# Replacement Australian Customs Vessels Project

Review of PPP Suitability Assessment

Australian Customs Service

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Ernst & Young

# 1. Executive Summary

## 1.1 Introduction

Ernst & Young Transaction Advisory Services Ltd (in its capacity as a member of a panel of advisors to the Commonwealth of Australia) has been engaged by the Commonwealth of Australia represented by the Australian Customs Services ("Customs") to provide a Review of its Public Private Partnership: Procurement Options Analysis ("the Analysis") in relation to the procurement of the Replacement Australian Customs Vessel (RACV) Project ("The Project").

On 26 June 2008, Ernst & Young provided Customs with an interim report assessing the extent to which the draft Analysis appropriately addressed the requirements of the Department of Finance and Administration Financial Management Guidance No. 17: PPP Business Case Development (the Guidance). That report included specific recommendations on how the Analysis could more appropriately address the Guidance. On 25 July 2008, Customs provided Ernst & young with an amended Analysis.

The purpose of this report is not to make further recommendations for the development of the Analysis, but rather to comment on the conclusions of the analysis.

In conducting our assessment, we have relied on information provided to us by Customs in document form and through a series of verbal briefings and workshop discussions. We have not sought to verify or corroborate this information.

## 1.2 The Project

The Replacement ACV Project involves the acquisition by the Australian Customs Service of maritime patrol, surveillance and response capability (Mission System). The acquisition of the Mission System will replace the existing ACVs with an enhanced maritime platform to meet required current and future capabilities.

As part of the acquisition activity, the RACV Project will also acquire a through-life-support package (Support System) to provide for the maintenance and sustainability for the Mission System through life.

## 1.3 The Analysis

The aim of the Analysis conducted by Customs is to assess whether or not a Public Private Partnership (PPP) would have the potential to deliver superior value for money to the Government compared to a traditional procurement approach. The Analysis includes:

- A Preliminary Assessment of the Project for high level indicators that the Project is likely to deliver value for money if procured as a PPP (addressed here in section 2: Preliminary Assessment);
- Consideration of how Customs might procure the Project under both traditional and PPP procurement models (addressed here in section 3: Delivery Models);
- A preliminary high level assessment of the project risks and the potential allocation of risks under each model (addressed here in section 4: Risk Assessment);
- Assessment of the potential value for money achievable under the PPP procurement model (addressed here in section 5: Value for Money Assessment); and

- Assessment of the project constraints which could impact the choice of procurement model (addressed here in section 6: Constraints on the PPP Model).

As part of our review of the Analysis, we examined whether provision of a commercial master and crew should be included in the likely PPP model being used in the Analysis. It has been agreed that the provision of a commercial master and crew should be excluded from the baseline PPP model under consideration in this analysis. An executive decision has however not been made on the inclusion or exclusion of this service from any proposed contracting approach. Consequently, if the PPP option is to be taken forward beyond this assessment, then an alternative model including provision of master and crew would need to be revisited for further assessment. This discussion is presented in greater detail in section 3.

## 1.4 Risk Assessment

The risk assessment presented in this report concludes that there would appear to be limited opportunity for additional risk transfer under a PPP procurement approach compared to the Traditional model. The principal difference between the approaches would be the additional financial leverage provided under the PPP approach, and the additional certainty this brings in motivating the private sector to perform as required.

The value of this additional financial leverage with regards to motivating timely delivery might not be as significant as in more complex projects, since it has been suggested that, although the economic impact of a delay would be significant, the probability of a delay is low. This is because the mission system will most likely incorporate standard off-the-shelf vessel design, and that there are well established build times for these vessels.

The assessment presented in this report is based on certain assumptions regarding the ASDEFCON contracting template and the acceptance procedures for new vessels. These assumptions are described in greater detail in section 4.3.

It is acknowledged that there are specific risks in this Project associated with the use of the vessel in hazardous or threatening environments. Risk of loss or damage in these situations would not typically be transferred to the private sector under a PPP. The Project Company would seek indemnities and relief from its contractual obligations if loss or damage occurs in such circumstances. To the extent that certain activities are uninsurable, the Project Company would also seek carve-outs from its insurance obligations.

It should be stressed that Customs will always remain exposed to the consequences of capability risk, and this cannot be changed through the contracting mechanism that is adopted.

## 1.5 Value for Money Assessment

The value for money assessment considers both a review of empirical evidence from previous projects, and a qualitative assessment of the extent to which key value for money drivers are inherent in the project. These drivers provide an indicator of the potential for the project to deliver a superior value for money outcome under a PPP procurement model.

### 1.5.1 Value for Money Assessment - Empirical Evidence

There is growing evidence that privately financed projects can deliver overall value for money for Government. Section 5 considers the empirical information regarding the potential for privately financed projects to deliver value for money. Given the specific nature of the RACV project, the analysis of outcomes achieved on privately financed projects in other sectors provide useful background information, but must be applied with caution.

Customs should seek out similar empirical evidence as to the performance of the ASDEFCON suite of templates in procuring comparable defence projects to validate the expected procurement outcomes under the traditional model.

### 1.5.2 Value for Money Assessment – Qualitative Assessment

The following table presents a summary of the assessment of value for money drivers based on the arguments presented in the Analysis and supplementary discussions between Ernst & Young and Customs.

| Value for Money Driver | Potential for additional VfM under a PPP model in comparison to traditional procurement |
|---|---|
| Innovation | As a consequence of Customs seeking a mature and proven design ,the scope for innovation is limited to production techniques, supply and fitting of onboard systems, supply chain management and obsolescence management. |
| Risk Transfer | There is limited opportunity for additional risk transfer under a PPP procurement approach compared to the Traditional model.<br>The principal difference between the approaches would be the additional financial leverage provided under the PPP approach, and the additional certainty this brings in motivating the private sector to deliver the through life services as required.<br>There may also be potential to derive value from transferring residual value risk. |
| Improved Asset Utilisation | There is no scope for improved asset utilisation from third party revenue under a PPP model.<br>However asset utilisation of the vessels may be improved through the realisation of increased availability periods from improved maintenance activities. |
| Ownership and Management Synergies (whole of life costing) | The contractor is encouraged to take a whole of life cost approach to the project under both models. Customs has stated that under the ASDEFCON templates, the contractor would be held to their proposed lifecycle costs as they would do under a PPP contract. |
| Improved Project Management | A PPP model may improve overall project management as the PPP contractor is subject to increased financial incentives to achieve required performance benchmarks. |

The qualitative assessment of the value for money drivers concludes that there is some potential for a PPP to deliver superior value for money compared with the Traditional Procurement model, however this potential is limited.

It should be noted that the Traditional Procurement Model defined in this report incorporates the ASDEFCON contracting templates. The value for money assessment is based on Customs' representations that these templates would achieve a risk allocation profile very similar to a PPP model. The value for money assessment therefore finds the relative benefit of a PPP model to be less than it might have been if it was being compared to a traditional model which did not have the features of ASDEFCON. The historical performance of ASDEFCON in implementing and enforcing the risk allocation as stated needs to be confirmed to substantiate this assessment.

## 1.6 Constraints

The constraints identified which could impact on the selection of delivery model are:

- Timetable: Under the Traditional Procurement Model, Customs have informed us that the solicitation document is to be completed and released to industry in December 2008, with a view to going for second pass approval by the end of 2009. Under the PPP approach, it could be possible to prepare the tender documents in this time, however it would be preferable to invest more time and resources upfront in developing the specification and draft contract. With this additional investment upfront, it is still expected that a preferred contractor could be selected by the end of 2009. Under this approach there would be less need for further negotiations after selection of the preferred contractor.

- Certification: Customs has identified a requirement for participation in the verification, validation and certification of the baseline functional requirements of the Mission System. Customs' role in accepting a design under both traditional and PPP procurement reduces the potential for risk transfer, hence the potential for a PPP model to deliver enhanced value for money is constrained. This constraint could be managed to the extent that:

  a. An output specification for the RACV can be developed in sufficient detail to address all the project requirements prior to release of the tender documents; and

  b. Completion of the Mission System can be certified by an appropriate expert.

  If both of these requirements cannot be met, then this would constrain on the potential for a PPP to deliver superior value for money.

- Flexibility: Customs and Government may amend the roles and functions of the Mission System during its life to meet new or emerging threats. The full extent of operational flexibility that may be required will emerge as threats to boarder security evolve. If it is found that the operational requirements change to such an extent that it is not feasible to continue with the PPP arrangement, it should be acknowledged that Customs will have the ability to acquire the vessels from the Project Company and step into the through life support contracts. If it is considered, however, that this is a likely scenario and would arise early in the project term, this would diminish the potential for the PPP Procurement Model to deliver superior value for money.

## 1.7 Conclusion

Our assessment presented in this report concludes that a PPP model has some potential to deliver superior value for money over the Traditional Procurement approach for this Project, however this potential is limited.

This assessment is based on Customs' representations that the Traditional Procurement Model would achieve a risk allocation profile very similar to a PPP model. The value for money assessment therefore finds the relative benefit of a PPP model to be less than it might have been if it was being compared to a traditional model which did not have the features of ASDEFCON.

The findings of the value for money assessment would be significantly more robust if supported by evidence as to the risk allocation and contractual outcomes actually achieved on precedent Projects procured under the ASDEFCON templates. To the extent that ASDEFCON cannot be shown to have performed by delivering projects within budget and to timetable, then the value for money differential between the two procurement models would be significantly greater than this assessment suggests.

We note the following project constraints which could impact on the selection of procurement method:

- Customs have stated that the solicitation document should be completed and released to Industry by December 2008. It would be preferable under a PPP approach to spend more time in preparing the contract and output specification prior to calling for tenders. This would mean delaying the call for tenders, however the planned time for second pass approval should still be achievable.

- If an output specification for the RACV cannot be developed in sufficient detail to address all the project requirements prior to release of the tender documents, and completion of the Mission System in accordance with that specification cannot be certified by an appropriate expert, then this would limit the potential for a PPP model to deliver enhanced value for money.

- If it is considered likely that the operational requirements of the RACV are likely to change early in the contract so dramatically such that it is no longer feasible to continue with the contract this would reduce the potential to achieve a superior value for money outcome under a PPP model.

Customs is best placed to assess these constraints and the extent to which they may reduce the potential for the PPP model to deliver value for money.