

Mr Tim Cressey
Infrastructure Division
NSW Department of Transport
Level 6
18 Lee Street
Chippendale NSW 2008

2 June 2011

Dear Tim,

PROBITY ADVICE – LEICHHARDT PROPERTY

The Department of Transport (Department) has requested that Procure Group Pty Ltd, as probity advisor for the Inner West Light Rail project, provide advice in relation to a property owned by RailCorp adjacent to the light rail corridor in Leichhardt. Specifically, the Department has requested advice as to whether there is an obligation on Government from a procurement/sale policy perspective to enter into direct negotiations with the current lessee for an extension to the lease as has been requested by TDR.

BRIEF BACKGROUND

The site in question is 7 Darley Road Leichhardt. The current lessee is Tdrahhiel Pty Ltd (TDR), having acquired the lease from Kingsway Property Investments Pty Ltd in January 2007. The original lease was for a period of 50 years and commenced on 1 December 1968. The lease is due to expire on 30 November 2018.

We understand that the previous and current lessees have approached various NSW Government representatives on numerous occasions seeking an increase to the current lease term or to acquire the freehold title. On each of these occasions the request has been rejected.

The Department has undertaken an appraisal of its commercial and operational requirements for the site and the current value of the existing leasehold. We understand that both the Department and RailCorp have formed the view that on a strategic usage and commercial basis, it is not in the best interest of the Government to enter into direct negotiations with the current leaseholder.

DIRECT NEGOTIATIONS

The ICAC issued a publication in 2006 entitled *Direct Negotiations – Guidelines for Managing Risks in Direct Negotiations* (the Guidelines). This document provides guidance to public sector agencies when considering whether it may be appropriate to enter into direct negotiations, and if so, how negotiations should be managed. The guidelines state that “as a general rule direct negotiations should be avoided” on the basis that opportunities for corrupt conduct to occur are increased and because of the difficulty in demonstrating that best value for money has been achieved (p8). The Guidelines do note that there are occasions where direct negotiations may be justifiable.

The Government procurement/sale default position in accordance with the Guidelines is, however, that the market should be tested unless direct negotiations can be clearly justified and supported. This is to ensure that the Government obtains best value for money in an accountable and transparent manner. In order to justify direct negotiations in this instance, the incumbent leaseholder would need to have a legal right to negotiate or the Department would need to demonstrate, among other things that the incumbent leaseholder:

1. Had a unique opportunity to maximise the public benefit; and

2. Was offering something that clearly meets the Government's stated objectives for the site; and
3. Could clearly demonstrate that its proposal would deliver best value for money.

Based upon our discussions with Departmental representatives, none of these prerequisites are met by the current leaseholder. We understand that RailCorp representatives concur with this view. Further, Departmental representatives consider that the public benefit is likely to be increased if future opportunities to develop the site are offered to the market. This view is represented in draft briefing papers for the Director-General that, we understand, will be finalised shortly.

CONCLUSION

Based upon our review of the circumstances associated with the lease for 7 Darley Street Leichhardt, we have formed the view that entering into direct negotiations with Tdrahhciel Pty Ltd to extend the current lease would not be appropriate nor would it be in accordance with NSW Government guidance material issued by the Independent Commission Against Corruption. The appropriate course of action would be to offer any future lease/development/sale opportunity to the market.

Yours sincerely



Warwick Smith
Director
Procure Group Pty Ltd

Mr Tim Cressey
Infrastructure Division
NSW Department of Transport
Level 6
18 Lee Street
Chippendale NSW 2008

3 June 2011

Dear Tim,

PROBITY ADVICE – LEICHHARDT PROPERTY

The Department of Transport (Department) has requested that Procure Group Pty Ltd, as probity advisor for the Inner West Light Rail project, provide advice in relation to a property owned by RailCorp adjacent to the light rail corridor in Leichhardt. Specifically, the Department has requested advice as to whether there is an obligation on Government from a procurement/sale policy perspective to enter into direct negotiations with the current lessee for an extension to the lease as has been requested by TDR in a letter to the Premier dated 18 April 2011 which Procure has sighted.

BRIEF BACKGROUND

The site in question is 7 Darley Road Leichhardt. The current lessee is Tdrahhciel Pty Ltd (TDR), having acquired the lease from Kingsway Property Investments Pty Ltd in January 2007. The original lease was for a period of 50 years and commenced on 1 December 1968. The lease is due to expire on 30 November 2018.

We understand that the previous and current lessees have approached various NSW Government representatives on numerous occasions seeking an increase to the current lease term or to acquire the freehold title. On each of these occasions the request has been rejected.

The Department has undertaken an appraisal of its commercial and operational requirements for the site and the current value of the existing leasehold. We understand that both the Department and RailCorp have formed the view that on a strategic usage and commercial basis, it is not in the best interest of the Government to enter into direct negotiations with the current leaseholder for either an extension to the lease or sale of the freehold title.

DIRECT NEGOTIATIONS

The ICAC issued a publication in 2006 entitled *Direct Negotiations – Guidelines for Managing Risks in Direct Negotiations* (the Guidelines). This document provides guidance to public sector agencies when considering whether it may be appropriate to enter into direct negotiations, and if so, how negotiations should be managed. The guidelines state that “as a general rule direct negotiations should be avoided” on the basis that opportunities for corrupt conduct to occur are increased and because of the difficulty in demonstrating that best value for money has been achieved (p8). The Guidelines do note that there are occasions where direct negotiations may be justifiable.

The Government procurement/sale default position in accordance with the Guidelines is, however, that the market should be tested unless direct negotiations can be clearly justified and supported. This is to ensure that the Government obtains best value for money in an accountable and transparent manner. In order to justify direct negotiations in this instance, the incumbent leaseholder would need to have a legal right to negotiate or the Department would need to demonstrate, among other things that the incumbent leaseholder:

1. Had a unique opportunity to maximise the public benefit; and

2. Was offering something that clearly meets the Government's stated objectives for the site; and
3. Could clearly demonstrate that its proposal would deliver best value for money.

Based upon our discussions with Departmental and RailCorp representatives, none of these prerequisites are met by the current leaseholder. With regard to item 2 above, we note the Department's view that the TDR proposal may assist in improving access to the proposed light rail stop. The proposal does not, however, meet other Government objectives. Further, Departmental representatives consider that the public benefit is likely to be increased if future opportunities to develop the site are offered to the market. This view is represented in draft briefing papers for the Director-General that, we understand, will be finalised shortly.

CONCLUSION

Based upon our review of the circumstances associated with the lease for 7 Darley Street Leichhardt, we have formed the view that entering into direct negotiations with Tdrahhciel Pty Ltd to extend the current lease would not be appropriate nor would it be in accordance with NSW Government guidance material issued by the Independent Commission Against Corruption. The appropriate course of action would be to offer any future lease/development/sale opportunity to the market.

Yours sincerely



Warwick Smith
Director
Procure Group Pty Ltd

Mr John Fisher
Director Asset Management
Transport Construction Authority
Transport for NSW
Level 5, Tower A
Zenith Centre
821 Pacific Highway
Chatswood NSW 2067

23 January 2012

Dear John,

INTERIM PROBITY ADVICE – 7 Darley Road Leichhardt

Transport Construction Authority, Transport for NSW, (TNSW) has requested that Procure Group Pty Ltd (Procure), as probity advisor for the Inner West Light Rail Project (Project), provide probity advice in relation to the direct negotiations held with the lessee of 7 Darley Road Leichhardt, RailCorp owned land adjacent to the light rail corridor.

INTRODUCTION AND SCOPE

You have requested that Procure provide comments from a probity perspective regarding the appropriateness of direct negotiations with the lessee of 7 Darley Road Leichhardt to obtain a portion of the leased site to meet the needs of the Project in regard to the proposed Leichhardt Station.

To assist our understanding of the issues, you met with Catherine Boardman, from Procure, on Friday 20 January 2012 and provided the following:

- Heads of Agreement between Tdrachhciel Pty Ltd (TDR) and TNSW for 7 Darley Road, Leichhardt
- Briefing Note to Director General TNSW dated 10 November 2011 (and supporting documentation) regarding the timeline for events for the proposed access to the site and delays to the development of the site allegedly caused by the then RTA and TNSW.

You noted that Procure had provided draft probity advice dated 2 June 2011 with regard to whether there was an obligation on Government from a procure/sale policy perspective to enter into direct negotiations with the current lessee for an extension to the lease (as had been requested by TDR). On the basis of the information obtained at that time, Procure concluded that the appropriate course of action would be to offer any future lease/development/sale opportunity to the market.

Our probity comments have had regard to the “fundamental principles” described in the NSW Independent Commission Against Corruption document entitled Direct Negotiations – Guidelines for Managing Risks in Direct Negotiations (May 2006). These fundamental principles are:

- Obtaining best value for money
- Providing a fair chance to do business with government
- Demonstrating accountability and transparency
- Dealing with conflicts of interest.

This advice has been completed for the purpose of assisting TNSW in its decision making in relation to the acquisition of land required for the Project. It is based on information provided by TNSW. The advice cannot be relied upon by any other party or for any other purpose. While the Probity Adviser may provide input into decisions made, TNSW remains responsible for the probity of its processes and decisions made.

DIRECT NEGOTIATIONS

The Independent Commission Against Corruption, in its publication ***Direct Negotiations – Guidelines for Managing Risks in Direct Negotiations***, provides guidance to public sector agencies when considering whether it may be appropriate to enter into direct negotiations and, if so, how negotiations should be managed. The guidelines state that “as a general rule direct negotiations should be avoided” on the basis that opportunities for corrupt conduct to occur are increased and because of the difficulty in demonstrating that best value for money has been achieved (p8).

The Guidelines do note that there are occasions where direct negotiations may be justifiable. In relation to real property rights they note that where a person holds a long term lease over land, “direct negotiations may be justified on the basis that the land is unique and necessary to the project” and that whilst “in some cases, it may be practical for an agency to purchase or compulsorily acquire the property, ... these processes can be time-consuming and expensive” (p17).

With regard to any lease extension, the Government procurement/sale default position in accordance with the Guidelines is, however, that the market should be tested unless direct negotiations can be clearly justified and supported. This is to ensure that the Government obtains best value for money in an accountable and transparent manner.

In order to justify direct negotiations with the incumbent leaseholder TNSW must be able to demonstrate, among other things, that the “unique” solution offered by the incumbent leaseholder by virtue of its real property is the only, or clearly the best, solution to the agency’s requirements. Based upon the information provided by TNSW and our knowledge as probity adviser for the Project, there would appear to be a reasonable possibility from a probity perspective that some form of direct negotiations could be supported. However, the documentation made available to us to date does not indicate how TNSW has determined that the Heads of Agreement represents the best solution for Government in terms of:

1. the incumbent leaseholder’s unique opportunity to maximise the public benefit;
2. clearly meeting all the Government’s stated objectives for the site (Procure has assumed that the agreed portions of the site for temporary access, easement and permanent acquisition is consistent with the stated objectives of the Project, however, it is not clear whether the outcome reflects long term objectives for the balance of the site); and

3. clearly demonstrating that it will deliver best value for money.

Some of the key risk areas are the absence of any documented assessment of possible options for meeting the objectives of the Project, or a clear rationale for including the extension of the lease term within the scope of the negotiations (particularly given that the current lease is due to expire in less than 6 years and that the rent under the current lease is significantly in arrears). Procure considers that the following documentation is required to ensure the transparency and accountability of the decision-making process can be demonstrated:

- a cost-benefit analysis or similar study of potential options to verify that the outcome of direct negotiations does not sacrifice value for money. The report should address the scope of direct negotiations, including consideration of extending the lease term as part of the negotiations.

Options may include:

- o direct negotiations as carried out
- o direct negotiations without extending the lease
- o compulsory acquisition
- o termination of existing leasehold agreement
- o postponing construction of Leichhardt Station until the current lease expires
- o changing location of Leichhardt Station to remove the need to acquire any portion of the site in question.

The analysis should take account of both financial and non-financial costs and benefits (including consideration of the principle of providing a fair chance to do business with government, and consideration of the risks of non-performance by the current lessee)

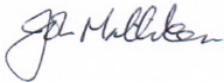
- evidence, if any, that the leaseholder has a legal right to negotiate a lease extension
- while the negotiations have already taken place, an indication of how these were planned and the protocols that were in place to ensure that the agreed scope was adhered to, who participated and whether or not the process was supported by independent experts (for example, legal advisers or commercial property services advisers, as required)
- records of the negotiation meetings (including as a minimum - date, time, location, purpose, attendees, key decisions/actions)
- evidence of approval processes (we note that the Director General has been kept informed on issues associated with the current leaseholder and that the Heads of Agreement has been signed by the Acting Director General, but have not sighted explicit approvals regarding the scope of direct negotiations – TNSW and RailCorp)

- Conflict of interest management strategies that were adopted (if these were not explicitly addressed during the negotiation process we recommend you obtain declarations of associations from participants to ensure TNSW is not exposed in this regard)

Procure would be happy to review any further documentation provided and to provide final probity advice once that is complete.

Please do not hesitate to contact me if you wish to discuss this interim advice.

Yours sincerely



John Milliken
Director
Procure Group Pty Ltd

Ms Brent Shanahan
Principal Manager Acquisitions, Property
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Transport for NSW
Level 5, Tower A, Zenith Centre
821 Pacific Highway
CHATSWOOD NSW 2067

1 August 2012

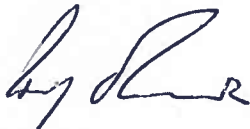
Dear Mr Shanahan

Probity Advice – Acquisition of 7 Darley Road Leichhardt.

O'Connor Marsden & Associates (OCM) has been engaged to provide probity advice to Transport for NSW (TfNSW) in accordance with your engagement correspondence of 14 June 2012. In this capacity, OCM has set out its report below in regard to probity aspects of TfNSW's proposed acquisition of 7 Darley Road, Leichhardt for the purposes of construction of the Inner West Rail Extension.

If you require any further information or wish to clarify any matters, please contact me on (02) 9252 2565.

Yours sincerely



**Rory O'Connor
Managing Director
O'Connor Marsden & Associates**

Contents

Executive Summary	5
Work Performed	8
Appendix A: Key Probity Principles	14
Appendix B: Statement of Responsibility	16

About OCM

The practitioners and team from O'Connor Marsden & Associates (OCM) are the market leader in the provision of probity services to the government sector across Australia. OCM has assembled a dedicated probity specific team that has conducted a considerable number of individual probity engagements for many Australian Local, State and Commonwealth government sector agencies, particularly targeting projects with high public profiles. The team has successfully addressed many complex probity matters such as conflict of interest management, interactive tendering processes, diverse stakeholder arrangements, detailed negotiation processes, testing phases and alternative bid submissions.

The services we provide are best described through our approach to Governance, Probity, Assurance and Forensic. Under Governance we provide advice and training programs in order to support project and program conformance and performance; under Probity, we review, audit and provide advice in relation to processes undertaken during procurement in order to meet the required standards and provide value-for-money; under Assurance, we examine and report on issues from an independent and expert third party perspective; and under Forensic we provide fraud and corruption risk management solutions, including Investigation Services.

About the Services

The services described in this document are of an audit and internal risk management nature only and are not intended to be of a financial services nature. The information set out in this document is provided for general information purposes and must not be relied on by the Agency without seeking independent advice on the relevant issues.

Confidential - this document and the information contained in it are confidential and should not be used or disclosed in any way without our prior consent.

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Executive Summary

Introduction

At the request of Transport for NSW (TfNSW), O'Connor Marsden & Associates (OCM) has undertaken a probity review of the process for the permanent and temporary acquisition by TfNSW of certain land located at 7 Darley Road, Leichhardt and a variation of the existing lease over that land (the land). The land is currently owned by Rail Corporation NSW (RailCorp) and subject to a lease held by Tdrahciel Pty Ltd (TPL) the current term of which is due to expire in 2018. TfNSW requires acquisition of part of the land, a footway easement, a work license and a partial lease surrender by TPL as tenant of the land for the construction of the Inner West Rail Extension (the light rail extension).

The engagement was performed in accordance with the Australian Auditing Standard on Assurance Engagements ASAE 3000, *Assurance Engagements Other than Audits or Reviews of Historical Financial Information* issued by the Australian Government Auditing and Assurance Standards Board. Further information in relation to the extent of the procedures performed and the scope of our engagement is detailed below and in the Statement of Responsibility in Appendix B.

Background

Transport for NSW (TfNSW) is constructing the Inner West Rail Extension (the light rail extension) from Lilyfield to Dulwich Hill. During the course of planning for the construction works it identified a parcel of land located at 7 Darley Road Leichhardt which falls outside of the existing rail corridor but which it identified as necessary to acquire in order to complete the project. The land is currently owned by Rail Corporation NSW (RailCorp) but is subject to a ground lease held by Tdrahciel Pty Ltd (TPL). TfNSW requires a portion of the leased land permanently as part of a proposed new station associated with the extension as well as temporary access to another portion of the land in order to undertake construction of the light rail extension.

The initial lease over the property was entered into in 1968 with a variation registered in 1994. From the documents we have been provided it appears that TPL took over the lease sometime in January 2007. Prior to this, in June 2006, a development application in relation to the land was lodged with Leichhardt Council by the previous tenant but it was rejected. As the new lessee TPL appealed this rejection to the Land and Environment Court which upheld the appeal and approved the development application.

It appears that the development application approved use of the land, amongst other things, for some form of retail operations. TPL claims that various retailers including Woolworths showed interest in entering into a sub lease for use of a portion of the land for this purpose. We have sighted correspondence between TPL and Woolworths and other smaller retailers which confirms this interest but nothing substantial appears to have eventuated. In any event, successful development of the property pursuant to the development application did not occur as there were a number of issues delaying the approval by Leichhardt Council and the Roads and Traffic Authority of the necessary road works. This approval was not forthcoming until early 2009.

TPL claims that in 2007 it also entered into negotiations with the then Department of Transport with a view to extending the term of the lease. During those discussions TPL asserts that the Department advised that some part of the property may be required for the light rail extension. TPL further asserts that due to the inability of the Department to

indicate the extent to which the property would be affected, various leasing opportunities had to be abandoned in 2008 and 2009. OPIAD

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In the circumstances, TfNSW considered that there were two options available to acquire the land, being compulsory acquisition or acquisition by agreement pursuant to the provisions of the *Land Acquisition (Just Terms Compensation) Act 1991* (the Land Acquisition Act). The costs associated with each of these options were prepared and analysed.

Having assessed those options TfNSW considered that acquisition by agreement provided the greatest certainty and posed the least risk from the legal, financial, project delivery and reputational viewpoints. It also considered that this option provided the greatest benefit for all parties. Acquisition by agreement involved TfNSW entering into direct negotiations with TPL and RailCorp as owner of the land. RailCorp indicated that it did not have any operational need for the leasehold land.

After prolonged negotiations a conditional Heads of Agreement (HOA) was entered into between TPL and TfNSW. We have been provided with a copy of that document dated 6 January 2012 and signed by Mr Shane Barr, Director of TPL and Mr Chris Lock, then Acting Director General for and on behalf of TfNSW. That HOA notes that it is subject to two conditions being;

- execution of a formal Deed of Acquisition and Release by TfNSW and TPL which is to be prepared by TfNSW solicitors at its cost and
- TfNSW receiving a satisfactory probity report acceptable to both RailCorp and TfNSW which is to be obtained at TfNSW's cost.

It is in this context that OCM has been requested to provide a probity advice as to the proposed acquisition by agreement.

Objectives

The Probity Advisor Brief from TfNSW requests that the probity report address the following:

- Determine whether the process followed is appropriate from a probity perspective;
- Confirm if direct negotiations by TfNSW in its role as acquiring authority are justified
- Determine whether RailCorp (as landlord) and as requested by TfNSW is entitled to grant an extension to the term of the current lease and consent to the lease variations, easements and other rights proposed by TfNSW without going to market at large on the basis that:
 - The extension and variations are part of the tenant's compensation resulting from the compulsory acquisition of interests necessary for the construction of the Inner West Light Rail Extension which is a public purpose in accordance with the TAA and the LAJTC Act

- Neither TfNSW nor the Landlord can engage in negotiations with other parties nor offer the ground lease to the public at large due to TPL holding an existing lease which does not expire until 2018.
- Confirm if the terms of the Deed of Acquisition by Agreement are appropriate.

In relation to the third and fourth dot points listed above, we have addressed these issues in the context of assessing whether the negotiation process has addressed the relevant probity principles in all material respects and we have provided observations in relation to these aspects of the negotiation process. In particular, we do not consider it within our area of expertise or consistent with the advice we have been asked to provide to express a concluded view as the appropriateness of the terms and conditions as expressed in the draft Deed.

Scope

In this respect, the scope of our engagement covers the probity aspects of the process undertaken by TfNSW in its dealings with TPL in order to gain access to the land necessary to complete the light rail extension.

We have focused on TfNSW's compliance with the requirements of:

- The ICAC *Guidelines for Managing Risks in Direct Negotiations*. May 2006 (ICAC Guidelines)
- The generally accepted probity principles as evidenced by TfNSW's negotiations with TPL. A description of these principles is included in Appendix A.

Methodology

Our methodology included an initial meeting with TfNSW where the background to the matter was discussed and examination of certain documentation provided to us, as more fully described under Work Performed, in order to review the documented probity controls and the related negotiation procedures. Additional clarifying information has also been provided on some key points raised in the initial Probity Advisor Brief.

As indicated by the HOA, the obtaining of a satisfactory probity report acceptable to both RailCorp and TfNSW is one of the conditions to be satisfied before agreement on the matters summarised in the HOA may be concluded. To this extent our advice has been sought in circumstances where the decision to negotiate directly with TPL with a view to acquiring the property by agreement has already been made. Our advice therefore is directed to a *post facto* review of that decision and the process leading up to the conditional agreement based on the material and information provided to us relating to these matters.

Conclusion

Based upon the work described in the Work Performed section, nothing has come to our attention to indicate that the negotiation process carried out by TfNSW with TPL for the lease variation relating to the land situated at 7 Darley Road Leichhardt has not substantially complied with the probity principles referred to and discussed in this advice.

Work Performed

In completing our work, we undertook the following tasks in order to provide advice from a probity perspective in regard to the process associated with the proposed agreement arising from direct negotiations involving TfNSW, TPL and RailCorp.

Rationale and authority to conduct direct negotiations

Criteria

The Independent Commission Against Corruption (ICAC) Guidelines state that while direct negotiations should generally be avoided due to the closed nature of the approach, there are circumstances where an agency can justify direct negotiations.

As a threshold issue, while stating a general rule, the ICAC's guidance on direct negotiations¹ acknowledges that an agency may "be forced into direct negotiations because of a lack of viable alternatives".

The ICAC's guidance material also makes reference to a number of circumstances where direct negotiations may be justified. With particular relevance to the circumstances of this matter as described in the Background section above, we note that one of the circumstances described by the ICAC relate to Real Property Rights. Real property rights exist if a proponent owns a parcel of land or real property that is on or near the site of the project, and direct negotiations may be justified on the basis that the land is unique and necessary to the project. We have been advised that the ICAC guidelines were reviewed and taken into account by TfNSW prior to entering into direct negotiations and during the course of the negotiations with TPL.

While we have not been provided with any documents or information on the issue, we assume that TfNSW has satisfied itself that there is no other viable site that meets its requirements in the same way that the Darley Street property does. On the basis that this is the case TPL is in a unique position given the current lease it holds over the property required and the rights that it thereby currently enjoys over the exclusive use of that property. We have previously noted that TPL continues to enjoy these rights under the current lease until 2018.

When referring to 'real property rights' the ICAC's guidance acknowledges that these rights can include long term leases or other rights over the land. Clearly, it would not be reasonable to delay construction of the light rail until 2018 when the current lease is due to expire. In these circumstances there is no current open market to engage with and the commencement of negotiations directly with TPL appears justified and reasonable in light of the existing lease.

In addition, ICAC's guidance material suggests that an agency, when determining the 'uniqueness' of the solution, should ensure that the unique solution offered by the proponent by virtue of the real property rights is the only, or clearly the best, solution to the agency's requirement². As indicated above we understand that TfNSW has satisfied itself that there is

¹ Direct Negotiations: Guidelines for managing risks in direct negotiations (Independent Commission Against Corruption, May 2006) – Chapter One: Understanding direct negotiations

² Chapter 2: Guidelines for Managing the Direct Negotiation Process, page 17

no other alternative site that meets the requirements in the same way as that offered by the Darley Street property.

In relation to the authority to commence direct negotiations we understand that the Director General's approval was obtained prior to entering negotiations with TPL and that negotiations were commenced by Mr John Fisher, Acting General Manager, Property, of the then Transport Construction Authority, (now TfNSW Transport Projects Division) with TPL in January this year. Given the sensitive nature and high public importance of the works in question the decision to deal directly with TPL and to acquire the property by agreement has been made at the appropriate senior level.

Value for Money

Criteria

The ICAC Guidelines require that direct negotiations should achieve a value for money outcome for Government.

The initial Probity Advisor Brief provided to us includes discussion and analysis of the various costs and benefits associated with each of the options considered by TfNSW to be available in acquiring the land in question. This includes a comparison and breakdown of the potential costs of compulsory acquisition as opposed to acquisition by agreement. The information set out in that brief, together with the supplementary information does suggest that obtaining value-for-money was a key objective guiding TfNSW in negotiating directly with TPL and in agreeing upon terms for that acquisition. Closely related was the need for long term arrangements regarding the site given the high public importance of the works for which the site is required.

We also note that in assessing whether to compulsorily acquire the property or to do so by agreement the various financial and legal consequences associated with each of these options has also been considered. In particular consideration was given to the prospect of TPL successfully challenging its entitlement to compensation based on it not being able to redevelop the land or on sell its interest. In the context of achieving a value for money outcome for Government it would have been more than appropriate for great weight to be attached to the desirability of avoiding costly, time consuming and in the circumstances problematic legal proceedings. In this regard we are advised that both TfNSW and TPL agreed that a negotiated solution would provide the best outcome for all concerned. TfNSW also acknowledges that TPL's inability to successfully develop the land is in part attributable to the uncertainty surrounding the future use of some of the land as indicated by RailCorp when TPL initially approached it to negotiate a further extension of the lease. We have already noted that TPL had previously foreshadowed this issue as a potential basis for a claim for compensation in correspondence with TfNSW if the site were to be compulsorily acquired.

We have not been provided with any documentation evidencing the negotiation process such as minutes of any meetings, documented decisions reflecting each stage of the negotiation process or anything in the way of a Negotiation Protocol directed to guiding negotiations. While no single document of this kind may have been prepared we have been advised that prior to any meetings with TPL a full document review of past correspondence between TfNSW, RailCorp and TPL in relation to the site and the related lease was conducted. We have also been advised that TfNSW has kept all documents and correspondence generated as a result of the negotiations as well as storing this material electronically on the TfNSW's data storage network thus evidencing an audit trail of decision making and creating an auditable document trail should further review on any aspect of the negotiations be required. To this extent, the matters referred to in the Probity Adviser Brief highlight the more salient points touching on TfNSW's acknowledged objective of achieving value for money as drawn from this larger body of material.

We do note the two independent expert reports provided by Lunney Watts & Associates Pty Ltd, property valuers and consultants, on behalf of TfNSW which we assume were obtained for use as part of the negotiations although each report appears to have been prepared after the HOA was signed.

The first of these reports provided valuations as at 1 March 2012 including:

- A determination of compensation of the proposed extinguishment of part of the Leasehold Interest over the subject property under the provisions of the Land Acquisition Act;
- A current market value assessment of the Lessor's interest
- Current market value of the Lessee's and Lessor's interests assuming a twenty year extension of the lease, from 2018 to 2038 and
- An assessment of the market value of the ground rental.

The second report addressed determination of compensation associated with partial acquisition of the land subject to the lease held by TPL.

Both of these reports are comprehensive and appear thorough and well considered and address the major issues of concern to all parties from the perspective of obtaining value for money.

The report addressing fair and reasonable compensation appears particularly wide ranging and detailed addressing such issues as;

- The relevant provisions of the Land Acquisition Act
- The impact of the development approvals obtained by TPL over the land;
- An analysis of the valuation rationale adopted;
- Considerations relating to the ground lease rental.

Review of the HOA and the terms of the draft Deed appear to take into account the matters addressed in these reports. As noted earlier, we are advised that TfNSW and RailCorp paid particular regard to obtaining best value for money in agreeing to proposed terms as reflected in the HOA and the draft Deed.

One aspect of the draft Deed that does deserve further comment in the context of consideration of value for money is the proposal to grant TPL an extension of the varied lease for another twenty years from 2018 to 2038. Clause 8.1 of the draft Deed provides that TPL agrees that it is fully compensated by the effect of the variation of the lease and in particular the extension of the term. OPIAD

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Providing a fair chance to do business with government

Criteria

The ICAC Guidelines require that direct negotiations must not prevent other organisations from being provided with a fair chance to do business with Government.

The ICAC Guidelines support an agency conducting direct negotiations with a proponent if only the proponent owns real property, intellectual property, or some other unique element, which can deliver a project's essential outcomes.

We have already noted that TPL has existing lease rights for approximately another six years over the whole of the property and that it would not be reasonable to delay construction of such an important piece of public infrastructure for this period. We have also noted the interest of at least one other party to tender for the site, either by acquisition or long term lease when the current lease expires. In these circumstances however it would not be unreasonable for TfNSW to deal directly with TPL with a view to acquiring parts of the property and providing for access to other parts in order to complete its construction. We have also noted the need for "bedding-down" long term arrangements given the important public aspect of those works.

Demonstrating accountability and transparency

Criteria

The ICAC guidance material requires the demonstration of accountability and transparency in direct negotiations.

We have already noted that while no single document in the form of a negotiation protocol was agreed upon and prepared before negotiations with TPL were commenced, the matters normally covered in such a document appear to have been addressed and acknowledged in other ways. A negotiation protocol is a useful tool that addresses the principles of probity for the negotiation process such as:

- confidentiality requirements
- conflicts of interest
- supervising negotiations

- names of the parties with authority to negotiate
- time table for negotiations
- assessment process

As noted previously many of these matters appear to have been addressed during the course of negotiations. We have been advised that there is a document trail of correspondence between TPL and TfNSW reflecting the various stages of the negotiation process such as information of the kind addressed in the reports of Lunney Watt and Associates setting out each party's position on key issues the subject of negotiation. There is no information that suggests TPL at any time had any probity issues associated with the negotiations and proposed agreement.

TfNSW has advised that once the draft Deed is executed it will publish the outcome on its website consistent with past practice relating to tenders and other procurement outcomes. Such a course is to be encouraged as it provides transparency by showing the process that has been followed allowing the public and other interested parties to be satisfied that appropriate procedures and processes have been followed and the relevant risks assessed and considered..

Dealing with conflicts of interest

Criteria

The ICAC guidance material notes that dealing with conflicts of interest is one of the probity principles in direct negotiations that should be managed.

We have been advised that Mr John Fisher of TfNSW was asked by Mr Chris Lock, the Acting Director General of TfNSW to take charge of the negotiations with TPL in January this year. Negotiations were commenced in response to TPL's correspondence with TfNSW expressing its frustrations at failing to achieve clarification of TfNSW's intentions in respect of the land. These negotiations were directed at reaching agreement on the land to be acquired by TfNSW and compensation payable to TPL for the surrender of its interest in part of the property.

We are advised that Mr Fisher had not previously met with Mr Shane Barr, the director of TPL who appears to have negotiated on behalf of TPL nor does he own any property interests in the Leichhardt area. At the time Mr Fisher was the Acting General Manager, Property at the then Transport Construction Agency. We have also been advised that Mr Fisher had no prior involvement with TPL or the construction of the light rail extension.

TfNSW also advise that all participants involved in the negotiations have been required to adhere to its Code of Conduct which includes such matters as acknowledging and managing any conflicts of interests. Steps were also taken to segregate duties and responsibilities amongst key personnel involved in such matters as identification of the preferred option to pursue, the negotiation process, appointment of independent valuers and probity auditors.

Risk Mitigation Strategies

Criteria

The ICAC's guidance material suggests that the risks associated with direct negotiations are reduced by adopting the following eight key steps during the negotiation process.

We have set out in the table below our observations on the compliance by TfNSW with the eight steps recommended by ICAC based on the information we have been provided:

ICAC recommended step	Observation	Agency compliance
1. Making the decision	<i>For this Project the decision making authority is the Director General of TfNSW who appears to have approved the decision to negotiate directly with TPL; the negotiation process was delegated to another senior officer of TfNSW under the Agency of the Director General.</i>	✓
2. Identifying and managing conflicts of interest	<i>Staff associated with the Project required to adhere to TfNSW Code of Conduct covering such matters as confidentiality and conflict of interest undertakings.</i>	✓
3. Obtaining external assistance	<i>TfNSW engaged the assistance of appropriate external advisors to provide expert advice on key issues of just and fair compensation and relevant market values and evaluations</i>	✓
4. Establishing a negotiation protocol.	<i>No single document created but relevant matters addressed and recorded in a series of other separate documents and correspondence</i>	✓
5. Agreeing the price and compensation	<i>Lease variation and compensation for acquisition agreed in principle based on relevant financial and legal considerations, lease term and OPIAD as well as on-going rent for Director General's review and final approval.</i>	Pending.
6. Segregating duties	<i>Segregation between the unit managing construction of the works and those who conducted direct negotiations with the lessee.</i>	✓
7. Supervising the Project.	<i>Lease amendment has not yet been approved</i>	Not currently applicable.
8. Post completion evaluation.	<i>Checklist for undertaking direct negotiations to be completed together with preparation of written summary review to serve as record of activities undertaken and final agreements reached. TfNSW has the resources and experience to conduct this review after completion of the project, if the project proceeds.</i>	Pending

Appendix A: Key Probity Principles

Accountability of the participants and transparency of the process

Accountability and Transparency are related concepts. Accountability involves agencies being able to justify the use of public resources to an appropriate authority by allocating and taking responsibility for past and expected performance. This includes aligning the decision making process with the appropriate delegated authority, and keeping adequate records that will leave an auditable trail. Transparency refers to the preparedness to open a project and its processes to scrutiny and possible criticism. This also involves providing reasons for all decisions that are taken and the provision of appropriate information to relevant stakeholders.

Fairness, impartiality and honesty

Individuals and organisations involved in preparing and submitting proposals are entitled to expect impartial treatment at every stage of the process. If they do not consider the process to be fair, impartial and honest they may withhold valuable ideas or be deterred from bidding in the future. Any form of bias, whether driven by personal interests or not, could jeopardise the integrity of the project. Procedures that include multiple person panels, independent members and observers mitigate this risk.

Management of Conflicts of Interest

A conflict of interest is a conflict between the public duty and private interests of a public official where the public official has private interests which could improperly influence their official duties and responsibilities. The community and potential tenderers have a right to expect that public officials will make decisions that are not influenced by private interests. Similarly, when the private sector is engaged to perform public sector duties, there is an obligation to ensure that conflicts of interest are disclosed and effectively managed. Perceived or potential conflicts of interest can be as damaging as actual conflicts, and procedures should be implemented to mitigate the effect.

Maintenance of confidentiality and ensuring security

Although accountability and transparency are fundamental to the work of public sector organisations and public officials, there is some information that needs to be kept confidential, at least for a specified period of time, in order to protect the integrity of the process and give tenderers the confidence to do business with government. This information can include the content of proposals, intellectual property and tenderers' pricing and profit structures. Importantly, much of the information relating to the project needs to be kept confidential up to the point where a contract is executed with the successful tenderer. However, once this has happened, government guidelines require that certain information be released, consistent with the fundamental principles of public sector accountability and transparency, as discussed above. Procedures must be implemented to ensure that no unauthorised release of confidential information occurs.

Attaining value for money

This is demonstrated by the use of an open competitive environment in which the market is tested regularly, and tenderers can make attractive, innovative proposals with the confidence

that they will be assessed on their merits. Value-for-Money is not necessarily achieved by accepting the lowest available price. The process should include: the evaluation of non-price criteria (such as the quality of the goods or services offered, the experience and past performance of the providers, the financial strength of the companies, the differing risk factors, the quality of the personnel, etc.); cost-benefit analysis against a target outcome or budget; the assessment of the total cost over the proposed life of the project; and, where appropriate, whether the outcome is best achieved by the Private Sector, using a Public Sector Comparator. Lapses in probity may lead to one or more parties obtaining unreasonable financial gains at the expense of the public interest. Procedures should include a comparison of the non-price and price criteria on a weighted basis, with both the criteria and the weighting between price and non-price criteria declared in the call documentation.

Appendix B: Statement of Responsibility

Management's responsibility for the evaluation process

The management of TfNSW (the Agency) are responsible for the design and implementation of the evaluation process controls in accordance with Government and the Agency's policies. This responsibility includes establishing and maintaining processes relevant to the evaluation process to ensure that the process meets appropriate probity policies, laws and regulations; and leads to selecting the most appropriate tenderer or tenderers under the prevailing circumstances.

Assurance practitioner's responsibility

Our responsibility is to express a conclusion on the Evaluation Process based on our review. We conducted our review in accordance with the Australian Auditing Standard on Assurance Engagements ASAE 3000, Assurance Engagements Other than Audits or Reviews of Historical Financial Information issued by the Australian Government Auditing and Assurance Standards Board, in order to state whether or not, on the basis of the procedures described and witnessed where appropriate, we have become aware of any matter that makes us believe that the evaluation process is not in accordance with the principles described above.

A review consists primarily of making enquiries, primarily of persons responsible for undertaking the evaluation process and its underlying documentation, applying analytical and other review procedures, and examination of evidence for a small number of transactions or events. A review is substantially less in scope than a reasonable assurance audit conducted in accordance with ASAE 3000. Accordingly, we do not express an audit opinion. Had we performed a reasonable assurance audit as defined by ASAE 3000 or an audit as defined by the Australian Auditing Standards, additional information may have come to our attention, which would have been reported to the Agency.

While conducting our review and/or in our report we may provide advice and/or recommendations in relation to the mitigation of risk of challenge to the processes undertaken by the Agency. In these cases, our responsibility is limited to providing such advice and/or recommendations, based on our experience and knowledge of the subject matter of the project. For the avoidance of doubt, the procedures performed in providing advice and/or recommendations do not constitute an assurance engagement in accordance with the Australian Auditing Standards for Assurance Engagements, nor do they represent any form of audit under the Australian Auditing Standards. We therefore do not express any form of assurance in relation to the advice and/or recommendations, and none should be inferred from any such commentary in this report.

Inherent limitations

Our Work is subject to the following limitations:

- Owing to the inherent limitations of any internal control structure, it is possible that errors or irregularities may occur and not be detected. Our procedures were not designed to detect all weaknesses in control procedures as they were not performed continuously throughout the period and the tests performed are on a sample basis.

- Any projection of the evaluation of the control procedures to future periods is subject to the risk that the systems may become inadequate because of changes in conditions, or that the degree of compliance with them may deteriorate.
- The matters raised in this report are only those which came to our attention during the course of performing our procedures and are not necessarily a comprehensive statement of all the weaknesses that exist or improvements that might be made. We cannot, in practice, examine every activity and procedure, nor can we be a substitute for management's responsibility to maintain adequate controls over all levels of operations and their responsibility to prevent and detect irregularities, including fraud. Accordingly, management should not rely on our report to identify all weaknesses that may exist in the evaluation process, or potential instances of non-compliance that may exist.

Advice and/or recommendations for improvement should be assessed by management for their full commercial impact before they are implemented.

Limitations on use

This report is made solely to the management of TfNSW in accordance with our engagement letter of 14 June 2012, for the purpose of providing comfort to senior management on the appropriateness and robustness of the evaluation process and should not be quoted in whole or in part without our prior written consent. We disclaim any assumption of responsibility for any reliance on this report to any person other than the management of the Agency, or for any purpose other than that for which it was prepared.

We disclaim all liability to any other party for all costs, loss, damages, and liability that the other party might suffer or incur arising from or relating to or in any way connected with the contents of our report, the provision of our report to the other party, or the reliance on our report by the other party.

Independence, Competence, and Experience

All professional personnel involved in this engagement have met the independence requirements of the Australian professional accounting bodies.

'C'

PROBITY ADVISOR BRIEF

7 DARLEY ROAD, LEICHARDT

BUSINESS CASE & ACQUISITION SUMMARY

Background Information

The property known as 7 Darley Road, Leichhardt is currently under a ground lease from RailCorp to Tdrahhciel Pty Ltd. TfNSW is proposing to construct the Inner West Rail Link Extension and requires various portions of the site to enable construction.

After prolonged negotiations, a conditional Heads of Agreement (HOA) was entered into between Tdrahhciel Pty Ltd and TfNSW (Attachment 1).

Following on from the HOA, documents have been drafted to formalise the compulsory acquisition by agreement of the required interests under the Land Acquisition Just Terms Compensation Act (LAJTCA).

The documents are listed below and included as "Attachment 2".

- i. Updated summary of the document terms;
- ii. Draft Deed of Acquisition & Release with the coloured site plan as Annexure A;
- iii. Draft Variation of Lease (Annexure D to Deed);
- iv. Draft Transfer Granting Easement for the footway easement (Annexure B to Deed);
- v. Draft of the Partial Lease Surrender (Annexure C to Deed).

Copies of various correspondence received from the tenant are included as "Attachment 3" and a valuation report and advice commissioned by TfNSW, is included as "Attachment 4".

RailCorp has confirmed that it does not have an operational need for the leasehold land and is agreeable to the key terms proposed subject to probity clearance, as evidenced by the HOA.

Outline of Acquisition Options

Essentially, there are two options available to TfNSW, Transport Projects Division (TPD), to acquire the interests necessary for the construction of the IWRLE project.

A) Compulsory Acquisition

Determining the cost of proceeding with compulsory acquisition in most cases is really dependent upon what the lessee could potentially claim. Compensation for a lessee's interest would normally be related to either profit rental or the lost opportunity to sub-lease.

The terms of the current lease **OPIAD** which expires in 2018, means that effectively there is unlikely to be profit rent.

In regards to the lost opportunity to sublease the key concern would be if the lessee was able to claim compensation for the lease not being extended. Currently the remaining term results in it not being economically viable to remediate or redevelop in order to sub lease the premises.

Arguably (see tenant's correspondence), **OPIAD**
OPIAD

The site is presently vacant and cannot be occupied in its current state. The lessee had intended to redevelop the site but due to uncertainty of tenure and delays, there is likely insufficient time remaining to redevelop the site to its full potential and make it commercially viable within the current lease term.

The lessee has provided support that they approached the landlord (RailCorp) in 2009 to extend the lease for a further 20 years. The landlord advised that they would not extend due to the possibility of the land being required for the IWRLE project. Consequently, OPIAD
OPIAD

If TfNSW were to proceed with compulsory acquisition, OPIAD
OPIAD

OPIAD

The current state of the improvements and site requires remediation or demolition. If the property is compulsorily acquired, the acquiring authority and/or RailCorp will be responsible for all associated costs and it is OPIAD. Under the current lease, the tenant owns and may remove all improvements (including the building structure), should it chose to do so, thereby denying the landlord the benefit of inheriting the improvements on expiry of the lease.

B) Acquisition by Agreement

As noted on the preceding page, a deed of acquisition has been prepared in negotiation with the lessor, lessee and TfNSW, the details of which are contained in the attachments.

A cost comparison of the two acquisition options is tabled below.

Option A - Potential Cost of Compulsory Acquisition to TfNSW

TPD Potential Cost Item	Amount	Comments
Tenant claim for costs & income loss	OPIAD	Tenant's claim dependent on determination
Disturbance		Includes valuation etc and would be dependent upon duration of process
Compensation for permanent land take		Dependent on determination
Compensation for access easement		Dependent on determination
Compensation for temporary worksite		Dependent on determination (3 year term)
Legal Costs		Would be dependent upon duration of process
Delay in site acquisition and impact on property		Potential costs to project & time and acquisition of alternative temporary worksite
Reputational risk & negative media		Cost of managing impacts only
TOTAL	OPIAD	Reduced to OPIAD if tenant claim for costs & income loss is unsuccessful.

RailCorp Potential Cost Item	Amount	Comments
OPIAD	OPIAD	Assuming Railcorp OPIAD OPIAD, ...
Remediation of site & improvements		Cost to bring improvements to lettable standard
Loss of Future Rent		Allow 12 months
Total	OPIAD	Subject to duration of legal proceedings

Total Potential Cost of Compulsory Acquisition to Transport Portfolio

Possible Worst Case (If tenant's claim for costs and loss of income is successful)	OPIAD
Likely Outcome (If tenant's claim is rejected & minimal compensation awarded)	

Option B - Potential Cost of Acquisition by Agreement to TfNSW

TPD Potential Cost Item	Amount	Comment
Legal & Probity costs	OPIAD	Majority work completed
Internal costs		Majority work completed
Re-instatement of lost car spaces		Incorporated into draft documents
Re-mediation of site (portion only)		Incorporated into draft documents
Total	OPIAD	Draft documents agreed between tenant and TPD, subject to probity & RailCorp review.

RailCorp Potential Item		
Legal costs	OPIAD	Draft documents to be reviewed by legal
Internal costs		RailCorp has signed off on HOA
Total	OPIAD	Documents to be issued post probity review

Total Potential Cost of Acquisition by Agreement to Transport Portfolio OPIAD

Possible Worst Case (If negotiations are protracted & design issues encountered)	
Likely Outcome (If final agreement is promptly reached and no probity issues)	

Benefits of Acquisition by Agreement (Assuming 20 year Lease Extension)

Acquisition by agreement will result in the following key benefits for the respective parties.

TPD, TfNSW (Acquiring Authority)	\$ Benefit	RailCorp (Landlord/Lessor)	\$ Benefit	Tdrahciel P/ L (Tenant/Lessee)	\$ Benefit
Permanent land to house lift & stairs for IWRLE station entry a OPIAD	OPIAD	20 year extension of ground lease to 2038, providing for more secure long term investment & cash flow.	OPIAD	Extension of lease by 20 years providing for certainty of tenure and ability to sell leasehold.	OPIAD
Permanent access easement enabling public entry to IWRLE station OPIAD	OPIAD	Rent for additional lease term increased from OPIAD	Included above	Ability to redevelop & sub lease as per approved DA and amortise development costs over the lease term.	Subjective benefit. Not costed.
3 year worksite for IWRLE station construction a OPIAD		OPIAD	OPIAD	OPIAD	
Permanent right to use tenant's sub-station at OPIAD		Site remediation, enhancement & refurbishment of building by tenant.		Ability to obtain funding for site/building improvements	Subjective benefit. Not costed.
Certainty of land provision, timing, design & associated cost benefits.	Subjective benefit. Not costed.	Transfer of ownership of all improvements on lease termination.		OPIAD	Subjective benefit. Not costed.
No TfNSW delivery reputational risk or negative publicity.	Subjective benefit. Not costed.	Ability for RailCorp to inherit future tenancies & resulting rental income	Subjective benefit. Not costed.	No legal action or dispute costs.	OPIAD
No legal action or dispute costs.	OPIAD	No legal action or dispute costs.	OPIAD		OPIAD
Total	OPIAD		OPIAD		OPIAD
Total Gross TfNSW Benefit		OPIAD		Total Lessee Benefit	

Business Case Summary

An analysis of the available information, which includes draft valuation reports and the suite of acquisition documents (attached), would indicate that acquisition of 7 Darley Road Leichardt by agreement provides greatest certainty and poses the least risk from legal, financial, project delivery and reputational viewpoints. It also provides the greatest benefits for all parties.

A financial comparison of the two acquisition options is provided in the table below.

Business Case Financial Summary	Option A Compulsory Acquisition (Dependent upon Legal Proceedings)		Option B Acquisition by Agreement
	Best Case	Worst Case	Likely Outcome (Based on Draft Deed)
Costs	OPIAD		
Transport Projects Division			
Railcorp			
Lessee			
Benefits			
Transport Projects Division			
Railcorp			
Lessee			
Total Net Benefit			
Transport Projects Division			
Railcorp			
Lessee			
TfNSW Portfolio			

Probity Instructions and Special Considerations

In addition to standard considerations, TfNSW requires the probity report address the following:

- determine whether the process followed is appropriate from a probity perspective
- confirm if direct negotiations by TfNSW in its role as acquiring authority are justified
- determine whether RailCorp (as landlord) and as requested by TfNSW, is entitled to grant an extension to the term of current lease and consent to the lease variations, easements and other rights proposed by TfNSW without going to the market at large on the basis that:
 - the extension and variations are part of the tenant's compensation resulting from the compulsory acquisition of interests necessary for the construction of the IWRLE, which is a public purpose in accordance with the TAA and the LAJTCA.
 - neither TfNSW nor the landlord can engage in negotiations with other parties nor offer the ground lease to the public at large due to Tdrahhciel Pty Ltd holding an existing lease which does not expire until 2018.
- confirm if the terms of the Deed of Acquisition by Agreement are appropriate.

For further details and to arrange a briefing, please contact:
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