

VERIFIED VERSION

PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE

Inquiry into Effective Decision Making for the Successful Delivery of Significant Infrastructure Projects

Melbourne — 24 August 2012

Members

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Mr P. Davis

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Witnesses

Mr G. Wilson, Secretary (affirmed), and

Mr P. Sammut, General Manager, Capital Projects (affirmed), Department of Sustainability and Environment.

**Necessary corrections to be notified to
executive officer of committee**

The CHAIR — I declare open the Public Accounts and Estimates Committee hearing on the inquiry into effective decision making for the successful delivery of significant infrastructure projects. On behalf of the committee I welcome from the Department of Sustainability and Environment Mr Greg Wilson, secretary, and Mr Peter Sammut, general manager, capital projects. Members of Parliament, departmental officers, members of the public and the media are also welcome.

In accordance with the guidelines for public hearings I remind members of the public gallery that they cannot participate in any way in the committee's proceedings. Only officers of the PAEC secretariat are to approach PAEC members. DSE staff, as requested by the secretary, can approach the table during the hearing to provide information to witnesses by leave of myself as Chairman. Written communication to witnesses can only be provided by officers of the PAEC secretariat. Members of the media are also requested to observe the guidelines for formally recording proceedings in the Legislative Council committee room and no more than two TV cameras are allowed. Please note that these proceedings are not being webcast.

All evidence taken by the committee is taken under the provisions of the Parliamentary Committees Act, attracts parliamentary privilege and is protected from judicial review. However, any comments made outside the precincts of the hearings are not protected by parliamentary privilege. All evidence given today is taken under an oath of affirmation and is being recorded.

Witnesses will be provided with proof versions of the transcript within 15 working days of the hearing, which are to be verified and returned to the committee secretariat and thereafter will be posted on the committee website. Following the presentation given by the secretary, the committee members will ask questions relating to the inquiry. Generally the procedure followed will be that for questions in the Legislative Assembly. I ask that all mobile phones be switched off or turned to silent, and I now call on the secretary to give a brief presentation of no more than 5 minutes if desired.

Mr WILSON — Thank you, Chair. We have an information pack that I will hand out and ask my colleague Mr Peter Sammut to talk to. Five or six of the slides contain some of the key dates, the features of the project and the contractual arrangements, and we thought that might be useful for the committee to have in hand. I will pass over to Peter for 5 minutes, and then we will take questions.

Mr SAMMUT — This presentation is essentially just to give you a little bit of a feel for some of the key features and some of the things that we think might be relevant to today's discussions. On slide 2 — the page numbering is on the bottom right-hand corner — is a quick outline of the key features. The project is obviously a public-private partnership. It is a 30-year contract. It has a fixed end date, all other things being equal, with the assets handed back over to the state at the end.

The project is obviously intended to provide a rainfall-independent supply of water. It has an annual water-ordering arrangement which is flexible and allows for water to be ordered in set block increments from anywhere between 0 and 150 gigalitres per annum. The quality of the water to come from the plant is to complement the quality of water that Melburnians are used to and that is there in the catchments. It has a two-way pipe — and I would like to talk a little bit about that in one of the other slides — connecting a range of other water authorities to the Melbourne network. The architecture and landscape have been designed to integrate into the coastline. There is a 225-hectare revegetated coastal park as part of the project, with a living green roof on the plant, as you will see in some of the other slides. There is 100 per cent offsetting of operational energy with renewable energy certificates, and there are some features to protect the marine environment.

As shown on slide 3, the project has essentially five major components: marine risers to take the water in and disperse it, long tunnels, the plant with an 84-kilometre pipeline and the power. You can see some general points there under the slide for your viewing later. I wanted to point out that the tunnels are sized for 200 gigalitres, the plant is sized for 150, the pipeline is sized for 200 and the power is sized for 200. Obviously the pipe and power are co-located in the same easement for the bulk of their length and are totally underground.

The slide on page 4 shows the plant at the bottom of the page. The yellow is the power; it is 87 kilometres underground heading to Cranbourne terminal station, a dedicated power supply. The blue on the right is the 84-kilometre pipeline connecting water from the plant effectively into Cardinia Reservoir and into the network at Berwick so that water can enter Cardinia Reservoir or go directly to customers. The instant the plant stops

running for any particular reason — operationally or by way of zero-gigalitre water order — water instantly comes back from Cardinia into the pipeline. Hence essentially we have a two-way pipe, so it is always full of water, allowing people in South Gippsland and Western Port to actually be connected to the Melbourne network and have security of supply, irrespective of whether the plant is running or not.

On the project parties, we provided a version of this slide in answer to the questions, but I will just outline some of the key parties. Obviously DSE is managing the project on behalf of the state government, and the contract is with AquaSure. You will hear the term ‘independent reviewer’ or an ‘environmental auditor’. That is a joint appointment of the state and AquaSure, and it is a joint venture between Davis Langdon and MWH Global. They are providing services to us, which I will talk about later. There is a design and construction contractor, Thiess Degrémont. Then you will see that Degrémont takes the lead with Thiess Services in the operation and maintenance phase, and a whole range of other parties are involved in the actual construction, design, design reviewing, proof engineering and various other aspects of the project.

On slide 6 we have a timeline of how the project progressed through its development phase and delivery phase. It is probably too complex to point out or elaborate on too much here, but suffice to say that there were multiple work streams progressing concurrently. The project had to comply with all environmental approvals. There were no exemptions from having to do environment effects statements, and it was also a controlled action under the commonwealth Environment Protection and Biodiversity Conservation Act.

The blue box on the left is when the project was announced. Sitting underneath it in the sort of orange colour is the tender or bidding process, and the project went from being announced to having an expression of interest invitation released within a year. Essentially within about a year after that it then reached what we call contract close, where the successful bidder was announced, with all of the environmental approvals and various other processes required as per the Partnerships Victoria policy, business cases and so forth. There was a debt syndication process, which I might talk about a little bit later, and then of course the construction phase. The project is now in the completion phase and commissioning phase and is actually being tested, and part of it is already running.

The next slide, slide 7, is essentially a snapshot of what we have on our website. These are the documents that have been released on the project. In my something like 30 years of experience they are more than any other project that I have been involved with, and my project team members say a similar thing. Something like 18 000 pages of documents and a whole host of other things, including the project deed, which is the contract with AquaSure, have been on the website since 2009. I will not cover the approval slide, but we had to obtain approvals under a whole range of acts.

With the contract, AquaSure is financing, designing, constructing, operating and maintaining the project. It is not like a design and construct contract or an alliance contract where you make progress payments during construction. They are fully financing it. The payment by the state is linked to the service. The service has not yet been delivered. The service is soon to be delivered, and the payments are linked to that service. No payments have been made to date to AquaSure, and there has been no cost increase to the state from the cost of the project as announced in 2009. In fact the overall contract costs have reduced due to the obvious program change.

There is a two-part payment mechanism. There is a water security payment and a water usage payment. The water security payment is for having the plant available and ready to deliver water if ordered and being kept in a ready state, and the water usage payment is for the water that is ordered when ordered.

Just maybe the last slide, actually. The committee asked some questions about initiatives. We just picked five. I will not elaborate much, because I think we covered them in our responses to the questions. There are five I have highlighted. The first is having a performance-based environmental assessment; it was the first of its type here in Victoria to my knowledge and to the advice of DPCD, and it has been very successful from our perspective, from the regulator’s perspective and also from the perspective of the private sector. The second is adding an environmental auditor to the traditional independent review role. The third is having done extensive marine and terrestrial investigations to allow the private sector to minimise, if you like, risk uncertainty pricing. Fourth is the temporary support for the debt syndication process. That contract closed, and there was a funding gap of about \$1.7 billion. There was a temporary Treasurer’s guarantee. It was for three years. The debt syndication process was 50 per cent oversubscribed in three months, extinguishing the need for the Treasurer’s

guarantee and ensuring that the project was fully privately financed, for which the project actually won 14 national and international awards. Finally there is something we have touched on at this committee before, which is the quality certified project management systems. We think that is a good initiative. We continue to do it, and we now have these systems for the operational phase of the project as well.

The CHAIR — Thank you. Thanks very much to both our witnesses for their attendance today. Just to recap, the purpose of this hearing relates to the broad issues that the committee is examining in regard to major infrastructure projects, and we are interested in issues of accountability, transparency and relevant skills, and capacity to derive an understanding of lessons learnt. Obviously the implementation of this PPP is not yet complete, but at the same time there are many matters that are worthy of the committee's consideration.

I want to acknowledge, before we go too far, the quality of the submission in relation to the questionnaire. I thought it contained a lot of very helpful information and will inform the committee's consideration. The way I intend to proceed with this session is that I intend to ask a number of questions to try to develop an understanding and awareness about some of the matters that are of concern to me as chairman, and then I will throw it to my colleagues. They will robustly, I am sure, examine some detail.

I am interested in something which would probably seem to the parties involved in managing this project to be quite transparent but continually arises as a point of confusion because different numbers are quoted in different publications. You know exactly what I am referring to, by the nodding of heads. In terms of the total project cost, to summarise — I think if we just use one standard term, it might be easier for the committee's examination and transparency. The standard term perhaps best used is 'net present cost to government' because we know what that number actually means. That, in your submission, is 5.72 billion. My understanding is that that excludes a further 308 million at present cost, which is in effect the project team cost, which has not been yet fully drawn. I think about two-thirds of it has been drawn but there remains just under 100 million yet to be drawn. That obviously gives us a total net present cost to government — which is not quite true, is it, because it is actually the Melbourne Water ratepayers who will be making the majority of the contribution to that — and a net present cost to Victoria of 6.1 billion if you add those two sums together. Is that correct?

Mr WILSON — That would be close — 5.72 plus 300 million.

The CHAIR — Three hundred and eight.

Mr SAMMUT — Yes.

The CHAIR — So 6.1. I just want to get a number around so everybody can be clear. That is the total quantum of the project. There are two components, being the payments which relate to the project and to the partners in the project, and the cost to the government of actually managing the delivery of the projects.

Mr SAMMUT — That is right.

Mr O'BRIEN — This is assuming the maximum amount of water has been — —

Mr SAMMUT — That is right. 5.72 billion net present cost is based on 150GL being ordered each and every year.

The CHAIR — Yes. That is the envelope, and in your evidence and in relation to the submission you make it clear that the longer it is before the project is actually delivered, the sum will reduce because there will not be any water delivery. Therefore the cost of any water, potentially, will be deducted from the total sum paid.

The other issue I want to get to in talking about the costs is: in addition to the delay in the payment schedule because of the deferment of completion, are there any penalties? I have not seen any reference to actual penalties for late delivery. Are there any penalties in the contract in addition?

Mr SAMMUT — No. The concept of penalties does not apply to public-private partnerships, because it is not funded during construction by the state.

The CHAIR — I am just trying to draw this issue out for clarity because it is a question that is often asked. So the maximum potential cost of this project is the total 6.1 billion less the cost we have just referred to.

In relation to the project team, which is referred to on a number of occasions, one of the issues we have identified in the course of hearings over the last few days particularly has been that one of the features that marks unsuccessful delivery of a project is that progressively it becomes an orphan because there is a lot of churning of project teams. Indeed on several of the projects we have examined there is nobody presently effectively responsible and therefore accountable for the delivery of those projects left standing, as it were, who was part of the original project team. Could you just advise the committee, for its information, of those who were part of the project team from inception, when the project was announced in 2007? Is anybody left on the team? Are they all on the team? What is the composition of the project team?

Mr SAMMUT — Certainly I have been there since the project was announced. I am still here.

Mr WILSON — That is the important one for me, Chair, if I can just add.

Mr SAMMUT — We have had relatively small turnover. I would say, if I had to estimate, that three-quarters of the team are still here from when the project was initially formed, and we are intending to be here long term because, as you rightly point out, often when projects transition from the design-and-construct phase to the operations phase they can lose personnel. In actual fact we have an agreement in place between DSE, Melbourne Water and the Minister for Water that DSE will continue to manage this contract through to the end of the project term, so we are actually just transitioning the same team we have now into an operations team using primarily the substantive employees to be there to manage the operations phase of the project. So we will have continuity.

The CHAIR — Good. A slightly tenuous but related question which goes around the establishment of the, if you like, project team — if you can flesh this out for me a little bit, because I am a little confused by the submission and other information in terms of the timing of events. For example, on page 2 there is reference to the completion of the business case. On page 2 of your submission you refer to the two shortlisted bidders and the announcement of the successful bidder, and then further on you say that during the two-year period between announcement of the project and award of the contract lots of work was undertaken, including the completion of a business case. I go to the issue of the business case because, again, the evidence to this committee during the course of this inquiry is that projects have typically failed to meet government expectations because there has been inadequate business case development. I am a bit perplexed about the way this is expressed. It is as if, ‘Well, we decided we were going to do this and then we decided to create a business case after the fact of making a decision’. Is that a correct interpretation or an incorrect interpretation, and would you like to go through the sequence? The reason I deliberately asked who was part of the original project team is that I am assuming that the project team was involved in all of the steps in terms of the carriage of the decision-making process? Could you tease that out for me, Mr Sammut?

Mr SAMMUT — Preceding the announcement of the project in the water plan in 2007 was a feasibility study conducted by Melbourne Water that ran for something like six to nine months. That feasibility study was completed. The project was announced in the water plan. The water plan indicates an intention to deliver a desalination plant. It indicates that the size of the plant was intended to be 150 gegalitres, but that size would be retested in the context of better supply and demand analysis and would be confirmed before an expression of interest was released. As you know, under public-private partnership policy in Victoria PPPs are strictly regulated in terms of having to go to get approvals at key steps during the procurement. The business case essentially built on the feasibility study that was conducted by Melbourne Water, and then looked at what form of procurement would have been the most suitable form of procurement. It then completed the traditional public interest tests, value-for-money tests and all of those prescribed tests.

As the project developed, things like the size of the project were reconfirmed. The form of delivery was reconfirmed. I think the form of delivery was announced in September 2007. We have a time line on our website. Then all of the other subsequent processes followed the PPP guidelines for ensuring that expression of interest documents were endorsed before they were released. Everything happened in what you would argue to be the normal way. It required a lot of concurrent and hard work, but that did not mean that the analysis was not still comprehensively completed.

The CHAIR — I have one further matter which relates to the deliberative stage, in which you have clarified that the project team was involved in all of the steps in effect. You might be able to make some observations about this. There has been some commentary. I refer specifically to some commentary about the two short-listed

bids which I saw in the *Business Spectator*, which comments on Leighton and what I would describe as the commercial context. What I found interesting, which I did not really understand prior to seeing this article — —

The article by Robert Gottliebsen in the *Business Spectator* of 12 March states:

In the desalination plant tender, Leighton subsidiary John Holland submitted a bid that was lower than the bid submitted by another Leighton subsidiary, Thiess. But the Brumby Victorian government chose the higher Thiess tender partly because of the relations it believed Thiess had with the building unions.

That may or may not be the case — it is a publication — but in terms of the evaluation of the bids, is it a fact that one bid was preferred to the other notwithstanding the competitive price of the bids?

Mr SAMMUT — The evaluation process takes into account a range of criteria. Those criteria are clearly communicated to both bidders as part of the expression of interest documents and as part of the request for proposal documents. The job of the evaluation team is to determine which proposal offers the best value for money against the evaluation criteria. This is how PPPs are always assessed, and that process was followed. We ended up selecting the one that offered us the best value for money overall against the project objectives, which were project objectives that were endorsed by the government for this project.

The CHAIR — Just so I am clear about it, in this context your evidence in effect is that the criteria was value for money, and in this sense if the commentary in the media is correct, then value for money took in a fairly subjective factor, which is a perception about relations with unions rather than simply dealing with the raw numbers in relation to cost? Is that a fair summary or not?

Mr SAMMUT — No, not really. That would be to oversimplify the evaluation process.

The CHAIR — That is what I am trying to do.

Mr PAKULA — Really?

The CHAIR — I am trying to simplify it so that it is clear to the public rather than just — —

Mr PAKULA — You are trying to simplify it to create a false impression.

The CHAIR — I am asking the questions.

Mr SAMMUT — The Partnerships Victoria policy requires the publication of what is called a project summary. All PPPs have this, and I think it is required to be published within three months of financial close. We published that summary in late 2009. In appendix 3 we included the evaluation criteria that were used. It is the project team's job to look at each aspect of the project against those evaluation criteria and compare the bids from the short-listed bidders. The actual evaluation structure was also released in the project summary, so we outlined the architecture of the evaluation structure. But you have evaluation criteria that range from technical through to environmental management, commercial structuring, community involvement and stakeholder management, financial, OHS and industrial relations, and I only have touched on a few. There is risk-adjusted cost, which is what you discussed, conformity with the request for proposal, compliance with the Victorian industry participation policy, probity and conflicts of interest and so forth.

You need to assess the bids against each of these criteria and compare them. What we released in the project summary was a total cost of the winning bid of \$5.72 billion. Public-private partnership policy does not include the state costs, because you are trying to compare what the state thought it would cost for it to build it versus what the private sector bid said it would cost for it to build it. We estimated the NPC to be \$6.7 billion; the winning bid was \$5.7 billion. That was a \$1 billion value-for-money saving — something like 14 per cent — and we thought that was a good deal.

The CHAIR — That is a slightly different perspective than the matter I was raising, which is the weighting that was given to the judgement around the relationship with the unions between the two bidders, but that is fine.

Mr PAKULA — I am grateful to you, Mr Sammut, for your clarification on the government's ongoing attempt to swift boat the project.

Mr O'BRIEN — Is that a question or a comment?

Mr PAKULA — Yes, there is a question.

Ms HENNESSY — Mr O'Brien, we have had an enormous amount of speeches from you.

Mr PAKULA — Without naming any individuals, I think it is fair to say that some of the commentary out there in the public domain about this project has been that either it should not have been built, or a dam would have been preferable. Then the alternative view being put about is that if a desal plant had to be built it should have been a much smaller desal plant of 50 gegalitres, or something of that nature. You have given us some evidence about the feasibility study that was conducted by Melbourne Water and about the business case that was done by DSE and the like. I would be interested from a broad perspective, Mr Sammut or Mr Wilson, if you could just take us through the modelling that was done, to the extent that you can talk to us about Melbourne Water's work, whether it be weather modelling, population modelling or industrial modelling that led to the decision to, firstly, build a desal plant rather than something else, and secondly, to build a plant at 150 gegalitres rather than one of a smaller capacity. If you could take us through that I would be grateful.

Mr O'BRIEN — Can we clarify — —

The CHAIR — No, Mr O'Brien. Mr Sammut to respond.

Mr SAMMUT — I cannot elaborate on that because we did not do any of that work. We are the infrastructure deliverers. We were there to deliver what the government had decided for us to deliver. We work on the inputs we provide and the inputs you would expect an infrastructure deliverer to provide. In terms of supply and demand analysis I know that work was done, obviously, but I cannot really comment on it because we had no key input to it from a capital projects division perspective.

Mr PAKULA — Was the modelling work you talked about primarily done by Melbourne Water rather than by DSE?

Mr SAMMUT — Yes.

Mr PAKULA — The other point I just wanted to go to is that you made some comments before about how the cost of the project has not changed government. You said, I think, it has gone down as a result of the fact that the plant is not up and running yet. You have given us the two figures: the \$1 billion difference in the PSC and then in response to Mr Davis's question I think the 6.1 NPV. Can you tell us how much has come off that already to this point in time as a consequence of the fact that the plant is not yet up and running?

Mr SAMMUT — Yes. It is difficult to quantify precisely at this point in time. The reason I say that is that it depends when the completion milestones are actually reached. Obviously they are in the final stages now, approaching reaching the milestones. The payments do not commence until you reach what is called the first milestone, which is preliminary commercial acceptance, when you have at least 50 gegalitres available. That is an optional milestone under the contract. You could skip that and go straight to what is called commercial acceptance, which is when 150 gegalitres is first able to be supplied. The payments then would not commence until commercial acceptance.

Commercial acceptance is a mandatory milestone. It was scheduled for 19 December 2011. It is public knowledge that this is now scheduled for 15 November this year. That is a program of course. I am sure AquaSure are trying hard not only to meet that but probably even to better it. That is still really subject to how they progress through the commissioning process and water payments by the state and revenue for AquaSure prior to them meeting the final completion milestone, which is called reliability testing finalisation, after they have passed a test where the plant runs for 30 consecutive days at maximum capacity, at 150 gegalitres. That is presently scheduled for the end of February 2013. Again AquaSure I am sure are trying to better that. But the payments by the state prior to what we call reliability testing finalisation is a prescribed formula with two variables — the time between the milestones and the amount of water produced between each milestone — and of course we do not know that.

After reliability testing finalisation it is pretty much an easily calculable thing because it is essentially the proportion of the remaining days in the financial year divided by 365 times the water security payment, given a

zero gigalitre water has been placed for the first year. So it is a little bit hard to determine at this point in time until the plant actually reaches some of these milestones and starts producing water.

Mr PAKULA — So you do not have a running tally?

Mr SAMMUT — In terms of?

Mr PAKULA — Ballpark?

Mr SAMMUT — It looks like several hundred million, at least.

Mr PAKULA — Several hundred million.

Mr SAMMUT — If I had to make an estimate, given we do not know when the milestones are precisely going to be reached and they have not been reached yet.

Mr MORRIS — Just a quick inquiry, if I may, before I get to a substantive question. I just had a quick look at the feasibility study from Melbourne Water dated June 2007. When was it released?

Mr SAMMUT — Then.

Mr MORRIS — It was released in June 2007.

Mr SAMMUT — Yes, June 2007.

Mr MORRIS — I know it was referred to in *Our Water Our Future*, but the document was actually available?

Mr SAMMUT — Yes, it was. I believe it was published at the time of the announcement of the water plan. It may have even been, if it was not on the same day, around about then.

Mr MORRIS — Moving on from Mr Pakula's point, perhaps we could explore a little bit the actual payment mechanism once it actually starts happening. The security payment is obvious, but I would also be interested to know how that works, particularly in relation to the various levels of orders that might be made over a year, whether the order is for 20, 50 or 150 gigalitres.

Mr SAMMUT — You are correct in saying two components, which we covered before, so there is a water security payment. The water security payment is effectively an availability payment; it is like an availability payment scheme in a public-private partnership. What the payment structure does is it avoids what I would paraphrase as all of the avoidable costs. It is not a take or pay; it does not require water to be produced from the plant. It essentially says to AquaSure, we will pay you a security payment provided the plant is successfully commissioned, has been tested to produce water to the right quality and to the right quantity during the tests and is maintained in a ready state such that if a water order is placed you are able to deliver on that water order when required.

Mr MORRIS — Essentially it is a stand-by payment — —

Mr SAMMUT — Yes, it is.

Mr MORRIS — Plus obviously a return on their investment.

Mr SAMMUT — Yes, it is. It is also at risk though. Let me give you an example that may help to illustrate this. If a water order of, just for the sake of illustration, say 150 gigalitres was placed, if only 100 gigalitres was delivered, that means only 100 over 150, or two-thirds of the water security payment would be paid to AquaSure. So it is at risk; it means the plant must be kept in a ready state and is subject to the plant performing. The water usage payment then is a variable cost which changes depending upon what water order is placed. That allows AquaSure to factor in those costs associated with producing water into the water usage payment and hence for the state not have to bear those costs if the water is not ordered. Those costs were also released in a matrix form for every water ordering option under the contract and for every water ordering year through to 2039. That table of costs was released in February 2011.

Mr MORRIS — And the increments?

Mr SAMMUT — If you move from a zero-gigalitre water order to, say, a 50-gigalitre water order, the difference is about \$25 million for 50 gigalitres, so it is about 50 cents a kilolitre. If you move to 150 gigalitres, it is about \$109 million and in round terms about 70-something cents per kilolitre incremental cost.

Mr MORRIS — And the quantum of the base payment?

Mr SAMMUT — The water security payment for the zero-gigalitre water order is \$654 million in the first year.

Mr MORRIS — Presumably the escalation formula for that will rise each year, or is it a fixed sum?

Mr SAMMUT — That is factored into the table that has been publicly released already. They are nominal dollars allowing for escalation, inflation.

Mr MORRIS — I am just trying to make sure we understand the detail, because I am not personally familiar with the table; our secretariat may well be. But if I go to look at the table later on and I do not have you in front of me to provide the answers, it will be somewhat challenging.

Mr SAMMUT — I do have it somewhere.

The CHAIR — Could I just intervene for a moment on the issue Mr Morris is raising? It is not clear to me what the consequence of a failure to maintain the water security is in terms of the financial impost to the contract. Let us assume that there have been zero water orders for the first year, then we go into a further period where the government wishes to order the maximum available amount of water and there is no water able to be delivered for a period. Just to use a case study, what would be the difference in the cost of the contract in relation to a failure to deliver for a month versus a failure to deliver for a year? The inference I drew from your evidence was that it is in effect a pro rata cost, but presumably the contract protects the state for a gross failure in the capacity to deliver — that is, for the security. How does that actually work? What is the penalty?

Mr WILSON — Like for an extended outage?

The CHAIR — Yes, for an extended period.

Mr SAMMUT — The payments are made monthly. Not all service payments are made monthly; some are made quarterly. The payments on this contract are made monthly. You are correct in saying the ability to deliver on the water order is measured on an annual basis. The payments are actually made based on the performance at the time. Of course it depends on what water volume you are ordering. If you are ordering 50 gigalitres and you have a plant of 150 gigalitres capacity, you may have some issues for a short period of time but be able to make up the supply during the balance of the financial year. Effectively that means you have delivered on what the government required, because we do not mandate when the water must be delivered on a month-by-month basis. The reason we did not do that is, if you like, to capture the value for money in terms of the operator optimising things like when they run the plant, at lower price electricity times and so on and so forth. So we were not prescriptive. We were trying to capture innovation and trying to capture for each discrete water ordering option the best actual value for money. Obviously when the plant is running at 150 gigalitres, because of a 150-gigalitre water order, it has about 7 per cent reserve capacity. Essentially it has to pretty much run all the time, but if it is a lesser water order it gives you a greater ability to be able to make up water.

Mr WILSON — Within the year.

Mr SAMMUT — Within the financial year.

The CHAIR — That is clearer.

Mr SAMMUT — I hope that explains that.

The CHAIR — Yes, thank you.

Mr MORRIS — Just a quick question on this, because that table is helpful. When we actually get to 2039–40 obviously none of us are going to be worried out it too much, but it is a 150 gegalitre take in that year worth \$256 million. Is that adjusted for CPI?

Mr SAMMUT — Yes, it is. Nominal dollars are dollars of the future year. Real dollars are dollars of today. The water security payment is not constant; it varies a little bit. As you can see in the tail end of the term, it drops.

Mr MORRIS — So effectively we are saying that is the present cost if CPI between now and 2040 were zero, which of course it is not going to be, but if it were?

Mr SAMMUT — No. First we calculate the dollars in each year of payment. They are called the real costs. We then escalate those according to the CPI, and those numbers grow to reflect inflation.

Mr MORRIS — So these are the forecasts?

Mr SAMMUT — They are the nominal dollars, yes. Then each of those nominal dollars is discounted at a set cabinet-approved discount rate for each project under PPPs to determine the net present cost that we started the discussions with.

Mr MORRIS — But in terms of what the state is actually obligated to pay in 2039–40, the figures here are, as I understand you, the anticipated payments, but presumably the actual payments are calculated on the real CPI.

Mr SAMMUT — No, they are the payments that we expect to make. If we were in 2039 today, we would be paying those dollars.

Mr MORRIS — We would be paying — —

Ms HENNESSY — Actuals.

Mr SAMMUT — Actuals, yes.

Mr MORRIS — One thousand and eight — \$1 billion.

Mr SAMMUT — Yes, because of course the value of money moves over time.

Mr MORRIS — That is what I am trying to get to. If CPI gets totally out of control and the agreed forecasts prove hopelessly wrong, then it is to the advantage of the state, whereas if CPI flatlines it is to the advantage of the contractor.

Mr WILSON — We plug the CPI figure in when it is known.

Mr SAMMUT — We have to plug it in when it is known. All PPPs work that way. Nobody can take CPI risk forever.

Mr MORRIS — But the job of the committee is to establish how it works.

Mr SAMMUT — Yes. That is how it works. There is an assumption in those numbers of ongoing CPI, and the actual payments might vary a little bit around that. It could be a little bit lower. We are generally conservative in the number we put because we are actually trying to represent the maximum cost. As was said, the right-hand column and the \$5.72 billion that we commenced discussions with are only around the 150-gegalitre water ordering column. So it is taking all of those nominal payments in the right-hand column and discounting those at the 7.3 per cent real rate to achieve \$5.72 billion. If you ordered zero gegalitres, obviously the net present cost reduces — the Auditor-General reported on this — by something like \$1.26 billion, or some number similar to that.

Mr WILSON — You are correct in the sense that they are forecast nominal payments, based on the formula in the contract, where you plug in a CPI estimate now and if in — —

Mr MORRIS — But when it comes time to pay it, the actual CPI is plugged into it.

Mr SAMMUT — Yes.

Mr MORRIS — Okay.

Mr WILSON — And water prices to the end consumers work in that way as well: the CPI minus an x-factor percentage determined by the Essential Services Commission. Inflation always is what it is on the day, and that is plugged in at the time.

Mr SAMMUT — Yes.

Mr MORRIS — I was just trying to establish whether there might be some huge variation one way or the other into the future. But that is useful. Can we hang onto that?

Mr WILSON — Yes.

Ms HENNESSY — Mr Sammut, I just wanted to ask you a question around the decision around the procurement model to do this project as a PPP. I was wondering if you could just talk us through what the public sector comparator was at the time and what additional costs taxpayers might have borne if this project had been done as a straight D and C.

Mr SAMMUT — We built the public sector comparator based on what we thought would be the most appropriate form of state procurement. We had selected a design-and-construct type of delivery form. In determining the delivery mechanism or the preferred form of procurement, whilst you actually calculate the public sector comparator and have that there as your benchmark, when selecting which procurement option you think is going to offer the best value for money you look at a range of factors, and one of them — I believe we discussed this briefly at the previous appearance — is whether the service output can be clearly articulated and whether you could link payment to service.

If you have projects where you cannot link payment to service, where the scope is likely to change significantly during the course of delivery, or where the risks cannot be clearly allocated up-front, often they are not the characteristics of a public-private partnership. But we felt here that we could link payments to the delivery of service and make payments only if we actually receive what we ask for and allow AquaSure, or both bidders at the time, to innovate as to how they actually achieve that. That of course was ultimately tested through a bid process and we ended up with the results that we ended up with.

It is probably also worth pointing out that the payments that you see in that table are now, if you like, locked in, and they were calculated or derived from the original capital cost that was bid, which was just under \$3.5 billion. The service payments have not changed. It is in the public domain as to the rising capital costs for the private sector on this project, but the service payments have not changed: they are still originally based on the capital cost as bid and thereafter detached from what the capital cost as bid was, if you can understand what I am saying. People bid the capital cost. They bid the operations and maintenance costs. They bid all of their financing costs. It is aggregated, turned into a set of service payments and then detached from the capital cost of the project, so the state is not bearing those consequences at present.

Ms HENNESSY — Consequences. So all things being equal, if you accept the assumptions that were made at the time that the public sector comparator was done, that would enable you to identify what the cost savings to the state and/or the taxpayer are by virtue of using the model that was used.

Mr SAMMUT — Yes. It gives you a quantitative mechanism to be able to satisfy what is called the value-for-money test in one of the Partnerships Victoria core tests. The value-for-money test is an absolute test and it must be passed; you must have positive value for money to be able to proceed with PPP procurement.

Ms HENNESSY — Often we have been talking about how it is that we have the concept of the public interest protected either through the procurement model or the contractual arrangements. Do you have any comment to make about how the public interest is protected by the contractual arrangements at a general level?

Mr SAMMUT — Again, that is another mandatory test. We have to articulate that as well, and we did. The project summary, which was released in 2009 and which I think is included in our response to the committee's questions, actually contains a series of tables showing how we have discharged our responsibilities under the public interest test and how that is being met.

I could go through elements of that if you wish, but it is actually in the response to the committee's questions. It covers a whole range of things in terms of how we release information to the public, in terms of protecting the interests of the state by way of the robustness of the contract and the way we would consult and engage with the community during the development of the project. There are a whole series of elements to that.

Mr ANGUS — I too want to look at the issue of the public sector comparator. I refer you to page 10 of your submission, where the tables are contained. Who prepared those calculations?

Mr SAMMUT — We did, the state — DSE.

Mr ANGUS — DSE?

Mr SAMMUT — Yes.

Mr ANGUS — Has Treasury got a role in that?

Mr SAMMUT — They are always involved in these things.

Mr ANGUS — So — —

Mr SAMMUT — To articulate that a bit better, the state project team has to build the public sector comparator. That has a lot of inputs to it. It is about assuming a form of procurement, so you then have to start to develop a reference project that is essentially the state's vision of what the project will look like, what the project's scope should be. So you essentially start to build up your own estimate as if you were to deliver this project yourself — just the same as if we were actually delivering a design-and-construct contract and producing the state's estimate for that. So, if you like, we develop the tunnel designs, the plant designs, the pipeline designs and the power designs, and we look at what the quantities and rates for those would be.

We then go through the classic Monte Carlo simulations for risk assessment, looking at probabilities of risks occurring and the likelihood of those occurring and the costs range. You then start to look at risk particularly — and you have to quantify risk — and it gets put together, and then it goes through a very exhaustive process of the state getting comfortable that it is the right estimate for the scope of the project, and there would be normally a myriad of reviews that go on as part of the state preparing the public sector comparator. It is Partnerships Victoria policy that the public sector comparator must be approved by government at a set stage in the procurement process.

Mr WILSON — The Treasury input into that is pretty strong in terms of the scrutiny of that work as it applies to Treasury itself.

Mr SAMMUT — Yes.

Mr ANGUS — In terms of the front end — all that quantification you just referred to — you have basically got experts within your own ranks, have you, that have the ability to cost out a project like this?

Mr SAMMUT — Yes, we have, as you do on these large-scale infrastructure projects. You will have a core government team, and you need that in terms of making sure that the work that is prepared for you is appropriate, and you will have a range of advisers, typically technical and engineering advisers, you will have commercial and financial advisers, you will have legal advisers, you will have cost estimators — all of those people have a role in the build-up of the public sector comparator. I guess different teams do this in different ways — it is not a prescribed formula for how you review it — but we certainly went through a range of internal processes to thoroughly review that, to test every element of it using our own experiences on top of advisers' experiences to make sure that that public sector comparator is right.

Mr ANGUS — So the costs associated with that, are they included in that \$308 million of your team?

Mr SAMMUT — Yes.

Mr ANGUS — In terms of the transferred risk, which on that table is the figure \$782 million, can you just tell me what the basis of that is? You referred to it in passing a moment ago. Could you give me a bit more information on it?

Mr SAMMUT — The public sector comparator has two components essentially. What are called the raw costs — and you will see them identified in the table and summarised on the third row — is made up of the raw capital cost and the raw operating and maintenance costs in net present cost terms. Then there are the risk adjustments, and they are pooled and they fall into two categories — they are either transferred risks or retained risks. It is essentially taking out the straight quantities and estimates in the raw public sector comparator line and then separating it from the risks and documenting all the risks and identifying them separately and then aggregating the two numbers. So you look at the raw quantities, rates, aggregates of just pure quantities and rates for every element of the project, but then you look at risk and all the elements of risk: design and construction risks, operation and maintenance risks, risks that quantities are not right — all sorts of things. As part of the process you actually have to quantify those, and there are tools that you can use and that we use to do that.

Mr ANGUS — Right, so there is like a schedule or multiple schedules that add up to that figure.

Mr SAMMUT — Yes.

Mr ANGUS — And who holds that? You have got that?

Mr SAMMUT — The public sector comparator is a document that exists in its own right.

Mr PAKULA — I want to get a better understanding of the water security payment. The way it was described, it was a payment to keep the plant maintained and available to supply water, and then there is the water drawing payment. But obviously in one of those components is a payment to the builder for the costs of construction. Is that in the water security payment component?

Mr SAMMUT — Yes, it is.

Mr PAKULA — Right, so is that, if you like, the lion's share of the water security payment — the actual payment for building the plant?

Mr SAMMUT — The bulk of it will be for the plant having been designed, built and financed.

Mr PAKULA — Right, okay. In some respects it is portrayed as unusual to have a payment even where no water is drawn, but when it is put in that context where it is in part a payment for, as you say, designing, building and maintaining the plant, how in a conceptual sense is it different from, for instance, government borrowing for and paying for building a dam, for example, and perhaps not drawing water from the dam for a period of time? In some years you do not draw from the Thomson. If you are paying to build any other water infrastructure, let us say a dam, and do not draw water from it in a particular year, is that actually any different from a water security payment in a year that you might not draw water from a desal plant?

Mr SAMMUT — Conceptually, it is not different. Maybe if I could just draw another analogy. If you took Southern Cross station's availability payment scheme to make the station available, it is really no different from what is happening here. The only difference here is that, unlike the plant, the station is used on a day-to-day basis, but the whole premise of the plant is that you are actually trying to replace a natural resource. There might be times when you need it; there may be times when you do not need it. There is no other payment mechanism that you could adopt that would have attracted private finance. It is not bankable. The project cannot be built and the private sector receive no revenue. It is making the plant available; it is taking risks to finance the plant, to design and construct the plant, to have it available and ready to deliver water.

Think of it more as the payment could have been including some delivery of water as well, but it did not. The payment could have been based on assuming that the plant constantly runs at a set production. We have excised that to the bare minimum, which is saying, 'Well, surely if the private sector is prepared to take the risk of financing the project, designing and constructing it, keeping it in a ready state, that plant is available to the state'. It is ready to deliver water to the right quantity, to the right quality. It is subject to certain tests during the year as well — called capacity test responses — where you come in and test that the plant is actually ready. In our view the payment mechanism could not have been any more efficient, because it avoids the avoidable costs.

The only difference here is that it is a facility that, simply because of the nature of the service that it is providing, is offset by water that is currently in the system. Unlike the station or a piece of road infrastructure,

where you construct it and there will be users for it always, even if there may not be as many as you expect or there may be more than you expect, the unique nature of this project really meant that the two-part payment mechanism allows all of the avoidable cost to be avoided and water users to bear the absolute minimum costs possible to be able to hold it in a ready state.

Mr PAKULA — Unless you did not build it at all.

Mr SAMMUT — Unless you did not build it at all. Once the decision is to build it, then we tried to optimise the payment mechanism.

Mr PAKULA — Coming back to the question I asked at the outset, you said there was a feasibility study done by Melbourne Water and then the water plan and then more work done. You said the water plan said 150 but subject to further testing. That further testing — would the DSE play a role in that?

Mr SAMMUT — Yes.

Mr PAKULA — So are you able to comment on that part of your work in terms of the sort of proving up the 150 gig decision rather than the decision to do something smaller?

The CHAIR — Is that the business case that we referred to earlier?

Mr PAKULA — It is the bit that came after the announcement of the water plan.

The CHAIR — Which is the business case, I take it.

Mr PAKULA — Yes.

Mr WILSON — Which is the lead-up to the expression of interest that was approved by cabinet.

Mr SAMMUT — There would have been — —

Mr PAKULA — Can you just take me through the work that DSE did, and the sort of inputs into the decision to sort of tick off on 150 as a size?

Mr SAMMUT — Yes, our input would have been around project costs — the equivalent of what the public sector comparator would have looked like for each size of option that people were contemplating, and procurement-type related impacts; not supply-demand, not what size, but what would be the impacts if a particular size were selected.

Mr PAKULA — If the committee wanted intelligent evidence about supply-demand modelling, modelling at the time and modelling going forward, we would have to talk to Melbourne Water. Is that the take out from this?

Mr WILSON — Certainly it is their job to look at scenarios of inflows, water demand and so on and those outlooks, which would be in water supply demand strategies and so on. More detailed analysis, I guess, would have been stuff that would have gone to cabinet throughout that year in settling that cabinet decision on the expression of interest, so we will need to check what is available for the committee.

Mr PAKULA — No doubt they would have ongoing modelling as well.

Mr WILSON — Yes.

Ms HENNESSY — We went to WA, which of course made the mistake of building their desalination plant too small to begin with, so just in terms of how you test the robustness of the sizing — —

Mr WILSON — There was a central region water strategy, and there was a range of work being done, as you would expect, after. When I left the department in 2005 it was eight years of drought and everyone thought that would be it, but it seemed to keep going. So a lot of attention was paid and a lot of work done in that space by Melbourne Water particularly as the supply body, but others as well.

Mr SAMMUT — There was a strategy that was released in 2006 that even preceded the feasibility studies. They are ongoing water strategies.

Mr PAKULA — I understand.

Mr WILSON — The central region sustainable water strategy.

Mr PAKULA — We can go back and look at the feasibility studies. If we wanted oral evidence and detail, we could speak to Melbourne Water.

Mr SAMMUT — The central regional sustainable strategy would be publicly available somewhere.

Mr O'BRIEN — This needs a bit of context. That is why I interrupted Mr Pakula before. Not all of the cabinet submissions and the key assumptions as to water availability expectations and demand usage were publicly available at the time, were they? Certainly I do not know what has been released now, but it is not as easy to say that it is all available on those key assumptions, is it?

Mr WILSON — Certainly we could find out what is publicly available, but I am not sure. I was not in the department at the time it went to cabinet, but we can have a look at what was available.

Mr O'BRIEN — I would just like you to be very careful. I do not want you to inadvertently mislead the committee or the public. I just want you to clarify what assumptions are publicly available and what were at the time.

Mr WILSON — Just to be clear, what I am saying is that I do not know what went to cabinet and what did not, but we can find out what was public, and the committee ought be to be able to get what was public, and we will happily gather that material for you. What went to cabinet, I do not know. I was not in the department at the time, but in any event I would not be allowed to disclose it because of cabinet confidentiality, just to be clear on that one.

Mr O'BRIEN — That is right. That is what I wanted you to be clear on, because one of the key issues is in terms of the assumptions, and we have been exploring this in relation to the feasibility of the business case. It is understood or it has been said out in the community that the assumptions that were around in 2006–07 about whether or not there would be rainfall again or the extent of rainfall and the extent to which the plant would be needed, as opposed to other water options that were capable of being implemented. That is a key decision that ultimately was a cabinet decision for which the cabinet will take responsibility.

Mr PAKULA — You have to do it when you build things.

Mr O'BRIEN — Thanks, Mr Pakula. You do. That will be the key question, because of those key assumptions as to the need for a desalination plant. It is one of the most expensive if not the most expensive way of procuring water, isn't it? As opposed to a dam or particularly, as was urged by the opposition at the time, water-saving devices within the existing water treatments — —

Mr PAKULA — That was after you urged for a desal.

Mr O'BRIEN — No, we said a desalination plant feasibility study on a much smaller plant.

Mr PAKULA — In Werribee.

Ms HENNESSY — Just like in WA, which did not work, Mr O'Brien.

The CHAIR — Colleagues — —

Mr O'BRIEN — I got scolded for interrupting to clarify something.

The CHAIR — I am trying to call the committee to order, Mr O'Brien, so if you just be patient for a moment.

Mr PAKULA — No-one else tried to put words in the witnesses' mouth.

Mr O'BRIEN — Mr Pakula, you have been verballing five times as much as me, and yet you accuse me of it. It is called hypocrisy, and I would like you to restrain yourself.

The CHAIR — Thank you, Mr O'Brien. Colleagues, it is Friday afternoon, and we have been at it all week, and we have been well behaved generally. Mr Pakula, if you want to overtly demonstrate that you are trying to bait Mr O'Brien, let us have that on the record. It is inappropriate, it is demeaning of the committee and demeaning of your standing as well. Can we just have order? Mr O'Brien to proceed without interruption.

Mr O'BRIEN — I need to take you through a couple of things if I could. One document you have not referred to is the Auditor-General's review headed *Planning for Water Infrastructure in Victoria*. I did not see in your initial timetable references to the original estimates that were publicly released of the capital cost. They are not in that submission you have made to this committee, are they, of the \$3.1 billion?

Mr SAMMUT — The Melbourne Water feasibility study had the capital cost of various sized projects in it.

Mr O'BRIEN — Yes, but the specific criticism from the Auditor-General is that, in going to the public in 2006, effectively you had the \$3.1 billion based on a business case equivalent. This published capital cost was not the highest probability estimate available.

Mr SAMMUT — Two thousand and six was before the project was announced.

Mr O'BRIEN — Two thousand and seven — I correct that. The report inadvertently says 2006. I have made a correction by hand. I am sorry I repeated it, but the substantive point is that one of the criticisms is that the extent it went out to the public as a capital cost, it went out at \$3.1 billion, when the option was to go out at the higher figure, and I put it to you that, as the report indicates:

In contrast, the desalination plant costs were based on a significant body of technical work on the project costs and risks. However, the decision was made to publish a lower probability figure (i.e. a lower estimate) when a higher probability figure was available.

This is in the context of one of the key criticisms being stakeholder input and the extent of it in this project, which is ultimately that all the users of not just Melbourne but through the pipeline down to Barwon in my region in Geelong as well. That is correct, isn't it? That is one of the criticisms and that is what you did not do.

Mr SAMMUT — May I ask, was that a comment on the feasibility study?

Mr O'BRIEN — I believe it was a comment on the business case, but it was a comment on the June 2007 announcement.

Mr SAMMUT — On the announcement in the water plan?

Mr O'BRIEN — Are you aware of the comment, to use a recent phrase?

Mr SAMMUT — I am aware of most of the Auditor-General's comments, and I recollect that one. I believe that was a comment relating to cost estimates that were released in the Melbourne Water feasibility study, where they actually had probabilistic-based cost estimates. The water plan, I think, may have referred to the cost of the plant as \$3.1 billion capex. We have on our website, because this is a question that has been asked through our community liaison group and others, a fact sheet, if you like, and if you take the \$3.1 billion announced in 2007, which was the essence, I think, of the Auditor-General's comments — what probabilistic-based estimate should have been used — I am now making the comment on an actual comparison of that number, irrespective of whether it was P80, P70 or P90. If you take \$3.1 billion, escalate it at the actual ABS indices that occurred between 2007 and when we reached contract close, that equates to \$3.42 billion. AquaSure's winning bid was \$3.46 billion. That included underground power, which was an additional feature.

Mr O'BRIEN — I will talk about power in a second, but just to return to my question, do you accept, and I will read the last part to give you an opportunity to accept this criticism from the Auditor-General in this process that:

It is reasonable for the community to expect that, if a more accurate cost is available, then this cost would be disclosed rather than a less accurate cost. If the less accurate estimate is published then this needs to be justified.

This is the choice between the \$3.1 billion and the higher costs. Do you accept that criticism, in retrospect?

Mr SAMMUT — No, because there is no such thing as a more accurate cost. There could be a more conservative cost. If you are using a P90 cost compared to a P70 cost or P80 cost, you will end up with a higher number simply because the Monte Carlo simulations are essentially giving you an envelope of cost based on probabilistic outcome. If you want to take it to the extreme, you could have a P95 cost, which means you have 95 per cent probability, effectively, of the number not being exceeded.

Mr O'BRIEN — Could I pause you there, because I want to keep to my other questions. I know you could have kept going with that explanation. If I changed the word that the auditor used from 'accurate' to 'conservative', would you accept the criticism?

Mr SAMMUT — I am not sure what the criticism is actually saying. What I am saying is: irrespective of the probabilistic outcome and irrespective of the Auditor-General's comments, maybe this was coincidence. But in fact, if you took the actual 2009 winning bidder's costs back to 2007 dollars, it was \$3.1 billion. It was exactly the same number.

Mr O'BRIEN — The size of the plant is the next question I would like to take you to. We have the Kwinana plant as a comparator. We have been to see that plant. Forgive me if my numbers are wrong, and let me know if they are, but you have got approximately 52.56 gigalitres out of that plant in 2006 dollars for about \$387 million cost, which is about 13 per gigalitre, as opposed to, on the chair's numbers, 150 gigalitres at maximal production of this plant at 6.1. You have a much larger scale plant, and your public sector comparator is still dealing with the public sector construction of the larger scale plant.

If you look at it in broad assumptions about how much water Victoria needs, would you accept that, in a sense, Perth has a much greater need for water than potentially Victoria does with its wetter climate and more frequent rain events — and subsequent rain events since the decision was made may have borne that out to some extent? Would you accept as a fair criticism — and it will be played out over the 30-year period, perhaps, as Mr Pakula has outlined, in terms of the ultimate judgement — that Victoria, by going through the process that it has in relation to this purchase, has purchased far too big a plant for its actual desalination water needs as opposed to the other water availability possibilities?

Mr SAMMUT — I cannot comment on that because that is supply and demand. I thought you were going to the cost comparison of projects.

Mr O'BRIEN — No, I was going to the key assumption on the size of the plant, and I would like you to comment on the ultimate size of the plant chosen for Victoria in comparison to a smaller option that could have been chosen, as a cost comparator. Do you have any comments on that? I ask Mr Wilson.

Mr WILSON — Should we have chosen a smaller plant for the cost comparison — the public sector comparator?

Mr O'BRIEN — Yes, so that rather than spending 5.1 or 3.1 or billions of dollars, we are spending something like half a billion dollars instead.

Mr WILSON — I guess from my point of view the policies require us to do a public sector comparator on what we have got to produce, which was the 150 gigalitre plant scalable to 200, if that is correct, Peter?

Mr SAMMUT — Yes.

Mr WILSON — And we have done that, versus what I think would be an apples with oranges comparison almost — a different size completely.

Mr O'BRIEN — Or a big apple with a small apple, perhaps?

Mr WILSON — From my point of view, the cabinet made the decision after a year of deliberation following that 2007 water plan and decided on 150 gigalitres. We went through the process of managing the implementation of that in the best way in order to get the best value for money for Victoria. So asking us to comment on whether it was the right decision or not, I am not sure we could comment on that.

The CHAIR — Just to round this up, perhaps the best way of dealing with it is to say simply that the scale of the plant was a matter for cabinet and that your contribution to the project, in effect, commenced after that cabinet policy decision, so the issue of scale is a matter entirely for executive government.

Mr PAKULA — Chair — —

The CHAIR — I am just trying to clarify for Mr O'Brien so we can move on.

Mr PAKULA — The size of the plant was based on a feasibility study that these gentlemen say they did not do. If the committee wanted to get better information about that, we would need to speak with Melbourne Water. That was the earlier evidence.

Mr O'BRIEN — No, that is not the entire answer, Mr Pakula. We could get an answer from the former cabinet; perhaps that would be another way to go.

The CHAIR — I am trying to move on past this point.

Mr PAKULA — We are happy to have Melbourne Water brought in.

The CHAIR — The point is: let us clarify that the evidence that the department is providing is that their engagement in this process commenced after an executive decision by the cabinet in terms of scale; is that correct?

Mr WILSON — Not exactly, Chair. What I am saying is that the implementation of the project commenced once cabinet decided that they were going to go out with the expression of interest, and that was managed by Mr Sammut here. What occurred was we were involved — or the department was involved — in the processes of producing material for the deliberations and so on, in the lead-up to that, but that is cabinet in confidence.

Mr O'BRIEN — Could I go to a slightly different matter that relates to the — —

Ms HENNESSY — Excuse me Mr O'Brien — —

Mr O'BRIEN — We have got to the end, where it was cabinet in confidence, and it was my line of questioning, but if — —

The CHAIR — Mr O'Brien, I think we will take a pause. We will have Ms Hennessy, and we might come back to you shortly.

Ms HENNESSY — Thank you. On the issue of Melbourne Water in respect of Melbourne Water overcharging customers for the desal plant, when did DSE become aware of that overcharge?

Mr WILSON — I am not sure, and I am not sure that I would characterise it in that way. Basically a decision was made on prices back in 2009 which relied on certain forecasts and so on to produce price caps. There are overs and unders of all sorts of variables in that calculation, so I am not sure of the exact dates.

Ms HENNESSY — Would you provide that advice to the committee.

Mr WILSON — I am happy to get back to you on the background of that to the extent that it is — —

Ms HENNESSY — Thank you.

Mr SAMMUT — Chair, can I clarify — I do not want to leave anyone with a misconception. You said about the feasibility study — just to make sure that everybody is clear — the feasibility study was done by Melbourne Water. It was released at the same time as the water plan. The water plan announced a plant of a particular size, effectively tentatively. It said it would be subject to further analysis and further testing. My division got involved straight after the water plan when we were asked to deliver the project. We were certainly involved in that whole process, but our contribution to that process was around advising people on the impact of the costs of the various options.

Mr PAKULA — Rather than the modelling.

Mr SAMMUT — Rather than the supply-demand analysis. Obviously we are infrastructure delivery experts, not climatologists.

The CHAIR — Just to round this off quickly, Mr O'Brien.

Mr O'BRIEN — One number that has also been released, I think, has been the difference in costs per kilolitre of water in 2012–13. It cost \$13.58 for the 50-gigalitre purchase; and this is contrasted with about \$1.50 per kilolitre under present usage. That is an indicator of the size. You have seen those numbers, I presume. They were released through the Premier's office last year.

What I would like to take you to is the key decision in relation to the break-up between the availability payment and effectively the charge payment where we have about 18 billion in that full net present value in relation to the availability payment. Is it not the case that if the assumption that we do not need the plant as much as we might have thought we would have, turns out to be correct, now or into the future, could we not have restructured this deal to provide a better value for taxpayers and ultimately Melbourne Water users where there was a lesser amount of the availability component and more water taken in the charges, so that as a supply of water it could be in better competition with these other sources, especially given its high electricity components in terms of its production? Could you provide specifics as to consideration given to the relative amounts, being the available payment versus the usage payment?

The CHAIR — Did you get the question?

Mr SAMMUT — Yes, I did, thank you, Chair. In some ways it is tied back to the last commentary that I made around the procurement decisions. Once the decision was then made — if we follow those steps that I just talked about — as to the size of the project, we were actually effectively entering a procurement process where we were telling the market that this was the size now that the government wished to have from the plant. They will have structured their bids around the level of the private finance they needed to raise to build a plant of that particular scope. It was for a 150-gigalitre plant, and the water security payment, if you come back to our earlier discussion around it being for the design, construction and financing is, if you like, a manifestation of the size of the plant. The water security payment is linked to the size of the plant, because it is linked to the capital cost of construction of the physical facility. To go back after the contract is executed and ask for a redistribution of the two will be essentially to say to somebody, 'You will not be paid for the capital costs that have been raised to fund the project', because they have borrowed 4.8 billion.

Mr O'BRIEN — I was not asking you to go back; I was asking you to look hypothetically at the options for the pricing of this PPP model if we had changed our decision-making process and particularly if we had taken more time before the fundamental water plan decisions were made — I know that is cabinet, but in terms of your information. If it turns out that we are going to need less water for the state and for the Melbourne Water users than originally anticipated, would it not have been better to have a weighted lower availability payment than the 18.1 billion and higher on usage — so make it the reverse, with 5 billion weighted. I am not saying this could be negotiated, but in terms of objectives, retrospectively — because it is now retrospective — would that not have been a better way to go for the users?

Mr SAMMUT — What I expect would have happened — just like anything in life if the scope was less, the cost will be less. But I expect it would have been a proportional reduction. We still would have ended up with a proportional reduction in both but a relativity between the water security and the water usage payment that is pretty much what you see now.

To go to a model that you are talking about is essentially going to a take-or-pay-model. We would have needed to have committed to a certain minimum volume, because nobody is going to take the risk that if a zero gigalitre water order is placed — you are not going to get any money. That would have taken us to a model whereby instead of having 0, 50, 75, 100, 125 or 150 we may only have had the option of 50, 75 or 100, with a minimum of 50. You must always take a minimum of 50, for example.

Mr O'BRIEN — But it could still have been net cheaper. Even the evaluation process may have been better if forecasting — particularly as the criticisms in relation to public consultation in terms of the key stakeholders who were not involved in these decisions — was taken.

Mr SAMMUT — For the same size scope it is hard to envisage that we could have got a better deal than we have currently. You would have to have made a different decision on a different scope.

Mr O'BRIEN — Again that is the question and not the assumption, but I will leave it at that.

The CHAIR — We are just about to wrap it up. For the sake of completeness, it would be helpful for the transcript, because we have had a lot of discussion around the payment arrangements, to know what are the financial obligations of the state under the contract if no orders for water purchase are placed by the government?

Mr SAMMUT — That commitment is effectively a zero-gigalitre water ordering scenario, which is the column in the table under the number 0.

The CHAIR — And therefore the only obligation on the state is the water security payment?

Mr SAMMUT — Yes, that is correct, as per the numbers in that column.

The CHAIR — Thank you very much. That wraps it up. Thank you very much for attending today and for informing the committee. I know that a number of the members of the committee have additional questions, and it may be that the committee sends some further questions on notice to the department. Thank you for your participation. Within a fortnight you will receive a transcript. If you could make any relevant corrections of fact — and there were some moments today where I think you may want to check the transcript — it would be helpful. It would also be helpful if you could return the transcript within a couple of days. They will then be placed on the website. Thank you.

Witnesses withdrew.