Commercial Principles for Infrastructure Projects

2022

Introduction

The purpose of these principles is to assist NSW Government Agencies to provide a consistent, reasonable and equitable approach to developing contractual terms for capital projects. These principles considered the increase in scale and number of large, complex infrastructure projects and capacity constraints within industry given the level of activity across NSW and Australia.

These commercial principles were developed in consultation with agencies and industry and includes principles on:

- Reliance on pre-contract information
- Liability arrangements
- Professional indemnity insurance
- Interface risk management
- Timely resolution of issues
- Contracting out from being bound by legislation

These commercial principles will continue to be expanded to include principles for other contractual terms such as requirements for contractor submissions and reporting..

The significance of reliance, liability arrangements and professional indemnity insurance varies depending on the form of contract – it is high where there is limited early engagement and investigation, no early works, and where contracts are lump sum with a heavy risk allocation to contractors. The significance of those commercial factors can be reduced where there is considerable early investigation and industry engagement, where projects are de-risked through early works and where there are elements of works that are more open book.

Objectives

Government's goal is to support a sustainable industry by increasing industry participation, competition and efficiency in the delivery of infrastructure in NSW through a sustainable risk allocation, all of which combined provide value for money for NSW citizens.

Purpose

Agencies will continue to be responsible for leading the planning, procurement and delivery of their own projects. Discussions about appropriate contractual terms will be led by agencies within existing decision-making delegations and bodies. This guideline outlines the expectations for how agencies determine some contractual terms to optimise risk allocation to meet Government's objectives. The principles reflect practices adopted in recent procurements in NSW.

Expected Behaviours

- Work together in the interests of a successful project.
- Keep front of mind the NSW Government's objectives.
- Consideration and engagement on project specific issues early and regularly
- Parties should be innovative and open-minded in their approach to proposed solutions and act with the intent of these Guidelines.
- Contractors are encouraged to advise relevant Secretaries, CEOs or Infrastructure NSW in the event that these principles are not consistently applied by agencies.

Application

NSW Government Agencies should consider applying these guidelines to all NSW Government projects and PPPs, to be procured, with project specific amendments, where necessary.

Commercial Principles

Reliance on pre-contract information

- Agencies are encouraged to undertake due diligence early to reduce risk and identify appropriate mitigation through early works or contracting approaches when it comes to unknown or known inground conditions (contamination and utilities). This aligns with the Premier's Memorandum M2021-10 *Procurement for Large, Complex Infrastructure Projects*
- Agencies are encouraged to provide contractors with a level of reliance on baseline information and agree a contractual framework to manage change. Providing no reliance shifts the focus for contractors on pricing potential risk scenarios rather than optimising proposals and focussing on mitigations when predictions change, invariably leading to increased bid costs.
- Agencies should always provide context as to the level of due diligence undertaken (e.g. it may not represent all information available, rather what the agency has collected, a sample of an area, a level of sensitivity testing, etc.)
- Agencies are encouraged to explore options to involve contractors in due diligence early and pre-award.
- Contractors cannot solely rely on accuracy or completeness of site information documents provided by the NSW Government Agency. Contractors are to conduct their own assessment of risk, and should be prompt in advising any errors or flaws they identify in information provided by clients.

During the planning phase:

- Agencies to conduct site investigations/due diligence on project site/s.
- Agencies will provide different forms of reliance to Contractors on specific categories of information.
- The key types of reliance that could be provided to Contractors, depends on the category of information and by way of example of ground conditions, are set out in the table below.
- The risk for each of the types of reliance can be negotiated to best reflect the specific circumstances of the project.

Form of Reliance	Risk	Benefit	Mechanism	Relief
Baseline reliance	State	Contractor	Contractor prices and programs the works required based on the baseline information provided (Tender Baseline).	If the Tender Baseline is inaccurate, the contractor may claim entitlements under the contract – time and/or costs
Reliance Letter	State's Consultant	Contractor	Contractor may rely on consultant's report to the extent set out in the Reliance Letter (usually data only, and not interpretation of that data, or completeness of it). No reliance as between State and Contractor – report provided as an Information Document	Contractor may bring a claim against the State's Consultant for inaccuracies in the reports. No entitlements from State.
Exception to Fitness for Purpose (FFP) warranty	State	Contractor	Compliance with elements of the technical specification that the Contractor is to rely upon, will shield the Contractor from breach of its obligations that the Works and Design Documentation are FFP and free from Defects.	Shield only, no entitlements from State.
Design reliance	State (passed to designer where possible)	Contractor	State provides a design or key design input as a Contract Document. Contractor prices and programs the development of the design, if required, and construction of the works based on that design or input.	A material defect, error or omission or change in the State's design or input may entitle the Contractor to time and costs where it cannot be remedied in further design development.

During the tender phase:

- To mitigate the risk of delays and costs due to inaccurate information:
    - Agency's due diligence provides a baseline for pricing purposes
    - Agency should be clear on whether due diligence documents provided to tenderers are for 'information only' or can be 'relied upon'.
- Agency to ask for a tender based on Agency's due diligence and agree a regime to share risk if the actual conditions are different. For example; contractor to use preliminaries to cover unexpected costs, but rates don't include overheads or profits.

- Contractors may propose alternative approaches to reduce risk in their tender responses and there is a regime to deal with changes.
- If the Agency completes the design (e.g. Construct Only contracts), the Agency should offer to novate any consultancy agreements to the construction contractor. This means that design warranties will be assigned (and the risk is effectively transferred) to construction contractor.

Liability arrangements

Agencies are encouraged to consider alternative approaches to joint and several liability and contractual limitations on liability, taking into consideration project specifics. Agencies should use every opportunity to size contract packages to attract Tier 2/3 contractors or joint ventures between Tier 1 and Tier 2/3 contractors to increase participation and competition in accordance with the Premier's Memorandum M2021-10 *Procurement for Large, Complex Infrastructure Projects*. Additional relief may be required for Tier 2/3 contractors to support Government's objectives. These provisions should be considered alongside those on professional indemnity insurance.

Joint and Several liability

- Agencies will consider alternative ways to limit liability without absolving either party of liability for their own share of works.
- Subject to the points below, agencies can require joint and several liability where contractors enter partnerships (e.g. joint ventures) as a starting point.
- Agencies should invite potential tenderers to propose alternative liability arrangements, where it presents a value for money outcome to the State by increasing competition and participation (e.g. these arrangements could include Delivery Partner Models through subcontracts, liability percentage split (based on scope), joint and several liability unless dominant JV partner becomes insolvent, in which case smaller partner's liability percentage is less).
- Where Agencies stipulate that Tier 1 contractor tenderers must partner with a contractor of a lower tier, then the Agency should consider ways to limit the liability of the smaller partners (especially in the case of insolvency).
- The Agency should consider the following principles when considering alternatives to joint and several liability:
    - value for money outcome to the State, which takes considers Government's objectives
    - must not require the State to attribute fault between the joint venture entities
    - must provide the State with appropriate security in relation to the risks associated with the delivery of the works
    - account for current and future financial strength of the entities in relation to their liability for the works in respect of the joint and several arrangement.

Proportionate Liability

- Agencies are permitted to apportion liability amongst parties according to their proportionate responsibility and are required to submit a report to Public Works Authority that justifies why they are contracting out of proportionate liability under Part 4 of the Civil Liability Act NSW.

Limitations on liability

- Contractors should provide adequate security to prevent and/or mitigate the Agency suffering financial loss if the contractor breaches the contract/or fails to fulfil its obligations. Security can take the form of contractual terms on liability, cash retention, bonding, insurances, a parent company guarantee to guarantee all of the obligations of the contractor under the contract, etc.
- Agencies should determine limitations on liability on a project/market basis (as opposed to a standard, 'proportion of contract value' approach) to appropriately reflect the level of financial risk retained by the Agency.
- Agencies must consider the extent to which project insurance may cover the risks in determining any capped amount.
- Agencies should ensure limitations on liability do not preclude available insurance cover, to the agency's (principals') detriment.
- Agencies should apply a broad cap to contractor's liability (i.e. cap applies to total liability not liability to indemnify).
- Liability may be uncapped for certain risks, irrespective of contract value. This may warrant the Agency excluding certain risks from the limitation on liability. For example, liability is uncapped for:
    1. Liability that cannot be limited at law
    2. Personal injury, death or illness
    3. Wilful or reckless misconduct, fraud or criminal conduct
    4. Insurance proceeds that are or would have been recoverable
    5. Abandonment of obligations
    6. Intellectual Property indemnity & warranty
- Agencies may decide, depending on scope of work, to sculpt specific liabilities across the project timeline to align with the risk exposure to the principal at the relevant time, where the level of risk changes significantly over time.
- Agencies should increase the liability cap where a variation significantly increases the value of the contract sum.

Professional Indemnity Insurance

These guidelines on professional indemnity (PI) insurance must be considered alongside those on joint and several liability and liability caps.

Professional Indemnity insurance costs have risen significantly over the last few years and the market for PI insurance in Australia is highly constrained, which is impacting final project pricing. Most professional indemnity claims relate to design issues.

Agencies should work with Treasury to check the application of Treasury Circular TC16/11 'Mandatory Principal Arranged Insurance (PAI) for all major capital works projects'.

In general

- Agencies are encouraged to use early contractor involvement to mitigate design risks before entering procurement. This aligns with the Default Procurement Practices in the Premier's Memorandum M2021-10 *Procurement for Large, Complex Infrastructure Projects*
- The level of PI cover required must be commensurate to the value and nature of services.
- Contractors should continue to take out PI insurance for smaller value projects where the market for PI may be less constrained.

iCare Principal-Arranged Insurance

- iCare is to provide PI insurance for certain major complex engineering projects where prevailing market conditions for PI insurance are highly constrained.
- iCare will provide general terms and conditions on a portfolio basis.
- Project specific policy wording will be available at tendering stage, providing a level of certainty to tenderers.
- iCare is updating the Treasury Circular TC16/11 'Mandatory Principal Arranged Insurance (PAI) for all major capital works projects' to provide for the State to arrange PI cover for these types of major projects.
- The Performance & Financial Management Council will consider the amended Circular before Treasury seeks the Treasury Secretary's approval of it in the coming months.

Interface risk management

Interface risks need to be appropriately investigated, understood, considered, and documented prior to the release of tender documents to industry, to enable contractors to better manage, mitigate and price interface issues. Particularly on major, complex projects, it is important that Agencies in consultation with tenderers, understand interface issues early, to appropriately stage and package works and to develop appropriate mechanisms to incentivise cooperation between parties.

Project planning and tender phases

- Agencies should develop a delivery strategy which outlines the staging and packaging approach for the works during the Business Case phase. Works at risk of scope changes, and that can be separated and completed in advance of the main works, should be prioritised as early works packages where possible to minimise interface risks.
- Agencies should consider engaging constructability advisers to provide advice on interfaces prior to the development of tender documentation where complex interfaces exist, particularly in brownfield sites, or greenfield sites adjacent to brownfields.
- During the Tender phase, where possible detailed commercial principles should be shared with tenderers which describe the approach for project wide risks, cooperation with contractors, third party agreements and community stakeholder management.
    - For single-site or building projects
        - Agencies should allow sufficient time in the project's base program to minimise interfaces. (See DPC Circular C2020-22 'Timely Information on Infrastructure Projects – A Guide' for guidance on announcing reliable project timeframes.)
        - During the planning and design phase, Agencies should minimise intra-project interfaces by separating contractors by time and space, where practically feasible.
    - For all projects:
        - Agencies should identify all major interface obligations for tenderers to assess and respond to during the tender phase. On complex projects, Agencies' delivery and packing strategies will need to respond to both physical integration and time interfaces.
        - Agencies should allow sufficient time to facilitate productive engagement between tenderers (or the preferred proponent) and relevant interfacing parties to optimise interface arrangements, discuss detailed risk allocation and ensure tender pricing can appropriately allow for the interface risks.
        - Interface risks should be clearly set out and agreed during the tender phase, with consideration of availability and specificity of information at tender for the relevant interface risks.

- Where possible, Agencies should enter into interface agreements with interfacing parties before tender award. Agencies are encouraged to share relevant interface agreements with bidders early in the tender process and incorporate them into the project agreement. Agencies to novate agreements where the contractor will take on the interface obligations of the State.
- All parties need to provide utility companies with reliable information on project priority and expected time frames to effectively plan and commit utility companies' resources and to assist contractors and/or agencies to obtain timely access to utility services.
- Agencies should develop appropriate commercial mechanisms to incentivise cooperation between multiple parties based on specific, identified interface risks, e.g. site access.

Delivery phase

- Where appropriate, the contract should require lead representatives from Agencies and contractor(s) to meet regularly to proactively manage interfaces and escalate issues as necessary (e.g. an 'interface committee') during construction.
- Contractors must cooperate, collaborate, coordinate, and integrate activities with relevant parties to enable successful delivery and minimise potential interface risks. This could be managed through a separate contractual agreement (e.g. a 'Master Interface Deed').
- Contractors must advise agencies where interface risks arise and ensure every effort from all parties is undertaken to minimise impact to the project's program and budget.
- Agencies to consider providing an entitlement for the contractor to claim time and cost relief where the contractor is impacted by specific and defined acts and omissions as agreed and set out in contract. The types of acts will be influenced by the project specifics and the contracting approach (e.g. PPPs, ITCs, fixed price) and may include for example, acts of:
  - another contractor
  - other government bodies/authorities outside of the control of the contractor, or
  - utility owners outside of the control of the contractor.

  Relief will consider risk-sharing mechanisms that incentivises contractors to mitigate interface and integration risks and to cooperate with interfacing parties. The agency may create separate relief regimes for the relevant interface risks/parties where this presents better value for money.
- Agencies to bear the risk where third parties (parties who can impact on the works but are not engaged in relation to the project) do not complete their activities according to the contractor's program, where this program has been accepted by the Agency and the contractor demonstrated that all attempts to encourage third parties to complete activities in accordance with risk sharing mechanisms failed.
- Agencies retain responsibility for other government agencies (except for planning and regulatory agencies). Where the contractor is impacted by another government agency, it is treated in the same manner as if the impact was by the agency. Contractors are expected to proactively manage their dealings with these external parties and demonstrate that all attempts to encourage government agencies to complete activities in accordance with risk sharing mechanisms failed.

Timely Resolution of Issues

These principles acknowledge that contractual claims are the most common manifestation of project issues.

The principles focus on how agencies and contractors can foster a culture of collaboration to resolve project issues proactively, rather than solely relying on the contractual mechanisms (which may result in protracted disputes).

Timely resolution of issues and formal claims is critical to ensuring a sustainable construction industry. Unresolved and protracted claims for work performed could adversely impact supply chains and erode the financial viability of subcontractors over time. Furthermore, they can be damaging to the culture and morale of the project teams, who are continuing to deliver a program of works.

All parties are expected to behave proactively in partnership to resolve issues on a best for project basis and encourage a culture of collaboration and resolution.

Issues during delivery

- The project should require the parties to have a regular open dialogue to proactively find a solution as issues arise and before the contractor makes a claim and/or escalates to senior forums.
- Where project teams cannot reach an agreement on an issue, it should be escalated to senior parties to enable project teams to continue to deliver whilst the issues are being addressed.
- Both the contractor and the agency should assess and mitigate impacts, prior to issuing a formal notice or making claims under the contract.
- Projects may include mutually agreed targets to respond to and resolve notifications and claims to avoid protracted disputes.
- Agencies and contractors should put in place effective governance structures to deal with matters escalated by the project team. Senior executives should be regularly informed the during delivery phase to be able to respond to issues, when escalated.

Claims

- Agencies should be fair and reasonable when attempting to resolve claims. All parties should ensure their representatives have the relevant authority to negotiate claims to avoid pro-longed dispute processes.
- Agencies should balance the need to resolve a claim in a timely manner, with the need to appropriately assess the validity of the claim, the supporting data provided and any interdependencies on other claims.
- The parties should work together towards a best-for-project outcome in all instances.
- Agencies must determine whether there is sufficient information and supporting evidence for the project team to consider a claim when it's first received. Agencies should promptly communicate to the contractor if it requires further information and the level of detail that is required. Part settlement of claims where possible, is encouraged.
- Claims may be settled according to the project's priorities (e.g. a project may have more flexibility on cost but not time).
- Contracts should include clear timeframes to progress and if necessary, escalate claims rapidly.
- Contractual escalation dispute processes (e.g. dispute avoidance boards, expert determination and or mediation) may be used to avoid formal disputes (e.g. without prejudice opinions) or to obtain a binding determination. The parties should first collaborate at the project team level, before they escalate to senior forums. Arbitration and litigation should be avenues of last resort.

Client contract out from being bound by legislation

Part 4 of the *Civil Liability Act 2002 (NSW)* apportions liability amongst parties according to their proportionate responsibility where a multi-party contractual structure exists. The provisions in Part 4 replaces the common law rule of joint and several liability, under which a party can recover the whole of its loss from one party, even though multiple parties may have caused loss.

A NSW Procurement Board Direction 2017-03 discourages NSW Government Agencies from contracting out of Part 4. This guideline therefore encourages the following:

- Agencies should only contract out from Part 4 of the Act where project specific circumstances justify. This should be considered with the principles established for joint and several liability in (SC0226-2022 *Construction Industry Commitments Update*).
- If an agency is to contract out from Part 4 of the *Civil Liability Act 2002,* it should clearly document the project specific reasons for this and advise Public Works Authority as it is required by NSW Procurement Board Direction 2017-03.
- Agencies should provide sufficient time during tender for Contractors to agree proportionate liability through cross-indemnity arrangements.

Agencies should limit contracting out of Part 4 to project specific circumstances where joint and several liability is appropriate and allow for liability to be apportioned, where third parties such as utility providers and early works contractors play a significant role (scope/technical expertise) on the same infrastructure project.