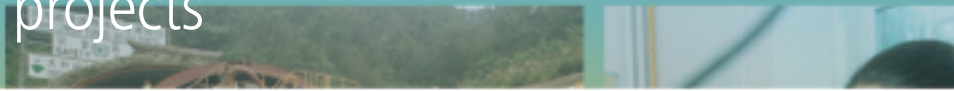




a guide to contract management for PFI and PPP projects



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Acknowledgements

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- **Review of operational PFI and PPP projects**
published by 4ps in 2005
- **PFI: Strengthening Long Term Partnerships**
published by HM Treasury in 2006
- **Report on Operational PFI projects**
published by PUK in 2006.

Disclaimer

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Section One

Introduction

A wide range of local authority Private Finance Initiative (PFI) and Public Private Partnership (PPP) contracts have now been operational for a number of years, with evidence suggesting that many are working well and delivering significant benefits to local authorities and their communities. The first local authority PFI deals were closed in the late 1990s, with sufficient data now becoming available to understand the key issues that are arising during the operational period.

Evaluation of these operational PFI/PPP projects has included in-depth reviews carried out by 4ps, HM Treasury and PUK which have resulted in the establishment of a PFI Operational Taskforce (encompassing 4ps and PUK). The principal aim of this taskforce is to provide proactive support and advice to those responsible for managing operational PPP/PFI projects. This is in direct response to one of the key findings of the reviews, that the provision of the excellent support and guidance that is available for the project development and procurement process should be further extended to cover the arrangements for ongoing contract management. The findings also highlighted the need for the operational management aspects of the contract to be strengthened and to be developed earlier in the procurement process.

This guide to contract management has been produced by 4ps to provide local authorities and their partners and stakeholders with a suggested approach to the requirements for contract management for a PFI/PPP project. Although specifically aimed at PFI and PPP contracts (typically long-term, complex contracts which are capital intensive in the early stages, involve payment on commencement of service and for performance), the general principles could be applied to a range of contracts. The guide identifies the key principles of contract management, gives advice on setting up an effective contract management team, and building a successful long-term relationship with the service provider. It examines what is required to manage service performance and administer the contract, and incorporates the good practice and lessons learned from current PPP/PFI contracts.

The aim of the guide is to be a user-friendly, quick reference strategic route map for local authority project directors and contract managers who are in the process of procuring and managing operational PFI/PPP projects, and who will have responsibility for the management of a PFI/PPP contract from financial close, throughout the construction or investment phase and the operational period. The advice and guidance given draws on the findings of the 4ps review of operational PFI and PPP projects which included interviews with the local authority and service provider representatives of operational projects across all sectors of local government, and from interviews carried out with project directors and contract managers during the development of this guide.

This guide follows on from the *4ps Guide for Project Directors and Project Owners* which provides a similar strategic route map for the project development and procurement process.

Finally, this guidance may also be read in conjunction with the *Operational Task Force 'Transition Guidance'* which is scheduled for publication in March 2007.

Section Two

What is contract management?

Contract management is the process of managing and administering the PFI/ PPP contract from the time it has been agreed at contract award, through to the end of the service period; referred to as the 'operational period' in this guide.

This guide focuses on the activities and processes which need to occur or be in place to ensure that the works and services are successfully delivered in accordance with the contract, and that an effective partnership is developed. Partnerships are covered in more detail in Section 4: Managing the relationship.

It is important for all stakeholders to recognise that the contract itself should be at the heart of the process – it is the foundation upon which the relationship is built, and compliance with the contract is a fundamental measure of Best Value.

The central aims of the contract management activity are to ensure that:

- the local authority's agreed contractual position is protected
- the agreed allocation of risk is maintained and that Best Value is achieved
- monitoring of the service provider's performance against the output specification is undertaken to ensure that the financial implications of any failure to perform have been taken into consideration and appropriate action taken
- payment for the service is conditional upon the quality of performance of the service provider
- services are delivered in accordance with the contract
- continuous improvement in contract performance and service delivery is maintained.

There are four key components to the contract management function, all of which are interrelated and are required for a successful operational period. These components and the principal activities they involve are illustrated in Figures 1 and 2. Figure 2 highlights the key aspects of each component, and sets out the structure used for this guide.

Figure 1 **The four components of contract management**

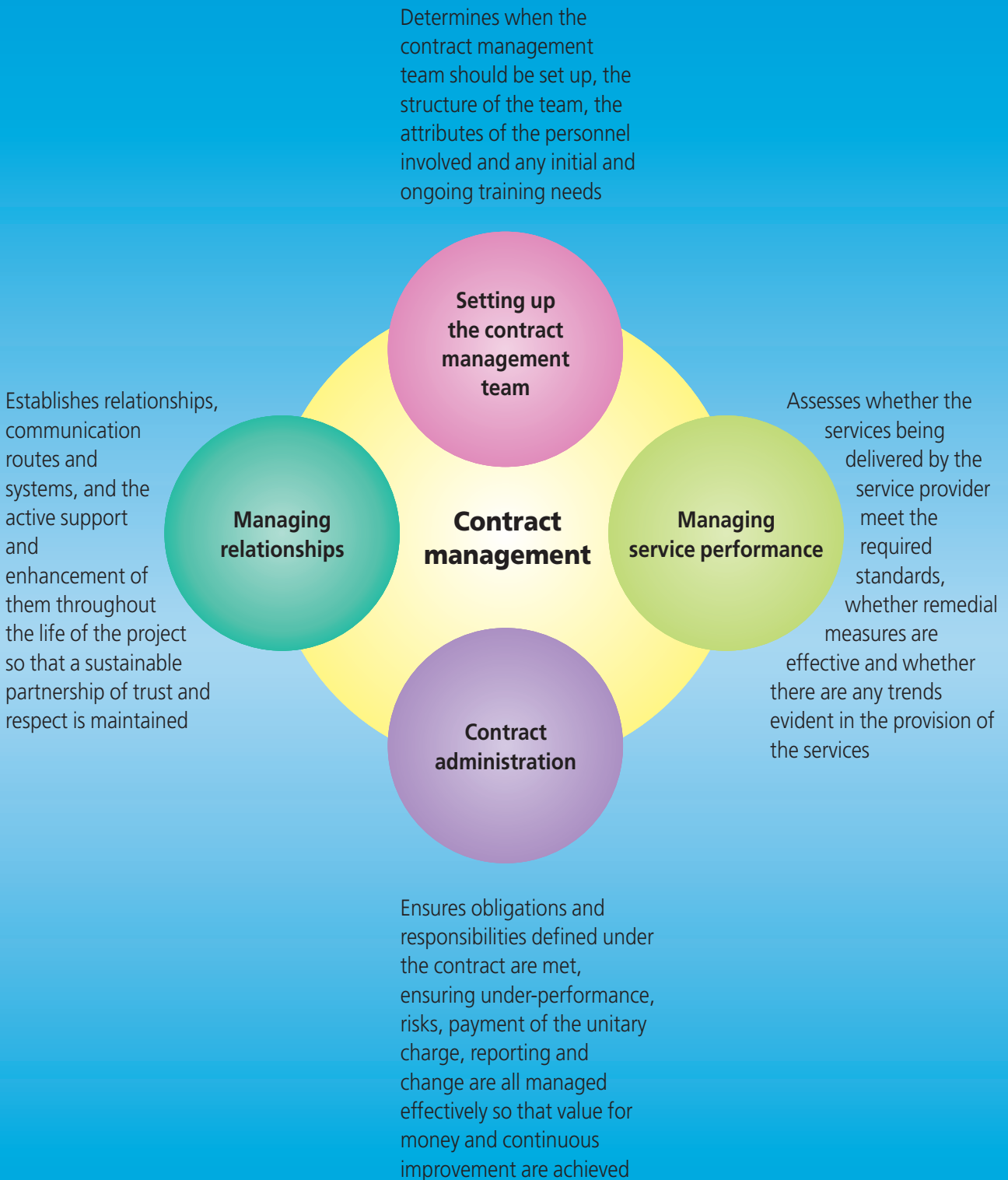


Figure 2 The four components of contract management

Setting up the contract management team	Managing relationships	Managing service performance	Contract administration
3.1 When should contract management commence?	4.1 Identification and development of good partnership working	5.1 Why should service performance be monitored and measured?	6.1 The payment mechanism
3.2 Determining the contract management team structure	4.2 Development of partnership protocols and behaviours	5.2 The fundamentals of performance measurement	6.2 Dealing with disputes
3.3 Determining and securing the resources required for contract management	4.3 Defining communication protocols, routes and systems	5.3 Working with the service provider to mobilise services	6.3 Variations to the contract
3.4 Job profiles, skills, and competencies required for contract management	4.4 Overcoming relationship difficulties	5.4 Monthly performance monitoring processes and payment	6.4 Benchmarking and market testing
3.5 Identifying the initial and ongoing training requirements	4.5 Developing successful relationships	5.5 Monitoring the provision of the services	6.5 Contract administration checklists
3.6 Ensuring continuity of the contract management function	4.6 Practical problem and dispute resolution	5.6 Tools for measuring performance – helpdesk	Payment mechanism checklist
3.7 Setting up the contract management team checklist	4.7 Managing relationships checklist	5.7 Managing service performance checklist	Benchmarking and market testing checklist
			Dispute resolution checklist
			Service variation checklist

Section Three

Setting up the contract management team

3.1 When should contract management commence?

The foundations for good contract management are laid during the procurement stage of a PFI/PPP project, and it is therefore vital that contract management is considered throughout the procurement process and, where possible, the contract manager is involved in the procurement.

Early involvement in the procurement process will enable the contract manager to gain a thorough understanding of the local authority's requirements, will better assist the development of pragmatic and 'user friendly' performance measurement systems, allow input into the evaluation of the solutions and bids received, and will mean that they have good understanding of the service methodologies at service commencement.

This early involvement in the procurement process is likely to produce better contract management, particularly in the period immediately after service commencement, because the contract manager will have:

- a clear understanding of the processes required for contract management
- a strong understanding of the contract documentation
- knowledge of what was agreed during Competitive Dialogue (or negotiation)
- a clear understanding of the service provider's service methodologies
- an involvement in and the ability to influence the mobilisation and transition period.

"Involvement in the procurement, and then the ongoing contract management has been a huge benefit in terms of continuity of knowledge on the project. The local authority project team, the experience and the continued involvement throughout the whole process helped to maintain a position of strength throughout all levels of negotiation. Due to this, a strong relationship has developed between the service provider and the local authority team, and this has established a strong 'want to do/can do' environment."

Local authority contract manager

Up to the award of the contract, the project director will have managed and had overall responsibility for delivery of the project. Typically the project director will have been supported for the procurement phase by a project manager and a team of legal, financial and technical specialists who will be sourced both from within the local authority and supplemented by external advisors. Once the contract is awarded, it is typical for the project director and the project team to be replaced by a contract manager and a new team. Although there are instances where the project director 'becomes' the contract manager, it is more often the case that this team is not the same as the procurement team. This exposes the project to continuity problems. If there is no contract management involvement until just prior to service commencement, a number of avoidable issues can occur. For example:

- a lack of knowledge and understanding of what the service provider's intentions were within their solution, as well as what has been incorporated into the contract, resulting in conflict and affecting the establishment of the partnering relationship

- a lack of knowledge of the payment mechanism and monitoring system, leading to deductions not being made for poor performance
- non-involvement in the mobilisation, leading to a lack of opportunity to influence the implementation of services, and therefore a lack of awareness of problems and the implementation of the solutions
- the late appointment of the contract management team, meaning that they will have to quickly gain knowledge of the documentation and the service monitoring processes at the same time that the service provider is commencing delivery of services. This could lead to issues not being resolved in a timely manner.

The project director's focus during procurement will have been finalising the contract. However, during this period it is important that contract management requirements for the service period are scoped, and if possible, the appropriate personnel for contract management are identified, as it is they who will have to enforce the contract and monitor the service requirements.

'I was told at an early stage in the procurement phase that I would be the contract manager for the project. I therefore had a vested interest in the output specification and project documentation and would not allow them to be signed off until I was completely satisfied with their content.'

Local authority contract manager

'Having only been involved with the project since the award of contract to the service provider, there is a lot of history that I am not aware of. Knowledge of what had been discussed during the procurement would have been invaluable, especially as there has been a high turnover of service provider staff.'

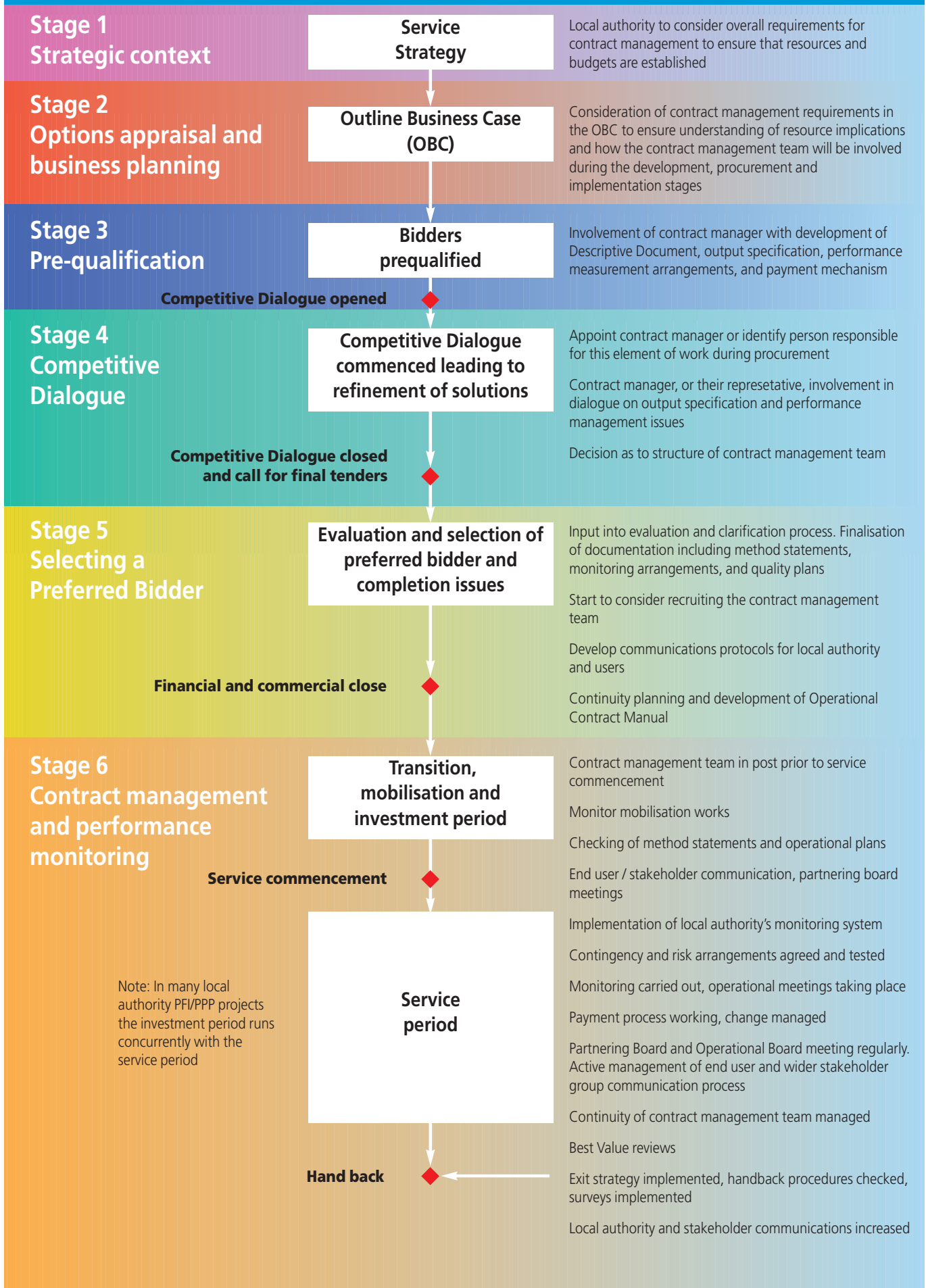
Local authority contract manager

From the research undertaken, figure 3 shows what is regarded as best practice for contract management and the principal inputs by the contract management team.

Although resources may dictate the time at which a dedicated contract manager is appointed and engaged in the procurement process, it is nevertheless important to consider who will be carrying out the contract management role as early as possible to allow time for external recruitment if necessary. If a dedicated contract manager is not to be appointed during the Competitive Dialogue stage of the procurement process, which is recommended, a transitional approach should be considered – using one option, or a combination of two options:

- delegating responsibility for contract management input during Competitive Dialogue to someone at senior level within the local authority who will have an involvement in the service period. This will address some of the continuity issues outlined earlier, including helping to develop the long-term relationships which are fundamental to the success of partnership working
- appointing an external advisor who will be given responsibility for knowledge transfer to the contract management team when they are appointed.

Figure 3 Map of contract management involvement throughout the project development and procurement stages



3.2 Determining the contract management team structure

In order to maximise partnership working within a PPP/PFI project, a project structure which will enable strong working relationships to develop at all levels between the local authority, the service users (such as schools) the service provider, and, for PFI projects the SPV, is needed. The local authority should be aiming for a structure with clear lines of communication and reporting procedures, and for a balanced relationship, i.e. one that is not so adversarial that the relationship disintegrates, nor one that is so lenient that the service provider does not deliver the requisite level of service. This is covered in more detail in Section 4.

The typical project structures for PFI/PPP contracts consist of a Partnership Board, a Contract Management Board and an operational team, as illustrated in Figure 4. This structure is generic, and should be tailored to suit the local authority's specific project and existing structures and governance arrangements. It is important to map out the project structure to be utilised for the operational period during Competitive Dialogue, so that the service provider is clear on how they will formally interface with the local authority and so that the senior management and stakeholder input can be assessed and secured.

The **Partnership Board** would typically meet quarterly and has responsibility for ensuring the partnership is operating successfully. This board also acts as a focal point for communications to all stakeholders, and as a point of reference if problems need to be escalated, such as following enactment of the formal dispute resolution procedure. The primary objectives and functions of the Partnership Board are to:

- provide a strategic overview to ensure long-term issues are properly considered
- ensure that the objectives of the contract are met over the full term of the contract
- ensure an ethos of working in partnership is developed and maintained
- ensure that the project is aligned with both parties' business or service plans
- ensure effective communication is taking place at all levels
- provide a strategic overview to ensure long-term issues are properly resolved
- consider and report on any changes in legislation
- agree proposed efficiencies and changes
- set year-on-year improvement targets if appropriate
- promote Best Value through the management of whole-life costing, through innovation and service improvements

The **Contract Management Board** (or Operations Board) would typically meet monthly. It is normally responsible for monitoring service delivery against service levels and key performance indicators, and also for ensuring that day-to-day contractual matters are dealt with as efficiently as possible. The approach and attitude of team members who form this group must therefore be ideally suited for a partnering relationship. The primary objectives and functions of the Contract Management Board are to:

- review the monitoring report and matters arising from it
- review the payment report and agree payments due
- resolve issues regarding production of information
- take a forward view of the project
- identify efficiencies and necessary changes

- record/discuss issues affecting the contract, for example, compensation events, delays, extensions of time
- review areas of conflict
- ensure the Partnership Board is briefed and actions taken
- promote partnership working

In summary, its function is to monitor and discuss performance, to promote and consider operational changes that would increase benefits to stakeholders, and to manage minor contractual variations.

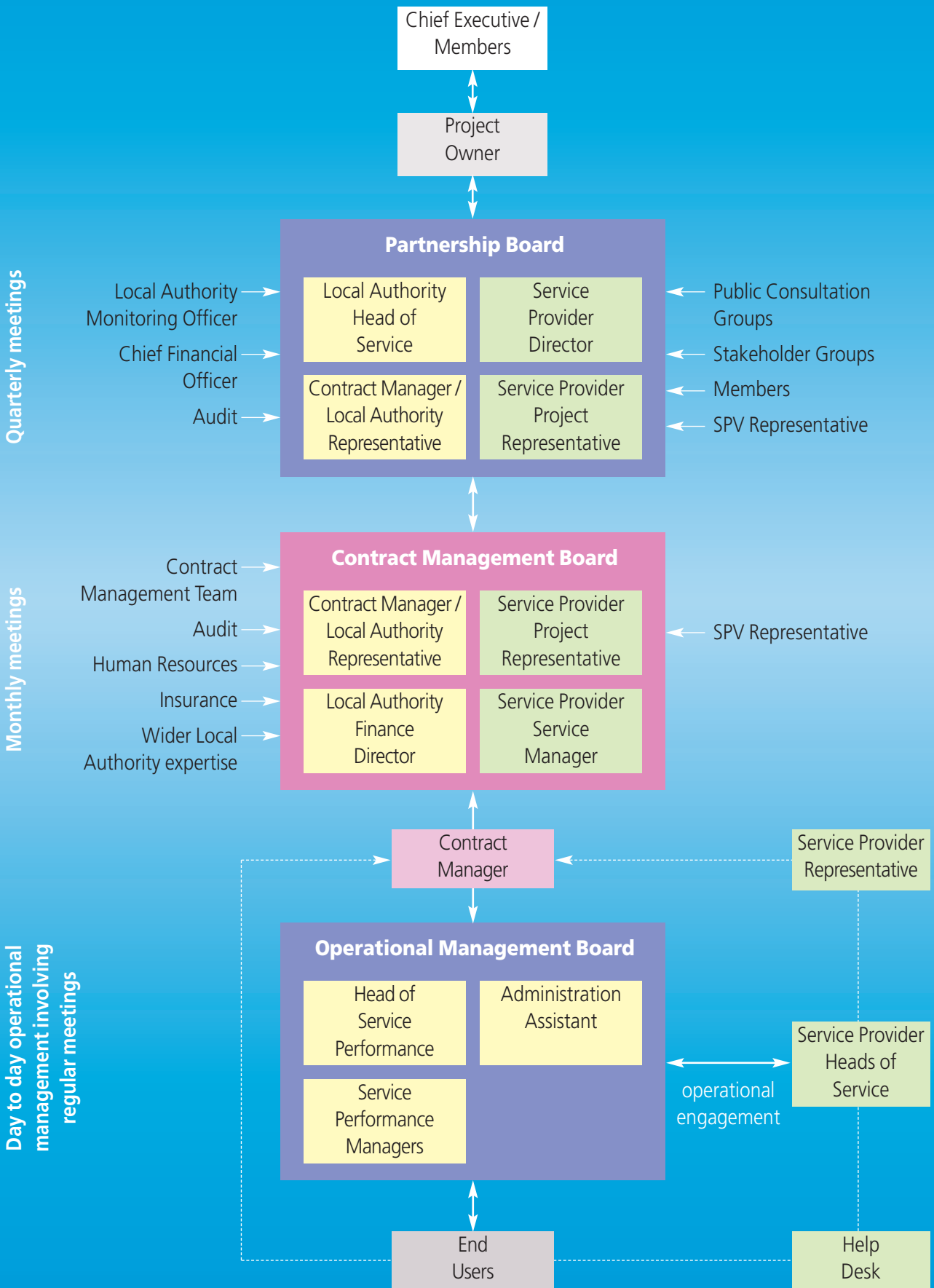
The **operational management team** meets on a regular basis and as such is the main interface between the local authority's contract management team and the personnel responsible for providing the service on behalf of the service provider, and often, when appropriate, the end users who are receiving the services, for example head teachers or their business managers in a school project. The main objectives for operational engagement are to:

- provide early identification of early issues
- produce monitoring reports and payment reports
- discuss and, whenever possible, resolve minor operational issues
- discuss day to day service provision with both the end users and service provider representatives
- ensure all parties are clear as to the level of service required
- promote partnership working

Often operational management meetings occur immediately before, or as part of, a Contract Management Board meeting, as many of the same personnel are involved.

Consideration should also be given to the holding of separate meetings to discuss/resolve significant issues prior to any formal Partnering or Operational Board meeting (such as financial disputes, personnel matters) so as not to detract from the main focus of the formal meetings. For example, in many contracts the service provider will meet with user representatives on a weekly or fortnightly basis, and also, separately with the local authority's contract management team. The importance of regular, frequent and co-operative communication between all stakeholders at an operational level cannot be over-emphasised.

Figure 4 Project structure



3.3 Determining and securing the resources required for contract management

The size of the contract management team will be dependant on the size and complexity of the project, how performance is to be monitored, and how the relationship will be managed. It is therefore difficult to provide generic guidance on the level of resources needed to effectively administer the contract. For small projects the whole of the contract management function may be performed by a single person, whereas larger projects often require a team of people. Local authorities need to be confident that they have understood and reviewed what the resource requirements will be for the various phases of the operational period, and have thought carefully about the skills they will need, as well as how they will secure those resources.

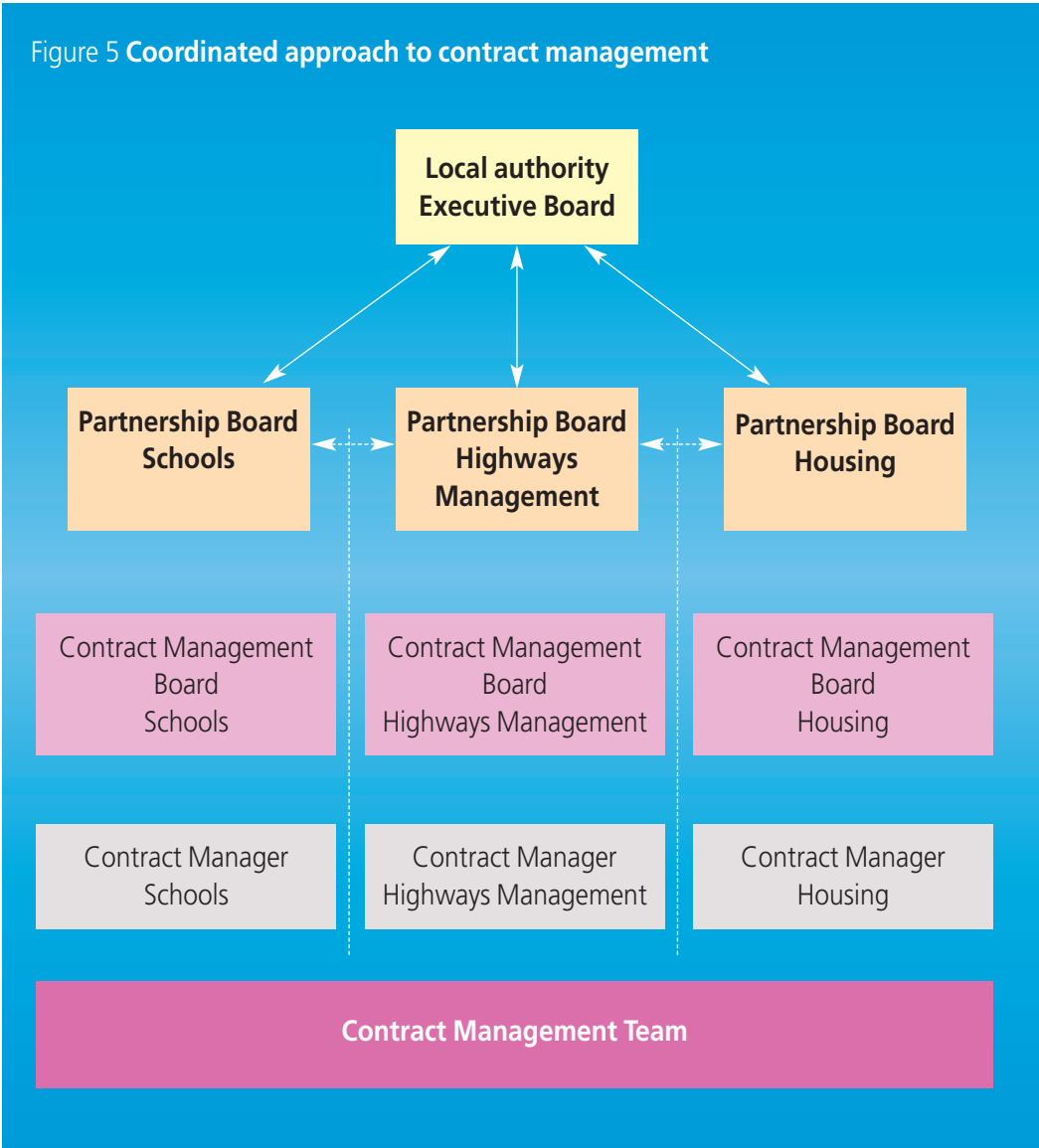
A contract management team might consist of a contract manager, (the local authority representative), a service performance manager, a communications manager, and administrative support. If the project is small and the monitoring of the service is straightforward then the contract manager may also take on the role of the service performance manager. Where a project covers many sites or functions, local staff may act as service performance managers reporting back, possibly through their own operational lines, to a central contract manager. However, careful consideration needs to be given to this approach. If the local staff perform other duties (for instance a head teacher in a schools project), they may not have the capacity to take on the additional role of performance monitoring and recording service failures which is necessary to make the appropriate payment deductions and ensure that best value is being achieved. It should also be noted that it is the local authority's responsibility to monitor service performance, and delegating this does not remove that responsibility.

It is not necessary to have a team consisting of experts in all aspects of the contract. A contract management team can be supported on an ad-hoc basis with expertise from elsewhere within the local authority, or by external advisors. For example, the catering and nutritional advice required for a residential care home could be provided by expertise from within a school's catering team.

Within the contract, there should be the requirement for the local authority to appoint a 'local authority representative', or equivalent, who is responsible for acting on the authority's behalf in relation to liaising with the service provider representative in respect of all aspects of the service. This person is likely to be the contract manager.

If a local authority has a number of operational PFI/PPP projects, and/or other complex contracts, as shown in Figure 5, there may be the opportunity to share some contract management functions or perhaps to have a single team for monitoring the operation of the projects i.e. a centralised contract management team. Centralising the contract management team could bring a number of benefits to the local authority, in that it would promote more efficient knowledge and skills sharing and would facilitate the implementation of best practice across all the local authority's operational PFI and PPP projects. In addition, greater efficiency of resources could be realised, whilst generating a potentially more attractive career path for the staff working within the central team, thus aiding staff retention.

In determining the contract management team structures, local authorities should give consideration to the methods for promoting greater efficiency of knowledge and skill sharing, and the methods by which lessons learned and best practice will be implemented across all operational projects, and indeed how this knowledge will be fed back into their projects that are in the procurement phase. A centralised approach would also avoid 'silo' working and ensure that best practice is shared.



3.4 Job profiles, skills and competencies required for contract management

It is important that local authorities consider at an early stage in the development of a project the staff they will require for the operational phase. Local authorities need to identify and appoint appropriately skilled staff with the right attributes and appropriate levels of empowerment to carry out contract management duties. Failure to do this will inevitably lead to under-resourcing of the operational phase, particularly in the early stages which are most intensive, and will lead to variable quality of management of the contract.

The contract manager plays a key role in developing relationships with the service provider and monitoring the service provider's performance, and therefore is a critical appointment. As such, the appointment is likely to be full-time and will take account of the risk and complexity of the project. The contract manager is required to:

- have clarity of his/her role, levels of delegated authority and reporting lines
- be empowered to make decisions to enable the contract to successfully operate on a daily basis
- have the requisite seniority and experience to reflect the level of delegated authority and complexity of the project
- have the appropriate skills and experience in contract management
- have the ability to lead a team – which may be multi-disciplinary
- communicate effectively with all members of the contract management team, Partnering Board, stakeholders, users and the wider community
- put in place an appropriate contract management methodology and risk register
- put in place an appropriate performance monitoring and audit system
- oversee and ensure the service provider mobilises effectively and on programme
- keep the output specification and method statements up-to-date
- form a good, long-term, sustainable relationship with the service provider
- ensure that service standards are provided and maintained and have day to day links with the service provider
- monitor the service provider's ongoing performance and service delivery
- agree monthly payments/deductions to the service provider
- ensure Best Value is obtained
- identify key trends in the service delivery and the service provider's performance
- ensure remedial measures for improving service delivery are implemented when required, and monitor the service provider's approach to rectifying non-compliance
- manage changes in legislation within the contract
- manage variations, benchmarking, market testing and change
- monitor and manage risk
- be responsible for the ongoing training requirements of the contract management team
- deal with disputes and default

“Although the project required significant capital investment, the service period monitoring was very simple. Consequently the appointed contract manager was not a senior member of staff and the project did not receive much attention from within the local authority once the service period had commenced. As a result when things went wrong they did not come to the attention of senior management within the local authority until the problems had escalated significantly.”
Service provider

- ensure the contract remains up-to-date with changes and variations agreed
- provide quality assurance
- undertake business planning with the service provider, looking for opportunities to enhance delivery and improve value for money
- review service specifications on a periodic basis
- network with other local authorities to understand and share best practice
- review exit strategy and handback procedures.

The main skills and knowledge for the contract manager and the contract management team collectively are:

Skills, attitude and experience

- demonstrates strong leadership skills
- has good people skills (interpersonal and management)
- has a partnering 'win: win' ethos for relationship management
- has a positive outlook and attitude and is proactive
- demonstrates effective negotiating skills
- is able to manage relationships successfully and resolve conflict
- is able to manage users and their demands
- is able to work effectively with a team
- is able to plan resource requirements effectively
- exercises good judgement, based on experience and sound analysis
- has experience in managing complex services
- has experience in performing contract monitoring
- can establish processes for monitoring performance
- has the ability to anticipate and respond to future business needs
- possesses well-developed analytical skills
- has good organisational and QA skills
- has a realistic and practical approach to change and innovation
- is able to develop strategies to meet changing contractual needs
- is able to apply contract management procedures
- is able to evaluate and control expenditure

Knowledge of

- relationship management
- partnership working
- managing a team
- developing a team
- service monitoring processes and the data required to do so
- output specifications and performance measurement systems
- end user requirements (eg the requirements of schools)
- procurement processes
- government accounting principles
- benchmarking/market testing
- the private sector and its business drivers
- changes and developments in the relevant service markets

When recruiting a contract management team, consideration should first be given to the skills, knowledge and abilities of staff already working in the local authority. Within a directorate familiar with delivering technical/engineering services, for instance, there will be staff with expertise in dealing with setting up and monitoring contracts, and they may be capable of transferring their skills to a PFI/PPP project. This in-house experience can be enhanced through training, but the recruitment process must be started early enough for training and any knowledge transfer from the procurement team to take place prior to service commencement.

“Resource for the management of PFI/PPP contracts has often been underestimated and it has been difficult to recruit people with the relevant expertise/knowledge. Succession planning within the team is vital to ensure that there are always the skills and knowledge available.”
Local authority contract manager

3.5 Identifying the initial and ongoing training requirements

Although there are some skills available within local authorities, some difficulty is being experienced with the recruitment of personnel into contract management posts. Local authorities must therefore ensure that appropriate training is provided, both ‘on-the-job’ training as well as the more formal training that will be necessary.

Training falls into two categories: general, which can often be sourced within local authorities; and specific, which will probably need to be sourced externally.

General training in contract management

- basic contract management principles
- project management
- negotiating skills
- general commercial skills
- communication
- partnership working.

Training specific to PPP/PFI projects

- mobilisation and handover
- change management
- the payment mechanism and its application
- helpdesk function and performance monitoring
- the application of the contract
- contractual change and variation management
- benchmarking and market testing.

Help and guidance is already provided through 4ps Network Groups. 4ps has also launched a new skills development course on contract management, and will continue to develop this further in collaboration with the Operational Taskforce.

3.6 Ensuring continuity of the contract management function

Since most PFI/PPP contracts are long-term arrangements (typically 25 years), it is unlikely that those involved at the outset of the contract will still be in post at the end of the service period. Key to long term success is therefore knowledge management, deployment of robust processes and succession planning.

The aim should therefore be for continuity of contract management procedures from the procurement stage onwards. Succession planning and training of personnel will be imperative to ensure the contract continues to run smoothly, otherwise knowledge, mutual understanding, trust and the relationship between the parties will suffer. This is especially true for the senior members of the contract management team. It is vital that incoming officers recognise the background to the contract.

Whilst succession planning can be put in place, and training of both current and new staff can be given, it is recommended that an **Operational Contract Manual** is developed. This will ensure clear understanding of the over-arching principles of the contract, and will give key information on the structure and application of the contract. Ideally the *Operational Contract Manual* should be produced prior to service commencement so that it also assists those involved with the period immediately after service commencement when contract management activity is high.

The *Operational Contract Manual* should be written in plain English and should be a comprehensive summary of the operation of the contract. It is essential that it is updated regularly. The manual should be as succinct as possible and should utilise process maps to clarify key processes and principles to encourage its use by the team, end users, service provider and wider stakeholder network.

The *Operational Contract Manual* should be viewed as a working document that facilitates both the initial transition period between the procurement phase and the operational phase, and the subsequent transition between contract managers over the life of the contract.

A suggested contents list for an *Operational Contract Manual* is set out overleaf.

To assist 'user friendliness' and hence actual use, it may be useful to break this down into 'sub-manuals' by key section, such as performance monitoring, help desk, and payment mechanism.

The Operational Contract Manual

Introduction	Purpose of document and what it covers
Project objectives	Project overview and principles
The authority team structure	Contract management team organogram including the core team and the wider local authority and stakeholders
	Roles and responsibilities
	Key contacts
Service provider team structure	Organogram of service provider and SPV
	Roles and responsibilities
	Key contacts
	Consortium management arrangements
Governance	Partnering Board Members, role and responsibility
	Operational Board Members, role and responsibility
	Decision making processes
	Delegated powers
Communication protocols	Communication processes with all key parties
	Reporting requirements
Meetings	Type, purpose and frequency
	Membership and chairpersons
	Outputs
The contract	Purpose and overview
	Key operational clauses
	Details and reasons for changes
Key dates	Meetings
	Reviews
	Benchmarking and market testing
Payment mechanism	Principles
	Application for payment process
	Service point deductions
Performance monitoring	Key output specification requirements
	Method statements and procedures
	Issues
	Records
Helpdesk	Operation
	Procedures
	Escalation
Audit and record keeping	Contractual requirements
	Government requirements
	Audit trail of changes
Risk	Risk allocation
	Issues
	Changes since contract award
Performance targets and BVPI	Overview
	Previous and current issues
	Changes since contract award including reasons
Example appendices	Key contacts
	Facilities Management Guide or summary of services – a note for end users on what they can expect
	Performance standards – a note for end users on what they can expect
	Process for handling variations

3.7 Setting up the contract management team – checklist

The following checklist shows the key issues to be addressed in setting up the contract management team.

Setting up the contract management team checklist

- Identify the extent of contract management resources required during the initial business planning process
- Quantify and secure funding for the contract management team early in the business planning process
- Allocate contract management responsibility early in the procurement stage
- Identify any staff already working in the local authority who have skills, knowledge and abilities that can be transferred to a PPP/PFI project
- If external recruitment is required, then start this process early
- Involve the contract manager, or their representative, in Competitive Dialogue and evaluation of bids during the Competitive Dialogue period to ensure thorough understanding of the contract and ownership
- Ensure the contract management team is in place well in advance of service commencement
- Ensure the partnership ethos is developed and maintained
- Identify initial and ongoing team training requirements
- Ensure the contract manager fully understands the contract, output specification and payment mechanism that are being, or have been agreed
- Produce an Operational Contract Manual for handover between the procurement team and contract management team

Section Four

Managing the relationship

4.1 Identification and development of good partnership working

By their very nature, PFI/PPP projects involve long-term relationships between local authorities, service providers, SPVs where they exist, and end users. The effective management of these relationships is essential to achieve long-term success. The key to this is the establishment of a collaborative working (partnering) relationship, together with systems and communications that actively support and enhance the relationship throughout the life of the project. When 'things go wrong' in a contractual relationship the result is a reduction in efficiency leading to a reduction in value for money; a healthy relationship is characterised by trust, respect, openness, co-operation and working together to solve problems and achieve mutual goals. Good relationships are efficient and achieve best value, as adversarial conflict is avoided.

A useful definition of partnering, based around an Office of Government Commerce definition, is as follows:

"A form of collaborative working between customers and suppliers. It is characterised by openness, communication, mutual trust and sharing information. Its success is dependent on the people and relationship aspects. The management of a partnering arrangement is usually proactive rather than reactive, and both parties work together to identify optimum solutions and to anticipate and resolve problems in a constructive, collaborative way."

Why things can go wrong in relationships

When significant issues arise in a PFI/PPP contract, it is usually due to either the materialisation of an operational risk or a relationship risk, or possibly the materialisation of a defect in the agreed contract. For example, a design defect or a price defect which should have been identified during the due diligence process. Systems and methodologies should be in place to mitigate operational risks and to deal with them if they occur. Relationship risk is more complicated, and it can be the result of poor or unsatisfactory communication and co-operation and usually follows, and exacerbates, a reduction in mutual trust. Some examples of common perceptions and misconceptions that can affect a relationship are:

- there is no such thing as the perfect individual and the perfect team; people often promise to do more than they can actually achieve, and people make genuine mistakes
- local authorities may perceive that poor reaction times from a service provider are due to cost-reduction strategies, when in fact the reaction times originally specified were inappropriate
- service providers might blame slowness in decision-making by the local authority on unwillingness to spend money, when in fact they do not understand the local authority's sign-off procedures
- concerns about performance reporting may result from misunderstandings, or lack of understanding of the performance regime and the payment mechanism
- relationships and/or service delivery and/or performance measurement is not based on a robust understanding and deployment of the contract
- partnership ethos in the relationship is not embraced.

Such perceptions and misconceptions can be avoided through the generation of trust and transparency within the team, which can be achieved through the adoption of a partnering and collaborative working relationship.

4.2 Development of partnership protocols and behaviours

The four cornerstones of partnering are :

- the development of agreed and easily understood mutual objectives
- the adoption of a collaborative, 'win: win' approach to problem solving
- the development of a quick and co-operative problem resolution strategy
- a commitment towards continuous, measured improvement

A partnering style of working is a commitment by the parties within a PFI/PPP contract to collaborate to achieve mutual goals. Incentivisation for service providers comes from the PFI payment mechanism and the possibility of maximising returns through the provision of a good service. Service providers appreciate a supportive client who has an awareness of their key drivers, and recognises the needs of the service provider to make a reasonable profit and develop new business. The overall goals for the local authority are customer satisfaction and best value. Goals can therefore be aligned to become mutual goals, which are then achieved through inter-partner collaboration and joint problem solving. The result is less conflict, and improved performance in terms of quality, time and cost. Over the life of the contract, further benefits accrue as the whole team builds on lessons learnt and continually improves.

The development of a project statement prior to service commencement which describes the ethos and principles which all parties will ascribe to should be considered, as it will give a positive start to the relationship. This should be addressed in the Operational Manual (see section 3.6).

4.3 Defining communication protocols, routes and systems

To a large extent, successful partnering relationships are between people rather than organisations. There are many instances of such relationships breaking down when new or replacement team members takeover relationship management responsibilities. People's attitudes towards one another contain beliefs about trustworthiness based on either past experience or current information available. Hence individual attitudes are an important aspect in the building of trust and the development of relationships. Trust generation formed through the adoption of the right attitude leads to interpersonal co-operation and synergistic relationships which in turn helps to optimise efficiency and achieve value for money.

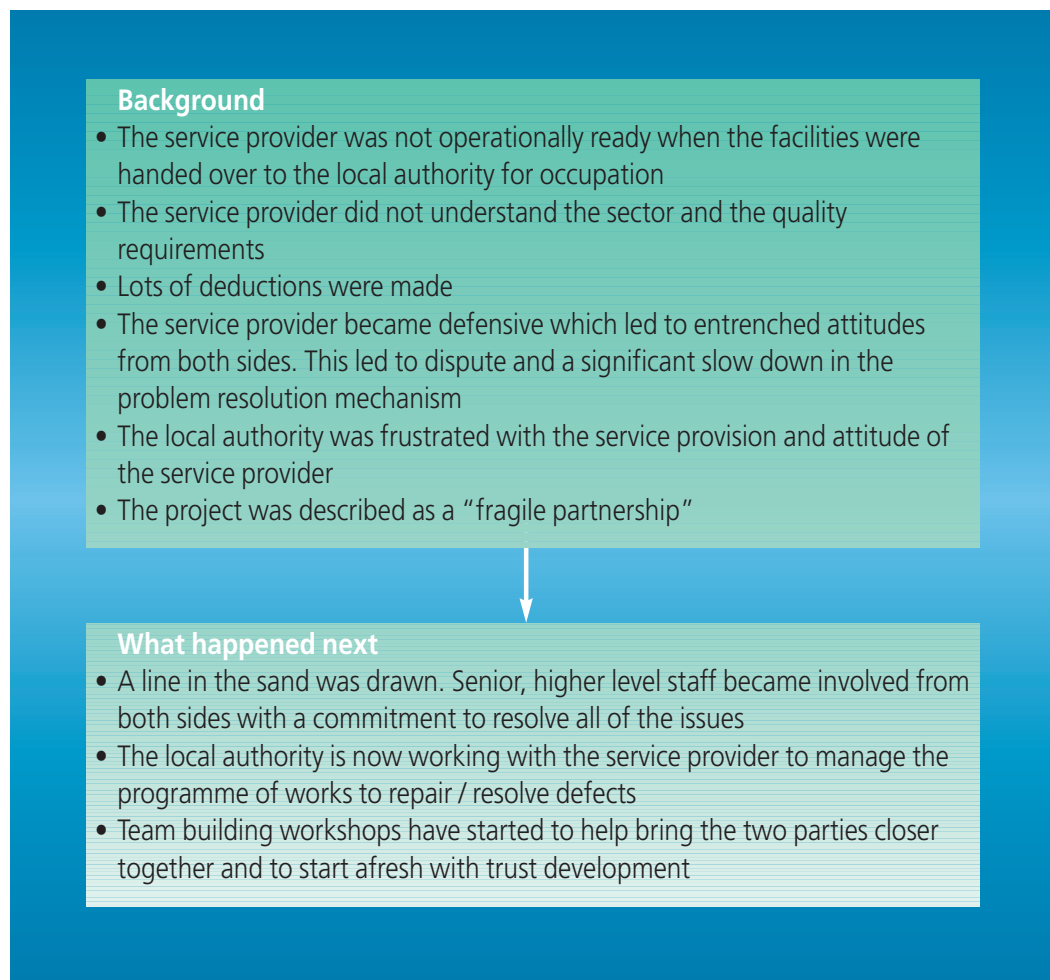
When developing collaborative working arrangements, all parties need to approach the project with a collaborative, rather than an adversarial attitude. To establish good collaborative working, externally facilitated team-building workshops should be undertaken throughout the life of the project, to help foster the relationships and the development of a team 'culture'.

If roles and responsibilities are clearly defined and understood by all individuals within the partnering team then this will help to minimise conflict. This includes defining governance structures and establishing procedures for monitoring and reporting. It also includes understanding risk allocation and who is responsible for managing the risk. Open communication is another key trait of successful partnering relationships, and good lines of communication should be established at the outset of the relationship. However, formalised communication lines should not preclude informal communications which often enables

problem resolution to be expedited in a more efficient way. Co-location of teams in one building or office area may aid openness of communication, trust generation and relationship building and this should be considered when the collaborative working relationship is formed.

4.4 Overcoming relationship difficulties

There is a probability that during the life of a project there will be a time where the relationship between the parties, for many reasons, may become strained. Work will be required to get the relationship back on track and it is recommended that an independent facilitator is brought in to help determine the underlying problems and assist with the relationship building. The type and amount of work required will vary, but with a positive and open attitude and a determination to succeed, the issues should get resolved as illustrated in the example below.



4.5 **Developing successful relationships**

The many good examples of schemes where successful partnering relationships are helping service providers to function efficiently, provide customer satisfaction and deliver value for money, have the following key characteristics:

- the team taking the project through the Competitive Dialogue went on to form the operational team, ie there was continuity of staff, and trust was established before the operational stage began
- there is a focus on the relationship first, and an adoption of a no-blame culture, consequently issues are resolved quickly and efficiently
- both parties look for opportunities for joint training and development. Working together in this way fosters and maintains trust
- if problems do occur, an external facilitator is brought in immediately to help resolve them
- the wider authority recognises the partnership.

4.6 **Practical problem and dispute resolution**

Conflict and dispute typically occur within a contract when a problem occurs. Therefore a key aspect of a partnering relationship is the resolution of problems quickly and efficiently without dispute. This can be achieved through defined mechanisms such as:

- agreed and documented discussion and agreement, with 'side letters' to the contract if necessary
- through the contractual change mechanism (change in service; small works and service provider change in service)
- agreed arrangements for change to the local authority's performance requirements and the service provider's method statements.

However, as mentioned above, it is rare to find systems or methodologies for the resolution of relationship problems. It is common sense for partners in long-term PFI relationships to realise and admit to each other openly that problems will occur and so devise a strategy at the outset for dealing with these.

The basic tenets of a collaborative problem resolution methodology are as follows:

- development of a systematic approach incorporating an agreement to seek win-win solutions, rather than parties to blame
- open discussions and equality of rights
- mutual acceptance that adversarial attitudes waste time and money.

Where disagreement takes on a legal perspective it should be approached through:

- escalation to senior management
- formal dispute procedures in the contract
- mediation.

Trust and challenge

Trust and respect need to be fostered and maintained, but this can only be achieved if partners make the effort to develop relationships positively. Trust improves with time, and with the proliferation of positive experiences.

The development of 'cosy' relationships needs to be avoided, as such conditions can lead to opportunism. This means that one party perceives an opportunity to gain advantage from the situation through a departure from the defined service parameters, for instance in the form of work-shirking or failure to carry out repetitive tasks. The risk of opportunism within a partnering relationship depends on:

- the incentives a partner has to be opportunistic
- the occasions presented for opportunism
- the propensity a partner has for opportunism.

As trust develops, cosy relationships can occur through a perception that performance monitoring can be relaxed. However, this then presents either partner with an occasion for opportunism, the incentive clearly being the cost or quality advantages that might result. Truly trustworthy partners, however, will not seek to exploit partnering conditions, especially if relationships are producing satisfactory results for both parties.

Whilst trusting relationships are more efficient than adversarial ones, it is important to understand that trust must be fostered and then maintained. The contract is there as a tool to fall back on in the eventuality that problems cannot be resolved using collaborative methods, but should generally be used only as an aid in performance monitoring and benchmarking.

Key to engendering real trust and mutual respect is the setting of boundaries and protocols for all parties and clear processes for control of the project. An example of this is in the early stages of the contract when local authorities may have a tendency to be more lenient towards their service provider's failure to deliver services to the required standard, as the relationship is still in its infancy. Local authorities should rigidly apply the payment mechanism and applicable deductions from day one of the contract, to give a clear message of the way in which poor performance standards will be dealt with, and also to avoid the setting of precedents which may be difficult to break later.

Challenge is also key to achieving mutual respect. Local authorities should ensure that it is clear from the start of the relationship that they will challenge decisions and information. They need to do this to demonstrate to their auditors that they are delivering best value. For example the local authority and the service provider should consider the development of a joint working protocol for dealing with innovation, that clearly shows each party's responsibilities, but also outlines the local authority's challenge process in reviewing information that will be supplied in support of the innovative idea.

4.7 Managing the relationship – checklist

The following checklist shows the key issues to be addressed in managing the relationship with the service provider.

Managing the relationship checklist

- Set up a project team structure with clear reporting lines and procedures
- Develop the relationship prior to service commencement
- Have a partnering ethos at the centre of the relationship
- Have an agreement to seek win-win solutions, rather than parties to blame
- Give constant attention to the relationship
- Ensure the expectations, aspirations and concerns of all stakeholders are identified at an early stage and an effective change management process adopted to deal with these
- Revisit these factors on a periodic basis
- Consider using an independent facilitator to help build the relationship and also help when problems arise
- Avoid the development of a 'cosy' relationship that could lead to opportunism
- Create an open team environment between the parties so that problems can be resolved more readily
- Seek to fully integrate the parties as one team, and consider co-locating
- Maintain good, open communications, both formal and informal, particularly with end users to ensure there are no perception gaps
- Look for opportunities for joint development and delivery of joint training for staff
- Consider holding joint innovation workshops
- Strive for less paperwork and more constructive correspondence
- Ensure all parties understand the contract from day one and clarify any 'grey areas'
- Ensure all parties are clear as to the level of service required, inform end users in advance what to expect
- Make clear the responsibilities that are retained by the local authority, and all parties' roles and responsibilities
- Set up a project team structure with clear reporting lines and procedures
- Understand all parties' business goals and try to align these with that of the project
- Develop a project statement prior to service commencement which describes the ethos and principles to which all parties will subscribe
- Make sure the service provider is operationally ready when the service is to commence
- Where possible, ensure continuity of construction and operational teams to facilitate handover
- Discuss and, whenever possible, resolve minor operational issues
- Discuss day-to-day service provision with both the end users and service provider representatives
- Consideration should be given to the holding of separate meetings to discuss/resolve significant issues prior to any formal partnering or operational board meeting
- Recognise the needs of the service provider to make a profit and develop new business

Section Five

Managing service performance

At the most basic level, managing service performance involves monitoring achievement of the contracted service outputs, ensuring appropriate payment deductions are made, and ensuring that contractual performance improvement processes are enacted and complied with to return performance to the required level. ie ensure the local authority is getting what it pays for and also the level of service it has specified. It should also ensure that the service provider is operating in a safe manner in compliance with the appropriate statutes, regulations and policies.

This should all be achieved by undertaking the tasks and following the processes set out in the Operational Contract Manual. ie the manual sets out the framework for managing the service performance.

The contract management function should ensure that monitoring processes and procedures are in place at the commencement of service, with roles and responsibilities clearly outlined and contractual requirements met, so service performance can be managed from day one.

5.1 Why should service performance be monitored and measured?

The service levels to be provided for a project are detailed in the output specification and method statements developed as part of the contract. The service provider is required under the contract to perform the services to these standards. A main activity of the contract management function is to assess the performance of the service provider against the contract and the standards set, and ensure that:

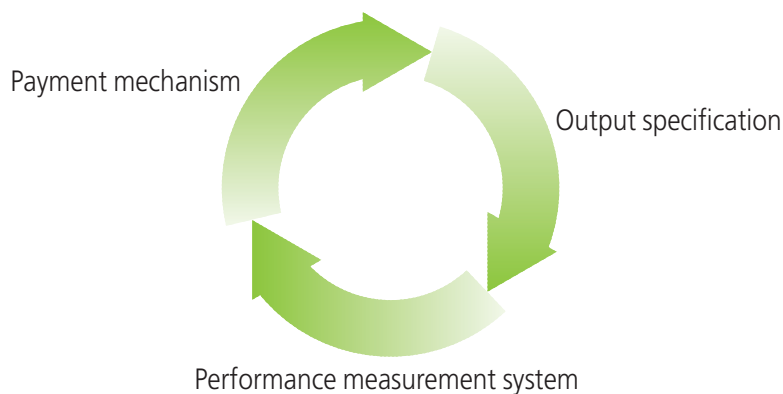
- the performance of the service provider is measured to assess the standards provided against the required outputs specified in the contract
- best value is realised
- change is monitored
- risk is managed
- service improvements are implemented when service standards are not fulfilled
- remedial measures being implemented are effective
- monitoring meetings are held on a regular basis and in accordance with the contractual requirements
- obligations for payment are made on time and in accordance with the contract
- continual improvement is encouraged.

In summary, contractual compliance is achieved and can be demonstrated.

5.2 The fundamentals of performance measurement

Managing service performance is fundamental to the contract, as it is through this process that payments to the service provider are calculated and any deductions are negotiated and agreed. It is therefore vital that there is a good understanding of the relationship between the requirements in the output specification, the performance measurement system, and the method for making deductions for poor performance as set out in the payment mechanism.

Figure 6 **Payment mechanism and output specification interaction**



The output specification and the levels and terms under which the service should be provided should be clearly defined to ensure that the client/customer and the service provider understand what targets have to be met. The output specification should include a manageable number of performance targets to incentivise the service provider to deliver the services. Method statements should set out the service provider's approach for delivering the specified services.

The performance measuring system which sets out the systems and methods to be used to monitor the service being provided should be understood and should reflect the local authority service requirements.

The payment mechanism sets out how payments and deductions will be made and will be interlinked with the output specification. It may be appropriate to include in the payment mechanism a bedding in period, which allows the service provider a specified period of time in which to 'bed-in' their service delivery, during which time a lower threshold is applied to the deduction regime. Other advice would be to consider (where appropriate) running a trial period before formal operations commence. The fundamentals of the mechanism should be calibrated by the local authority during the procurement process to ensure that it reflects the local authority's expectations of levels of deductions.

Drafting of the output specification, performance measuring system and payment mechanism commences before procurement starts, with documents being fine-tuned during Competitive Dialogue, and confirmed at the preferred bidder stage.

It may be the case, particularly if the contract management function only has significant involvement with the contract post procurement, that there are 'grey areas' in the output

specification, performance measurement system and payment mechanism. This can also occur where the 'output' is difficult to define, for example, 'cleanliness'. One of the earliest actions of the contract management team should then be to try and clarify such issues and agree a joint understanding between the local authority, end users and service provider to seek to mitigate the potential for future misunderstandings or conflict.

Irrespective of the point above, the contract management function, working with the service provider, should seek to ensure that all key protagonists understand these three elements – possibly through running workshops.

5.3 Working with the service provider to mobilise services

The importance of getting the mobilisation process correct cannot be over-stated. Poor mobilisation, often compounded by building snagging issues, can create relationship and service delivery issues from very early in the contract – which can then take considerable time and effort to address.

Local authorities should work closely with the service provider to review and develop the mobilisation plan and process and become assured that maximum available time is allowed, sufficient resources are allocated by all parties, a comprehensive programme and task list is developed and implemented, critical paths identified, and a robust communication process involving all stakeholders, including the construction contractor – which is key – is in place. ie a robust project management approach is adopted.

Local authorities should work with the service provider during the mobilisation period to fully understand in practical detail the services to be provided. It is during this period that the existing relationship can be strengthened and built upon, and the joint working practices, that have been developed in principle during the procurement process, are implemented and tested so that service delivery is working well at service commencement. The mobilisation period should be of an adequate length to ensure that the local authority is confident that service delivery will be at an appropriate level at service commencement and that any issues with delivery, helpdesk (or management information system) and monitoring are addressed prior to commencement. The contract management arrangements should be in place to review the service provider's method statements before financial close.

It is also at this time that users of the services should be inducted on the service levels that they should expect, and how to carry out their role in the monitoring of the service, including how to utilise the helpdesk, and processes and structures for communication.

Partnering workshops can be extremely helpful during mobilisation. These workshops can assist in developing and strengthening the relationship further.

"There was no contract management involvement during the mobilisation period. I commenced at the service commencement on site. As a consequence the service provider was not operationally ready, the helpdesk was not set up correctly, and no one had been in post to check."

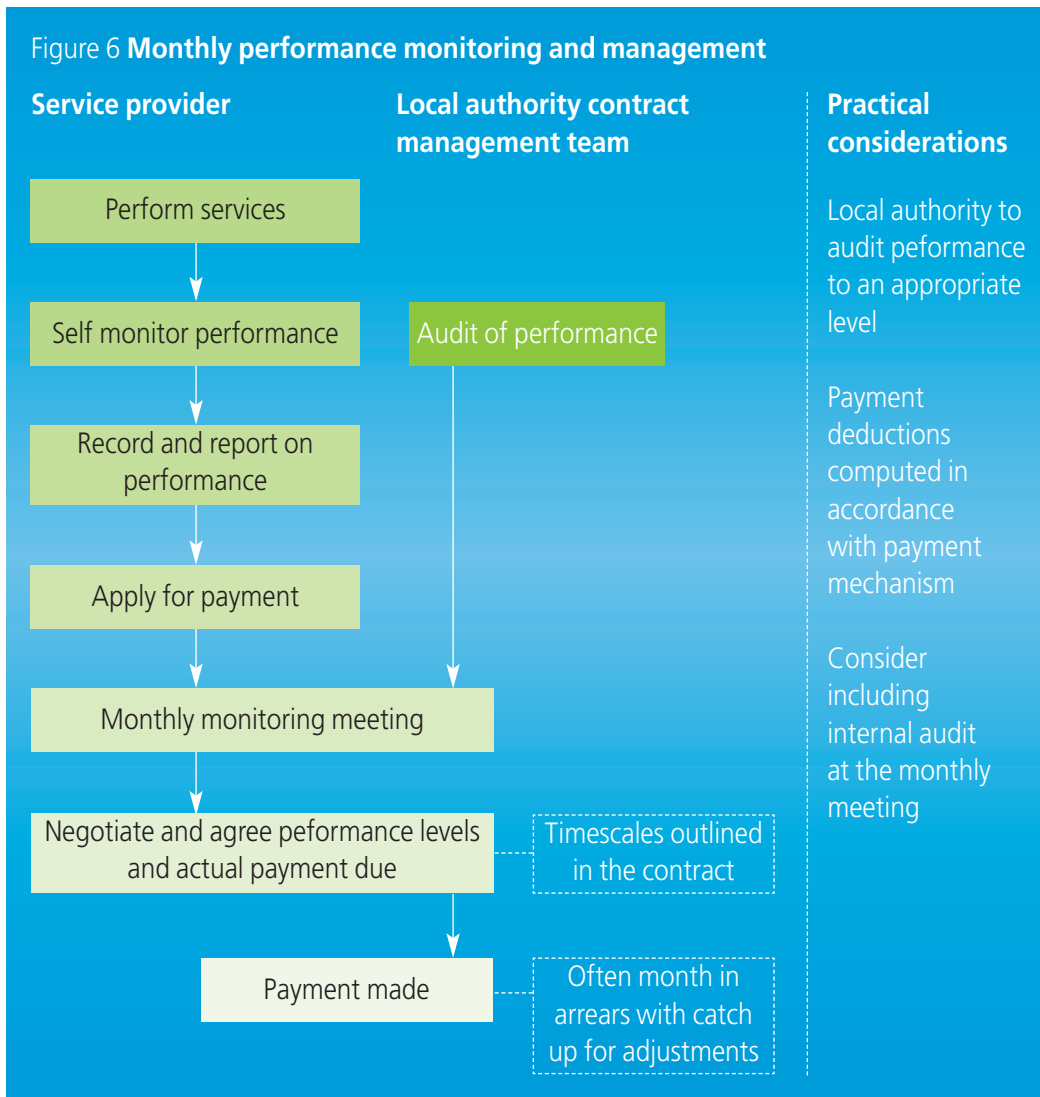
Local authority contract manager

5.4 Monthly performance monitoring processes and payment

The monthly performance monitoring and payment process involves the service provider self-monitoring and reporting the level of compliance achieved for that month. The contract manager should ensure that the timescales outlined for payment are achieved, and that the service provider's reports are provided to the level of detail agreed with the local authority and within the agreed timescale.

Figure 6 illustrates the sequence of activities within the reporting period.

While these contracts are typically 'self monitoring', local authorities should not forget that there is an audit requirement placed on them to provide evidence of performance against payment. Local authorities need to ensure that they have a robust and documented procedure in place to validate the payment of invoices and to ensure that they only pay for the level of service provided. Local authorities should ensure that they involve their auditors in the process of validation of payments and obtain agreement to the level of monitoring and validation that the local authority needs to undertake to satisfy their auditors requirements.



5.5 Monitoring the provision of the services

Processes and resources for monitoring and measuring the provision of the services should be identified by local authorities at an early stage of the procurement, with training provided for those who will be involved to ensure that they understand all the issues and the level of measurement that is expected.

Contract management team responsibilities

The service provider has an overall responsibility to provide the services to the standards agreed with the local authority. In order to do this, there is a requirement to self-monitor the services provided. The service provider's monitoring processes include the production of a monthly monitoring report, which will usually form the basis of the monthly local authority and service provider meeting, at which the content of the monitoring report and any issues such as under-performance and payment deductions will be discussed. In most PFI/PPP projects, the service provider will appoint a contract/service manager who typically has overall responsibility for:

- managing the service delivery
- liaising with the local authority client
- monitoring performance and providing formal monthly reports to the local authority
- confirming compliance with the requirements of the contract
- identifying issues for discussion, future workload, risk and opportunities
- risk management and ensuring that all appropriate controls are in place.

"It is important that the local authority monitoring procedures are kept simple and that the level of monitoring reflects the significance of the service and avoids being overly onerous in terms of process and level of auditing."

Local authority contract manager

The service provider responsibilities

The service provider should have in place:

- performance monitoring procedures
- quality management and management information systems
- procedures for the management of its sub-contractors
- systems for recording contract information
- a reporting mechanism

and should have a robust audit trail supporting its assessment of performance. ie when challenged, the service provider can clearly and readily support its assessment.

The local authority should ensure that the service provider's process ties in to the local authority meeting and payment processes.

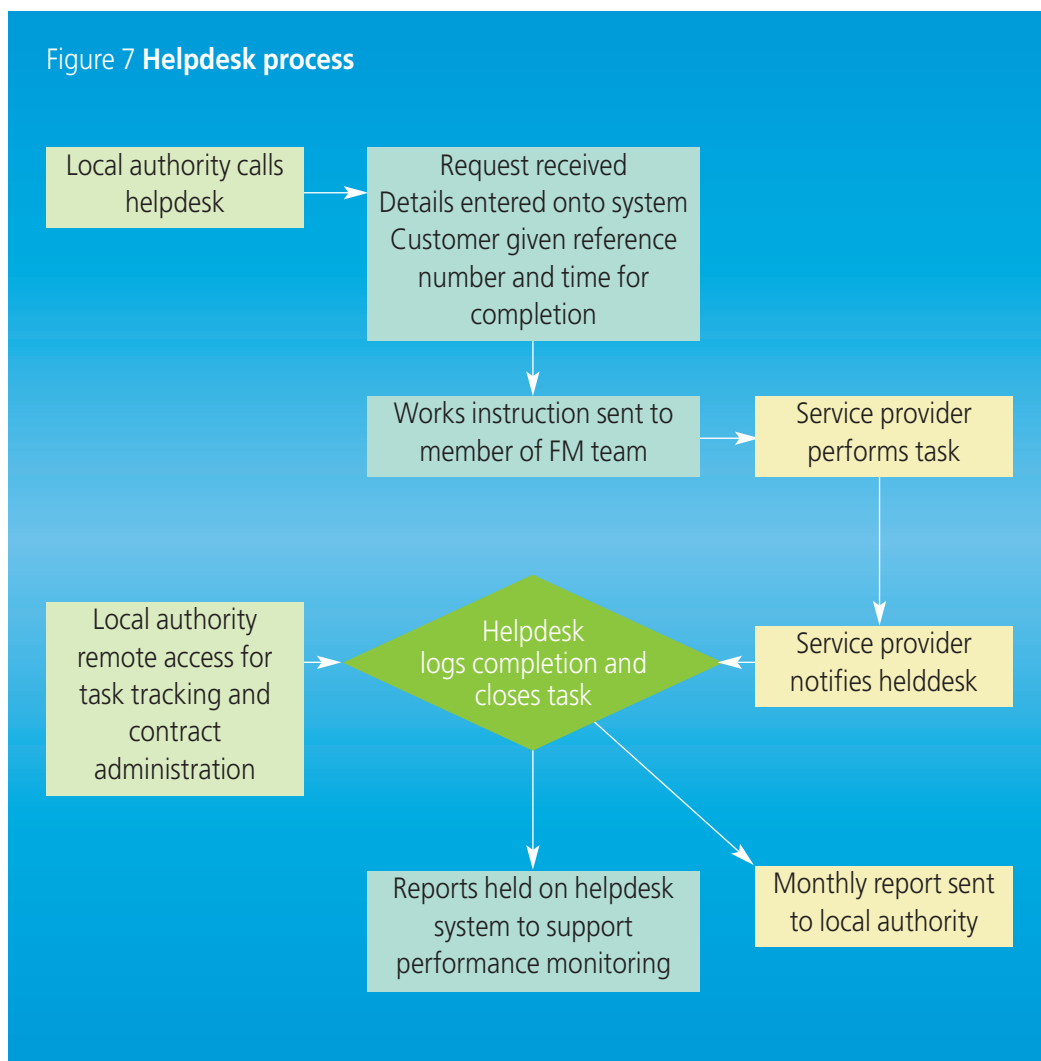
5.6 Tools for measuring performance – helpdesk

A key tool for contract management and monitoring is the service provider's helpdesk. There should be a requirement in the contract for the local authority contract management team to have access to this system on a 'read-only' basis. This enables the contract management team to track customer requests and interrogate the service provider's compliance with the contract requirements. It also facilitates the reporting process. It can also be very useful for nominated representatives of the end user to have similar access, for similar reasons.

Contract managers who have had access to such a system have reported that this made communication much easier and made contract management meetings more productive, with less debate around compliance issues.

Where the local authority has a helpdesk in operation, there may be merit in using it for managing calls and monitoring responses in conjunction with the service provider.

The helpdesk process is illustrated in Figure 7.



Additional information to manage service performance

The local authority should seek, where possible, additional information about the supplier's activities in the spirit of partnership. This will enable all stakeholders to understand practical operational issues being faced. Such information might include HR information such as staff turnover, staff training, etc, and non-commercial information about performance of, issues, and initiatives with sub-contractors. In short any such information that will provide the local authority and end users with better understanding of the activities and issues being faced by the service supplier. This should increase empathy and understanding in the partnership, and also potentially allow greater innovation and jointly developed solutions.

5.8 Managing service performance – checklist

This checklist shows the key issues to be addressed in managing service performance.

Managing service performance checklist

- The contract continues to meet the vision for the service, and the aims and objectives of the project
- The local authority understands the services they are purchasing and the standards these services are to be performed to
- The local authority, contract management team and end users understand what is not acceptable in terms of service delivery
- The payment mechanism has been calibrated correctly before contract award
- The contract management team is in place, has sufficient resources and the team has had suitable training
- The service provider's performance monitoring procedures are clear, well documented, and understood by the contract management team
- The service provider's quality management and management information systems are in place and understood by the contract management team
- The service provider has clear procedures for the management of its subcontractors
- Systems for recording contract information are in place
- The service provider and local authority have clear reporting procedures in place that have been agreed between the parties
- The local authority has a robust performance monitoring regime that was developed during the procurement phase of the project
- Deductions for snagging issues are separated from the service performance issues so there is no confusion
- The users of the services have been trained on the service levels that they should expect and how to carry out their role in monitoring the service, including helpdesks and processes and structures for communication
- Service performance is assessed against the contract standards
- Effective remedial measures and service improvements are implemented when service standards are not fulfilled
- Trends in poor service delivery and poor rectification are identified and monitored
- The contract manager understands what remedies can be utilised for poor service performance, and when and how to use them
- Payment is based on satisfactory performance, and is commensurate with the performance achieved
- Service delivery is consistent with the local authority's Best Value obligation
- Payment and deductions are agreed and obligations for payment are made on time and in accordance with the contract
- A helpdesk is in place and recording service requests

Managing service performance checklist continued

- Performance indicators are reviewed by the local authority to ensure they reflect performance of services
- Regular consultation with stakeholders is arranged
- Monthly reports are prepared and circulated by the service provider
- Customer surveys are conducted to assess perception
- Method statements are kept up to date
- Continuous improvement is encouraged
- Monitoring meetings are held in accordance with the contract to discuss performance
- Risks are identified and managed.

Contract administration

Clear administrative procedures should be in place to ensure that all parties to the contract understand who does what, when and how. The formal governance of the contract includes:

- cost monitoring and payment procedures
- management reporting
- change control procedures
- coordination of best value reviews
- benchmarking and market testing.

Contract administration is not only about ensuring the obligations and responsibilities defined under the contract are met, but ensuring such things as under-performance, risks, payment of the unitary charge, reporting and variations to the contract are all managed effectively so that best value is achieved.

Where contracted standards are not fulfilled, the local authority must also apply mechanisms, established in the contract, to rectify any under-performance in the provision of the services.

Contract management involves the local authority and service provider working together to achieve continuous improvement in performance over the life of the contract, which is measured via benchmarking of services and best value reviews.

6.1 The payment mechanism

The payment mechanism is at the heart of the contract, as it puts into financial effect the allocation of risk and responsibility between the local authority and the service provider. It determines the payments the local authority makes to the service provider, and establishes the incentives for the service provider to deliver exactly what service is required, in a manner that gives value for money. It is important for contract managers to rigorously implement the payment mechanism and make the appropriate deductions that will incentivise good performance from their service provider. Figure 8 illustrates the key features of the payment mechanism.

Figure 8 Key features of the payment mechanism

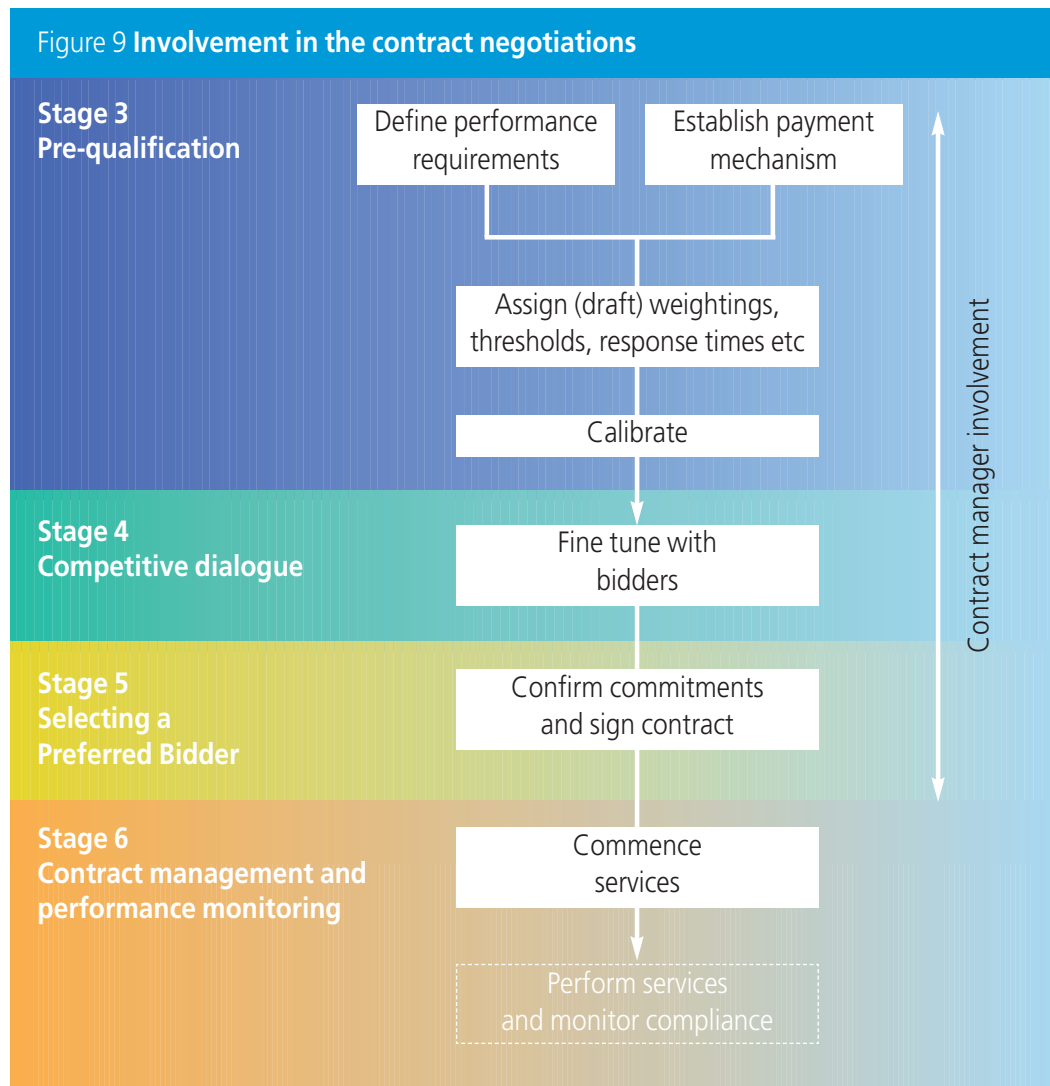
Principles	<ul style="list-style-type: none"> Puts into effect service obligations Determines payment Incentivises good performance Fair and equitable to both Best value Establishes relationship
Key features	<ul style="list-style-type: none"> No payment until services are available Single unitary charge for the service (incorporating availability and performance) Deductions for substandard performance Deductions reflect severity of failure No payment unless the facility is available

The payment mechanism is in place to ensure that the local authority's objectives for the project are being delivered, and that they are linked to the outputs for the project, set out in the output specification.

4ps have developed model payment mechanisms for a range of services. These are available as part of *4ps procurement packs*.

It is important that the contract manager is involved at the procurement stage in the development of the payment mechanism, including negotiating thresholds and response times relevant to the project, and ensuring that the performance monitoring regime is robust.

Figure 9 identifies the ideal involvement of the contract manager in the payment mechanism during the procurement period.



“It is important that the contract manager has had the opportunity at the procurement stage to understand the workings of the payment mechanism and to have had an involvement in negotiating thresholds and response times relevant to the project and ensuring that the performance monitoring regime is robust.”

Local authority contract manager

The payment mechanism’s impact on the service provider

In the event that the service provider fails to perform the service to the agreed standards, there should be incentives for the service provider to remedy the failure. These incentives should be in the contract, the output specification and the payment mechanism. These remedies include immediate deductions from the payment due to the service provider (the unitary charge) and the ability to award penalty points that ultimately can lead to termination of the contract for continued poor performance.

The payment mechanism should meet the requirements of the local authority and should be based on reasonable rectification periods and deductions that are to the correct level of severity (determined by performing a calibration of the payment mechanism utilising potential scenarios that could arise).

It is important that the payment mechanism is assessed during the procurement phase, with risks and levels of deductions clearly understood by all parties, including wider stakeholders and end users. Stakeholders involved in the project will require specific workshops and/or briefings to enable them to understand the significance of deductions against various service delivery scenarios. For example, in a school project the headteacher may want to understand what level of deduction will be applied if they are unable to utilise the main dining hall for a period of time, to ascertain whether the appropriate level of significance has been attached to this area.

6.2 Dealing with disputes

The procedures for liaising with the service provider in terms of regular monthly meetings and ensuring the monitoring of performance, along with clear methods for recording and discussing monitoring outcomes, can assist in resolving issues outside of the contract.

Why do disputes happen?

There are a number of operational situations which can potentially lead to disputes between the service provider and the local authority, and these situations are mainly related to payment and processes. In the event that a dispute does arise, the process for dealing with it will be outlined in the contract and this should be followed. The contract manager should, however, as part of their role, endeavour to ensure that formal disputes do not arise, as they are time-consuming for all parties and can divert effort away from the running of the contract and the delivery of services. Effective performance monitoring, clear methods for recording and discussing monitoring outcomes, and liaison with the service provider at regular monthly meetings, can help to resolve issues.

How can disputes be avoided?

Having clear project documentation, and clear operational processes and procedures in place, which are implemented, can assist in ensuring that all parties understand their obligations and avoid the need for debate regarding understanding of service requirements. Local authorities should ensure that expectations are realistic, and that users understand these, and that all parties have signed up to clear service requirements.

“I do not think that we all clearly understood what was always in the service provider bid, as some issues were down to an interpretation of the original documents. This has led to some issues with service provider performance. We have not had to go down a formal dispute procedure, but it has taken time to discuss and come to agreement on some of the issues”

Local authority contract manager

“We have in place a good partnership arrangement and we do discuss all issues as they arise outside of any formal meeting arrangements. This works well for us”

Local authority contract manager

Local authorities should ensure that they have in place formal arrangements to deal with issues, but should not underestimate the requirement to deal with issues as they arise on an informal basis.

Dealing with persistent default and when to enforce the contract

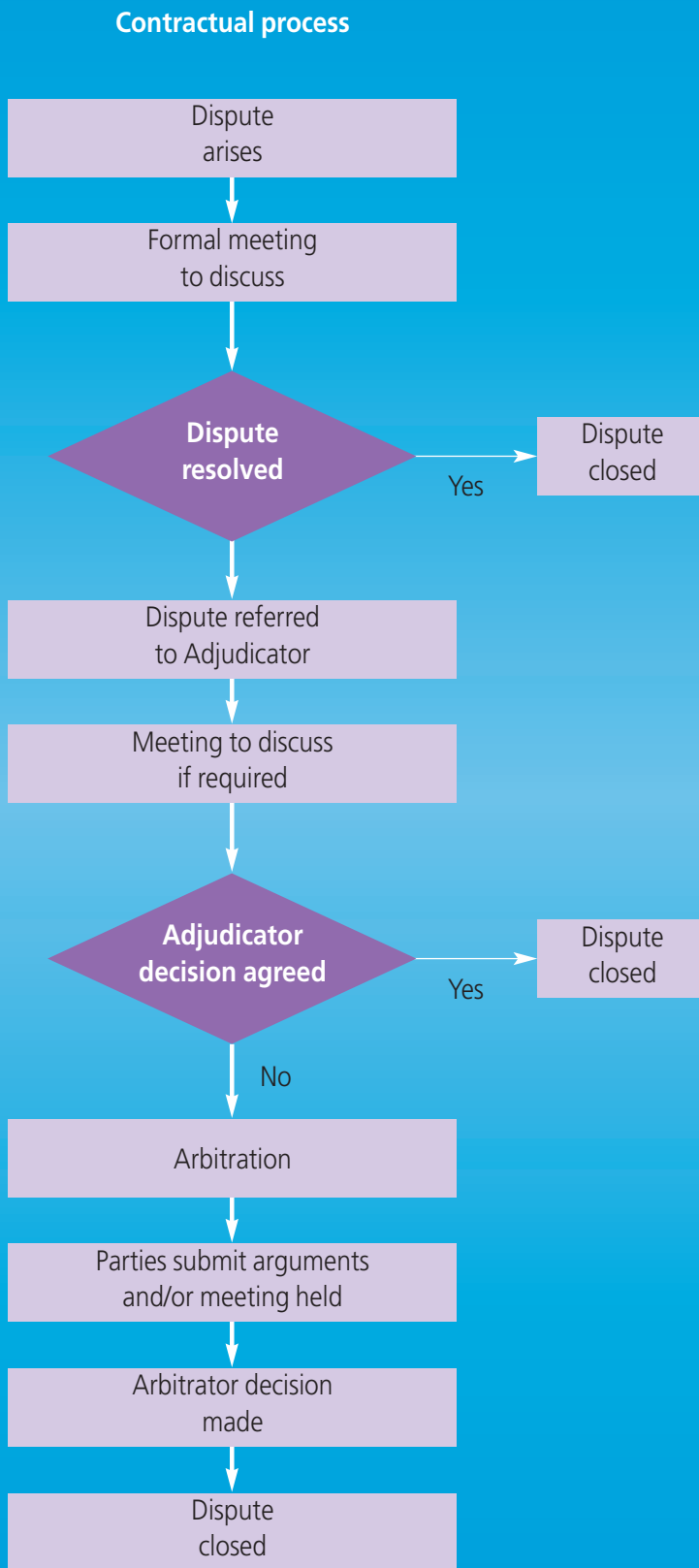
Contracts have in place various methods for dealing with default by the service provider. These range from allocation of points leading to increased monitoring, to the service provider having to put in place action plans. More formal methods for dealing with persistent default include the potential for the local authority to step-in and manage the service, and eventual termination of a contract.

Where a service provider is failing to achieve standards on a regular basis the local authority should consider requiring their service provider to produce an action plan that identifies measures to improve service delivery. External facilitation can also be used to assist all parties to discuss issues around a table and identify a way forward outside the formal dispute resolution procedure.

All of the formal processes for dealing with default should be seen as the last resort to be taken. Contract managers should use informal methods to attempt to resolve disputes and ensure that regular communication is in place.

A dispute resolution procedure is given in Figure 10.

Figure 10 **Dispute resolution procedure**



Practical considerations

Involve an independent facilitator

Be clear on the timescales between each stage

Use the right people with the correct level of skill and knowledge at the right stage

Ensure that all informal routes have been exhausted prior to going down the formal route

6.3 Variations to the contract

Changes to services and procedures may have an impact on how the service is provided, its overall performance and the cost of the service and best value of the contract. The output specification and management of change is therefore an important area of contract administration.

Typically, requests for change (variations to the contract) will be service-type or new build/variation changes which will occur due to changing business requirements or service developments, for example technology advancements. As a change to the contractual arrangement affects the scope of the service, both parties need to calculate the risk associated with the change proposed.

Change in law can also have an impact on service provision. The service provider is required to provide services in compliance with legislation, so if there is any change in law during the service period, the service provider is obliged to comply with the new legislation. The liability for the cost of the change is dependant on the change.

How are variations managed?

Best value will be the key driver in assessing the implication of the change requested, and the local authority will need to assess any cost increase or decrease. Typically, a schedule of small works/schedule of rates should be included within the contract which will provide the basis for the costs, and this must be set at a sufficiently high level. This will need to be reviewed annually, or in accordance with the contract. These are normally only applicable to the smaller variation requests.

Local authorities should ensure that robust methods for costing are demonstrated by the service provider for all variations (such as benchmarking and market testing), and that they have signed up to the local authority procedures when providing quotes for works of any significance. The local authority should challenge information provided by the service provider to ensure they are satisfied with its robustness and also to demonstrate that they are achieving best value.

Local authorities should also ensure that they have in place a register recording all variations to the service. This will enable the local authority to manage budgets, understand any changes to cost provided during benchmarking and market testing, and will provide an audit trail of variations to the contract.

The process to be followed for a change in law is shown in Figure 11, and the process to be followed for a local authority change is shown in Figure 12.

Figure 11 Change in law

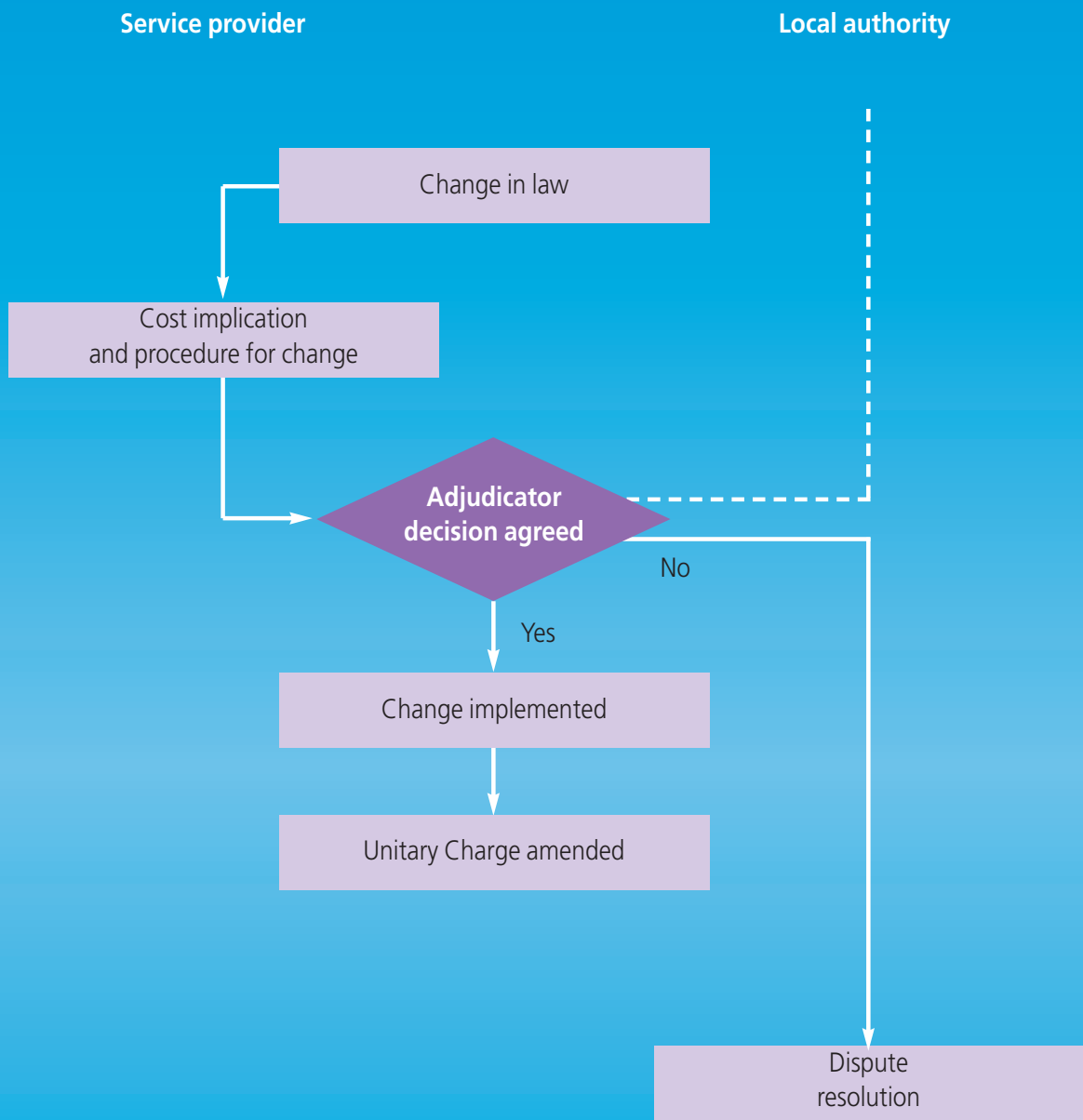
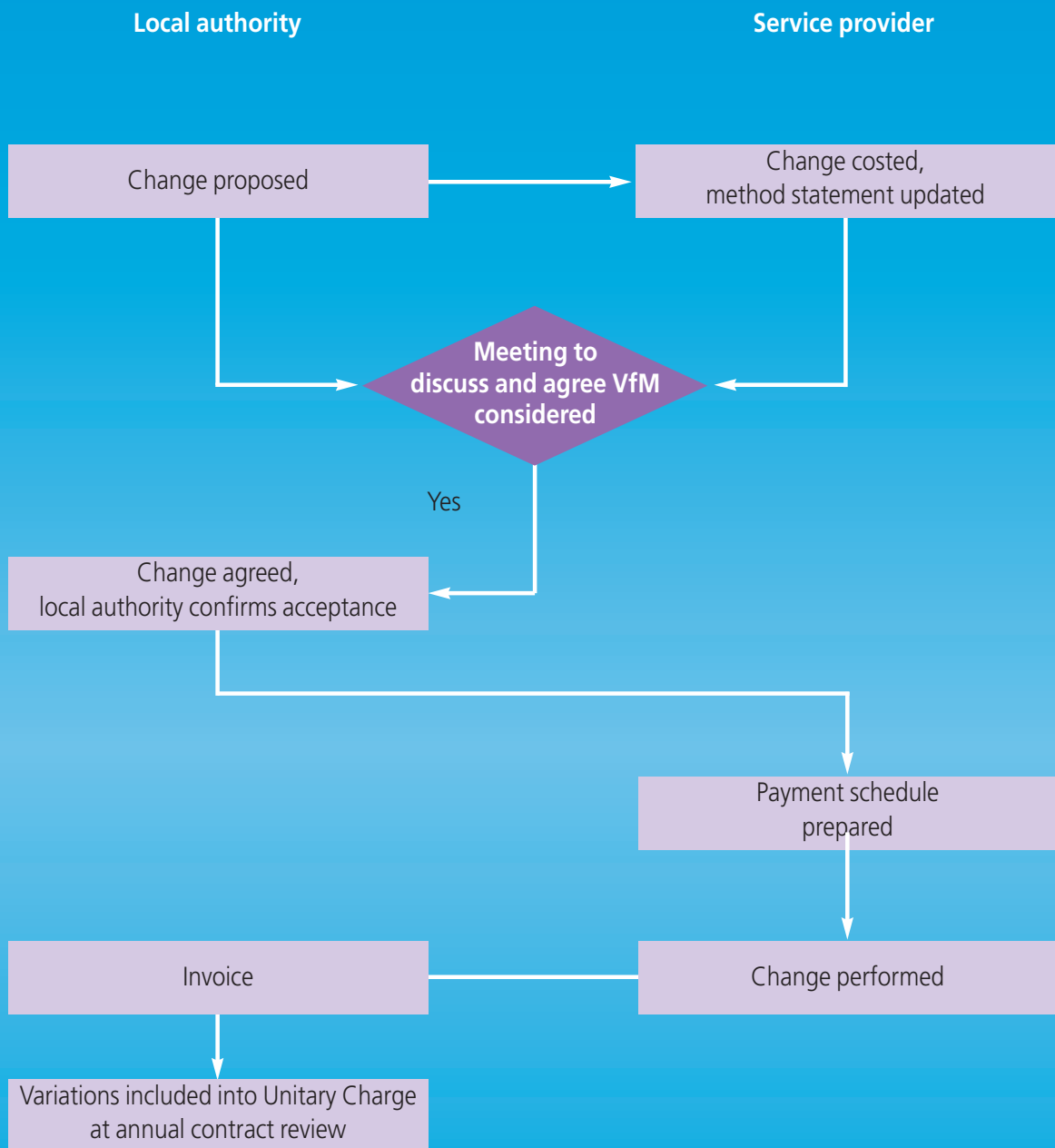


Figure 12 Service variations / new works



6.4 Benchmarking and market testing

The aim of benchmarking and market testing is to ensure best value and service performance is maintained for soft services. Benchmarking and market testing provisions should have been drafted into the contract. It is important to ensure that benchmarking or market testing exercises are carried out in accordance with the contract, and that the agreed drafting properly reflects the needs of the service/project.

Local authorities are used to performing benchmarking for services, and many have a procedure in place.

What is the requirement?

The contract may include an obligation for soft services to be benchmarked and/or market tested at intervals, defined in the contract, during the operational period. Both benchmarking and market testing should be implemented to demonstrate long term best value of soft service provision in PFI contracts, it is commonly referred to as 'value-testing'. In PFI/PPP contracts there is a requirement for the service provider to manage these value testing processes. However, the service provider and the local authority should carry out the benchmarking and/or market testing as a joint exercise, as there would be little value in the service provider performing the exercise and simply reporting the results as they both must agree on a value for money outcome. That said, the main focus of this exercise should be on the service provider demonstrating value for money and the local authority using market testing as a means of securing the best deal.

Value testing is an ideal opportunity to review the output specification and to adjust service levels to better meet the authority's requirements for the future, subject to cost implications.

The benchmarking and market testing process

The benchmark and market testing exercise should be undertaken by both the service provider and local authority against services of a similar size, complexity and service level. Similar PFI/PPP projects should be benchmarked against other standard benchmark data. Good practice is to set up a project team comprising representatives from the service provider and the local authority to oversee the benchmarking exercise.

Practical arrangements for benchmarking and market testing should be drawn up in conjunction with the service provider well in advance of benchmarking and market testing. Local authorities who have gone through benchmarking/ market testing are suggesting that from initial discussions to final agreement, benchmarking may take a minimum of nine months. If it is followed by market testing, or if market testing alone is conducted, the process could take up to two years. Local authorities need to employ project management disciplines from the outset and produce a project plan to cover the following considerations:

- the reassessment of requirements, and possible changes to the specification
- the schedule – agree milestones
- defining respective roles – agreeing responsibility
- methodology – agree the approach to be employed
- communications – make sure everyone is informed.

A clear plan, agreed from the outset, that has a timetable allowing adequate time for iteration, clarification and negotiation, is required. Departments should be involved early in the process, and all relevant legislation and appropriate guidance relating to employee rights must be fully complied with.

Specialist technical, financial and legal advice may be required by the local authority, and it should be noted that benchmarking/ market testing can be a resource intensive activity. Local authorities need to plan their budgets carefully for these exercises.

Both parties should independently collect data to be utilised for comparative purposes in the value testing exercise. The service provider will utilise their data to identify a benchmark cost for the services and the local authority will utilise their data to examine, interrogate and validate the results of the exercise. Comparative data should be valid and should be transparently compiled. The service provider's own costs of providing services are not a valid comparator. The data compiled will need to be adjusted to be project specific, taking account of specific aspects of service provision and factors such as regional variations.

Openness and fair competition are key aspects of any market testing activity; local authorities need to encourage an active bidding market whilst avoiding potential conflicts of interest between the service provider and bidding sub-contractors. Consideration should be given to utilising an independent project manager to manage the exercise.

Detailed guidance on benchmarking and market testing is contained in *Operational Taskforce Note 1: Benchmarking and Market Testing* published in October 2006.

6.5 Contract administration checklists

Payment mechanism checklist

- The payment mechanism meets the requirements of the local authority, based on reasonable rectification
- Performance requirements have been defined
- The payment mechanism is understood and implemented
- The payment mechanism has been calibrated by the local authority
- Priced variations to the contract are checked to ensure that they are value for money
- The payment mechanism makes deductions from the unitary charge for sub-standard performance
- Mechanisms are established to rectify underperformance
- Continuous improvement is achieved over the life of the contract
- Clear and recordable processes and documentation are introduced as part of the overall contract management
- Risk management strategies are kept under review
- The allocation of risk and responsibility between the service provider and the local authority is in place and understood
- Both parties to work together to ensure that disputes do not arise
- Regular meetings are in place

Benchmarking / market testing checklist

- Costs and services should be benchmarked in accordance with the contract
- Start planning for benchmarking and market testing between 9 to 24 months in advance of the due date
- Ensure a clear plan is in place and agreed in advance of commencement for the benchmarking / market testing exercise, that allows adequate time for iteration, clarification and negotiation.
- Secure adequate resources and skills
- The benchmark/market testing exercise is undertaken utilising reputable organisations delivering services of comparable size and quality
- For market testing encourage bidders to develop a competitive process
- Consider utilising an independent manager for managing any market testing exercise
- Agree sources of benchmark information
- Avoid conflicts of interest
- Service delivery is consistent with the local authority's expected quality and competitiveness
- The benchmark and market testing cost is based on comparing service standards and prices on a like-for-like basis.
- The service provider will pay for the benchmarking / market testing exercise and employ 'open book' accounting
- Stakeholder consultation should be undertaken
- Review the output specification and potentially adjust service levels to better meet the local authority's requirements for the future
- Ensure the risk profile is reviewed and not altered significantly
- Ensure adequate time for the funders' involvement
- Keep users informed of progress
- Agreed services may be changed following benchmarking and market testing
- The contract continues to meet the aims and objectives set for the project
- The unitary charge is revised following benchmarking / market testing

Dispute resolution checklist

- Contract managers should endeavour to ensure that formal disputes do not arise by communicating regularly and discussing issues as they arise
- The local authority contract manager and the service provider representative agree that a dispute is a possibility only after all other methods have failed
- Consider the involvement of an independent facilitator to aid resolution of issues
- Contract managers have a key role to play in managing the dispute resolution process, and this role should be understood by all parties
- Adjudication and arbitration is sought when parties fail to agree within the timescales
- Disputes when they arise should be dealt with in accordance with the contract
- All parties should be informed of progress with any issues
- Risks have been reviewed at all stages of the process
- Consider seeking external professional advice and assistance. Utilise the right people with the right skills at each stage of the process

Service variation checklist

- Best value is maintained and verified by the local authority
- The service provider provides robust evidence and identifies costs in a clear format to support variation
- Permanent variations are incorporated into the unitary charge
- The service provider incorporates costs into the billing process
- The processes outlined in the contract need to be followed by both parties
- Small works rates to be reviewed annually
- A register of all changes and variations to the contract should be maintained throughout the life of the contract
- Both parties should discuss implications of any changes using both informal and formal communication
- Timings for any variations should be agreed
- Compliance with legislation is maintained throughout the life of the contract

Trouble shooting

When things start to go wrong in the operation of PPP/PFI projects, it is often difficult to identify the underlying causes. The following table shows some typical indicators of an issue to be resolved, and some potential first actions.

Indicators	Possible causes	Action
The end users are not satisfied with the service they are receiving	The end users do not understand the service they are receiving	Hold a facilitated workshop with the end users to discuss their issues and ensure that they have an understanding of, and have bought into, the service levels in the contract
	The end users' expectations are too high	Provide end users with a 'crib-sheet' which clearly describes the services they should be receiving and the standards to which they should be delivered
	The service provider is not providing the services to the contracted level	Audit the services being provided to assess the actual levels provided, identify any deficiencies
		Review the quality of service provision at the monthly meetings with the service provider, and agree any remedial measures to be taken
		Review the service provider's method statements and, if appropriate, ensure the service provider amends them accordingly
		Monitor and audit the effectiveness of any remedial measures
	There is a problem between the service provider's personnel 'on site' who are interfacing with the end users	More senior members of the local authority team visit the 'site' of the service and talk to all parties (separately)
		Develop a communication plan with all parties to improve their relationship with all parties
The local authority is not satisfied with the service	The local authority and service provider have different interpretations of the contract	Review the service requirements within the contract
		Review the services being provided
	The service provider is not adequately resourced	Hold a meeting with the service provider to discuss the issue. Consider bringing in an external facilitator

Indicators	Possible causes	Action
Agreed rectifications are not being carried out	Service provider has inadequate resources to rectify	<p>Hold a meeting with the service provider to discuss the issue. Consider bringing in an external facilitator</p> <p>Service provider to put into place an action plan to improve service performance</p>
	Helpdesk staff are not adequately trained	<p>Review the helpdesk records and check for any key themes or inaccuracies</p> <p>Review with the service provider the training requirements of the helpdesk staff to ensure they have an understanding of the contractual requirements</p>
Deductions for poor performance are not incentivising the service provider to improve performance	Payment mechanism not working	<p>Review the calibration of the payment mechanism by using real scenarios. Are deductions enough to incentivise the service provider?</p> <p>If the payment mechanism is not calibrated appropriately, the local authority needs to review whether the payment mechanism can be changed through negotiation. External advice will need to be sought</p> <p>If the payment mechanism is calibrated appropriately then the local authority may not be applying the appropriate deductions</p>
	Local authority is not applying the appropriate deductions	<p>Review the procedures for monitoring service performance and applying payment deductions. Identify why the appropriate deductions are not being made and develop a procedure that will ensure the appropriate deductions are made</p> <p>Monitor the performance of the service provider, under the new system, to identify if the deductions are incentivising performance</p>

Indicators	Possible causes	Action
The relationship has become adversarial	Poor communication processes and protocols in place	Request an operational project review for an independent view and decision on the way forward Hold a partnering board meeting to discuss the issues and agree the way forward
	Poor contract documentation Lack of understanding of what each party is trying to achieve	Review the contract and identify the areas for improvement. Can these improvements be made without recourse to contract amendments? If so, then produce documents/ procedures, in conjunction with the service provider, that will address the issue If there is a requirement to alter the contract then external advice should be sought
Service standards are not being achieved	The service provider has inadequate resources to meet service requirements	Hold a meeting with the service provider prior to discussing the issue. Consider bringing in an external facilitator Put in place an action plan with key dates and ensure that the service provider reports on improvements
	The service provider has not trained staff	
	The services are not being monitored or supervised adequately	Increase service monitoring

Appendix Two

Definitions

The following definitions apply throughout this document

Service provider means the local authority's partner in the PPP/PFI contract and includes all of the sub-contractors, facilities managers and other parties who are responsible for the delivery of the services.

Project means the overall PPP/ PFI scheme

Contract means the agreement entered into between the local authority and the service provider

Unitary charge means the payment made to the service provider for the services delivered under the contract

Payment mechanism means the method of calculation of the unitary charge as defined in the contract.

Contract management means the activities carried out by a local authority to take a PPP/PFI project from financial close through to the end of the service period.

Service means the requirements of the contract which the service provider has to deliver

SPVs means special purpose vehicle

VfM means value for money



Telephone 020 7808 1470
operations@4ps.gov.uk
www.4ps.gov.uk

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