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For: Geoff Mayman
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Sent by Email

Dear Geoff

Arterial Stage 1 Increased Forecast Cost to Complete – Available Options

1. As requested, below is our brief advice on the options available to Queenstown-Lakes District Council (**QLDC** or **Council**) under the Whakatipu Transport Programme Alliance Agreement (**PAA**) in the current scenario of a further increase in the forecast cost to complete the Arterial Stage 1 Work Package (referred to as the **Arterial project**).

2. Capitalised words or terms that are not otherwise defined in this letter have the meaning assigned to them in the PAA.

Background

3. QLDC and New Zealand Transport Agency (**Waka Kotahi**) are the Owner Participants under the PAA. Downer New Zealand Limited, Fulton Hogan Limited, Beca Limited and WSP New Zealand Limited are the Non-Owner Participants.

4. QLDC and Waka Kotahi are also parties to a separate Owners' Agreement dated 6 August 2021.

5. QLDC is fully responsible for costs and liabilities associated with the Arterial Stage 1 Work Package, without contribution from Waka Kotahi.

6. In December 2023 the Alliance provided the Programme Alliance Board (the **Board**) with an updated forecast cost to complete the Arterial project to $97million. This is $34.2 million over the current approved Final Target Cost of $62.8million[1].

7. We understand that the updated forecast cost to complete plus QLDC's internal (non-Alliance) forecast costs now exceed Council's current approved budget for the Arterial project, which we understand was based on updated forecasts and approved by Council in April 2023.

[1] These figures are for Limb 1 (Net Actual Cost of the Work) only. Limb 2 (Nominated Corporate Overhead and Profit Lump Sum) will be exhausted because of the extent of the cost overruns (measured against the Final Target Cost) for the Arterial Stage 1 Work Package.

8. The reasons for the cost increases have been provided to the Board and/or will be explained by QLDC staff including in an impending Council Report.

9. We have assumed for the purpose of this advice that QLDC does not have recourse against any other the party for the increased costs/budget that will be needed to complete the Arterial project (e.g. for failure of Non-Owner Participants to carry out the Work in accordance with the principles of the PAA, failure of the External Alliance Auditor to properly approve payments in accordance with the PAA etc).

Summary of Options

10. Under the PAA, QLDC has two viable options in response to the further increase in the forecast cost to complete the Arterial project. These are:

    (a) Option 1: Pay the Non-Owner Participants the increased actual cost to complete the full scope of the Work in the Arterial project.

    (b) Option 2: Direct a 'Change' to decrease the remaining scope of Work in the Arterial project, thus avoiding payment by QLDC of the additional forecast cost overruns (in whole or in part) and reducing the Final Target Cost. QLDC could choose to exercise this option now or continue work until the Council's current approved budget for the Arterial project runs out and then direct a Change.

11. While there is a third potential option, being to terminate the PAA for convenience, this would require Waka Kotahi's agreement and involve directing that all Work under the Alliance (not just the Work in the Arterial Stage 1 Work Package) cease permanently.

12. Given our understanding that there are other incomplete Work Packages under the Alliance which Waka Kotahi owns, we do not consider that termination for convenience is a viable option as Waka Kotahi would be very unlikely to agree this.

13. Further, it is not necessary to terminate the PAA if QLDC decides it wants to avoid paying the additional forecast cost to complete because the same result can be achieved by directing a Change deleting work from the Arterial project, as per Option 2.

14. We have therefore discounted the potential third option of termination for convenience and only discuss Options 1 and 2 in the balance of this advice.

Discussion of Options

Option 1 – Pay Non-Owner Participants to complete the full scope of Arterial project

15. Under the PAA, clause 2.3.1, the Owner Participants' specific obligations are to:

    (a) Provide access to each Site for a Work Package to enable the Alliance Participants to under the Work under the Alliance; and

(b) Pay the Non-Owner Participants,

each in accordance with the PAA.

16. The terms of compensation are contained in Schedule 8 to the PAA and refer to the three 'Limbs' of payment: Limb 1 (New Actual Cost), Limb 2 (Nominated Corporate Overhead and Profit Lump Sum), and Limb 3 (Performance Based Payments – sharing of underrun or overrun in costs).

17. As noted above, QLDC is 100% responsible for the cost (Limbs 1/2/3, as applicable) of the Arterial project.

18. Option 1 is straightforward and does not require any specific action to be taken under the PAA. QLDC would simply continue paying the Non-Owner Participants the Limb 1 (Net Actual Cost of the Work for the Arterial project) in accordance with the terms of the PAA.

19. As noted above, (see footnote 1), only Limb 1 will be payable to the Non-Owner Participants in the current scenario because the extent of the cost overruns (measured against the Final Target Price) mean that Non-Owner Participants will not recover their overhead/profit (Limb 2) for the Arterial project.

20. It does, however, mean that QLDC will need to approve additional funding to cover the increased forecast cost to complete the full scope of the Arterial project.

Option 2 – Direct a Change to delete work/descope the Arterial project

21. Section 14 of the PAA deals with Changes and Variations. Clause 14.1.1 gives an Owner Participant in respect of one of its Work Packages or the Board the right to direct a 'Change'.

22. 'Change' is defined in Schedule 2 of the PAA (Definitions) as:

    A change in the scope, timing or nature of the Work under the Alliance directed by an Owner Participant or the PAB <u>including the deletion of work</u>. [underlining added]

23. The Alliance Participants are required to comply with any such direction, as per clause 14.1.1.

24. Accordingly, QLDC as the Owner Participant for the Arterial project can rely on clause 14.1 to direct a Change which involves deletion of all, or parts of, the remaining scope of work to be completed under the Alliance for this Work Package.

25. We note that for a Change to be considered a Variation, the PAB must approve it as a Variation under clause 14.3 of the PAA. The PAB will do so if it decides there is:

    (a) a significant increase or decrease in the scope of the Work under the Alliance for the relevant Work Package initiated or approved by an Owner Participant; or

(b) a change in the fundamental parameters underlying the design of the Alliance Works the relevant Work Package,

and which justifies an adjustment to the Final Target Cost for that Work Package (see PAA, clause 14.2.1(a)).

26. Accordingly, if Option 2 is chosen, QLDC should seek approval from the Board that the proposed direction by QLDC deleting work from the Arterial project is a Variation. This will enable the Final Target Cost to be adjusted downward thus preserving the portion of cost overrun to be repaid by the Non-Owner Participants. It also enables the Board to determine an appropriate adjustment to the Target Completion Date for the Arterial project to reflect the reduced scope, as per 14.3.3 of the PAA.

27. Option 2 would have the obvious benefit of reducing, to the extent of the cost/value of the deleted scope, the additional forecast cost to complete the Arterial project. However, QLDC should consider what part or parts of the remaining scope of work can reasonably be deleted and not carried out under the Alliance along with the practical impacts of this.

28. It will also be important for QLDC to consider the timing of any direction to delete work from the Arterial project. In effect. whether QLC should direct deletion of parts of the work scope now and reorganise the remaining scope of the Arterial project or continue with the current scope of work as currently planned and only direct the deletion once the approved Council funding limit is reached.

29. We have not been asked to comment in this advice letter on the likely impacts or issues with QLDC choosing this option, Option 2, over Option 1 or about the appropriate timing of any direction to delete parts of the scope of the Arterial project. We understand that you and/or other QLDC staff will be providing information to Council about these matters to assist it in deciding what option it wants to pursue.

30. Please contact me directly if you would like to discuss this advice.

Yours faithfully
SIMPSON GRIERSON

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Shanti Frater
Partner