

CHAPTER 7 – CONTINGENT ASSETS AND CONTINGENT LIABILITIES

CONTINGENT ASSETS

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

These can be classified into either quantifiable, where the potential economic benefit is known, or non-quantifiable. Table 7.1 contains quantifiable contingent assets as at June 2007 and a revised estimate of these contingent assets as at June 2008.

Quantifiable contingent assets

Table 7.1: Quantifiable contingent assets

	(\$ million)	
	As at June 2007	Estimate for June 2008 ^(a)
Guarantees, Indemnities	1.3	1.3
Potential early termination of contractual arrangements ^(b)	119.3	119.3
Legal proceedings and disputes	17.0	17.0
Other ^(c)	112.7	112.7
Total contingent assets	250.2	250.2

Source: Department of Treasury and Finance

Notes:

- (a) There have been no material changes to quantifiable contingent assets since last reported in the 2006-07 Financial Report for the State of Victoria.
- (b) Included under 'potential early termination of contractual arrangements' are any additional costs arising to the Director of Public Transport on early termination of the public transport partnership agreements. The operator must, to the extent of the performance bonds, indemnify the Director for any losses, damages or costs incurred by him as a result of early termination. If the operator does not do so, the Director has the right to draw on the operator's performance bonds for the amount of losses, damages or costs. The nominal value of these bonds is \$119.3 million.
- (c) 'Other' includes the EastLink project of \$92 million. The remaining amounts in 'Other' relate to smaller individual contingencies.

EastLink

On 14 October 2004, the state entered into a concession deed with ConnectEast to design, construct, finance and operate EastLink. Various performance bonds provided under the concession deed can be drawn by the state in circumstances where the concessionaire (ConnectEast) or one of its contractors fails to meet its obligations. These bonds include a construction bond (\$87 million) and an operation phase bond (\$5 million). In the event of certain default events, there is potential for the \$5 million to increase to \$20 million.

Non-quantifiable contingent assets

City Link compensable enhancement claims

The Melbourne City Link Concession Deed contains compensable enhancement provisions that enable the Victorian Government to claim 50 per cent of additional revenue derived by City Link Melbourne Limited as a result of certain events that particularly benefit City Link, including changes to the adjoining road network.

On 20 May 2005, the Victorian Government lodged a compensable enhancement claim relating to works to improve the traffic flow on the Westgate Freeway between Lorimer and Montague Streets.

Under the Monash Westgate Freeways Improvement project, the Victorian Government's share of revenue uplifts will be calculated and paid three years after the completion of the project.

EastLink

As indicated above, on 14 October 2004, the state entered into a concession deed with ConnectEast to design, construct, finance and operate EastLink. In addition to the quantifiable contingent assets listed above, there is a non-quantifiable contingent asset relating to the Hand Over Bond through which ConnectEast has an obligation to the State, in certain limited circumstances, to provide a bond to cover project rectification costs to the end of the concession period in 2043.

Channel Deepening Project Environmental Performance Bond

On 14 December 2007, the Minister for Environment and Climate Change approved the Channel Deepening Project under the *Coastal Management Act 1995*. The approval was subject to a number of conditions, including the Port of Melbourne Corporation providing a \$100 million environmental performance bond. The potential impact from this arrangement is that, in the event the bond is called upon, the Minister for Environment and Climate Change (being the beneficiary of the bond) will receive funds up to an amount of \$100 million, which are to be used for remedial or recovery works as agreed with the Minister for Roads and Ports.

CONTINGENT LIABILITIES

A contingent liability is:

- a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non occurrence of one or more uncertain future events not wholly within the control of the entity; or
- a present obligation that arises from past events but is not recognised because:
 - it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
 - the amount of the obligation cannot be measured with sufficient reliability.

As with contingent assets, contingent liabilities are also classified as either quantifiable or non-quantifiable. Table 7.2 contains quantifiable contingent liabilities as at June 2007 and a revised estimate of these contingent liabilities as at June 2008.

Quantifiable contingent liabilities

Table 7.2: Quantifiable contingent liabilities

	(\$ million)	
	As at June 2007	Estimate for June 2008
Guarantees, Indemnities	364.7	425.3
Potential early termination of contractual arrangements
Legal proceedings and disputes	285.1	242.9
Other	355.8	207.8
Non-general government debt ^(a)	3 678.6	4 803.4
Total contingent liabilities	4 684.3	5 679.4

Source: Department of Treasury and Finance

Note:

(a) Represents guarantees for loans made by the general government sector to agencies in the public non-financial corporations sector, primarily the water entities and other non-general government sector entities. The increase since June 2007 is mainly due to increased water industry capital works.

Non-quantifiable contingent liabilities

A number of potential obligations, which are non-quantifiable at this time, have been recognised by the government arising from:

- indemnities provided in relation to transactions, including financial arrangements and consultancy services, as well as for directors and administrators;
- performance guarantees, warranties, letters of comfort, and the like;
- deeds in respect of certain obligations; and
- unclaimed moneys which may be subject to future claims by the general public against the State.

Asset sales

Potential exposures are associated with the sale of a number of assets and services where the purchaser was provided with various indemnities and warranties.

Royal Melbourne Showgrounds

A contingent liability exists relative to any claims which may be made against the Showgrounds Nominees Pty Ltd arising from joint venture dealings as outlined in the Development and Operations Agreement for the Royal Melbourne Showgrounds. An undertaking has been given by the joint venture parties to meet the indexed service fees payable to the Concessionaire (Developer) under the Development and Operations Agreement as and when they fall due, subject to the Concessionaire's achievement of defined service standards at the Showgrounds and relevant abatement if there are service failures.

Under the State Support Deed, Core Land, the state undertakes to ensure the performance of the payment obligations in favour of the Concessionaire and the performance of the joint venture financial obligations in favour of the security trustee.

Under the State Commitment to the Royal Agricultural Society (RAS), the state has agreed to support certain obligations of the RAS which may arise out of the Joint Venture Agreement. In accordance with the terms in the State Commitment to the RAS, the State will meet certain RAS obligations, in the form of a loan, if requested by RAS when RAS does not have financial capacity to pay and provided RAS has materially complied with all its material obligations under the Project Objectives Agreement, RAS Events Agreement and other Joint Venture project documents. If any outstanding loan amount remains unpaid at a date which is 25 years after the commencement of the operation term under the Development and Operation Agreement, the RAS will be obliged to satisfy and discharge each such outstanding loan amount. This may take the form of the transfer to the state of the whole of the RAS' participating interest in the joint venture.

The state has also entered into an agreement through the State Support Deed – Non-Core Land with Showgrounds Retail Developments Pty Ltd and the RAS whereby the State agrees to support certain payment obligations of the Royal Agricultural Society of Victoria Limited that may arise under the Non-Core Development Agreement. In March 2007 Showgrounds Retail Developments Pty Ltd subsequently assigned all its rights and obligations under these agreements, via an Assignment Deed, to Coles Group Property Developments Ltd.

Public transport rail partnership agreements

The Director of Public Transport, on behalf of the Crown, entered into new partnership contractual arrangements with franchisees to operate rail transport services in the State, operative from 18 April 2004. The following summarises the major contingent liabilities arising from those arrangements.

Contingent liabilities on early termination or expiry of franchise agreement

Franchise assets: to maintain continuity of services, the Director at early termination or expiry of the franchise agreement will either purchase the assets or have the assets transferred to the successor.

Unfunded superannuation: at the early termination or expiry of the contract, the Director will assume any unfunded superannuation amounts (apart from contributions the franchisee is required to pay over the contract term) to the extent that the State becomes the successor operator.

National Express receivership

In December 2002, the government appointed receivers and managers to the National Express train and tram franchises, in order to protect government interests, ensure continuation of services up to the commencement of new franchise agreements, and deal with any subsequent termination issues.

The Treasurer, under the Receivership Deed of Indemnity, has agreed to indemnify the receivers for debts properly incurred by them in the course of receivership. The Treasurer has also agreed to remunerate the receivers in accordance with the rates set out in the deed.

Melbourne City Link

An outstanding claim exists from Transurban City Link Limited, pursuant to the Melbourne City Link Concession Deed, relating to an alleged Material Adverse Effect in respect of the construction of Wurundjeri Way. Expert determination found in favour of the state. However, the claim has now been appealed to arbitration, which is currently proceeding. VicRoads is defending this claim and is unable to assess the likelihood of success at this time.

EastLink

On 14 October 2004, the state entered into a Concession Deed with ConnectEast to design, construct, finance and operate EastLink. The major non quantifiable contingent liability arising from the concession deed relates to the Key Risk Management Regime. The Regime relates to the occurrence of certain circumstances that may have a detrimental impact on the concessionaire's ability to achieve its forecast returns. It identifies the areas that enable the concessionaire to claim redress from the State. These may include acts of prevention, failure to support a principal road interface, changes in state law, Native Title and the environmental effects statement.

Native Title

A number of claims have been filed with the Federal Court under the *Native Title Act 1993* that affect Victoria. While many such claims are being processed through the legal system, the government has committed itself to resolving claims through mediation, where possible. It is not feasible at this time to quantify any future liability.

HIH Insurance

The state's quantifiable direct exposures arising from the collapse of the HIH Insurance Group are included in the liabilities shown in the financial statements of the agencies directly responsible for them – such as the Victorian WorkCover Authority and the Victorian Managed Insurance Authority (VMIA) – and are consolidated in the financial statements of the state.

The state's obligations in respect of its builders' warranty insurance rescue package are direct liabilities of the state itself. They do not form part of the liabilities of the VMIA which manages claims on behalf of the state, this responsibility having been transferred to VMIA from the Housing Guarantee Fund Limited, under the *House Contracts Guarantee (Amendment) Act 2005*.

The state also retains some unquantifiable contingent exposures arising from the collapse of the HIH Insurance Group. These contingent exposures arise primarily through the possibility that the state may be involved in litigation in which it would be entitled to recover damages from third parties. If these third parties were insured by HIH, recovery in full may not be possible.

Land remediation – environmental concerns

A number of Victorian Government properties have been identified as potentially contaminated sites. The state does not admit any liability in respect of these sites. However, remedial expenditure may be incurred to restore the sites to an acceptable environmental standard.

Victorian Managed Insurance Authority – property and public liability

The VMIA was established in 1996 as a captive insurer for departments and participating bodies, predominantly in the general government sector. VMIA provides its client bodies with a range of insurance cover, including for property, public and products liability, professional indemnity and contract works. VMIA reinsures in the private market for losses above \$50 million arising out of any one event, up to a maximum for each type of cover (e.g. \$1,500 million for property and \$750 million for public liability). The risk of losses above these reinsured levels and below \$50 million is borne by the state.

Victorian Managed Insurance Authority – public healthcare insurances

VMIA insures the public healthcare system for a range of insurances, including medical indemnity risks. The government has indemnified VMIA for losses on its public sector medical indemnity portfolio that exceed 120 per cent of claims estimates to be incurred in any one policy year.

Gambling licences

In 1992, a gaming operator's licence was issued to the Trustees of the Will and Estate of the late George Adams, now trading as Tatts Group. In 1994, the state issued a wagering and gaming licence to TABCORP Holdings Limited (TABCORP). These licences expire in 2012 and the end of licence arrangements are specified in the *Gambling Regulation Act 2003*.

These end of licence arrangements include compensation provisions for the licensees predicated on the current licensing arrangements being rolled over for a further period beyond 2012.

On 10 April 2008, the government announced a new regulatory model for the post-2012 licences. The main changes include:

- separating the wagering and gaming licence to instead license wagering on a stand-alone basis; and
- transitioning from the current gaming operator duopoly to a system where venue operators are licensed to own and operate gaming machines in their own right.

After considering the end of licence arrangements in the *Gambling Regulation Act 2003*, the government has formed the view that neither Tatts Group nor TABCORP will be entitled to compensation after the expiration of their current licences.

The government does not intend to alter or amend the provisions in the *Gambling Regulation Act 2003* that deal specifically with the end of licence arrangements for Tatts Group and TABCORP.

Builders' warranty

On 13 March 2002, Victoria and New South Wales jointly announced a series of reforms to Builders' warranty insurance arrangements. This announcement included a commitment to provide a catastrophe fund capable of supporting claims above \$10 million. To meet this commitment, the two states offered reinsurance arrangements to all builders' warranty insurers covering claims in respect of any one builder in excess of \$10 million, with each state reinsuring claims relating to properties in that state. South Australia has since also become involved in these arrangements. Since builders' warranty insurance commenced, there have been no losses by an insurer to any one builder that exceed this amount.

Victoria has reinsurance agreements giving effect to these arrangements with three insurers. These agreements require each insurer to pay reinsurance premiums to Victoria (and to any other state that is also a party to such an agreement) that are estimated to be sufficient for the state to at least break even on these arrangements. However, the state retains an unquantifiable contingent liability for additional claims.

