



ANZSOG Case Program

Reading the fine print: contract governance in the privatised Victorian Prison Sector

2016-184.1

Victoria's prison system, long plagued with issues, was by the early 1990s facing a number of significant problems. Operating costs were high, there was declining and inadequate infrastructure, and poor productivity and low levels of accountability and transparency were evident.¹ In particular there were allegations of poor conditions and that minimum standards were viewed more as 'guiding principles... intended to show the spirit in which correctional programs should be administered and the goals towards which administrators should aim'.² Having insufficient public funding available for improvement, the Kennett Liberal-National government oversaw a significant privatisation agenda and reform.³ With significant enthusiasm for New Public Management and the outsourcing of government services, the government commissioned three new private prisons under the public-private partnership (PPP) model. By the end of 1997, approximately 45% of the state's prison population was housed in private prisons, a change that brought new challenges in contract governance and management.⁴

This case was written by Professor Graeme Hodge and Ms Emille Boulot of Monash University. It has been prepared from published materials and field research as a basis for class discussion rather than to illustrate either effective or ineffective handling of a managerial situation. The assistance of all interviewees is gratefully acknowledged, however responsibility for content rests with the authors.

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¹ Daly, T. (1997) 'Policy overview and framework for prison privatisation in Victoria', Paper presented at the *Australian Institute of Criminology Conference Privatisation and Public Policy: A Correctional Case Study*, Melbourne, 16-17 June.

² Conference of Correctional Administrators (1996) *Standard Guidelines for Corrections in Australia*, Melbourne, Corrective Services Ministers' Conference, Section 1.

³ Sands, V. & Hodge, G.A. (2014) 'The Victorian Government's prison privatisation project (1992-2010): The pathway to cost efficiency? A longitudinal analysis', *Contemporary Issues in Business and Government* 20 (1), pp7-26.

⁴ Daly, op cit.

Managing a hybrid public and private sector

To manage a newly hybrid public and private sector, in 1995 the government established the Office of the Correctional Services Commissioner (OCSC), within the Department of Justice & Regulation (DOJR), to advise on policy and monitor service delivery. The Public Sector Corrections Agency was established to manage the delivery of services through public prisons, and a Corrections Contract Administrator and Branch was set up as the purchaser of services from the private sector as well as the manager of the associated contracts and agreements.⁵

The first round of prison PPP contracts were signed in the mid-1990s: Deer Park Metropolitan Women's Centre and Port Phillip Prison (both 1996) and the Fulham Correctional Centre (1997). The Port Phillip Prison and the Fulham Correctional Centre contracts were for accommodation services as well as correctional services with both having a concession period⁶ of 20 years for accommodation services and 5 years (Port Phillip) and 3 years (Fulham) for correctional services.⁷ The Prison Service Agreements for Port Phillip Prison and Fulham Correctional Centre linked performance payments to service standards with an additional 'performance-linked fee' at the end of each year.⁸ The contracts allowed for reductions in the accommodation services charge and the performance-linked fee if the contractor had not provided the services to the standards specified in the contracts. (*Exhibit A* lists contractual quality standards).

Improving accountability, limiting involvement

It would not be long before issues arose around these first contracts. For instance, at Port Phillip Prison, issues with the agreement had resulted in an issuing of a default notice and a government inquiry.⁹ Deer Park Metropolitan Women's Centre, with similar contractual requirements, had received three default notices relating to performance standards with the OCSC¹⁰ in 2000 finding that there were difficulties in persuading the contractor and the contract management branch of DOJR to 'fully comprehend and acknowledge the extent and implications of contractual obligations in relation to prison management, leading to a final breakdown in contractual, competence and goodwill trust'.¹¹ An administrator was appointed to manage Deer Park in 2000, with ownership and management consequently transferred to the public sector due to 'contractual anomalies'. New policies, a new governance structure, and new Partnership Victoria state-wide guidelines for government agencies were in place before the next PPP contracts were signed.

In 1999, the Victorian Auditor General¹² had identified a number of concerns regarding the independence of the OCSC and other shortcomings in relation to the accountability of the Commissioner. The Auditor-General recommended that the regulatory framework should establish

⁵ Daly, op cit.

⁶ A 'concession' or 'concession period' is a contractual provision that provides an exclusive right to operate, maintain and/or carry out investment for a defined period of time.

⁷ There is provision for the contracts to be extended by 10 years for Port Phillip Prison and 20 years for Fulham Correctional Centre. However, there is no obligation to transfer the assets prior to the expiry of the Crown leases, which expire in 2037 for Port Phillip Prison and 2047 for Fulham Correctional Centre.

⁸ In 2009, the maximum performance-linked fee as a proportion of the sum of the accommodation and correctional services fees was 1.6% for Port Phillip Prison and 3.3% for Fulham Correctional Centre.

⁹ Kirby, P., Roche, V. & Greaves, B. (2000) *Independent Investigation into the Management and Operations of Victoria's Private Prisons* (Kirby Report), Department of Justice - Corrections Victoria, Melbourne.

¹⁰ Office of Correctional Services Commissioner (OCSC) (2000) *Correctional Services Commissioner's Report on the Metropolitan Women Correctional Centre's Compliance with its Contractual Obligations and Prison Services Agreement*, OCS, Melbourne.

¹¹ English, L. and Baxter, J. (2010) 'The changing nature of contracting and trust in public-private partnerships: The case of Victoria PPP prisons', *Abacus*, 46 (3), pp289-319.

¹² Auditor General of Victoria (1999) *Victoria's Prison System: Community Protection and Prisoner Welfare*. Special Report No. 60, Victorian Auditor-General's Office (VAGO), Melbourne.

the Commissioner at arm's length from the department with a direct line of accountability either to the parliament or via the minister. Following the release of this report, the newly elected Bracks Labor Government sought further reform.

In 2003 the Victorian corrections sector was restructured with the aim of establishing what the Minister for Corrections called 'A More Seamless System'.¹³ Corrections Victoria, a business unit of the DOJR was established to oversee the entire prison sector. The role of the unit was to implement court judgments and orders of the Adult Parole Board. It set strategy, policy and standards for the management of the state's system of correctional facilities as well as developing programs for the containment and rehabilitation of prisoners and the community-based supervision of offenders. The former OCSC, the public service provider and the contract administration team for private prisons were brought together as one entity within Corrections Victoria. A Corrections Inspectorate business unit was established to monitor and inspect the performance of public and private prisons.

Two further accommodation services contracts for a concession period of 25 years (Marngoneet Correctional Centre Accommodation Services PPP and the Metropolitan Remand Centre Accommodation Services PPP) were signed in 2003. Following a change in policy, the role of contractors in the delivery of public services was significantly curtailed.¹⁴ Private involvement was now limited to the design and build of prisons and the provision of ancillary services to support the infrastructure. Corrections Victoria was therefore required to undertake the 'core' functions of these prisons (i.e. custodial services). The new contracts were known as Facility Service Agreements (FSAs).

The FSAs for the Metropolitan Remand Centre and the Marngoneet Correctional Centre were undertaken in accordance with the *Partnerships Victoria Framework (Exhibit B)* developed in 2000. These contracts built in monthly fees for accommodation services and these fees could be reduced where faults were not rectified within prescribed time limits. The FSAs also allowed for spot-checking and auditing of performance against the key performance indicators (KPIs). Independent observers English and Baxter¹⁵ considered these simpler but stronger post-2000 contracts promoted the development of goodwill and trust that should avert the problems encountered with the first round of contracts.

An overdue audit

In 2010, the Victorian Auditor General's Office (VAGO) audited the management of prison accommodation PPPs, noting¹⁶ that an audit was overdue, not only because of prison contracts dating back more than ten years, but also that DOJR was unable to demonstrate that it was continuing to receive value-for-money in terms of the standard of prison accommodation services it was purchasing.

In relation to contractual governance, VAGO¹⁷ found that the early Prison Service Agreements (PSAs) for the Port Phillip Prison and Fulham Correctional Centre PPP contracts did not adequately define the quality standards for accommodation services and could not therefore adequately monitor the contractor's performance and enforce service payment reductions. (This lack of adequately specified quality standards had been a long-standing issue for DOJR).¹⁸ The private operator was not required to report KPI information on accommodation services, rather the PSA only required the operator to

¹³ Sands, V. (2004) 'Regulatory independence, public accountability and the Victorian prison system', *Australian Journal of Public Administration* 63 (4), pp50-58.

¹⁴ Partnerships Victoria (2005) *Partnerships Victoria Guidance Material: Standard Commercial Principles*, Victorian Department of Treasury and Finance, Melbourne.

¹⁵ English and Baxter, op cit.

¹⁶ Victorian Auditor-General's Office (2010) *Management of Prison Accommodation Using Public Private Partnerships*, Report No. 2010-11:9, VAGO, Melbourne.

¹⁷ Ibid.

¹⁸ Kirby et al., op cit.

keep sufficient data such that an audit trail could be established. There were no provisions for independent audits of performance data, although DOJR had introduced an annual accommodation service review. While these reviews often identified issues and faults, the PSAs did not define the standards for timely rectifications of these faults.¹⁹

The PSAs for the Port Phillip Prison and Fulham Correctional Centre were also silent on the standard of the facilities when returned to the state at the end of the concession period. VAGO noted that the contractors would have recovered all capital and debt-servicing costs incurred for the initial construction of the facility by 2012 for Port Phillip Prison and 2017 for Fulham Correctional Centre. With no debt service payments at risk from that time, the contractor would have little incentive to maintain the quality of the buildings.²⁰

Better mechanisms under-used

Despite the better contractual mechanisms introduced in 2003 for oversight in the Metropolitan Remand Centre and the Marngoneet Correctional Centre, VAGO²¹ found that these provisions were underutilised and decisions were under-documented when utilised. Better quality evidence was required to determine whether the reported data supplied to DOJR from the prison operators was complete and accurate. The *Partnerships Victoria Framework* (see *Exhibit B*), applying to these contracts, required that contractors provide an independent audit report of KPI data, and quarterly KPI reports on request. However, at the time of VAGO's 2010 audit, DOJR had neither audited the data provided to it nor had it otherwise independently verified. DOJR considered the contractor's own internal audits of its systems and processes provided adequate assurance of data integrity. On the other hand, VAGO concluded that as DOJR did not have a direct relationship with the internal auditor, nor receive internal audit reports either from the contractor or directly from its own internal auditor, there was no reasonable basis to assume that the data provided was accurate.

Similarly, despite the arguably better service quality requirements in the post-2000 Facility Service agreements, VAGO concluded that DOJR was not using contract provisions effectively to monitor and evaluate contractor performance across the private prison sector. In particular VAGO was concerned that, by not documenting the reasons for granting extensions of time to rectify faults, DOJR could not obtain an advantage in the renegotiation of services or standards and could not demonstrate that these decisions have not financially disadvantaged the state. Because there were several separate DOJR divisions involved in the management of the privatised prison sector, governance structures were overly complex, with multiple reporting lines and duplication of responsibility.

Other observers, such as English and Baxter²² have also critiqued the 2003 governance restructure. They see it as having done little to increase the independence of the monitoring of performance and other regulatory functions, and may have even decreased it compared to the previous institutional model. As well, although the shift to a privatised prison sector was largely motivated by getting better value-for-money and decreasing costs, according to comparative performance reporting by the independent Productivity Commission, Victoria spends more per prisoner than any other state or territory (with the exception of the ACT and Tasmania).²³

¹⁹ In their separate review, English and Baxter op.cit., note that the PSAs do not include provisions for changes in the scope of services or performance standards, and there is an absence of gain sharing provisions with macro-level descriptions of quality specifications.

²⁰ VAGO 2010, op cit.

²¹ VAGO 2010, op cit.

²² English and Baxter, op.cit.

²³ Steering Committee for the Review of Government Service Provision (2012) *Report on Government Services*, Productivity Commission, Canberra.

A new approach at Ararat

In 2010, the Minister for Corrections signed a PPP agreement with Aegis Correctional Partnership Pty Ltd (Aegis) to design, construct and finance a range of new facilities and systems including a 358-bed medium security expansion of the existing Ararat Prison, for a period of 25 years. Aegis entered into a range of contractual relationships with its consortium partners to deliver parts of the project, but Aegis itself was ultimately responsible for the delivery of the project.

The Ararat prison redevelopment was contracted after the release of *Infrastructure Australia National Guidelines* (2008) (*Exhibit C*). These guidelines, partly modelled on those issued earlier by Partnerships Victoria, apply to PPP projects throughout Australia and were developed to assist states to develop and manage PPPs, to maintain long-term value-for-money, and to manage PPP contracts. Although it is too early to be clear as to the impact that these guidelines have had upon oversight capability and contract performance mechanisms in Victoria, there were significant improvements in the Ararat Prison Project Agreement. These included contract provisions enabling the State to ask Aegis to perform additional minor works without the need to invoke the modifications regime, and for the contractor to save costs from new technology. It also allowed re-pricing of services, and the period of review was cut from seven to five years. The contract also tightened up the abatement regime for service failures, in particular changing the costs of underperformance to better reflect the diminished value to the state of service failures. The *Partnerships Victoria Framework* required the Ararat Prison Project Agreement to include:

- reductions in service payments for late reporting
- time extensions for state payments where the private party is late with performance information
- reductions in service payments for repeated faults of the same nature
- reductions in service payments where faults have not been fixed.

Following the VAGO report, DOJR had undertaken a review of its operations, leading to a simplified governance structure. One single contract administration unit is now responsible for contractual oversight.

Contract management of private prisons is now managed under the Business Division of Corrections Victoria, overseen by the Commissioner. An independent business unit of DOJR, the Office of Correctional Services Review, reports independently to the Secretary for the Department of Justice on the effectiveness of Corrections Victoria's management of the Victorian prison system.

Ravenhall rewrites the rules

Ravenhall Prison Project is Victoria's latest privately operated correctional facility. The PPP agreement signed in 2014 demonstrates what Corrections Victoria has learned from the 'mountain of experience' it has accumulated in over 20 years of PPP operation. The Ravenhall project has contracted accommodation as well as custodial services, following a change from the previous core (i.e. facility only) services policy. In this case the private provider, GEO Consortium, is to design, build, finance and operate a 1000 bed prison and provide 'continuum of care' services, with pre- and post-prison support, work and education programs.

In contrast to some of the earlier prison contracts, the Ravenhall contract is more detailed and sophisticated. From the perspective of operational governance and institutional capability, the project is one of the first PPPs to carry the initial project team through into the operation period of the prison to ensure continuity of knowledge and corporate memory. Well in advance of commercial acceptance the Corrections Victoria contract administrator will be assigned and will work together with the

project team. Once the project enters into its operation term, it will then be handed over to the Corrections Victoria contract administration team.²⁴

DOJR personnel²⁵ indicate that the project has been designed to place the service delivery and the operator of the prison at the centre of each stage of the project.

We've said from day one, it's all about service delivery. The operator has to be front and centre at every stage.

For the first time in Australia, the Ravenhall Prison contract includes a 'payment by results' component. Ravenhall will be the first social services contract in Australia to include incentive payments for reductions in reoffending. Two KPIs in the contract govern this 'payment by results' component, examining the actual rate of recidivism and whether former prisoners are receiving support with stable housing and employment and so on.

I'd like to think that [the governance of PPPs] has moved on considerably. Certainly we've spent a lot of time examining the entire payment mechanism and looking at how it was structured and how it was measured and so on. We have included an element of what we call payment by results. So there is an element of the payment that is at risk. It's not a huge proportion but it's a very important component of the overall payment.

The contract has also built in a reviewable services regime in addition to the usual modification clauses. This allows for all services including provision of mental health services and delivery of corrections services, to be reviewable rather than just 'fringe' facilities such as grounds maintenance or waste management services in earlier agreements.

One thing is for certain, the correctional system changes over time, whether it's the security system or requirements or just the cohort. So while Ravenhall is initially concentrating on younger offenders, those on shorter term sentences and those with mental health needs, that may well change over time as well. So it has to have that flexibility... you have to build the mechanism into the contract.

DOJR personnel noted that governing in the medium to long term in the corrections sector has moved on considerably from the early prison PPP contracts. The department, in comparison to 10 years ago, has significantly more experience, complemented by an expanded contract management team supported by advisors and consultants.

I think [the Ravenhall Project] is possibly the latest in a long line of learning. Years ago Treasury realised there were issues with ongoing contract management so they developed the concept of the contract administration plans and manuals to try to better capture some of that knowledge. But I think it is having the project team – almost the same team particularly at the senior level – continue right through the transaction and the development phase is, I think, just another step in this learning cycle.

The continual improvements that can be observed over the 20 years of the management of the private prison sector in Victoria indicate that DOJR and Corrections Victoria have taken notice of previous contract issues and weaknesses and improved the contracting process.

[The department has] significant levels of experience now with social infrastructure projects, along with an expanded contract management team supported by advisors and consultants as necessary. It's quite an educated client now. I think that's really the key.

²⁴ Hodge, G., Boulot, E., Duffield, C. & Greve, C. (forthcoming) 'After the ribbon-cutting: Governing PPPs in the medium to long term', paper submitted to *Australian Journal of Public Administration*.

²⁵ The following section draws on interviews conducted with personnel in the Department of Justice.

Exhibit A: The evolution of quality standards in the Victorian PSAs: examples of contract provisions

Port Phillip Prison 1996	Metropolitan Remand Centre 2003	Ararat Prison 2010	Ravenhall Prison 2014
Prisoners to be predominantly accommodated in single cells.	80% of cells must be single with the remaining mixed accommodation.	Two ground floor and universally accessible cells to each of the 76 bed units.	This information appears to be confidential.
The contractor is required to keep the facility in good and substantial repair and condition. Facility must be kept clean and free of rubbish and vermin (clause 26.1).	Obligation on contractor to prepare asset management plan and monthly maintenance schedules (clause 21). The contract identifies 418 potential faults that the contractor must fix within eight hours or abatements are applicable	The contract identifies 875 potential faults that the contractor must fix within eight hours. Failure to do so results in abatements being applicable. Point deductions against the overall bonus pool also occur.	The contract states that the private party is required to maintain the Facilities so that the Facilities meet the Fit For Purpose Warranty. This warranty requires the Project Co to ensure that the Facilities will be Fit For Purpose by reference to the standards required at the Date of Commercial Acceptance and comply with all applicable Laws and all Quality Standards for the duration of the Operating Phase. The prison is also required to be maintained in accordance with (i) the Asset Management Plan; (ii) Best Industry Practices; and (iii) and other obligations under the project agreement.
The contractor must refurbish the facility in compliance with the refurbishment schedule. VAGO (2010) notes that this schedule is illegible in parts and too small to read in others.	The refurbishment schedule identifies clearly the projects that must be undertaken monthly and annually.	The refurbishment schedule identifies which projects need to be completed monthly and annually. It also documents DOJR's checking procedures against the quality standards.	This information is confidential.

Source: Victorian Auditor-General's Office (2010); the Port Phillip Prison Service Agreement, (July 1996), Metropolitan Remand Centre Facility Service Agreement (2003), the Ararat Prison Project Agreement (2010) and the Ravenhall Prison Project Agreement (2014).

Exhibit B: Partnerships Victoria Framework (2013) Summary

The Partnerships Victoria policy, introduced in 2000, provides the framework for a whole of government approach to the provision of public infrastructure and related ancillary services through public private partnerships. The policy and guidelines were replaced by updated National PPP Policy and Guidelines in December 2008 which applied to all PPP projects in Victoria from January 2009. The current Partnerships Victoria Framework requires compliance with both the National Public Private Partnerships Policy and Guidelines and the Partnerships Victoria Requirements (2013) and annexures.

Partnerships Victoria Requirements (2013)²⁶

The Partnerships Victoria Requirements were first introduced in 2010. Where the National Guidelines allow for flexibility, the Victorian specific requirements and related information do not. The Partnerships Victoria Framework apply the National Policy and Guidelines and also complement the whole-of-government investment lifecycle and High Value High Risk guidelines and other asset management initiatives that apply in Victoria. The Partnerships Victoria Requirements include a range of contract management guides and practice notes for the management of long-term contracts.

The Requirements set out the approval process for PPPs in Victoria in accordance with the National Guidelines. They also set out budgeting requirements, use of the Public Sector Comparator (PSC) requirements, discount rate methodology and use of modified financing arrangements. In addition the Requirements set out the tender process, the application of the National Commercial Principles and the requirement of a Public Interest Test. Probity requirements ensure that proposed PPP projects be conducted in accordance with the Victorian Government Purchasing Board Guidelines – Managing Probity (2013) and Guide to Managing a Probity Practitioner (2013). The Requirements also establish requirements around accounting and taxation matters. In particular the Partnerships Victoria Requirements note the need for advice of specialist advisers and liaison with the Department of Treasury and Finance and note that the National PPP Guidelines Volume 2: Practitioner’s Guide contains current advice on accounting and taxation matters which are relevant in Victoria. All Victorian PPP projects are also subject to review and disclosure requirements. With all executed PPP contracts to be published in full (with limited exceptions from disclosure) on the Tenders website (www.tenders.vic.gov.au) in accordance with Victorian Government Purchasing Board Policy. A project summary of each PPP project must also be released within three months of the financial close of the project detailing the key project features and the key commercial features of the project based on the contract. Finally the Partnerships Victoria Requirements set out the Contract Management Framework and note the range of contract management guidance materials.

²⁶ Available online: <http://www.dtf.vic.gov.au/Publications/Infrastructure-Delivery-publications/Partnerships-Victoria/Partnerships-Victoria-Requirements>.

Exhibit C: Infrastructure Australia National Public Private Partnership Policy and Guidelines Summary

The National Policy and Guidelines issued in November 2008 provide a common framework for Australian federal, state and territory governments for public-private partnerships. This is supplemented with state specific guidelines issued by their respective public-private partnership authorities. In Victoria, all public-private partnership projects entered into by state budget sector agencies are required to comply with both the National Policy and Guidelines and Partnerships Victoria specific guidelines. The application of national and state policies to the provision of infrastructure by a public enterprise is determined on a project by project basis. The National Policy and Guidelines are considered largely consistent with the previous public-private partnerships policy framework in Victoria prior to November 2008.

Both the national and Partnerships Victoria policies and guidelines are described as seeking value for money, innovation, market competition and good project governance. A number of state-specific objectives have also been identified in Victoria's policy framework. These include maximising social and economic returns from government expenditure, promoting growth and employment opportunities for the whole of Victoria and managing contracts in a proactive, practical and constructive manner.