THE DEVELOPMENT OF PPPs IN AUSTRALIA

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1. THE AUSTRALIAN EVOLUTION OF THE PPP CONCEPT

All Australian Governments, both state and Commonwealth, have long been open to private sector involvement in the provision of public infrastructure. Contractual strategies which predate the term "Public Private Partnership" (PPP), but which have since come to fall under the PPP banner, have been utilised in Australia for some years. It is only recently, however, that the development of such strategies has moved from being a matter of *ad hoc* progression, to a more directed approach under what can be viewed as a growing culture of flexibility and innovation on the part of government.

As a discrete policy stream, the advocacy of PPPs has emerged out of the continued budgetary constraints faced by the various governments, and the exhaustion of opportunities for outright privatisation of major public infrastructure.[2] State and federal Governments began to explore more subtle alternatives for accessing private sector resources in the delivery and operation of public facilities. Policy discourse turned away from emphasis on public sector restructuring and "trimming the fat", towards the search for innovative financing solutions and more precise analysis of exactly how the government can most effectively meet infrastructure requirements. This broad change in policy focus is manifest in the current expression by various governments of a preference for the PPP form.

The term "Public Private Partnership" has largely been applied *ex post facto* in the Australian context. By the time the term had been imported from the United Kingdom, the approach itself had been widely applied in Australia. Specifically, the "Build, Own, Operate and Transfer" (BOOT) structure—which would come to form the backbone of Australia's PPP experience—had been employed since the 1980s.

What has been occurring is an *ad hoc* expansion and revision of BOOT and other long-standing structures. It is now possible to identify a range of distinct developments relevant to what we now understand as the PPP. Because, for instance, the BOOT structure was not always appropriate, as in cases where a "user-pays" revenue stream could not be accessed, or the infrastructure in

[1] The author gratefully acknowledges the assistance provided in the preparation of this paper by Michelle Wood and Jane Hansen, Legal Assistants, Clayton Utz, Sydney.

[2] See T Skotnicki, "Double Act" (2001) 23 *Business Review Weekly* (16 March) 72.

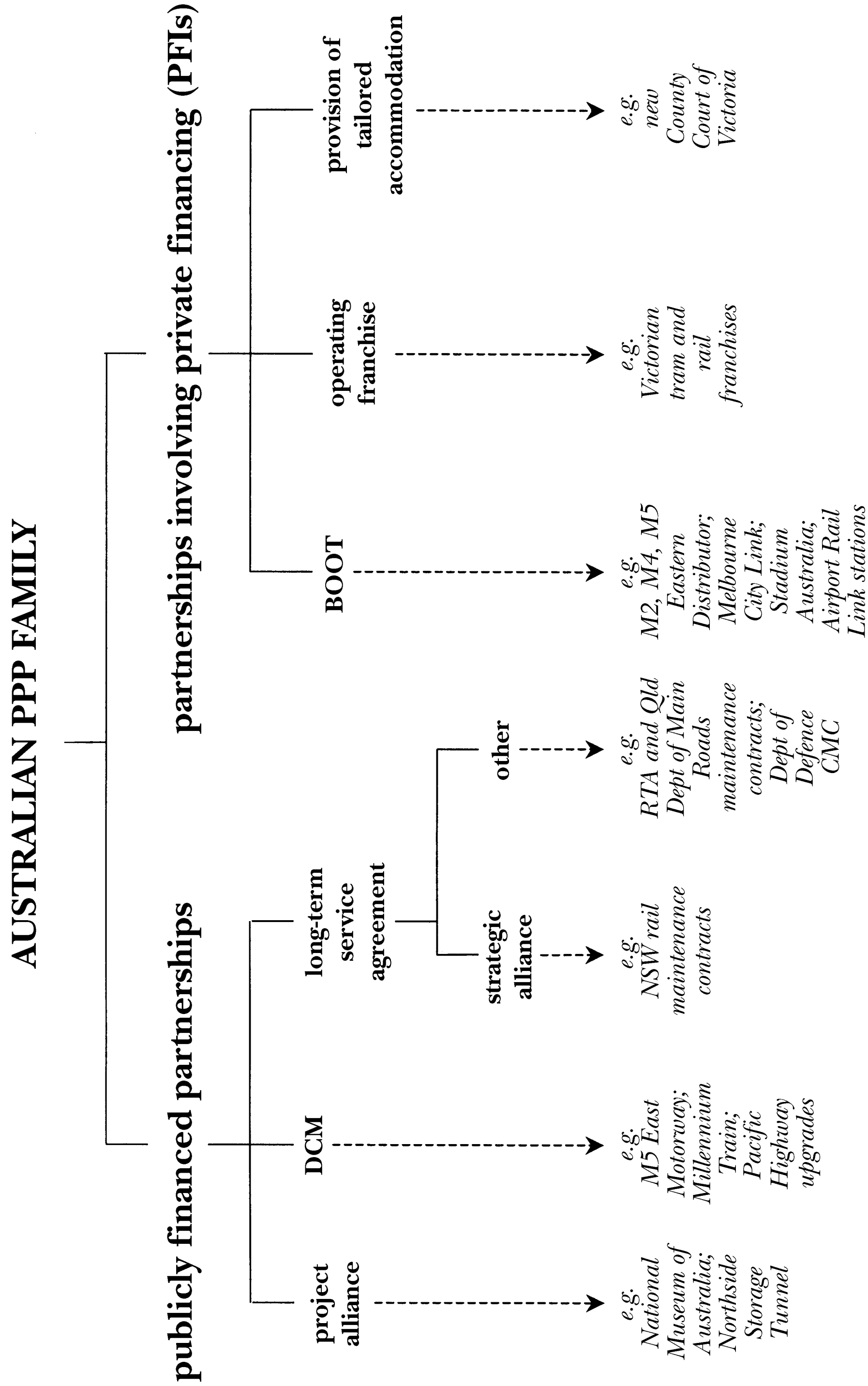
question was already in existence, variations on the BOOT theme began to appear. Sometimes such a variation would be a lateral development of BOOT, as in the case of operating franchises let for specified concession periods in respect of existing infrastructure. Other instances would involve what might be described as the vertical development of BOOT or other conventional structures—the most important of such developments is performance-based remuneration mechanisms which are able to be superimposed over older contractual structures and allow the government to ensure better service quality. Further variations entailed the radical overhauling of the relationship between parties to the conventional contractual form, in order to encourage collaboration and mutual gain between the government and the contractor in question.

Developments like these have grown into a range of infrastructure strategies which can be seen as the Australian PPP family. The term "PPP" is used broadly, and it is worth noting that the idea of "partnership" between the private sector and government is taken up in a variety of ways in Australia. This is in contrast to the British usage of "PPP", where the term is effectively interchangeable with "Private Financing Initiative" (PFI).[3] In Australia, PFIs are viewed as a subset of PPPs: they are PPPs under which a private sector operator, having indicated its willingness to accept and share risk, works with the government first in financing, and then in creating and/or managing, infrastructure. BOOT is an example of a PPP which is a PFI. Beyond PFIs, however, it is also arguable that PPP is understood in Australia to mean other arrangements which can be described as partnerships between government and the private sector, even if the infrastructure is publicly funded. This would include, for instance, semi-permanent service provision relationships, the purpose of which might be to enable a private contractor to contribute its expertise to the government's asset management strategy. Moreover, PPP may encompass situations where "alliancing" is used in infrastructure delivery, this perhaps being the most genuine form of partnership between government and private sector consistent with probity requirements. Figure 1 shows a simple breakdown of what can be described as the Australian PPP family, encompassing both PFI and publicly financed methods of delivery.

Although seemingly disparate, this range of PPP approaches is coherent in its demonstration of a new and overt flexibility on the part of the public sector, driven by the desirability of tailoring the contract to the particular project. In considering the optimal mode of delivery, every aspect of a project is "up for grabs", including ownership structure (short of outright privatisation), sources of remuneration, risk allocation, and the delineation between "core" and "non-core" services (that is, those to be retained by the government and those which can be outsourced). In this spirit, the term "PPP" has been adopted because it indicates collaboration between the

[3] There, "PFI" was employed by the former Conservative Government, and "PPP" by the current Labour Government.

FIGURE 1 DIAGRAM OF THE AUSTRALIAN PPP FAMILY



public and private sectors without spelling out the precise manner of this collaboration.

A further manifestation of this same flexibility is the rejection of "no-go zones" in relation to what kinds of infrastructure might be the subject of a PPP. There has always been a sense that there is a substantive difference between economic infrastructure (transport, power, water, telecommunications, etc.) and social infrastructure (schools, hospitals, justice facilities, policing, etc.). The PPP approach in Australia takes the view that governments should be open to private sector involvement in both kinds of infrastructure, subject to (a) the reservation to the government of "core" services; and (b) the recognition that social and economic infrastructure *usually* rely on different revenue bases. That is, economic infrastructure is generally able to access an end-use revenue source. This is usually unavailable in respect of social infrastructure, and sometimes insufficient in the case of economic infrastructure (for example, tollways do not work for rural roads). While part of the task of the PPP approach is to develop alternative remuneration structures in such cases, they are not beyond the scope of the approach.

It is to be noted, however, that private financing will not be appropriate for some projects. Part of the government's embracing of flexibility is retaining openness to the possibility that one of the older, purely publicly funded contract strategies, might be more suitable in a given situation. A good example in the Australian context is that of rural roads. While BOOT and other PFI variations are most classically suited to the urban tollway, Australian rural roads never convey the volume of traffic necessary to make either an independent "user pays" revenue stream or "shadow tolling"[4] viable debt-financing repayment options. The "Design, Construct and Maintain" (DCM) contract structure (which may be a form of PPP even though it is not a PFI) is a better choice of strategy for transferring ongoing maintenance responsibility for rural roads over to the private sector. In short, it is recognised that applying private financing models as a blanket rule will invite the failure of some projects.[5]

2. RECENT MOVES TO CLARIFY GOVERNMENT POLICY

Before discussing specific PPP developments, it is useful to review the current status of state and federal policy in respect of PPP. In short, there is currently no national unity of policy, and some governments are significantly more

[4] Shadow tolling is a remuneration method whereby the private operator is paid on a patronage basis, but by the government rather than by the individual end-user. That is, the government pays the "toll".

[5] Another issue will be the degree of control the government wishes to maintain over the project. For example, the NSW RTA will, for the most part, procure private sector services in delivering the Parramatta-Liverpool rapid bus transitways on a "Construct Only" basis, because the project involves high levels of environmental and community sensitivity, as well as comprising a novel transportation system, such that the RTA requires maximum control of the design and administration of the project.

advanced than others in issuing PPP policy. In particular, there is no Commonwealth policy statement in the area, although several Commonwealth Ministers have strongly backed the PPP form. Some states, however, have established or are establishing detailed policy documents.

While the Federal Government is to some extent still preoccupied with the possibilities of privatisation as an asset management strategy, various of its agencies have in recent years shown increasing support for PPPs, especially PFIs, in the delivery of new infrastructure. In particular, the Minister for Finance and Administration[6] and the Minister for Transport and Regional Services[7] have each flagged the British PPP experience as worthy of observation. Mr Anderson has emphasised the potential for PPPs to be used across the board, from the application of BOOT in the provision of large-scale infrastructure to other forms of partnership between local and state governments and private operators in maintaining local facilities. Mr Fahey has indicated that the Federal Government is currently looking into establishing a PPP framework in accordance with standing legislation and procurement policy.[8] The Department of Defence has also published a discussion paper, *Private Financing of Defence Capability*, which considers lessons learned from domestic and UK experience. It expresses qualified approval of the PPP approach. Federal support for PPPs is also illustrated in the employment of PPP structures at the Departmental level. An example of this is the Defence Department's "Comprehensive Maintenance Contract", which engages a private operator to participate in the maintenance and management of its plant and equipment on a fixed term basis.

In June 2000, the Victorian Government published its *Partnerships Victoria* policy, followed by Guidance Materials.[9] This documentation states that, where public infrastructure and ancillary services are needed, the Government will make no presumption that either the public or the private sector is the best provider. What is required is consideration of the whole-of-life costing of the infrastructure and the benefits of risk transferral in each case. If it is clear that the private sector can deliver the service more cost-effectively than could the Government, the private sector will be invited to do so, subject to the arrangement passing a public interest test (set out in the document).

A *Partnerships Victoria* project is a contract for services rather than for physical assets. Ownership and control of infrastructure is a subsidiary issue,

[6] See, for example, the address given by John Fahey, MP, Minister for Finance and Administration, at the CEDA Conference on Public/Private Partnerships in the Provision of Government Services: A New Direction, 14 August 2001.

[7] See, for example, the address given by John Anderson, MP, Minister for Transport and Regional Services, to the CEDA State of the Nation Annual Conference, 22 June 2000.

[8] Financial Management and Accountability Act 1997 (Cth); Outcomes and Outputs Framework; Competitive Tendering and Contracting Initiative.

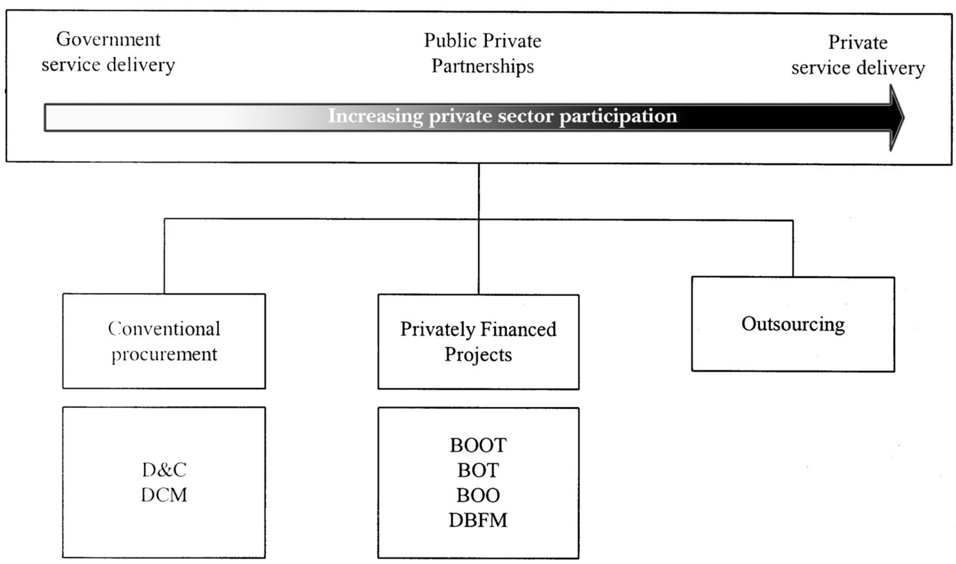
[9] *Partnerships Victoria*, and the *Guidance Materials* (*Overview; Practitioners Guide; Risk Allocation and Contractual Issues*; and a technical note on the *Public Sector Comparator*) are available at http://www.vic.gov.au/treasury/partnerships.html

to be decided in the circumstances. There is no preferred contracting strategy under the policy. The Government adopts the "optimal risk allocation" approach, that is, the party best able to manage the risk assumes it. This presumes that the private party will bear all risks associated with design, construction and operation of the infrastructure.

The *Partnerships Victoria* material is the first detailed document of its kind in Australia. It goes a long way to solidifying the future application of PPPs in Australia by declaring Victoria's commitment to the approach, inspiring other States to do likewise, and creating greater certainty for potential private sector participants.

New South Wales most closely follows the Victorian lead. In November 2001 it published *Working with Government Guidelines for Privately Financed Projects*.[10] These *Guidelines* specifically cover Privately Financed Projects (PFPs) which they acknowledge to be part of the broader spectrum of Public Private Partnerships (PPPs) which the *Guidelines* consider to be a general term covering any contracted relationship between the public and private sectors to produce an asset or to deliver a service. The relationship between PFPs and PPPs is described diagrammatically in *Working with Government* (see Figure 2).

FIGURE 2 PUBLIC SERVICE DELIVERY SPECTRUM



The guidelines introduce the concept of the evaluation of broader public interests before any project is offered as a PFP, detail risk management

[10] *Working with Government Guidelines for Privately Financed Projects* can be found at http://www.nsw.gov.au/wwg

procedures for evaluation and allocation of project risks, and require the development for each project of a Public Sector Comparator (PSC) showing the hypothetical risk-adjusted cost of government itself delivering the required project outcomes.

The Queensland Government has also strongly backed PPPs. In September 2001 it issued a document entitled *Public Private Partnership Policy: achieving value for money in public infrastructure and service delivery,*[11] which is a high level framework intended to be underpinned by detailed guidance material to be developed in consultation with government agencies and private sector parties. The policy applies to the provision of public infrastructure and any infrastructure related service delivery that may involve private investment or financing. The Queensland Government's Public Private Partnerships Policy replaces the 1997 *Policy Framework for Private Sector Involvement in Public Infrastructure and Service Delivery*, and is closely aligned with the Victorian Government's policy agenda.

In April 2002, the Queensland Government confirmed its continuing interest in the use of private investment for the delivery of infrastructure. The Beattie Government released for public comment its updated *Public Private Partnership Guidance Material* which supports the Queensland Government's PPP policy. Minister for State Development, Mr Tom Barton, said the aim of the guidance material is to provide a clear framework within which parties can work in partnership to achieve the objectives of Queensland's PPP policy, namely:

- To deliver improved services and better value for money through appropriate risk sharing between public and private sector parties.
- Encouraging private sector innovation.
- Optimising asset utilisation.
- Integrated whole of life management of public infrastructure.

The next move by the State Government will involve the implementation of its PPP policy by progressing projects through the preliminary assessment stage. The Queensland Government has acknowledged that the PPP method presents a real cost to governments and, as a result, particular PPP options will be strictly assessed on an individual basis as to whether the cost of a project does represent value for money.

3. OVERVIEW OF KEY PPP DEVELOPMENTS IN AUSTRALIA

Although the Australian PPP experience has been largely in respect of BOOT and "Build, Own and Operate" (BOO) projects, this paper does not go into detail in describing these structures as they will be quite familiar to those interested. Suffice it to say that BOOT remains the backbone of Australian

[11] The *Public Private Partnership Policy: achieving value for money in public infrastructure and service delivery* can be found at http://www.sd.qld.gov.au

PPP developments in several ways. For one thing, it is overwhelmingly the most common PFI structure employed in the delivery of large-scale infrastructure. For another, significant PPP developments, such as shadow tolling, are variations on the basic BOOT concept. The DCM structure is another familiar, and commonly used, form of PPP which is not described in detail in this paper. This section shall outline further key PPP developments, providing examples of each.

(a) Operating franchises

Rather than sell off existing infrastructure, the franchise approach has been adopted to transfer operating risk, control and entitlement to revenue of infrastructure facilities to the private sector for finite concession periods under fixed-term contracts. Under such franchises, the private sector owner/operator will have to pay a concession fee, as well as penalties to the government should it fail to meet service standards. This contracting strategy provides all of the benefits of simple contracting out, with the added incentive on the part of the operator to improve efficiency and grow patronage.

The most sophisticated and successful franchise model adopted in Australia has been the series of rail franchises let by the Victorian Government in 1999. The former Public Transport Corporation was split into five passenger separate train and tram businesses, and then sought expressions of interest from the private sector for the management control franchises of each business. The franchises were divided between three consortia.

Under the agreements, franchisees committed contractually to deliver more services, and deliver at a significantly higher standard, than had been the case under public management of the infrastructure, and to provide that maintenance and operation services and improvements are to be provided in the context of progressively decreasing state subsidies. The franchisees further agreed to invest specified minimum amounts in a range of initiatives to improve and in some cases expand services.[12] There was also a design and construct element to the agreements, requiring franchisees to ensure the performance of mandated works (funded by the state or the operator depending upon where the work fell in relation to expressed criteria).

In return for discharging the above obligations, the franchisees earn remuneration through the following revenue sources:

- *Base subsidy*: subsidy payable by the state, determined during the bidding process and set out in the franchise agreement.

[12] In NEG's case, it committed to the investment of more than $1 billion across its three franchises: P Strachan, "Is this privatisation—or a public/private partnership?" (2000) *Track and Signal* (Oct/Nov) 29–31 at 29.

- *Operational Performance Regime incentives*: financial incentives payable by the state where pre-defined levels of operational performance are exceeded.
- *Patronage incentives*: financial incentives payable by the state where pre-determined levels of patronage growth are exceeded.
- *Farebox revenue*: revenue from ticket sales.
- *Concession top-up*: reimbursement by the state in respect of tickets sold at concession prices.
- *Other revenue*: revenue earned from ancillary commercial activities such as retailing and advertising; and
- *Access and inter-operator revenue*: revenue earned from regulated or contractual access changes payable by third party operators for use of the franchisee's assets or services provided by the franchisee.

The OPR component (based on the UK scheme) acted both as a performance-based revenue source, and as a method of enforcing the objectives of the Government in the absence of its direct control of the business. Like its UK counterpart, the OPR uses the performance measure of the "performance minute", a weighted average lateness statistic for each passenger train operator based on recordings of train data at monitoring points. Operators become entitled to incentive payments by exceeding the benchmark by a specified degree (that is, attaining an outstanding result). If, on the other hand, performance is below the benchmarked level, the operator must make a penalty payment to the government. The Victorian OPR differs from the UK OPR in several respects, as for example in its doubling of the dollar value of each performance minute after the first year of the franchise period. That is, franchisees are now paying twice as much for delays and receiving twice as much by way of bonus.

Thus far, adoption of the OPR under the Victorian rail franchises has had a qualified reception. While generally functional, there has been criticism that benchmark levels were unrealistic. The head of one of the franchisee companies cites an example from the V/Line franchise: "During one week in July [1999], V/Line achieved one of its best performance records ever with 100% service delivery and 97% punctuality—but earned a bonus of just $112."[13] A further example is that despite improving the punctuality of Swanston Trams from 55% in the first quarter of 1999 to 70.4% in the first quarter of 2000, the franchisee incurred performance penalties of $1m.[14] These examples illustrate problems with the projection of benchmarks from historical data and the need for incentive schemes to recognise relative as well as absolute improvements in performance. The other major problem with the OPR is that it does not recognise measures taken by the operator to implement improvements which do not manifest in performance minutes. Such improvements may be, for example, to the general condition of the

[13] Strachan, *op. cit.*, at 30.
[14] *Ibid.*

rolling stock. This problem is properly dealt with by implementing alongside the OPR a broader KPI (Key Performance Indicator) regime.

(b) Provision of tailored accommodation services

As mentioned above, a feature of the policy shift towards PPP is the government's increasingly careful consideration of what it is exactly that it wants out of a relationship with a private sector provider. In other words, government is becoming increasing loathe to assume wider burdens than necessary to procure the precise service it requires. This is most obviously the case in respect of government leasing of tailored accommodation. In essence, this is a BOO project undertaken by private sector providers in exchange for the government guaranteeing to take out a long-term lease of the infrastructure provided. At its own cost, the private operator will construct a facility built to meet specified requirements set out by the government (which will become a tenant upon completion), and also provide associated services (such as security and communications) for which the government will pay a service charge. The combined revenue from rent and service charges over the term of the lease should be enough for the private operator to recoup its investment and make a return. The facility remains at all times in private ownership, and the owner is free not to renew the lease after expiry. The government obtains the accommodation and related services it requires without being encumbered by actual ownership of the asset.

The only Australian example of this kind of arrangement is the agreement between the Victorian Government and a private contractor for the provision of new court rooms, administrative accommodation and support facilities for the Victorian County Court. Under the agreement, the contractor will construct a new building to house the County Court (including a library, a common room and conference rooms) on state-owned land under a 99-year lease to the contractor. The contractor is then obliged to make these facilities available to the Department of Justice for a 20-year term (at the close of which neither party is under a renewal obligation). The contractor is furthermore required to provide ancillary support in the form of IT systems, building maintenance, court allocation and building administration, and security. Remuneration is made via two streams. The first is a rental fee for the provision of building services. This is subject to abatement if the services fall below agreed levels. The second is a court services fee, which comprises a fee payable for the reservation of space and a courtroom usage fee.

(c) Project and strategic alliances

Tired of the disputation, waste and general culture of defensiveness that characterises conventional construction contracts, various government agencies in Australia have been active in promoting relationship contracting,[15] with the most interesting developments occurring in the area of alliancing. Although alliancing is not a PFI, it is arguable that it is the contracting strategy which most closely approaches the formation of a true partnership between the government and a private operator.

To provide a highly simplified overview of the *project alliance*,[16] it is based on a recognition that a contractually robust arrangement for true co-operation between parties requires alteration to the fundamentals of contract. To this end, parties contract to align their commercial interests and cede almost all of their ordinary rights to bring claims.

Commercial risk and reward are shared such that it is in all participants' interests to work co-operatively and openly. The government will agree to meet all direct costs and some overhead incurred by non-owner parties, and the other parties will achieve profit in the form of a share of any savings made in relation to the target cost. Non-government parties may further be rewarded by meeting whatever key performance indicators (KPIs) the owner considers important. For instance, other KPIs established in Australian infrastructure projects include benchmarks in respect of environment, safety and employment of indigenous people.[17] The approach taken in respect of risk is known as "risk embrace": risk is not allocated between the parties; rather, all participants share all risk and attempt to manage it collaboratively.

The truly distinctive feature of the project alliance is that it contains a "no disputes" clause. All differences of opinion are resolved by the alliance board (comprising representatives of each party), and require unanimity of decision. Parties expressly contract away any entitlements to a legal or equitable cause of action against other parties except in the case of wilful default or possibly insolvency. This is in order to force consensus and a collaborative search for solutions. It is quite a radical departure from conventional contracting and the government necessarily takes a leap of faith in establishing an alliance. However, non-government participants are carefully selected through a process of competitive tender and intensive workshopping as to attitudinal aspects of alliancing. It has been generally found that this process, and the alliance board structure, do indeed facilitate trust and co-operation, and the management of events such as latent conditions within the alliance without resort to disputation. Prominent successful project alliances include the recently opened National Museum of Australia in Canberra, and the Northside Sewerage Tunnel in New South Wales.

Where the government is contracting for the maintenance, operation, management or upgrade of existing infrastructure, or for the delivery of a

[15] See, e.g., Australian Constructors Association, *Relationship Contracting: Optimising Project Outcomes* (1999).

[16] For a detailed examination of project alliancing, D Jones, "Project Alliances", presented to "Who's risk? Managing Risk in Construction—Who Pays?" Conference, Hong Kong, 20–21 November 2000.

[17] The bidding process, KPI negotiations and performance assessment must be the subject of independent audit in order to demonstrate probity.

series of smaller similar or related projects, a *strategic alliance* rather than a project alliance is applicable. Essentially, a strategic alliance is a long-term arrangement for the outsourcing of services on a cost-plus basis with commercial drivers facilitating the meeting of the government's objectives and adhering to the attitudinal aspects of alliancing. Without actually handing over ownership of the item of infrastructure, a strategic alliance cultivates an "owner's" attitude on the part of the service provider towards the facility it is maintaining. Ideally, a strategic alliance should be embarked upon by parties who genuinely see the arrangement as the formation of a new (if nominal) entity—the alliance—established on near-collegiate terms. There may also be a "no disputes" clause as under project alliancing. In exchange for the contractor taking the risk of committing resources on a long-term, and perhaps indefinite, basis, it will be guaranteed a certain amount of work—"a core workload"—for the period of the alliance. An Australian illustration of strategic alliancing is the Infrastructure Works and Maintenance Services Provider (IWMP) contracts let by the NSW Rail Access Corporation (RAC).

(d) Contracts for long-term service provision

A final form of PPP is the long-term service provision arrangement, which allows the government to enter into a close, on-going relationship with a private operator without having to either cede control of the item of infrastructure or go as far as establishing an alliance structure. A long-term service provision arrangement can be considered a (non-PFI) PPP because it allows the private operator to assume an owner-like position in respect of the infrastructure and contribute its expertise to the government's asset management strategy. Such arrangements are most commonly used by the government to procure maintenance services on a semi-permanent basis, and will usually involve performance-based remuneration.

A prime example of a long-term service provision arrangement is the Department of Defence's Comprehensive Maintenance Contract (CMC), which looks strategically at how the private sector can best be involved in maintaining Department infrastructure and, in respect of plant and equipment, seeks to have the contractor assume a strategic role in asset management.

The CMC works on the premise that general maintenance tasks are qualitatively different from the upkeep of plant and equipment, and that these services should be procured on different bases. Essentially, in respect of general building and facilities maintenance, the Department requires a manager who will see to it that such tasks, typically corrective, get done by an appropriate sub-contractor. On the other hand, for plant and equipment maintenance, the Department seeks a contractor to work with it to identify and perform the more specialised predictive, preventative and reactive maintenance work associated with the upkeep of plant and equipment. The one contractor will fulfil dual roles, applying separate maintenance methodologies and being remunerated on a distinct basis in each case.

It is the second component, the maintenance of plant and equipment, which is the more illustrative of a partnership between the Department and the private operator. Upkeep of plant and equipment is naturally a more specialised task than general maintenance and comprises a mixture of predictive, preventative and reactive maintenance measures. Furthermore, it is especially important in respect of plant and equipment that maintenance methodology takes advantage of whatever new technologies may come to light and that possible cost savings are identified and communicated to the government. The Department will identify performance requirements and set them out in a specification. The contractor is then expected to provide industry expertise and take advantage of current maintenance technologies in accordance with the specifications to ensure plant and equipment operate as required through the contract term.

In addition to a basic fee for services, the contract implements a performance monitoring regime which rewards the contractor for meeting or exceeding the performance requirements in respect of plant and equipment maintenance. Performance is monitored against evaluation criteria negotiated between the parties. This incentive scheme is designed to achieve a shift from traditional reactionary and task-orientated maintenance to a proactive and performance-orientated maintenance strategy. It also seeks also to encourage a "one-team" approach between the Department and the contractor, and ideally build a long-term working relationship.

Additional examples of service provision arrangements involving performance-based remuneration can be found in the NSW RTA *Road Maintenance Reform Package* initiatives and the Queensland Department of Main Roads' Road Maintenance Performance Contract, each of which employs private operators (and local government providers) to maintain state roads on a performance benchmark basis.

4. ISSUES REQUIRING RESOLUTION

There remain certain PPP-related issues which require the attention of state and federal governments. The most often cited of these is a federal taxation problem: PPPs can sometimes be considered in breach of section 51AD of the *Income Tax Assessment Act* 1997 (Cth).

Essentially, this section denies tax deductions for interest, depreciation and investment allowances incurred by owners of leased properties where the end-user is tax-exempt, as in the case of state governments. The section is designed to stop the states from providing tax benefits to private parties at the expense of the Commonwealth, and imposes a test of who controls the asset.

The problem here is that the control test generates uncertainty as to whether the asset will be considered to be under state control for the purposes of the Act. The test is criticised as coming down to such arbitrary considerations as who sets the speed limits on tollways.[18] The combination of the costs associated with obtaining an advance ruling from the Australian Taxation Office on the issue (if the ATO will give one at all) and the inconsistency between state and federal policies on the matter (with NSW, for instance, requiring an ATO ruling before giving approval to a preferred PPP proponent), act as a disincentive to invest in state infrastructure. Projects can be structured to get around the restrictions of section 51AD of the Act but it is expensive to do so.

A sensible solution would appear to be that if it can be demonstrated that operating risk has been transferred to a private sector operator, that operator should be able to claim depreciation and other benefits on its investment. It is recommended that, until the section is changed, state governments hold early discussions with the ATO rather than waiting until documentation on a project is finalised and seeking an ATO ruling at that stage. State and federal governments are currently discussing these issues and it is hoped that resolution will soon be achieved.[19]

A further issue which will require resolution as governments continue to explore alliancing possibilities is the contradictions between alliance structures and policy such as *Partnerships Victoria* in respect of risk transfer. As mentioned above, a *Partnerships Victoria* project adopts "optimal risk allocation" (the party best able to manage the risk accepts it), whereas a crucial feature of an alliance is that both parties embrace all risk and manage it within the alliance. An alliance conducted under the umbrella of a policy such as *Partnerships Victoria* will have to resolve this contradiction, either by allowing PPPs to depart from the optimal risk allocation default, or by structuring the alliance so that the contractor does take responsibility for some risk, most likely in return for a larger share of potential reward. This last solution, however, may mean that the alliance cannot be viewed as a "pure alliance".

5. CONCLUSION

Australia's PPP experience began long before the term "public private partnership" was used in that country, yet the adoption of the PPP label has given government policy a new coherence and vigour. Australian jurisdictions are consolidating the extensive knowledge derived from their past experiences with private sector involvement in the provision of infrastructure, and combining this with information and ideas from overseas sources. In some areas, particularly in performance-based and relationship contracting, Australian projects have led the way in crafting genuine and

[18] Skotnicki, *op. cit.*, p. 73.

[19] For a detailed discussion of taxation issues see N Orow and M Andrew, "Funding the Privatisation of Public Utilities: Taxation Aspects of Structured Finance", (1999) 28 *Australian Tax Review* 121.

intimate partnerships between the government bodies and private providers involved.

With respect to transport, health, utilities and other infrastructure, there is enormous scope for the application and elaboration of the PPP form. Upcoming important projects which will be executed as PPPs include Sydney's Cross City Tunnel, Western Sydney Orbital motorway, and Lane Cove Tunnel. Industry bodies, governments and other players (particularly financial and legal practitioners) will ensure that future projects see private and public sectors in Australia working together in an increasingly confident manner. It is beyond doubt that the future holds further development in this area.