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Application of State laws to Commonwealth infrastructure projects

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A question that frequently arises in relation to Commonwealth property and infrastructure projects is whether State laws apply to the development of those projects. Although this is a simple question, unfortunately it does not have a simple answer. This is because the question raises some deep issues about our federal system.

Where the Commonwealth is merely providing funding for a project through a grant or funding agreement, the application of State laws will not often be an issue. Where the Commonwealth is directly involved in the project, the application of State environmental, planning and building laws in particular will need to be considered quite frequently.

At a practical level, three basic questions need to be asked to resolve this issue. (Further questions arise where the development is on a Commonwealth place (s 52(i) of the Constitution and the *Commonwealth Places (Application of Laws) Act 1970*), or issues arise in relation to proceedings against the Commonwealth (see s 64 of the *Judiciary Act 1903*)). These questions often need to be asked in relation to various types of provisions in a State law; there may be different answers for different sections of the one Act.

Does the State law seek to apply to the Commonwealth?

In order to determine whether a particular State law binds the Commonwealth it is necessary to determine whether, as a matter of statutory construction, the State law is intended to have that effect.

There is the presumption that the Crown is not bound by the general words of a statute. The presumption extends beyond the Crown in right of the enacting legislature, to the Crown in right of the other body politics forming the Australian federation.

Some State Acts say that they bind the Crown of the other body politics. For example, some NSW laws say they bind the Crown 'not only in right of New South Wales but also, so far as the legislative power of Parliament permits, the Crown in all its other capacities'. This is an indication of an intent to bind the Commonwealth, but is not always conclusive.

Is the State law inconsistent with a law of the Commonwealth?

Section 109 of the Australian Constitution provides that where a law of a State is inconsistent with a law of the Commonwealth, the law of the Commonwealth prevails. Therefore a State law which seeks to bind the Commonwealth will not do so if it is inconsistent with a Commonwealth law.

This issue

Does the Commonwealth have a general immunity from the State law?

This is in practice the most difficult question. In a 1997 decision of the High Court of Australia, *Re Residential Tenancies Tribunal of New South Wales and Henderson; Ex parte Defence Housing Authority* (1997) 190 CLR 410 (*Henderson*), the Court rejected a proposition that the Commonwealth cannot be bound by State legislation because of a broad immunity. However, the Court held that the Commonwealth did have a limited immunity.

Capacities v activities

In *Henderson*, some members of the High Court drew a distinction between 'the capacities of the Crown on the one hand, by which we mean its rights, powers, privileges and immunities, and the exercise of those capacities on the other' (at 438). The purpose in drawing this distinction was 'to draw a further distinction between legislation which purports to modify the nature of the executive power vested in the Crown – its capacities – and legislation which assumes those capacities and merely seeks to regulate activities in which the Crown may choose to engage in the exercise of those capacities' (at 439). The conclusion was that a State law cannot restrict or modify the executive capacities of the Commonwealth, but a State law of general application can operate to regulate activities which the Commonwealth chooses to undertake, for example, entering into contracts.

On the basis of the discussion in *Henderson*, the Commonwealth will generally be subject to a State law which merely seeks to regulate activities or govern transactions in relation to a property or infrastructure project in which the Commonwealth chooses to engage in the exercise of its executive capacities.

Some Justices in *Henderson* also held that it would be rare for the Commonwealth's implied constitutional immunity from State law to be shared by bodies established by legislation.

... it is likely that the Commonwealth is entitled to assert immunity from State laws that would prevent it from erecting a building or using land for a particular project.

Licences

However, the principle in *Henderson* is often a difficult one to apply in practice, for example where the Commonwealth is required by State law to obtain a licence or approval before undertaking an activity. The effect of such a requirement may be to prohibit the Commonwealth from undertaking the activity, and thus restrict or modify its executive capacity, not just regulate its activities. For example, it is likely that the Commonwealth is entitled to assert immunity from State laws that would prevent it from erecting a building or using land for a particular project.

On the other hand, an obligation arising under a State building law on the owner of land to observe safety standards in constructing a building on that land would probably be capable of binding the Commonwealth. Similarly, general State laws imposing safety or pollution controls on the conduct of a project are probably capable of binding the Commonwealth. This will be possible subject to the issues we have noted in the first and second questions, that is where the law intends to bind the Commonwealth, and is not inconsistent with a Commonwealth law.

See also AGS *Legal Briefing* No. 36 (30 August 1997) 'The Commonwealth's Implied Constitutional Immunity from State Law' and *Legal Briefing* No. 47 (29 June 1999) 'Application of State Laws to the Commonwealth'.

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Commonwealth Procurement Guidelines – implications for real property and infrastructure activities

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On 1 January 2005, new *Commonwealth Procurement Guidelines* (CPGs) came into effect. These guidelines apply to all FMA agencies under the *Financial Management and Accountability Act 1997* and to some agencies under the *Commonwealth Authorities and Companies Act 1997*.[1] The new guidelines implement Australia's obligations under the Australia – United States Free Trade Agreement and introduce some changes to procurement of property and infrastructure. The Department of Finance and Administration (Finance) is expected to issue guidelines about specific implementation issues for real property[2] and construction transactions.

How do the CPGs apply to real property and infrastructure transactions?

The new CPGs establish some new requirements that are applicable to all procurements and some mandatory procedures that are only applicable to certain higher value transactions. For real property/infrastructure transactions, the position is shown in the table below.

New requirements applicable to all procurements

As the table indicates, grants are not subject to the CPGs. In some cases it may not be entirely clear whether a transaction is a procurement or a grant. You may need to take particular advice on this issue. Assuming that the transaction is a procurement, the following aspects of the general provisions of the CPGs will be applicable in each case.

Value for money remains the core principle for government procurement. The CPGs indicate that value for money is enhanced by encouraging competition, promoting the use of resources in an efficient, effective and ethical manner and making decisions in an accountable and transparent manner. Chapters 5, 6 and 7 of the CPGs expand on these principles.

Type of transaction	*CPGs apply*	*Mandatory Procurement Procedures apply*
Standard real property leasing	Yes	No (CPGs App B (1))
Pre-commitment leasing	Yes	Position may vary from case to case – take specific advice
Domestic construction services[3]	Yes	Yes – if value exceeds $6m.
Overseas construction services	Yes	No – but initial domestic advice may be covered. (CPGs App B(9))
Private finance arrangements	Yes	Yes – if value exceeds relevant thresholds (PF arrangements will generally exceed $20m in any case.)
Procurement for direct purposes of providing foreign assistance	Yes	No. (CPGs App B (5))
Purchase of land	Yes	No. (CPGs App B (1))
Property or project related contracts such as management, consultants, project managers, utilities, cleaning, security, maintenance etc.	Yes	Yes – if value exceeds $80,000 ($400,000 for CAC bodies) if procured on a stand alone basis. Position where procured in anticipation of a broader construction project still to be clarified.
Fitout contracts	Yes	Position may vary from case to case – take specific advice.
Grants for property and infrastructure	No (CPGs 2.5)	No (CPGs 2.5)[4]

Many of the general requirements remain as in the previous CPGs. Some changes that are of particular interest for real property and infrastructure projects are highlighted below.

Competition

The CPGs indicate that procurement processes should be commensurate with the size and risk profile of the project. It is not always necessary to run a tender process for procurements that are not covered by the mandatory procedures.

It is not permissible to discriminate between tenderers on the basis of foreign affiliation or ownership, location or size (for example, it is not acceptable to indicate that only Australian-owned construction companies will be considered). Goods and services must be assessed on the basis of their suitability for their intended purpose, and not on the basis of their origin. (CPGs 5.2) Processes must not unfairly discriminate against SMEs.

Efficiency, effectiveness and ethics

Risk management must be built into agency processes – particular attention is needed in relation to indemnities and capped liability.

- In many cases it will be necessary to consider matters of liability, risk management and indemnities in evaluating tenders – this will require agencies to consider these matters before their requests for tender are issued.
- Finance Circular 2003/02 *Guidelines for Issuing and Managing Indemnities, Guarantees, Warranties and Letters of Comfort* should be consulted.
- Many real property transactions contain indemnities. For example, when an agency leases premises it will often be required to provide an indemnity in favour of the landlord. Such indemnities will often require an approval under the delegations provided to agencies in relation to Regulation 10 of the Financial Management and Accountability Regulations 1997 in which case Finance Circular 2004/10 *Using the Financial Management and Accountability Regulation 10 Delegation* will be relevant.

Risk management must be built into agency processes – particular attention is needed in relation to indemnities and capped liability.

There is also a continuing focus on probity considerations such as conflicts of interest (see more generally AGS *Commercial notes* No. 15 'Managing probity and process issues in procurement', 14 March 2005). Regard should also be had to the Department of Finance and Administration's *Guidance on Ethics and Probity in Government Procurement*, January 2005.

Accountability and transparency

Agencies must ensure that they comply with applicable government legislation and policy. Finance has issued the *Guidance on Complying with Legislation and Government Policy in Procurement,* January 2005. Policies and legislation that have particular application to real property and infrastructure transactions include:

- the *National Code of Practice for the Construction Industry*
- the *Public Works Committee Act 1969*
- *Lands Acquisition Act 1989* requirements in relation to acquisition and disposal of interests in land
- the *Environment Protection and Biodiversity Act 1999* and various environmental policies including 'green office' considerations.

Agencies are required to maintain documentation sufficient to provide an understanding of the decision-making processes. In addition to other requirements to retain the documents, the CPGs require that they be retained for at least 3 years. (7.11) Outsourced service providers should also be required to maintain appropriate systems for recording decisions.

Agencies are now required to have an Annual Procurement Plan which would include procurement of leased premises, construction services etc. In addition the CPGs contain specific reporting requirements.

Austender is now to be used to publish annual procurement plans and any open tenders.

The CPGs also indicate that agencies need to have fair, equitable and non discriminatory complaints handling procedures. (7.36)

New requirements – Mandatory Procurement Procedures

Neither grants, real property leases nor sale and purchase of real property are covered by the mandatory procedures. However construction contracts, potentially some precommitment leasing, private finance arrangements and real property related agreements such as management and consultancy contracts, contracts with utilities, fitout and cleaning etc. will generally be subject to the mandatory procedures if they exceed the financial thresholds.

What are the major changes for transactions that are subject to the mandatory procedures?

- Most procurements will need to go to open tender.
- Evaluation criteria must be published (8.22) and tenders must be evaluated in accordance with those criteria.
- Specifications should generally be based on performance and functional requirements and rely on international standards. (8.25) Trade name or similar descriptions are to be avoided or at the very least expressed as 'or equivalent'. (8.26)
- Agencies may specify conditions for participation (i.e. requirements which if not met mean that a tenderer will be excluded from consideration) but those requirements must relate to legal, commercial, technical and financial abilities which may include relevant experience. (8.16, 8.17)
  - Conditions for participation that are likely to be acceptable include: a requirement to sign a confidentiality deed, being solvent, experience relevant to the job.
  - Conditions for participation that would generally not be acceptable include a requirement of previous experience with the particular agency or the Australian Government, and place of origin of goods.
- Agencies will generally have to allow 25 days or more for tender responses for tender documents issued electronically or 30 days or more for hard copy (there are some circumstances where a shorter period is allowed, for example where goods are commercially available). The tender period must allow sufficient time to prepare and lodge submissions. (8.32, 8.33)
- Late tenders can no longer be accepted unless due to agency mishandling. (8.38)
- There is an obligation to award a contract to the best 'value for money' tender that meets all relevant requirements unless it is not in the public interest.

Grants, real property leases and sale and purchase of real property are not covered by the mandatory procedures.

Submissions that do not meet the minimum form and content requirements at the time of opening can not be further considered (subject to correction of unintentional errors of form at the agency's discretion). (8.39/8.40)

What should you do to comply with the mandatory procurement requirements?

— Check that your tender documents have been updated to take account of the new CPGs – they should ideally reflect the language used in the CPGs, such as conditions for participation and minimum form and content requirements.

— Procurements need to be valued to determine whether they are covered procurements. Where a procurement is to be conducted in multiple parts with contracts awarded either at the same time or over a period of time, with one or more suppliers, the estimated value of the real property or services being procured must include the estimated total maximum value of all of the contracts. (8.7/8.10)

— Consider carefully what, if any, requirements will be mandatory requirements that will be expressed to be conditions for participation or essential requirements – if a tenderer does not satisfy these requirements you will not be able to consider their tender.

— Review your 'reserved rights' provisions – some rights may no longer be consistent with the new CPGs. Check your evaluation processes to ensure you have:

- correctly stated the basis on which you propose to evaluate
- asked for information that is relevant to the evaluation
- stages in the evaluation that deal with the assessment of 'form and content requirements' and 'conditions for participation'.

— Make sure you record the reasons for your decisions, including any view you take about the application or otherwise of the CPGs generally or the mandatory procurement procedures.

— Review the *Guidance on the Mandatory Procurement Procedures*, Department of Finance and Administration, January 2005.

Check that your tender documents have been updated to take account of the new CPGs – they should ideally reflect the language used in the CPGs.

Simon Konecny *has extensive knowledge and experience in property and contracting matters including acquisitions and disposals, leasing and advice on leasing obligations, fitouts, building and construction matters, tenders and advice in relation to tender processes and strategies, outsourcing and consultancy arrangements, indemnities and licence arrangements.*

Notes

1 Agencies declared for the purposes of section 47A(2) of the *Commonwealth Authorities and Companies Act 1997*. For those agencies the CPGs only apply for procurements which exceed $400,000 including GST or $6m for construction services.

2 The CPGs use the term *property* to refer to 'every type of right, interest or thing which is legally capable of being owned. This includes, but is not restricted to, physical goods and real property as well as intangibles such as intellectual property, contract options and goodwill.' (CPGs 2.2)

3 'Construction Services' are procurements related to the construction of buildings and all procurements covered by the *Public Works Committee Act 1969*. (CPGs App E)

4 While the CPGs generally do not apply, larger grants that take the form of contracts rather than conditional gifts are required to be notified on the Internet. (CPGs 7.27)

Private financing – key issues

National

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This note gives a 'snapshot' of some of the key issues to be considered in conducting a private financing (PF) project. Value adds which can be derived from a PF proposal include innovation (based on output specifications), risk transfer, improved asset utilisation, ownership and management synergies and improved project management.

The core principle underpinning the Commonwealth Policy Principles for the use of private financing is value for money, which is to be tested by comparing the outputs and costs of a private financing proposal against the Public Sector Comparator or Project Cost Benchmark (PCB). The PCB is designed to reflect the most efficient public sector delivery option assessed on a whole-of-life risk-adjusted basis which is likely to be achieved for the relevant project.

Some key issues to be considered in a PF transaction

Risk events

How each risk event is dealt with depends on the nature of the project, the likelihood of the event occurring and the value for money obtainable if the contractor prices the risk of the event occurring into its bid price. For example, it would probably be most cost effective for government to accept native title risk (i.e. make it a compensation event) than to require the contractor to assume and price this risk. Similarly, government should probably assume planning approval risk since the obtaining of approval under the EPBC Act and from the Public Works Committee is best managed by government.

Three typical types of risk event in a PF project are:

— compensation events

— relief events

— force majeure.

Compensation events are designed to cater for those risks carried by government which cause delay or increased costs to the contractor. They would typically include a breach of an obligation by government or those for whom it is responsible or a change to the scope of the government's requirements.

The types of events usually dealt with as relief events include:

— insurable risks such as damage by fire, explosion, storm, flood, earthquake, riot and civil commotion etc.

— failure by a statutory authority to carry out works or provide necessary services

— accidental loss or damage to the development or roads servicing it

— failure or shortage of power, fuel or transport

— strikes or other industry action generally affecting the relevant industry.

No compensation should be paid by government to the contractor for the occurrence of a relief event.

Force majeure events are designed to give the affected party relief from liability and, if the event continues for a certain period, to give the parties

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a right to terminate the contract. These events are treated differently from relief events as neither government nor the contractor is in a better position than the other to manage the risk or effects of the occurrence.

Typically, force majeure events would include:

— war, armed conflict or terrorism

— nuclear, chemical or biological contamination, or

— supersonic pressure waves.

Deductions reflecting the seriousness of performance failure should be made from the unitary charge.

Price and payment

The key features of the payment mechanism for a PF project generally include:

— no payment being made until the infrastructure and services are available

— a single unitary charge (i.e. payment is not made up of separate, independent elements)

— the single unitary charge should only be paid to the extent that the infrastructure and service are available (i.e. proportionate number of units).

Deductions should be made from the unitary charge reflecting the seriousness of performance failure (i.e. no service, no payment – use of performance points).

Care should also be exercised not to effectively accept the risk of the financing of the project by guaranteeing the contractor's finance charges through the agreed payment mechanism.

Service requirements and availability

The key issue is what constitutes 'availability'. Agreement with the contractor will be more easily reached where the definition is objective and measurable. Examples of appropriate objective criteria may include:

— non-provision of a specific level of access

— non-provision of specified physical and environmental conditions

— a failure in services and other utilities

— non-provision of a specified level of ambient temperature

— non-provision of a specified level of lighting

— non-provision of a fully functioning communications or information services infrastructure.

The cheapest unitary charge may provide government with the least flexibility in managing the contract.

Change in service

There is an inevitable tension between cost and flexibility in a PF contract. The cheapest unitary charge may provide government with the least flexibility in managing the contract, as the ability to absorb unforeseen changes and risks inevitably comes at a price. To preserve flexibility, government will need to consider carefully whether it requires:

— pre-priced options to vary scope

— pre-priced unit rates for additional capacity

— comprehensive rights to insist on benchmarking market costs

— open book accounting

— cost transparency linked to prescribed margins for pre-agreed risk profiles.

The change procedure in a PF contract is not dissimilar to that for directing variations in traditional procurement. However, under a PF contract the contractor's financiers are unlikely to agree to any change which increases the project risk, financing risk or reduces the rate of return on the project. On the other hand, if the contractor is fully protected against the consequences of a government-initiated change and how it is to be paid for, there should be no objection by the financiers.

Treatment of assets on expiry of service period

It will often be the case that best value for money will determine that the Commonwealth takes control of assets on expiry of the contract. This may be because there is a long-term public sector demand for the use of the facility (i.e. beyond 20 years) and there is no clear practical alternative use due to its location and the specialist nature of the facility.

Accordingly, the facility should automatically transfer to the Commonwealth on expiry of the contract, or at least an option to purchase the asset at a nominal cost should be sought. Options for the Commonwealth include:

- taking possession of the asset at no cost
- re-tendering provision of the service.

Contractual provisions covering the following should be considered:

- the condition of the facility, any rectification works, their cost and how they are paid for
- any design life requirement after the expiry date
- inspection prior to handover
- provision for assignment of warranties, contracts and other rights relating to the project.

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Lender step-in rights – tripartite agreement

A feature of PF transactions is generally a requirement for a form of tripartite agreement to be entered into between government, the contractor and the financiers. The tripartite agreement will usually give senior lenders an opportunity to rectify breaches or to transfer the contract. Senior lenders are usually incentivised to take control of the project, as any failure to do so will lead to termination of the contract and allow the government to re-tender the contract.

If the senior lenders decide not to step in then the government should also have the right to elect whether to re-tender the unexpired term of the contract or to have the contract valued on the basis of there being no re-tendering.

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The precommitment lease – a vehicle for infrastructure delivery

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The precommitment lease (the PL) provides agencies (the tenant) with a possible procurement solution for the development of infrastructure 'off budget' through the use of private finance. The PL permits the tenant to achieve purpose-designed and built infrastructure without the risks associated with land acquisition, design, construction and long-term ownership.

What is a precommitment lease?

The essential elements of the PL are that:

— the developer designs and constructs to the tenant's design requirements and warrants the suitability of the land, and that when completed, the project will satisfy those requirements

— the lease, the conditions of which are agreed at the inception of the project, commences following compliance by the developer with the tenant's design requirements (practical completion).

Risks and benefits for the tenant

The tenant's principal risk is to manage its project design and specification requirements to ensure they are comprehensively addressed in a design brief which drives the developer's obligations to document, construct and lease to satisfy those requirements. The tenant's design brief records the technical specifications in terms of performance and functional requirements and references those specifications to recognised standards. The tenant's other risks, which include managing variations, design and construction of fitout and delays, can be reduced by engaging a project manager. If the tenant chooses, the risk associated with the design and construction of fitout can be transferred to the developer.

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The benefits for the tenant in adopting the PL as a procurement method are that:

— with the exception of funding the fitout component (usually assumed by the tenant), the developer is responsible for project funding which is recovered as rent and outgoings under the lease – if the developer funds the fitout component, that cost can be amortised over the term of the lease or reflected in additional rent

— the delivery of the infrastructure is accelerated because the project can commence prior to the completion of design documentation and without the need for land acquisition by the tenant

— the tenant's costs are capped because rent, outgoings and all other obligations of the tenant under the lease are fixed prior to the commencement of the project

— the developer assumes the risks associated with land acquisition, securing development and building approvals and effecting design and construction

— the lease provides the tenant with greater flexibility than ownership and assures the level of building performance specified in the tenant's design brief.

Who should have responsibility for fitout?

All infrastructure requires some degree of fitout and the tenant must decide whether to retain responsibility for its design and construction or place that responsibility with the developer. Irrespective of which party takes responsibility, it is usual for the tenant to document the fitout to the stage of drawings and specifications suitable for construction, based on drawings and specifications for the building structure prepared by the developer.

If the developer is responsible for design and construction of fitout, it assumes responsibility for the tenant's fitout drawings and specifications and is paid a fitout management fee expressed as a percentage of the total fitout construction cost. In that event, the tenant controls the fitout cost by requiring the developer to divide the fitout drawings and specifications into trade packages and to enter into trade package contracts approved by the tenant following a competitive tender process. If the tenant agrees to fund the cost of fitout rather than amortise that cost over the term of the lease or reflect that cost in additional rent, the tenant makes progress payments to the developer based on the value, from time to time, of the fitout works as certified by the tenant.

The benefits for the tenant if responsibility for the fitout is placed with the developer are that:

— the total project cost is generally reduced as savings are achieved through integration of the fitout works with the construction of the building structure

— the infrastructure becomes available for use by the tenant earlier and immediately following practical completion as opposed to a staged process of practical completion by the developer of the building structure followed by a period to permit fitout by the tenant

— the building performance covenants and the warranties on the part of the developer under the lease are not compromised as the developer is responsible for all work, including fitout

— the defects liability provisions of the PL apply to the building structure and the fitout.

If the tenant retains responsibility for fitout design and construction, it must decide whether to commence construction of fitout before or following practical completion of the building structure.

If the tenant retains responsibility for fitout design and construction, it must decide whether to commence construction of fitout before or following practical completion of the building structure. If fitout construction is commenced prior to practical completion, the tenant is exposed to the possibility of claims for delays to the developer's program and practical completion. Further, it may not be possible to properly certify practical completion of the building structure following the commencement of fitout construction. To avoid these difficulties, the PL may provide for a timeframe following practical completion during which the tenant may commence fitout construction prior to the commencement of the lease. This timeframe, however, may be viewed by the developer as a 'rent-free' period which either reduces the level of incentive offered by the developer or increases the rent rate provided for in the PL.

Programming, variations, delays and practical completion

Ensuring compliance with the works program, evaluating the causes of delay, managing variations and certifying practical completion are those specialised tenant's functions which justify the procurement of project management services. Some of the considerations relevant to these issues are:

Works program
A program in the form of a bar chart which identifies the start and finish dates for each activity must be maintained by the developer and amended at specified intervals to address delays. The cause of a delay will determine whether the date for practical completion should be extended.

Delays
The developer must be entitled to extend the date for practical completion if it is delayed in effecting completion as a result of a breach of the PL by the tenant or variations required by the tenant. Subject to the developer being obliged to avoid or minimise the consequences of these delays, the additional cost and expense incurred by the developer as a consequence of the delays is met by the tenant. The developer should be entitled to extend the date for practical completion without entitlement to additional costs and expenses if practical completion is delayed by an event which is not caused by the developer, is not a breach of the PL by the developer, is not caused by inclement weather or a dispute directed at the works or the developer.

If variations produce additional cost, that cost can be amortised or reflected in rent.

Variations
The PL should permit the tenant to require variations to the design brief, provide for a method to cost those variations and for payment of that cost by the tenant (if the variations increase the cost of effecting practical completion) or for a reduction in the rent rate under the lease (if the variations result in a decrease in the cost of effecting practical completion). If variations produce additional cost, that cost can be amortised or reflected in rent.

Practical completion
The tenant should be careful to ensure that the PL defines practical completion to include all of the tenant's requirements in relation to the use of the project and permits the tenant to certify practical completion, subject to the dispute resolution provisions of the PL.

Lease issues

Some of the more important PL lease issues to consider are:

- The commencement date of the lease must be defined in a manner which ensures that the tenant cannot be required to commence the lease earlier than the required date for practical completion. If the tenant takes responsibility for fitout design and construction, the lease should not commence until the expiration of a specified period following the later of the date for practical completion provided under the agreement and the actual date of practical completion. This period will allow the tenant to commence or complete fitout prior to the commencement of the lease.
- A balance must be achieved in relation to the term of the lease having regard to the fact that the project will be viable only if the developer receives an appropriate return, by way of rent, under the lease. An option to purchase, and multiple short-term options to extend the lease add flexibility, and should be considered.
- An effective way of structuring rent for the first rent period of the lease is to agree an annual rate per square metre subject to a specified maximum area having regard to one of definitions of lettable area in the Property Council of Australia's *Method of Measurement for Lettable Area* (March 1997). The method of determining rent for the second and each subsequent rent period of the lease must be specified in the PL.

An option to purchase, and multiple short-term options to extend the lease add flexibility, and should be considered.

— The lease should contain warranties by the developer in relation to the fitness of the structure for the required use and that the operation of critical building services will satisfy the standards specified in the tenant's original design brief.

— Responsibility for the maintenance and repair of the structure and the critical building services should rest with the developer as this is consistent with the developer's design and construction obligations under the PL.

— The tenant must decide whether ownership of its fitout should vest in it or in the developer as this will impact on the tenant's repair, maintenance and make-good obligations.

— Remedies should be available to the tenant in the event of a malfunction or failure of a critical building service. The tenant's remedies could include a right to abate rent or to rectify the fault at the developer's cost and to set-off that cost against rent.

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Selecting a method for infrastructure funding

There are numerous methods for infrastructure funding and more are continuing to evolve. Two of these are the funding agreement and the various forms of more recently developed private finance (PF).

Funding agreements

Under a funding agreement the government provides money from appropriated funds to another party (state or local government, community group, industry etc.), and the other party in turn uses those funds (either with or without its own money) to develop the infrastructure.

The responsibilities of the parties are regulated by the terms of the funding agreement. From the government's perspective, the obligation is often little more than to provide a set amount of funds on the achievement of certain milestones by the recipient.

Private finance

Private finance comes in different shapes and sizes, but generally speaking involves the government having a long-term business relationship with a private party and the risks and returns of the project being shared between the parties.

Key features of private finance are that:

— control of 'core' services is still retained by the government

— there is a process for comparing the cost of the anticipated private finance with what it would cost to traditionally procure the project

— private sector capital will be used to develop the infrastructure, and

— the services are provided on a performance-based contract.

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Factors which influence choice of funding method

Some factors in determining which method to choose are:

Funding objective

Is it a commercial arrangement under which the government is procuring economic or social infrastructure for the public good? Or does it have less of a commercial aspect to it and more of a policy implementation flavour? Objectives in these latter cases can go beyond value for money and may include increasing employment, providing training opportunities and fostering community and economic development. A funding agreement may be appropriate if this is the case.

Nature of the infrastructure

Is it hard economic infrastructure such as roads, railways, ports, water and sewerage plant, energy and telecommunications? Or is it social infrastructure such as schools, hospitals, child care, aged care accommodation, public security and the administration of justice? The core social services are not always suitable for delivery using a private finance model and may be better dealt with by direct procurement or funding agreements.

Duration of the arrangement

Private finance usually requires a long term to make it financially attractive for investors. There are high sunk costs in the initial years of infrastructure development and it is only over a longer term that investors may recoup their capital and take a profit. Funding agreements are better suited to relatively short-term arrangements.

Private finance usually requires a long term to make it financially attractive for investors.

Availability of funding

Scarcity of funding alone cannot be determinative in selecting a funding method. However, where an infrastructure project can demonstrate value for money as against the anticipated cost to government for the same direct procurement or funding arrangement, there is every justification for accessing private sector funds for the development.

Size of project

Small and simple projects do not lend themselves well to private finance. The complexity and cost of private finance would outweigh the benefits. Equally, small-scale projects do not provide the opportunities for innovation or generation of profits which underpin the justification for private finance. Accordingly, they are more likely to be suited to funding agreements or direct procurements.

Experience and capability of the government and the other party

Another relevant factor is the experience and capability of the government and the other party. In areas of economic infrastructure, the private sector may be best placed in terms of knowledge and experience. In other circumstances, however, such as the delivery of some social infrastructure, the government or another level of government may be the party that possesses the most skills and expertise.

Risk transfer

One of the cornerstones of private finance is the better efficiency promised by the transfer of risk from the government to the private contractor. With the exception of construction risk, a private finance arrangement will usually transfer to the private sector risks customarily borne by the government in relation to financing, design, operation and ownership. With funding agreements, risk transfer is not usually one of the objectives. However, in more complex funding arrangements, the agreement will need to deal in detail with the consequences should various risks eventuate.

Advantages and disadvantages

Funding agreements

The advantages of the funding agreement method are that:

— for simple projects it is relatively simple and inexpensive to negotiate and document

— there is a high degree of standardisation.

Disadvantages include:

— it has limitations in terms of the complexity of project for which it is suitable, particularly for long-term projects

— it involves the government yielding a large degree of control.

Private finance

Properly employed private finance arrangements can:

— uniquely tap into private sector financial and intellectual capital

— provide better services at lower prices to users

— bring delivery of service on-line more quickly.

Private finance can suit projects of higher cost and complexity and which offer opportunities to tap into private sector experience for greater efficiencies.

The two principal disadvantages of private finance are its complexity and cost. Private finance arrangements generally take much longer to negotiate and document than funding agreements. This additional complexity has cost implications for both the government and the other parties. Having said that, a funding agreement that involves project financiers may well involve similar complexity and cost because of the need for tripartite arrangements with financiers and security documentation.

No single approach to infrastructure funding is objectively right or wrong from a legal perspective. Much depends on the objective of the funding, what is being funded, how much it costs and who should pay for it, who is going to use it and who is providing any services in relation to the infrastructure.

In very general terms, it can be said that funding agreements will suit relatively simple and straightforward projects where the government's involvement may cease upon completion and where there are objectives other than value for money involved. Private finance, on the other hand, can suit projects of higher cost and complexity and which offer opportunities to tap into private sector experience for greater efficiencies.

Andrew Miles *has specialist expertise in the areas of property, construction and procurement. He regularly assists clients to identify and manage public sector risk in commercial contracts. Andrew frequently advises on guarantees, indemnities, performance bonds, limitations of liability, multiple entity transactions and the most appropriate structuring for transactions in the government framework.*

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