PUBLIC ACCOUNTS COMMITTEE

INQUIRY INTO CONTRACTS ENTERED INTO BETWEEN CONSOLIDATED CONSTRUCTIONS PTY LTD AND MAIN ROADS WA AND THE PUBLIC TRANSPORT AUTHORITY

TRANSCRIPT OF EVIDENCE TAKEN
AT PERTH
ON MONDAY, 24 MAY 2004

SESSION 4

Members

Mr J.B. D'Orazio (Chairman)
Mr M.G. House (Deputy Chairman)
Mr J.L. Bradshaw
Mr A.J. Dean
Ms J.A. Radisich

[1.15 pm]

WALDOCK, MR REECE,
Acting Chief Executive Officer, Public Transport Authority,
Public Transport House, West Parade,
West Perth, examined:

LEAF, MR JOHN WILLIAM,
Director, Finance and Contracts, Public Transport Authority,
Public Transport House, West Parade,
West Perth, examined:

The CHAIRMAN: Welcome. The committee hearing is a proceeding of Parliament and warrants the same respect that the proceedings in the House itself demand. Even though you are not required to give evidence on oath, any deliberate misleading of the committee may be regarded as contempt of Parliament. Have you completed the Details of Witness forms?

The Witnesses: Yes.

The CHAIRMAN: Do you understand the notes attached to them?

The Witnesses: Yes.

The CHAIRMAN: Did you receive and read an information for witnesses briefing sheet regarding giving evidence before parliamentary committees?

The Witnesses: Yes.

The CHAIRMAN: The committee has received your submission. Do you propose any amendments to it?

The Witnesses: No.

The CHAIRMAN: Is it your wish that the submission be incorporated as part of the transcript of evidence?

The Witnesses: Yes.

The CHAIRMAN: Before we ask any questions, would you like to make an opening statement about your submission?

Mr Waldock: We will talk to it.

The CHAIRMAN: Do you want to start off by telling us a bit about the Public Transport Authority, its connections with Consolidated Constructions Pty Ltd and the contracts, what status those contracts are at and anything else?

Mr Waldock: I will start off by talking about the Public Transport Authority in the context of the business. Over the past few years we have had, and certainly in the next few years we will have, a capital works program in the order of about $300 million to $400 million a year. In fact, next year it is a bit higher at about $500 million. Part of my job, as well as running public transport services, is to meet government commitments. There are many of those in terms of the challenges in delivering infrastructure on time. As part of that, of course, we are very clear about delivering products on time but also about making sure that the taxpayer gets value for money. We certainly consider risk one of the issues that has been around for a long time. Certainly manifesting itself very clearly at the present is a thin market for construction. We will talk about that as we go through. Certainly we and many other infrastructure agencies are finding it pretty tough to get competitive bids. In fact, the industry has changed over recent years. There has been a consolidation of a number of the key players, including the Leighton group, which also has Thiess Pty Ltd as a fully owned subsidiary. John Holland Pty Ltd is a 70 per cent owned subsidiary and will shortly go to 100 per cent. We are seeing a contraction of the players in the industry. We are also finding the market busy. It is a buoyant market. It is a challenge to meet all the outcomes demanded by the Government.

The CHAIRMAN: If it is such a buoyant market, how come Consolidated had this problem?

Mr Waldock: Interestingly enough, I was with the John Holland group yesterday. Bill Wild would argue that this a dangerous time for the construction industry. When they are very busy there is so much work around that they have to pick the right contracts and then they are busy picking the right contracts. At the same, the subcontractors think that they can put their prices up, and he would argue this is the time you will see most contractors go to the wall, during buoyant periods like this. Whether that is right or wrong, that is his view.

The Public Transport Authority is pretty well recognised for its risk management in all parts of its business, whether it is operational safety, contract, finance, environmental or operations. We have a rigorous approach to risk management. Indeed, I am often invited by RiskCover and other major players in government to talk about how the PTA manages risk. We would like to think that as part of our business, risk is fundamental and that we are the best at it. I think we have a pretty good track record. As well as that, with regards to the State Supply Commission, we have enjoyed over a number of years - before PTA and before Western Australian Government Railways Commission was Westrail - total exemption. We have been able to demonstrate to the commission that we have appropriate processes and practices in place to manage all purchasing and procurement. It is interesting that when I came in about three and half years ago we had pulled ourselves away from Westrail, which at that stage was WA Government Railways Commission. It was very much smaller in some respects with a risk profile. As part of that process, we then went about making sure that we met all requirements, certainly State Supply Commission requirements, and to that extent we did a number of health checks. I would like to think - the committee will probably be seeking evidence - that it saw us as one of the agencies that has a good track record of meeting all requirements of the State Supply Commission. We are now just finalising - we have already had the first assessment of ISO; that is, quality accreditation ISO 9001, which is the highest standard of being a quality accredited contract management team. We have good standards in place and a very high quality of people, and we pride ourselves on our work.

The CHAIRMAN: You have given the PTA a plug. However, how can you give a contract to Consolidated after it has already done work, has not on two new jobs and it has gone broke?

Mr Waldock: Of course, I was leading to that.

Mr M.G. HOUSE: We could do without all the self-aggrandisement, thanks. I am busy; I do not need to listen to that.

Mr Waldock: I thought it was important to lead out with what we have in place and now we will move into this. I will talk about the prequalification of Consolidated; that is, the issue in which the committee is interested. We have covered many of the issues in our submissions, but I am more than happy to go through them individually if I can.

The CHAIRMAN: When were the contracts for Gosnells and Armadale stations given to Consolidated?

Mr Waldock: They are detailed in the submission. The awards were made in September and October.

The CHAIRMAN: You have told the committee how wonderful you are. In July, there was a $2.3 million writ on Consolidated. Main Roads' assessment of this company was, at best, 18 out of 30 on the scale it uses, which means it just made a pass. That was prior to the $2.3 million writ served on it by Odin Central Services Pty Ltd.

[1.22 pm]

Mr Waldock: Certainly when we did the prequalification, it was moderate. That was our assessment. It is detailed how that assessment was made. The dynamic risk score and Dun and Bradstreet are certainly our most important tools of assessment. That was only showing moderate at the time as well. We prequalified it in March and at best it was moderate. We had two bids for both and we will talk about how the other would have gone before we finish. Therefore, the company was a moderate risk at that stage, and we make reference to that in our submission. It had been just over six months and our period of reassessment should have been spent pretty much assessing it. However, if we had reassessed the company during that period, we would have found its dynamic risk score had improved. There would not have been any flashing red lights for us in terms of dynamic risk score. Main Roads Western Australia might have suggested to the committee - I do not know what it did suggest - that it was more an issue of delinquency score; in other words, non-paid accounts. That certainly went the wrong way. However, the company's dynamic risk score had improved. As a principal or a contractor, the Dun and Bradstreet is our most important measure.

The CHAIRMAN: Nice words. However, the bottom line is that you prequalified this company in March. You did not do anything about prequalifying it again before you gave it a contract.

Mr Waldock: No, that is right.

The CHAIRMAN: The company was already a marginal risk in March - there was already some doubt whether the company was in decent shape at that time. In July, a writ was issued for $2.3 million. If Main Roads had known about it, it probably would not have gone ahead with its contract. Now you are telling me that in August/October, with no other warning lights or flashing lights, you said, "Oh well, we assessed the company in March and it was okay, let's give it a job."

Mr Waldock: No, we did not say that. In fact, John, do you want to just -

Mr Leaf: I would like to elaborate a little on the process that we went through. Our process for risk assessment of a contract starts well before looking at the individual tenders. We start by looking at the contract and the nature of the risk to the organisation in its entirety. The contract that we were looking at here, for which four players had prequalified, was for $25 million and included some nine individual projects. It is not possible to divide 25 by nine and come up with an answer of $2 million to $3 million a contract. Nevertheless, when station contracts are assessed for all risks - which is not just financial but also political risk and risk to the customer services, as we are building the actual station - we consider 12 to 15 different categories of risk assessment. We decided that this contract fell into an intermediate category. That is the beginning of the process. We then ask ourselves what the contract includes. Our policy says that when we prequalify tenderers as part of a process, we must carry out a financial health check before a prequalification is completed. We completed that process in February or March 2003. For our in-house assessment we get the last three sets of financial statements, do a full ratio analysis and look at how long the business has been operating, who the directors are and a whole range of things. At that time and according to that assessment, we decided that Consolidated Constructions Pty Ltd was a moderate risk. The company had been around for 30 to 50 years, it had a annual turnover of $100 million and it worked in the construction industry. If we were to look at the balance sheet of many companies working within the construction industry and do a rigorous accounting assessment, many of them would be found to be technically insolvent. However, many of them do not go to the wall during that time. At that stage we felt that the company was a moderate risk. We said that the contracts were intermediate in terms of our assessment. We ran a Dun and Bradstreet check just to make absolutely sure that there was no inconsistency between our assessment of the company's financial health and how Dun and Bradstreet ranked it as an independent worldwide organisation. Dun and

Bradstreet came back with a full report, not a minor one, including a full dynamic risk score and delinquency report. We looked at the writs against the company at that time -

The CHAIRMAN: Was that in February?

Mr Leaf: This was in February. I am going to carry on because there is a gap of time that we need to address, and I want to talk about the hindsight that can be applied in circumstances like that. In February, we got back the Dun and Bradstreet report and it indicated exactly as we had perceived; that the dynamic risk score was moderate. The company was not perceived by Dun and Bradstreet to be a company in difficulty. While we were going through that process, we had already awarded works to Consolidated Constructions under a previous tender and award process. It was working on the Claisebrook station for us, a job worth $2.2 million from memory. It completed that job on time and on budget. It was doing a number of smaller tasks for us around car parks and several stations, again, all going according to the contract. There was no reason to suspect that the company was in any trouble. We never heard anything from any subcontractors working on those jobs for the company that there was any difficulty with those contracts. That is background behind the matter. I did research and follow-up on the matter and asked myself whether we did a good job, whether we did a thorough assessment and whether we had made sure that we covered the risk in this process. I found that we should have documented some observations. We did follow-up between March and the awarding of these contracts, and the question arose of whether we should do another financial assessment if we were to award the contract then. I acknowledge that this is hearsay, but people had said to me that the company had just completed the Claisebrook job and that they were not aware of any reason we should have a problem. Further financial statements would not have been put out since we reviewed the last ones, so we were not going to find out anything there. We did not deem it appropriate, given the size of these contracts and the risk that we had perceived as moderate, which we had checked out independently, to do a further financial check. Hindsight definitely says that we should have.

The CHAIRMAN: This morning some representatives from Main Roads said that in July they were aware of this lawsuit for $2.3 million. Would that not have rung some warning bells for you?

Mr Leaf: With respect, it is enormously difficult to pick a point in time when you do the check. We might have got Dun and Bradstreet to run that check in June, and the lawsuit would not have been there. We might miss the date when an actual action takes place and gets recorded in the Dun and Bradstreet record by just one day, but we do not carry out an independent check on that criterion. We are not looking to find -

[1.30 pm]

The CHAIRMAN: I understand that, but these contracts were awarded in September and October when Main Roads knew in July, and the rumours were going around then, that Consolidated had this lawsuit against it; yet, no-one said that there was a warning bell there.

Mr Leaf: In our organisation, the Public Transport Authority, we did not have anybody telling us that it was a warning bell.

Mr M.G. HOUSE: Where does “moderate” sit in the spectrum of awarding contracts? You said that Consolidated came out as moderate. What do you call above moderate and below moderate?

Mr Leaf: I am not sure that I understand exactly.

Mr M.G. HOUSE: You said that in your rating of Consolidated the risk factor came out as moderate. Do you recall saying that?

Mr Leaf: Yes.

Mr M.G. HOUSE: Where does moderate sit in the spectrum of awarding contracts? Would most contracts be awarded to companies that pose a moderate risk or would they be awarded at above or below moderate risk?

Mr Leaf: If I may refer to appendix 5, we have included the assessment scoring sheet that we use in our organisation. We score four different levels for each tenderer. We look at the nature of the applicant, its financial conditions, the industry assessment and the financial security. There are five different categories of risk. A score less than zero means that we must refuse credit; a score from zero to 40 indicates a significant credit risk; a score from 41 to 80 indicates a moderate credit risk; a score of 81 to 120 indicates a sound credit risk; and a score of 121 plus indicates first-class credit risk. They are labelled A, B, C, D and E. This is a C; it is right in the middle. I cannot answer right now just what percentage of contracts we award in each of those five categories. It would take some degree of research.

The CHAIRMAN: Just give us some idea of what sorts of companies would fit into those categories. For example, where would the company that you signed yesterday fall?

Mr Waldock: John Holland Pty Ltd would be at the upper level.

The CHAIRMAN: It would be in the A category, would it?

Mr Waldock: Yes, it would certainly be lower risk.

Mr M.G. HOUSE: Are they rated A to E or E to A?

Mr Waldock: It would be lower risk. I just want to mention that -

Mr M.G. HOUSE: Hang on.

The CHAIRMAN: We want to get a comparison of what sorts of companies you are talking about are in these categories. Which companies are in the intermediate category?

Mr Waldock: John, do you want to talk about the dynamic risk or companies that would have been rated no higher than Consolidated?

Mr Leaf: I would just like to clarify it. You ask what sorts of companies fit into those categories, but there is no answer that says that today or tomorrow or in a year’s time or two years time, a company today will fit into that category. It is probably important to bear in mind that if you had asked me in February/March 2003 where Consolidated sat, I would have told you for sure that it sat as moderate.

The CHAIRMAN: Let us take February 2003. I want you to use the same evaluation at the same time. I just want to see what sorts of companies we are talking about in that intermediate category, the good category and the extra good category.

Mr Leaf: I have not come today with the exact credit rating of each of those contracts. John Holland Pty Ltd, Broad Construction Services Pty Ltd and Lakis Construction Pty Ltd were the other three prequalified tenderers on the panel. Broad Construction Services as it stands today has a dynamic delinquency score that is no worse than Consolidated Constructions at the time of the project. Broad today has a dynamic delinquency score rated as severe. John Holland has a dynamic delinquency score, which is what seems to be creating most of the reasons for the sorts of questions being asked, apart from the writ. John Holland is high.

The CHAIRMAN: Meaning high risk?

Mr Leaf: High meaning that it was in the same category as Consolidated in terms of its payment record to subcontractors.

Mr Waldock: Not in risk.

Mr M.G. HOUSE: High in terms of what if not in risk? I do not understand the answer.

Mr Waldock: Dun and Bradstreet uses two measures. It uses the dynamic risk assessment and the delinquency score, so there are two different measures. A number of companies can be severe in one category, which is bad, yet quite good in the other. The delinquency score is a measure of how contractors pay their subcontractors.

Mr M.G. HOUSE: We are talking about your scoring sheet, no-one else's. You said "we score". Do you recall that?

Mr Waldock: Yes.

Mr M.G. HOUSE: John then read out a list of how you score. I am not talking about Dun and Bradstreet. I want to be very clear about this. I am talking about your scoring sheet.

Mr Waldock: So we do not talk about their scores.

Mr M.G. HOUSE: It is how you rate it. You can talk about anything you like, but I want you to answer the question. You rated this company as moderate. The Chairman asked for examples of other companies that are moderate, above or below, so that we can understand.

Mr Waldock: John has answered the question.

The CHAIRMAN: He has not answered the question.

Mr Waldock: Are you talking about the four companies?

Mr Leaf: What I would like to do is take that on notice, come back to you and give you a list of companies that we have recently rated as moderate, rather than say something now.

Mr M.G. HOUSE: Thank you. Could we have companies above and below moderate also?

The CHAIRMAN: More importantly, we would like some companies that are above so that we can get a handle on how secure they are.

Mr Waldock: Is this purely our rating, not Dun and Bradstreet's?

Mr M.G. HOUSE: Yes, we want to hear about your decision-making process, not Dun and Bradstreet's. Correct me if I am wrong, but did I hear you say that at the time you made the decision John Holland was rated the same as Consolidated?

Mr Leaf: I am not saying yes or no. I will come back to you with how they were rated. This is a dynamic process. We are constantly looking at companies to enter into contracts with. We do not always undertake a financial evaluation for a particular contract, because we may already have an ongoing contract that we have let in the previous six months.

The CHAIRMAN: Do not be defensive. We are not attacking you on the process. We just want a better understanding of the process. All we are trying to do is to get to the bottom of it, because in the end contracts happen. We merely want an understanding of where it is at. I think that Reece made some comments that made some of us get a bit annoyed because he was saying how wonderful it is and we are not quite sure whether that is true. If you ask me why would you check because you have five other contracts going and you would not normally check, that is fair enough. It is not a question of whether it is good, bad or indifferent. We just want to understand what process occurred and which companies they are. For example, if you have dealt with a company for 20 years and it has always been good, why would you check it after three months?

Mr Leaf: We have a process to which we apply yardsticks for when we do a recheck. If we have gone longer than 12 months without doing a check, even though it might be a supplier that we have engaged for several years, we would still undertake another financial assessment.

The CHAIRMAN: Do you undertake to give to us a list of the companies and the way in which you score them? The question that arises from that is that in the case of the Main Roads contract in which the main contractor won the contract and then subcontracted 80 per cent of the work, did you then check the subcontractor?

Mr Leaf: No, in fact one of the reasons we engaged head contractors is to protect the State against the risk of the Public Transport Authority contracting with every subcontractor. It is clear that many subcontractors do not have the financial strength of Consolidated Constructions. We cannot find financial records to check a balance sheet. They are often family companies. We therefore have a process internally of engaging head contractors so that we can protect the State by having the risk of the financial viability of subcontractors guaranteed for us by the head contractor.

The CHAIRMAN: I understand that. In the case of Consolidated, say, getting a $7.6 million contract and subcontracting $6 million worth of that to another subcontractor, as part of the process of tendering would you ever check the second major subcontractor to see that it is okay?

Mr Waldock: No, we would not.

Ms J.A. RADISICH: Is there any requirement for the head contractor to provide any explanation to you about its major subcontractor?

Mr Waldock: I do not think so. Clearly with consortiums and others as joint partners, we do of course go to each one and take joint and several guarantees, or we often go to the strongest partner and assess it, but we do not do it with subcontractors.

[1.40 pm]

The CHAIRMAN: So you obviously then also concede that that is a problem. It is not in your case, because you do not have the problem that Main Roads had, in which it subcontracted, but -

Mr Waldock: I think it is a problem, but I am not sure that even if I did recognise the problem - I mean, certainly our legal advice is that, from a State's protection point of view, the more we move into involving subcontractors, the more we also expose the State to future liabilities.

The CHAIRMAN: But you would want some financial commitment from someone who is a major, major subcontractor. For example, in the case of Carr Civil in that Main Roads job, it got $6 million out of the $7.6 million. Would you not as a state agency want to know that if Consolidated and that company went broke, you would be covered? Who are you going to chase when the little blokes on the street are not getting paid?

Mr Waldock: It is certainly not something that we have considered to any great depth. I guess what I am saying is that I would still be very conscious about the obligations of the contractor - the person we are dealing with. That is what we are dealing with him for. That is where we are transferring the risk. I understand what you are saying, but I would certainly want a bit more of an understanding of the legalities of that.

Mr J.L. BRADSHAW: With these large contracts that we are talking with, when did you get Dun and Bradstreet's assessment?

Mr Waldock: As detailed in the appendices, it was as part of the prequalification when we identified Consolidated as moderate. As part of the process - it is a standard process - we then do a Dun and Bradstreet check.

Mr J.L. BRADSHAW: Do you have any comeback on Dun and Bradstreet when, as in this case, Consolidated has gone under? You have obviously been given bad advice. Surely under the circumstances you would have a comeback on Dun and Bradstreet if it has given you advice that is incorrect.

Mr Waldock: As John said, Dun and Bradstreet is only one of the instruments that we use to do the risk assessment.

Mr J.L. BRADSHAW: They would be looking at the financial capabilities -

Mr Waldock: Yes, they would. That is part of their model. They have got a very complex model in which they actually put in all these factors and come up with a risk assessment. I am not sure. I think this happens regularly. I am sure Dun and Bradstreet have lots of disclaimers.

Mr M.G. HOUSE: Of the contracts that the Public Transport Authority has been involved in, how many have gone bad?

Mr Waldock: That is an interesting point. I have been here for only three and a half years, and John has had many more years than me, but certainly we cannot think of the last one that went bad. I guess if there was any message I would like to leave it is that whatever checks and balances and more processes we become involved in is weighed up against the cost of doing that, because, as I say, we have not had one go bad that anyone in the organisation can remember. So when these things come along, sure, they are of great concern to us, but it has to be weighed up with the history.

Mr M.G. HOUSE: In the tier of things, does the Public Transport Authority or Main Roads take the prime responsibility for this particular issue?

Mr Waldock: Do you mean for finishing the job or looking after subcontractors?

Mr M.G. HOUSE: Both, if you like. You are not looking after the job, but in terms of the contractual arrangements with the contractor in this particular instance, I was under the impression it was Main Roads that was the principal authority. Is that correct?

Mr Waldock: It is exactly the same with both. We have got similar pieces of legislation. This contract is not made with the minister. It is made with the authority in our case, and the authority is me in this particular case, so I am the principal, and the authority takes responsibility for it.

Mr M.G. HOUSE: So this is the first one that has gone bad that you can recall?

The CHAIRMAN: How much extra money is it going to cost to finish the two contracts - Gosnells and Armadale?

Mr Waldock: It is early days - well, it is not early days. It is actually getting towards finalisation. It depends, when you say extra money, on what we get back from the liquidator.

The CHAIRMAN: I assume you are not going to get very much back from the liquidator.

Mr Waldock: Let us assume it is 15c or 20c in the dollar. We think that it will cost in the order of - the last I heard was - $1.5 million each, so a $3 million price tag.

Mr M.G. HOUSE: Extra - in addition?

Mr Waldock: Extra.

The CHAIRMAN: For a $4 million project?

Mr Waldock: No, it was never a $4 million project.

The CHAIRMAN: They were $2 million each, were they?

Mr Waldock: No. Armadale was $6.4 million, I think, and Gosnells was $6 million, so it is the order of $12 million.

The CHAIRMAN: So it is an extra $3 million.

Mr M.G. HOUSE: What was the nearest tender? Do you know?

Mr Waldock: We can talk about that, because I think that is very interesting.

Mr M.G. HOUSE: In terms of dollars, can you remember what the difference was?

Mr Waldock: Yes. I think in the case of Armadale, it was Broad Constructions. I think it was about $800 000 more. That was the next bid. I think for Gosnells it was Lakis Constructions, and it was about $400 000 to $500 000 more.

The CHAIRMAN: How can it be so far out?

Mr Waldock: In terms of bids?

The CHAIRMAN: Yes - $1 million on a $6 million job is a helluva lot of money. I remember from my days in tendering if we were not within $100 000, there was something wrong.

Mr Waldock: We do get, I guess, a distribution. In fact, the last year and half has been interesting, because some contracts are of an extraordinary type. The contract that we signed yesterday was within just a very small percentage, as was the railcars contract. In terms of these smaller jobs, it really depends on just how busy the various contractors are at the time and whether they want to buy a job. Certainly not too many are buying jobs at the present moment. Others are so busy they just do not want it, and they price accordingly. We certainly did not see any sort of surprises in the bid range.

The CHAIRMAN: Please explain something to me. This company is a bit of a problem, so why did you waive the decision to have a bank guarantee?

Mr Waldock: I do not think it was seen to be a bit of a problem.

The CHAIRMAN: You have just said it was moderate.

Mr Waldock: That is not a bit of a problem from our point of view. We understand it is moderate. Certainly, as John said, they had done some work for us before. We had actually involved them in our work in the past two years and we were very satisfied with their work. I do not think there was any bit of a problem.

Mr M.G. HOUSE: But they were the second lowest. You have zero, which means nothing; you have another category; and then these guys were next. They are the second lowest. You cannot count zero - they have got no credibility. They are the second lowest. That is where they ranked, according to your own evidence.

Mr Waldock: Do you want to qualify that, John? I do not think that is right.

Mr Leaf: There are five categories. They are right in the middle.

Mr M.G. HOUSE: Discount the zero ones that you said do not rate, and then there is the next one -

Mr Waldock: So there are only three ranges, I guess.

Mr M.G. HOUSE: So if you start from the top, they are third out of five, and if you start from the bottom, they are second last out of three, yet you guys waived the bank guarantee.

The CHAIRMAN: It is just a pass.

Mr M.G. HOUSE: You guys waived a bank guarantee to a company that really was not doing all that well.

Mr Waldock: If I could respond, and these things are judgments, and sometimes in hindsight I guess we could all do that. Certainly we had done work with them for the past year and half, and they were very satisfactory. In both fields there were two bidders. It was not as though we had a plethora of people to go to. There was not much bidding, and these were, we believe, clearly projects that we wanted to move on with. We had a big capital works demand. I guess at the end of it we made a decision about whether we would look at a bank guarantee or retention. We use both tools. Bank guarantees are a difficult one. If we were worried about risk all the time we would always go to the Leightons of the world.

The CHAIRMAN: Do you know what happened when they went into liquidation? The banks paid out their guarantees. That was the first thing they did.

Mr Waldock: But even if there had been a bank guarantee, I can tell you a bank guarantee would not have been a panacea. As it was, with a bank guarantee we would normally put on 10 per cent -

The CHAIRMAN: An amount of $600 000 would go a long way towards making sure -

Mr Waldock: We have already got retention money. There would not have been much difference. Indeed, we made a choice between retention and a bank guarantee. If they had got that bank guarantee, they would have said, "Yes, you can have a bank guarantee, and we will charge you accordingly a premium for that".

Mr M.G. HOUSE: So, had you not heard any word around town that they might be a bit suss, Reece?

Mr Waldock: We had not heard anything.

Mr M.G. HOUSE: Yet a member of Parliament gave a half-hour dissertation - you can read it in *Hansard* - about how their reputation was all around town.

The CHAIRMAN: They had not paid their bills on Christmas Island a year before.

Mr Waldock: Certainly, and I think as part of the process - and we talk in our submission about how government agencies talk often about these things - we had not heard anything, had we, John?

[1.50 pm]

Mr Leaf: I would like to add a comment that is clearly in our submission. John Holland is a company which we are very close to and which we were talking to as part of the package A negotiations, and we actually said to its key negotiator on its contract, "You lost money on Consolidated. How come in the industry you did not know in December/January that Consolidated had a problem and you extended this line of credit to them?" They said, "It was not common knowledge that they were in trouble". John Holland is a very well-respected company in this State. We have done business with it for a long time. It is not a fool in financial affairs, and it extended credit. Now, when we talk about the different degrees of risk, we have a risk in a contract if we cannot get our contract completed on time. When somebody extends credit, you have a risk that the actual value of the goods supplied to them has not been paid for. I am not saying that one is any more risky than the other. However, I have more trouble parting with my money than I do engaging a builder to build a product for me. I am getting much more cautious about extending credit to somebody than I am about giving them a contract. To take the analogy a bit further, I am building my house and I look at several different builders around town. I have a moderate risk, and he will do my house building for me for $250 000. If he had the lowest credit risk of all, and wanted charge me a $100 000 premium, I would to some extent make some gut-feeling judgment. I would look at how long he has been around. If he has been a moderate risk for 50 years, but is still here, I would take that into account. Analogies like that are not always useful. We look at the whole risk environment.

Mr Waldock: If we looked at Multiplex, Broad Construction, which is a fully owned division of Leighton Contractors, or MacMahon Contractors, which is one of the biggest, I think you would find their delinquency scores at times were terrible. Is that right?

Mr Leaf: The construction industry is noticeable for delinquency scores that are, to be honest, variable. The construction industry goes through phases of having a very full order book, and everything going extremely well, when those in the industry can make payments on time. They get into periods of difficulty when times get leaner and they are between one contract and another, and their payments slow. My background is in private enterprise, and I was rewarded for how tight I could keep the payments to suppliers. If I could extend my payment terms by 10 days, and keep that money in the bank on call -

The CHAIRMAN: I would pay you a bonus as well, and I would expect you to do it as well. That is understood.

Mr Leaf: The industry also understands that. Managing the cash flow for a construction company is the way they actually make some of the cream on the job. They make their money out of variations to the contract, and they make their money out of managing their cash flow, and negotiating the toughest terms they can with their subcontractors. We know that. We know that they are running in a relatively risky environment compared with others. It is more risky than retail, and it is more risky than banking, although with the National Australia Bank these days, you would wonder. There was more risk for insurance when HIH went down. Anything that we do, financially, has an element of risk. I would stand by the Public Transport Authority's record for its processes and the application of them. Sure, we have highlighted a number of issues that, in hindsight, we would have done differently, but I cannot guarantee that. To be perfectly frank, even if today somebody turned the clock back and I had a little more information, even about Odin and the $2 million suit, I might have said, "Look, here is a $100 million a year business in the construction industry. If they have not got the odd writ against them, I would be surprised." I cannot predict whether that would have changed my mind. Indeed, we will know that very shortly, because we are entering into finalising the contracts of the second bidders, and there are issues there as well.

The CHAIRMAN: The second bidders are the companies that have come in to finish the work off. Do we know who they are?

Mr Waldock: Yes, Lakis Constructions is one, and Broad is the other. We are having the same issues all over again.

The CHAIRMAN: Are you saying that Broad is worse than Consolidated was?

Mr Leaf: Bank guarantees are one form of security. We look for who owns the businesses. In the case of Broad Construction Services, it is owned by Leighton Contractors. We are negotiating right now for a parent guarantee from Leighton Contractors for Broad. Sometimes these organisations ask why they should get the parent to guarantee the work they are tendering for. We will stick to our guns in this case, partly because we have been burnt. We will not take any risks at the present time in anything, but sometimes we will accept Broad because of its current standing in the market. Lakis is different from Broad. It is a family trust. It is technically insolvent because the family trust is owed $1 million in current liabilities. We are negotiating with Lakis now to get an assurance that it will not call in the $1 million of beneficiary distributions during the completion of that contract. These are all things that must be done in the particular circumstances of each individual organisation we enter into a contract with. Another point I would like to make is that, when we enter into a long-term construction project that could be anywhere between six months and three years, the nature of the parties we are dealing with during that time can and will change. I guarantee that during the course of the package A construction, the partners - John Holland, MacMahon and Multiplex - will fluctuate between high, medium and low credit risk. I cannot guarantee that, but I could come back in three years and show you a graph. It is an industry for which you look at the best information you have at a particular time, and your management team works on the contract, and your financial team does the assessments. You rely on their professional judgment, and I believe that is what we are doing in this case.

Mr M.G. HOUSE: What do you reckon the margins are in a construction job? Do you have a rough idea what margin they make on a job like the station job?

Mr Leaf: I could not answer that, because I am not close. What the margins are on any particular job is a burning question. I guess you could easily come back and say what the industry average profit was, but now I could not, because that is difficult. Businesses have different structures, and their profit can be manipulated by whom their parent is.

The CHAIRMAN: They factor in a figure.

Mr Leaf: Exactly. Broad Constructions is owned by Leighton, and may very well have a large amount of its profit taken out for a management fee. We could not even judge that. It is quite complex.

The CHAIRMAN: Just for the record, you are now suing Consolidated for the unfinished work?

Mr Waldock: We are queuing up as a creditor.

The CHAIRMAN: What are you claiming from it?

Mr Waldock: As I mentioned earlier, we think it could be in the order of $3 million when it is finished, which we will be seeking from Consolidated.

The CHAIRMAN: Have you got some claim in at the moment?

Mr Waldock: The liquidator went out earlier and sought estimates of what the claims would be, and we gave them an early indication of $2.4 million.

The CHAIRMAN: It could be up to $3 million.

Mr Waldock: You asked earlier about the subcontractors. It was a good business decision, but it was all closing in on us. You do not leave half-finished projects sitting around for any period of time. We moved in straight away and tried to hold in all the subcontractors. There were issues there. All the subcontractors felt that they were losing money, of course, from Consolidated, and they wanted to put it on the Government. It was never our problem. It was Consolidated's problem, but we had to make some judgments again. We negotiated with each subcontractor a figure that we could justify to get the job finished and do good business, but that at the same time allowed them to move on and be reasonably happy about finishing the job. Some of it was under duress.

The CHAIRMAN: Why do we need these other companies to come in now and finish it?

Mr Waldock: We are running it with those companies at the present moment on a cost-plus basis, as it were. We are trying to lock them into contracts to finish it properly. We did not want the subcontractors there at the time to walk off the site. The bricklaying was a quarter finished at Armadale. There were enormous issues about them walking off.

The CHAIRMAN: Did you engage them as a separate contract?

Mr Waldock: We used both the second contractors on a cost-plus basis, to keep the work going.

The CHAIRMAN: So have they got the contract still, and have you not gone directly to the subcontractors?

Mr Waldock: I think the Government would be terrible at that. That is one thing government should not do, particularly with outstanding contracts with other contractors that do not have any of our terms and conditions. We would get killed there.

The CHAIRMAN: Thank you for your evidence, and we look forward to getting that further information. If we need you, we will call you back again.