New South Wales cataloguing-in publication data

New South Wales. Audit Office.

Performance audit : the M2 Motorway / The Audit Office of New South Wales.

ISBN 0731048636

1. M2 Motorway (Sydney, N.S.W.) - 2. Express highways - New South Wales - Sydney - Design and construction - Auditing. I. Title: M2 Motorway.

388.122099441

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Introduction

INTRODUCTION

On Tuesday 22 November 1994, the Legislative Assembly resolved, *inter alia*:

- (2) That as a consequence, this House calls upon the Auditor-General to immediately and urgently fully review the terms and conditions of the M2 contracts for report to the House by 9.00am Thursday 1 December 1994.
- (3) That in his review, the Auditor-General obtain independent legal advice on all matters relating to the M2 contracts, including, but not restricted to, the following matters:
 - whether the contracts are legally binding;
 - whether variations in the contracts may be made; and
 - whether a contract binding governments and taxpayers for up to 45 years is constitutionally valid and whether it is appropriate in light of financial and other issues.
- (4) That this House calls upon the Government to make all documents, including Cabinet and legal documents, available to the Auditor-General to ensure a full, in-depth inquiry under the terms of this motion.

The performance audit commenced the next day as papers relating to the M2 (Deeds, Agreements, reviews, reports) were being forwarded to the Audit Office by the Government.

Consistent with the resolution, the Audit Office asked the firm Minter Ellison Morris Fletcher Solicitors to advise on the matters specifically raised by the Assembly. It was also asked to prepare in plain English some understanding of the legal arrangements surrounding the development of the M2.

The Audit Office also engaged Professor R.Walker as a consultant for the Report.

In the time available, this was a formidable request. The material legal documents cover over twenty-two documents said to stand four feet high.

Minter Ellison Morris Fletcher was selected for this task from a process that saw many legal firms, including the Crown Solicitor's Office, exclude themselves because of possible conflicts of interest.

The results of Minter Ellison Morris Fletcher's work is fully reflected in this Report.

The estimated full costs of undertaking this project and producing this Report are in the order of \$138,000. Of this, some \$32,000 was paid to obtain the necessary advice from legal consultants.

The Assembly's resolution could not have been met without the full support and co-operation of the Government and especially of the Minister for Roads who ensured that The Audit Office had the full help of the Department of Transport and of the Roads and Traffic Authority (RTA). Consistent with the Assembly's resolution, the Government also waived its legal right to restrict access to Cabinet and certain legal documents so that The Audit Office had, as far as could be ascertained, full access to all material documents.

The Report is the outcome of sustained effort by all relevant persons over a short time frame. This involved staff of The Audit Office working long hours including of course through the intervening weekend. Their essential contribution is particularly appreciated.

In relation to the audit there is one specific matter that needs to be commented on. That relates to the general question of treating publically available documents as confidential in the course of conducting Performance Audit.

Confidentiality

In his letter of 24 November 1994 on the conduct of this performance audit on the M2, the Chief Executive of the RTA advised that:

the Minister for Roads has advised the Parliament that the Government did not propose to table the contract deed (that is, between the Authority and The Hills Motorway) at this time,

and

the private sector parties to the contracts have agreed that they be furnished to you (The Audit Office) for purposes of your review only. They have released the documents on the basis that they should not be made public without their specific consent.

This approach to confidentiality on the part of the Government and the private sector parties conflicts with the practice followed by the private sector elsewhere with respect to the same documents.

Although these confidentiality strictures were echoed by some of the private participants in the M2 and their legal advisers, Clayton Utz, advisers to one of the participants, rightly pointed out that “..... the Deed of Consent is a public document - pursuant to the prospectus it is available to all prospective equity investors -.....”. Moreover, it is known that members of the public have been provided with access to documents including the Base Case Model which was specifically identified as confidential by the private sector participants.

It is natural that the private sector should be anxious about the prospects of unwanted publicity. But there seems to be no good reason why the Government should accept that position, seemingly without question or consideration.

The question of confidentiality of private sector - public sector documents relating to infrastructure has recently been considered in two forums. The Public Accounts Committee (Report No. 73, July 1993):

..... carefully considered the question of private infrastructure contract disclosure..... it believes that such disclosures should be more specific than is presently the case under the Freedom of Information Act and that such disclosures should be available to the public as a matter of course. (page v)

This approach did not, I think, take into account the significantly broader public disclosures that can and do operate - as in the case of the M2 - in the context of a prospectus.

That Report also pre-dated the Committee's Report No. 77, January 1994, which discussed the same matter.

This latter report notes the practice in California in the same area. There, every Deed and document is available to the public, once the agreement is executed.

The same Report notes the views of Mr Perry, President, Australian Council for Infrastructure Development. On the question of disclosure Mr Perry observed that the issue was not nearly as contentious as previously thought:

The private sector by and large took the view that disclosure had to occur and in fact in some ways was of benefit. “If there was nothing to hide, then why hide it?”

These views appear to contrast with the approach actually taken by the Government and the proponents of the M2. Parliament was still not provided with access to documents which had been fully summarised in a public prospectus. And many of these documents were, on registering the prospectus or subsequently, public documents.

The timely release of information, as recommended by the Public Accounts Committee and a more sensitive - and less secretive - approach to disclosure may reduce rather than induce concerns.

Another area of potential difference relates to the value of innovative concepts. Mr Williams, Department of Transportation, California has a view on the matter that appears to contrast with that of the RTA. Mr Williams takes:

.....some small exception with the argument that the private sector has come up with something so unique that they can't patent it or copyright it and that if they put it into an agreement with the government, the government somehow has a right to not disclose that to the public. I take some exception to that because I just don't believe there are many things like that that need protecting. (Report No. 77, page 39)

In the RTA's Invitation for Preliminary Proposals for the M2, Guidelines for Proponent, it said:

..... the RTA's position is that it recognises that copyright will not protect concepts. Therefore, subject to any requirement of the Freedom of Information Act 1989, the RTA would be prepared to enter into binding agreements with proponents restricting the use by the RTA of confidential information in an appropriate case. Proponents should indicate any aspects of their proposals which are the subject of a claim for confidentiality.

There need not be any inconsistency between the two approaches, but RTA's practice, which is fully consistent with and supported by Government guidelines, would need to be informed by a dose of California's scepticism to allow the same beneficial openness as exists in California.

It may be, if the M2 signed documents were as accessible to the Parliament as they were to the public, the Parliament might have been able to come to a considered view on the matter in its own way.

Certainly, it does raise concern that documents are not available to Parliament even though an authoritative precis and many of the documents themselves are classed as ‘public’ documents in the context of a prospectus.

This does not detract from the RTA’s efforts, on the announcement of the M2 contract, to release a good deal more information than had been its practice for earlier projects, such as the M4. This included a summary of the key commercial arrangements and provisions.

Summary of Findings

SUMMARY OF FINDINGS

Legal Issues

The contractual arrangements concerning the M2 are, in the main, the arrangements that one would expect for a privately developed, privately owned urban tollway.

In particular, one would expect that private owners of the M2 would seek to protect themselves against future, unplanned public transport developments that could adversely affect the value of their investment. That protection is especially important because so much of urban public transport is supplied by governments at below marginal costs. The owners of the M2 could not be expected to compete successfully against such subsidised substitutes.

Other contractual elements suggest that the private sector has protected itself against other, government initiatives that would materially adversely affect the M2 - including certain tax changes at the State or Commonwealth levels, except for income tax changes.

It is reasonable to seek protection against government initiatives that discriminate against the M2. It is less reasonable for a government to agree to a renegotiation process leading to restoration, if material adverse effects are evident when the government is acting in a non-discriminatory way and the owners of the M2 are but one of a number of firms adversely affected by government action.

Legal Questions Raised by the Legislative Assembly

The legal consultants advise that to the extent examined the contracts affecting the Government are binding. They are valid under the New South Wales' constitution and under the particular laws that regulate such agreements.

The actions of Government cannot of course circumscribe the sovereignty of Parliament. On this basis Parliament has the theoretical ability to legislate so that the agreements between the Government and the private sector proponents of the M2 are null and void from the date of the execution. And under the Constitution of New South Wales no compensation for any loss of property rights is required to be paid to the developers.

There are very few precedents in modern Australia for a Parliament to act in this way, although a former New South Wales Government did appropriate without just compensation certain coal rights held by private persons.

Parliaments wisely consider carefully the consequences of exercising their sovereign powers to overturn retrospectively the normal application of its laws.

Such care reflects the large future costs that those actions would impose on the citizenry because of the resultant increase in risks that investors must factor in when contemplating further investments in the State.

Missing Links

The M2 arrangements and the processes that led to the agreements reflect an improvement over those evident for the M4, M5 and the Sydney Harbour Tunnel.

Nonetheless, it shares a weakness of the M5 in that the arrangements do not appropriately deal with any future road developments between the M2 and the west and between the M2 and the Gore Hill Freeway.

It is evident to all that the roadway between the western end of the Gore Hill Freeway and the eastern end of the M2 is poor in light of the traffic it is currently expected to carry.

It is also evident that the M2 is expected to generate additional traffic which must adversely impact on that roadway and which might accelerate the need for a solution to deteriorating traffic flow.

Finally, it is likely that any improvement in that roadway will benefit those wishing to use the M2 and thus the owners of the M2.

This is analogous to the benefits gained by the owners of the M5 on the completion of the Western extension and on the completion of the proposed Eastern extension.

The agreements between the proponents of the M2 and the RTA do not adequately allow the Authority to capture those benefits, although the proponents have successfully included clauses that allow restoration for any losses they suffer from road developments.

The incentive rent arrangements and the conditions allowing the term of the arrangements to be held to 36 years (rather than 45 years) are not considered to be adequate to capture an appropriate proportion of the benefits internal to the project. The incentive rent does not commence until after repayment of the project debt, and the reduced term provisions do not come into effect until the real after tax internal rate of return for equity investors exceeds 16.0% p.a. Not all benefits are captured, eg. safety and reduced congestion, that will accrue to users of other roads when the M2 is completed.

**Private Ownership
and Risk
Management**

As discussed above, the private owners of the M2 (except to the extent that they agree otherwise) can reasonably expect restoration for material adverse effects of public transport (including roads) substitute developments.

It is likely, however, that such protection as is offered by those restoration clauses is inadequate to allow the M2 proponents properly to manage these future traffic risks. This is because it is difficult to determine the causality of adverse traffic flows and there are likely to be large transaction costs anyway in seeking restoration or in monitoring developments over the period of the contract.

If the private sector is not in as good a position as the RTA in managing these (and other) traffic risks, it follows that, to obtain the same rate of return adjusted for risk as the RTA, the private sector would have to charge a higher toll than the RTA.

The internal rate of return that the private sector equity investors expect from the M2 is expressed in the Base Case Model in the following (nominal per annum) terms: 18.5% pre-tax cash return or 16% post tax return which is the pre-tax equivalent of 24.4%. These can be compared to the nominal rate of 18.7% per annum pre-tax developed using the normal cost of capital model.

It is arguable that some of the difference at least might reflect the cost of risk.

**Private
Ownership and
Optional Public
Transport
Network**

The restoration clause with respect to substitute public transport (including roads) proposals affecting the specified areas of the north-west could mitigate against the development of an optimum network prior to the next 45 years.

The adverse affects need not be large and need not exist, if future Governments can explain to the public why making restoration to the owners of the M2 for a proposed alternative public transport scheme is appropriate.

There is no immediate prospect of a competitive public transport development (ie. a development not already taken into account by the M2 proponents) but the length of the contract - up to 45 years - suggests that there is a reasonable risk of an event occurring which may activate the restoration provision of the contract.

The same adverse affects could also be evident if the M2 were in public ownership, and if too much weight were given to the affect on M2 toll revenues of a public transport development.

This suggests that imposing specific tolls on urban motorways may not be the most efficient revenue raising means available to the Government. The network characteristics of roads and the preponderance of toll-less roads may cause inefficiencies for toll bearing motorways.

There is no evidence that the economic effects of private ownership or of toll bearing motorways has been carefully examined by the Government. It assumes - when there are reasons to question the assumption - that privately owned tollways are beneficial. That may stem from confusing private ownership with private participation for which the evidence of benefits is strongly established.

An additional factor should be considered in this area is the large transaction costs (amounting to \$26 million or over 5% of total project costs) incurred by the private sector in establishing the project. Public ownership with significant private participation would have involved a fraction of these costs.

**Process of
Arrangements**

The procedures adopted by the RTA to develop the contracted arrangements appear sound.

The arrangements were the outcome of a tender process and the unsuccessful tenderers should have represented formidable competition to the successful tenderer.

The report of the private probity auditor gives important, additional comfort that the process was robust.

However, there continues to be a greater concern than is necessary to protect against disclosure of signed agreements.

The position taken with respect to M2 documents was inconsistent with that adopted in other jurisdictions (California) and inconsistent with need.

Ironically, the M2 participants were demanding a level of confidentiality on documents given to The Audit Office that they themselves did not meet of others requesting the documents. Document described as confidential by the M2 participants to The Audit Office were often public documents. Documents that The Audit Office could not copy without permission had been given to the public by the M2 participants.

This should not only be embarrassing to those asserting confidentiality, it should be enlightening to those in the Government who supported those assertions.

Financial Analysis

The financial analysis shows that the RTA can expect a nominal return, 6% pa, from its contribution to the M2. This return is calculated on cash flows. It ignores the non-cash costs and benefits of the M2. Even that return could be overstated if the traffic projections are seen as optimistic or if the value of the RTA's land contribution is factored in.

As noted above, the Hills' investor is expected to receive an 18.5% pre-tax cash return or 16% post-tax return which is the pre-tax equivalent of 24.4%. This rate of return now reflects a low construction risk but it reflects some period of financing risk after Hills had reached binding agreement with the RTA. The early subscription of professional funds to the float suggests that the market sees the investment as particularly attractive, notwithstanding the remaining, important traffic risk in the assumptions.

The traffic projections used by the M2 developers, as disclosed in the prospectus, are significantly higher than those used in the processes leading to the formal determination under the *Environmental Planning and Assessment Act 1979* to build the M2.

For the year 2006, the traffic flow noted in the prospectus is over 50% greater than the maximum flow identified in the environmental impact documents. The difference in revenue terms is greater again. (The M2 developers use a \$2 toll compared to a \$0.70 toll in the environmental process.)

This suggests that a significant market risk exists that should be taken into account in commenting on the returns expected by Hills.

If the traffic flows are optimistically forecast, there is risk facing the RTA receiving its rent, because that debt is deferrable and is subordinated. In this way, it can be argued that the Authority bears some traffic risk.

A measure of the risk, using the Base Case Model is the net present value of rent received as accrued, \$29.5 million, or the net present value of deferred rent, \$1.1 million. This risk does not, of course, extend to any obligation to any other party, (eg investors, bond-holders) if the traffic forecast is not achieved.

It has also been argued that, if the forecasts are optimistic, the road should not be built. Such an argument emphasises the value of private sector ownership (it reduces public risks at the expense of the private lenders and investors) but does not counter the view that the concept of an M2 road was approved on lower traffic forecast.

Risk Analysis

It has already been noted that the agreements put some risks to the private sector that appear appropriate (given private ownership of the M2).

Those that appear appropriately to be borne by the private sector include:

- (a) establishment costs
- (b) financing (except for early effects of interest rate changes)
- (c) construction (except for some possible land problems)
- (d) operations
- (e) maintenance
- (f) traffic or market risk.

The risk that currently appears to be dominant is the traffic or market risk.

Some other risks are borne by the Government which arguably should be at the Government's expense. Those include: land title, discriminatory action against the M2 and the adverse effects of substitute public transport.

But some risks are borne by the State which arguably should be borne by Hills as with any other firm. Important amongst these are State or Commonwealth taxation changes materially affecting the project's gross revenues (but not income tax changes).

All in all, the RTA has handled risk allocation in a noticeably clearer way in these M2 arrangements than in previous arrangements for Motorways and the Tunnel.

Planning Process for the M2

The Audit found that the restoration clause included in the M2 agreements was, from the viewpoint of the developer, unexceptional. Indeed, without such a clause the project would have presented significant risks to the developer.

From the Government's view the restoration clause would have had a practical counterpart, if the M2 was owned by the public sector. Under these circumstances, adversely affecting the traffic quantity on the M2 would have led to a fall in public sector revenue.

The Government's risk to pay restoration has, however, been mitigated by the processes that have led to its sponsoring of the M2. That process has been much improved over the last few years and has been integrated with planning and other transport options.

That process, the inherent diseconomy of heavy rail in a low density suburban environment, and the apparent unwillingness of urban rail users to pay even marginal costs, suggests that there are low risks that any major heavy rail project would be an important renegotiable event. This is not to say that some small heavy rail projects not yet approved could lead to negotiations between the M2 owners and the RTA.

Recommendations

RECOMMENDATIONS

It is recommended that the Government undertake its own examination, or participate actively in the examination by others such as the Economic Planning Advisory Council, on the economic efficiency of urban tollways (compared to other revenue options), and on the economic efficiency of privately owned versus publicly owned urban tollways.

Notwithstanding that private ownership of urban tollways has only been assumed to be beneficial compared to other options, on financial grounds the M2 arrangements should continue. The economic costs to the State of overturning these arrangements - with or especially without compensation for costs plus some damages - are likely to be large.

The Government reconsider its restricting position on confidentiality of documents, for executed infrastructure agreements, given the evidence against a restricted view available from practice in California and from general private sector opinion. Such a reconsideration should reflect the tendency of the private sector involved in a particular project to request confidentiality unnecessarily - even of public documents. The reconsideration should also include an objective analysis of the costs of tabling versus the benefits that accountability can offer.

Roads and Traffic Authority Response

ROADS AND TRAFFIC AUTHORITY RESPONSE

Explanatory Note The legislative requirements of the *Public Finance and Audit Act, 1983*, pertaining to performance audits provide that the Auditor-General must not release such a report unless both the Head of the affected authority and the responsible Minister have been given a period of twenty eight days to consider the report. A discussion draft of the report was provided to the Head of the RTA on 29 November 1994 to permit discussion of the matters raised prior to the reporting deadline set by Parliament.

To satisfy the November 22 1994 resolution of the Legislative Assembly for a report to be made to the House by 1 December 1994, the Auditor-General provided a formal Draft Report to the Minister for Roads. The Minister subsequently tabled that Draft Report at the start of business for the Legislative Assembly on the required date (1 December 1994).

The Auditor-General also provided a copy of the formal Draft Report to the Head of the RTA, and has subsequently allowed the required statutory waiting period to expire prior to releasing this document as a final published report.

On 16 December 1994 the RTA's Chief Solicitor advised that:

In view of the discussions which took place between the Minister, the Auditor-General and the Chief Executive during the preparation of the Draft Report, the Authority, with one exception, does not wish to make any submission or comment on the Report. The exception is set out in a letter dated 1 December 1994 ... from the Chief Executive to the Minister and concerns the assertion in the Draft Report that the RTA bears partial traffic risk in relation to the project. It will be acceptable to the Authority for its comments on this issue to be either included in, or annexed to, the Report.

RTA Advice to Minister

The Chief Executive's letter of 1 December 1994 to the Minister for Roads is replicated below.

Dear Minister

M2 TOLLWAY; AUDITOR-GENERAL'S REPORT

I am advised that it is your intention to table the draft Auditor-General's report relating to the M2 tollway in Parliament today in accordance with Parliament's resolution of 22 November 1994.

The final draft of the Auditor-General's report was received by the Roads and Traffic Authority at approximately 1.00 am on 1 December 1994. In normal circumstances the RTA would avail itself of the appropriate consultation provisions of the Public Finance and Audit Act. However, in order to meet the intent of Parliament that this report be tabled on 1 December, the RTA has sought wherever possible to resolve issues of substance through informal consultation with the Auditor-General and his staff.

There is one substantive issue that is not agreed between the Auditor-General and the RTA which I consider necessary to bring to your attention. The Audit Report asserts that the RTA bears partial traffic risk in relation to the project (see Table 1, page 40; page 88)¹.

As stated by the Auditor-General's independent legal advisors, Minter Ellison Morris Fletcher, in their advice (page 60, section 4.2 (a))²:

"The Company carries the risk that traffic volumes and revenue are lower than those projected....."

This opinion is confirmed in the Project documentation and the Prospectus of the Company provided to the Auditor-General by the RTA.

The Auditor-General for his part seeks to argue that the risk that the Company may default on its obligation to pay land rent is tantamount to the RTA accepting partial traffic risk.

The RTA does not accept the Auditor-General's assertion which is contrary to the legal obligations entered into by the parties.

Yours sincerely

(signed)

M Moore-Wilton

¹ References are now page 44; page 94.

² Reference is now page 65.

**Audit Response
to RTA
Comments**

Audit maintains its conclusion that the RTA bears some traffic or market risk associated with the project. Whilst the project documentation and prospectus indicate that traffic risk is to be borne by Hills, the terms of the project between the Government and Hills provide that the RTA also has a financial exposure to traffic risk.

Should traffic projections assumed by the developers prove to be unachievable, revenue to Hills would be lower than forecast. If a specified (threshold) internal rate of return is not achieved by Hills, rent payable by Hills to the RTA (for use of the land occupied) is able to be replaced by a non-interest bearing promissory note, which is subordinate to other debt of the project.

Because the net present value of rent owing to the RTA is dependent on actual traffic flow, Audit concludes that the RTA has taken on some of the traffic risk associated with the project.

The M2 Project

THE M2 PROJECT

Description

The M2 will provide a continuous high capacity motorway between the Lower North Shore and the rapidly developing north-west.

The project comprises of:

- approximately 21 km of motorway, comprising 2 carriageways each of 2 lanes from Epping and Pittwater Roads, North Ryde to Old Windsor Road, Baulkham Hills
- a 2 way, 2 lane centre busway between Beecroft Road, Epping and Windsor Road, Baulkham Hills
- a bus rail interchange at Epping Station
- eight interchanges and connections to arterial roads and crossings of the M2 for motorists and pedestrians
- main toll plaza located between Balaclava and Culloden Roads, and
- secondary toll plazas located at the on and off ramps on the western side of Pennant Hills Road.

The Project Deed also defines the boundary within which possible proposed transport developments require the Minister to consult with the company in respect of any possible effect of such developments on the M2. A map outlining the area is at Figure 1.

Term

If the Project Deed is terminated, the Trust Lease terminates simultaneously. Otherwise, the term of the Trust Lease commences on the M2 Motorway Commencement Date and ends on the 45th anniversary of the M2 Motorway Commencement Date, unless the Trustee derives an amount sufficient to give the Trust's investors (treated as if they were all Notional Initial Trust Investors) a real after tax internal rate of return from the Project equal to one of the following:

- (a) over 16.5% per annum between the M2 Motorway Commencement Date and its 36th anniversary. If so, the term ends (at the option of the RTA) on its 36th anniversary;
- (b) if paragraph (a) does not apply, over 16% per annum between the M2 Motorway Commencement Date and its 39th anniversary. If so, the term ends (at the option of the RTA) on its 39th anniversary; or

- (c) if neither paragraph (a) or (b) apply, over 16% per annum between the M2 Motorway Commencement Date and its 42nd anniversary. If so, the term ends (at the option of the RTA) on its 42nd anniversary.

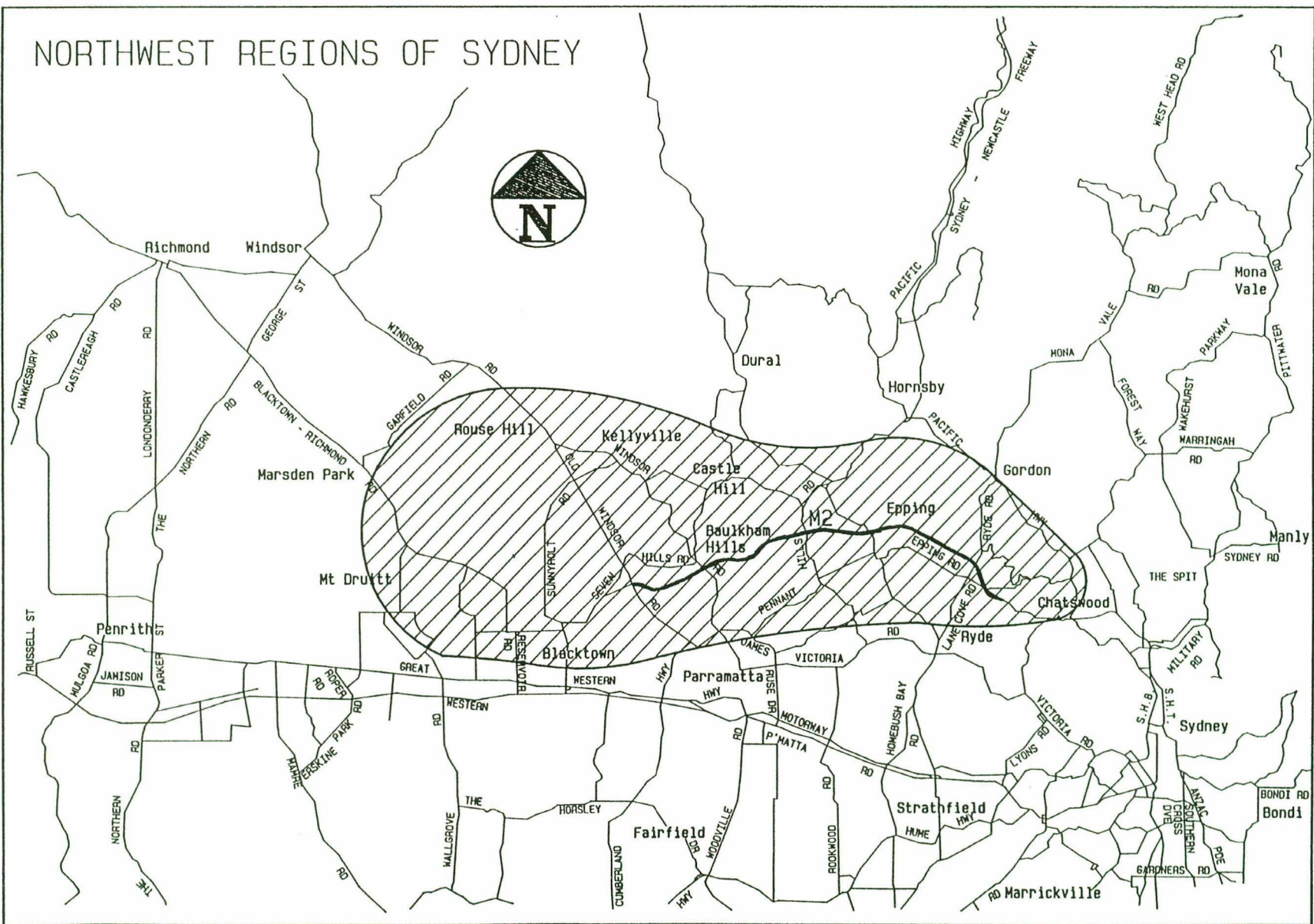


Figure 1

History of the M2

HISTORY OF THE M2

Planning

The M2, also known as the F2, Castlereagh Freeway and the Northwest Transport Link, has been part of the State's transport strategy since the 1950s.

The County of Cumberland Planning Scheme 1951 adopted a radial road network to the Sydney City centre. A part of this radial road was identified from Epping Road at its crossing with the Lane Cove River turning north alongside the Northern Suburbs General Cemetery and running alongside the Lane Cove River to Alma Road.

The Sydney Region: Growth and Change - Prelude to a Plan 1967 planning document identified a 'probable future expressway' heading west towards Blacktown. This was located approximately along the route of the proposed Expressway.

The 1968 *Sydney Region Outline Plan* was the first regional plan showing a reservation, which was approved by the then Commissioner of Main Roads in 1967. The expressway reserve extended east-west towards Castlereagh, which was the origin of the name for the proposed expressway. The plan also identified a north-west sector including Rouse Hill, Marsden Park and Scheyville as a future urban growth area of Sydney.

A road reservation was identified in the Shire of Baulkham Hills Planning Scheme 1971. This road reserve extended west of Pennant Hills Road to Old Windsor Road.

In 1974 the *Sydney Area Transportation Study* (SATS) identified six major transport corridors servicing the needs of an expanding metropolis. These corridors included a north-western corridor extending to Rouse Hill via Epping and Ryde. The existing road and rail links within the north-western corridor were considered inadequate.

A review was undertaken in 1976 of the *Sydney Area Transportation Study* by the Urban Transport Advisory Committee (URTAC). This review revised future road reservation needs and abandoned some of the major transport corridors, while maintaining the provision for the abovementioned north-western corridor both east and west of Pennant Hills Road.

The Hornsby Planning Scheme 1977 and Ryde Planning Scheme 1979 identified a road reserve along the route of the proposed expressway east of Pennant Hills Road.

In 1984 the *North Western Region Traffic and Transportation Study* considered an expressway from Epping to Seven Hills as an important east-west route to relieve traffic congestion on the existing arterial roads.

The *Regional Road Hierarchy Report* 1986 prepared by the Western Regional Organisation of Councils (WSROC) assumed that an expressway along the reservation would be constructed to at least two lanes in the early 1990s. In the longer term it recommended the expressway be converted to four lanes from Pennant Hills Road to Old Windsor Road.

The *Roads 2000 - Sydney Region* document prepared in 1987 by the then Department of Main Roads (DMR) was published prior to the completion of *Sydney Into Its Third Century Metropolitan Strategy*. *Roads 2000* complemented the part of the *Metropolitan Strategy* which considered Sydney's road transport needs up to the year 2000. It outlined a grid of arterial roads and by-passes of major 'centres'. *Roads 2000* also outlined an orbital route around Sydney to direct traffic from the major highways and to distribute this to the arterial roads. The orbital route incorporated an expressway along the reservation from Mowbray Road (previously known and referred to as the Channel 10 site) to Old Windsor Road. The expressway was considered in *Roads 2000* as having a role of linking the future growth of the north west sector, including Baulkham Hills, Blacktown and Rouse Hill development areas, with established northern areas.

In 1988 the *Sydney Into Its Third Century - Metropolitan Strategy for the Sydney Region* took the *Roads 2000* document into consideration and provided for a 4.5 million population by the year 2011. The *Strategy* constituted a framework for planning and decision making. It recommended a 'concentrated alternative' for urban development in order to encourage higher densities of residential development and to promote the development of commercial centres. The implementation of the *Strategy* was to be achieved through series of transport studies and regional environmental plans.

A plan jointly prepared by the then DMR and Department of Environment and Planning, *Draft Regional Plan for Arterial Roads in Growth Areas* 1988, produced a 30 year network of arterial roads to serve the roads needs of the *Metropolitan Strategy*. This road network included an expressway along the reservation.

The *North-West Sector Roads Needs Study 1989* was undertaken by the RTA. The “north-west sector” in this study referred to the area bounded by Pacific Highway, Epping Road and Pennant Hills Road. This study identified different options for connecting the F3 Expressway to an expressway along the reservation. The study provided for considerable debate within the community as the study identified opportunities for linking suburbs into an expressway along the reservation through the development of further arterial roads.

A *Rouse Hill Development Area Arterial and Sub-Arterial Road Study 1989* was commissioned by the Department of Planning to prepare traffic forecasts and recommend funding for roads in the north-west sector including Rouse Hill, Marsden Park and Scheyville.

It recognised that an expressway between Pennant Hills Road and Old Windsor Road was a vital link in connecting the north-west sector to the eastern part of Sydney. However, this document did not make specific reference to an expressway along the reservation east of Pennant Hills Road.

The *Rouse Hill Development Area (RHDA) Sydney Regional Environmental Plan (SREP No.19) 1989* prepared by the Department of Planning, identified the likely future population of Rouse Hill. The *Plan* also identified the need to provide employment access to the area by linking the RHDA with Parramatta, Blacktown, the University of Western Sydney and the proposed Badgerys Creek Airport. The *Plan* showed an expressway along the reservation west of Pennant Hills Road but not east of Pennant Hills.

In 1989 the Hoxton Park - Parramatta - Baulkham Hills Public Transport Corridor (SREP No.18) identified that, within the reserve located north of Parramatta, a corridor could facilitate buses, light rail or other new technology systems. SREP No.18 promotes public transport access to Parramatta.

In 1988 the Government made a commitment to improve transport facilities to the north-west of Sydney by constructing the F2 Castlereagh Freeway.

**Environmental
Impact Statement
1989**

The RTA pursuant to section 1113(3) of the *Environment Planning and Assessment Act 1979* (EPA), exhibited, between 6 June 1989 and 21 July 1989, an Environmental Impact Statement (EIS) in respect of a proposed four-lane freeway (known as the Castlereagh Freeway) 11.5 km in length from Pennant Hills Road Carlingford to the Lane Cove River at North Ryde.

As a result of the EIS process and in view of the submissions received which indicated a broad community concern over the project, the Government convened a Commission of Inquiry.

Commission of Inquiry 1989/90

On 22 August 1989 the then Minister for Planning directed an inquiry be held into the proposal in accordance with Section 119 of the EPA Act. The Minister appointed Commissioner John Woodward, Commissioner of Inquiry for Environment and Planning, to constitute the Commission of Inquiry.

The Commissioner of Inquiry reported to the Minister for Planning in July 1990 in a document entitled *A Proposed Expressway from Pennant Hills Road, Beecroft to Pittwater Road, Ryde known as the F2 Stage 1*.

The principal findings were that the proposal should not be constructed, and that an upgrading of the existing east-west road system between Pennant Hills Road and Epping Road near the (former) Channel 10 site (together with other measures, including improvements in public transport during peak periods) should be implemented as a matter of high priority.

Other major findings included:

- (a) traffic congestion on the existing road system during peak periods is already severe and required amelioration
- (b) the existing road system works relatively well outside peak periods and could be improved by alternative upgrade works
- (c) the principal cause of peak hour traffic congestion is the high volume of commuters using private cars for journeys to and from work, and the low levels of service of public transport, and
- (d) the environmental impacts of the proposal would be severe, and would include a sudden and substantial increase in noise levels (particularly at night), significant visual impacts, loss of residential amenity and a permanent degradation of the present high residual qualities and general tranquillity of the area, loss of urban bushland, and a decline in air quality in residential precincts to levels comparable with other busy main arterial roads.

The Report stated that the findings apply only to the Castlereagh Freeway proposal and “should not be taken in any way to be a judgment on the construction of a roadway west of Pennant Hills Road”.

The recommendations in the *Report* included that:

- the existing road system should be upgraded
- without delay, a by-pass should be constructed to link Carlingford Road to Epping Road, and the Epping Road should be widened to 6 lanes through its whole length
- widening of Carlingford Road, the construction of an interchange at Pennant Hills Road, and improvements to intersections on Epping Road
- urgent improvements be made to public transport in peak periods and that a public transport study of the region should be carried out as a matter of priority
- a review of future urban growth and associated transport and traffic demands in the region be undertaken and based on up-to-date origin and destination surveys
- a realistic appraisal of growth in the North West Sector be completed
- an examination of practical measures to restrain eastward commuter movements from the West and North West by private cars in peak periods (including controls on commuter car-parking facilities at the major commercial centres at Chatswood, North Sydney and the CBD)
- measures to encourage more commuters towards Parramatta and Blacktown, and
- the existing road reservation be retained for 10 years.

Subject to a feasibility study, the *Report* favoured a tunnel under Pembroke Street linking Carlingford and Epping Roads.

A community backlash occurred against the main recommendation of the Woodward Commission of Inquiry to widen Epping Road to six lanes and support for the expressway.

**Minister for
Planning
Response to
Commission of
Inquiry**

On 17 August 1990, the then Minister for Planning wrote to the RTA:

The Commissioner [Commission of Inquiry] makes the recommendation that the proposal will not proceed at this time and that alternative roadworks should be undertaken. The Commissioner also recommends that the freeway reservation should be retained and the proposal be reviewed in the future.

The Minister for Planning also stated:

The Commissioner's findings and recommendations raise a number of issues which in my opinion warrant further examination prior to a final decision being made on the proposal. In particular, those issues which I consider warrant examination are:

- (i) *traffic projections upon which the proposal was based;*
- (ii) *population growth predictions used in justification of the proposals;*
- (iii) *the costing of the proposal;*
- (iv) *the feasibility and costing of the alternative road proposals recommended by the Commissioner; and*
- (v) *the potential effectiveness of alternative proposals recommended by the Commissioner.*

On 7 March 1991, the RTA wrote to the Department of Planning conveying the RTA's understanding that the Minister for Planning's letter of 17 August 1990 was not intended to be an advice, that is, as to whether in the opinion of the Minister, after considering the findings and recommendations of the Commission of Inquiry, there are no, or that there are, environmental grounds for the project to continue for the purposes of the Environmental Planning and Assessment Act 1979, and requesting the Minister to give such advice [if it was the Minister's intention to do so].

**Proposed
Environmental
Impact Statement
1990**

On 13 September 1990, the then Minister for Roads announced the preparation of an Environmental Impact Statement relating to a transport link for Sydney's North West Region. The ministerial statement included:

....the commencement of a major Environmental Impact Statement (EIS) to find solutions for the rapidly growing transport needs of the North Western Metropolitan area. The EIS will determine what measures are needed to provide a balanced transport strategy....

....It is anticipated the North West sector will have a population of 250,000 people - the size of Canberra - within 20 years....

....The decision to conduct the EIS was prompted by the findings of the Commission into the Castlereagh Freeway. The Commission rejected the F2 Castlereagh Freeway as proposed by the Roads and Traffic Authority. The Commission of Inquiry suggested other options should be considered such as improvements in public transport, a tunnel by-pass of Epping Railway overbridge and upgrading of existing roads....

....Since then, Hornsby, Baulkham Hills, Parramatta and Hawkesbury Councils have expressed opposition to the Epping Tunnel proposal and called on the State Government to construct an "environmentally sympathetic" Castlereagh Freeway....

....The EIS will examine transport options for the area west of Pennant Hills Road through to Old Windsor Road. This section will provide essential infrastructure to cater for the population growth expected in the north west sector.

As a result of the EIS, the following proposal emerged:

- (a) to construct an expressway from the Lane Cove River to Old Windsor Road
- (b) the expressway would, with some lateral deviations at certain points along the route, be located within the existing road reservation
- (c) the expressway would cross on bridges over Devlins and Terrys Creeks and between the Main Northern Railway line and the proposed bridge over Terrys Creek, the expressway would pass through a tunnel. The expressway would also cross on bridges over Darling Mills Creek and pass through parts of the Darling Mills State Forest. Two variations are proposed for the route through Devlins Creek. Two variations are proposed for the route near Mahers Road and Pennant Hills Golf Course. Four variations are proposed for the route through Darling Mills State Forest
- (d) the expressway would be approximately 30m wide and would consist of four traffic lanes (two in each direction) and two breakdown lanes (one in each direction). The breakdown lanes would be available for use by bicycles
- (e) two busway lanes (one in each direction) would be located in the centre of the expressway between Beecroft Road and Old Windsor Road. The busway would leave the expressway where the expressway meets Beecroft Road and would lead via Beecroft Road to a bus interchange at Epping Station. The busway would be constructed so as to allow its conversion to use as a light railway

- (f) grade-separated interchanges would be built at the following locations along the route:

Delhi Road
Lane Cove Road
Balaclava Road
Beecroft Road
Pennant Hills Road
Windsor Road, and

- (g) toll plazas would be constructed and operated between Culloden and Balaclava Roads and on the eastbound off-load and the westbound on-load ramps at Pennant Hills Road.

The RTA was the proponent of the proposal within the meaning of the EPA Act.

The following documents constituted the EIS:

- (a) *North West Transport Links East Environmental Impact Statement* prepared for The RTA of NSW Sydney Western Region by Maunsell Pty Limited April 1992, and
- (b) *Environmental Impact Statement North West Transport Link Pennant Hills Road to Old Windsor Road* prepared in Sydney by Manidis Roberts Consultants and Snowy Mountains Engineering Corporation Limited on behalf of the NSW RTA.

The two EIS statements were exhibited in 1992.

A wide and varied community consultative process was undertaken by the RTA.

**Formal
Determination on
EIS**

A formal determination, in accordance with the Environmental Planning and Assessment Act 1979 to build the North West Transport Link now known as the M2 was made in May 1993 by the Minister for Roads.

**Capital Works
Committee**

The Premier's Department on 6 August 1993 advised the Minister for Transport and Minister for Roads that at the Capital Works Committee meeting of 27 July 1993 approval had been granted for the RTA to call for expressions of interest for the construction, financing and operation of the M2 subject to:

1. Clear understanding that the Capital Works Committee of Cabinet has only given its approval for the RTA to seek Expressions of Interest from private sector participants and has not committed the provision of Government funding for the project
2. The document seeking Expressions of Interest explicitly stating that the successful private sector proponent will be expected to bear all the construction risk and traffic risk and that bids should be developed on this basis
- 3 RTA returning to the Capital Works Committee of Cabinet after firm offers have been received for a final decision on whether to proceed with the project, taking into account the Government contribution required and Loan Council aspects.

Expressions of Interest

Invitations for Preliminary Proposals to finance, design, construct, operate and maintain the M2 were advertised on 8 September 1993.

Proposals Received

Four proposals were received by the closing date of 2 December 1993:

Norwest Motorway Company Pty Limited
The Hills Motorway Limited
(hereafter called Hills)
NW Link Pty Limited
NTA Consortium

Proponent Selected

On 11 February 1994 Hills was selected as the sole preferred proponent.

The Hills Motorway Limited

Hills is a consortium of Abigroup Limited, Obayashi Corporation and Scetauroute with Westpac Banking Corporation and Macquarie Underwriting Limited as financiers.

Execution of Contract

The Capital Works Committee on 22 June 1994 approved the RTA entering into final negotiations with Hills. The Project Deed between the RTA, the Minister for Transport and Minister for Roads, Hills and Perpetual Trustees was signed on 26 August 1994.

Balancing Risks and Benefits

BALANCING RISKS AND BENEFITS

M2 Arrangements Component

The arrangements between the RTA and the principals of the M2 avoid some of the major problems evident from the Sydney Harbour Tunnel, the M4 and the M5.

As reported elsewhere, a critical difficulty with the Tunnel is that it appears to be a private sector project when virtually all of the post-construction risks remain with the State. This is not the case with the M2 because its owners will face important continuing risks.

In the case of the M4, an important problem stems from the decision to locate the Toll Plaza so that a large proportion of toll payers do not use the major roadway provided by the private sector. Again, the Agreements around the M2 avoid this problem.

The development of the M5 was marred because the original arrangements- and even the current arrangements - do not adequately reflect that each of the three elements of the M5 (the Eastern, Central and Western sections) has important financial implications for the remaining elements. (For example, the proposed Eastern section would provide large additional traffic flows, and toll revenue, for Interlink. The arrangements between the RTA and Interlink seem not to allow the Authority to capture these “windfall gains” to Interlink.)

As discussed elsewhere, the M2 arrangements share this weakness because the agreements do not adequately contemplate that either the Eastern or Western missing links (to the Gore Hill Freeway and to Mt Druitt respectively) will be undertaken within the term of the arrangements.

The M2 agreements also allow the private sector to pass some risks back to the Government that ordinarily belong to the private sector.

And the agreements seem to be somewhat imbalanced: they appear to concentrate on events that cause or could cause the developers a cost, but do not canvass similar events that allow the developers a benefit. Where costs arise, some Government concession is sought but where benefits arise, they are to the profit of the developers. This imbalance is moderated - at least to some extent - by provision allowing for incentive rent and early completion, if Hills’ investors receive higher returns as defined in the agreements.

Overall, there are not the major drawbacks experienced in the past: the processes and arrangements show improvements over earlier models.

**Benefits of
Private
Participation**

Because the M2 does represent an improved relationship between the RTA and the private developer, it demonstrates, without distraction, some of the fundamental issues involved in such projects.

The Public Accounts Committee, RTA and others have identified significant potential advantages what can be derived from the contestable participation of the private sector in the provision of public infrastructure. These include:

- accelerated availability of facilities
- innovative design
- efficient construction
- closer examination of capital/maintenance costs trade-offs
- cost-effective operation
- reduction in friction between relevant parties
- stronger incentive for proper economic assessment, and
- greater ability to levy efficient tolls.

But not all of the benefits require private sector ownership.

A contestable contract that allowed for, say, fixed price construction, together with a lengthy maintenance and operation contract would provide most of the above benefits, to the extent that they are available.

And some of the potential benefits are questionable. For example, it is only arguable that an owner of a private toll road has a greater capacity to levy efficient tolls than the government owner of a public toll road. (For this purpose, efficient tolls are tolls that equal marginal costs. The general effect of efficient tolls is to help ensure that the tollway is used to its optimum capacity for as much of the day as is possible) For a start, the Government is already involved in private tolls: it sets conditions on the toll raising for all of the existing Motorways and the Sydney Harbour Tunnel. And the Government might find it difficult to eschew this responsibility because of arguments about monopoly and externality issues.

In any event, it is difficult to see how a constant toll which does not take into account or reflect congestion costs or peak use or other demand factors can be describe as efficient.

Because the RTA selects the Motorway that is to be financed and operated by the private sector, there is less weight to the argument that the road's economic assessment is better undertaken by the intended private owner. It is also relevant that the Authority has

either underwritten the entire cost of the project (the Tunnel) or has provided valuable financial conclusions (the M4 and M5) that must change the economies of a stand-alone private project. Such economic concessions are also evident in the M2.

This appears to leave two claimed benefits from the participation of the private sector as owners of public infrastructure.

The benefit most often cited is that private ownership and thus private financing means that the infrastructure is provided earlier than otherwise.

This is certainly an argument that supports the imposition of tolls (or other user charges) but tolling does not necessarily involve the private sector. For the argument to succeed, it must be shown that the private sector could raise finance which the public sector could not.

When Loan Council allocations were effectively constraining the State's ability to raise funds (as they were when the Public Accounts Committee first reported on the financing of infrastructure) the argument about funding limits was clearly based.

Now that Loan Council operations do not act as a constraint, an examination of the initial funding of a revenue earning asset should not presume that the Government cannot fund construction. Rather, the examination should ask which of the government or private sector is better positioned to fund an infrastructure.

It may be that the private sector will be the more efficient financier and owner of a public infrastructure. Some of the principal conditions necessary for this is that the private sector does carry the risks of ownership and is in a better position than the RTA to manage those risks.

This view was succinctly expressed by M E Beesley and D A Henster (*Private Tollroads in Urban Areas: Some Thoughts on the Economic and Financial Issues 1990*) when they observed:

If privatisation of Roads is to be socially successful, it should be introduced as an element of a broader planning process and not justified simply on the basis of a public funding shortfall. So much is likely to be widely appreciated and agreed. (page 3)

This conclusion appears to conflict with the Governments *Integrated Transport Strategy for Greater Sydney: A New South Wales Government Vision*, October 1993. There, "the need to provide a

**Fundamental
Issues of Private
Ownership**

sound basis for private sector involvement in transport infrastructure development and service delivery” is seen as an operational goal in its own right. Consistent with this, the RTA saw the early development of the M2 as requiring private sector ownership.

No-one it seems, has considered whether there are drawbacks to private ownership that might outweigh its benefits.

Roads and especially urban roads have strong features that flow from their being part of a physical network. The value of a particular road is drawn from its connections to other roads. (This is especially so for urban roads.)

And because they are part of a network there are often several ways to move from one point to another. That is, there are usually one or more substitutes for a given journey.

There are other characteristics about urban roads that make them different to ordinary goods and services.

The users of roads might impose costs on others for which the users might not have to pay. Costs often mentioned relate to the qualities of air, vision and sound. And the actual marginal cost of a motor vehicle user of a road can vary quite markedly depending on the time of travel. (It can be well below the average cost of providing the road and it can exceed those costs by a good margin.)

Most of these characteristics could be taken into account in a study deciding on how a road is to be priced and who is best placed to own the road.

The Audit Office has seen no evidence that such a study has been undertaken by the Government.

The Government had conducted an economic evaluation of a North West Transport Link Eastern Section (1992) but this did not examine ownership matters (and it would not normally be expected to).

The Environment Impact Statements assumed private ownership but did not examine whether there could or would be different outcomes based on the private or public sector ownership of the M2 (except to indicate that the public sector ownership would, because of funding issues, lead to a deferral of the project).

It may be that an overall examination of the implications of private/public ownership of all public infrastructure is unnecessary or unadvisable.

But the network of roads and other transport modes is a crucial issue to the city. And prices for road use are an important economic tool in which the State has an interest. Finally, the State should seek to ensure that the party best equipped to manage the risk has that role, otherwise a higher toll will be required than is necessary.

**Private
Ownership and
the M2**

The above issues can be reduced to the following questions:

- what is the financial advantage to the State from private ownership of the M2
- what, if any, is the conflict between protecting private benefits and ensuring optional public transport

One of the difficulties for private owners of urban roads (this is less a problem for inter-city private roads) is that there are often several substitutes to using a tolled road.

A private owner can be expected to cope with the existence of these substitutes when considering an investment, but might not be able to carry the risk that additional substitutes or improved substitutes might be established during the life of the investment.

The potential impact of these additional substitutes is significant because, unlike the M2, the substitutes might not carry a toll price. Accordingly, the owners of the M2 could be confronted with a currently unplanned competition that is heavily subsidised and that can reduce significantly the value of the M2 investment.

There are two broad ways to manage that risk. One is to increase the expected return on the investment to reflect the risk of unknown, future subsidised competitors by increasing tolls from planned levels.

This is not always possible because the resulting toll may be so high as to render the project uneconomic, but appears to have been adopted in the case of the M2.

The second broad method is to seek restoration if the Government modifies the public transport network so as to affect adversely the income of the owners. This approach is also reflected in the M2 arrangements. In itself it is unexceptional.

However, the restoration clause cannot entirely reduce the risks described above. Whether or not any improvement in the road network around the M2 detracts from the viability of the M2 might be difficult to determine. Such improvements would be only one of a number of changes (employment, weather, seasons, tourists, migrants, wages, petrol costs) that can affect traffic volumes.

In any event, there are large transaction costs involved in analysing such changes as might occur in the period of the contract (up to 45 years) and proving that Government action on traffic flows caused a material financial loss.

There is thus the argument that private sector owners of the M2 are not as well placed as the RTA to manage the traffic risks involved in the M2.

The Authority does have the pre-eminent responsibility for managing the cross city arterial flows of traffic and is well versed in directing traffic from over-used to under-used road facilities.

It also has a critical role in helping to define the long-term characteristics of the city in its collaborative work with the Department of Planning and of Transport. This role - especially as it relates to the North-West of Sydney - is vital to the long-term future of the M2.

If it is sustainable - as seems likely - that the private owners of the M2 are less well placed to manage demand risk than the Authority, it is possible that the M2 toll would have needed to be higher for private owners than for the RTA, for the same risk-adjusted rate of return.

In short, in order to achieve the same rate of return adjusted for risk, the private owners of the M2 will need a higher toll for users than would the RTA.

A second important issue is whether, compared to public ownership, the private ownership of an arterial tollway would lead to an inferior road network.

This question can be explained by considering the implications of the renegotiation clause discussed above.

There are already several proposed or possible light rail or railway projects that fall within the land area considered to be relevant to the M2.

Some of these rail projects have been assessed by the M2 owners as not relevant to their investment. Others have not been put to the M2 owners.

Similarly, some potential improvements to the road network within M2's affected land area have been seen as not affecting the private investments in the M2. Others have not yet been assessed one way or the other.

It is very likely over the life of the contract (up to 45 years) that there will be very significant proposed changes to Sydney's public transport. (Only a very small proportion of current Sydney residents could personally know or remember Sydney's public transport system as it was in 1949, 45 years ago.)

And it is highly likely that, in order to move towards an optimum public transport network, some action should be taken that will lead to the owners of the M2 requesting restoration. There is nothing wrong with such restoration; it would in theory be equivalent to a reduction in revenue from a state-owned M2.

The more important question is whether the prospects of such restoration would lead to an inferior transport network than would occur under public ownership.

Whether or not the renegotiation clause will inhibit or prevent those desirable changes is unknown. More than likely though, such changes would have a higher chance of success if the M2 tollway were owned by the public sector.

This benefit of public ownership does not reflect different financial effects: it is based on the likely difficulties for the Government of the day in restoring to the private owners of the M2 compared with the difficulties for the Government in explaining reduced revenues from a publicly owned M2.

In summary, private ownership of urban tollways could lead to a higher toll than public ownership, because the public owner can better manage crucial traffic risks. Private ownership might also reduce the chances of an optimum public transport network.

Perhaps for these two reasons, there appear to be few examples in the world of privately owned urban tollways. There are large tollways in Europe (owned mostly by public authorities or mixed public/private authorities) and in the USA (owned mostly by public authorities). And these tollways are predominantly for intercity travel. Only recently in the USA and Canada has there been a move to urban tollways, mostly still in public hands.

In Japan the private sector has been involved in urban tollways since the early 1960s. But, in the way that business and government relate in Japan, the urban tollways are highly regulated (their toll revenues can be pooled or tolls can be equalised) and the private bonds issued by private companies to fund toll roads “are purchased by local banks following the intervention of local authorities” (OECD, *Toll Financing and Private Sector Involvement in Road Infrastructure Development*, 1987, page 94).

This Audit cannot definitely answer whether from a financial viewpoint private ownership of the M2 is in the State’s interest. It suggests that it need not be in the State’s interest and it recommends that the Government, with respect to future projects, carefully examine the relative economic effects of private versus public ownership of urban tollways (and the effects of different revenue raising mechanisms).

A table outlining all of the identified purported risks is below:

Table 1 - Risks and Benefits

RISKS³	LIKELIHOOD	BORNE BY RTA	BORNE BY HILLS or other Private Sector Interests
	Assessed by RTA		
Construction Risks			
• Time and Costs overruns	High		Primary
• Construction Defect	Low		Primary
• Site Access/Acquisition	High	Primary	
• Strike Action	Low		Primary
• Force Majeure Event	Low	Partial	Partial
• Validity of Environmental Impact Determination	Low	Primary	
• Withdrawal of Offer by Hills	Low		Primary
• Civil Disobedience	Low	Primary	
• Possible Disruption to other Roads/Road Network	Not Assessed	Primary	
• Possibility of Need for Other Water and Drainage Works	Not Assessed	Primary	
Traffic/Revenue Risks	High	Partial	Primary
• Competing Transport Systems	Low	Primary	
• Population Growth below anticipated levels	Not Assessed	Partial	Primary
• Residential and Employment Distribution	Not Assessed	Partial	Primary
• Petrol Costs	Not Assessed	Partial	Primary
• Tourist Levels	Not Assessed	Partial	Primary
Operating Risks			
• Major Maintenance/Repairs	High		Primary
• Increases above CPI in State Taxes and Council Rates	High	Primary	
• Force Majeure	Low	Partial	Partial
• Civil Disobedience	Low	Primary	
• Competing Transport Systems	Low	Primary	
• Changes in State Law	Low	Primary	
• Changes in Federal Law (except income tax)	Low	Primary	
• Damage or Destruction of the Motorway	Low	Primary	Primary
• Additional Works arising from Traffic Use of the Motorway	Not Assessed	Primary	
Financing Risks			
• Repayment of Project Debt	Low		Primary
• Interest Rate Risk to Date of Signing of Deal	High	Primary	
• Interest Rate Risk after Date of Signing Deal	Low		Primary

3. Some of these risks will have no impact on one or other of the parties unless the related events have a material adverse impact on the project.

The Assessment Process

THE ASSESSMENT PROCESS

Project Development

Audit Criteria **To determine if the RTA followed due process in developing the M2 project in that project objectives were stated, EIS conducted, financial feasibility was assessed and community consultation had taken place.**

The RTA has appeared to follow appropriate administrative processes in the development of the M2 project. Project documentation indicates that the project has been planned since the 1950s, and since the Government's commitment to the project in 1988 numerous studies of the M2 have been undertaken.

The M2 has been subject to a number of environmental impact assessments. These have included wide community consultation and the display of environmental impact statements for both the east and west sections of the M2.

The RTA engaged ANZ Capel Court Corporate Services to run a financial model to assess the viability of the M2 as a privately funded tollroad and to determine the amount the RTA would need to contribute.

NSW Treasury's Evaluation **Assessment of the project's economic appraisal by NSW Treasury indicated that the project was marginal in terms of its benefits to the community and that RTA's contribution to the project varied greatly depending on the assumptions adopted.**

These findings were considered by the Capital Works Committee on 27 July 1993 where the decision was taken to proceed with calling expressions of interest but with the Government reserving its decision on whether or not the project would proceed.

Conditions and Principles for Private Sector Involvement

Guidelines for Participation The approach that Government agencies are required to adopt in the case of private sector involvements in public roads is outlined in the *Guidelines for Private Sector Participation in the Provision of Infrastructure*. This was released by the NSW Office of Economic Development in June 1990.

The Guidelines apply to infrastructure projects only and establish:

- conditions that must be met, including the calling for expressions of interest, the conduct of economic appraisals and the approval from the Capital Works Committee of Cabinet
- principles regarding risk sharing, funding and restrictions, and
- criteria for assessment.

Public Accounts Committee

The Public Accounts Committee (PAC) of the NSW Parliament in its Reports No. 73 (July 1993) and No. 80 (February 1994) made recommendations regarding the involvement of The Audit Office in future infrastructure developments. A copy of the recommendations are in Appendix 1.

The Government is presently reviewing its Infrastructure Guidelines in light of the PAC's Reports.

RTA's Assessment Process

Audit Criteria

To determine if the RTA followed due process in seeking expressions of interest and assessing proposals.

Expressions of Interest

The Capital Works Committee at its meeting on 27 July 1993 gave approval to the RTA to invite the private sector to submit preliminary proposals to finance, design, construct, operate and maintain the M2 Motorway.

Approval was granted on the basis that, in seeking expressions of interest, the Government was not committing itself to the provision of funding for the project and that the private sector proponents will be expected to bear all risks associated with construction and traffic.

The RTA advertised for expressions of interest on 8 September 1993 and closed on 2 December 1993. Four preliminary proposals were received.

Assessment Criteria

RTA invited expressions of interest based on the requirements detailed in the RTA document *Guidelines for Proponents*. The document provided details of the M2 project specification, technical requirements and the assessment criteria and the evaluation process that the RTA was to use.

Proponents were required to provide information on:

- project details and staging
- financing proposals

- risks or benefits associated with the project
- qualifications and conditions to the offer
- details of proponents and their experience
- transport strategies, and
- Loan Council considerations.

Assessment Process

The assessment of the preliminary proposals was undertaken by a panel of four RTA staff. Professional assistance was provided to the panel by Blake Dawson Waldron (legal); Infrastructure Development Corporation (financial) and Evans and Peck (technical).

The assessment included evaluation of the proposals against the criteria, the allocation of risk and the degree of confidence in the ability to translate the preliminary proposal into a final agreement.

The proponents made presentations on their preliminary proposals to the Assessment Panel on 16 and 17 December 1993. Clarification of financial models and responses to detailed questions were provided by the proponents in January 1994. Detailed reports from the legal, technical and financial advisers were also considered by the panel in making its recommendation.

RTA's assessment process is outlined in Figure 2.

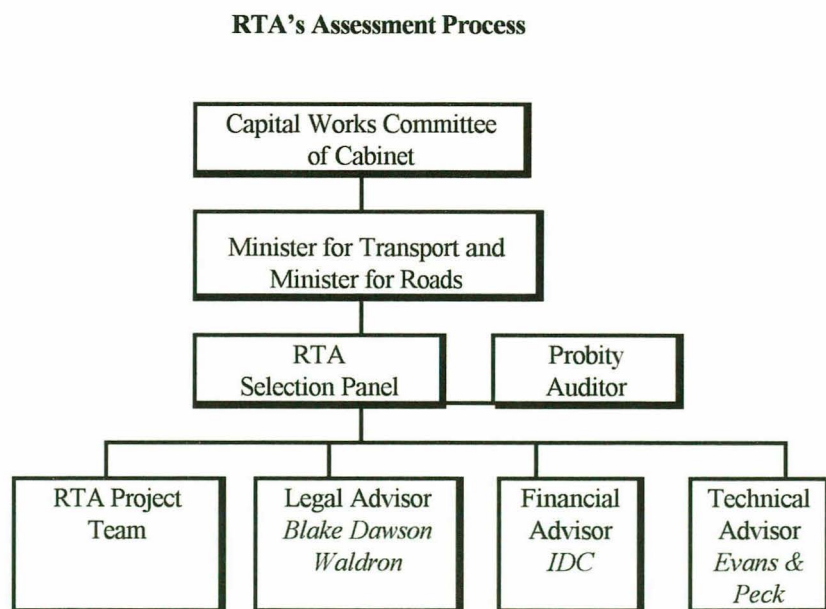


Figure 2

Role of the Probity Auditor

A Probity Auditor from Deloitte Touche Tohmatsu was appointed to ensure that the process being followed to select a preferred proponent for the project was fair and equitable and executed in a manner which should ensure that there could be no substantial complaint against the probity of the process.

The Probity Auditor, while present, did not participate in the evaluation and selection process.

Results of Assessment

Assessment Panel Recommendation The Assessment Panel appears to have evaluated each proposal against the published criteria.

The Assessment Panel reported that:

...the Hills Motorway Limited was the only proponent offering to construct, finance, own and operate the Project without any requirement for RTA financial contribution or any RTA underwriting.

Although the Panel reported that Hills' proposal did not require any financial contribution for the RTA; the RTA were still required to contribute \$120m for land acquisitions required for the project irrespective of the proponent selected.

The Assessment Panel considered that the Hills Motorway Ltd (Hills) proposal provided the best offer for provision of the link and recommended that Hills be invited to undertake a more detailed investigation and submit a firm offer.

Hills was approached by the RTA to provide a detailed offer which was received in May 1994. This was evaluated by the Assessment Panel which reported in June 1994 that the detailed offer:

.....does not differ in a material way from the Company's preliminary proposal so as to make it unacceptable to the Authority.

Approval to Enter into Negotiations

The Capital Works Committee on 22 June 1994 approved the RTA entering into final negotiations with Hills to finance, construct and operate the M2 on the basis that the RTA contribution/construction grant be fixed at \$29m as a result of the Government's decision to exclude surplus land from the deal and that the RTA make restoration to Hills for the effect of interest rate movements. The final amount of the RTA's contribution was to be approved by the Minister for Roads.

The RTA agreed to cover Hills for any movements in interest rates from the date the preliminary offer was submitted (2 December 1993) up to the execution of the contract (26 August 1994).

Negotiation of Contract

The RTA's team of negotiators included two members of the Assessment Panel and the RTA retained the legal and financial advisers previously used for the assessment process.

Approval to proceed with the M2 contract was provided by the Premier on 23 August 1994.

The contract was signed by the Minister for Roads on 26 August 1994.

RTA's Adherence to Government Guidelines

The approach adopted by the RTA for calling expressions of interest and the assessment of proposals meets the NSW Government requirements outlined in the *Guidelines for Private Sector Participation in the Provision of Infrastructure*.

The RTA's legal advisers, Blake Dawson Waldron have examined the Assessment Committee Report on behalf of the RTA and concluded that the approach adopted by the Committee did not contravene the principles established in the Guidelines.

Cost of Assessment

The cost of the provision of professional advice to the Assessment Panel throughout the process has been estimated by the RTA to be \$2.0 million.

Other Requirements

Requirements under the PAFA Act

The requirements for private sector participation infrastructure is set out in the *Public Authorities (Financial Accommodation) Act 1987*.

The 1991 amendments to the Act established a requirement that approval from the Treasurer was needed for all projects which qualify as joint financing arrangements.

The RTA obtained the required approvals from the Treasurer on 22 August 1994.

Specific Probity Issues

Audit Criteria

To determine if the RTA has addressed probity issues during the assessment and selection process.

**ICAC
Involvement**

The Independent Commission Against Corruption (ICAC) was not initially approached by the RTA to provide advice on the potential integrity issues that may have arisen from the approach adopted by the RTA for the assessment of proposals.

Two potential probity issues arose during the assessment and evaluation process. ICAC was not approached regarding the first matter until 16 August 1994. ICAC provided clearance on the matter.

The second matter was not referred to ICAC until 23 August 1994 with clearance from ICAC being received on the day of signing the contract (26 August 1994).

If ICAC's findings on these matters had been to the contrary, it would have put the entire process in disrepute. For such a costly and time consuming exercise involving a high profile, controversial project, it would seem more appropriate that the RTA followed the directions set out in Premier's Memorandum No. 93-94 that suggests ICAC be consulted early on in the process.

**Findings of the
Probity Auditor**

The Probity Auditor confirmed that he was satisfied that all matters of probity with regard to the evaluation of the Hills offer had been adequately addressed by the Assessment Panel.

Conclusions

RTA appears to have followed appropriate administrative practices in the assessment and selection of proponents for the M2. The approach that was adopted by the RTA for calling expressions of interest and the assessment of proposals meets the requirements established in the *Guidelines*.

Major Changes/Alterations Since Project Definition

The audit findings in regard to the administrative process adopted by RTA indicate that due process has been followed. There are, however, some aspects to the process that should be mentioned.

**Establishment of
the boundaries
of the Northwest
Region**

The project documentation and the *Project Deed* provide a map of the Northwest Region of Sydney that expands from Marsden Park (West boundary) to Chatswood (East boundary) and encompasses the Pacific Highway from Gordon to Chatswood.

The RTA documentation indicates that following discussions with the Government it was agreed that the areas adjacent to the Pacific Highway be excluded from the project.

The RTA file note indicates that Hills had also consented to these changes.

The map that has been included as Exhibit I (shown in Figure 1 of this Report) to the signed *Project Deed* does not reflect these changes.

It is noted that Hills confirmed on 25 August 1994 that any upgrade of the North Shore railway line or the Pacific Highway from Chatswood to Hornsby would not constitute grounds for renegotiation under the M2 Project Deed. On this basis the RTA did not see a need to change the map.

Surplus Land

The *Guidelines for Proponents* document which accompanied the invitation for expressions of interest identified approximately 20 hectares of land owned by Government authorities surplus to the needs of the M2. Proponents were invited to suggest ways of realising the development potential of the land so as to benefit the project as a whole and minimise the Government's financial contribution to the project.

The Government advised the RTA on 17 March 1994 that the surplus land would no longer form part of the project and that Hills' firm offer should exclude the development of the land.

In its preliminary proposal, Hills placed a present value of \$20m on the land with the expectation of a development benefit of \$35m in later years. Hills sought and received restoration for the exclusion of the surplus land.

The Capital Works Committee approval for RTA to enter into final negotiations with Hills placed a limit of \$29m on RTA's contribution/construction grant to Hills, as a result of the removal of the surplus land.

Hills final offer indicated that RTA's contribution would be \$20m in net present value which is to be provided by way of RTA accepting financial responsibility for work to be carried out on the project.

Interest Rate Variation

The RTA negotiated with Hills concerning restoration for the increase in interest rates between the date of their proposal and the date the contract was signed.

The Assessment Committee and the RTA's financial advisers in considering Hills' final offer, which provided for a \$30m contribution by the RTA in respect of interest rate variations (as at 9 June 1994), determined that this amount was not a material variation to Hills preliminary proposal and did not warrant reconsideration of the other proponents proposals because all other proposals would have been similarly affected.

The RTA's contribution to Hills for variations in the interest rate from receipt of Hills' preliminary proposal in December 1993 to execution of the *Project Deed* in August 1994 has been calculated at \$39m.

**The Location of
Bus Lanes**

The Environmental Impact Determination (EID) stated that the project should provide a centrally located dedicated busway reservation between Beecroft Road and Old Windsor Road. The busway, as proposed, included centrally located two lane, two way, roadway separated from the main tollway carriageway by raised medians. Buses will be expected to pay a toll equal to that levied on similar vehicles.

During the concept phase Hills proposed an alternative, by relocating the busway on the side of the tollroad. This was considered by Hills to be the safer alternative.

The RTA did not agree with the Hills' proposal. The centrally located busway has remained in the project design. A rumble strip between the carriageway and the busway and the provision of a central 1.2m high New Jersey barrier has been included in the design.

RTA considers that the main adverse impact of the change proposed by Hills:

...would be the possible community perception of a reduced commitment to public transport and the apparent increased difficulty of converting the bus lane to light rail.

**Amendment to
Scope of Works**

Through the negotiation process, agreement was reached with Hills in August 1994 to include specific provision in the M2 Scope of Works and Project Deed relating to the possible conversion of the busway to light rail. The amendment merely provides that there can be negotiation, if a government decides in the future to pursue a light rail option. There will need to be re-engineering of the base of the road and provision of other structures to support any light rail.

Legal Considerations

LEGAL CONSIDERATIONS

Legal Opinion on the M2

In conducting this Performance Audit, the Audit Office obtained the services of Minter Ellison Morris Fletcher, Solicitors to provide legal advice on the M2 project.

The advice received from Minter Ellison Morris Fletcher has been reproduced in its entirety.

The legal advice below indicates that the RTA may terminate the Project Deed under certain limited conditions as set out in the Deed, but it has no right to terminate for its own convenience. If the Company and the Trustee lawfully terminates the Project Deed cost of such a termination is very difficult to quantify but could be of the order of several hundreds of millions of dollars. Additional to that cost would be the cost flowing from perceived or actual increased sovereign risks.

The Audit Office accept this advice as being consistent with its understanding of the arrangements.

M2 Motorway Contracts

A. Advice Sought

You have asked for our advice in relation to specific questions arising out of the resolution passed by the Legislative Assembly on 22 November 1994. These are:

1. Are the contracts to which each of the Roads and Traffic Authority (RTA) and the State of New South Wales (State) are parties (the M2 Contracts) legally binding?
- 2A. Can the terms of the M2 Contracts be varied?
- 2B. Can the work under the M2 Project Deed be varied?
3. Is a contract binding governments and taxpayers for up to 45 years valid under the NSW Constitution?
4. What is the legal nature of the allocation of certain risks including those relating to fall in revenue due to alternative roads or public transport, and changes in taxation?

B. Short Answers

Our short answers to questions 1 to 4, elaborated below, are:

1. Yes, assuming compliance with the legal formalities and conditions precedent.
- 2A. Yes, but only by agreement.
- 2B. Yes, under clause 6.2, but (except for one environmental category) only by agreement.
3. This depends on the particular contract, but the length of the term is irrelevant. The M2 Contracts almost certainly are valid under the constitution. Parliament may if it wishes to do so, enact a law affecting the rights of the parties and abolishing any right to compensation or damages.
4. This does not allow a short answer.

C. Basis of our advice

This advice has been provided within a very short time-frame and is therefore inherently not as detailed as it might otherwise have been. It is based on our reading and understanding in the time available of the contractual documents which we have seen, ie (following your numbering system):

1. Project Deed (but not the annexures to it).
2. Deed of Guarantee under the Public Authorities (Financial Arrangements) Act 1987 (NSW) (the 'PAFA Act').
3. Project Management Services Deed.
4. RTA Deed of Charge.
5. Trust Lease.
6. Company Lease.
7. Trust Concurrent Lease.
8. Sub-lease from Company to Trustee.
9. Design and Construction Deed.
13. RTA Deed of Consent

21. Deed of Original Charge and Assignment.

(unnumbered) Trust Deed for the Hills Motorway Trust (unsigned version).

For conciseness and clarity we have summarised the effect of provisions, rather than quoted extensively from them or repeated their full effect. You will appreciate that there may be differences between a paraphrase of a provision and its full and detailed effect. This advice should therefore be read in conjunction with the relevant provisions.

We have used the definitions in the M2 Contracts. Where the Hills Motorway Ltd Prospectus has reasonably correctly summarised the effect of a relevant provision, we have not repeated that summary.

D. Advice

1. Are the M2 Contracts legally binding?

1.1 **Legal capacity**

The M2 Contracts may not be valid if one or more of the parties lacks the legal capacity to contract.

1.2 **Legal capacity of the Company and the Trustee**

We have assumed that the Company and the Trustee were properly incorporated and continue to be corporations under the Corporations Law. We have carried out no company searches.

If both are corporations, they have the legal capacity of a natural person: s161 of the Corporations Law.

We have not seen the Powers of Attorney pursuant to which the Company and the Trust appointed their attorneys to execute the M2 Contracts. There appears to have been a high level of sophisticated legal and financial advice on the events leading up to signing of the M2 Contracts. It is therefore unlikely that the purported 'attorneys' were not duly appointed and authorised to bind the Company and the Trustee. However, if in fact the purported attorneys were not duly appointed and authorised to bind the Company and the Trustee, the RTA and the State can either:

- (i) assume that the attorneys were duly appointed and had authority to bind the Company and the Trustee: s164(3) of the Corporations Law; or

- (ii) (depending on supervening events how soon after signing the decision is made) choose not to be bound.

1.3 Legal capacity of the RTA and the State

The RTA

There seems no doubt that the Chief Executive has legal capacity to bind the RTA. Section 48(2) of the *Transport Administration Act 1988* (NSW) provides that any act done in the name of the RTA by the Chief Executive is taken to have been done by the RTA. Further, the RTA has power under legislation to enter into contracts for the carrying out of works or the performance of services: section 53(1)(b) of the *Transport Administration Act 1988*. This is a broad power, but a meticulous examination of the RTA's contractual obligations is required in order to determine if all the contractual arrangements fall within power. However, this power coupled with the power under section 20(1) of the PAFA Act would probably suffice.

The State

We believe that the Minister has the legal capacity to enter into the relevant M2 Contracts. Any doubt about that is removed by the Premier's approval to the Minister entering into the M2 Contracts on 23 August 1994.

1.4 Illegality

The M2 Contracts may not be binding if specific statutory requirements have not been complied with.

RTA

Any of the contractual obligations of the RTA which fall outside the joint financing arrangements recommended by the Minister and approved by the Treasurer under section 20(1) of the PAFA Act, would need to be supported by the general powers of the RTA under the legislation conferring functions or powers on the RTA.

For the purpose of this advice we have assumed that the RTA in entering into the M2 Contracts has complied with its duty under Section 81(1) of the *Transport Administration Act 1988* (NSW) to operate as effectively and economically as possible and to exercise efficiency and economy in incurring expenditure. Whether the entry into the M2 Contracts is consistent with the efficiency and economy duties of the RTA

is of course a matter for financial and commercial rather than legal assessment.

We have also assumed that:

- (i) the funding for the payments to be made by the RTA under the Project Services Management Deed to Hills Construction is to be paid from the 'Roads and Traffic Fund' established under section 77 of the *Transport Administration Act 1988* (NSW); and
- (ii) if the work to be designed and constructed under that Deed is a 'State work' under section 80 of that Act, Parliament has provided money in the Fund for that purpose.

We confirm advice from the Director of Audit, Mr Kalagurgetic, that we need not be concerned with whether the M2 Contracts comply with anything referred to in Division 2 (Accounting Arrangements) of Part 2 of the *Public Finance and Audit Act 1983* (NSW).

Is the proposed toll lawful?

The M2 Contracts authorise the charging of a toll. One potential issue is whether the proposed toll is lawful. If it is regarded as a tax, rather than a charge on a person using the road for the use of the road, the toll can only be imposed through legislation.

1.5 Fettering freedom of action

(a) The doctrine of 'executive necessity'

This doctrine derives from the case of *The Amphitrite* [1921] 3 KB 500. There Rowlatt J dismissed a petition on the ground that there was no enforceable contract between the Crown and the shipowners because:

"It is not competent for the Government to fetter its future executive action which must necessarily be determined by the needs of the community when the question arises. It cannot by contract hamper its freedom of action in matters which concern the welfare of the State".

(b) The State's freedom of action

Assuming that the doctrine of executive necessity is a valid principle of law, it may be contended that the obligation of the Minister under clause 2.7 of the Project Deed to consider any possible effect on the M2 Motorway when granting any concession in respect of any public transport infrastructure service in the Northwest Regions of Sydney is not enforceable. It may be argued that this provision is unenforceable because it hampers the freedom of action in matters which concern the welfare of the State. Nonetheless, the Minister's only obligations under clause 2.7 are to consult with the Company and Trustee and to have regard to the effect on the M2 Motorway. These are very limited obligations.

(c) The RTA's discretion

The parties agree in the Project Deed (clause 1.6) that, subject to the Deed, the RTA's unfettered discretion to use its statutory powers is not unlawfully restricted or otherwise affected by the Project Documents. Clause 1.6(a) attempts to avoid a fetter on the RTA's statutory powers, but this is expressed to be subject to what the RTA and State promise to do in the Deed. Whether the RTA has in effect agreed to fetter its future statutory discretion depends on a full analysis of the RTA's statutory powers and duties which is beyond the scope of this urgent advice. However no obvious material fetter was apparent to us in reviewing the documents.

1.6 Satisfaction of condition precedent

The obligation of the parties to the Project Deed to perform is subject to the prior occurrence of all of the seven events listed in clause 1.11 and described collectively as a 'condition precedent'. If one or more of the events do not occur, the Project Deed will still exist, but there will be no obligation to perform on any party to the deed.

We understand that you are at present unaware as to whether all those events have occurred, but are obtaining separate advice about this. These events are as follows:

- (a) the RTA, the Company and the Trustee execute the Deed of Charge;

- (b) the RTA makes a recommendation to the Minister that, in accordance with section 63 of the *Roads Act 1993* (NSW), he direct that the functions of any roads authority in respect of the M2 Motorway are the responsibility of the RTA;
- (c) the Minister makes that direction;
- (d) the RTA receives evidence, in form and substance satisfactory to it, that the Project Facilities Agreement is executed and immediately binding on the parties;
- (e) the Minister recommends, and the Treasurer approves, the RTA entering into the Project Documents in accordance with section 20(1) of the PAFA Act;
- (f) the Minister executes a guarantee under section 22B of the PAFA Act which is satisfactory to the Trustee and the Company in form and substance, in respect of the RTA's obligations under the Project Documents; and
- (g) the Project Management Services Deed is executed and immediately binding on the parties.

From the documents which we have inspected, it appears that conditions (a) and (d) to (g) have been fulfilled. We are unable to make any comment about conditions (b) and (c).

2. Can the M2 Contracts be varied?

2A. Variations to the terms of the M2 Contracts

As with any contract, the terms of any of the M2 Contracts may be varied if the parties agree. However, depending on the effect of the variation, it may require a further recommendation of the Minister and approval of the Treasurer under s20(1) of the PAFA Act in order to be legally effective. This is because the existing recommendation and approval were in relation only to the present arrangement.

Further, if a variation to the terms is proposed, it would be at least desirable that there be prior consultation between RTA and Treasury as requested in that letter. Although by the Deed of Guarantee the State guarantees the performance by

the RTA of its obligations under the transaction documents, the Guarantee also extends to any variation or replacement of the transaction documents: see clause 2.6(a)(ix). Despite, this general principle, a radical change to the arrangements making them entirely different, could result in the PAFA Act Guarantee not being enforceable against the State in relation to the M2 Contracts as varied, in which case a fresh PAFA Act Guarantee would be required.

2B. Variation to the work

2B.1 General

With one exception, none of the parties under the Project Deed may unilaterally compel a change to the physical work - this can only be achieved by written agreement: clause 6.2. This applies as much to the busway conversion to light rail or other transport (referred to in clause 6.2A) as to any other variation. Although clause 1.2(c)(iii) of the Scope of the Works and Technical Criteria which is Exhibit K to the Project Deed ('Scope') actually envisages the potential for such a change, it cannot be imposed unilaterally and must be negotiated by agreement.

2B.2 RTA required variations

The exception is that the RTA may require the Company and Trustee to comply with recommendations made to the RTA as a result of the community liaison process required by the Environmental Impact Determination referred to in clauses 5.1(b)(iii) and 6.2(e), unless that requirement is listed in Schedule 1 to the Scope. If the RTA requires work to be done under this provision which is outside the Scope, then the RTA indemnifies the Company and Trustee for additional cost: clause 6.2(e).

2B.3 Cost of agreed variations

The cost of an agreed variation, must if it increases the Scope, be met by an extension of the Term, a payment by the RTA, an adjustment in rights and obligations of the parties, or a combination: clause 6.2(c). In contrast, cost savings are shared equitably and mutually by negotiation 'in good faith': clause 6.2(d). There is therefore no complete equivalence in the financial consequences as between additional cost variations on the one hand, and reduced cost variations on the other.

3. **Is a contract binding governments and taxpayers for up to 45 years valid under the NSW Constitution?**

This depends on the particular contract. The M2 Contracts almost certainly are valid under the New South Wales Constitution. Parliament may if, it wishes to do so, enact a law affecting the rights of the parties and abolishing any right to compensation or damages.

Can Parliament legislate out the M2 Contracts and abolish any right to compensation?

By Section 5 of the *Constitution Act 1902* the Parliament of New South Wales has, subject to the provisions of the Commonwealth of Australia Constitution Act, power 'to make laws for the peace, welfare and good government of New South Wales in all cases whatsoever'. This broad legislative power would enable the New South Wales Parliament to pass a law affecting the obligations of the parties to the M2 Contracts not only prospectively but also retrospectively.

The M2 Contracts are expressed to be governed by the laws of New South Wales and the laws of New South Wales can be changed from time to time by the Parliament. Indeed the Project Deed itself acknowledges this possibility. The provisions dealing with RTA default state that the Company and the Trustee may terminate the Deed on 30 days written notice to RTA if certain circumstances occur, including a New South Wales Act prohibiting (or which has the effect of prohibiting) the Company or the Trustee from carrying out the Project, or levying or keeping tolls.

Further, it is also clearly established that the Executive cannot fetter the Parliament's powers and the doctrine of Parliamentary sovereignty enables the Parliament to make or unmake any law whatsoever: *British Railways Board v. Pockan* [1974] A.C. 765. It follows that the New South Wales Parliament can enact a law affecting the rights of the parties under the M2 Contracts and abolishing any right to compensation or damages.

Of course the New South Wales Parliament cannot affect any right which exists under Commonwealth law, nor can it affect any right which exists under foreign law and is enforceable in a foreign State. But it is difficult to think of Commonwealth laws which would have an impact on the parties to the M2 Contracts.

4. Risk Allocation

4.1 Approach

We have considered risk allocation in two ways. First, by using the headings in Section 5 of the Prospectus and comparing the statements made in that Section and Section 8 on the one hand against our reading of the documents on the other. Where no comment is made in relation to a heading in Section 5, it can be assumed that we believe the Prospectus statement (combining both Sections 5 and 8) to be accurate. Secondly we have considered some specific areas of risk which we thought relevant.

4.2 Headings in Section 5 of the Prospectus

(a) Traffic Risk

The Company carries the risk that traffic volumes and revenue are lower than those projected (clause 2.3(a) of the Project Deed) unless there is "incorrectness or inaccuracy in the assumptions made in the Base Case Model" due to breach of the Project Deed by the RTA (clause 2.3(b)).

(b) Construction Risk

Although the Company and Trustee have, through the Design and Construction Deed, sub-contracted all of the risk of sub-surface defects to the Contractors. However, due to the combined effect of clauses 2.1(d)(ii) and 3.5(c) of the Project Deed, the RTA has only passed the risk of sub-surface defects on to the Company and the Trustee to the extent that they do not have a Material Adverse Effect.

4.3 Risks relating to increases in taxation or new taxation

(a) New South Wales taxation which discriminates

The RTA must under clause 2.16 of the Project Deed reimburse the Company or Trustee as the case may be for the increased cost of NSW taxation which, by the manner in which it is imposed, discriminates against:

1. the Company or the Operator in the operation, maintenance or repair of the M2 Motorway;
2. the Company or the Trustee in the design or construction of the Company Road/Trust Road; or

3. private operators of tollroads generally.

The example you gave of the introduction of a services tax by the State would, if of general application to the provision of services, not discriminate in the way caught by clause 2.16 and therefore not be reimbursable by the RTA. However, a services tax resulting in additional cost may be caught under other provisions: see below.

(b) New Commonwealth or State taxes

New Commonwealth or State taxes (except those of the State which discriminate as discussed above) which increase the cost of performance of the Company's and the Trustee's obligations under the Project Deed, the Company Lease, the Trust Lease or Trust Concurrent Leases beyond that 'reasonably anticipated' at the time of entering into the Project Deed are events requiring good faith negotiation under clauses 2.1(f) and (g)(ii).

Although there is no corresponding obligation requiring negotiation in good faith resulting in a payment to the RTA or the State in the event that taxation is reduced. One assumes that a reduction in taxation increases the real after tax internal rate of return thereby permitting a potentially earlier transfer of the M2 Motorway to the RTA (see definition of 'Term' in the Leases).

(c) Local Government and Water Board rates

The Company must pay all local government and water board rates or charges in respect of the Premises, but the RTA must, on demand, reimburse the Company and the Trustee the amount by which those rates exceed \$224,069 per year (CPI indexed): clauses 9.7 and 17.5.

(d) Land tax

The Company and Trustee are liable to pay any land tax assessed under the Land Tax Act 1956 (NSW) or the Land Tax Management Act 1956 (NSW) or replacement legislation, but the RTA must indemnify the Company and the Trustee: clause 17.6.

4.4 Alternative public transport infrastructure and alternative roads

Although this is summarised in section 8 of the Prospectus, you have specifically asked us to address this risk.

Under clause 2.7, the Minister must consult with the Company in good faith in respect of any proposed development of, or the granting of a concession in respect of, any public transport infrastructure (including public or private passenger or freight train services) to service the specified Northwest Regions of Sydney.

The Minister must also have regard to the effect on the M2 Motorway (and its traffic usage) and the fact that M2 Motorway is the principal passenger and freight arterial route servicing the Northwest Regions of Sydney.

Further, under clauses 2.1(d)(iv) and (v) if the NSW government (or any of its authorities or agencies):

- (a) develops, substantially upgrades or grants a concession to develop or substantially upgrade an Alternative Road;
- (b) permits the development or substantial upgrading of, or the grant of a concession to develop or substantially upgrade, an Alternative Road; or
- (c) takes action relating to the servicing of the transport requirements of the Northwest Region of Sydney which discriminates against the Company in the operation and maintenance of the M2 Motorway or prejudices the operational results of the M2 Motorway

and the Company and the Trustee reasonably considers that that has had a Material Adverse Effect on the Project, then under clauses 2.1(g) and (h) the RTA or the Minister must negotiate in good faith with the Company and the Trustee to enable the Trustee to:

- (i) repay the Project Debt in a substantially unaffected manner; and
- (ii) give the Trust investors the Equity Return they would have received if the event had not occurred or:
 - (A) in the case of an Alternative Road, the Base Case Equity Return plus 3%, if lower; or
 - (B) in the case of servicing transport requirements, the Base Case Equity Return, if lower.

Therefore if the NSW government is involved in the development of an Alternative Road or public transport to service the Northwest Regions of Sydney, the Minister or the RTA may have to negotiate in good faith with the Company and Trustee as provided by clause 2.1(g) and (h).

4.5 Specific Risk Areas

(a) Financing Risk

We are able to confirm that the financing risk is not carried by the RTA or the State. Beyond that, in accordance with our instructions, we have not looked at where that risk ultimately lies.

(b) Residual Risk

The RTA and the State rely entirely on the Company and the Trustee for the performance of their obligations under the Project Deed. There appear to be no guarantees from third parties supporting the performance of either the Company or the Trustee. An assessment therefore needs to be made as to the ability of the Company and the Trustee to perform these obligations and the consequences of their failing to do so.

It is relevant that the Company and Trustee have sub-contracted most of the risk to sub-contractors under the Design and Construction Deed and the Operating and Maintenance Agreement. The capacity of these sub-contractors to perform their obligations and their ability to meet the financial consequences of failing to do so is relevant. Beyond that, it is necessary to look at the 'worth' of the Company and the Trustee, and the priorities existing between the financiers on the one hand, and the State and the RTA on the other.

The liability of the Trustee to the State and the RTA is (by clause 1.8A of the Project Deed) limited to trust assets, including the M2 Motorway. We assume that the Trust Deed has been signed. There is no limit on the Company's liability, but we have made no assessment of its 'worth'. Although we have not seen any deeds of charge between the financiers and the Trustees or the Company, we assume that the financiers have first charge over all assets and undertaking of the Company and over all assets of the Trust.

The RTA also has a similar charge but it ranks behind the financiers in terms of priority, subject to two exceptions:

- (i) the balance of the Construction Payment Account (for the Ancillary Works) less amounts due for work performed but not paid for; and
- (ii) damage, expense, loss or liability suffered or incurred by the RTA by reason of the Company or Trustee failing to rectify a default or remedy a breach of warranty.

Therefore, subject to this, if the Company or the Trustee become insolvent, the financiers will have first right to be paid out, followed by the RTA.

(c) Step-in rights of the RTA and the State

If the Company or the Trustee fail to rectify a default or remedy a breach of warranty in accordance with a remedy notice under clause 14.1(a), or if urgent action is necessary, the RTA may take any action which it considers appropriate to rectify that default, remedy that breach of warranty or take that urgent action, and the Company and Trustee must indemnify the RTA for reasonable damage or loss unless arising from the RTA's negligence or wilful default: clause 14.1(d). The rights of the RTA to take action under this provision do not, however, entitle it to step into the shoes of the Company/Trustee, to terminate the Project Deed or to remain on the Land forever, but are of a temporary nature.

If the Project Deed is terminated prior to completion of the M2 Motorway, the RTA or the State cannot automatically step into the shoes of the Company/Trustee in relation to the Design and Construction Deed. We have not seen the Operating and Maintenance Agreement, but the Prospectus does not mention any step-in right for the RTA or the State if the Project Deed is terminated; on the contrary, as is the case with the Design and Construction Deed, the Operating and Maintenance Agreement is automatically terminated.

On early termination of the Project Deed construction activity would cease. In practice the RTA, the State and the financiers would be driven into negotiating a new arrangement.

(d) Termination for convenience

The RTA may terminate the Project Deed if the events of default set out in clause 14.3 occur, but it has no right to terminate for its own convenience.

(e) Compensation payable by RTA and the Minister if the Company and Trustee terminate

If the Company and the Trustee terminate the Project Deed after the occurrence of one of the events listed in clause 14.4 (these include sovereign risk events) the Minister must pay to the Company and Trustee the Early Termination Amount. This is basically defined as the Project Debt plus an amount sufficient to give the Notional Initial Trust Investor the expected after tax internal rate of return over the full term, having regard to amounts the Trustee had previously received and discounted at a rate to be agreed to take account of early receipt.

Further, the RTA and the Minister must compensate the Company and Trustee for any damage, expense, loss or liability the Company or the Trustee incur as a consequence of that termination: clause 14.6(b)(i).

At the top of page 64 the Prospectus states:

This provision only permits loss of future profit to be claimed up to an amount which would have been necessary to enable the Notional Initial Trust Investor to receive the Equity Return on its investment over the Term having regard to amounts the Trustee has previously received and discounted at a rate to be agreed to take account of early receipt.

However, the clause is not as clear as it might be. We think it is best described as attempting to make the statement that the Trustee is entitled to enough to pay out debt, recover damage and expense incurred, and obtain a rate of return for equity based on a pre-agreed measure.

Further there is no express limit on or formula for what the Company (as compared with the Trustee) may claim under clause 14.6(b)(i). The Company would need to establish that the amount it claims is damage, expense, loss or liability which it incurs as a consequence of the termination.

We await your further instructions

Yours faithfully

MINTER ELLISON MORRIS FLETCHER

Effectiveness Issues

EFFECTIVENESS ISSUES

Concepts

A key issue to be considered in any discussion of a development such as the M2 is its effectiveness. Effectiveness can be defined to mean a number of things, and will often mean different things to different people. In the field of performance auditing the general approach to considering effectiveness involves assessing the extent to which a program or action has achieved the objectives it was intended to satisfy. That is, in general terms, were the results or benefits what were expected?

Since the M2 has yet to be constructed, such an appraisal is not yet possible at a detailed level. However, there are still some significant aspects of effectiveness which can be considered even at this early stage. In the limited time available for this audit, two aspects of effectiveness have been selected for comment.

Scope of Review

Firstly, in considering effectiveness it is important that the project not be considered in isolation. Whilst most focus in evaluating such projects is usually in terms of matters of detail relating to the project, it is also important that evaluation not be limited to considering the project solely of and in itself. Some consideration of wider policy and strategic objectives, and how the M2 project fits into them, has therefore been made.

Second, the approach taken to the M2 project, including how it has been packaged, can have an important impact on the ability of the project to ultimately satisfy its objectives. Some early consideration of this aspect can be made now.

Overall Coordination and Integration of Strategic Planning

The Big Picture

In developing public sector services generally, and particularly where major public capital projects are concerned, it is important that a focus on detail does not lead to a loss of attention to the big picture. Conflicting decisions and actions over time, or between the various functional units of government, can lead to considerable inefficiency, waste and lower overall performance than was desired; hence reduced effectiveness and poor value for money.

Audit Criteria

Audit sought to establish the extent to which observable and consistent/complementary linkages can be traced through the various levels of planning operating within the State.

Dimensions of Planning

The value of formal planning as a means of setting out a path towards a definable target or outcome has long been recognised. Planning within the public sector is sometimes quite vigorous and extensive. This is a highly desirable trait.

Within the NSW public sector planning can be observed at many levels and in many areas. Planning occurs at both the macro and micro levels on the one hand; and on a range of geographical bases on the other hand (eg. on State-wide basis, and by regions, cities and zones). It also occurs on a variety of industry or service-type bases (eg. education, power, water supply, wastewater disposal, transport etc).

Potential for Impeding Effectiveness

While such a range of planning activities demonstrates a commitment to planning, they also present a risk that a lack of coordination and integration could occur. This in turn could lead to poor results. Just as an absence of planning can hinder optimal performance, so too poor integration of planning can act as a significant impediment to effectiveness.

It is fair to say that such problems have occurred over the years. An example of this is recognised in the Government's publication *Integrated Transport Strategy for Greater Sydney (a first release for public discussion, October 1993)*, [the draft ITS] which stated that:

For too long planners have failed to integrate transport considerations into urban development and there has been a lack of foresight in transport infrastructure and service planning. ... In the absence of this integration, transport investment and service development will be ad hoc and fragmented and the efficiency benefits reaped from recent reforms will not be optimised. (page 2)

Road Planning in Context

In 1991 the RTA published a report titled *Road Transport Future Directions*. The report sought to look at transport in NSW over the next 20 to 30 years. The need for such an examination is explained as follows:

[The Report] has its origins in the corporate review of the RTA conducted by Booz Allen and Hamilton in 1989, which identified, inter alia, the absence of a State road network development strategy. The Future Directions Study is a step towards filling this gap and will contribute to the development of a broader State transport strategy. (page iii)

The Booz Allen and Hamilton comments were made irrespective of pre-existing road development plans, such as the *1946 Main Road Development Plan*, and *Roads 2000* (1987).

Planning Gaps **Two significant planning gaps were identified; the lack of either a comprehensive State-wide road network strategy or an effectively integrated overall transport strategy.**

Need for a Broad Planning Base *Road Transport Future Directions* rightly highlighted that it would be difficult for the RTA to develop a strategic plan for its area of interests in isolation from a broader planning context. This precisely highlights the concept of the need for integrated planning if effectiveness is not to be impaired.

Road Transport Future Directions explains that:

The RTA has limited scope for strategy development until broader Government and community consensus emerges on several key strategic directions. The RTA cannot pursue an integrated demand management strategy on its own. It is also not certain that outcomes desirable to meet transport objectives may remain desirable in a wider context. (page xix)

In particular, the report also highlighted that integration at the overall transport planning level was insufficient, and that an even broader planning base was required:

Changes in the way land use is managed and in land use/transport planning are necessary for any successful integrated land use/transport strategy. (page xvii)

This is a key issue, and has since become a major focus for continuing reform and development of effective policies and processes.

The draft ITS (hereafter called the ITS) has accepted and built upon these earlier foundations. It makes it clear that:

The need to adopt more sophisticated and integrated approaches to transport planning in NSW is seen as an urgent priority. Recent approaches simply have not served the community well enough. (page 14)

The ITS goes on to say:

Planners have, by definition, looked forward, but they have not always looked in the right direction. Transport planners have tended to work separately from land use, environmental and economic planners, producing complex technical models to predict and accommodate transport demand. This approach assumes that the emerging pattern of demand arising from land use decisions is efficient and appropriate and that it should be accommodated. ... There has been no overall sense of where our cities ought to be heading to guide technical effort.

... Integration of land use and transport planning must become more than a loose wish amongst knowing professionals. (page 14)

From this it is clear that until quite recently planning at all levels was not operating in the manner which we today expect, and which is required to produce effective outcomes.

**Strategic
Planning Layers**

Integrating planning across a wide base can best be achieved through a structured, or layered, top-down approach. This requires strategic parameters to be initially defined at the most macro level possible, and then to break the vision down in a tiered fashion through other plans with a progressively narrower focus.

Whilst at present such a planning regime has not been fully implemented, indications are that it is now very close. Clearly a great deal of progress has been made in the past three years.

That is not to say that broadly based strategic planning has not existed over the years. A variety of plans have existed at various times, for example:

- County of Cumberland Planning Scheme (1951)
- Sydney Region Outline Plan 1970-2000 (1968)
- Sydney Into Its Third Century - Metropolitan Strategy for the Sydney Region (1988), and
- Sydney Into Its Third Century (1989 update).

**Integrated
Planning
Framework**

However, it has now been determined that there had been a prolonged failure to bring all the various aspects and elements of planning together in a logical framework. Such a framework has been developed over the past three years. It is depicted in Figure 3.

Framework for Integrated Urban Land Use and Transport Planning

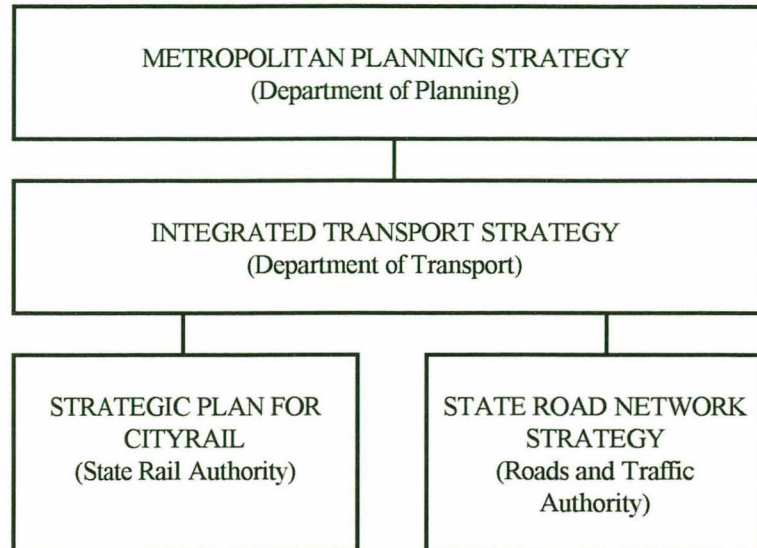


Figure 3

All of the documents referred to in Figure 3 are still in draft form at this time. However, finalisation of the Metropolitan Planning Strategy (hereafter called the Metropolitan Strategy) and the ITS is reportedly imminent. The State Rail Authority (SRA) and RTA strategic plans are reportedly to be released shortly for public discussion.

The Metropolitan Strategy is the second update of the 1988 planning strategy.

The ITS is intended to provide a set of strategies and priorities for transport planning.

Together, the intention is that they provide, for the first time, a comprehensive and integrated framework for urban development and transport planning in the Greater Metropolitan Region (Sydney, Newcastle and Wollongong).

Detailed Operational Plans

In order to support the objectives of the Metropolitan Strategy, the ITS identifies a framework of strategic transport corridors. The ITS is intended to provide the framework for the operating agencies (eg. RTA, SRA) to develop their own strategic action plans, and for the development of regional and area strategies.

**Strategic
Management
Processes**

Publication of visions and strategies does not necessarily achieve change, nor ensure that activities continue along the well intentioned initial lines established by such strategies. Institutional reforms are required to set up a strategic management process.

Suitable operational level arrangements are required if, on a functional level, integrated and coordinated arrangements are to work in practice. Only through such measures can rhetoric be made into reality.

The ITS recognises the importance of such measures:

... institutional reforms ... [are necessary to] ensure that transport and land use actions support one another and that decisions taken within each arm of the transport administration are both consistent with the strategic directions and with operational and investment decisions of the other transport bodies.

... The critical ingredient is a move away from fragmented decision making towards collective decisions on urban management principles and priorities ... (page 8)

**Transport
Integration
Council**

A crucial element to achieving such outcomes is the creation of a Transport Integration Council. The Council is convened by the Minister for Transport and comprises the heads of the Transport and Planning Departments, the three operational transport authorities and an industry association representative.

Amongst the Council's roles is the following key responsibility defined in its Terms of Reference:

to develop strategies that ensure a transport planning framework that is integrated: between modes; with land use planning; and between different levels of government, and specifically to monitor implementation of the Integrated Transport Strategy.

**Transport
Taskforce**

The Council is supported at a more detailed officer level by a Transport Taskforce comprising key senior officers from a range of relevant government agencies.

Conclusions

The above discussion highlights that until very recently there was not effective integration of planning processes between the various areas and levels of government.

Developments in the past several years have clearly improved the overall situation; at least in theory. The challenge now remaining is to demonstrate that the proposed benefits of the new arrangements can in fact be realised.

Planning for the M2 : Integration Issues

Audit Criteria **Audit sought to establish the extent to which the M2 can be seen to complement, or at least not to conflict, with other State objectives, strategies or priorities.**

Consistency With Broad Planning Objectives The history of the M2 was outlined earlier. Given the M2's long development history, it obviously predates the establishment of the various new integrated planning processes which have been outlined above.

Details and commentary on the specific processes employed for the planning of the M2 are described elsewhere in this report. Whilst those processes would be somewhat different today, from a necessarily brief examination by Audit, the M2 appears to be generally consistent with the broad objectives outlined in current macro planning documents in several ways:

Priority

- its apparent high priority for the RTA seems to correlate with the short-term priority allocated to development of the Macquarie-Parramatta-Castlereagh Corridor in the ITS, and

Urban Planning

- it appears to be consistent with the urban containment objectives of the Metropolitan Planning Strategy.

Consistency With Integrated Transport Strategy Objectives The entire thrust of the ITS is concerned with facilitating an integrated approach to the development of transport infrastructure. The ITS establishes a fundamental philosophy which is intended to be applied in all relevant aspects: broad strategy, macro planning and operational planning. It is intended to bind together all facets of transport planning into a cohesive and integrated body of effort.

Considering the M2 in this context, two particular elements of the draft ITS were of interest to Audit.

The ITS clearly sets out an intent that all transport developments be complementary:

[ensure that] ... decisions taken within each arm of the transport administration are both consistent with the strategic directions and with the operational and investment decisions of the other transport bodies. (page 8)

The ITS also sets out a number of specific key goals under three headings; economic efficiency, environmental protection and social equity. Under the latter heading, one of the defined goals is stated as follows:

the need to provide infrastructure and services which maintain transport opportunities for all sectors of the community. (page 3)

The intent of this goal is explained later in the ITS, as:

providing services and facilities which maintain travel opportunities and choices for all sectors of the community. (page 25)

Policy Objectives	There is thus a clear emphasis in the ITS on complementary development and keeping community travel options open. This provides a policy objective against which the situation surrounding the M2 development can be assessed as part of an overall consideration of effectiveness.
M2 Contract Conditions	Clauses 2.1(d)(iv) and (v) of the <i>Project Deed</i> identify certain classes of possible developments which, if undertaken during the currency of the M2 contract, would be deemed matters “capable of materially adversely affecting the Project.”
Impact of Other Developments with Adverse effects on the M2	Should such events give rise to a <i>materially adverse effect</i> (as defined by Clause 1.1), then under Clause 2.1(e) the Company and the Trustee may require the Minister to enter into negotiations with a view to enabling the Trustee to receive benefits from the project as defined in the contract. In practical terms this could mean awarding restoration in some form, either direct or indirect, and/or some renegotiation of aspects of the contract.
Geographic Area of Concern	The particular events which are defined by Clauses 2.1(d)(iv) and (v) of the <i>Project Deed</i> relate to the development of either alternate roads or alternative public transport infrastructure within the area of coverage for the M2 defined in Exhibit I to the <i>Project Deed</i> . This area was depicted earlier in Figure 1.
Conflict with Policy Objectives	<p>The issue to be considered is whether these conditions of the contract provide any conflict with broader policy objectives, such as those from the ITS mentioned earlier.</p> <p>In the broadest possible sense some conflict is apparent. In theory, the development of some possible future options may be affected by the M2 contract. To the extent that future options may wish to consider alternate roads or other public transport infrastructure within the defined region of the M2, such options would now need to</p>

be evaluated with the additional impost of possible impact on the M2, and the ramifications flowing from that.

Such of course is the case in most decisions. The selection of one option today often has implications for the shaping of future options. To some extent this will always be inevitable. However, one of the fundamental purposes of the ITS is to manage such situations to best effect.

Since the M2 is planned to be developed through a private sector approach, the issue of contract renegotiation has to be considered, and additional costs possibly borne, which would not apply if the road had been funded by government.

**Impact on
Future Options**

The extent to which such an argument carries any real implications, as opposed to theoretical ones, depends on the likelihood of any future developments of the sort which would be affected by the M2 contract.

**Future Road
Developments**

Given that the development of future alternate roads would be under the auspices of the RTA, conflicts with the M2 appear to be an unlikely situation. Whether or not the RTA may have contemplated any such future developments had the M2 contract not been framed in this manner is an unknown. Relying on a one-off solution to the road transport needs of the north-west of Sydney (as they relate to the area affected by the M2) for such an extended period could be argued to be unwise.

**Future Rail
Developments**

The possible future development of heavy rail within the defined region is another possibility to be considered.

Heavy rail is a major investment. It is only justified where population and demand levels are high. This usually means that an area would need to be some considerable way through its development life cycle, and probably into a long-term-stable trend, before such an investment would usually be seriously considered.

It appears to be regarded by the planning bodies that investment in heavy rail in the areas concerned here is unlikely in the short or medium term future; that is, within the expected lifetime of the M2 contract.

Again, however, a period in excess of forty years is a long time. One has only to consider the significant changes in development strategies for Sydney over the past forty years. It is very clear that the particular region involved will continue to develop substantially.

Significant continued development of public transport infrastructure within the region is certain. Whether or not such development would constitute grounds for renegotiation of the M2 contract is impossible to determine at this stage.

Specific Conflicts The impact of certain currently planned specific developments and upgrading of transport infrastructure within the region were checked out with Hills by the RTA during the negotiation. It appears that no adverse effects have so far been identified which would give rise to any difficulty.

Whilst no actual instances of conflict may have been identified to date, it is known that a specific proposal for a new heavy rail link in the general area has received some consideration in recent times.

As already mentioned, the present view of the planning bodies is that the timing of any future development of this sort would not be expected to cause any problem for the M2 contract.

However, the fact that such a proposal has been developed, which requires some effort, could support a view that a shorter horizon for such a development may eventuate.

Missing Links A further issue which can be discussed as part of the integration, and effectiveness theme is the aspect of “missing links”.

Problems with the M5 Motorway One of the strongest and most enduring public criticisms of another recent motorway development, the M5, was that it was not delivered to the community as a fully integrated transport corridor when it was first opened.

Both ends of the M5 initially failed to link into the overall road network in a manner which users found suitable. As a result, user satisfaction with the project was affected for some time. Major works have now eliminated this problem at one end of the M5. However, complaints continue that there is a “missing link” at the city end of the M5.

Such problems are not merely inconvenient. When users are required to pay to travel on such road systems there is a higher expectation that such matters will have been resolved. Failure to do so creates a poor public perception of the effectiveness of public sector planning processes.

Missing Links for the M2 Motorway Figure 1 indicates that similar criticisms may occur with the M2. The RTA have advised that expressway links at the city end of the M2 will not be completed for several years. At the other end, there also appears to be potential for a future link or links into other road arteries.

Conclusions

The form of contract developed for the M2 provides some conflict, at least in theory, with other policy objectives set out in the Integrated Transport Strategy. In practice, this conflict may not be significant. However, there are some grounds for the view that possible conflicts with future transport developments may occur.

The issue of “missing links” for the M2 appears likely to affect the level of community satisfaction with the project, and hence its effectiveness, at least in the short term.

Planning for the M2 : Approach and Packaging

Project Objectives

Clause 2.1 of the Project Deed sets out the policy and intent of the project. In terms of project objectives, the starting point given is that it is the Government’s policy to increase private sector participation in the provision of essential infrastructure, including the roads system.

The objectives of that policy, and subsequently of the M2 project, are then set out as subsets of that policy.

Assessment of Alternate Approaches

Earlier sections of this Report dealing with project processes and balancing of risk observed that there was some question as to the extent to which a range of alternate approaches were considered in deciding upon the approach to developing the M2.

In this context the ITS is very clear that a new approach to investment appraisal is required on what has been used in the past. The ITS sets out a policy to ensure that all different modal options are compared, and that funding options are evaluated so that optimal decisions are made; public interests are safeguarded and the community receives most value for the money spent.

Financial Arrangements

Detailed financial matters may also affect the overall effectiveness of the project. Such matters are examined elsewhere in this Report, where there is discussion of the impact of the various financial arrangements in the contract on such matters as net present value to the State, and direct costs to users.

Financial Analysis

FINANCIAL ANALYSIS

Results and Conclusions

The Base Case Model adopted by the RTA and Hills provides the basic financial projections for the project. It projects cashflows for the entire project term of 45 years. Using the information contained in the Model, plus additional information, the Audit Office has calculated a likely net present value of \$91.8m or an internal rate of return to the RTA of approximately 6%.

These estimated returns are based on assumptions about events which have inherent risks.

In arriving at these results there are a number of these assumptions and results of the Base Case Model that warrant comment.

- The income projection is based on achieving predicted traffic flow from the very start of the project. There appears to be, however, differing opinions among experts as to the appropriate level of predicted traffic flow.
- The project indicates that an after tax return of 12.25% to initial trust investors is required before Hills commences paying cash to the RTA for the land rental. These payments do not commence until 2028.
- The Base Case Model indicates that until and including 2027 Hills is to issue subordinated, non interest bearing, promissory notes to the RTA, instead of cash, for those rentals. The forecast in the model shows that it is in the period 2028 to the end of the lease term that these non interest bearing, promissory notes are to be repaid. In the absence of this arrangement, the Government would likely have had to agree to increasing the toll charges, the term of the lease or its initial contribution to this project.
- The total nominal value of rent payable is \$887.4m while the nominal value of the deferment of land rental amounts to \$408.6m. Based on Audit Office calculations the difference to the RTA arising from the deferment is \$28.4m in net present value terms. This could be considered as a contribution by the New South Wales taxpayers towards the building of the project. Alternatively, it can be seen as part of a negotiated arrangement that secures the benefits of the M2. Such arrangements - like that executed for the M5 had no rent component. As part of this rental arrangement, there is provision for the RTA to receive an incentive rent depending on the returns secured by the investors. The Base Case

Model suggests an amount of \$137.4m (nominal) or \$158,000 (NPV) is available to RTA.

- The RTA guaranteed restoration to Hills for any increases in interest rates from the date of Hills preliminary proposal to execution of the contract. It is noted that the negotiation did not cover the possibility of an interest rate fall. The RTA indicates that the risk of a fall in interest rates was considered remote by its advisers. As a consequence of the increase rate movements in the intervening period the RTA is now committed in net present value terms to \$39m restoration. The RTA has also agreed to replace a commitment, to provide land valued at \$20m for Hills' own use and benefit, with a payment for site preparation work.

The acceptability of these returns may also need to be considered against any investment hurdle rate (generally considered as the minimum rate of return required from a project, having regard to the cost of debt capital and equity capital) established by the government or the RTA.

To the extent that the private sector participants in the project have a different risk profile from that of the RTA, they would seek a different rate of return. The Base Case Model forecasts, for example, internal rates of returns to initial equity investors of 18.5% pre-tax cash return or 16.4% post tax which is the pre tax equivalent of 24.4%.

These points indicate that the financial model has been structured on a basis that rewards the private investors before the RTA. This occurs to the extent that any return to the RTA is deferred until either the project achieves a 12.25% after tax return to its investors or the debt is repaid.

One of the RTA's exposure relates to the loss of deferred rent payable, that has a possible total Net Present Value of \$1.1m, and is small in light of the whole contract. The major return to RTA comes from the possession of the M2 within 45 years.

Net Present Value/Internal Rate of Return Results

Financial analysis on the project extended to assessing the likely net present value and internal rate of return the project offered the RTA. This analysis has been summarised in Table 6.

Results from four different scenarios are provided below:

Table 2

		NPV
IRR		\$m
%		
6	Scenario 1 (most likely)	91.8
5	Scenario 2	79.2
7	Scenario 3	107.6
8	Scenario 4	120.2

Scenario 1, considered the most likely of the four, is primarily based upon financial projections and operating parameters accepted by the RTA and Hills Motorway. These parameters are contained in the Base Case Model.

Key points arising from the analysis include:

- under the Base Case Model, there is a deferment of rents receivable by the RTA, until 2028, resulting in a very low net present value attributable to those future cash flows
- there is a value to the RTA, of the right to receive the roadway in the future. This is the major benefit to the RTA in net present value terms
- better traffic flow in the north-west region than exists now may be considered as a benefit to the RTA. No value was determined for this factor in the absence of attributable cash flows. However, benefits in the form of reduced road maintenance costs have been assessed, and
- the value of Government land contributed to the project (and eventually returned) has not been included in the analysis and is therefore excluded from the results of the four scenarios.

Deferment of Rents Receivable

The land under the motorway is owned by the RTA and leased to Hills Motorway Trust pursuant to the 'Trust Lease' and the 'Trust Concurrent Lease'. The leases provide for a base rent of

\$7.0 million, commencing in the 1998 financial period and escalated annually by the Consumer Price Index (CPI) increase, for a term of up to 45 years. The Base Case Model applies a CPI increase of 4.06% per annum for the entire period, resulting in a total base rent of \$887.4 million in nominal dollars.

These lease arrangements for the M2 are a first, and allow the true costs of the M2 to be more accurately reflected than occurred in earlier projects.

The leases provide that the RTA is paid its base rents in the year to which it relates, subject to the project delivering a “threshold” real, after-tax, internal rate of return of 12.25% per annum to notional initial trust investors. If that threshold rate is not achieved, the rent payable to the RTA is replaced by a non-interest bearing promissory note, subordinated to other debt of the project.

The Base Case Model shows substantial amounts of rental income due to the RTA, between 1998 and 2027, becoming subordinated, deferred and non-interest earning.

The Trust Lease and the Trust Concurrent Lease also make provision for the payment of “Incentive Rent” to the RTA in certain circumstances. This is designed to allow the RTA to share in the potential success of the project above a certain level.

The Source and Application of Funds Statement in the Base Case Model appears to indicate that incentive rent is payable during the term of the lease as the total payments are shown as \$1,024.8m.

From the Source and Application of Funds Statement rents due, paid and deferred are shown as follows:

Table 3

	Rents due \$m	PNote issued \$m	PNote paid \$m	Rent paid \$m	Total paid \$m
Years					
1998-2027	408.6	408.6			
2027-2042	478.8		546.0	478.8	1024.8
	887.4	408.6	546.0	478.8	1024.8

Table 3 indicates that the Base Case Model assumes a cash flow of \$1024.8m to the RTA, relating to rents. Using a discount rate of 18.7% per annum, the present value of that amount is \$1.1m. The basis for that discount rate is outlined in Table 6.

The Source and Application of Funds Statement in the Base Case Model appears to conflict with the Profit and Loss Statement in the Model in relation to the total payable under the leases to the RTA as follows:

	Rent Payable \$m
Source and Application of Funds Statement	1,024.8
Profit and Loss Statement	887.4

The Audit has been unable to determine the reason for this apparent discrepancy. Nor have explanations provided by RTA's financial advisers offered adequate reasons.

**Value of RTA's
Right to Receive
The Roadway**

The RTA has a right to receive the M2 Roadway at the end of 2042. The roadway would have some value at that time and, accordingly, results in a benefit to the RTA.

Information provided by the RTA indicates the written down replacement cost at time of hand-back is approximately \$334.8m. Audit has calculated the present value of that at \$249.4m.

**Traffic Flow
Benefits**

There is a high likelihood that the RTA will receive traffic benefits to its road network from the connection of the M2 to that network. Those benefits also accrue to the motorist. Because this is a benefit without directly attributable cash flows, this benefit has not been quantified.

Savings may also accrue to the RTA through reduced maintenance on adjoining roads. These would be normally regarded as ancillary benefits, rather than a direct return or benefit from the M2.

Nevertheless, an assessment of such savings have been made in a model constructed by RTA's financial advisers, and is in the order of \$375m. The present value of such benefits has been assessed at \$12.6m and has been brought to account in Table 6.

**Traffic Estimates
At Toll Plaza**

Traffic risk is adopted by the investors in Hills in that the revenue estimates are based upon certain traffic projections. The Base Case Model contains those estimates, which are summarised below:

Table 4

	-----Average Daily Volume-----		
	Main Plaza	P/Hills Plaza	Total
In 1998			
- Cars	52,479	19,545	72,024
- Other	4,563	1,700	6,263

			78,287

2027-2042			
- Cars	71,494	26,626	98,120
- Other	6,217	2,315	8,532

			106,652

In relation to such traffic estimates, the Audit sought to address two related issues:

- how were the average annual daily traffic (AADT) estimates in the Base Case Model calculated , and
- did the toll plazas have sufficient capacity to process that traffic ?

It was found that the AADT estimates for 2006, the basis upon which estimates were made, were carried out years apart. These estimates were carried out by Guttridge Haskins & Davey Pty Ltd (GHD) for Hills, and Denis Johnson & Associates (DJA) for the RTA. Those estimates provided different results, as outlined below:

	AADT* in 2006	Assumed Toll
DJA	53,200	\$0.70
GHD	91,902	\$2.00

(* AADT is the estimated annual traffic divided by 365 days)

Differences between the two estimates can legitimately arise from a number of factors, such as possible differences in raw traffic counts undertaken for the project. Audit understands that industry practice is to convert raw traffic counts (conducted for a two hour period in peak morning traffic) into a daily equivalent by a factor of 5.88. This closely approximates the factor of 6.0 applied in the Base Case Model. It was noted, however, that the underlying methodologies, in arriving at the AADT, differed in some respects. For example, in converting those raw counts to

AADTs, DJA allows for 114 non-working days in the year. The Base Case Model, on the other hand, adopts a conversion factor which does not make such allowances.

It is assumed that some price elasticity exists for toll paying motorists (i.e. the lower the toll, the more it is used). This is not entirely evident in the estimates provided by DJA and GHD. RTA has orally advised that the GHD estimate may have benefited from being a relatively later assessment than DJA's and was able to observe the experiences at the M4 and M5 tollway plazas. Whether this adequately explains the difference of almost 40% between the DJA estimate and that adopted in the Base Case Model is unclear.

In examining the second issue (capacity of the Toll plazas), Audit was able to refer to the design parameters in the Design & Construction Deed. Schedule 3 of that Deed, which outlines the design parameters for the toll plazas, provides:

Main Toll Plaza

The main toll plaza has been designed for:

- Overall Traffic

1998	52,500 cars,	4,600 trucks both ways per day
2008	62,800 cars,	5,500 trucks both ways per day

Traffic Distribution (weekdays)

	Peak Hours	Rest of Day-time	Night-time
Cars	33%	57%	10%
Trucks	20%	70%	10%

- Traffic Split at Peak Hours
60/40

For each direction of travel, 6 lanes would be offered to traffic providing a full capacity between 3,700 to 4,800 vehicles per hour according to the equipment installed and the ratio of trucks to total traffic and the market potential share of AVI. A detailed study will allow determination of the equipment to be installed from the opening day, based on:

- the detailed traffic study;
- the marketing study (commuters, trucks regular users, etc); and
- the AVI market share projections.

and

Toll Plazas on ramps at Pennant Hills Interchange

Each Toll Plaza at Pennant Hills interchange has been designed for:

1998	-	9800 cars 850 trucks per day
2008	-	11,700 cars 1,000 trucks per day

Distribution and traffic split; similar to barrier.

The design of the equipment of a ramp barrier is to take care of the particular operation of such barriers.

Each ramp will be a four lane barrier with the same type of equipment as described for the main toll plaza reaching a capacity between 2,000 and 2,400 vehicles per hour.

By one measure, the parameters provide for the toll plazas to be designed for overall traffic levels (in 1998), which are summarised below:

Table 5

	Main Plaza	P/Hills Plaza	Total
Cars	52,500	19,600	72,100
Other	4,600	1,700	6,300

Those traffic levels equate with the traffic estimates carried in the Base Case Model. The RTA, however, has orally advised that the overall traffic estimates (in the Design & Construction Deed) summarised in Table 5 are merely to indicate the operating requirements at the toll plazas - such as operating staff levels.

The RTA has advised Audit that the daily capacity of the toll plazas is typically twelve times hourly capacity, calculated as follows:

Main Toll Plaza	$2 \times 4250 \times 12 =$	102,000/day
Pennant Hills Plaza	$2 \times 2200 \times 12 =$	52,800/day

On the assumption that the latter method offers the correct measure of toll plaza capacity, then the estimated traffic volumes ought to be adequately accommodated.

This does not, however, resolve some of the earlier discussed inherent uncertainties offered in the overall traffic assumptions contained in the Base Case Model. And, although traffic risk is carried by Hills investors, a lower than anticipated revenue stream has implications for the timing of repayments of RTA's rental promissory notes.

This indicates that equity investors in Hills carry the preponderant traffic risk. The State has no obligation towards any investor or any bond holder for the M2 to make any payments to them because of traffic risks. But the RTA has taken some of that risk by agreeing to receiving its returns (rent) on a subordinated, interest free and deferred basis.

**Value Of
Government
Land
Contribution**

It is noted that substantial tracts of land had to be contributed by the Government to the project. These had either already been in RTA's possession or had been acquired from other Government agencies for the purpose of the project.

The historical cost of these holdings, in RTA's books of account, are likely to be minimal. This is because some of this land may have been acquired many years earlier, while other land may have been acquired from other Government agencies for a transfer cost of only \$1.

However, it is likely that the value of such land is material. The 1992 Environmental Impact Statements indicate a 1991 valuation of \$257m for all land required for the project. Of this, approximately \$120m was recognised as the cost of land purchased and to be purchased, implying that a value of approximately \$137m (at 1991 valuation) may be placed on the other land contributions.

The exclusion of such value from Table 6 has the effect of showing a higher internal rate of return to the RTA.

**Interest Rate
Restoration And
Construction
Payments**

The RTA has agreed to make restoration to Hills Motorway for any increases in interest rates between the date of their preliminary proposal and the date of execution of the agreements.

In a submission from the RTA to its Minister, it was noted that the effect of a 25 basis point increase in interest rates equated to approximately \$4m. At the time of execution (26 August, 1994), the amount of such restoration was agreed by the RTA to be \$39m. In assessing the reasonableness of that amount, RTA's financial advisers noted that 10 year Commonwealth Government bond rate increased by approximately 270 basis points during that period.

The RTA also had agreed to provide surplus land to Hills, for the purpose of enabling Hills to develop that land for its own benefit. The RTA placed a value of \$20m on that land. By comparison, the Valuer-General, in a May 1994 valuation determined a value of \$21.7m for the land. Documents indicate that the Government expressed some reservation over the provision of the land to Hills and instructed the RTA to exclude the land from the project.

An alternative arrangement was agreed upon in August 1994 whereby the total of interest rate restoration and the value of the land would be reflected as a payment by the RTA for some site preparation work.

The combined value of such arrangements therefore was \$59m, comprising:

Interest rate restoration	\$39m
Surplus land contribution	\$20m

Those payments were to be made in four instalments to September 1997, such payments totalling \$66.5m in nominal dollars. The present value of those payments was assessed by the RTA to be \$59m.

Table 6

RTA'S EXPOSURE TO M2 MOTORWAY PROJECT

TABLE OF 4 SCENARIOS

	LIKELIHOOD		SCENARIO 1		SCENARIO 2		SCENARIO 3		SCENARIO 4	
	High	Low	VALUE		VALUE		VALUE		VALUE	
			PV	Nominal	PV	Nominal	PV	Nominal	PV	Nominal
			30.11.94 \$m	\$m	30.11.94 \$m	\$m	30.11.94 \$m	\$m	30.11.94 \$m	\$m
COSTS/RISKS/CONTRIBUTIONS										
* Non-Govt land purchases	*		112.3	120.0	112.3	120.0	112.3	120.0	112.3	120.0
* Other land	*									
* Construction payments	*		59.0	66.5	59.0	66.5	59.0	66.5	59.0	66.5
* Rates & taxes above CPI		*								
* Termination compensation		*								
* Alternative roads		*								
			171.3	186.5	171.3	186.5	171.3	186.5	171.3	186.5
RETURN/BENEFITS										
* Rents	*		1.1	1024.8	1.1	1024.8	29.5	1024.8	29.5	1024.8
* Incentive rents		*								
* Right to roadway	*		249.4	334.8	249.4	334.8	249.4	334.8	249.4	334.8
* Sinking fund		*	0	0	0	0	0	0	0	0
* Better traffic flow	*									
* Reduced road mtce costs		*	12.6	375.0					12.6	375.0
			263.1	1734.6	250.5	1359.6	278.9	1359.6	291.5	1734.6
NET RETURNS			91.8	1548.1	79.2	1173.1	107.6	1173.1	120.2	1548.1

INTERNAL RATE OF RETURN

6%

5%

7%

8%

***Assumptions
applied in
Table 6:****Basic parameters*

The audit identified the major risks and benefits from the project and isolated those applicable to the government and/or the RTA. These are reflected in the table.

The table is constructed to identify, from the government's perspective:

- a) Major risks/costs/contributions to the project;
- b) Major benefits/returns from the project;
- c) Categorisation of a) and b) into those relatively more likely than others

The table has been constructed from information provided by the RTA to its Minister (communications dated 14.6.94 and 22.8.94), as well as other information provided by the RTA for the purposes of this audit.

There is a view that post-handover (2042 onwards) cashflows, such as tollplaza receipts ought to be accommodated in the analysis. However, the capitalisation (present value) of those cashflows merely offers an alternative value to the underlying asset (the tollway) which is already recognised as a "right to receive". Accordingly, the inclusion of those post-handover cashflows will result in a double-counting of the roadway asset.

Adopting a discount rate

The discount rate of 18.7 % per annum, applied to cash flows, have been determined using the Capital Asset Pricing Model (CAPM), and based on the following assumptions:

Risk free rate of return = 10.6%
 Expected return for all assets = 17.1%
 Volatility of transport sector = 25% *

* (as per Budget Paper No 6, 1994-95 Budget)

Four different scenarios

Four different scenarios have been reflected in the accompanying Table. These are based upon combinations arising from two variables introduced to the models, viz:

- Rents receivable by the RTA; and
- Road maintenance savings costs realised

This results in a matrix of four scenarios , as follows:

		Variable 1	
		(Rent payment deferred)	
		YES	NO
Variable 2 (Road mtce savings)	NO	<i>Scenario 2</i>	<i>Scenario 3</i>
	YES	<i>Scenario 1</i>	<i>Scenario 4</i>

Appendices

APPENDIX 1

Public Accounts Committee Inquiry Into Infrastructure Management in NSW

The Public Accounts Committee of the New South Wales Parliament in Report No. 73 (July 1993) made recommendations on management of infrastructure projects from the conceptual stage to that of awarding contracts (Volume 1). The Public Accounts Committee (PAC) further reported in Report No. 80 (February 1994) on financing issues, the sharing of risks between the public and private sectors, and the role of the Loan Council (Volume 2).

As outlined in the PAC report there are a number of ways that privately funded infrastructure projects can be classified:

BOT: Build, Operate, Transfer

In this model the private sector builds the facility, relying largely on resources it can mobilise (a mixture of equity and debt) together with, in some cases, government support to a greater or lesser degree; it operates it for a certain period (usually between 15 and 30 years) and then transfers it, for no payment, to the government. In this model, either the government, or another private sector company operates the facility.

An example of this model in NSW is the Junee Private Prison.

BOO: Build, Own, Operate

In this model, the private sector again funds the project and owns and operates it for a long period.

Examples of this are the four water treatment plants proposed by the Water Board at Woronora, Illawarra, Macarthur and Prospect, and the Port Macquarie hospital which was the subject of a Public Accounts Special Committee report in June 1992.

BOOT: Build Own, Operate and Transfer

In this model, the private sector finances the construction, owns and operates the facility for a set period and then transfers it to the government at no cost at the end.

Examples of this are the Harbour Tunnel, the M4 and M5 motorways, and the Bennelong Car Park.

As outlined by the PAC reports there are no set guidelines to follow.

The PAC has attempted to draw recommendations and consequently be a catalyst in introducing guidelines based on events that have occurred to date. As detailed in the PAC report the public/private sector projects commenced, completed or abandoned have had a chequered career.

The PAC made 50 recommendations in its Volume 1 Report of which 6 are of special interest to the Auditor-General. The Volume 2 Report contained 28 recommendations of which one was of special interest to the Auditor-General.

The specific recommendations that together are of relevance to the Auditor-General are:

Volume 1 Report:

45. *That the Premier's Department prepare guidelines, in generally applicable terms, on the elements of BOT-type contracts which should be included in the summaries prepared by agencies and made available to the Parliament and the public.*
46. *That for all privately-financed projects above \$5 million, the agency prepare, within 90 days after the contract is signed, a summary of the main points of the contract, unless the contract has been disclosed in full in the meantime.*
47. *The Committee believes that the elements in the summaries should include:*
 - *the full identity of the successful proponents, including details of cross ownership of relevant companies*
 - *the duration of the contract, including details of future transfers of assets of significant value to the government at no or nominal cost and details of the right to receive the asset and the date of the future transfer*
 - *the identification of any assets transferred to the contractor by the public sector*
 - *all maintenance provisions in the contract*
 - *the price payable by the public*
 - *the basis for changes in the price payable by the public*
 - *provision for renegotiation*
 - *the results of cost benefit analyses*
 - *the risk sharing in the construction and operational phases quantified in NPV terms (where possible) and*

specifying the major assumptions involved

- *significant guarantees to undertakings, including loans, entered into or agreed to be entered into, with an estimate of either the range, or the maximum amount, of any contingent liability*
- *to the extent not covered above, the remaining key elements of the contractual agreements.*

The statements would not disclose:

- *the private sector's cost structure or profit margins*
 - *matters having an intellectual property characteristic*
 - *any other matters where disclosure would substantially commercially disadvantage the contracting firm with its competition.*
48. *That this summary be vetted for accuracy by the Auditor-General or his nominee, and that these services be paid for by the public sector agency.*
49. *That the Auditor-General present this report to Parliament. If he is not satisfied with the accuracy of the summary, or has experienced difficulty in obtaining information, he should refer the matter to the Public Accounts Committee.*
50. *Whilst the use of the independent white knights in the form of ministerial advisory groups and such like to review tenders and independent legal or financial consultants to review other aspects are very useful and are to be encouraged to ensure probity and best practice, they can never be a complete substitute for external oversight by the courts, the ICAC or the Auditor-General.*

However, input into and further development of such best practice and oversight could be usefully made by the Auditor-General and the ICAC on a cooperative basis by providing advice to such independent white knights and financial consultants.

Volume 2 Report:

5. *That, given the important role of the Auditor-General in the accountability process, he specifically examine, when carrying out special audits of completed public-private projects, not merely the financial costs of these projects, but also their wider social and economic benefits, but that he do so in*

conformity with his charter to consider economy, efficiency and effectiveness.

In making its recommendations the PAC was aware that general guidelines would benefit public sector agencies and private sector participants in privately funded infrastructure projects. They would allay the fears of the public at large; as stated in the PAC Volume 1 Report "speculation, suspicions and unfounded allegations would largely be pre-empted, resulting in greater predictability for the private sector and an easier life generally". Public sector agencies would also benefit from guidelines because, as reported by the PAC, "at present, they sometimes appear to be mounting exaggerated efforts to protect information which the private sector turns out to be quite happy to release".

In the PAC Volume 2 Report it was stated that three important principles are to be borne in mind with privately funded infrastructure projects:

1. *There should be maximum transparency in all public-private sector deals.*
2. *There should be maximum competition in bidding for such deals.*
3. *Private participation in such deals should result in a net benefit to the public.*

The Government on 14 October 1994 responded to each of the PAC recommendations.

In relation to the 7 recommendations affecting the Auditor-General the Government responded:

For recommendations 45 to 49 (Volume 1 Report):

Agreed in principle. Guidelines in preparation.

For recommendation 50 (Volume 1 Report):

Agreed in principle. Arrangements have been made to secure the co-operation of the ICAC to assist during the project development phase.

For recommendation 15 (Volume 2 Report):

Not supported. Considered to be beyond the charter of the Auditor-General.

Performance Audit Reports and Related Publications

Agency or Issue Examined	Title of Performance Audit Report or Publication	Date Tabled in Parliament or Published
Department of Housing	<i>Public Housing Construction: Selected Management Matters</i>	5 December 1991
Police Service, Department of Corrective Services, Ambulance Service, Fire Brigades and Others	<i>Training and Development for the State's Disciplined Services: Stream 1 - Training Facilities</i>	24 September 1992
Public Servant Housing	<i>Rental and Management Aspects of Public Servant Housing</i>	28 September 1992
Police Service	<i>Air Travel Arrangements</i>	8 December 1992
Fraud Control	<i>Fraud Control Strategies</i>	15 June 1993
HomeFund Program	<i>The Special Audit of the HomeFund Program</i>	17 September 1993
State Rail Authority	<i>Countrylink: A Review of Costs, Fare Levels, Concession Fares and CSO Arrangements</i>	10 December 1993
Ambulance Service, Fire Brigades	<i>Training and Development for the State's Disciplined Services: Stream 2 - Skills Maintenance Training</i>	13 December 1993
Fraud Control	<i>Fraud Control: Developing an Effective Strategy (joint publication with the Office of Public Management, Premier's Department)</i>	30 March 1994
Aboriginal Land Council	<i>Statutory Investments and Business Enterprises</i>	31 August 1994
Aboriginal Land Claims	<i>Aboriginal Land Claims</i>	31 August 1994
Children's Services	<i>Preschool and Long Day Care</i>	10 October 1994

Agency or Issue Examined	Title of Performance Audit Report or Publication	Date Tabled in Parliament or Published
<hr/>		
Road and Traffic Authority	<i>Private Participation in the Provision of Public Infrastructure (Accounting Treatments; Sydney Harbour Tunnel; M4 Tollway; M5 Tollway)</i>	17 October 1994
Sydney Olympics 2000	<i>Review of Estimates</i>	18 November 1994
State Bank	<i>Special Audit Report: Proposed Sale of the State Bank of New South Wales</i>	13 January 1995
Roads and Traffic Authority	<i>The M2 Motorway</i>	31 January 1995

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